

# 2020

## Annual reports

- on the implementation of the EU budget for the 2020 financial year and
- on the activities funded by the 8th, 9th, 10th and 11th European Development Funds (EDFs) for the 2020 financial year



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Pursuant to Article 287(1) and (4) of the TFEU, Article 258 of Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012, and Article 43 of Council Regulation (EU) 2018/1877 of 26 November 2018 on the financial regulation applicable to the 11th European Development Fund, and repealing Regulation (EU) 2015/323

**the Court of Auditors of the European Union, at its meetings of 8 and 15 July 2021, adopted its**

## **ANNUAL REPORTS**

### **for the 2020 financial year**

The reports, together with the institutions' replies to the Court's observations, have been sent to the authorities responsible for giving discharge and to the other institutions.

The Members of the Court of Auditors are:

Klaus-Heiner LEHNE (President), Ladislav BALKO, Lazaros S. LAZAROU, Pietro RUSSO, Baudilio TOMÉ MUGURUZA, Iliana IVANOVA, Alex BRENNINKMEIJER, Nikolaos MILIONIS, Bettina JAKOBSEN, Samo JEREB, Jan GREGOR, Mihails KOZLOVS, Rimantas ŠADŽIUS, Leo BRINCAT, Juhan PARTS, Ildikó GÁLL-PELCZ, Eva LINDSTRÖM, Tony MURPHY, Hannu TAKKULA, Annemie TURTELBOOM, Viorel ȘTEFAN, Ivana MALETIĆ, Francois-Roger CAZALA, Joëlle ELVINGER, Helga BERGER, Marek OPIOLA

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# **Annual report on the implementation of the EU budget for the 2020 financial year**

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# General Introduction

**0.1.** The European Court of Auditors (ECA) is an institution<sup>1</sup> of the European Union (EU) and the external auditor of the EU's finances<sup>2</sup>. In this capacity, we act as the independent guardian of the financial interests of all EU citizens, notably by helping to improve the EU's financial management. More information on our work can be found in our annual activity reports, our special reports, our review documents and our opinions on new or updated EU laws or other decisions with financial management implications<sup>3</sup>.

**0.2.** The EU's general budget is adopted annually by the Council of the European Union and by the European Parliament. Our annual report, combined as appropriate with our other products, provides a basis for the *discharge procedure*, in which the Parliament, acting on a recommendation from the Council, decides whether the European Commission has satisfactorily met its budgetary responsibilities. Upon publication, we forward our annual report to Member States' national parliaments, the European Parliament and the Council.

**0.3.** Our 2020 annual report is once again split into two separate parts. This part of the report concerns the reliability of the EU *consolidated accounts* and the *legality and regularity of transactions*. The other part covers our reporting on the performance of the EU budget at the end of 2020<sup>4</sup>.

<sup>1</sup> The ECA was established as an institution by Article 13 of the Treaty on European Union, also known as the Maastricht Treaty (OJ C 191, 29.7.1992, p. 1). However, it was first established by the Treaty of Brussels in 1977, as the new Community body responsible for the external audit function (OJ L 359, 31.12.1977, p. 1).

<sup>2</sup> Articles 285 to 287 of the Treaty on the Functioning of the European Union (TFEU) (OJ C 326, 26.10.2012, p. 169).

<sup>3</sup> Available on our website: [www.eca.europa.eu](http://www.eca.europa.eu).

<sup>4</sup> 'Report of the European Court of Auditors on the performance of the EU budget – Status at the end of 2020

**0.4.** The central element of our report is the *statement of assurance* on the reliability of the EU consolidated accounts and the legality and regularity of transactions. This statement is supplemented by specific assessments for each major area of EU activity.

**0.5.** This part of our report is structured as follows:

- chapter 1 contains the statement of assurance, a summary of the results of our audit on the reliability of accounts and the legality and regularity of transactions, including the Commission’s regularity information and a summary of our audit approach;
- chapter 2 presents our analysis of budgetary and financial management;
- chapter 3 presents our findings on EU revenue;
- chapters 4 to 9 show, for the main headings of the 2014-2020 *multiannual financial framework (MFF)*<sup>5</sup>, the results of our testing of the legality and regularity of transactions and our review of the Commission’s *annual activity reports*, elements of its internal control systems and other governance arrangements.

**0.6.** As there are no separate financial statements for individual MFF headings, the conclusions for each chapter do not constitute an audit opinion. Instead, the chapters describe significant issues specific to each MFF heading.

**0.7.** We aim to present our observations in a clear and concise way. We cannot always avoid using terms specific to the EU, its policies and budget, or to accounting and auditing. On our website, we have published a glossary with explanations of most of these specific terms<sup>6</sup>. The terms defined in the glossary appear in *italics* when they first appear in each chapter.

<sup>5</sup> We do not report separately on heading 6 (‘Compensations’) and expenditure outside the MFF. For heading 3 (‘Security and citizenship’) and heading 4 (‘Global Europe’), in chapters 7 and 8 respectively, we do not provide a specific assessment.

<sup>6</sup> <https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=58667>

**0.8.** It is our responsibility, as external auditor, to report our audit findings and draw the necessary conclusions so as to provide an independent and impartial assessment of the reliability of the EU accounts and the legality and regularity of transactions. COVID-19 travel restrictions prevented us, in almost all cases, from performing on-the-spot checks, and we carried out most of our work through desk reviews and by interviewing auditees remotely. While not carrying out on-the-spot checks may increase the detection risk, the evidence obtained enabled us to complete our work and to conclude on it.

**0.9.** The Commission's replies to our observations (and, where appropriate, the replies of other EU institutions and bodies) are presented together with this report.

# Chapter 1

**The statement of assurance and supporting information**

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# The ECA's Statement of Assurance provided to the European Parliament and the Council – independent auditor's report

## Opinion

### I. We have audited:

- (a) the *consolidated accounts* of the European Union, which comprise the consolidated financial statements<sup>1</sup> and the budgetary implementation reports<sup>2</sup> for the financial year ended 31 December 2020, approved by the Commission on 30 June 2021;
- (b) the legality and regularity of the underlying transactions, as required by Article 287 of the Treaty on the Functioning of the European Union (TFEU).

## Reliability of the accounts

### Opinion on the reliability of the accounts

**II.** In our opinion, the consolidated accounts of the European Union (EU) for the year ended 31 December 2020 present fairly, in all material respects, the EU's financial position as at 31 December 2020, the results of its operations, its cash flows and the changes in its net assets for the year then ended, in accordance with the Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

<sup>1</sup> The consolidated financial statements comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets, and a summary of significant accounting policies and other explanatory notes (including segment reporting).

<sup>2</sup> The budgetary implementation reports also comprise explanatory notes.

## Legality and regularity of the transactions underlying the accounts

### Revenue

#### *Opinion on the legality and regularity of revenue*

**III.** In our opinion, the revenue underlying the accounts for the year ended 31 December 2020 is legal and regular in all material respects.

### Expenditure

#### *Adverse opinion on the legality and regularity of expenditure*

**IV.** In our opinion, owing to the significance of the matter described under ‘Basis for adverse opinion on the legality and regularity of expenditure’, the expenditure accepted in the accounts for the year ended 31 December 2020 is materially affected by error.

#### *Basis for opinion*

**V.** We have conducted our audit in accordance with the IFAC International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under these standards and codes are described in more detail in the ‘Auditor’s responsibilities’ section of our report. We have also met independence requirements and fulfilled our ethical obligations under the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *Basis for adverse opinion on the legality and regularity of expenditure*

**VI.** Our overall estimated level of error for expenditure accepted in the accounts for the year ended 31 December 2020 is 2,7 %. A substantial proportion of this expenditure - more than half, is materially affected by error. This concerns mainly reimbursement-based expenditure, in which the estimated level of error is 4,0 %. Due largely to a further rise in ‘Cohesion’ spending, such expenditure increased to €87.2 billion in 2020, representing 59.0 % of our audit population<sup>3</sup>. The effects of the errors we found are therefore both material and pervasive to the accepted expenditure of the year.

<sup>3</sup> We provide further information in paragraphs **1.21-1.26** of our 2020 annual report.

## Key audit matters

### We assessed the liability for pension and other employee benefits

**VII.** The EU balance sheet includes a liability for pension and other employee benefits amounting to €116.0 billion at the end of 2020, representing more than one third of the total 2020 liabilities of €313.5 billion.

**VIII.** Most of the liability for pension and other employee benefits relates to the Pension Scheme of Officials and Other Servants of the European Union (PSEO), amounting to €100.7 billion. The liability recorded in the accounts is an estimate of the present value of expected future payments the EU will have to make to settle its pension obligations.

**IX.** The benefits paid under the pension scheme are charged to the EU budget. While the EU has not created a dedicated pension fund to cover the cost of future pension obligations, Member States jointly guarantee the payment of the benefits, and officials contribute one third of the cost of financing the scheme. Eurostat calculates this liability annually on behalf of the Commission's accounting officer, using parameters such as the age profile and life expectancy of EU officials and assumptions about future economic conditions. These parameters and assumptions are also assessed by the Commission's actuarial advisors.

**X.** The increase in the pension liability in 2020 is mainly due to the decrease in the nominal discount rate, which is affected by a reduction in global interest rates<sup>4</sup>. This is the main contributor to a 98 % increase in the pension liability between 2014 and 2020, from €50.9 billion to €100.7 billion<sup>5</sup>.

**XI.** The second largest part of the liability for pension and other employee benefits is the EU's estimated liability towards the Joint Sickness Insurance Scheme (JSIS), which amounted to €12.9 billion at the end of 2020. This liability relates to EU staff members' healthcare costs payable during post-activity periods (net of their contributions).

**XII.** As part of our audit, we assess the actuarial assumptions made for these schemes and the resulting valuation. We base our evaluation on work carried out by an external, independent actuarial expert. We check the basic data underlying the calculations, the actuarial parameters and the calculation of the liability. We also examine the presentation of the liabilities in the consolidated balance sheet and the notes to the consolidated financial statements.

**XIII.** We conclude that the estimate of the overall liability for pension and other employee benefits stated in the consolidated balance sheet is fair and reliable. Finally, we will continue to assess the calculation of this significant liability, including the reliability of the underlying data, thereby contributing to the Commission's continued monitoring thereof.

**We assessed significant year-end estimates presented in the accounts**

**XIV.** At the end of 2020, the estimated value of eligible expenses incurred by beneficiaries but not yet reported was €107.8 billion (end of 2019: €105.7 billion). These amounts were recorded as accrued expenses<sup>4</sup>.

**XV.** At the end of 2020, the estimated amount unused by the financial instruments under shared management and aid schemes recognised in the accounts was €7.2 billion (end of 2019: €6.9 billion), shown in the balance sheet as 'Other advances to Member States'.

**XVI.** In order to assess these year-end estimates, we examined the system the Commission had set up for the cut-off calculations to ensure its correctness and completeness in the directorates-general where most payments were made. During our audit work on the sample of invoices and pre-financing payments, we examined the relevant cut-off calculations in order to address the risk of accruals being misstated. We sought additional clarification from the Commission's accounting services on the general methodology for establishing these estimates.

**XVII.** We conclude that the estimate of the overall amount of accrued charges and other advances to Member States is presented fairly in the consolidated balance sheet.

**We reviewed the asset and corresponding revenue amounts (from non-exchange transactions) generated by the UK's withdrawal process**

**XVIII.** On 1 February 2020, the United Kingdom (UK) ceased to be an EU Member State. Following the conclusion of the agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (the 'Withdrawal Agreement') between the two parties, the UK committed to honour all financial obligations

<sup>4</sup> 2020 EU annual accounts, note 2.9.

<sup>5</sup> Disclosed in note 2.9 to the EU annual accounts in 2014-2020.

<sup>6</sup> These comprise accrued charges of €64.4 billion on the liabilities side of the balance sheet and, on the assets side, €43.4 billion reducing the value of pre-financing.

under previous multiannual financial frameworks arising from its EU membership. During the transition period, which ended on 31 December 2020, the UK continued to contribute to and benefit from the EU budget, as if it were a Member State.

**XIX.** Following the end of transition period further mutual obligations on the part of the EU and the UK give rise to certain liabilities and receivables for the EU. These obligations must be reflected in the EU's annual accounts. The Commission estimated that, at the balance sheet date, the UK owed the EU €49.6 billion while the EU owed the UK €2.1 billion. Therefore, at the balance sheet date, the EU accounts showed a net receivable due from the UK of €47.5 billion.

**XX.** As part of our normal audit procedures, we discussed with the Commission the timing, accuracy and completeness of the asset and corresponding revenue amounts recognised. We recalculated the amounts concerned, reconciled them with the underlying records and checked the appropriateness of any assumptions used.

**XXI.** We conclude that the estimates of the total assets and revenue recognised in relation to the UK's withdrawal process are presented fairly in the consolidated annual accounts. We will keep these amounts under review going forward.

#### **We assessed the impact of COVID-19 related measures on the accounts**

**XXII.** In reaction to the COVID-19 pandemic the Commission mobilised substantial resources to strengthen Member States' public health sectors and mitigate the socio-economic impact of the crisis in the European Union. This included funding urgent medical supplies, introducing more flexibility in the use of financial support from the European Structural and Investment Funds and providing loans on favourable terms to Member States. The financial effects of those initiatives had a significant impact on the financial statements.

**XXIII.** As part of our normal audit procedures, we audited the EU's assets, liabilities, revenue and expenses, including those related to the measures taken by the Commission. We conclude that they are presented fairly in the consolidated annual accounts.

#### **Other matters**

**XXIV.** Management is responsible for providing 'other information'. This term encompasses the 'Financial highlights of the year', but not the consolidated accounts or our report on these. Our opinion on the consolidated accounts does not cover this other information, and we do not express any form of assurance conclusion on it. Our responsibility in connection with the audit of the

consolidated accounts is to read the other information and consider whether it is materially inconsistent with the consolidated accounts or the knowledge we have obtained in the audit or otherwise appears to be materially misstated. If we conclude that the other information is materially misstated, we are required to report this accordingly. We have nothing to report in this regard.

### **Responsibilities of management**

**XXV.** In accordance with Articles 310 to 325 of the TFEU and with the Financial Regulation, management is responsible for preparing and presenting the EU's consolidated accounts on the basis of internationally accepted accounting standards for the public sector, and for the legality and regularity of the underlying transactions. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities (laws, regulations, principles, rules and standards) which govern them. The Commission is ultimately responsible for the legality and regularity of the transactions underlying the EU's accounts (Article 317 of the TFEU).

**XXVI.** When preparing the consolidated accounts, management is responsible for assessing the EU's ability to continue as a going concern, disclosing any relevant matters and using the going concern basis of accounting unless it either intends to liquidate the entity or cease operations, or has no realistic alternative but to do so.

**XXVII.** The Commission is responsible for overseeing the EU's financial reporting process.

**XXVIII.** Under the Financial Regulation (Title XIII), the Commission's accounting officer must present for audit the consolidated accounts of the EU first as provisional accounts by 31 March of the following year and as final accounts by 31 July. The provisional accounts should already give a true and fair view of the EU's financial position. It is therefore imperative that all items of the provisional accounts are presented as final calculations, allowing us to perform our task in line with (Title XIII) of the Financial Regulation and by the given deadlines. Any changes between the provisional and final accounts would normally result from our observations only.

## **Auditor's responsibilities for the audit of the consolidated accounts and underlying transactions**

**XXIX.** Our objectives are to obtain reasonable assurance as to whether the EU's consolidated accounts are free from material misstatement and the underlying transactions are legal and regular and on the basis of our audit, to provide the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. Reasonable assurance is a high level of assurance, but it is not a guarantee that the audit has necessarily detected all instances of material misstatement or non-compliance that may exist. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence any economic decisions taken on the basis of these consolidated accounts.

**XXX.** For revenue, our examination of VAT and GNI-based own resources takes as its starting point the macroeconomic aggregates from which these are calculated, and assesses the Commission's systems for processing these up to the point at which the Member States' contributions have been received and recorded in the consolidated accounts. For traditional own resources, we examine the customs authorities' accounts and analyse the flow of duties up until the amounts have been received by the Commission and recorded in the accounts.

**XXXI.** For expenditure, we examine payment transactions once expenditure has been incurred, recorded and accepted. This examination covers all categories of payments at the point they are made, except advances. We examine advance payments once the recipient of funds has provided evidence of their proper use and the institution or body has accepted that evidence by clearing the advance payment, which might not happen until a subsequent year.

**XXXII.** We exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- (a) Identify and assess the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of EU law, whether due to fraud or error. We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

- (b) Obtain an understanding of internal control relevant to the audit in order to design appropriate audit procedures, but not for the purpose of expressing an opinion on the *effectiveness* of the internal control.
- (c) Evaluate the appropriateness of the accounting policies used by management and the reasonableness of management's accounting estimates and related disclosures.
- (d) Conclude as to the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, as to whether material uncertainty exists owing to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that such material uncertainty exists, we are required to draw attention in our report to the related disclosures in the consolidated accounts or, if these disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the entity to cease to continue as a going concern.
- (e) Evaluate the overall presentation, structure and content of the consolidated accounts, including all disclosures, and assess whether the consolidated accounts fairly represent the underlying transactions and events.
- (f) Obtain sufficient appropriate audit evidence regarding the financial information on the entities covered by the EU's scope of consolidation to express an opinion on the consolidated accounts and the underlying transactions. We are responsible for directing, supervising and carrying out the audit, and are solely responsible for our audit opinion.

**XXXIII.** We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including findings of any significant deficiencies in internal control.

**XXXIV.** Of the matters discussed with the Commission and other audited entities, we determine which were of most significance in the audit of the consolidated accounts and are therefore the key audit matters for the current period. We describe these matters in our report unless law or regulation precludes public disclosure or, as happens extremely rarely, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh any public interest benefits.

15 July 2021.

Klaus-Heiner LEHNE  
*President*

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# Introduction

## The role of the European Court of Auditors

**1.1.** We are the EU's independent auditor. In accordance with the Treaty on the Functioning of the European Union (TFEU)<sup>7</sup>, we:

- (a) give our opinion on the EU's accounts;
- (b) check whether the EU budget is used in accordance with applicable laws and regulations;
- (c) report on whether EU spending is economic, efficient and effective<sup>8</sup>; and
- (d) advise on proposed legislation with a financial impact.

**1.2.** Our work for the *statement of assurance* (explained in [Annex 1.1](#)) fulfils the first and second of these objectives. We present the performance aspects of the budget's implementation (the economy, efficiency and effectiveness of spending) in a separate part of our annual report<sup>9</sup>. Taken together, our audit work also provides a key input into our opinions on proposed legislation.

**1.3.** This chapter of the annual report:

- (a) sets out the background to our statement of assurance and gives an overview of our findings and conclusions on the reliability of accounts and the *regularity of transactions*, including the Commission's regularity information;
- (b) includes information on our reporting of cases of suspected fraud to OLAF and our audits on EU action to combat fraud;
- (c) summarises our audit approach (see [Annex 1.1](#)).

<sup>7</sup> Articles 285 to 287 of the Treaty on the Functioning of the European Union (TFEU) ([OJ C 326, 26.10.2012, p. 47](#)).

<sup>8</sup> See glossary: *Sound financial management*.

<sup>9</sup> We report on these aspects in 'Report of the European Court of Auditors on the performance of the EU budget – Status at the end of 2020' and our performance-related special reports.

**1.4.** COVID-19 travel restrictions prevented us, in almost all cases, from carrying out on-the-spot checks, obtaining original documents, interviewing auditee staff face to face and verifying the physical existence of EU-funded outputs. We therefore carried out most of our work through desk reviews and by interviewing auditees remotely. While not carrying out on the spot checks may increase the detection risk<sup>10</sup>, the evidence that we obtained from our auditees enabled us to complete our work and conclude on it.

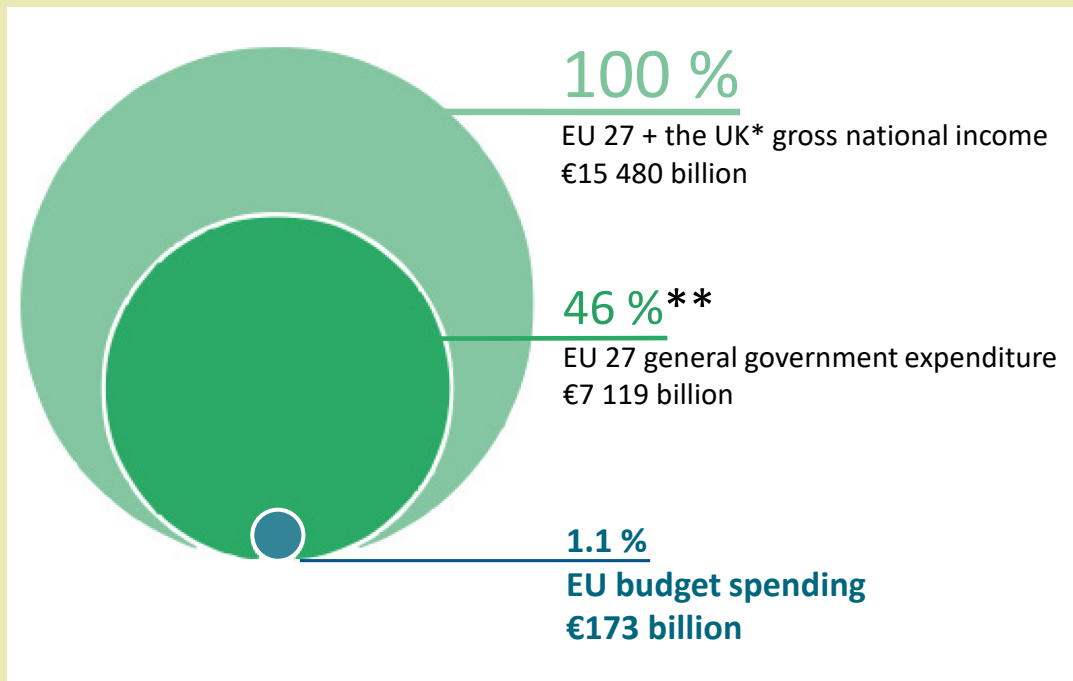
## EU spending is a significant tool for achieving policy objectives

**1.5.** EU spending is an important tool for achieving policy objectives, but not the only one. Other important measures include the use of legislation and the right of free movement of goods, services, capital and people throughout the EU. In 2020, EU spending amounted to €173.3 billion<sup>11</sup>, representing 1.1 % of the combined gross national income of the EU Member States and the UK<sup>12</sup> (see **Box 1.1**).

<sup>10</sup> Detection risk is the risk that the auditor will not detect a deviation that has not been corrected by the entity's **internal controls**.

<sup>11</sup> See 2020 consolidated annual accounts of the EU, budgetary implementation reports and explanatory notes, 4.3 MFF: Implementation of payment *appropriations*.

<sup>12</sup> Combined GNI of EU Member States plus the United Kingdom, 2020 annual accounts of the European Commission – Annex A – Revenue, EU-27 general government expenditure see [https://ec.europa.eu/eurostat/databrowser/view/gov\\_10a\\_main/](https://ec.europa.eu/eurostat/databrowser/view/gov_10a_main/).

**Box 1.1****2020 EU spending as a share of gross national income (GNI) and general government expenditure**

\* Combined GNI of EU Member States plus the United Kingdom, given that it contributed to the EU budget as the other EU Member States did in 2020.

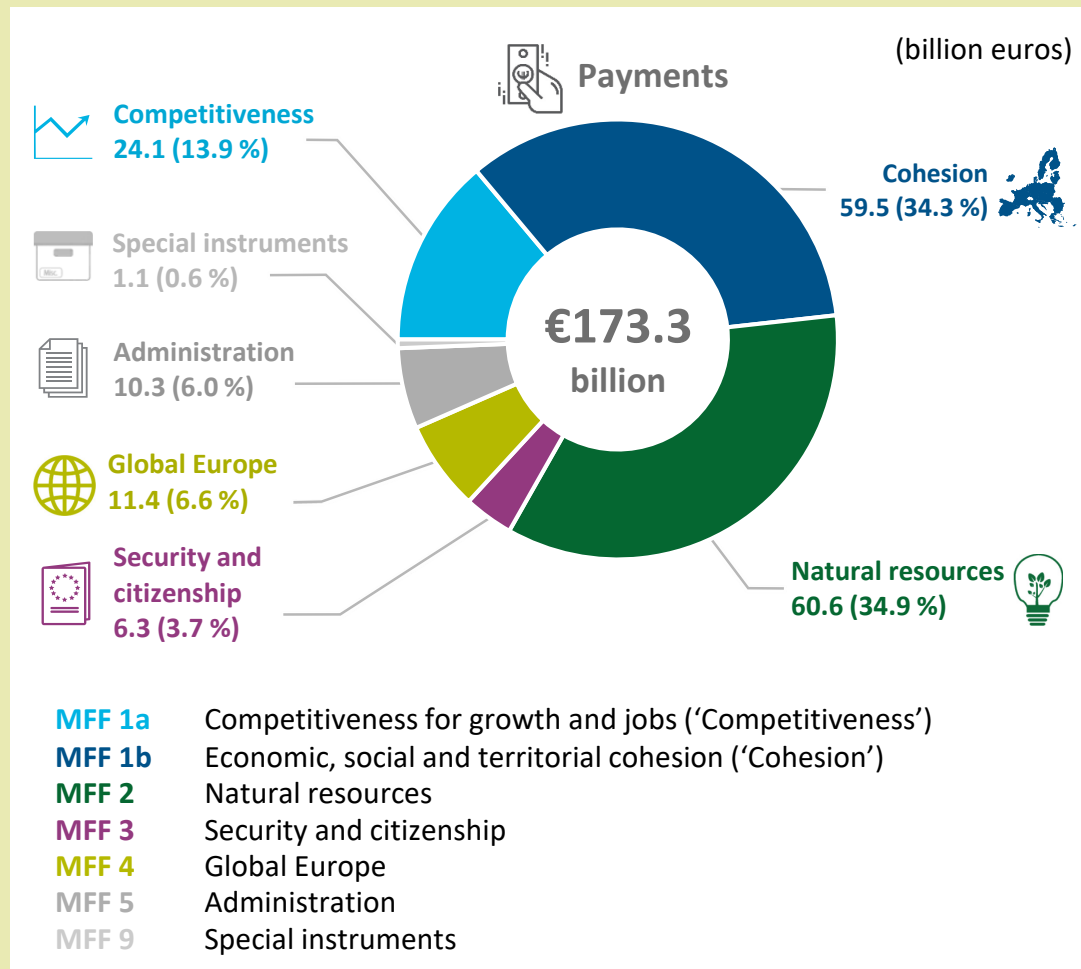
\*\* As a proportion of EU 27 gross national income excluding the UK, EU 27 general government expenditure would represent 54 %.

Source: Member States' GNI: 2020 annual accounts of the European Commission – Annex A – Revenue; Member States general government expenditure: Eurostat – annual national accounts; EU spending: European Commission – 2020 consolidated annual accounts of the European Union.

**1.6.** EU funds are disbursed to beneficiaries either through single payments/annual instalments or through a series of payments within multiannual spending schemes. Payments from the 2020 EU budget comprised €134.6 billion in single, interim or final payments, plus €38.7 billion in pre-financing. As [Box 1.2](#) shows, the largest shares of the EU budget went to 'Natural resources' and 'Cohesion', followed by 'Competitiveness'.

## Box 1.2

## 2020 payments per multiannual financial framework (MFF) heading



Source: ECA.

# Audit findings for the 2020 financial year

## Reliability of the accounts

### The accounts were not affected by material misstatements

**1.7.** Our findings concern the EU's consolidated accounts<sup>13</sup> (the 'accounts') for the 2020 financial year. We received them, together with the accounting officer's letter of representation, on 1 July 2021, before the final date for presentation allowed under the Financial Regulation<sup>14</sup>. The accounts are accompanied by a 'Financial highlights of the year' section, which includes the financial statement analysis<sup>15</sup>. This section is not covered by our audit opinion. In accordance with auditing standards, however, we have assessed its consistency with the information in the accounts.

**1.8.** The accounts published by the Commission show that, at 31 December 2020, total liabilities amounted to €313.4 billion, compared with €280.0 billion of total assets. The difference of €33.4 billion represented the (negative) net assets, comprising reserves and the portion of expenses already incurred by the EU up to 31 December that must be funded by future budgets. The economic result for 2020 was €57.4 billion.

