

ΕΒΡΟΠΕΪΣΚΑ ΣΜΕΤΗΑ ΠΑΛΙΑΤΑ
TRIBUNAL DE CUENTAS EUROPEO
EVROPSKÝ ÚČETNÍ DVŮR
DEN EUROPÆISKE REVISIONSRET
EUROPÄISCHER RECHNUNGSHOF
EUROOPA KONTROLLIKODA
ΕΥΡΩΠΑΪΚΟ ΕΛΕΓΚΤΙΚΟ ΣΥΝΕΔΡΙΟ
EUROPEAN COURT OF AUDITORS
COUR DES COMPTES EUROPÉENNE
CÚIRT INIÚCHÓIRÍ NA HEORPA



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Response by the European Court of Auditors to the Commission's communication 'Reforming the Budget, Changing Europe'

Introduction

1. The European Court of Auditors audits whether the Community budget is properly accounted for; whether financial operations are legal and regular; and whether Community policies are effectively, efficiently and economically carried out. Drawing on its audit experience, the Court welcomes the opportunity to contribute to the debate, initiated by the Commission's consultation paper, on how the EU budget can best assist the Union in meeting the challenges of the next decade and beyond. The Court has assumed that the budget review is intended to be a future-oriented process rather than an exercise of fine-tuning within present rules.

The Community budget: expenditure

2. The Court's comments below respond primarily to four questions posed in the Commission's consultation paper which are of particular relevance to the legality, regularity, effectiveness, efficiency and economy of spending:
 - What criteria should be used to ensure that the principle of European added value is applied effectively?
 - How should policy objectives be properly reflected in spending priorities?
 - How could the effectiveness and efficiency of budget delivery be improved?
 - Could the transparency and accountability of the budget be further enhanced?

The nature of EU expenditure

3. In general the Community budget does not finance the direct provision of goods and services to European citizens. Instead it part-finances the activities of other private or public sector agents. Examples include: national and regional policies to enhance economic and social

cohesion within the Union; the education, research and development activities of universities, research institutes and the private sector; the maintenance of the Union's external frontiers; the economic development policies of third countries.

4. Payments under the Common Agricultural Policy (CAP), including direct payments to farmers, represent the principal exception: they are 100% financed by the Community.
5. Management of most of the Community budget (the CAP, cohesion, external spending) involves the governments (national and/or regional) of Member States or of third countries: it is an example of multi-level governance in a large and diverse Union.
6. The Court assumes that these observations will continue to be valid over the period addressed by the Commission's consultation paper.

Choosing expenditure priorities: adding value.

7. In its communication, the Commission recognises that EU spending must be based on an assessment of the added value of EU spending. The Court welcomes this emphasis. Expenditure programmes which do not add European value are by definition unlikely to be an effective and efficient use of the EU taxpayer's money.
8. The Court suggests that an attempt might be made to define and articulate this concept, drawing for example on the following principles:
 - Expenditure from the Community budget within the Union must offer clear and visible benefits for the EU and for its citizens which could not be achieved by spending only at national, regional or local level, but could rather, by reason of the scale or effects of the proposed action, be better achieved at Union level;
 - Expenditure with trans-frontier effects or common interest is prima facie a stronger candidate for EU action than expenditure with limited geographical effects;
 - Reasonable concentration of expenditure is prima facie likely to support the objective of adding value;
 - For expenditure outside the Union, such as on development assistance, value added is also likely to be enhanced by a selective approach: for example, focusing on the coordination of development assistance in areas where there is global donor endorsement and focusing on activities for which specific EU expertise is of particular value.
9. Such principles might be embodied in a suitable political declaration or in EU legislation. Like the guidance on subsidiarity and proportionality in the Treaties, they would provide criteria for the guidance of the Union's political authorities.

Designing and running expenditure programmes: eligibility, accountability and governance and cost-effective management.

10. In the Court's view, if the EU budget is to meet the standards proposed in the Commission's consultation paper ('targeted to best effect, managed to the highest standards, bringing tangible improvements to the daily lives of citizens') close attention must be paid to the design of expenditure programmes, in particular:
- the terms on which EU spending is made available to budgetary recipients: *eligibility*;
 - responsibility for managing the budget: *accountability and governance*;
 - the cost-effectiveness of *management arrangements*.
11. The Court suggests that, in designing eligibility, governance and management arrangements for Community spending, the following principles should be applied.

Clarity of objectives.

