



**Reflections by the European Court of Auditors on
the Commission's Communication**

**"Towards a common understanding of the concept of tolerable risk of
error"**

1. In its opinion 2/2004 the Court of Auditors pointed out that: there is a trade-off between the cost and benefits of checking expenditure: increasing the intensity of checks will reduce errors but will increase control costs;
2. The Court suggested that the Council and Parliament should reach agreement on the trade-off between costs and benefits of expenditure controls: in other words on the risk of residual errors in expenditure which is tolerable.
3. Of course, the concept of a 'Tolerable Risk of Error' needs to be clearly distinguished from that of the 'Materiality Threshold' the definition of which must remain the responsibility of the external auditor.
4. The Court therefore welcomes the Commission's initiative in presenting to the Political Authorities its communication on tolerable risk although the Commission's approach, as presented in its communication, suffers from some conceptual awkwardness, a lack of consideration of political issues and serious weaknesses in its practical application.
5. In its communication the Commission compares the estimated costs and benefits (reduced errors) of expenditure controls. The Commission describes as the 'tolerable risk of error' the level of error at which estimated marginal benefits and costs of controls are equal: in other words, the point at which the cost of increasing controls equals the value of additional errors

prevented or corrected. However, it might be more accurate to describe this point as the estimated “economic optimum”.

6. As the Court indicated in its opinion 2/2004, it is for the Union's political institutions to take a decision on the level of risk which they are prepared to tolerate when approving EU spending programmes. In doing so they might wish to take into account not merely economic considerations but also political concerns.

7. The model outlined in the Commission's communication is expressed as a graph drawn on the basis of two points.

- The first point represents the current cost of controls and the estimated remaining level of error.
- The second point represents the case where all transactions are checked. The Commission has estimated this point by using the estimated average cost of an individual control on the spot multiplied by the estimated number of transactions. The Commission assumes a zero error rate at this point.

8. It is difficult to reach a robust view on the above basis about the trade-off between additional costs of controls and a lower incidence of error (i.e. about the slope of the curve in the Commission's graphs).

9. In its analysis of a 'tolerable risk of error' for ERDF expenditure, the 'error rate' which has been applied by the Commission is the Lower Error Limit (lower end of the estimated range of the possible error) and not the estimated value of the Most Likely Error. This implies that the 'Economic Equilibrium Optimum' should be at a different level from the one shown in the Commission's communication.

10. The Commission's data, based on work undertaken in 2008, include estimates of costs incurred by Member States. The Commission has so far not undertaken any further processing (e.g. verification or harmonisation) of these data. As it admits in its paper, the figures obtained from the Member States are mostly incomplete. The quality of data is a problem which has

already been highlighted by the Court on various occasions. It appears necessary for the Commission to complete the data collection and validation exercise to provide greater assurance in the definition of the benefits and costs of controls to accompany any further elaboration of the model. It would appear desirable if this updated information on the cost of controls, residual level of errors, etc., distinguished between the Member States.

11. In its communication, the Commission acknowledges that a reduction in error rates should be possible even without an increase in expenditure on controls. This represents a very strong message in terms of what could be done and what needs to be attempted.

12. It should be clear that any comparison between estimated benefits and costs of controls must be based on reasonable confidence that controls are being applied in an efficient and effective manner.

13. The Commission has also noted in its Communication that any decision on a tolerable risk of error should be based, among other things, on the potential for further simplification. The Court similarly underlines the importance and benefits of further simplification and its potential impact on the reduction of errors / irregularities.

14. It is for the Union's political institutions to decide how to use or respond to the Commission's communication. The Court, however, suggests that the work should be completed in order to ensure that figures are sufficient, consistent and reliable.

15. The Court notes that analysis of the costs and benefits of expenditure programmes could inform not just discussions about 'tolerable risk' but also a review of the regulatory regime and management structure for the programmes concerned. In some cases the pertinent question might not be whether there is a 'tolerable risk of error' but whether the risk of error is so great that the particular scheme or programme in question should be discontinued or substantially changed. Indeed, the concept of 'tolerable risk' should also be given specific consideration when designing expenditure (and revenue) schemes or programmes.