<sup>13</sup> The consolidated accounts comprise:

- (a) the consolidated financial statements covering the balance sheet (presenting the assets and liabilities at the end of the year), the statement of financial performance (recognising the income and expenses of the year), the cash-flow statement (disclosing how changes in the accounts affect cash and cash equivalents) and the statement of changes in net assets, as well as the notes to the financial statements;
- (b) the budget implementation reports covering the revenue and expenditure for the year, as well as the related notes.

<sup>14</sup> Regulation (EU, Euratom) No 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 966/2012 ([OJ L 193, 30.07.2018, p. 1](#)).

<sup>15</sup> See [Recommended Practice Guideline 2 \(RPG 2\)](#) 'Financial Statement Discussion and Analysis' of International Public Sector Accounting Standards Board (IPSASB).

**1.9.** Our audit found that the accounts were not affected by material misstatements. Additionally, we present the results of our work on the financial and budgetary management of EU funds in **chapter 2**.

## Key audit matters relating to the 2020 financial statements

**1.10.** Key audit matters are those matters that, according to our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, but we do not provide a separate opinion on these matters. We report on key audit matters in our statement of assurance.

## Regularity of transactions

**1.11.** We examined EU revenue and expenditure to assess whether it had been collected and spent in compliance with the applicable laws and regulations. We present our audit results for revenue in **chapter 3** and for expenditure in **chapters 4-9**.

## Our audit covers revenue and expenditure transactions underlying the accounts

**1.12.** For revenue, we obtained assurance for our audit opinion by assessing the selected key systems, complemented by transaction testing. The sample of transactions examined was designed to be representative of all sources of revenue, which comprises three categories of own resources and revenue stemming from other sources (see paragraphs **3.2-3.3**).

**1.13.** For expenditure, we defined a representative sample of 728 transactions. They comprise transfers of funds from the EU budget to *final recipients* of EU spending (see paragraphs **(11)** and **(12)** of **Annex 1.1**). Our testing of these transactions contributed to our statement of assurance and our estimation of the proportion of irregular transactions in the overall audit population, in high-risk and low-risk expenditure (see paragraph **1.18**) and in each MFF heading where we provide a specific assessment (MFFs 1a, 1b, 2 and 5).

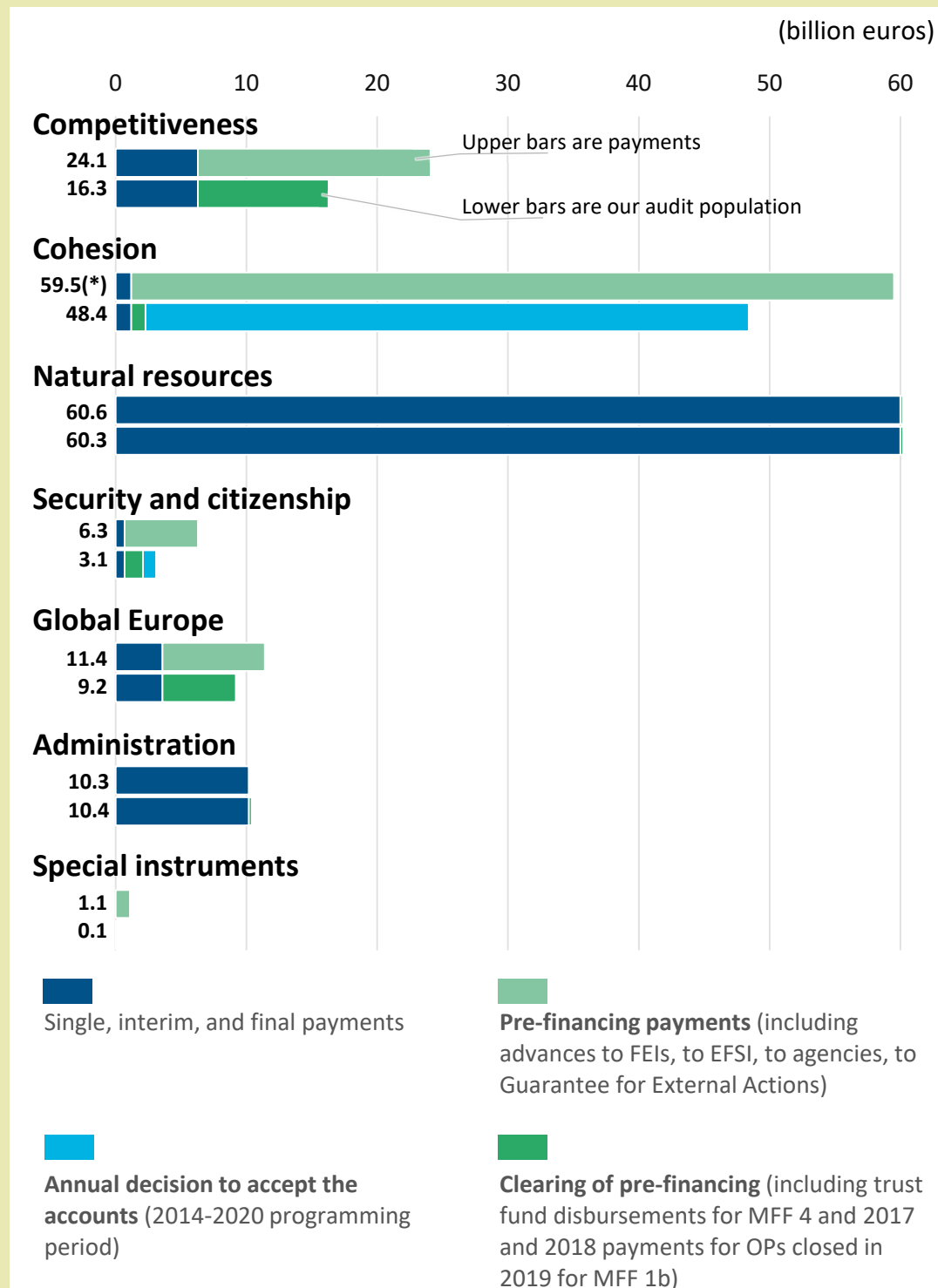
**1.14.** Our 2020 audit population for testing revenue amounted to €174.3 billion (see **Box 3.1** and paragraph **3.4**) and for expenditure totalled €147.8 billion. These amounts include both contributions from and payments to the United Kingdom, in line with the conditions outlined in the withdrawal agreement<sup>16</sup>.

**1.15.** **Box 1.3** shows our audit population - broken down into single, interim (where accepted by the Commission) and final payments; clearings of pre-financing; and annual decisions to accept the accounts - in comparison with EU spending per MFF heading (see paragraph **(11)** of **Annex 1.1**).

<sup>16</sup> Article 135(1) of the [withdrawal agreement](#) states “For the years 2019 and 2020, in accordance with Part Four, the United Kingdom shall contribute to and participate in the implementation of the Union budgets.”

### Box 1.3

#### Comparison of our audit population (€147.8 billion) and EU spending (€173.3 billion) by MFF heading in 2020



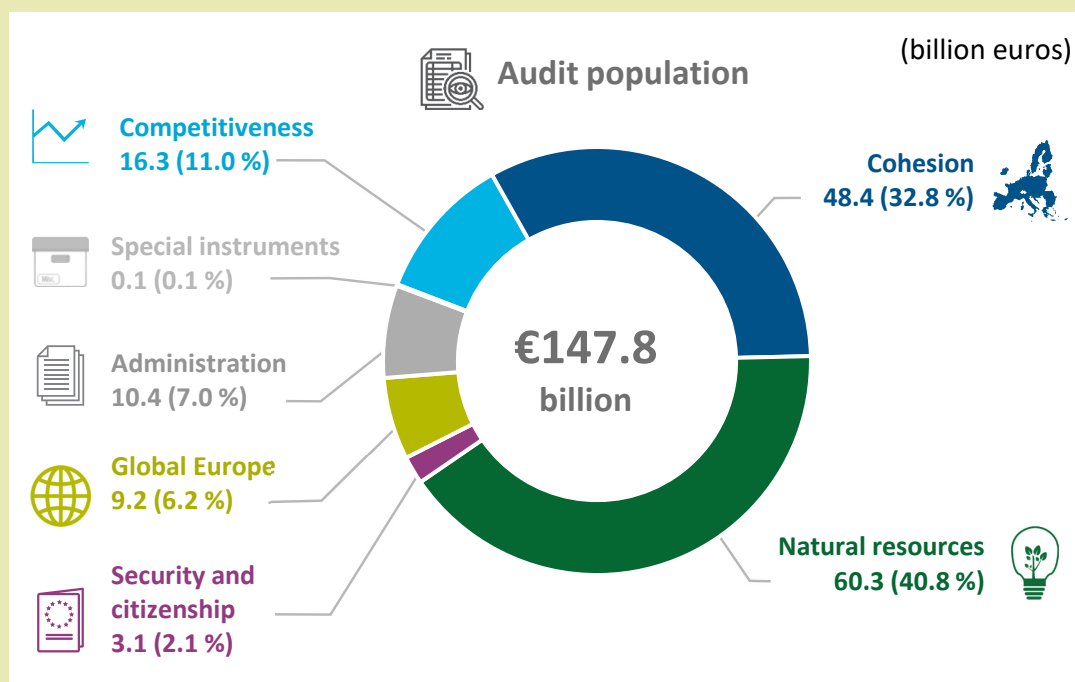
(\*) For 'Cohesion', the €58.3 billion pre-financing amount includes 2014-2020 interim payments relating to expenditure not yet accepted by the Commission €47.2 billion (see **Box 5.1**).

Source: ECA.

**1.16.** Box 1.4 shows that ‘Natural resources’ makes up the largest share of our overall population (40.8 %), followed by ‘Cohesion’ (32.8 %) and ‘Competitiveness’ (11.0 %).

#### Box 1.4

#### Overview of our 2020 audit population of 147.8 billion euros by MFF heading



Source: ECA.

#### Error continues to be present in specific types of spending

**1.17.** For the regularity of EU revenue and expenditure, our key findings were:

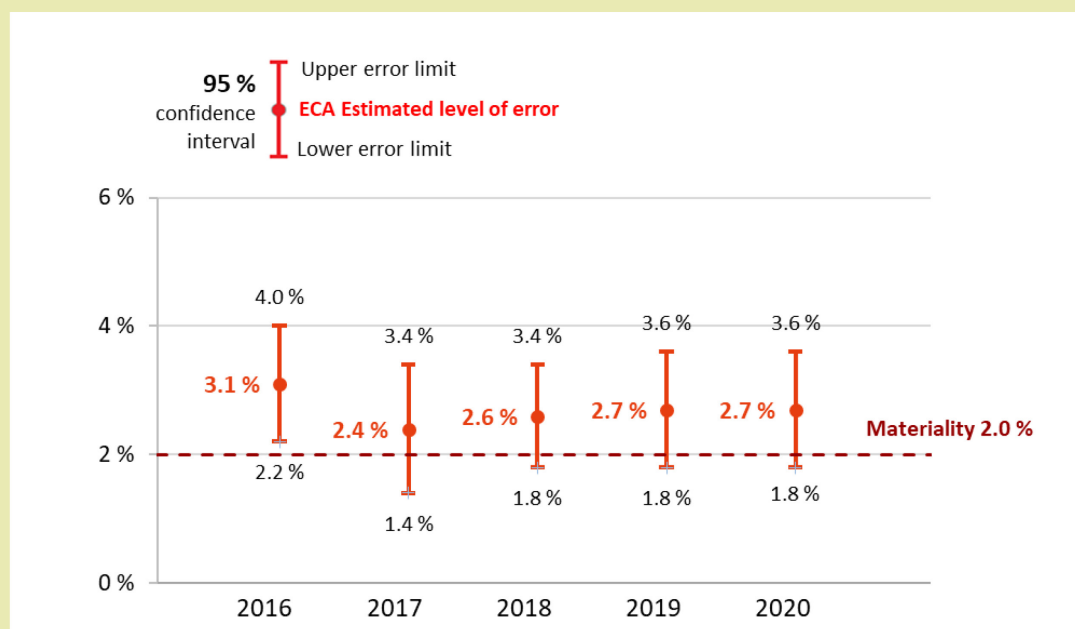
- (a) For revenue, the overall audit evidence indicates that the level of error was not material. The revenue-related systems we examined were generally effective. However, the key internal *traditional own resources* (TOR) controls we assessed in certain Member States and the closure of the GNI verification cycle we assessed at the Commission were partially effective due to persistent weaknesses (see paragraphs 3.9-3.17). We also detected significant weaknesses in Member States' controls to reduce the *customs gap* that require EU action. These weaknesses do not affect our audit opinion on revenue, as they do not concern the transactions underlying the accounts but rather the risk of TOR being incomplete. Our recent

special report on customs controls recommended improvement in this area (see paragraphs **3.18** and **3.19**)<sup>17</sup>.

- (b) For expenditure, our audit evidence indicates that the overall level of error was material at 2.7<sup>18</sup> (see **Box 1.5**). ‘Cohesion’ was the biggest contributor to this rate with (41.8 %), followed by ‘Natural resources’ (29.3 %), ‘Competitiveness’ (15.5 %) and ‘Global Europe’ (8.1 %). Material error continues to be present in high-risk expenditure, which is mainly reimbursement-based (see paragraphs **1.18** and **1.21-1.22**). Such expenditure represented 59.0 % of our audit population.

### Box 1.5

#### Estimated level of error (2016-2020)



We define **error** as an amount of money that should not have been paid out from the EU budget. Errors occur when money is not used in accordance with the relevant EU legislation and hence not as the Council and European Parliament intended when adopting that legislation, or when it is not used in accordance with specific national rules.

Source: ECA.

<sup>17</sup> See [special report 04/2021](#) “Customs controls: insufficient harmonisation hampers EU financial interests”.

<sup>18</sup> We have 95 % confidence that the estimated level of error in the population lies between 1.8 % and 3.6 % (the lower and upper level error limits respectively).

## The complexity of rules and the way EU funds are disbursed have an impact on the risk of error

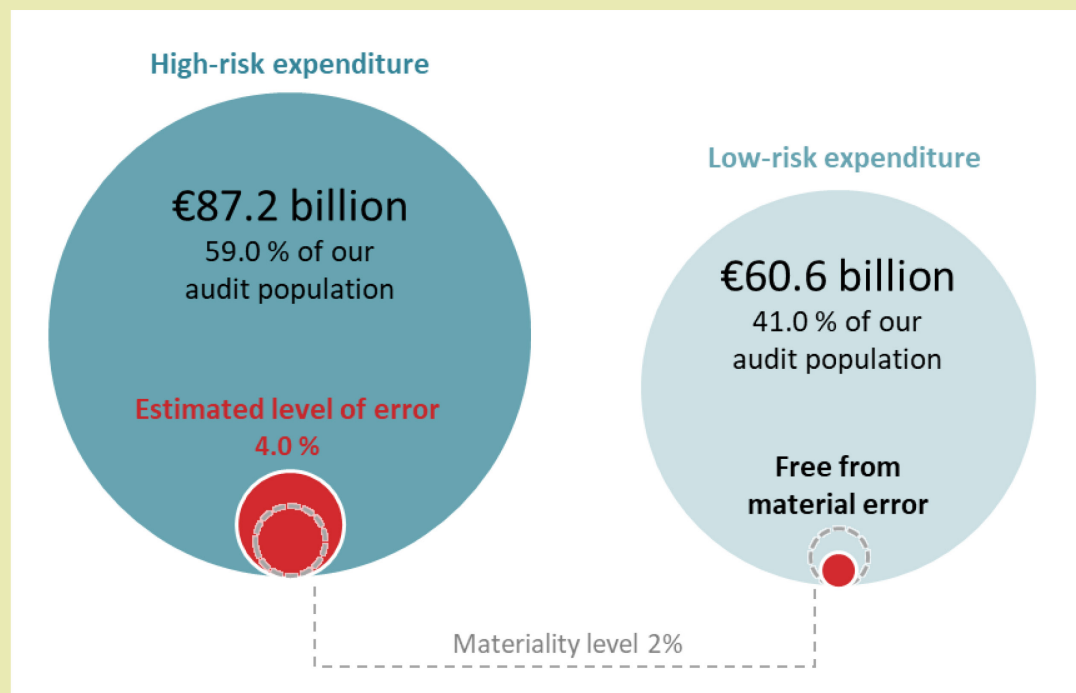
**1.18.** Following our risk analysis, which is based on our past audit results and assessment of management and control systems, we divided our audit population of underlying transactions into high-risk and low-risk expenditure in order to select our representative sample.

- The risk of error is lower for expenditure subject to simplified rules. This type of expenditure encompasses mainly those **entitlement-based payments**<sup>19</sup> for which beneficiaries must meet certain, often simple conditions.
- The risk of error is high for expenditure subject to complex rules. This is mainly the case for **reimbursement-based payments**, where beneficiaries have to submit claims for eligible costs they have incurred. To this end, as well as demonstrating that they are engaged in an activity eligible for support, they must provide evidence of the reimbursable costs they have incurred. In doing so, they must often follow complex rules regarding what can be claimed (eligibility) and how costs can be properly incurred (public procurement or state aid rules).

**1.19.** In 2020, we continued to find that low-risk expenditure was free from material error, but that high-risk expenditure remained affected by material error. Our 2020 audit results therefore reaffirm our assessment and risk classification, reflecting that the way funds are disbursed has an impact on the risk of error.

**1.20.** *Box 1.6* and paragraphs **1.21-1.30** provide more information on the high-risk population and the errors we found therein.

<sup>19</sup> Entitlement-based expenditure includes administrative expenditure.

**Box 1.6****Breakdown of the 2020 audit population into low-risk and high-risk expenditure**

Source: ECA.

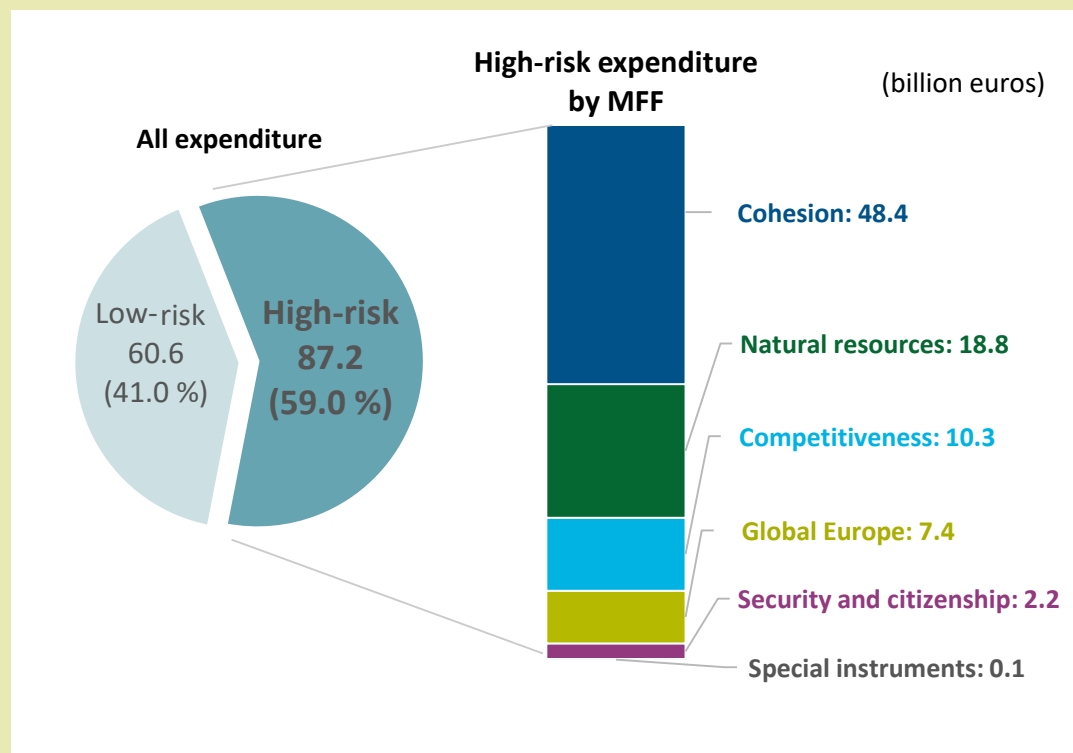
**A substantial proportion of our audit population is affected by material error**

**1.21.** High-risk expenditure represents 59.0 % of our audit population and has increased compared to last year, when it represented around 53.1 %. The higher proportion of high-risk expenditure this year is largely due to a further €20.0 billion increase in our 'Cohesion' audit population. [Box 1.7](#) shows that 'Cohesion' makes up the largest share of our high-risk population (€48.4 billion), followed by 'Natural resources' (€18.8 billion) and 'Competitiveness' (€10.3 billion).


**1.22.** Taking into account the results of our testing of high-risk expenditure across all MFF headings, we estimate the level of error in this type of expenditure at 4.0 % (2019: 4.9 %), which exceeds the materiality threshold of 2.0 % (see [Box 1.6](#)).


## Box 1.7


## Breakdown of high-risk expenditure by MFF heading




Source: ECA.

**1.23.**  'Cohesion' (**chapter 5**): expenditure in this area is mainly implemented through the European Regional Development Fund, the Cohesion Fund and the European Social Fund. It is predominated by reimbursement-based payments, which we consider to be high-risk. The main types of error that we found and quantified were ineligible projects and expenditure, infringements of internal market rules (in particular non-compliance with state aid rules) and absence of essential supporting documents.

**1.24.**  'Natural resources' (**chapter 6**): for spending areas we had identified as high-risk (rural development, market measures, fisheries, the environment and climate action), representing around 31 % of payments under this heading, we once again found a material level of error. Expenditure in these areas mainly takes the form of reimbursement. Ineligible costs, administrative errors and absence of essential supporting documents are the most common errors found in this area.

**1.25.**  ‘Competitiveness’ (**chapter 4**): as in previous years in this area, research expenditure (Horizon 2020 and the Seventh Framework Programme, FP7) remains high-risk and is the main source of error. Errors in research spending include different categories of ineligible costs (in particular direct personnel costs and other *direct costs*), absence of essential supporting documents and lack of audit trail.

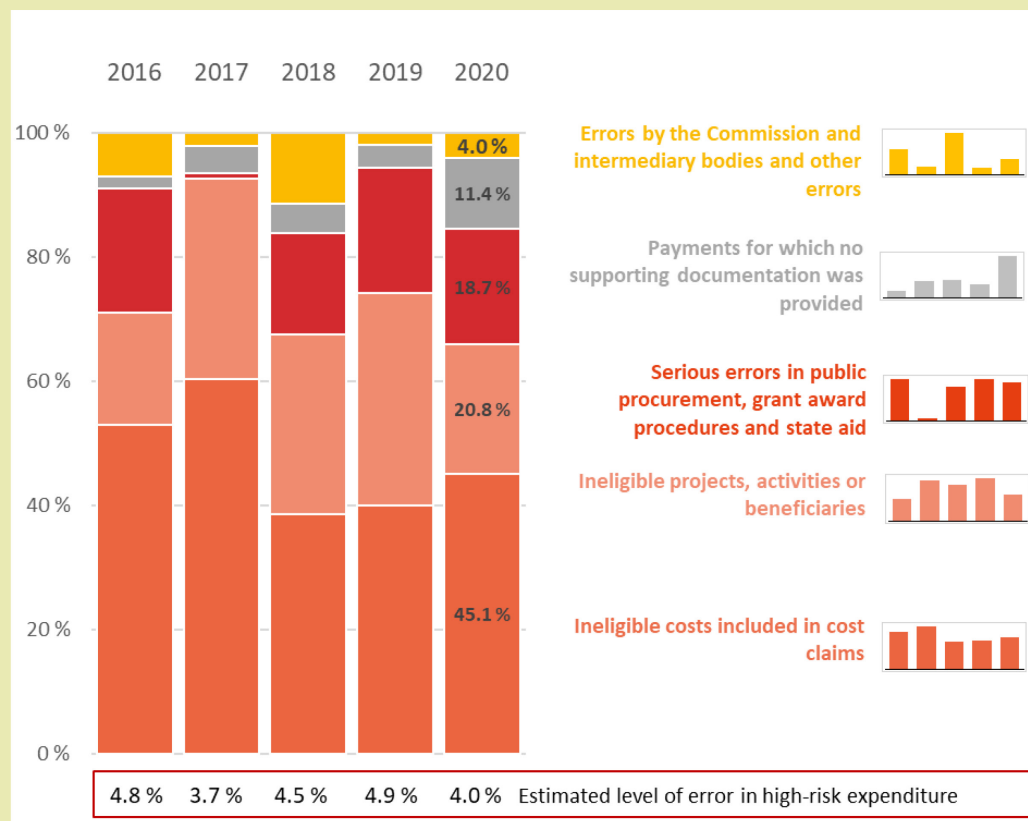
**1.26.**  ‘Global Europe’ (**chapter 8**): expenditure in this area is mostly reimbursement-based and covers external actions funded by the EU budget. All types of expenditure under this heading are considered high-risk, except for budget support payments, which represent around 19 % of this spending. Most errors found in this area concern absence of essential supporting documents, non-compliance with public procurement rules, costs not incurred and ineligible costs.

**Eligibility errors still contribute most to the estimated level of error for high-risk expenditure**

**1.27.** As in recent years, we describe in detail below the error types found in high-risk expenditure, as this is where material error persists. **Box 1.8** shows the contribution of each error type to the estimated level of error for high-risk expenditure in 2020, alongside the estimates from 2016 to 2019.

### Box 1.8

#### Contribution to the 2020 estimated level of error for high-risk expenditure, by error type



Source: ECA.

**1.28.** In 2020, we continued to find eligibility errors, which made a significant contribution of 65.9 % (2019: 74 %) to our estimated level of error for high-risk expenditure, mainly in 'Competitiveness', 'Cohesion' and 'Natural Resources'. Of these errors, ineligible costs included in costs claims contributed 45.1 % and ineligible projects, activities or beneficiaries 20.8 %.

**1.29.** In addition, we found errors related to infringements of state aid rules in 'Cohesion' and of public procurement rules in 'Competitiveness' and 'Global Europe'. These errors contributed 18.7 % to our estimated level of error for high-risk expenditure (2019: 20 %).

**1.30.** Moreover, in 2020 the proportion of the estimated level of error made up of payments for which no essential supporting documentation was provided increased significantly on 2019, mainly in 'Global Europe' and 'Competitiveness'. These errors

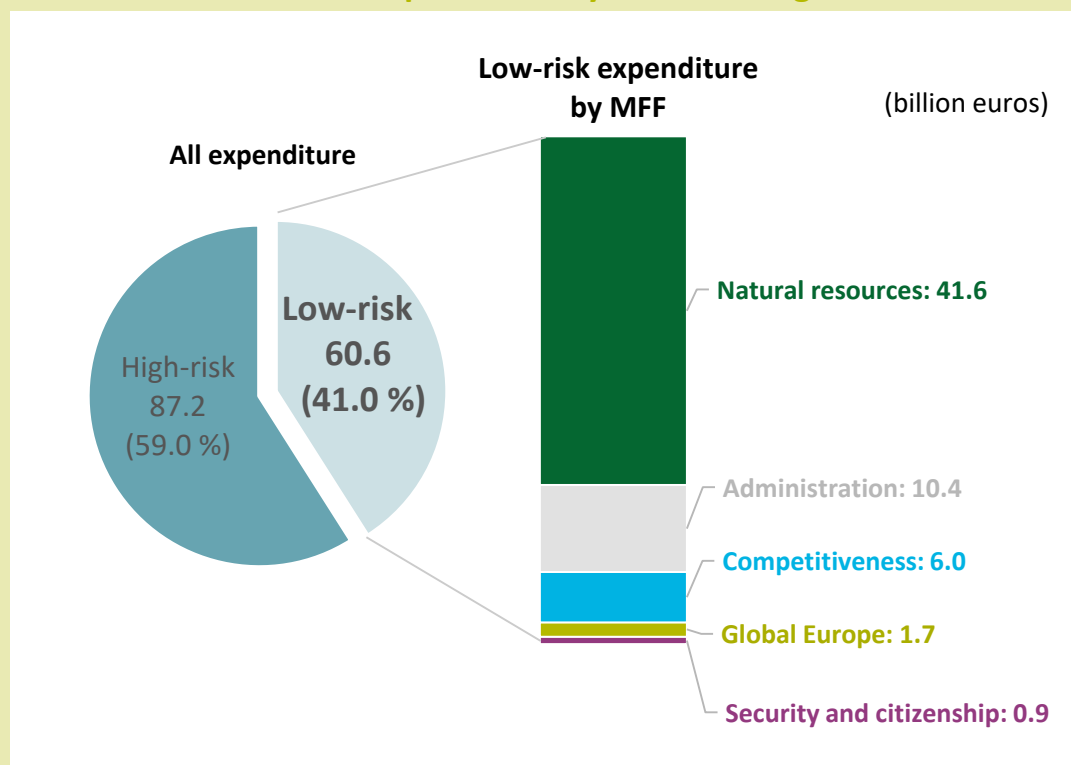
contributed 11.4 % (2019: 4 %) to our estimated level of error for high-risk expenditure.