12. The Court's audits have revealed a lack of clarity in the objectives of some spending programmes. Examples can be found in the Court's special reports 7/2006 (investment in rural development), 1/2007 (structural funds mid-term processes) and 9/2007 (evaluation of the RTD framework programme). If the objectives of an expenditure scheme are unclear (and numerous), it is unlikely to provide clear added value to the Union. Lack of clarity and potentially contradictory goals mean that essentially political decisions are not taken at the right level. It is also harder to assess and audit the results of the Union's interventions, as is for instance demonstrated in the area of development assistance where the impact of actions is either not known at all or limited, and where performance indicators are not well developed (see Special Report 4/2005 on the Commission's management of economic cooperation in Asia and Special Report 6/2007 on the effectiveness of technical assistance in the context of capacity development).

Simplification.

13. The Court has frequently drawn attention in its annual and special reports to the complexity of the eligibility conditions for many expenditure schemes. Examples can be found in the chapters of the Court's annual reports dealing with structural actions and internal policies and in special report 1/2004 (management of indirect actions under the 5th RTD framework programme). The Commission has also commented adversely, for example in its 'Synthesis Report' on the Commission's management activities in 2006 (COM(2007)274 final of 30 May 2007), on the complexity of rules related to eligible costs.
14. The Court suggests that Community expenditure programmes are most likely to be effective in adding value, and least likely to be inherently prone to high levels of irregularity, if eligibility conditions are kept as simple as is realistically possible. In designing Community expenditure programmes it is appropriate to ask what are the simplest eligibility conditions likely to ensure that expenditure is undertaken which meets the intentions of the legislator.

15. If simplification is to bring its full benefits, it needs to be applied at the practical as well as the conceptual level. For example, the CAP single payments scheme is conceptually a simplifying measure. But its implementation involved considerable complexities because of the wide choices available to the Member States. This is illustrated by the Court's audit findings in its 2006 Annual Report and acknowledged by the Commission in the context of the CAP Healthcheck. The difference between the establishment of objectives and their implementation was also well illustrated in the Court's Special Report on Producer Organisations (Special Report 8/2006 of 28 June 2006).
16. As the Court's opinion 2/2004 underlines, internal control systems will not be effective and efficient unless the legislation setting up the expenditure scheme concerned is sufficiently clear to permit the effective use of funds. Unnecessary complexity in legislation – such as requirements which do not contribute to the scheme's main objectives – should be avoided.

Realism.

17. The Court has found that some expenditure programmes are set up in a way which makes it difficult or impossible to ensure that the conditions for spending are met. Examples can be found in the Court's Special Reports 1/2004 (on management of the 5th RTD framework programme) and 3/2005 (agri-environmental measures). See also the Court's opinion 1/2006 on the 7th RTD framework programme. A scheme whose eligibility conditions are unrealistic is unlikely to add value to the Union. Expenditure programmes should either be established on a realistic basis - or should not be undertaken. In the area of development assistance the Court has noted (see for instance Special Report 6/2006 on environmental aspects of development cooperation) that the Commission's expertise is often too limited for the role it seeks to undertake.
18. The Court points out that simplification, clarity of objectives and realism are all principles that should make it easier to design and run successful cost-effective expenditure programmes in the Union. It is better to set up schemes that run with relative ease than to attempt to compensate for complex eligibility requirements by complex governance and management arrangements.

Transparency and Accountability.

19. For decision-makers to be responsible for their decisions - and thus accountable - underlying information has to be clear and transparent. Lack of transparency makes evaluation and "follow up" harder and decreases the general public's possibility to hold decision makers accountable. In order to make the budget more transparent it should for example be ensured that there is no ambiguity as to what is included in different budget headings.
20. Without clear lines of responsibility and accountability, expenditure cannot be well managed. The Court has drawn attention, notably in its Opinion no 2/2004 on a Community Internal Control Framework, to the need for clear accountability arrangements for EU spending. A clear allocation of responsibilities is of particular importance in areas of the budget where management responsibilities are shared between the Commission and the Member States.
21. In this context, the Court notes the following:
 - The Reform Treaty amends Article 274 of the Treaty establishing the European Community. In its new form within the Treaty on the Functioning of the European Union,

that article will provide that the Commission implements the budget on its own responsibility in cooperation with the Member States; the control and audit obligations of the Member States in the implementation of the budget and the resulting responsibilities are to be laid down in regulations.

- In significant parts of the budget (the structural funds) rules on eligibility of expenditure are set at national level. The Commission is obliged to satisfy itself that Member States correctly apply these national requirements. This represents a complex set of roles and responsibilities

22. In the area of development assistance the Court has noted a lack of ownership among recipient countries. Combined with a limited absorption capacity of the assistance offered this negatively affects the possibilities for deconcentrated management of assistance (see for instance Special Report 5/2006 on the MEDA Programme).