### We did not find a material level of error in low-risk expenditure

**1.31.** For low-risk expenditure, which represented 41.0 % of our audit population, we conclude that the estimated level of error is below our materiality threshold of 2.0 %, as was also the case in 2018 and 2019. Low-risk expenditure mainly comprises entitlement-based payments and administrative expenditure (see [Box 1.9](#)). Entitlement-based payments include *direct aid* for farmers ('Natural resources' – **chapter 6**), student and research fellowships ('Competitiveness' – **chapter 4**) and budget support for non-EU countries ('Global Europe' – **chapter 8**). Administrative expenditure mainly comprises the salaries and pensions of EU civil servants ('Administration' – **chapter 9**).

#### Box 1.9

#### Breakdown of low-risk expenditure by MFF heading



Source: ECA.

## The Commission's regularity information

**1.32.** The Commission is ultimately responsible for implementing the EU budget, regardless of the management mode (direct, indirect or shared management). The Commission accounts for its actions in three reports, which are included in the 'Integrated Financial Reporting Package'<sup>20</sup>:

- (a) Consolidated accounts of the European Union;
- (b) Annual Management and Performance Report for the EU budget (AMPR);
- (c) Report on the follow-up to the discharge of the previous financial year.

## The Commission's estimate of error is at the lower end of our range

**1.33.** In the AMPR, the Commission presents, for the transactions underlying the 2020 accounts, its assessment of the risk at payment<sup>21</sup>. The risk at payment represents the Commission's estimate of the amount, at the moment of payment, that has been paid without being in accordance with the applicable rules. This concept is closest to our estimate of the level of error.

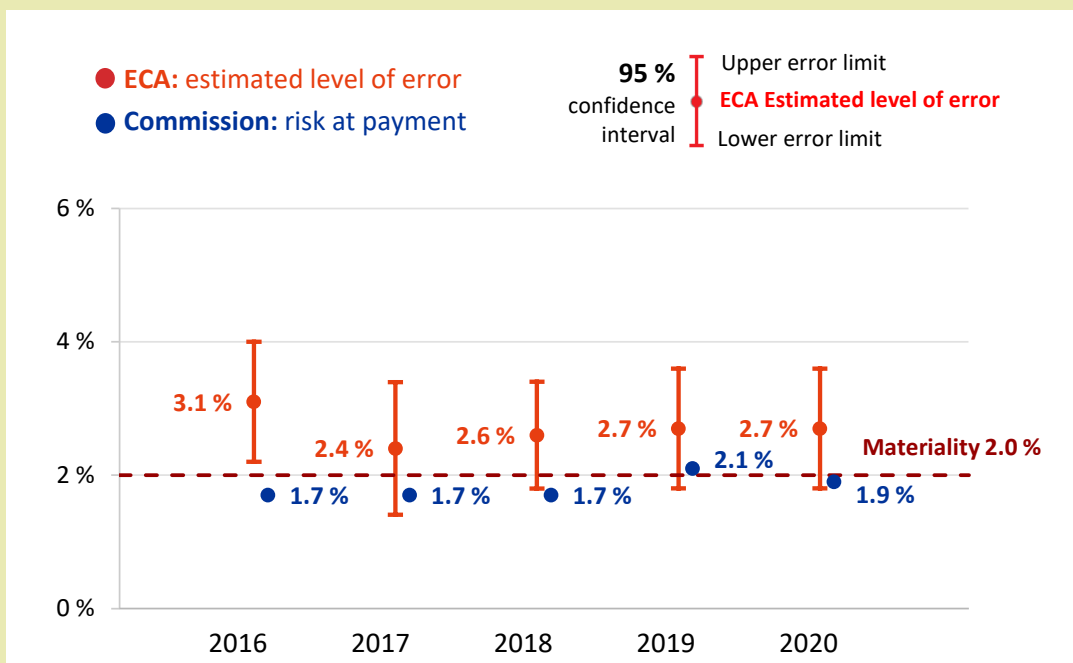
**1.34.** *Box 1.10* presents the Commission's figures for the risk at payment alongside the range of our estimated level of error. The Commission's risk at payment for 2020 is 1.9 %, which is below our estimated level of error of 2.7 % (2019: 2.7 %) and at the lower end of our range, which is between 1.8 % and 3.6 %. We provide information in paragraphs **1.35-1.39** which describe the factors contributing to the difference in the figures.

<sup>20</sup> [https://ec.europa.eu/info/publications/integrated-financial-and-accountability-reporting-2019\\_en](https://ec.europa.eu/info/publications/integrated-financial-and-accountability-reporting-2019_en).

<sup>21</sup> Article 247(1)(b)(i) of the [Financial Regulation](#) requires that the AMPR include an estimation of the level of error in Union expenditure.

### Box 1.10

#### The Commission's estimate of the risk at payment versus our estimated level of error



Source: ECA.

#### Issues remain with the process for preparing the AMPR and the regularity information therein

**1.35.** The AMPR summarises key information on internal control and financial management referred to in the annual activity reports (AARs) of the various Commission directorates-general (DGs)<sup>22</sup>. Responsibility for these reports follows the division of responsibilities set out in the Commission's governance arrangements. The directors-general are responsible for the reliability of the information provided in their respective AARs, while the college of Commissioners adopts the AMPR and therefore ultimately has responsibility for and ownership of the report's production and the information presented therein.

<sup>22</sup> As required by Article 247(1)(b) of the [Financial Regulation](#).

**1.36.** To support the college in this procedure, the Directorate-General for Budget (DG BUDG) and the Secretariat-General review the information in the other DGs' AARs and use this information as the basis for reporting in the AMPR. They also inform the Corporate Management Board (CMB), in a joint note, about the results of their review<sup>23</sup>. Although DG BUDG and the Secretariat-General play a leading role in producing the AMPR, they are not provided with detailed instructions on the content and scope of the AMPR and the related review of other DGs' AARs. Issuing such instructions would help the college to ensure that it provides relevant and reliable information.

**1.37.** Last year, we reported on issues affecting the risk at payment, which is disclosed individually for the different policy areas in the respective AARs and as an aggregate figure in the AMPR<sup>24</sup>. We found that these estimates were affected by the Commission's particular role, as reflected in its methodology, and by weaknesses in *ex-post* checks. The issues we reported concerned *ex-post* audits by the Commission's Common Audit Service ('Competitiveness'); Member States' controls, reflected in their control statistics ('Natural Resources'); checks by Member State audit authorities ('Cohesion'); and the annually commissioned residual error rate (RER) study ('Global Europe'). We consider that these issues still exist and affect the estimation of the risk at payment. We report on them in greater detail in **chapter 4**, where we find that the rate for 'Competitiveness' is still potentially understated, **chapter 5**, where we consider the figure for 'Cohesion' to be a minimum rate, and **chapter 8**, where we note that the issues we identified may contribute to the underestimation of the rate for 'Global Europe'.

**1.38.** In [Box 1.11](#), we compare our estimated level of error with the Commission's estimates for those MFF headings for which we provide a specific assessment<sup>25</sup>.

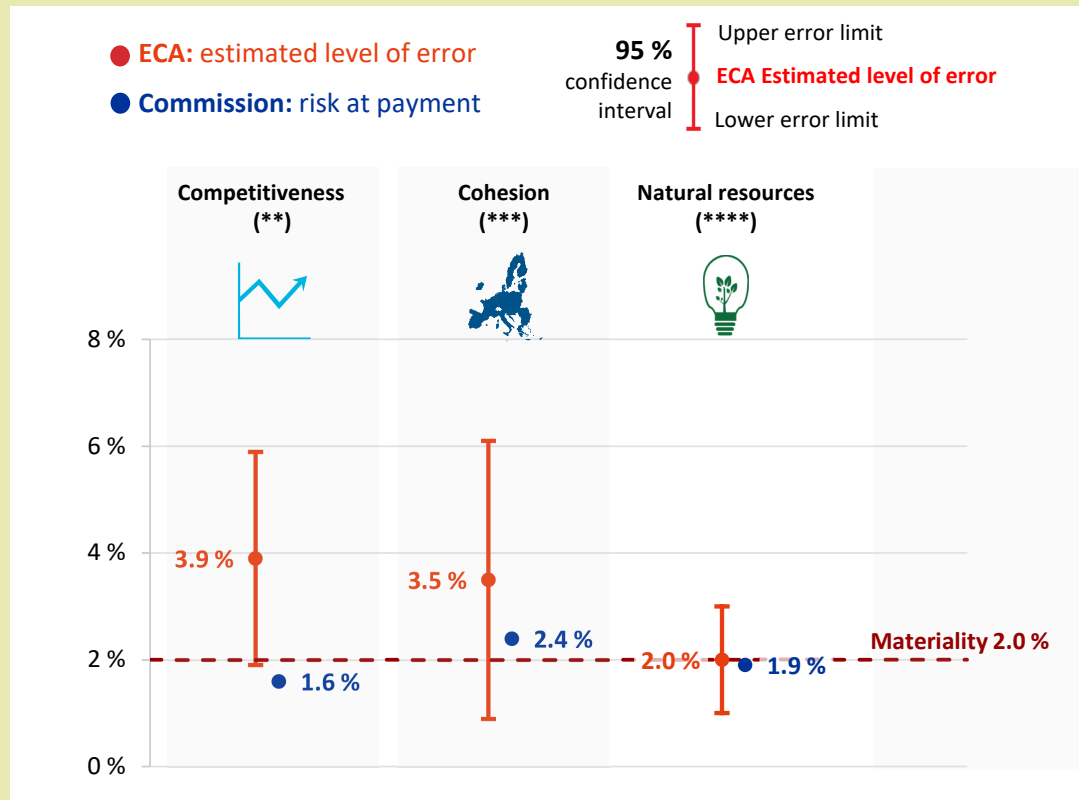
<sup>23</sup> The Corporate Management Board provides coordination, oversight, advice and strategic orientation on corporate management issues. Its members are the directors-general responsible for budget, human resources and security and the Director-General of the Legal Service. It reports to the President and the Commissioner(s) in charge of budget, human resources and administration, and produces an annual report to the college.

<sup>24</sup> See [Box 1.11 \(2019 annual report\)](#).

<sup>25</sup> As the Commission does not present an overall figure for the risk at payment for MFF heading 1a ('Competitiveness') in the AMPR (the Commission splits it into two policy areas), we had to group the figures presented by the Commission in the AARs.

### Box 1.11

#### Our estimate of the 2020 level of error versus the Commission's estimate of the risk at payment for MFF headings<sup>(\*)</sup>



(\*) For 'Administration', neither the Commission nor the ECA found a material level of error.

(\*\*) Commission DGs and services: ECFIN, GROW, MOVE, ENER, RTD, CNECT, JRC, FISMA, TAXUD, EAC, EASME, EACEA, INEA, ERCEA, REA and DEFIS. Some DGs were allocated to more than one MFF heading (EACEA and INEA).

(\*\*\*) Commission DGs EMPL, REGIO, REFORM and INEA.

(\*\*\*\*) Commission DGs AGRI, CLIMA, ENV and MARE.

Source: ECA.

**1.39.** The comparison shows that the Commission figures are below our estimates for these three policy areas. We found that:

- for '**Competitiveness**', the estimate of the risk at payment for this MFF heading of 1,6 %, which we calculated based on the information in the AMPR, is below our range for the estimated level of error (see paragraph 4.37).
- for '**Cohesion**', the Commission's estimate for this MFF heading is 2.4 %, which confirms that the level of error in this policy area is material. The Commission's estimate is in the lower half of our range, below our estimated level of error (see paragraph 5.58).

- for **‘Natural resources’**, the Commission’s estimate of risk at payment (1,9 %) is slightly below our estimated level of error and within our range (see paragraph **6.38**).

### **The Commission’s reporting on financial corrections and recoveries is complex and not always clear**

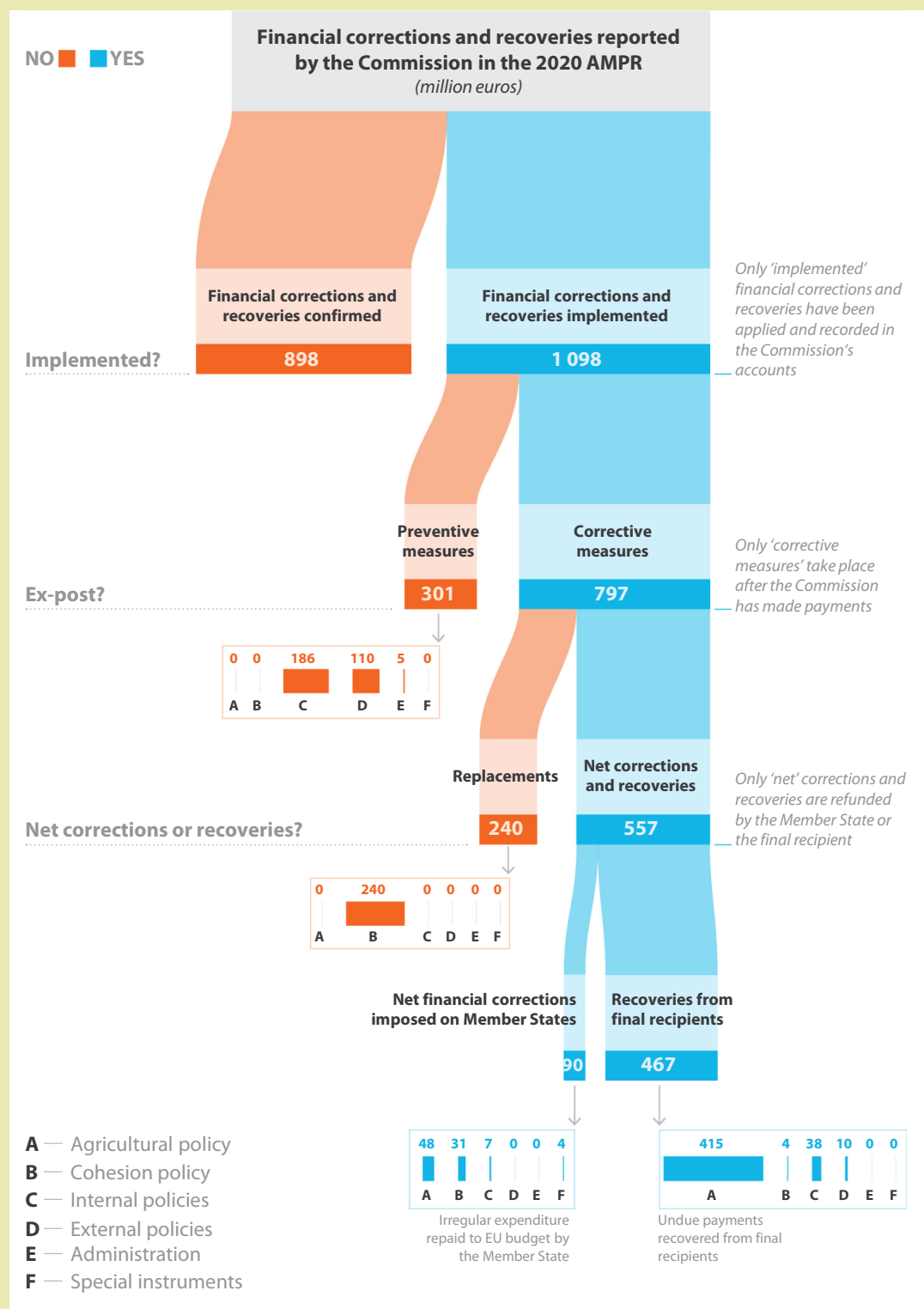
**1.40.** The Commission, in line with the Financial Regulation, provides information in the AMPR on preventive and corrective measures to protect the budget from illegal or irregular expenditure. Although the AMPR underlines the importance of these measures, we found the way it presents actual financial corrections and recoveries to be complex and not always clear.

**1.41.** The AMPR presents several different amounts of actual financial corrections and recoveries. Depending on what phase the corrections or recoveries are at, they can be ‘confirmed’ (meaning only that a decision to correct or recover has been taken) or ‘implemented’ (meaning the established amount has actually been applied and recorded in the Commission’s accounts). Depending on the stage of the control process at which they take place, they can be ‘*ex-ante*’ (i.e. deductions before payment) or ‘*ex-post*’ (i.e. corrections after payment). The AMPR also differentiates between financial corrections with ‘replacements’, where in ‘Cohesion’ the Member State can withdraw the irregular expenditure and declare new expenditure, and ‘net financial corrections’, where it cannot and the amounts are returned to the EU budget. All these distinctions make it extremely difficult to get a clear idea of the amount of irregular expenditure that has been corrected and ultimately returned to the EU budget.

**1.42.** *Box 1.12*, which shows the composition of actual financial corrections and recoveries reported in the 2020 AMPR, illustrates this complexity.

## Box 1.12

## Financial corrections and recoveries reported by the Commission in the 2020 AMPR



Source: ECA based on 2020 AMPR.

**1.43.** In 2020, the amount of implemented corrections reported (€1 098 million) is significantly lower than in 2019 (€2 885 million). According to the Commission, this decrease is due to reimbursements of previous years' corrections in agriculture following judgments by the Court of Justice and the high closure rate of the 2007-2013 cohesion policy programmes. Net corrections and recoveries implemented by the Commission in 2020 (i.e. the amount collected and ultimately corrected) totalled €557 million. This amount mainly concerns previous years (recoveries going back to 2005) and programming periods (net corrections going back to 1994-1999). For cohesion, as of the end of 2020, no net financial corrections had yet been made for the 2014-2020 programming period. Recoveries made in 2020 in respect of expenditure from the same year (2020) concerned internal and external policies and amounted to €1.4 million.

## We report suspected fraud to OLAF

**1.44.** Fraud is any intentional act or omission relating to the use or presentation of false, incorrect or incomplete statements or documents, the non-disclosure of required information and the improper use of EU funds<sup>26</sup>. Fraud has the effect of harming or potentially harming the EU's financial interests.

**1.45.** The primary responsibility for preventing and detecting fraud rests with both management and those charged with the governance of an entity. Article 325 of the TFEU requires the EU and its Member States to counter fraud or other illegal activities affecting the Union's financial interests.

**1.46.** As the EU's external auditor, we do not have a mandate to investigate cases of suspected fraud against the EU's financial interests. We take account of the risk of fraud before starting audits (see paragraphs (27)-(29) in [Annex 1.1](#)) and review our procedures regularly. We forward to OLAF any suspicion of fraud, corruption or other illegal activity affecting the EU's financial interests that we identify in the course of our audit work (including our work on performance) or on the basis of information provided to us directly by third parties. OLAF then follows up on these cases, decides whether to launch an investigation and cooperates as necessary with Member State authorities.

**1.47.** The European Public Prosecutor's Office (EPPO), established in 2017, is an independent EU body with powers to investigate, prosecute and bring to judgment crimes against the EU budget, such as fraud, corruption or serious cross-border VAT fraud. In June 2021, the ECA started cooperating with the EPPO based on the administrative arrangement between the two organisations.<sup>27</sup>

<sup>26</sup> Article 3 of [Directive \(EU\) 2017/1371](#) of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law.

<sup>27</sup> Articles 99, 103, 110 of the [Council Regulation \(EU\) 2017/1939](#) of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office (the 'EPPO').

**1.48.** In the course of the year 2020, we reported to OLAF six instances of suspected fraud found during our audits (in 2019: nine), from which OLAF has opened six investigations.

**1.49.** The suspected fraud cases arising from our work in 2020 that we referred to OLAF most frequently concerned suspicions of artificial creation of the necessary conditions for EU financing, declaration of costs not meeting the eligibility criteria, use of the grant for purposes other than allowed or procurement irregularities. Based on information arising from our audit work between 2011 and 2020, OLAF recommended the recovery of a total of €536 million relating to 37 cases<sup>28</sup>.

**1.50.** In addition to our reporting to OLAF, we also cover fraud-related topics in chapters of this annual report (see paragraphs **5.45-5.47** and **8.28** and recommendation **8.3**) where we refer to related weaknesses in the audit authorities' work and in the RER studies. In addition, we cover fraud in separate audits. We have published a special report on anti-fraud measures in EU spending<sup>29</sup> and on tackling fraud in EU cohesion spending<sup>30</sup> in 2019. We are currently carrying out audits to examine whether the Commission has taken appropriate action on fraud in the common agricultural policy (CAP) spending and on conflict of interest in shared management (CAP and cohesion policy).

<sup>28</sup> The information is provided by OLAF and is not examined by us.

<sup>29</sup> [Special report 01/2019](#) 'Fighting fraud in EU spending: action needed'.

<sup>30</sup> [Special report 06/2019](#) 'Tackling fraud in EU cohesion spending: managing authorities need to strengthen detection, response and coordination'.

## Conclusions

**1.51.** The key function of this chapter is to support the audit opinion presented in the statement of assurance. We present the related audit results in paragraphs [1.52](#) and [1.53](#).

### Audit results

**1.52.** We conclude that the accounts were not affected by material misstatements.

**1.53.** As for the regularity of transactions, we conclude that revenue was free from material error. For expenditure, our audit results show that the estimated level of error remained the same as last year at 2.7 %. High-risk (mainly reimbursement-based) expenditure was affected by a material level of error. This year, the proportion of such expenditure in our audit population further increased to 59.0 %, and it continues to represent a substantial part of our audit population.

# Annexes

## Annex 1.1 – Audit approach and methodology

- (1) This annex outlines our audit approach and methodology, which conform to the international standards on auditing and ensure that our audit opinions are supported by sufficient and appropriate audit evidence. This annex also refers to the main differences between our audit approach and the way the Commission estimates and reports on the level of irregularities<sup>31</sup>, while exercising its duties as manager of the EU budget. To this end, we clarify how we:
  - extrapolate the errors found (paragraph (6));
  - structure our chapters around MFF headings (paragraph (8));
  - apply EU and national rules (paragraph (9)) and
  - quantify procurement errors (paragraph (18)).
- (2) Our audit approach is available on our website<sup>32</sup>. We use an assurance model to plan our work. In our planning, we consider the risk of errors occurring (inherent risk) and the risk of errors not being prevented or detected and corrected (control risk).

### PART 1 – Audit approach and methodology for the reliability of accounts

- (3) We examine the EU's consolidated accounts to determine their reliability. These consist of:
  - (a) the consolidated financial statements; and
  - (b) the budgetary implementation reports.
- (4) The consolidated accounts should properly present, in all material respects:
  - (a) the financial position of the European Union at year end;
  - (b) the results of its operations and cash flows; and

<sup>31</sup> See footnote 83 on page 72 of the Commission's 2020 AMPR.

<sup>32</sup> <https://www.eca.europa.eu/en/Pages/AuditMethodology.aspx>

- (c) the changes in net assets for the year ended.
- (5) In our audit, we:
  - (a) evaluate the accounting control environment
  - (b) check the functioning of key accounting procedures and the year-end closure process;
  - (c) analyse the main accounting data for consistency and reasonableness;
  - (d) analyse and reconcile accounts and/or balances;
  - (e) perform substantive tests of commitments, payments and specific balance sheet items, based on representative samples;
  - (f) use the work of other auditors where possible, in accordance with international standards on auditing, particularly when auditing borrowing and lending activities managed by the Commission for which external audit certificates are available.

## **PART 2 – Audit approach and methodology for the regularity of transactions**

- (6) Our current approach for assessing whether the transactions underlying the accounts comply with EU rules and regulations is to rely mainly on direct testing of compliance for a large, random, representative sample of transactions. According to accepted statistical practices, extrapolation of the results of a statistical sample provides the best estimate for the error rate. We divide our sample into high-risk and low-risk expenditure and different strata for the MFF headings on which we report. This procedure allows us to extrapolate the errors we detect to the areas concerned.
- (7) However, we consider whether we can make efficient use of the checks on regularity already performed by others. If we want to use the results of these checks in our audit work, in line with audit standards, we assess the independence and competence of the other party and the scope and adequacy of its work.

### **How we test transactions**

- (8) We organise our audit work and report its results around the various MFF headings in line with the budget structure decided by the legislator. Under each MFF heading where we provide a specific assessment (**chapters 4, 5, 6 and 9**), we test a representative sample of transactions in order to estimate the share of irregular transactions in the overall population.

- (9) For each selected transaction, we determine whether or not the claim or payment was made for the purpose approved in the budget and specified in legislation. Our assessment takes due account of the interpretation of EU and national law provided by national judicial courts or national independent and authoritative bodies and the European Court of Justice. We examine how the amount of the claim or payment was calculated (for larger claims: based on a selection representative of all items in the transaction). This involves tracing the transaction from the budgetary accounts to the final recipient (e.g. a farmer, or the organiser of a training course or development aid project), testing compliance at each level.
- (10) When testing revenue transactions, our examination of value added tax and GNI-based own resources takes as a starting point the macroeconomic aggregates based on which these are calculated. We examine the Commission's controls on these Member State contributions up to the point they were received and recorded in the consolidated accounts. For traditional own resources, we examine the customs authorities' accounts and the flow of duties — again up to the point they were received and recorded by the Commission.
- (11) On the expenditure side, we examine expenditure at the point when final recipients of EU funds have undertaken activities or incurred costs, and when the Commission has accepted the expenditure (*'accepted expenditure'*). This applies to all categories of payments (including those made to purchase assets). In practice, this means that our population of transactions covers interim and final payments. We did not examine pre-financing payments at the point they were made, but rather once:
- (a) the final recipient of EU funds (e.g. a farmer, a research institute, a company providing publicly procured works or services) has provided evidence of their use; and
  - (b) the Commission (or other institution or body managing EU funds) has accepted the final use of the funds by clearing the advance.
- (12) Changes to the 2014-2020 legislation for 'Cohesion' had an impact on what the Commission considers 'accepted expenditure' in this area. Since 2017, our audit population for this MFF heading has consisted, for the 2014-2020 period, of expenditure included in the accounts accepted annually by the Commission and, for the 2007-2013 period, of final payments (including pre-financing already cleared). This means we tested transactions for which Member States should have implemented all relevant actions to correct errors that they themselves had identified. Our objective is, in addition to contributing to the 2020 statement of

assurance, to review the work of audit authorities and conclude on the reliability of the Commission's key regularity indicator for this area – the residual error rate.

- (13) Our audit sample is designed to provide an estimate of the level of error for the expenditure as a whole rather than for individual transactions (e.g. a particular project). We use monetary unit sampling to select claims or payments and, at a lower level, individual items within a transaction (e.g. project invoices, parcels in a claim by a farmer). The error rates reported for these items should not be seen as a conclusion on their respective transactions, but rather contribute directly to the overall level of error for EU expenditure as a whole.
- (14) We do not examine transactions in every Member State, beneficiary state and region in any given year. While we may name certain Member States, beneficiary states and/or regions, this does not mean that the examples do not occur elsewhere. The illustrative examples presented in this report do not form a basis for conclusions to be drawn on the specific Member States, beneficiary states and/or regions concerned.
- (15) Our approach is not designed to gather data on the frequency of error in the whole population. Therefore, figures presented on the number of errors detected in an MFF heading, in expenditure managed by a DG or in spending in a particular Member State are not an indication of the frequency of error in EU-funded transactions or in individual Member States.

#### **How we evaluate and present the results of transaction testing**

- (16) An error may concern all or part of the amount involved in an individual transaction. We consider whether errors are quantifiable or non-quantifiable, i.e. whether or not it is possible to measure how much of the amount examined was affected by the error. Errors detected and corrected prior to and independently of our checks are excluded from the calculation and frequency of error, since their detection and correction demonstrate that the control systems have worked effectively.
- (17) Our criteria for the quantification of public procurement errors are described in the document 'Non-compliance with the rules on public procurement – types of irregularities and basis for quantification'<sup>33</sup>.
- (18) Our quantification may differ from that used by the Commission or Member States when deciding how to respond to the misapplication of the public

<sup>33</sup> Quantification of public procurement errors (pdf)  
<https://www.eca.europa.eu/en/Pages/AuditMethodology.aspx>.

procurement rules. We quantify only serious breaches of procurement rules. We quantify as 100 % procurement errors only those infringements that have prevented the best bid from winning the tender, rendering expenditure under this contract ineligible. We do not use flat rates for the different types of infringement of procurement rules as the Commission does<sup>34</sup> We base our quantification of public procurement errors on the amounts of ineligible expenditure in examined transactions.

### **Estimated level of error**

- (19) For most MFF headings and for the overall EU budget, we present an ‘estimated level of error’ (ELE), which takes account of quantifiable errors only and is expressed as a percentage. Examples of errors are quantifiable breaches of applicable regulations, rules or contract or grant conditions. We also estimate the lower error limit (LEL) and the upper error limit (UEL).
- (20) We use the level of 2.0 % as materiality threshold for our opinion. We also take account of the nature, amount and context of errors and other information available.
- (21) We no longer base our statement of assurance solely on our overall estimate of error. Since 2016, we have continued to identify low-risk areas of the EU budget, where we expect to find a non-material level of error in accepted expenditure, and high-risk areas, where we assume there will be a material level of error. For this purpose, we consider, in addition to inherent and control risks, our assessment of management and control systems together with past audit results. For example, we treat some entitlement-based rural development expenditure as high-risk based on our past audit experience. This split enables us to determine as efficiently as possible whether material errors found are pervasive.

### **How we examine systems and report the results**

- (22) The Commission, other EU institutions and bodies, Member State authorities, beneficiary countries and regions establish systems for managing the risks to the budget and overseeing/ensuring the regularity of transactions. It is helpful to examine these systems in order to identify areas for improvement.

<sup>34</sup> Commission’s 2019 guidelines on financial corrections in case of public procurement irregularities in the [annex to the Commission decision of 14.5.2019](#) laying down the guidelines for determining financial corrections to be made to expenditure financed by the Union for non-compliance with the applicable rules on public procurement, C(2019) 3452.

- (23) Each MFF heading, including revenue, involves many individual systems. We present the results of our systems work together with recommendations for improvement.

#### **How we arrive at our opinions in the statement of assurance**

- (24) We plan our work to obtain sufficient, relevant and reliable audit evidence for our opinion on the regularity of transactions underlying the EU's consolidated accounts. This work is reported on in **chapters 3-9**. Our opinion is set out in the statement of assurance. Our work allows us to arrive at an informed opinion as to whether errors in the population exceed or fall within the materiality limits.
- (25) Where we find a material level of error and determine its impact on the audit opinion, we must determine whether or not the errors, or the absence of audit evidence, are 'pervasive'. In doing so, we apply the guidance contained in ISSAI 1705<sup>35</sup> (extending this guidance to apply to issues of legality and regularity, in accordance with our mandate). Where errors are material and pervasive, we present an adverse opinion.
- (26) An error or absence of audit evidence are 'pervasive' if, in the auditor's judgment, they are not confined to specific elements, accounts or items in the financial statements (i.e. they occur throughout the accounts or transactions tested). Even if they are so confined, they are still pervasive if they represent, or could represent, a substantial proportion of the financial statements, or relate to disclosures which are fundamental to users' understanding of the financial statements.

#### **PART 3 – Audit procedures in relation to fraud**

- (27) We identify and assess the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of EU law, whether due to fraud or error.
- (28) We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

<sup>35</sup> ISSAI 1705 – Modifications to the Opinion in the Independent Auditor's Report.

- (29) If we have reason to suspect that fraudulent activity has taken place, we report this to OLAF, the EU's anti-fraud office. OLAF is responsible for carrying out any resulting investigations. We report several cases per year to OLAF.

**PART 4 — Link between the audit opinions on the reliability of accounts and on the regularity of transactions**

- (30) We have issued:

- (a) an audit opinion on the consolidated accounts of the EU for the financial year ended; and
- (b) audit opinions on the regularity of the revenue and expenditure underlying those accounts.

- (31) Our work and our opinions follow the IFAC's International Standards on Auditing and Codes of Ethics and INTOSAI's International Standards of Supreme Audit Institutions.

- (32) Where auditors issue audit opinions on both the reliability of accounts and the regularity of transactions underlying those accounts, these standards state that a modified opinion on the regularity of transactions does not, in itself, lead to a modified opinion on the reliability of accounts.

## Chapter 2

### Budgetary and financial management

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# Introduction

**2.1.** This chapter presents the main budgetary and financial issues we identified in our work for 2020, a financial year in which the EU budget was strongly affected by the COVID-19 pandemic. In this chapter, we also report on budgetary and financial risks and challenges identified that the EU may face in future years. The chapter is based on our review of the budgetary figures for the 2014-2020 MFF, our own work performed for the annual report, special reports, reviews and opinions, and on documents published by the Commission and other stakeholders.

# Budgetary and financial management in 2020

**The 2020 budget was almost fully implemented and extensive use was made of the tools available to react to the COVID-19 pandemic**

**2.2.** In the following sections, we analyse how the EU budget was implemented in 2020, the last year of the 2014-2020 multiannual financial framework (MFF)<sup>1</sup>. We also analyse how the EU used the budget's capacity and flexibility to respond to the COVID-19 pandemic.

## Budget implementation was high in 2020

**2.3.** The ceiling set by the MFF for 2020 was €168.8 billion for commitment appropriations<sup>2</sup>. The *budgetary authority* approved €168.7 billion for commitment appropriations in the initial budget. See [Box 2.1](#). During 2020, the budgetary authority approved nine amending budgets, of which seven amended the expenditure side of the 2020 EU budget. They increased commitment appropriations by €5.2 billion. Commitment appropriations increased to €173.9 billion, an amount above the ceiling of the MFF. Exceeding this ceiling was made possible by the use of special instruments, such as the European Union Solidarity Fund<sup>3</sup>. Almost all available commitment appropriations were used. An amount of €172.9 billion was committed, 99.5 % of the total available amount.

<sup>1</sup> Council Regulation (EU, EURATOM) No 1311/2013 of 2 December 2013, laying down the multiannual financial framework for the years 2014-2020. ([OJ L 347, 20.12.2013, p. 884](#)).

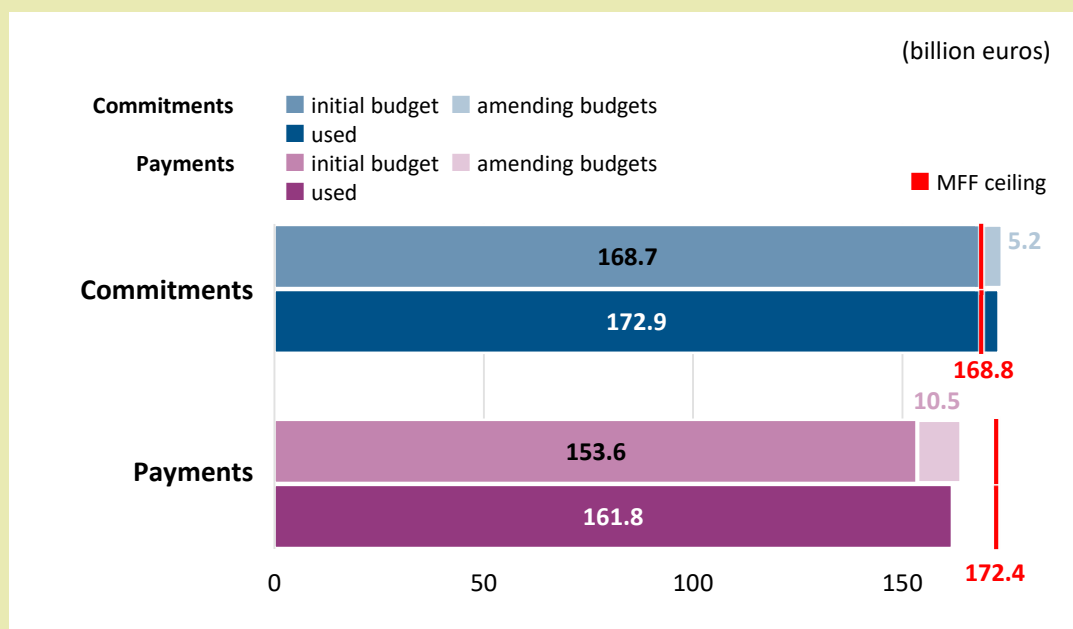
<sup>2</sup> [COM\(2019\) 310 final](#) – Communication from the Commission to the Council and the European Parliament – Technical adjustment of the financial framework for 2020 in line with movements in GNI (ESA 2010)(Article 6 of Council Regulation No 1311/2013 laying down the multiannual financial framework for the years 2014-2020).

<sup>3</sup> For a full list see Articles 3(2) and 9-15 of the Council Regulation No 1311/2013 laying down the multiannual financial framework for the years 2014-2020.

**2.4.** The ceiling set by the MFF for 2020 was €172.4 billion for payment appropriations<sup>4</sup>. The budgetary authority approved €153.6 billion for payment appropriations in the initial budget. During 2020, amending budgets increased payment appropriations by €10.5 billion. Payment appropriations increased to €164.1 billion, well within the ceiling of the MFF. The use of available payment appropriations was slightly lower: €161.8 billion was paid, 98.6 % of the available total<sup>5</sup>. See [Box 2.1](#). Total payments in 2020, including carry-overs and assigned revenue, were €173.3 billion, made up of payments from the 2020 final budget of €161.8 billion, carry-overs of €1.6 billion, and assigned revenue of €9.9 billion<sup>6</sup>.

### Box 2.1

#### Budget implementation in 2020



Source: Consolidated annual accounts of the European Union – Financial year 2020, Budgetary implementation reports and explanatory notes – notes 4.1.-4.3. and COM(2019) 310 Technical adjustment of the financial framework for 2020.

<sup>4</sup> [COM\(2019\) 310 final](#) – Communication from the Commission to the Council and the European Parliament – Technical adjustment of the financial framework for 2020 in line with movements in GNI (ESA 2010)(Article 6 of Council Regulation No 1311/2013 laying down the multiannual financial framework for the years 2014-2020).

<sup>5</sup> We exclude carry-overs and assigned revenue from this analysis because they are not part of the adopted budget, and are subject to different rules.

<sup>6</sup> See consolidated annual accounts of the European Union – Financial year 2020, Budgetary implementation reports and explanatory notes – note 4.3.

## Many changes were made to the 2020 budget due to the COVID-19 pandemic

**2.5.** In order to react quickly to the COVID-19 pandemic and provide support, two main budgetary tools were used: transfers and amending budgets. Transfers are movements of funds between different sections of the existing budget. Amending budgets add or subtract funds to or from the original budget. Five of the nine amending budgets were at least partially COVID-19-related. We consider a part of an amending budget to be COVID-19-related when COVID-19 is mentioned in the relevant part of the decision. Some of the amending budgets related to the relaxation of applicable rules introduced by the EU co-legislators to facilitate the use of the European Structural and Investment Funds (ESIF) and thereby provide additional liquidity and exceptional flexibility for COVID-19-related expenditure<sup>7</sup>. For example, transfers of funds between regions, the lifting of the requirement to concentrate funding on specific themes, and co-financing at a rate of up to 100 % became possible for one year. Member States were also not required to reimburse to the EU budget €7.6 billion of unspent annual pre-financing of ESIF funds<sup>8</sup> from the previous year. This eased the treasury management of the Member States.







**2.6.** *Box 2.2* shows changes in 2020 commitment and payment appropriations, made by using transfers and amending budgets approved by the budgetary authority, broken down by MFF heading. The total amount of additional commitment appropriations inserted through amending budgets was €5.2 billion, of which €3.3 billion was for COVID-19-related expenditure. For payment appropriations, the total amount of amending budgets over the year was €10.5 billion, of which €9.4 billion was for COVID-19-related expenditure.

<sup>7</sup> [Regulation \(EU\) 2020/460](#) of the European Parliament and of the Council amending Regulations (EU) No 1301/2013, (EU) No 1303/2013 and (EU) No 508/2014 as regards specific measures to mobilise investments in the healthcare systems of Member States and in other sectors of their economies in response to the COVID-19 outbreak (Coronavirus Response Investment Initiative) (CRII), [Regulation \(EU\) 2020/558 of the European Parliament and of the Council amending Regulations \(EU\) No 1301/2013 and \(EU\) No 1303/2013](#) as regards specific measures to provide exceptional flexibility for the use of the European Structural and Investments Funds in response to the COVID-19 outbreak (CRII+) and [Regulation \(EU\) 2020/872 of the European Parliament and of the Council of 24 June 2020 amending Regulation \(EU\) No 1305/2013](#) as regards a specific measure to provide exceptional temporary support under the European Agricultural Fund for Rural Development (EAFRD) in response to the COVID-19 outbreak.

<sup>8</sup> There is no annual pre-financing for the EAFRD.

## Box 2.2

## Transfers and amending budgets as a response to the COVID-19 pandemic (in million euros)

		Commitment appropriations		Payment appropriations	
Headings		Transfers*	Amending budgets*	Transfers*	Amending budgets*
	<b>1. Smart and inclusive growth</b>	<b>-8</b>	<b>-12</b>	<b>-215</b>	<b>5 184</b>
	1.a Competitiveness for growth and jobs	-8	-12	-263	-9
	1.b Economic, social and territorial cohesion			48	5 193
	<i>of which: Finance liquidity under CRII and CRII+ and 100% EU financing</i>			48	5 100
	<b>2. Sustainable growth: natural resources</b>	<b>-1</b>	<b>49</b>	<b>22</b>	<b>799</b>
	<i>of which: Provide relief to farmers, through the European Agricultural Fund for Rural Development</i>				750
	<b>3. Security and citizenship</b>	<b>-69</b>	<b>3 119</b>	<b>50</b>	<b>2 664</b>
	<i>of which: Finance emergency support within the Union, through the re-activation of Emergency Support Instrument</i>		2 700		2 500
	<b>4. Global Europe</b>	<b>202</b>		<b>474</b>	<b>586</b>
	<b>5. Administration</b>	<b>-41</b>		<b>-42</b>	
	<b>9. Special instruments</b>		<b>133</b>		<b>133</b>
<b>Total</b>		<b>84</b>	<b>3 288</b>	<b>289</b>	<b>9 366</b>

(\*) In net amounts. The figures do not always add up because of rounding.

Source: ECA, based on budgetary authority decisions for amending budgets and transfers and data received from the Commission.

## The Commission has not yet published reports on EU funds used for COVID-19-related purposes

**2.7.** To increase transparency, taking account of information requests by the European Parliament<sup>9</sup>, the Commission began to internally track EU funds used for COVID-19-related purposes in the first half of 2020. The Commission has not yet published a report on COVID-19-related expenditure.







**2.8.** As [Box 2.3](#) shows, according to the non-published information the Commission provided to us, €12.9 billion of commitments in direct and indirect management had been made available for COVID-19-related purposes by the end of 2020. We found that around €0.2 billion COVID-19-related amounts had not been included in the €12.9 billion of commitments reported by the Commission to us, even though they were marked as COVID-19-related in the Commission's central accounting system. According to the same non-published information provided by the Commission, a further €34.2 billion was pledged or contracted under shared management by the Member States, bringing the total of EU funds made available for COVID-19-related purposes to €47.1 billion. For cohesion policy, the Commission has started making COVID-19-related information publicly available on its coronavirus dashboard<sup>10</sup>. The dashboard does not provide an overview of the COVID-19-related annual amounts committed or used.

<sup>9</sup> See, for example, [Opinion on Guidelines for the 2022 budgetary procedure – Section III 2020/2265\(BUI\)](#).

<sup>10</sup> [Coronavirus dashboard Website](#).

## Box 2.3

## Overview of amounts related to the response to the Covid-19 pandemic by the end of 2020 (in million euros)

Headings		Amounts committed in direct and indirect management	Amounts pledged or contracted in shared management
	<b>1. Smart and inclusive growth</b>	<b>2 558</b>	<b>33 496</b>
	1.a Competitiveness for growth and jobs	2 554	
	<i>of which:</i>		
	<i>Finance expenditure related to Erasmus+</i>	1 402	
	<i>Cover expenditure related to Horizon 2020</i>	1 150	
	1.b Economic, social and territorial cohesion	4	33 496
	<i>of which:</i>		
	<i>Provide additional liquidity to Member States through non-recovery of 2019 unspent pre-financing (under CRII and CRII+) – no direct budgetary impact</i>		7 600
	<i>Support 100% EU financing (CRII/CRII+)</i>		6 209
	<i>Provide full flexibility/ Reprogramming (CRII and CRII+)</i>		19 687
	<b>2. Sustainable growth: natural resources</b>	<b>1</b>	<b>705</b>
	<b>3. Security and citizenship</b>	<b>3 035</b>	
	<i>Of which:</i>		
	<i>Increase Emergency Support Instrument for vaccines</i>	2 151	
	<b>4. Global Europe</b>	<b>7 184</b>	
	<i>of which:</i>		
	<i>Finance reprogramming to help countries through the Development Cooperation Instrument</i>	3 181	
	<i>Finance reprogramming to help countries through the European Neighbourhood Instrument</i>	2 124	
	<b>5. Administration</b>	<b>6</b>	
	<b>9. Special instruments</b>	<b>133</b>	
	<b>Total</b>	<b>12 917</b>	<b>34 201</b>

Source: ECA, based on information from the Commission.

## Outstanding commitments have exceeded €300 billion

**2.9.** Outstanding commitments continued to rise; they reached €303.2 billion by the end of 2020. The increase was smaller than in previous years, partly due to the additional payment appropriations being made available for combating the COVID-19 pandemic. See paragraph [2.5](#) and [Box 2.4](#).

**2.10.** As we have noted before<sup>11</sup>, one of the main reasons for the high level of outstanding commitments is the annual gap resulting from the level of commitments being higher than the amount of payments made. In the 2021 adopted budget, commitment appropriations are lower than payment appropriations. We have noted in previous years that this is one of the main ways in which outstanding commitments can be reduced<sup>12</sup>.

**2.11.** According to the Commission's long-term forecasting<sup>13</sup>, which does not include the Next Generation EU (NGEU) instrument, the amount of outstanding commitments should remain fairly stable at this high level until 2027 (see [Box 2.4](#)). This will mainly be due to the very small annual gap between commitment appropriations and payment appropriations in the 2021-2027 MFF, which was not the case in the two previous MFFs. However, outstanding commitments will rise if, as in 2016-2020, commitments remain high and payment claims are lower than anticipated due to implementation delays.

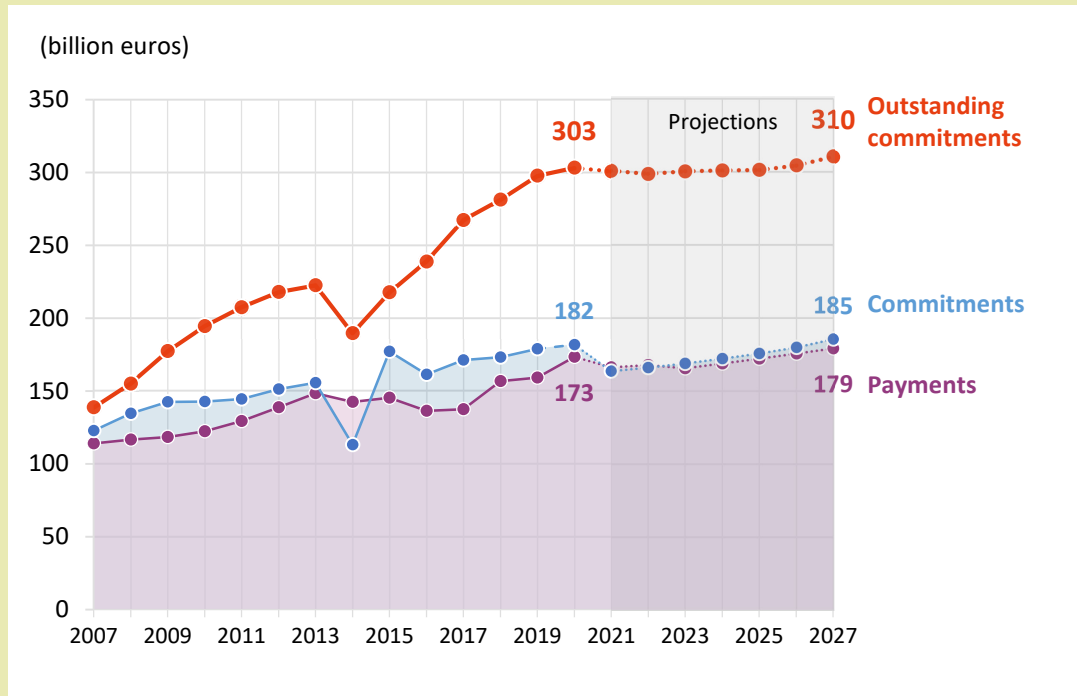
<sup>11</sup> Our [rapid case review 05/2019](#) 'Outstanding commitments - a closer look', published in April 2019.

<sup>12</sup> See our [2018 annual report](#), paragraphs 2.18-2.21, our [2017 annual report](#), paragraphs 2.46-2.49 and our [2016 annual report](#), paragraphs 2.32-2.39.

<sup>13</sup> [COM\(2020\) 298 final](#), 30.6.2020, the "Long-term forecast of future inflows and outflows of the EU budget (2021-2025)," and the update provided by the Commission on the [implications of the European Council conclusions of 17-21 July 2020 on the MFF 2021-2027](#).

## Box 2.4

### Outstanding commitments, commitments and payments



Source: Consolidated annual accounts of the EU for the years 2014 to 2020. For the projections until 2027: The “Long-term forecast of future inflows and outflows of the EU budget (2021-2025), COM(2020) 298 final, 30.6.2020” and the update provided by the Commission on the implications of the European Council conclusions of 17-21 July 2020 on the MFF 2021-2027.

### For the 2014-2020 MFF, payments were lower than planned

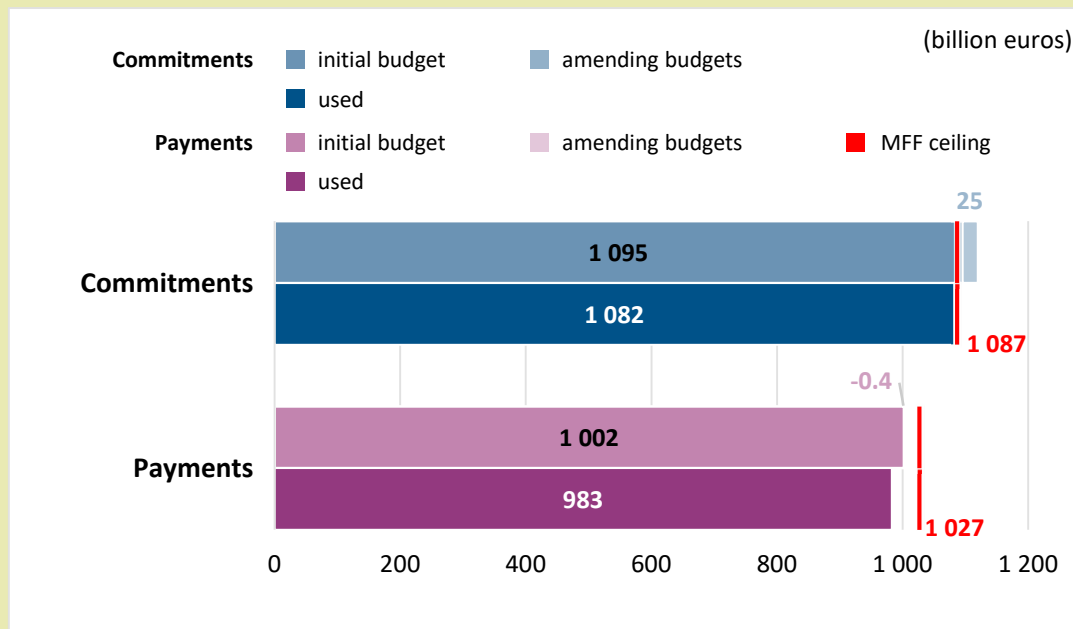
**2.12.** During the 2014-2020 MFF, €1 120 billion was available for commitments in the adopted budgets, whereas the MFF ceiling was €1 087 billion. Of the available commitment appropriations, €1 082 billion, 97 % was actually committed<sup>14</sup>.

**2.13.** The total amount of payments made from the EU budgets during the 2014-2020 period was €983 billion. This amount was €19 billion less than the adopted budgets, and about €44 billion below the MFF ceiling for 2014-2020. See [Box 2.5](#). The difference between commitments and payments made (€99 billion) is the main cause of the increase in outstanding commitments between 2013 and 2020.

<sup>14</sup> We exclude carry-overs, assigned revenue and re-programming from this analysis because they are not part of the adopted budget, and are subject to different rules.

## Box 2.5

### MFF 2014-2020 implementation – totals and ceilings



Source: Consolidated annual accounts of the EU for 2014-2020.

**2.14.** Commitments were close to the ceiling in each year of the 2014-2020 period, except 2014 (see [Box 2.6](#)). The reason for this was that the budgetary authority decided to exceptionally transfer commitment appropriations from 2014 to 2015 and subsequent years, due to the late adoption of the MFF and the delayed approval of operational programmes.

**2.15.** Payment appropriations were used almost in full in 2014 and 2015 to close the previous 2007-2013 MFF (see [Box 2.6](#)). However, between 2016 and 2020, payments have been lower than anticipated, as Member States have submitted lower ESIF claims (except for the EAFRD). Therefore, the global margin for payments – which automatically adjusts the payment ceiling upwards by moving unused payment appropriations from previous years to future years<sup>15</sup> – was largely not needed from 2018 to 2020. We analysed the impact of the global margin for payments in our 2018 annual report<sup>16</sup>.

<sup>15</sup> Article 5 of [Council Regulation No 1311/2013](#) laying down the multiannual financial framework for the years 2014-2020.

<sup>16</sup> Paragraphs 2.12 – 2.16, [2018 annual report](#).

## Box 2.6

### Budgeted and actual spending 2014-2020



Source: Consolidated annual accounts of the EU for 2014-2020.

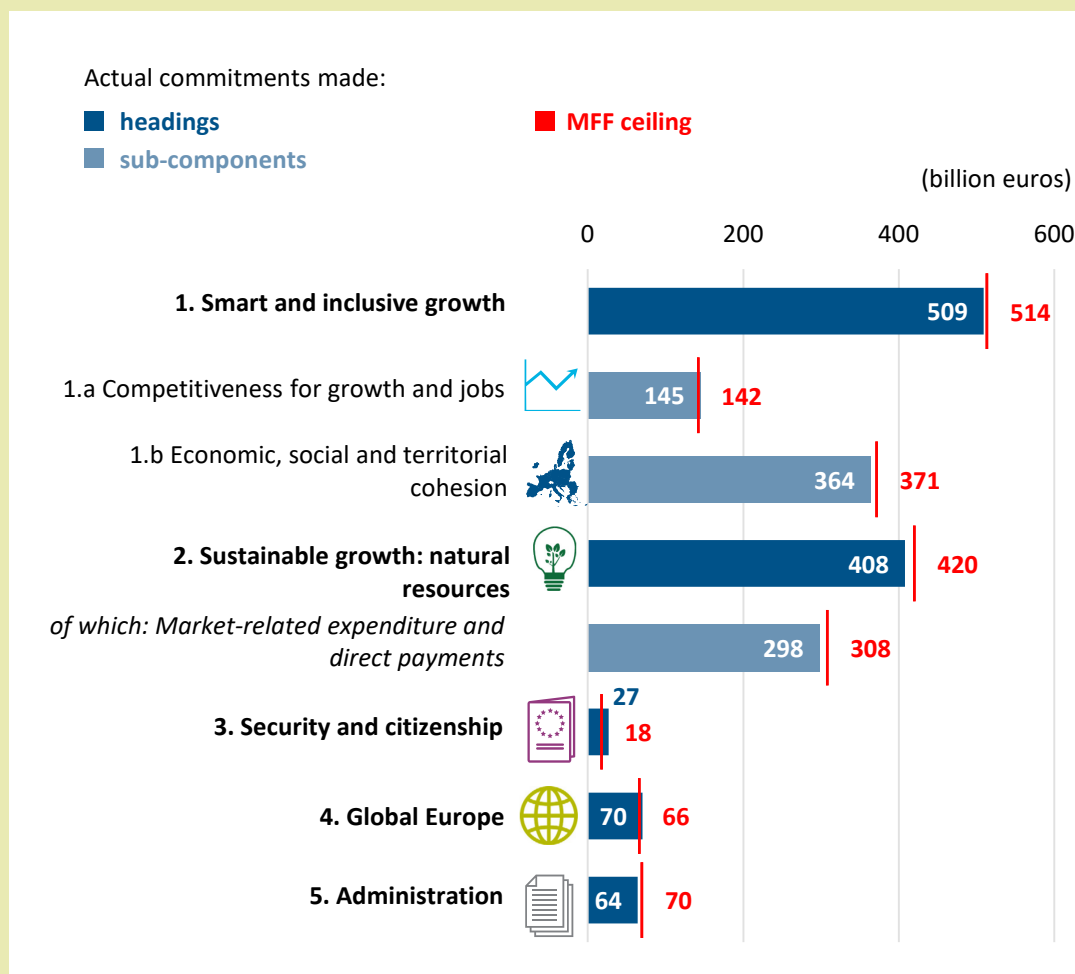
**2.16.** In the MFF, ceilings for commitment appropriations are specified for each MFF heading<sup>17</sup>. In the “Security and Citizenship” and “Global Europe” MFF headings, the level of commitments made was above the MFF ceilings. This was caused by

<sup>17</sup> See Article 3 and the Annex of the [Council Regulation No 1311/2013](#) laying down the multiannual financial framework for the years 2014-2020.

unforeseen needs, such as the refugee crisis<sup>18</sup> and COVID-19<sup>19</sup>. The extra financing for these headings was possible because of the flexibility provided by special instruments under the budget. See [Box 2.7](#).