Issues deserving further consideration

23. The Court recommends that the political authorities should be prepared, in the context of a fundamental review of the EU budget, to think radically about the design of expenditure programmes in the future.

24. In this context, the Court suggests that consideration should be given to the following questions:

- Is it possible to recast expenditure programmes in terms, not of eligible inputs, but in terms of acceptable outputs; with programmes based on a set of concrete objectives, and disbursements linked to the achievement of results?
- Insofar as expenditure schemes continue to be based on inputs, is it possible radically to simplify the basis of calculation. Could the Union, for example, make far greater use than at present of lump sum or flat rate payments instead of the reimbursement of 'real costs'?
- What should be the degree of national, regional or local discretion in managing expenditure programmes in which the Community budget supports national, regional or local policy initiatives ? On the one hand it can be argued that national or sub-national authorities are best able to judge how money is best spent within their territory in pursuit of EU objectives. On the other hand, the Commission has overall responsibility, in cooperation with Member States, for implementing the budget.
- Can control systems be defined in terms of their output (the risk objective and the resulting acceptable level of error to be achieved) rather than input as is currently the case (the number of the checks to be undertaken)? The advantages of doing so would be that:
 - all stakeholders - from management through to external auditors - would be aware of the aims of the control systems;
 - criteria could be adapted to meet the different risk and cost of control profiles for the various areas;
 - resources would be used in a more rational, open and, it must be hoped, better way.

- Can better use be made of the concept of "tolerable risk" when deciding expenditure programmes? Tolerable risk is a concept to be used not only when defining the focus and intensity of control systems (control systems cannot, and should not, aim for zero risk), but also when designing expenditure schemes or programmes. The way that expenditure is calculated, claimed for and distributed has an enormous impact on both its cost of administration and its inherent risk profile. Rational consideration of tolerable risk issues may cause the legislator to reject a proposal because of the risk and/or cost of containing that risk, or, on the other hand, demonstrate a greater risk appetite by accepting a proposal which is nonetheless judged desirable.
- As regards development assistance, should the Commission consider focussing on activities and actions which are based on commitment and ownership of the recipient countries as the most important condition for achieving impact and should it continue to provide capacity building activities taking the absorption capacity of the countries into account? Should the Commission as well reconsider the instruments for assistance provided to middle income countries such as Russia, China, and India, given the very limited effectiveness of traditional projects and programmes for those countries and the relative unimportance of aid in these countries as is demonstrated in recent Special Reports from the Court (see for instance Special Report 2/2006 on the performance of TACIS projects in the Russian Federation)?

The Community budget: revenue

25. The European Union's own resources system should be equitable, transparent, cost-effective and simple and must be based on criteria which best express each Member State's ability to contribute¹.
26. The present system is excessively complex, lacks transparency, is incomprehensible for EU citizens, and is not fully auditable.
 - The VAT-based resource resembles national contributions based on statistical data and estimates in addition to VAT actually received. Their calculation is complex and is the result of a number of detailed adjustments. There is no direct, clear relationship between VAT paid by the taxpayer and the "VAT-based" resource;
 - The GNI-based own resource is based on macro-economic statistics for which harmonization could still be improved;
 - The various correction mechanisms linked to the correction of budgetary imbalances introduce great complexity into the VAT and GNI call-up rate;
 - The underlying data can be audited directly only in the case of traditional own resources (customs duties, agricultural duties and sugar levies) (see the Court's Opinion 4/2005, point 22, and the Court's Annual Reports, Chapter on Revenue (most recently in AR 2006, paragraph 4.7).

¹ See conclusions of the 1999 Berlin European Council meeting as recalled in the Court's Opinions 4/2005 and 2/2006.

27. The design of the revenue side of the budget raises issues on which it is for the Union's political authorities to pronounce.

28. The Court however points out that there is considerable scope for simplifying and clarifying the own resources system:

- The review of arrangements for the correction of budgetary imbalances (UK rebate, lump sum payment to the Netherlands and Sweden, reduced VAT call-up rate for Austria, Germany, the Netherlands and Sweden, as well as the 25% collection costs for traditional own resources) should take account of the principles and observations set out above.
- As explained above, the "VAT-based" resource is levied on a 'virtual' basis (harmonised VAT base which may be subsequently capped and takes into account compensation arrangements for UK) which is complex to the point of incomprehensibility; the Court recommends that consideration should be given to the question whether the "VAT" resource still constitutes an appropriate part of the own resources system.

Future procedure

29. The Court notes that the key messages and trends in contributions to the consultation exercise will be presented at a large-scale conference. The Court would be happy to participate in such a conference.