### Box 2.7

#### Budgetary implementation for the main MFF headings 2014-2020



Source: 2014-2020 consolidated annual accounts of the EU.

<sup>18</sup> Council Regulation 2017/1123 of 20 June 2017 amending Regulation (EU, Euratom) No 1311/2013 laying down the multiannual financial framework for the years 2014-2020.

<sup>19</sup> Council Regulation 2020/538 of 17 April 2020 amending Regulation (EU, Euratom) No 1311/2013 laying down the multiannual financial framework for the years 2014-2020 as regards the scope of the Global Margin for Commitments.

## The absorption rate of ESIF funds is lower than the rate under the previous MFF

**2.17.** In 2020, ESIF eligibility rules for COVID-19-related expenditure were relaxed, and the possibility of 100 % EU financing (CRII and CRII+) was introduced<sup>20</sup>. These measures did not result in a significant increase of the absorption rate in 2020. The rate of annual absorption of the ESIF funds allocated to the Member States during the 2014-2020 MFF increased from 12 % in 2019 to 15 % in 2020. The amount paid in 2020 was €72 billion, compared to €57 billion in 2019. This brought the cumulative absorption of the 2014-2020 MFF period to 55 % at the end of 2020. In total, €256 billion of the total ESIF allocation of €465 billion had been paid by the end of 2020. By the end of 2020, all of the €465 billion allocated to the Member States had been committed<sup>21</sup>.

**2.18.** The overall annual absorption rate in 2020, the final year of the current MFF, was the same as in 2013 (15 %), the final year of the previous 2007-2013 MFF. However, the cumulative absorption was around 7 % lower than under the previous MFF. This left 45 % (€209 billion) of the total amount of committed ESIF funds to be absorbed. This amount constitutes the main part of the €303 billion of outstanding commitments at the end of 2020 (see paragraph 2.9). We note, however, that the 2007-2013 MFF was generally subject to the n+2 rule, whereas the 2014-2020 MFF is subject to the n+3 rule.

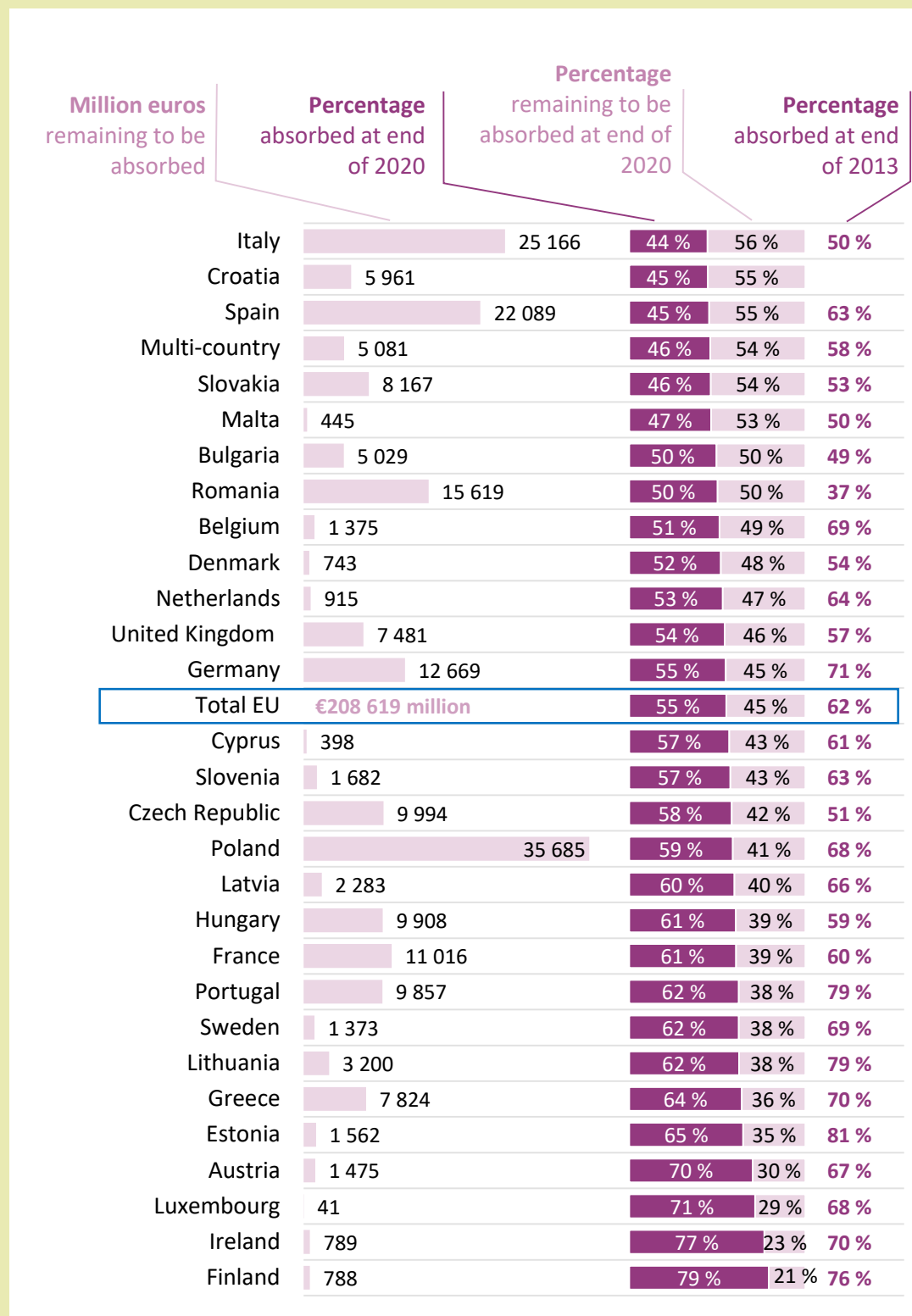
**2.19.** As [Box 2.8](#) shows, there are considerable differences between Member States in the absorption of the ESIF funds allocated to them during the 2014-2020 MFF. Finland, for example, has absorbed 79 % of its total allocation, while the three Member States where the absorption rate was lowest (Italy, Croatia and Spain) have absorbed only around 45 % of their committed amounts. Italy, Spain and Poland comprise almost 40 % of the payments remaining to be absorbed: approximately €83 billion of the total remaining (€209 billion).

<sup>20</sup> These changes partially apply to the EAFRD. However, the main adaptation of the EAFRD to the COVID-19 crisis was through Regulation (EU) No 2020/872 of June 2020.

<sup>21</sup> The only exception was an operational programme of €8 million for which an amendment was not finalised in 2020, but in 2021.

## Box 2.8

## 2014–2020 ESIF: amounts left to absorb



Source: ECA, based on information from the Commission.

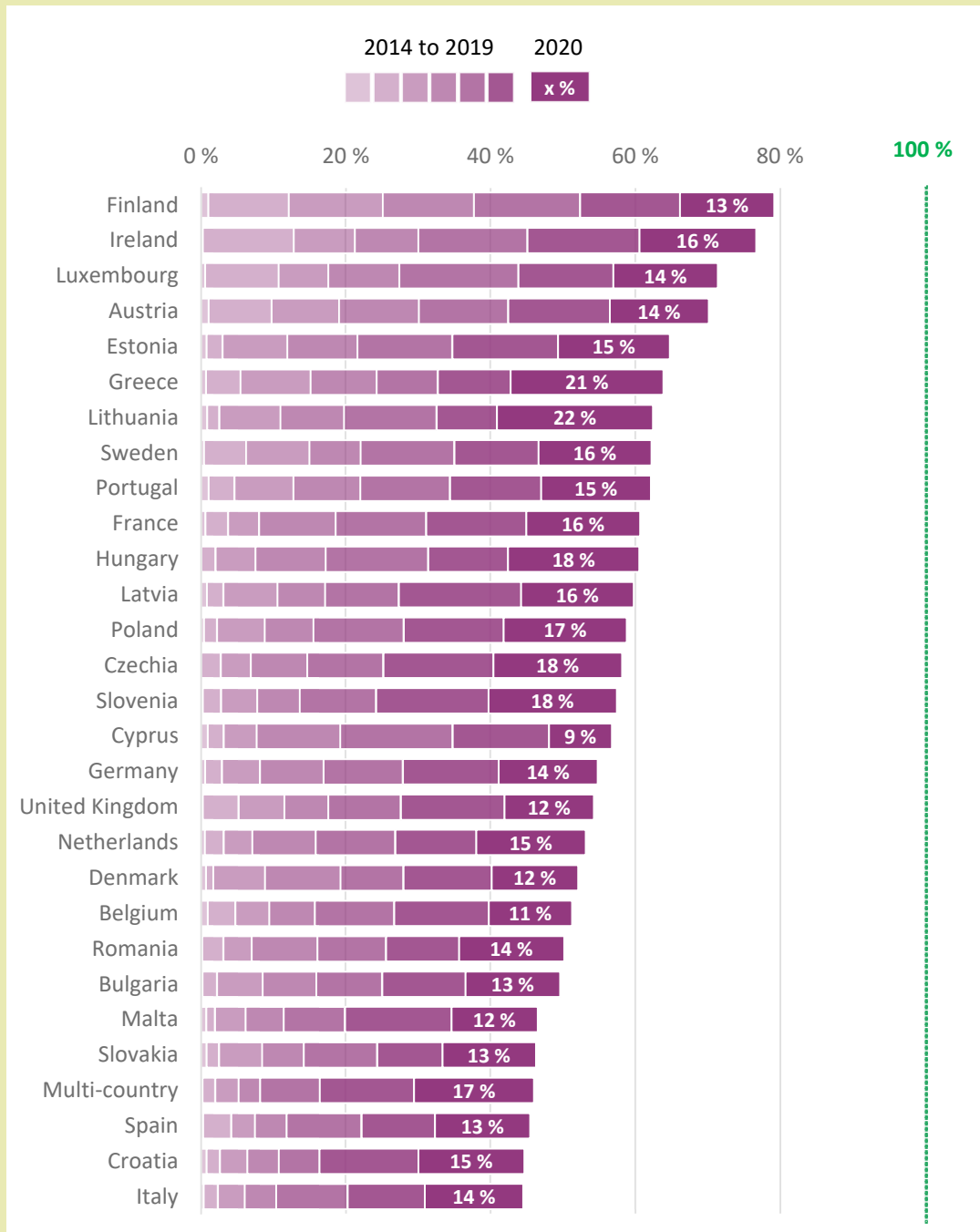
**2.20.** *Box 2.9* shows total ESIF funds absorption by year up to the end of 2020. Previous experience suggests that the absorption rate is likely to increase<sup>22</sup>, but this may still not be sufficient to allow all funds to be absorbed. In 2014, the Commission set up the Task Force for Better Implementation for cohesion policy programmes. The Task Force, which ran until the end of 2015, was designed to support Member States facing difficulties in implementing their operational programmes in using the remaining funding from the 2007-2013 period. The measures taken led to a marked increase in absorption for the assisted Member States, but we noted an insufficient focus on results<sup>23</sup>.

<sup>22</sup> *Special report 17/2018*: Commission's and Member States' actions in the last years of the 2007-2013 programmes tackled low absorption but had insufficient focus on results, figure 4.

<sup>23</sup> *Special report 17/2018*, p. 34.

## Box 2.9

## Annual ESIF funds absorption levels for each Member State 2014-2020



Source: ECA, based on information from the Commission.

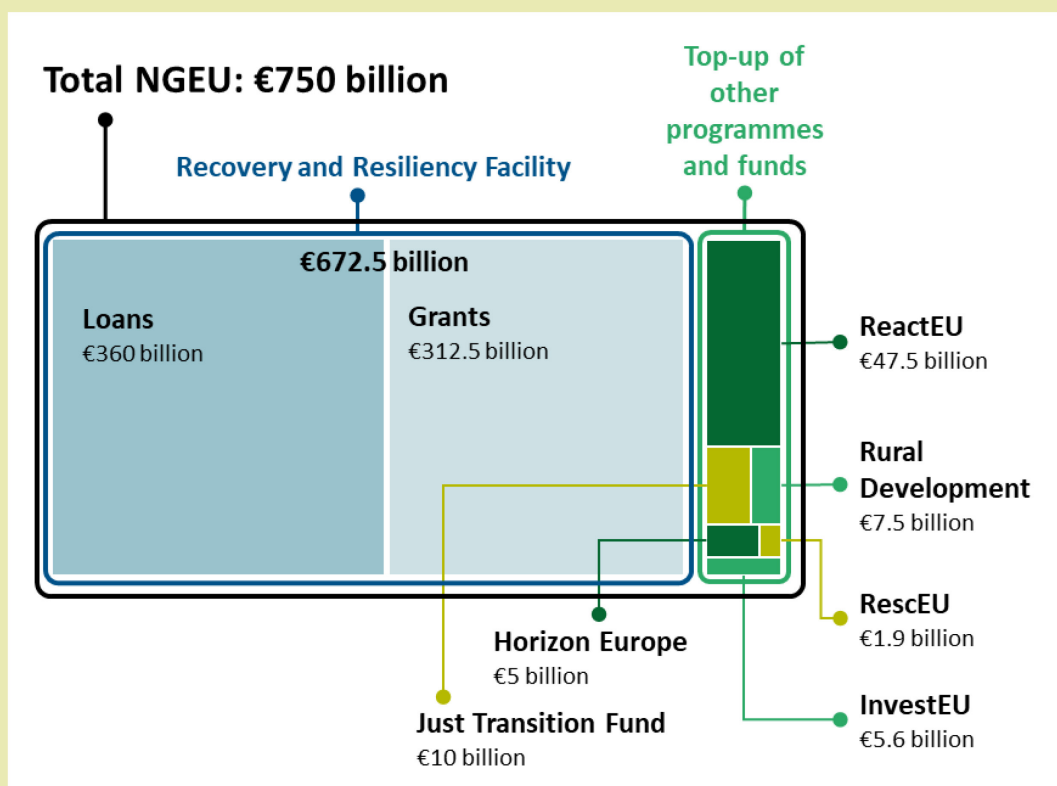
## Risks and challenges

### There are risks and challenges for the implementation of the 2021-2027 MFF and the NGEU instrument

**2.21.** The COVID-19 pandemic will have a substantial impact on the amount of funds that the EU will spend in future years. It has led to the rapid creation of the Next Generation EU (NGEU) instrument, which is aimed at countering the effects of the pandemic, maintaining the targets set by EU policies, and enabling Member States to become more resilient, sustainable and better prepared for the future. In the 2021-2027 MFF period, up to €750 billion will be available under the NGEU instrument (see [Box 2.10](#)).

#### Box 2.10

The NGEU will fund the new Recovery and Resiliency Facility and reinforce a number of MFF spending programmes



Note: all amounts in 2018 prices.

Source: ECA, based on information from the Commission.

**2.22.** For the 2021-2027 period, the combined funding allocation from the NGEU instrument and the MFF will be €1 824 billion (in 2018 prices, €1 074 billion from the 2021-2027 MFF and €750 billion from the NGEU instrument). This combined funding represents almost double the amount of the previous MFF allocation. We identified the following main risks and challenges:

- risk of delayed start to the implementation of shared management funds in the 2021-2027 MFF;
- challenges related to sound financial management in the use of funds due to COVID-19-related changes.

### **Risk of delayed start to the implementation of shared management funds in the 2021-2027 MFF**

**2.23.** We consider that the following main factors contribute to the risk of a delayed start to the implementation of shared management funds under the 2021-2027 MFF. These factors are similar to the ones that caused delays to the implementation of the 2014-2020 MFF. We have already pointed out several problems in recent years; we outline them below.

#### **Late adoption of legislation**

**2.24.** Although the Regulation for the new 2021-2027 MFF was proposed by the Commission in May 2018, it was only adopted on 17 December 2020<sup>24</sup>. The new programme period began in 2021, without the necessary sectoral legislative framework for the shared management funds in place (except for the EAGF and the EAFRD<sup>25</sup>). The Regulation governing the shared management funds (except the EAGF

<sup>24</sup> [Council Regulation 2020/2093 of 17 December 2020](#) laying down the multiannual financial framework for the years 2021 to 2027.

<sup>25</sup> Adoption of [Regulation \(EU\) 2020/2220 of the European Parliament and of the Council of 23 December 2020](#) laying down certain transitional provisions for support from the European Agricultural Fund for Rural Development (EAFRD) and from the European Agricultural Guarantee Fund (EAGF) in the years 2021 and 2022 and amending Regulations (EU) No 1305/2013, (EU) No 1306/2013 and (EU) No 1307/2013 as regards resources and application in the years 2021 and 2022 and Regulation (EU) No 1308/2013 as regards resources and the distribution of such support in respect of the years 2021 and 2022.

and the EAFRD), the Common Provisions Regulation, was only adopted on 24 June 2021.

**2.25.** This delay is greater than the one experienced in the previous two MFFs. In our 2018 annual report<sup>26</sup>, we recommended that legal frameworks should be adopted in good time so that Member States have enough time to plan their programmes. The Common Provisions Regulation for both MFF periods was adopted late: six months before the start of the 2007-2013 MFF period, and two weeks before the start of the 2014-2020 MFF period<sup>27</sup>. In previous reports, we noted that these delays had led to the late adoption of operational programmes and to the transfer of unused commitment appropriations of the first year to future years<sup>28</sup>. For the 2021-2027 MFF period, the delayed adoption of the Common Provisions Regulation, well beyond what happened in previous MFFs, is likely to result in the even later adoption of operational programmes, and further delays to the start of implementation. We note, however, that a number of simplifications which have been introduced, such as the continuation of the roles of national authorities, may help to accelerate the adoption of programmes and therefore partly reduce the delays.

**Speeding up the absorption and additional availability of financing will put pressure on administrative resources**

**2.26.** As noted in paragraph 2.17, the cumulative absorption rate of ESIF funds at the end of 2020 was only 55 %: much lower than at the same time in previous MFF periods (2000-2006: 68 %; 2007-2013: 62 %). We have previously noted<sup>29</sup> that the implementation of the 2007-2013 MFF period was delayed, as Member States were still using the commitments available from the previous period. Again, we note a similar situation where Member States still have substantial sums to absorb from the 2014-2020 MFF, which may delay the use of commitments under the 2021-2027 MFF.

<sup>26</sup> See the [2018 annual report](#), recommendation 2.1.c.

<sup>27</sup> General Regulation/CPR adopted 11.7.2006 for the 2007-2013 MFF and General Regulation/CPR adopted 17.12.2013 for the 2014-2020 MFF.

<sup>28</sup> See for example [2015 annual report](#), paragraph 2.6.

<sup>29</sup> [Special report 17/2018](#): Commission's and Member States' actions in the last years of the 2007-2013 programmes tackled low absorption but had insufficient focus on results, p. 22.

**2.27.** There is also a risk that the level of administrative resources needed to manage these funds in parallel may not be available, especially in the first years of the new MFF<sup>30</sup>. As an illustration, the Commission's and Member States' administrative resources will have to cover:

- o the ESIF under the 2014-2020 MFF until closure;
- o the shared management funds under the 2021-2027 MFF;
- o the increased allocations for shared management funds from the NGEU instrument in 2021 and subsequent years.

**2.28.** It is also likely that some parts of the Recovery and Resilience Facility (RRF) will be administered by the same administrative resources from 2021 onwards.

**2.29.** We have previously drawn attention to the problems that arise when the eligible periods of two different cohesion policy programme periods overlap<sup>31</sup>. In particular, the administrative burden is significantly increased for a time. This affects the start of the subsequent programming period. We note that the period of eligibility for Common Provisions Regulation funds ends in 2029, allowing the overlap between the closure of the 2021-2027 MFF and the phasing-in of the new one to be shortened to two years.

**2.30.** The RRF offers the possibility of full financing of the estimated cost of national recovery and resilience plans. This is normally not the case for the shared management funds<sup>32</sup>. In cases where financing is available either through the shared management funds or the RRF, this possibility of full support may make the RRF more attractive to Member States. We acknowledge, though, that support rates are not the only factor influencing Member States' choice of funding instrument.

<sup>30</sup> [Opinion 6/2020](#) (pursuant to Article 287(4) and 322(1)(a) TFEU) concerning the proposal for a regulation of the European Parliament and of the Council establishing a Recovery and Resilience Facility (COM(2020) 408), points 32-33 and 41, p. 13 and p. 18.

<sup>31</sup> [Special report 36/2016](#) 'An assessment of the arrangements for closure of the 2007-2013 cohesion and rural development programmes', paragraphs 129-130 and recommendation 4.

<sup>32</sup> [Opinion 6/2020](#), point 32, p. 13.

**2.31.** The 2021-2027 MFF Regulation does not include a mid-term review of the MFF, which was provided for in the original MFF legislation proposal. We note, however, that the Commission has committed to presenting a review of the functioning of the 2021-2027 MFF, which may offer an opportunity for any necessary changes. Article 7 of the MFF Regulation also provides a basis for the adjustment of MFF ceilings if funds under shared management are adopted late.

### **COVID-19-related changes allow for quick reactions, but also pose challenges to sound financial management in the use of funds**

**2.32.** To help Member States in their efforts to deal with the negative effects of the COVID-19 pandemic, flexibility has been increased, and administrative requirements for the use of existing ESIF funds have been simplified (see paragraph 2.5). Although these measures have helped Member States to respond quickly, they may also lead to a weakening of established control systems, potentially increasing the risk of errors and irregularities<sup>33</sup>. We have previously drawn attention to the need to minimise the risks to compliance and sound financial management<sup>34</sup>.

**2.33.** The time during which RRF financing is available is much shorter than financing under the shared management funds. The RRF eligibility period started retroactively on 1 February 2020. The deadline by which milestones and targets must be completed is 31 August 2026<sup>35</sup>. During this MFF period, the overlapping of the RRF's scope and objectives with other EU programmes creates the risk of double funding, particularly since the RRF scheme will cover projects which are potentially eligible under other policy areas, such as cohesion, transport, energy and research<sup>36</sup>. We note that the Commission is currently working to establish its control strategy for the RRF

<sup>33</sup> IMF report – Fiscal affairs, August 26, 2020 - COVID-19 Funds in Response to the Pandemic.

<sup>34</sup> ECA 2020/C 159/01 opinion 3/2020 (pursuant to Articles 287(4) and 322(1)(a), TFEU) on the proposal 2020/0054(COD) for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1303/2013 and Regulation (EU) No 1301/2013 as regards specific measures to provide exceptional flexibility for the use of the European Structural and Investments Funds in response to the COVID-19 outbreak. Point 5, p. 2.

<sup>35</sup> Article 18(4)(i) and 20(5)(d) of Regulation 2021/241 of the European Parliament and of the Council establishing the Recovery and Resilience Facility.

<sup>36</sup> Opinion 6/2020, point 6, p. 5.

which comprises the Commission's main checks on RRF implementation by Member States.

## The EU budget's exposure to financial risks

### The SURE Instrument has increased the EU budget's exposure to financial risks

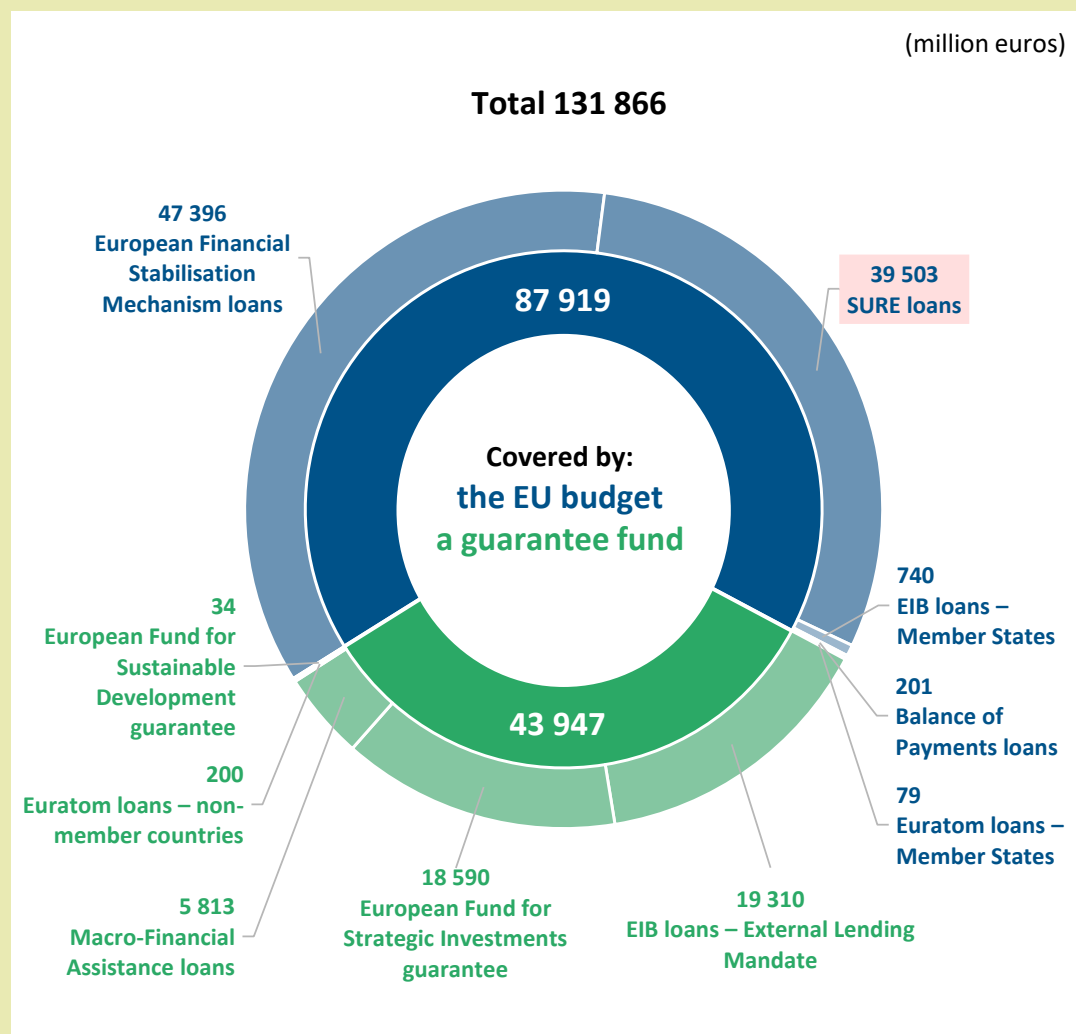
**2.34.** The total exposure of the EU budget to contingent liabilities – liabilities that depend on a specific future event occurring – increased from €90.5 billion at the end of 2019 to €131.9 billion<sup>37</sup> by the end of 2020, an increase of 46 %. This was almost completely due to the introduction of the European instrument for temporary support to mitigate unemployment risks in an emergency (the SURE Instrument)<sup>38</sup>, which added €39.5 billion of Member States' borrowing to the exposure figure by the end of 2020 (see [Box 2.11](#)). The Member States will be able to borrow up to €100 billion under the SURE Instrument until 2022 for urgent COVID-19-related purposes. By the end of 2020, €39.5 billion had already been borrowed. The EU budget guarantees these loans. Although the SURE loans increase overall exposure, the associated risks are reduced by safeguards built into the instrument, in particular by means of a guarantee system under which all Member States counter-guarantee the risk borne by the EU budget up to €25 billion.

<sup>37</sup> Consolidated accounts of the EU 2020, notes 4.1.1 and 4.1.2.

<sup>38</sup> [Council Regulation \(EU\) 2020/672 of 19 May 2020](#) on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak.

### Box 2.11

#### Exposure of the EU budget to risks at 31 December 2020, broken down by category



Source: ECA, based on the consolidated accounts of the European Union for 2020, notes 4.1.1 and 4.1.2.

**2.35.** We have reviewed the reports of the Commission on the EU budget's exposure to contingent liabilities<sup>39</sup>. The Commission considered the EU budget's level

<sup>39</sup> COM(2020) 677 – Report from the Commission to the European Parliament and the Council on guarantees covered by the general budget - Situation at 31 December 2019 and accompanying the document Commission staff working document SWD(2020) 241; annual report 2019 on the EU financial architecture (point 16 of the Inter-institutional Agreement); COM(2020) 327 – Report from the Commission to the European Parliament, the Council and the Court of Auditors on the guarantee fund for external actions and its management

of exposure to be sustainable at the end of 2020. We analysed the nature of the exposure of the EU budget in our 2019 annual report<sup>40</sup> and concluded that the exposure could be regarded as sustainable at the end of 2019. The introduction of the SURE instrument represents the key material change to the risk borne by the EU budget in 2020.

**2.36.** In 2020, the Commission calculated that the annual risk exposure of the EU budget in 2021 would be €14.1 billion. Later on, however, Ireland and Portugal requested that loan repayments totalling €9.7 billion due in 2021 be rescheduled to future years<sup>41</sup>. This shifted the risk to future years, and reduced the annual risk to the EU budget in 2021 to €4.4 billion. In 2020, the annual risk amounted to €4.5 billion.

### **The NGEU instrument will have a major impact on overall exposure from 2021 onwards**

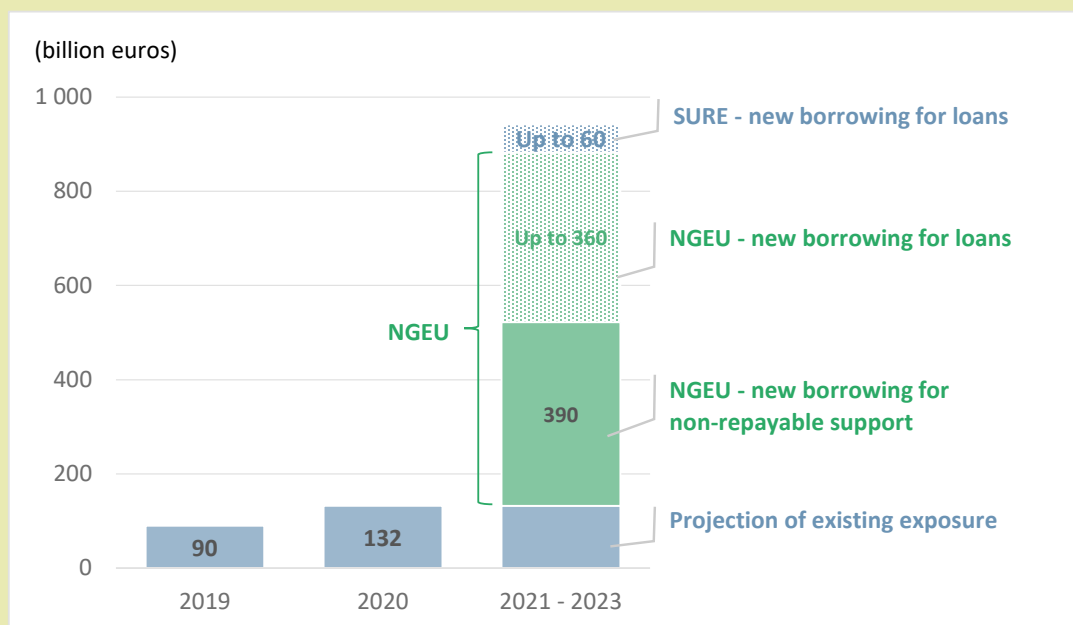
**2.37.** The NGEU instrument will make it possible for the EU to take quick and strong action. But it will substantially increase the overall exposure of the EU budget by up to €750 billion (in 2018 prices) in the years to come. See [Box 2.12](#). Specifically, €390 billion will be made available in the form of grants and budgetary guarantees, and up to €360 billion will be made available as loans to Member States. The Commission will borrow the necessary funds on the financial markets on behalf of the EU; this borrowing will be guaranteed by the EU budget. This could increase its overall exposure to as much as about €940 billion. As a result, the Commission will face the challenge of scaling up its administrative capacities to ensure the sound management of larger transactions in capital markets than ever before, including bond issuance and the management of financial risks<sup>42</sup>.

in 2019 and accompanying the document, [Commission staff working document SWD\(2020\) 136](#); [COM\(2020\) 385](#) - Report from the Commission to the European Parliament, the Council and the Court of Auditors on the management of the guarantee fund of the European Fund for Strategic Investments in 2019 and accompanying the document, [Commission staff working document SWD\(2020\) 162](#).

<sup>40</sup> See our 2019 [annual report](#), paragraphs 2.22-2.34.

<sup>41</sup> [COM\(2020\) 677](#) – Report from the Commission to the European Parliament and the Council on guarantees covered by the general budget - Situation at 31 December 2019 and accompanying the document [Commission staff working document SWD\(2020\) 241](#).

<sup>42</sup> Our [review 06/2020](#) - Risks, challenges and opportunities in the EU's economic policy response to the COVID-19 pandemic – paragraph 87.

**Box 2.12****Comparison of past and possible future overall exposure of the EU budget**

*Source:* ECA, based on COM(2020) 677 – Report from the Commission to the European Parliament and the Council on guarantees covered by the general budget - Situation at 31 December 2019; Commission staff working document SWD(2020) 241; and NGEU- and SURE-related legislation.

**2.38.** The overall exposure does not mean that all of these funds can be called upon in one year. We also note that the increased exposure linked to the NGEU instrument is planned to be balanced out by a temporary dedicated increase in the own resources ceiling of 0.6% GNI for the duration of the liabilities incurred under the NGEU instrument.

# Conclusions and recommendations

## Conclusions

**2.39.** In 2020, commitment and payment appropriations were almost fully used. The EU budgetary authority decided to deploy special instruments to make commitments above the MFF ceiling. Payments were well within the MFF ceiling. See paragraphs [2.3-2.4](#).

**2.40.** To respond to the COVID-19 pandemic, the EU rapidly used the budget to provide support through transfers and amending budgets. Overall amounts of €3.3 billion of additional commitment appropriations and €9.4 billion of additional payment appropriations were inserted through amending budgets for COVID-19-related expenditure. In addition, the EU relaxed the existing rules governing the ESIF to allow additional liquidity and flexibility for the Member States. See paragraphs [2.5-2.6](#).

**2.41.** The Commission informed us that €12.9 billion of commitments under direct and indirect management had been made available for COVID-19-related purposes by the end of 2020. We found that around €0.2 billion COVID-19-related amounts had not been included in these €12.9 billion of commitments, even though they were marked as COVID-19-related in the Commission's central accounting system. According to the Commission, a further €34.2 billion was pledged or contracted under shared management by the Member States, bringing the total of EU funds made available for COVID-19-related purposes to €47.1 billion. The Commission has not yet published a report on COVID-19-related expenditure. See paragraphs [2.7-2.8](#).

**2.42.** Outstanding commitments exceeded €300 billion. The Commission estimated that they will remain fairly stable at this high level until 2027 (without NGEU). However, outstanding commitments will rise if, as in 2016-2020, commitments remain high and payment claims are lower than anticipated due to implementation delays. See paragraphs [2.9-2.11](#).

**2.43.** In the 2014-2020 MFF period, commitment appropriations were almost fully used. However, payment appropriations during these seven years were used less than anticipated from 2016 onwards due to delays in ESIF implementation. In total, the payments remained nearly €45 billion below the MFF ceiling for 2014-2020. See paragraphs [2.12-2.16](#).

**2.44.** Absorption speed is lagging behind that of the previous MFF. Average cumulative absorption has only reached 55 %. There are substantial differences in absorption between Member States. There is a risk that not all of the €209 billion in ESIF funding still available to the Member States will be absorbed. See paragraphs [2.17-2.20](#).

**2.45.** Delays in the adoption of required legislation and slow overall absorption of 2014-2020 ESIF funding may lead to delays in the implementation of shared management funds in the 2021-2027 MFF. While COVID-19-related measures have helped the Member States to respond quickly to the pandemic, there is a risk that the level of administrative resources needed to manage the substantial increase due to the RRF together with the new MFF and the old MFF in parallel may not be sufficient. The risk is especially high in the first years of the new MFF, potentially leading to additional delays, the weakening of control systems, and irregularities and unsound financial management. See paragraphs [2.21-2.33](#).

**2.46.** Due to the introduction of the NGEU and SURE instruments, the exposure of the EU budget will rise substantially, by as much as about €940 billion, in the years to come. This is planned to be balanced out by an increase in the EU's financing capacity as a result of a temporary increase in the own resources ceiling. See paragraphs [2.34-2.38](#).

## Recommendations

### Recommendation 2.1 – Reporting on EU funds for COVID-19-related purposes

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To allow for the comprehensive reporting of the committed and expensed amounts relating to the COVID-19 pandemic including amounts pledged or contracted in 2020 – the Commission should standardise the recording of EU budgetary expenditure for COVID-19-related purposes and report on it to the budgetary authority at least annually, for as long as is deemed necessary.

**Timeframe: By end 2021**

## **Recommendation 2.2 – Gradually reducing outstanding commitments**

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With a view to gradually reducing the overall level of outstanding commitments in the years to come, the Commission should analyse the factors contributing to the evolution of outstanding commitments and, based on the results, take appropriate action.

**Timeframe: By end 2023**

## **Recommendation 2.3 – Promoting the sound use of EU funding**

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In the light of the substantial increases in the level and types of EU funding available over the coming years, including amounts remaining from the previous MFF period, the Commission should set up measures to ensure that additional advisory support is available to national authorities, thereby facilitating Member States' sound use of these funds.

**Timeframe: By end 2022**

## Chapter 3

### Revenue

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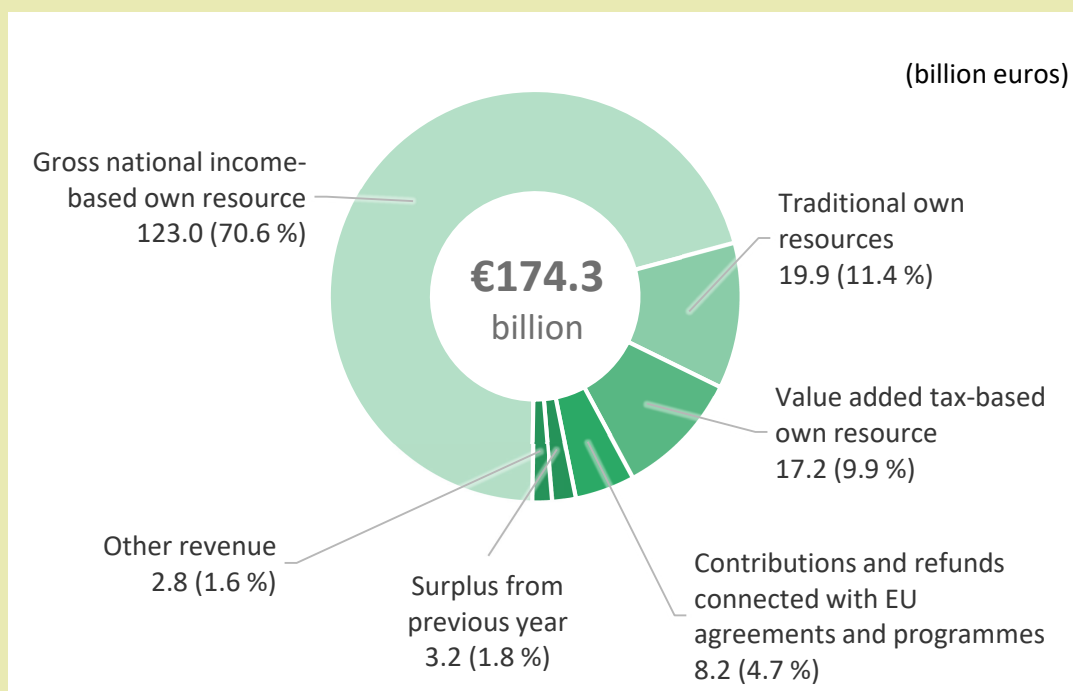
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# Introduction

**3.1.** This chapter presents our findings related to revenue, which comprises both own resources and other revenue. **Box 3.1** gives a breakdown of revenue in 2020.

## Box 3.1

### Revenue – 2020 breakdown<sup>(\*)</sup>



Total revenue 2020<sup>(\*\*)</sup>: €174.3 billion

<sup>(\*)</sup> In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph **10**).

<sup>(\*\*)</sup> This amount represents the EU's actual budget revenue. The amount of €224.0 billion in the statement of financial performance is calculated using accrual-based accounting.

Source: 2020 consolidated accounts of the European Union.

## Brief description

### 3.2. Most revenue (92 %) comes from the three categories of own resources<sup>1</sup>:

- (a) the **gross national income-based (GNI-based) own resource** provides 70.6 % of EU revenue, balancing the EU budget after revenue from all other sources has been calculated. Each Member State contributes proportionally, according to its GNI;
- (b) **traditional own resources (TOR)** provide 11.4 % of EU revenue. They comprise customs duties on imports collected by the Member States. The EU budget receives 80 % of the total amount; Member States retain the remaining 20 % to cover collection costs;
- (c) the **value added tax-based (VAT-based) own resource** provides 9.9 % of EU revenue. Contributions under this own resource are calculated using a uniform rate applied to Member States' harmonised VAT assessment bases.

**3.3.** Revenue also includes amounts received from other sources. The most significant of these sources are contributions and refunds connected with EU agreements and programmes (4.7 % of EU revenue), such as revenue relating to the conformity clearance of the EAGF and EAFRD, and non-EU countries' contributions to EU programmes and activities<sup>2</sup>.

<sup>1</sup> Council Decision (EU, Euratom) No 2014/335 of 26 May 2014 on the system of own resources of the European Union ([OJ L 168](#), 7.6.2014, p. 105), Article 2.

<sup>2</sup> See [review 03/2021](#) "Financial contributions from non-EU countries to the EU and Member States".

## Audit scope and approach

**3.4.** Applying the audit approach and methods set out in **Annex 1.1**, we obtained assurance for our audit opinion on revenue by assessing the key selected systems, supplemented by transaction testing. Our objective was to contribute to the overall statement of assurance as described in **Annex 1.1**. We examined the following for revenue in 2020:

- (a) a sample of 55 Commission recovery orders, designed to be representative of all sources of revenue;
- (b) the Commission's systems for:
  - (i) ensuring that the Member States' GNI and VAT data constitute an appropriate basis for the calculation and collection of own-resource contributions<sup>3</sup>
  - (ii) managing TOR and ensuring that Member States have effective systems for collecting and reporting the correct amounts of TOR and making them available
  - (iii) managing fines and penalties
  - (iv) calculating the amounts resulting from correction mechanisms;
- (c) the systems for TOR accounting in three Member States (Spain, France and the Netherlands) selected on the basis of both the amount of customs duties they collected and our risk assessment;
- (d) the reliability of the information on regularity contained in DG BUDG and Eurostat's annual activity reports.

<sup>3</sup> Our starting point was the agreed GNI data and the harmonised VAT base prepared by Member States. We did not directly test the statistics and data produced by the Commission and Member States.

**3.5.** Customs duties are at risk of either not being declared or being declared incorrectly to the national customs authorities by importers. The “customs gap”<sup>4</sup>, i.e. the evaded amounts not captured in Member States’ TOR accounting systems, does not fall within the scope of our audit opinion on revenue. However, since the customs gap may affect the amounts of duties established by Member States, we assessed for the second year in a row the EU action taken to reduce the gap and mitigate the risk that TOR are not complete.

**3.6.** In doing so, we examined the results of the Commission’s TOR follow-up inspections of Member States’ customs control strategies for tackling the risk of undervalued imports<sup>5</sup>. We also used the results of our recent special report on customs controls<sup>6</sup>, in which we assessed whether the new risk management framework introduced by the Commission, in cooperation with Member States, ensures uniform application of customs controls to safeguard the EU’s financial interests.

<sup>4</sup> The difference between the theoretical level of import duty that should be collected for the economy as a whole and actual import duty collected.

<sup>5</sup> See also paragraph 3.14 of our [2019 annual report](#).

<sup>6</sup> See [special report 04/2021](#) “Customs controls: insufficient harmonisation hampers EU financial interests”.

## Regularity of transactions

**3.7.** This section presents our observations on the regularity of revenue transactions. We have based our conclusion on the regularity of transactions underlying the EU accounts on our assessment of the Commission's systems for calculating and collecting revenue<sup>7</sup>. Our examination of a sample of 55 recovery orders revealed that none of them was affected by a quantifiable error. [Annex 3.1](#) provides an overview of the results of transaction testing.

<sup>7</sup> See paragraph **10** in **Annex 1.1**.

## Examination of elements of internal control systems

**3.8.** As explained in paragraph 3.4, we selected and examined a number of systems. The observations on those systems do not affect our overall unmodified opinion on the regularity of EU revenue (see **chapter 1**). However, they do highlight persistent weaknesses in the effectiveness of control systems at the level of both the Commission and Member States, the most important of which affect the Commission's closure of the GNI verification cycle and the reliability of the TOR statements in the Netherlands.

### Keeping the GNI data open for 10 years causes budgetary uncertainty

**3.9.** Within its GNI multiannual verification cycle, the Commission examines whether the procedures Member States use to compile their national accounts comply with ESA 2010<sup>8</sup>, and whether GNI data are comparable, reliable and exhaustive<sup>9</sup>. In 2020, the Commission closed its verification cycle in respect of GNI data for own resources from the year 2010<sup>10</sup> onwards for all Member States except France, for which verification was delayed due to the unsatisfactory description of the compilation procedures in its GNI Inventory, as we have reported in previous years<sup>11</sup>. This creates

<sup>8</sup> ESA 2010 (European system of national and regional accounts) is the EU's internationally compatible accounting framework. It is used to create a systematic and detailed description of an economy. See Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174, 26.6.2013, p. 1).

<sup>9</sup> See Article 5 of Council Regulation (EC, Euratom) No 1287/2003 of 15 July 2003 on the harmonisation of gross national income at market prices (GNI Regulation) (OJ L 181, 19.7.2003, p. 1). This was replaced by Regulation (EU) No 2019/516 of the European Parliament and of the Council of 19 March 2019 on the harmonisation of gross national income at market prices and repealing Council Directive 89/130/EEC, Euratom, and Council Regulation (EC, Euratom) No 1287/2003 (GNI Regulation), in particular Article 5(2) thereof (OJ L 91, 29.3.2019, p. 19).

<sup>10</sup> Except for Croatia, where the period over which data remain open starts from 2013.

<sup>11</sup> See paragraph 4.18 of our 2018 annual report and paragraph 3.21 of our 2019 annual report.

uncertainty as regards calculating the future contributions of both France and the other Member States.

**3.10.** As a result of the verification cycle closure, the Commission set a large number of GNI reservations in respect of specific compilation procedures in the Member States that called for improvement<sup>12</sup> (see [Annex 3.2](#)). With the exception of the one regarding the impact of globalisation on GNI (see paragraph [3.11](#)), these reservations keep 10 years of Member States' statistical data open for changes<sup>13</sup>. This significantly increases budgetary uncertainty in the national budgets as regards the GNI-based contribution, as we have reported in the past<sup>14</sup>.

### The impact of globalisation on GNI is not properly addressed

**3.11.** With regard to the GNI reservation related to the impact of globalisation, allowing the incorporation of a more accurate estimate of the research and development (R&D) assets of multinational companies<sup>15</sup>, the Commission reduced the data revision period by making 2018 the starting year for changes. While responding to Member States' difficulties in obtaining data for earlier years from multinational companies, such exception weakens the comparability, reliability and exhaustiveness of Member States' GNI from 2010 to 2017. This limitation is not in line with the EU rules<sup>16</sup> on the calculation of the GNI-based own resource.

<sup>12</sup> Transaction-specific and transversal reservations replacing the process-specific reservations.

<sup>13</sup> The EU legislation on the calculation of own resources allows for the adjustment of GNI data for a given financial year up to the year n+4. This four-year rule may be extended by setting a GNI reservation in cases where the quality of data needs to be improved.

<sup>14</sup> See paragraphs 68-70 and recommendation 2 in [special report 11/2013](#) "Getting the Gross National Income (GNI) data right: a more structured and better-focused approach would improve the effectiveness of the Commission's verifications", and paragraph 4.9-4.10 and recommendation 1 in our [2014 annual report](#).

<sup>15</sup> See paragraph 3.20 of our [2019 annual report](#).

<sup>16</sup> Council Regulation (EU, EURATOM) No 609/2014 of 26 May 2014 on the methods and procedures for making available the traditional, VAT and GNI-based own resources and on the measures to meet cash requirements ([OJ L 168, 7.6.2014, p. 39](#)), Article 10b(4).

## Despite improvements, the number of VAT reservations and TOR open points remains high

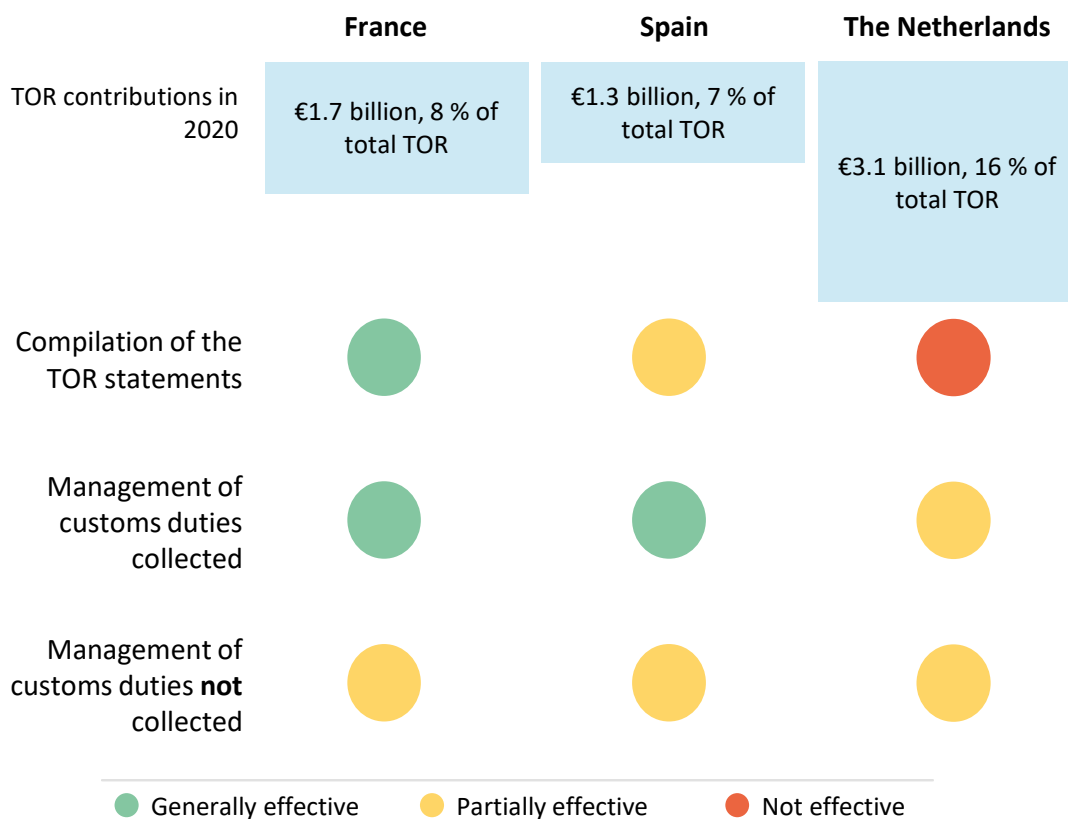
**3.12.** We examined the process of the Commission's verification of the VAT base calculation and of TOR, and have provided an overview of the outstanding reservations and open points set by the Commission for weaknesses detected (see [Annex 3.2](#)). Compared to last year, the number of VAT reservations increased from 95 to 104 (9 %) and the number of TOR open points decreased from 356 to 326 (8 %). At the same time, we noted good progress in Member States' resolution of weaknesses identified in previous years, resulting in the lifting of VAT reservations and closing of TOR open points, but numerous unresolved weaknesses remain.

## Weaknesses persist in Member States' accounting and management of TOR

**3.13.** We examined how three Member States (Spain, France and the Netherlands) draw up their statements of duties collected and not yet collected<sup>17</sup>, as well as their procedures for managing TOR owed to the EU budget (see [Annex 3.3](#)). Our assessment of Member States' key internal TOR control systems is presented in [Figure 3.1](#).

<sup>17</sup> Commission Implementing Decision (EU, Euratom) 2018/194 of 8 February 2018 establishing models for statements of accounts for entitlements to own resources and a form for reports on irrecoverable amounts corresponding to the entitlements to own resources pursuant to Council Regulation (EU, Euratom) No 609/2014 ([OJ L 36, 9.2.2018, p. 20](#)).

**Figure 3.1 – Assessment of key internal TOR control systems in the Member States selected**



Source: ECA.

**3.14.** We did not identify any significant problems in the drawing-up of the TOR statements (for both duties collected and not yet collected) in France. However, in the other two Member States examined we found that weaknesses we had previously identified persist (see [Box 3.2](#)).

### Box 3.2

#### Persistent weaknesses in the national control systems for compiling TOR statements

##### Spain

In our 2018 annual report<sup>18</sup>, we pointed out that the Spanish statements of customs duties collected included manual entries made to offset automatic bookings generated by the IT system. We found that the amounts made available to the EU budget had been incorrectly reduced by half a million euros due to an unauthorised manual intervention.

While noting improvements in the detection and correction of erroneous automatic bookings, we observed that, since the IT system is unchanged, the risk of incorrect compilation of the Spanish TOR statements continues to exist.

##### The Netherlands

Since 2013<sup>19</sup> we have reported several times that we are unable to properly assess the reliability of the Dutch statements (including those for duties collected and not yet collected) because the customs IT system does not allow us to establish an audit trail. Due to these IT system limitations, the national customs authorities also could not provide assurance that they properly mitigated the risk of double booking in the accounts of duties not collected, and that partial payments received from debtors were allocated correctly between TOR and national revenue.

Despite the Dutch authorities telling us in 2017 that these issues would be solved by March 2018, they persist three years later.

**3.15.** In 2020, the Commission examined in greater depth the systems national customs authorities use to compile the TOR statements. Out of 10 Member States inspected, the Commission assessed the reliability of these statements as partially satisfactory in six Member States<sup>20</sup> and generally satisfactory in four<sup>21</sup>.

<sup>18</sup> See paragraph 4.9 and Box 4.2 of our [2018 annual report](#).

<sup>19</sup> See paragraph 2.17 of our [2013 annual report](#) and paragraph 4.14 of our [2017 annual report](#).

<sup>20</sup> Bulgaria, France, Malta, Portugal, Slovakia and Sweden.

<sup>21</sup> Czechia, Germany, Hungary and Poland.

**3.16.** As in previous years<sup>22</sup>, we found weaknesses in the management of established duties not yet collected by national customs authorities.

**3.17.** In the Member States audited, we found delays in notifying and/or the accounting of customs debts (France and the Netherlands) and in recovering such debts (Spain, France and the Netherlands), as well as late write-offs of irrecoverable duties in the accounts (the Netherlands). The Commission also continues to detect and report shortcomings in this area, despite having provided Member States with additional guidance on managing these duties.

### **Lack of systematic monitoring of import data and insufficiently harmonised customs controls at EU level**

**3.18.** In the 2021 special report on customs controls, we noted that the Commission has not systematically conducted an EU-wide analysis of data on all EU imports to detect financial risks in customs<sup>23</sup>. This is also confirmed by our follow-up work on the recommendation we made in our 2017 annual report (see [Annex 3.4](#)). The inadequate monitoring of import data at EU level compromises the effectiveness of risk management underpinning Member States' selection of import declarations that are to be subject to customs controls.

**3.19.** While our special report recognised that the Commission's risk management framework is an important step for uniform application of customs controls, we concluded that it does not ensure sufficient harmonisation of control selection at Member State level to safeguard the EU's financial interests<sup>24</sup>. This is mainly due to weaknesses in the framework design at EU level, which allow significant divergence in the way Member States implement it. We noted that the Commission continued to detect weaknesses in and differences between the various national control strategies for tackling the risk of undervalued imports in the course of its TOR follow-up inspections in Member States (see [Box 3.3](#)).

<sup>22</sup> See, for example, paragraph 3.9 of our [2019 annual report](#), paragraph 4.10 of our [2018 annual report](#), and paragraph 4.15 of our [2017 annual report](#).

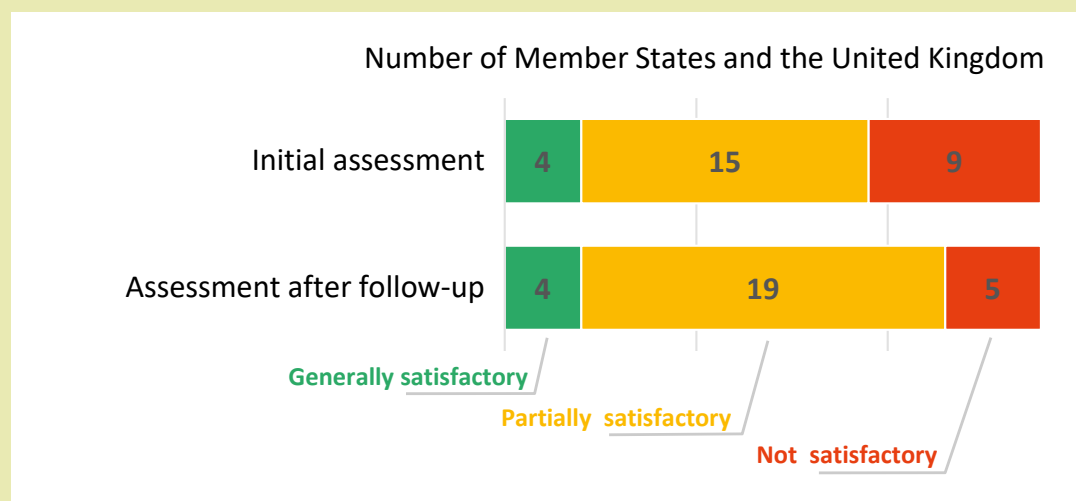
<sup>23</sup> See [special report 04/2021](#) "Customs controls: insufficient harmonisation hampers EU financial interests", paragraph 33.

<sup>24</sup> Idem, paragraph 62.

### Box 3.3

#### The Commission's assessment of Member States' control strategies for tackling the undervaluation risk is that they are still inadequate overall

The Commission carried out TOR inspections of the customs control strategy for tackling the risk of undervalued imports in all Member States in 2018 and 2019. Its assessment was that the national control strategy was either partially satisfactory or not satisfactory in 24 of the 28 Member States<sup>25</sup>. The Commission's 2019 and 2020 follow-up inspections that we reviewed revealed that three Member States and the United Kingdom had improved their control strategy (from not satisfactory to partially satisfactory). However, the situation is still inadequate overall.



Source: ECA based on the Commission's TOR inspection reports.

<sup>25</sup> See paragraphs 3.13 and 3.14 of our [2019 annual report](#).

## Annual activity reports

**3.20.** The information provided in the 2020 annual activity reports published by DG BUDG and Eurostat generally corroborated our findings and conclusions. However, the DG BUDG annual activity report did not include the weaknesses we detected concerning the compilation of the TOR statements of customs duties collected and not yet collected in the Netherlands (see [Box 3.2](#)).

**3.21.** For the fifth year in a row, DG BUDG has maintained the reservation that the TOR amounts transferred to the EU budget are inaccurate owing to undervaluation of textiles and shoes imported from China over the period from 2011 to 2017. The reservation was first set in 2016, when TOR losses attributable to the United Kingdom were quantified, and then extended to other Member States in 2018, without quantification.

**3.22.** The Commission's infringement case against the United Kingdom concerning the TOR losses due to these undervalued imports from China is awaiting judgement by the Court of Justice of the European Union. The last step taken was the Court of Justice hearing on 8 December 2020. The total potential losses resulting from the above reservation, which are booked as receivables in the 2020 consolidated accounts of the European Union, amounted to 2.1 billion euros of principal. Interest of 1.6 billion euros has also been booked because of the large share of the estimated customs duties dating back to 2011 that has not been made available.

# Conclusion and recommendations

## Conclusion

**3.23.** The overall audit evidence indicates that the level of error in revenue was not material. The revenue-related systems we examined were generally effective. However, the key internal TOR controls we assessed in certain Member States and the closure of the GNI verification cycle we assessed at the Commission were partially effective due to persistent weaknesses (see paragraphs [3.9-3.17](#)).

**3.24.** We also detected significant weaknesses in Member States' controls to reduce the customs gap that require EU action. These weaknesses do not affect our audit opinion on revenue, as they do not concern the transactions underlying the accounts but rather the risk that TOR are incomplete. Our recent special report on customs controls recommended improvement in this area<sup>26</sup> (see paragraphs [3.18](#) and [3.19](#)).

## Recommendations

**3.25.** [Annex 3.4](#) shows the findings of our follow-up review of the two recommendations we made in our 2017 annual report, and the two in our 2018 annual report that were to be implemented by the end of 2020. The Commission had implemented one recommendation in most respects, and three in some.

**3.26.** Based on this review and our findings and conclusions for 2020:

<sup>26</sup> See [special report 04/2021](#) "Customs controls: insufficient harmonisation hampers EU financial interests", recommendation 1 "Enhance the uniform application of customs controls" and recommendation 2 "Develop and implement a fully-fledged analysis and coordination capacity at EU level".

### **Recommendation 3.1 – Review and update the verification approach with a view to shortening the length of time GNI data remain open**

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We recommend that the Commission review and update its approach to verifying Member States' GNI data in future multiannual cycles with a view to further streamlining the process and reducing the period over which GNI data remain open after the end of the cycle.

**Timeframe: by the end of 2024 (end of the current verification cycle)**

### **Recommendation 3.2 – Further action needed to properly address the impact of globalisation on GNI**

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- (a) We recommend that the Commission, in cooperation with Member States' statistical authorities, continue to improve the capture of globalisation in national accounts to address the GNI reservation in this area for the years 2018 onwards.
- (b) If the impact of lifting the above reservation on national accounts were to differ significantly between Member States, the Commission should reassess the quality of the GNI data of previous years, with a view to informing the budgetary authority of the possible implications of the resulting revised statistics for the revenue budget since 2010.

**Timeframe: by mid-2023**

### **Recommendation 3.3 – Reliability of Dutch TOR statements**

---

We recommend that the Netherlands ensure that its monthly and quarterly TOR statements are reliable by solving the current weaknesses in its customs IT system regarding the lack of audit trail, the risk of double entries, and the incorrect allocation of partial payments.

**Timeframe: by the end of 2022**

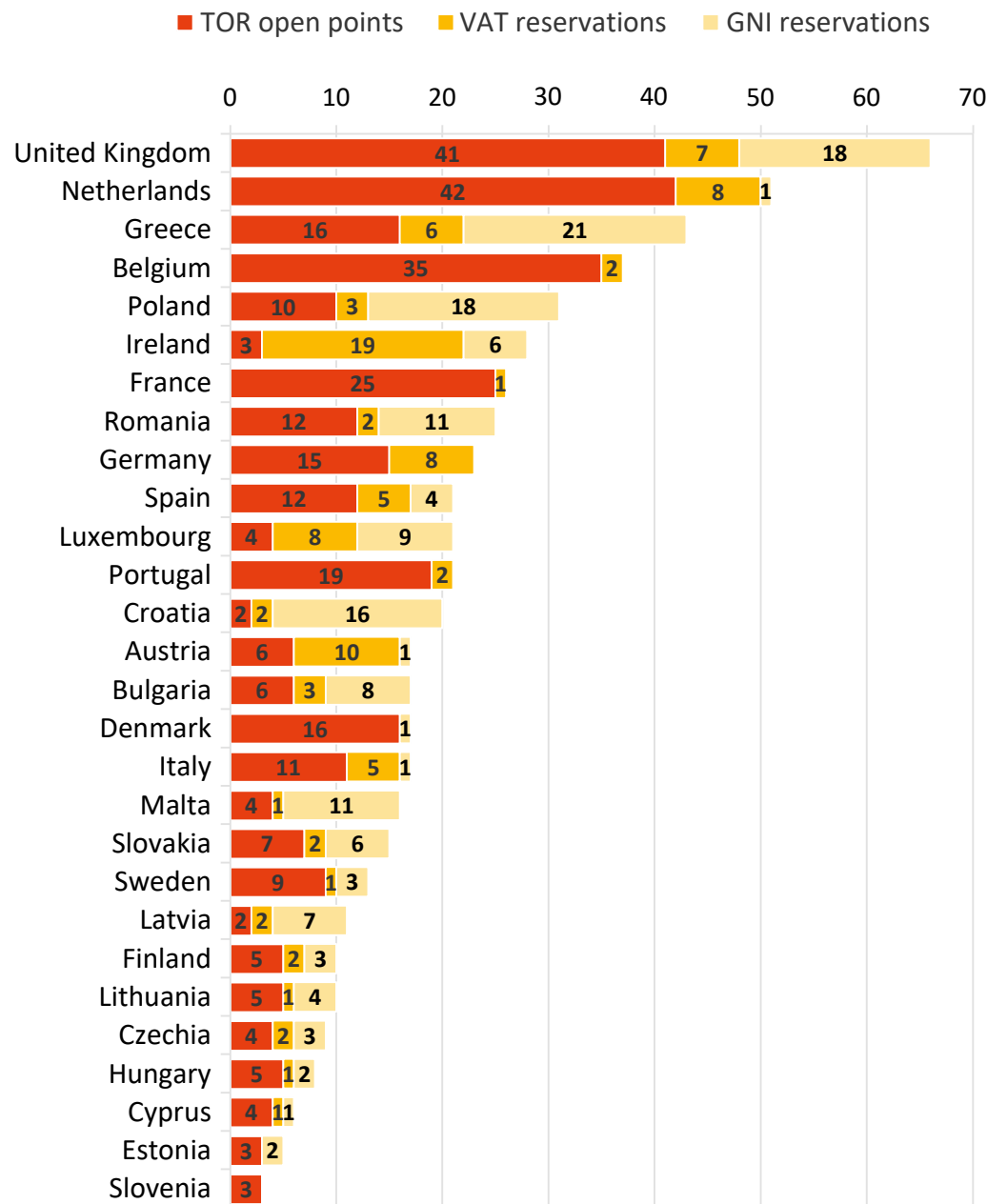
# Annexes

## Annex 3.1 – Results of transaction testing for revenue

	2020	2019
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	55	55
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	Free of material error	Free of material error

Source: ECA.

### Annex 3.2 – Number of outstanding GNI reservations, VAT reservations and TOR open points by Member State at 31.12.2020

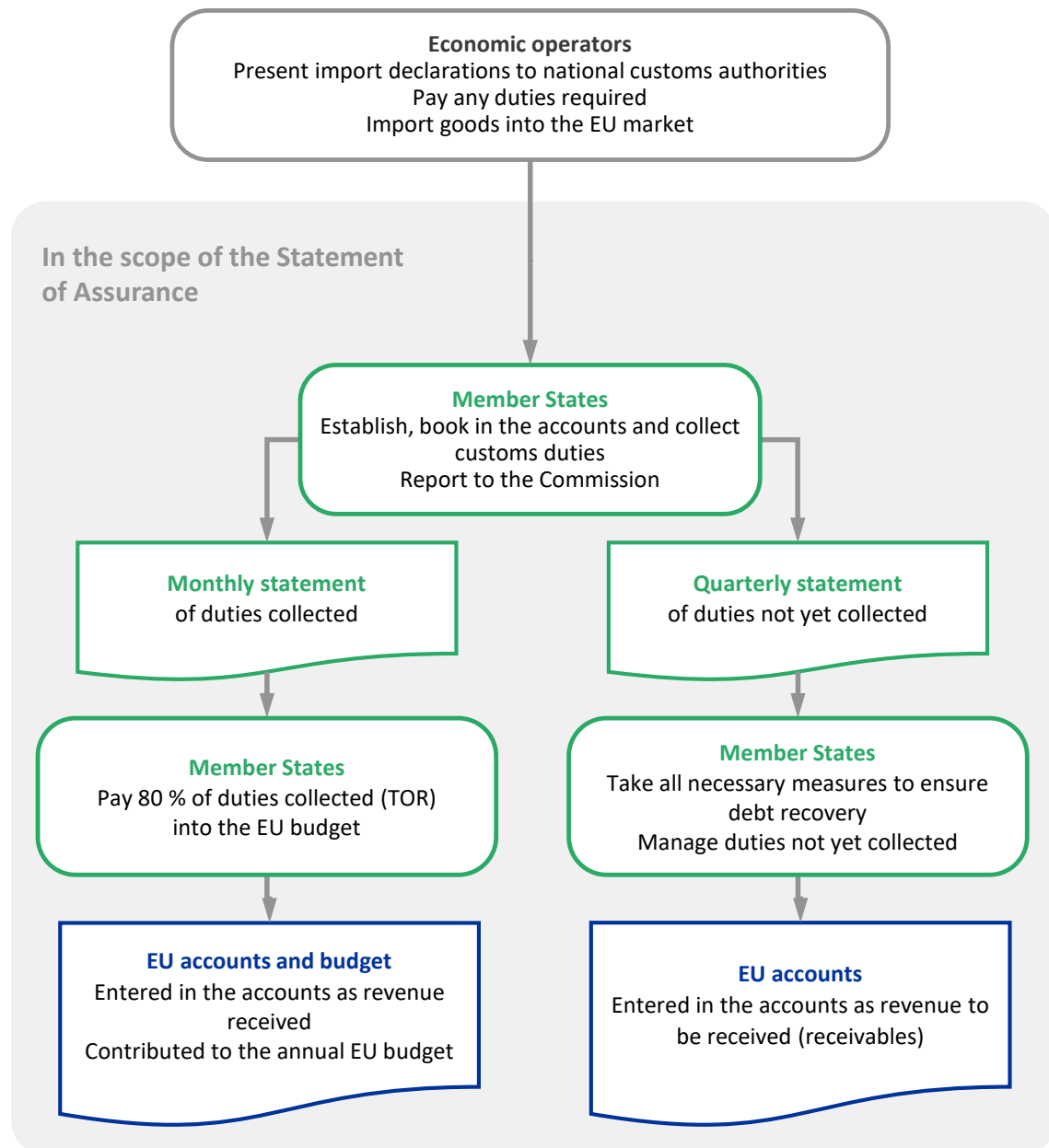


	TOR open points	VAT reservations	GNI reservations
<b>TOTAL 31.12.2020</b>	<b>326</b>	<b>104</b>	<b>157</b>
<b>TOTAL 31.12.2019</b>	<b>356</b>	<b>95</b>	<b>29</b>

Source: ECA based on the Commission's data<sup>27</sup>.

<sup>27</sup> The GNI-reservation figures represent only transaction-specific reservations regarding the data compiled as of 2010 in specific national accounts' components in the Member States concerned. There are also five transversal reservations for each Member State and the United Kingdom, a process-specific GNI reservation covering the United Kingdom's GNI data for 2016-2020, and one general reservation for France.

### Annex 3.3 – The process of drawing up the TOR statements of duties (collected and not yet collected) and their entry in the EU accounts and budget



Source: ECA based on current EU legislation and rules.

## Annex 3.4 – Follow-up of previous recommendations

### Follow-up of previous recommendations related to revenue

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2017	<p>We recommend that the Commission:</p> <p><b>TOR</b></p> <p><b>Recommendation 1:</b></p> <p>by the end of 2020, improve its monitoring of import flows, including making wider use of data mining techniques to analyse unusual patterns and their underlying reasons, and act promptly to ensure that due amounts of TOR are made available.</p>			X			
	<p><b>VAT-based own resource</b></p> <p><b>Recommendation 2:</b></p> <p>by the end of 2019, review the existing control framework and better document its application in verifying Member States' calculations of the WARs [Weighted Average Rates] used to obtain the harmonised VAT bases.</p>		X				

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2018	<p>We recommend that the Commission:</p> <p><b>Recommendation 1:</b> by the end of 2020, implement a more structured and documented risk assessment for its TOR inspection planning, including an analysis of each Member State's level of risk and of risks in relation to the drawing up of the A and B accounts.</p>			X			
	<p><b>Recommendation 2:</b> by the end of 2020, reinforce the scope of its monthly and quarterly checks of TOR A and B account statements by carrying out a deeper analysis of the unusual changes in order to ensure a prompt reaction to potential anomalies.</p>			X			

Source: ECA.

#### Notes on our analysis of the progress made:

##### Annual report 2017

##### Recommendation 1:

The Commission (DG BUDG) is currently using the THESEUS and Surveillance II databases to monitor the undervaluation trends in Member States. In December 2020, DG BUDG created a new data analysis team to support customs policy decisions and the enforcement strategy. However, the team's responsibilities, the frequency of data analysis and the use of such analysis are yet to be defined.

The Commission (DG TAXUD) has started to set up several tools that will improve the analysis of data on import flows. However, it considers that the monitoring of these flows will not improve significantly until the Surveillance III database comes into operation<sup>28</sup>, which is not expected to be before January 2023.

In 2019, the Commission's services (DG BUDG, DG TAXUD and OLAF) pooled resources to carry out a Joint Analytical Capacity pilot with the objective of exploring the use of data mining/analysis techniques. Follow-up of this action is underway.

In September 2020, the Commission published its Customs Action Plan (for the years 2020 to 2024) which provides for the development of data analysis at EU level. We have been informed that the Commission expects to fully address our recommendation by the end of 2022.

#### **Recommendation 2:**

The Commission (DG BUDG) revised its control procedures for verifying the Member States' calculations of the Weighted Average Rate (WAR) of VAT. This has improved the transparency, traceability and continuity of the controls. However, we found that the assessment of the impact of potential weaknesses in national accounts (covered by general GNI reservations) on the WAR calculation is not properly evidenced.

#### **Annual report 2018**

#### **Recommendation 1:**

We welcome the further formalisation of the risk assessment introduced by the Commission (DG BUDG) for its TOR inspection planning. However, we noted that the risk assessment framework still fails to display the assessment of each Member State's level of risk. The subject areas selected for TOR inspections are not yet based on a broader assessment of customs-related risks, including their impact and likelihood.

#### **Recommendation 2:**

The scope of the Commission's (DG BUDG) monthly and quarterly checks on statements of duties collected and not yet collected (A and B accounts) to detect unusual trends was not extended in line with our recommendation. It continues to be generally limited to checks on the consistency of the monthly and quarterly TOR statements. The analysis of these statements is also used to prepare the annual TOR inspections. In 2020, the Commission (DG BUDG) started to perform ad-hoc inspections and desk audits in order to react to emerging trends affecting the management of TOR, such as the risks related to undervalued imports in some Member States.

<sup>28</sup> See Box 3.2 of our [2019 annual report](#).

## Chapter 4

**Competitiveness for growth and jobs**

# Contents

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<b>Introduction</b>	4.1.-4.5.
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Conclusion	4.38.-4.40.
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<b>Annexes</b>	
Annex 4.1 – Results of transaction testing for ‘Competitiveness for growth and jobs’	
Annex 4.2 – Follow-up of previous recommendations regarding 'Competitiveness for growth and jobs'	

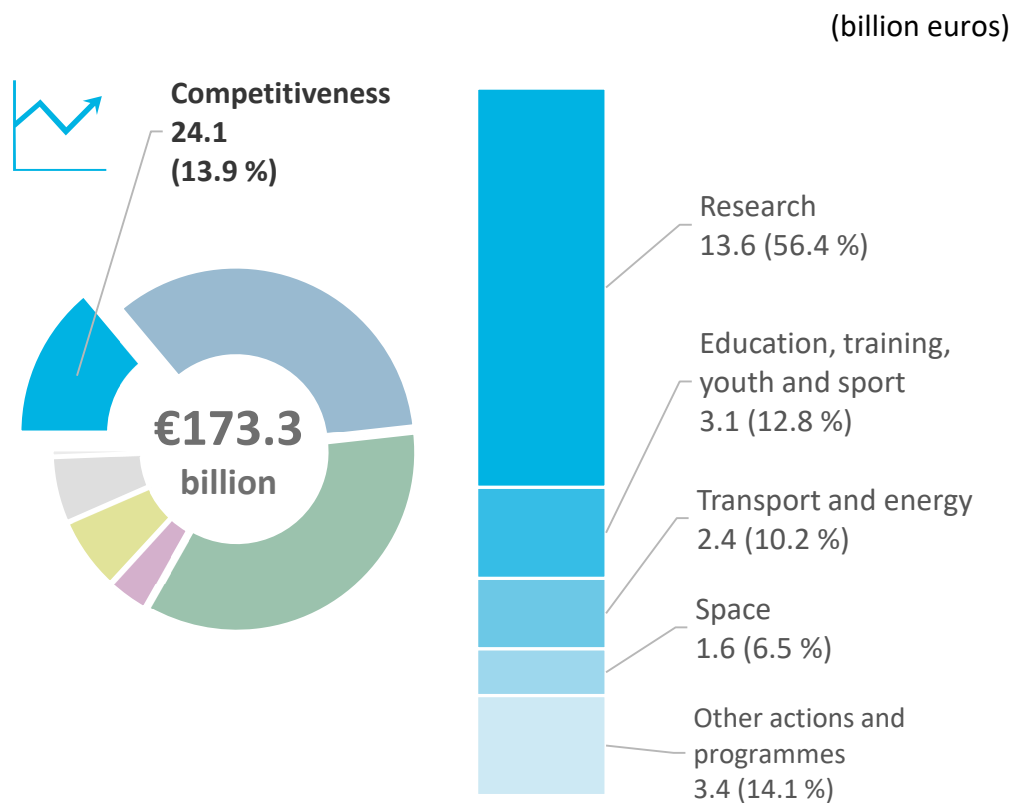
# Introduction

**4.1.** This chapter presents our findings for Multiannual Financial Framework 1a ‘Competitiveness for growth and jobs’ (MFF1a). **Box 4.1** gives an overview of the main activities and spending under this sub-heading in 2020.

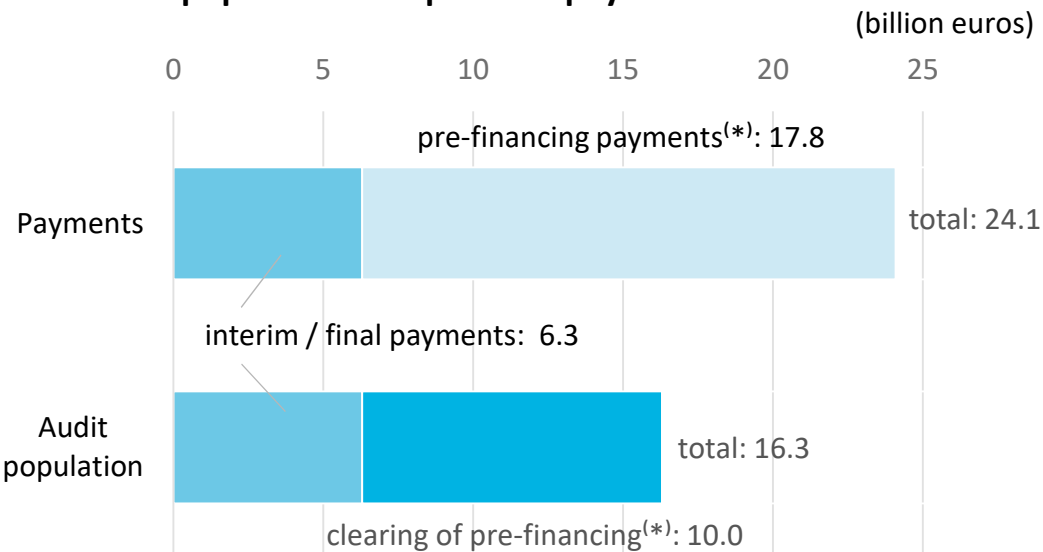
## Box 4.1

### MFF1a ‘Competitiveness for growth and jobs’ – 2020 breakdown

#### 2020 payments as a share of the EU budget and breakdown



### 2020 audit population compared to payments



(\*) In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 11).

Source: 2020 consolidated accounts of the European Union.

## Brief description

**4.2.** The programmes financed under ‘Competitiveness for growth and jobs’ are diverse and aim to foster an inclusive society, stimulate growth, boost research, development and innovation, and create employment in the EU.

**4.3.** The principal programmes are Horizon 2020<sup>1</sup> (H2020) for research and innovation (and its predecessor the Seventh Framework Programme<sup>2</sup>, FP7) and Erasmus+ for education, training, youth and sport. MFF1a also encompasses large infrastructure projects, such as the space programmes Galileo (the EU’s global satellite navigation system) and EGNOS (the European Geostationary Navigation Overlay Service) as well as the EU’s contribution to the International Thermonuclear Experimental Reactor (ITER) and the Connecting Europe Facility (CEF). MFF1a also includes financial instruments such as the European Fund for Strategic Investments (EFSI).

<sup>1</sup> The 2014-2020 Framework Programme for Research and Innovation (Horizon 2020).

<sup>2</sup> The Seventh Framework Programme for Research and Technological Development (2007-2013).

**4.4.** Most spending on these programmes is managed directly by the Commission, including through executive agencies, and takes the form of grants to public or private beneficiaries participating in projects. The Commission provides advances to beneficiaries upon signature of a grant agreement and reimburses the EU-funded costs they report, net of the advances. In the case of Erasmus+, expenditure is mostly managed by national agencies on behalf of the Commission (around 80 % of grants).

## Audit scope and approach

**4.5.** Applying the audit approach and methods set out in **Annex 1.1**, we examined the following for this MFF sub-heading in 2020:

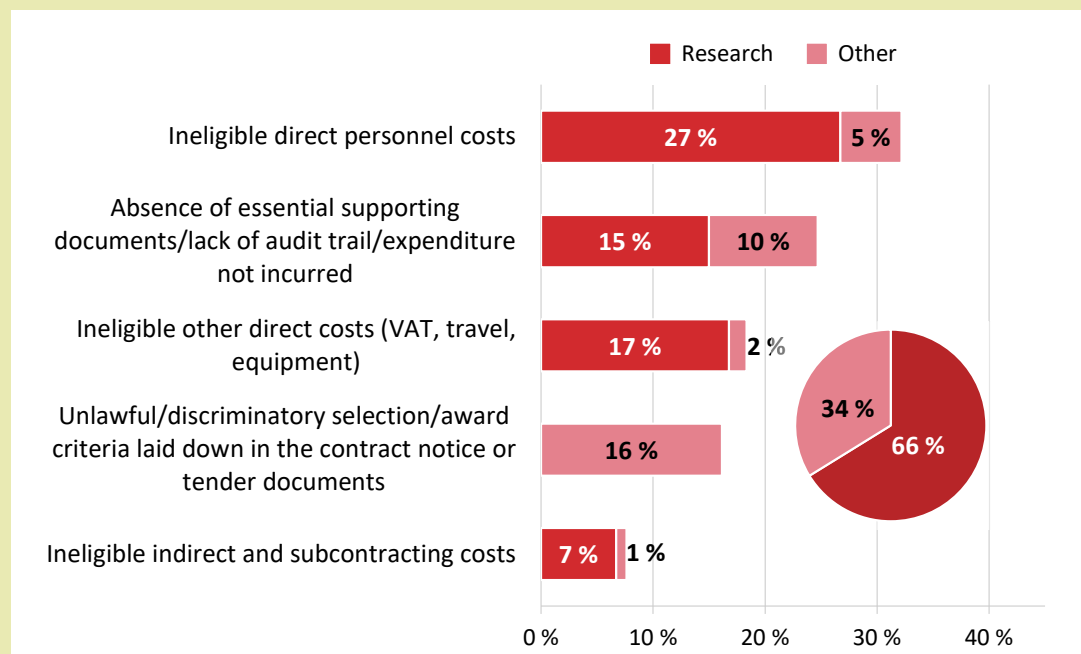
- (a) a sample of 133 transactions, in line with paragraph **9** of **Annex 1.1**. The sample was designed to be representative of the full range of spending under MFF1a. It consisted of 84 transactions in the area of research and innovation (80 for Horizon 2020 and 4 for FP7) and 49 under other programmes and activities, notably the CEF, Erasmus+, financial instruments, and space programmes. The beneficiaries audited were located in 22 Member States and the United Kingdom and five non-EU countries. Our objective was to provide a specific assessment for this MFF sub-heading and to contribute to the overall statement of assurance as described in **Annex 1.1**;
- (b) the regularity information in the annual activity reports of the Directorate-General for Research and Innovation (DG RTD), the Directorate-General for Communications Networks, Content and Technology (DG CONNECT) and the Innovation and Network Executive Agency (INEA), which the Commission then included in its Annual Management and Performance Report (AMPR);
- (c) the Commission's implementation of actions addressing the issues we had identified in previous years regarding the reliability of its *ex post* audit work on the regularity of expenditure under H2020. We focus on these issues every year with a view to possibly making better use of the available regularity information in future.

## Regularity of transactions

**4.6.** *Annex 4.1* provides an overview of the results of transaction testing. Of the 133 transactions we examined, 64 (48 %) contained errors. Based on the 37 errors we have quantified, we estimate the level of error to be 3.9 %<sup>3</sup>. *Box 4.2* gives a breakdown of our estimated level of error for 2020, distinguishing between research and other transactions.

### Box 4.2

#### Breakdown of the estimated level of error by error type



Source: ECA.

**4.7.** FP7 and H2020 spending remains higher-risk and the main source of errors that we detect. We found quantifiable errors relating to ineligible costs in 28 of the 84 research and innovation transactions in the sample. This represents 66 % of our estimated level of error for this sub-heading in 2020.

<sup>3</sup> We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the estimated level of error in the population lies between 1.9 % and 5.8 % (the lower and upper error limits respectively).

**4.8.** We have previously reported on the improvements in the programme design and the Commission's control strategy in respect of H2020<sup>4</sup>. Certain simplifications have made life easier for beneficiaries and contributed to reducing the risk of error. However, the results of our audit work and the Commission's own estimate (see paragraph 4.32) show that this has not reduced the error rate below the 2 % materiality threshold.

**4.9.** In the case of other programmes and activities, we detected quantifiable errors in nine of the 49 transactions in the sample. These included:

- (a) one case of irregularity in a procurement procedure (CEF);
- (b) an essential condition for payment not fulfilled<sup>5</sup> (European Employment Services Programme);
- (c) costs incurred outside the project eligibility period (European Statistical Programme);
- (d) ineligible staff costs (Research Programme of the Research Fund for Coal and Steel and the CEF).

**4.10.** The Commission had applied corrective measures that directly affected six of the transactions we sampled. These measures were relevant to our calculations, as they reduced our estimated level of error for this chapter by 0.12 percentage points. In 14 cases of quantifiable error made by final beneficiaries, the control procedures put in place by the Commission failed to prevent, or to detect and correct, the error before accepting the expenditure. Most of the undetected errors related to personnel costs. Had the Commission, or the auditors contracted by beneficiaries<sup>6</sup>, made proper use of all the information at their disposal, the estimated level of error for this chapter would have been 1.6 percentage points lower.

<sup>4</sup> For example in paragraph 5.13 of the [2018 annual report](#) and in [special report 28/2018](#): "The majority of simplification measures brought into Horizon 2020 have made life easier for beneficiaries, but opportunities to improve still exist".

<sup>5</sup> The beneficiary audited did not seek a written declaration from the future employers of the job applicants stating that the company's employment policy did not cover relocation costs. The purpose of this declaration is to avoid double funding of such costs.

<sup>6</sup> One element of the Commission's control system is the certificates on financial statements issued by auditors contracted by beneficiaries (see paragraph 4.11).

**4.11.** With regard to research expenditure, auditors contracted by the beneficiaries themselves at the end of a project provide certificates on financial statements (CFS). These certificates are intended to help the Commission check whether costs declared in the financial statements are eligible. However, we have repeatedly reported weaknesses in these certificates<sup>7</sup>. We found that ten of the 14 cases of detectable quantifiable errors had not been discovered by the auditors providing the certificates.

**4.12.** Moreover, certain categories of unit costs, such as the costs of providing transnational access to research infrastructure, are not tested by the contracted auditors, as the Commission does not require them to conduct this type of check. While unit costs are generally less prone to error than the reimbursement of actual costs, the number of units claimed may still be incorrect, as shown by our audits. These errors are thus unlikely to be detected by the Commission's control system.

### **Personnel costs continue to constitute the principal source of error, notably in research expenditure**

**4.13.** The rules for declaring personnel costs under H2020 remain complex, despite simplification efforts, and their calculation remains a major source of error in the cost claims. As we reported in our previous annual reports<sup>8</sup> and special report 28/2018, the methodology for calculating personnel costs has become more complex in some respects under H2020, and this has increased the risk of error. Of the 28 transactions affected by quantifiable errors in our sample of research transactions, 20, i.e. more than 70 %, involved incorrect application of the methodology for calculating personnel costs.

**4.14.** We have pointed out in previous annual reports<sup>9</sup> that the rule requiring use of the annual hourly rate applicable in the financial year most recently ended to declare costs relating to the subsequent (non-closed) reporting year leads to errors. Moreover, where the staff have worked exclusively on a given project, this rule creates an additional administrative burden for the beneficiaries and affects the costs that will be reimbursed. The above-mentioned historic rate will not reflect any salary increase the following year. Beneficiaries therefore often do not respect this rule and declare

<sup>7</sup> Paragraphs 5.15 of the [2018 annual report](#) and 4.10 of the [2019 annual report](#).

<sup>8</sup> Paragraphs 5.34 ([2017](#)), 5.16 ([2018](#)) and 4.11 ([2019](#)), and recommendation 1 ([2017](#)) which has still not been fully implemented.

<sup>9</sup> Paragraphs 5.17 ([2018](#)) and 4.12 ([2019](#)).

the costs actually incurred in the non-closed reporting year. We found nine such examples in 2020.

**4.15.** Beneficiaries cannot declare actual salary costs for the financial year underway unless they use the monthly hourly rate. However, our audits showed that the calculations involved in this option are too complex and therefore rarely correct. The main difficulty lies in allocating payments generated over a period of more than a month (such as holiday pay and the thirteenth month salary) to the months in which they were actually earned. The beneficiaries often make mistakes in this allocation, thereby distorting the monthly rates.

**4.16.** Other, less frequent, errors in personnel costs included the use of theoretical salary costs rather than actual figures, ineligible salary elements, ineligible hours worked outside the project eligibility period, and incorrect declaration of costs for staff seconded from linked third parties.

**4.17.** In respect of time recording, owing to the simplifications the Commission introduced into H2020, we observed fewer cases of non-compliance with the formal requirements. However, our checking of time sheets against absence records and statutory holidays revealed that, in many cases, staff still claimed hours worked on the funded projects during absences, public holidays and weekends. The poor quality of the systems increases the risk that the underlying records of hours are unreliable and the costs claimed are overstated. In one case the beneficiary did not present any time records, and we therefore considered all the staff costs ineligible.

### Issues related to subcontracting

**4.18.** When signing a grant agreement with the Commission, beneficiaries should explicitly state which parts of the work will be subcontracted, so that the corresponding costs are eligible, and best value for money is ensured. Distinguishing between own and subcontracted work is also important in determining eligibility to claim indirect costs: beneficiaries are not entitled to claim such costs where tasks are subcontracted, whereas they can claim 25 % of personnel costs for tasks they carry out themselves.

**4.19.** In our work we found several cases where beneficiaries had not had enough staff and had hired external consultants. However, they had not disclosed this fact to the Commission beforehand, and had claimed the cost of the consultants' services as own staff costs, together with the corresponding flat rate for indirect costs. In these cases we found all the costs in question to be ineligible.

**4.20.** This type of error concerned mostly private beneficiaries, for whom it is common practice to use the services of other companies. These beneficiaries were not always aware of the difference in treatment of direct personnel costs and the cost of external consultants under EU funded programmes (H2020 and CEF). The risk of such errors is particularly high in SMEs, which are strongly encouraged to take part in research programmes but may have few or no staff of their own. An example is given in [Box 4.3](#).

#### **Box 4.3**

##### **Example of subcontracting costs declared as direct personnel costs resulting in ineligible indirect costs**

One of the SMEs audited was actually a shell company. It had no payroll staff or premises of its own. The company address was the private residence of one of the SME owners. The company relied on the services of freelancers who worked from other parts of the country or abroad. It declared the payments made to freelancers as direct personnel costs. With regard to their own work on the project, the owners entered into consultancy agreements with their own company. They invoiced their services to the company, and subsequently claimed reimbursement from the EU at rates almost three times higher than the H2020 rates laid down for SME owners not receiving a salary. As a result of the incorrect classification of subcontracting costs as personnel costs, the company also unduly claimed €115 000 in indirect costs for staff and premises it did not have.

**4.21.** Beneficiaries also have difficulty in understanding the difference between the subcontracting of action tasks<sup>10</sup> and the provision of “other goods and services”<sup>11</sup>. This leads to incorrect cost classification in beneficiaries’ claims and has an impact on their entitlement to indirect costs, as described in paragraph 4.18.

## Types of errors in other direct costs

**4.22.** The types of errors we encountered in the other categories of costs included ineligible equipment costs, deductible VAT, costs not incurred, travel unconnected with the project, and incorrect exchange rates. An example of a cost claim involving several of these errors is provided in **Box 4.4**.

### Box 4.4

#### An example of multiple errors in a single cost claim

A beneficiary in the energy sector declared personnel, equipment and other costs. The beneficiary declared over 1 500 hours worked on weekends and public holidays by two employees, over €90 000 of depreciation costs for equipment it did not own, and 20 % ineligible deductible VAT on costs for consumables. The beneficiary also applied different incorrect exchange rates for costs incurred in the local currency.

<sup>10</sup> Subcontracts are concluded for the implementation of action tasks, or parts thereof, referred to in the description of the action.

<sup>11</sup> Contracts to purchase goods, works or services that are unconnected with the implementation of action tasks but necessary for their implementation. This category covers non-research related items, such as the purchase of consumables, dissemination costs, translation, event organisation, etc.

## Review of the regularity information provided by auditees

**4.23.** The Commission uses the results of its *ex post* audit work as a basis for calculating the amount at risk at payment, which it discloses in the DGs' AARs. Around 20 % of *ex post* audits of the entire H2020 family are carried out by DG RTD's Common Audit Service (CAS), and 80 % on its behalf by private audit firms<sup>12</sup> selected through a tendering procedure. The CAS draws its representative sample of approved cost statements for *ex post* audit at intervals of around 18 months.

**4.24.** For both our 2018 and 2019 annual reports, we reviewed a random sample of 20 *ex post* audits from the Commission's representative sample of H2020 payments. We performed this work with a view to possibly making better use of the available regularity information in future. Of the 40 audits we reviewed for the two years, we could not rely on the conclusions in 17 cases<sup>13</sup>.

**4.25.** In 2020 we performed a review of the Commission's *ex post* audit procedures in order to follow up on weaknesses we had identified in previous years and which had been the subject of recommendations in our 2018 and 2019 annual reports. We noted that the CAS took action to improve the quality of its *ex post* audits by, for example, increasing the quality requirements regarding private audit firms in the most recent call for tender, launched in 2020, and providing regular training to the audit firms and in-house auditors.

**4.26.** For all nine representatively selected *ex post* audits (relating to 11 cost statements) started in 2019 or 2020 and completed in 2020, we checked whether the sampling procedures were complied with and whether the CAS reviewed the standard audit checklists that need to be completed for every audit. We also drew a random sample of 10 audits, for which we checked how the CAS applied the corrections to the error rate calculation methodology.

<sup>12</sup> External audit firms that apply the same audit methodology as the CAS auditors.

<sup>13</sup> Paragraphs 5.33 of the [2018 annual report](#) and 4.27 of the [2019 annual report](#).

## **Sampling at the level of the cost statements audited was not always in line with the established procedures**

**4.27.** We found that the CAS's quality reviewers did not verify the sampling performed in-house or by external auditors for their audits. In two cases we detected a breach of the CAS sampling rules, and found that in most cases the information required to re-perform the sampling was available only at the level of the auditors, and had not been requested by the CAS reviewers. Moreover, we found that the CAS does not check whether the private audit firms have filled in the standard audit checklists it has designed for documenting the audit work.

## **Despite the improvements introduced by the Commission, the representative error rate is potentially understated**

**4.28.** In order to rectify the methodological issue previously raised by the ECA which led to an understatement of the error rate<sup>14</sup>, the CAS calculated a top-up based on 790 audits closed in 2020. This resulted in an increase in the error rate of 0.41 percentage points, which was disclosed in the Annual Activity Reports that we reviewed (see paragraph 4.30). We did not find any significant differences in our re-performance of 10 calculations. However, we found that the sampling procedures in two of the 10 cases did not fully comply with the CAS sampling rules for H2020 *ex post* audits.

**4.29.** To address the quantitative findings of the ECA's 2018 and 2019 reviews of 40 *ex post* audits, the CAS calculated an additional increase of 0.13 percentage points in the error rate. This increase was not explicitly disclosed in the AARs. We acknowledge the efforts made by the CAS to quantify the impact, even though the revised rate does not take into account the fact that such errors could also have occurred in the ex-post audits not reviewed by the ECA. Some of our findings were also based on qualitative aspects, such as weaknesses in audit procedures. Thus, the error rate is potentially understated.

<sup>14</sup> The error rate was calculated as a share of all the accepted costs, instead of the amount actually audited. This meant that the denominator in the error calculation was higher, so the error rate was understated; see Paragraph 5.34 of the [2018 annual report](#).

## Annual activity reports and other governance arrangements

**4.30.** The annual activity reports (AARs) we examined<sup>15</sup> reflected the information available and gave a fair assessment of the respective DGs'/Executive Agency's financial management in relation to the regularity of underlying transactions relating to MFF1a expenditure.

**4.31.** The audit work on FP7 is complete. The AARs of DG RTD and DG CONNECT confirm that the cumulative residual error rate for FP7 is above 2 %<sup>16</sup>. Because of the *de minimis* threshold for financial reservations<sup>17</sup> introduced in 2019, neither DG reported a quantified reservation. The same applied to the Research Programme of the Research Fund for Coal and Steel (3.13 %) managed by DG RTD.

**4.32.** With regard to H2020, DG RTD reported an expected representative error rate of 2.95 % for all DGs and other EU bodies managing EU research spending. The residual error rate is 2.24 % for DG RTD and 2.20 % for DG CONNECT. The *ex post* audits underlying the error rates covered payments made over the 2014-2019 period. The audit results for both DGs suggest that the error rate will remain within the range of 2 % to 5 % established by the Commission. The Commission does not consider that a reservation needs to be set for Horizon 2020 expenditure, as the trend is moving towards the ultimate objective of a 2 % residual error rate for the programme.

**4.33.** As regards the CIP and CEF programmes, DG CONNECT reported cumulative residual error rates that exceed by far the materiality threshold of 2 % (7.6 % and 4.75 %). Nevertheless, given the very low value of payments and the low financial impact, no reservation was placed on these programmes, in line with the *de minimis* threshold for financial reservations.

<sup>15</sup> DG RTD, DG CONNECT and INEA.

<sup>16</sup> 3.51 % for DG RTD and 3.22 % for DG CONNECT.

<sup>17</sup> Quantified AAR reservations in respect of residual error rates above the 2 % materiality threshold are deemed 'not substantial' in the case of segments representing less than 5 % of a DG's total payments and with a financial impact below €5 million.

**4.34.** In its AAR, INEA reported a residual error rate of 2.45 % for H2020 and 4.73% for CEF Telecom. INEA did not issue reservations, either in respect of H2020, because of the Commission's materiality threshold for the programme, or CEF Telecom, because of the *de minimis* threshold.

**4.35.** In its 2020 AAR, DG RTD disclosed 22 open IAS recommendations. Four of these were classified as 'very important', two of which related to the CAS's *ex post* audit strategy, and the other two concerned the management of experts. All overdue recommendations had been implemented, and the action plans for all open recommendations have been finalised and approved.

**4.36.** The IAS concluded that the internal control systems in place for the processes it audited are effective at DG CONNECT, as are those at INEA, but for the one very important recommendation resulting from the audit. This recommendation concerns INEA's *ex post* audit methodology for assessing the legality and regularity of amendments to implementing contracts.

**4.37.** We reviewed the information in the Commission's 2020 AMPR regarding the estimated risk at payment in the policy areas under MFF1a. The Commission does not calculate a single rate for MFF1a, but two: one for Research, Industry, Space, Energy and Transport (1.8 %), and another for Other Internal Policies (1.3 %). Based on the Commission's figures, we calculated that the rate for MFF1a as a whole would be 1.6 %. This percentage is both below materiality and our range of estimated level of error. Therefore, in our view, despite the measures already applied by the Commission, this rate is still understated.

# Conclusion and recommendations

## Conclusion

**4.38.** The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘Competitiveness for growth and jobs’ as a whole was material. For this MFF sub-heading, our testing of transactions produced an estimated overall level of error of 3.9 % (see [Annex 4.1](#)). Our results indicate that the level of error remains high for research and innovation expenditure, which was the main source of error, especially personnel costs, and much lower for the rest of the sub-heading.

**4.39.** The Commission has taken action to improve the quality of its *ex post* audits. However, its supervision and review thereof still has weaknesses. It has revised the method for calculating the representative error rate for H2020, leading to an increase of 0.41 percentage points.

**4.40.** The estimated risk at payment presented in the AMPR (1.6 %, as recalculated by us) is both below materiality and our range of estimated level of error.

## Recommendations

**4.41.** [Annex 4.2](#) shows the findings of our follow-up review of the recommendations we made in our 2018 and 2019 annual reports that were due to be implemented by 2020<sup>18</sup>. The Commission had implemented four recommendations in full and two in most respects.

**4.42.** Based on this review and our findings and conclusions for 2020, we recommend that the Commission:

<sup>18</sup> The recommendations we made in our [2017 annual report](#) required action by end of 2018. Therefore, we followed them up in the [2018 annual report](#).

### Recommendation 4.1

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Extend the scope of the certificates on financial statements to include unit cost categories for the new Research Framework Programme, Horizon Europe, in order to increase the level of detection and correction of errors in unit costs.

**Timeframe: 2022**

### Recommendation 4.2

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Implement actions, including a periodical review of the main causes of error in financial statements, providing guidance on complex issues such as subcontracting rules, and conducting information campaigns in order to reduce the error rate for H2020.

**Timeframe: 2021**

### Recommendation 4.3

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Further improve the quality of *ex post* audits by addressing the weaknesses in the sampling procedures at the level of cost statements and apply the corrections to the error calculation method for Horizon Europe.

**Timeframe: 2022**

## Annexes

### Annex 4.1 – Results of transaction testing for ‘Competitiveness for growth and jobs’

	2020	2019
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	133	130
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	3.9 %	4.0 %
Upper Error Limit (UEL)	5.8 %	
Lower Error Limit (LEL)	1.9 %	

## Annex 4.2 – Follow-up of previous recommendations regarding 'Competitiveness for growth and jobs'

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2018	By 2020 the Commission should: <b>Recommendation 1:</b> carry out more targeted checks of SMEs' and new entrants' cost claims and enhance its information campaign on the funding rules, targeting these important beneficiaries.		X				
	By end of 2020 the Commission should: <b>Recommendation 2:</b> as regards the next Research Framework Programme, further simplify the rules for calculating personnel costs and assess the added value of the mechanism for large research infrastructure costs and review how its methodology can be improved.	X <sup>19</sup>					

<sup>19</sup> The Commission has drafted the legislative proposal for Horizon Europe according to which the concept of productive hours and the various prescriptive methods for calculating personnel costs will be discontinued and a unique, simpler calculation based on a daily rate is proposed. This calculation would be performed per calendar year and would no longer be based on the most recently closed financial year. As regards Large Research Infrastructures (LRI), this complex cost category would be replaced by 'internally-invoiced goods and services', for which the eligibility conditions take account of beneficiaries' usual cost accounting practices.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	By mid 2020 the Commission should: <b>Recommendation 3:</b> as regards H2020, address the observations made in the context of our review of the <i>ex post</i> audits concerning documentation, sampling consistency and reporting, as well as the quality of the audit procedures.		x <sup>20</sup>				
	<b>Recommendation 4:</b> promptly address the findings of the Commission's Internal Audit Service concerning: — EACEA's internal control systems on the grant management process for Erasmus+;	x <sup>21</sup>					
2018	<b>Recommendation 4:</b> promptly address the findings of the Commission's Internal Audit Service concerning: — monitoring of compliance with contractual obligations and reporting requirements on	x <sup>22</sup>					

<sup>20</sup> The Commission has introduced measures intended to improve the quality of the ex post audit procedure, but some weaknesses persist (see paragraphs 4.24 and 4.27-4.28). The ECA will verify the effectiveness of these measures in the coming years.

<sup>21</sup> In its follow-up closed in January 2021, the IAS concluded positively on the implementation of its recommendations.

<sup>22</sup> In its follow-up closed in April 2021, the IAS concluded positively on the implementation of its recommendations.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	dissemination and exploitation in research and innovation projects.						
<b>2019</b>	By the end of 2020 the Commission should: <b>Recommendation 3:</b> further simplify the rules on personnel costs under the next Research Framework Programme (Horizon Europe).	X <sup>23</sup>					

Source: ECA.

<sup>23</sup> See footnote <sup>19</sup>.

## Chapter 5

**Economic, social and territorial cohesion**

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Policy objectives and spending instruments	5.2.-5.5.
<b>Audit scope and approach</b>	5.6.-5.12.
<b>Regularity of transactions, AARs and other governance arrangements</b>	5.13.-5.61.
<b>Results of our testing of transactions and review/re-performance of audit work</b>	5.14.-5.36.
Ineligible projects and costs	5.18.-5.26.
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Absence of essential supporting documents	5.35.-5.36.
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<b>Conclusion</b>	5.62.-5.65.
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<b>Annexes</b>	
<b>Annex 5.1 – Results of transaction testing</b>	
<b>Annex 5.2 – Information on EU action in the 27 Member States and the UK (2014-2020)</b>	
<b>Annex 5.3 – Follow-up of previous recommendations for 'Economic, social and territorial cohesion'</b>	

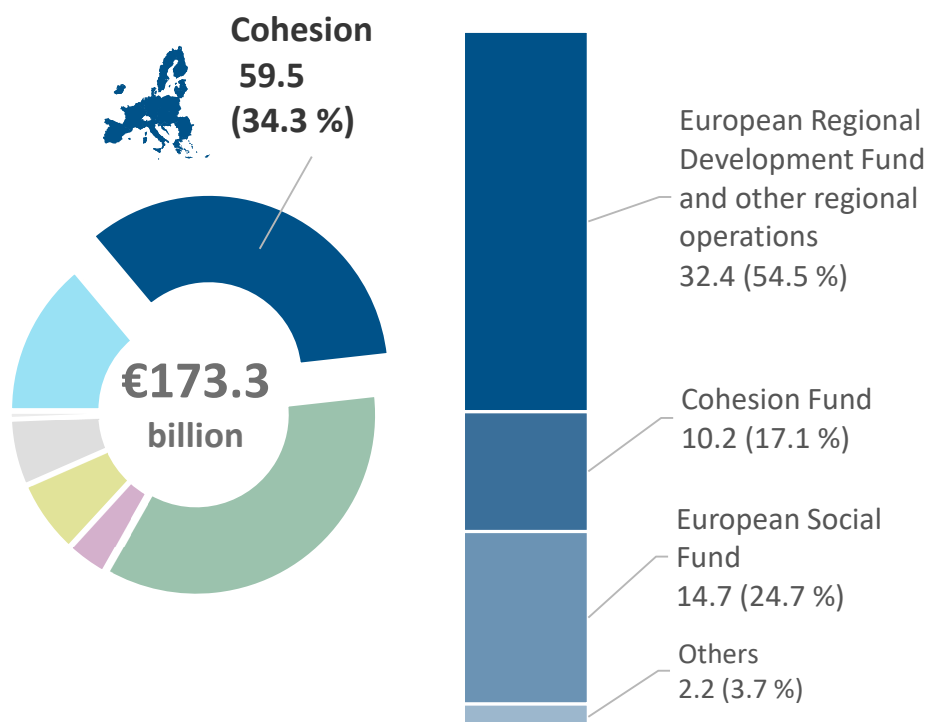
## Introduction

**5.1.** This chapter presents our findings for MFF sub-heading 1b ‘Economic, social and territorial cohesion’. **Box 5.1** gives an overview of the main activities and spending under this heading in 2020. For further details of the 2020 audit population, see paragraph **5.7**.

### Box 5.1

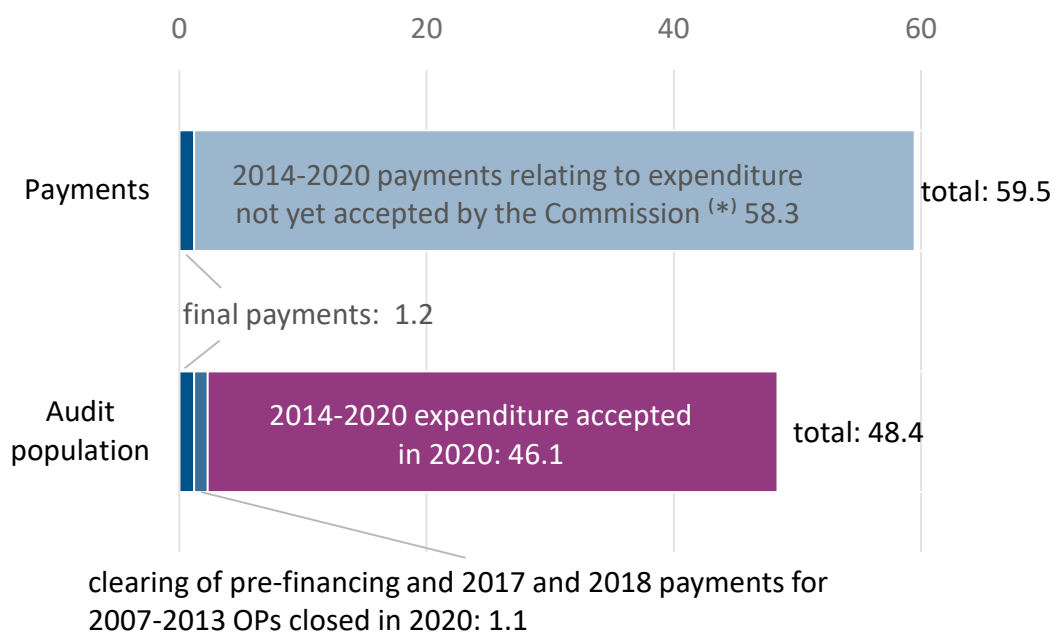
#### MFF sub-heading 1b ‘Economic, social and territorial cohesion’ – 2020 breakdown

**2020 payments as a share of the EU budget and breakdown by fund**  
(billion euros)



### 2020 audit population compared to payments

(billion euros)



(\*) The figure of €58.3 billion consists of annual advances and interim payments for the 2014-2020 programming period that were not included in the accounts underlying the assurance packages which the Commission accepted in 2020. In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 11), these payments are considered pre-financing and thus were not part of our audit population for the 2020 annual report. They will be included in our audit population in the year the Commission accepts the corresponding accounts (e.g. in the 2021 statement of assurance for payments belonging to the 2019/2020 accounting year).

Source: 2020 consolidated accounts of the European Union.

## Brief description

### Policy objectives and spending instruments

**5.2.** Spending under this sub-heading focuses on reducing development disparities between the different Member States and regions of the EU and strengthening all regions' competitiveness<sup>1</sup>. These objectives are implemented:

<sup>1</sup> See Articles 174 to 178 of the Treaty on the Functioning of the European Union (OJ C 326, 26.10.2012, p. 47).

- (a) through the following funds/instruments under shared management:
- the *European Regional Development Fund (ERDF)*, which aims to redress the main regional imbalances through financial support for the creation of infrastructure and productive job-creating investment, mainly by businesses;
  - the *Cohesion Fund (CF)*, which, in the interest of promoting sustainable development, finances environment and transport projects in Member States with a per capita *GNI* of less than 90 % of the EU average;
  - the *European Social Fund (ESF)*, which aims to encourage a high level of employment and the creation of more and better jobs, including measures through the *Youth Employment Initiative (YEI)* targeting regions with a high youth unemployment rate<sup>2</sup>;
  - other smaller schemes, such as the *Fund for European Aid to the Most Deprived (FEAD)*;
- (b) through a contribution from the Cohesion Fund to the *Connecting Europe Facility (CEF)*, which is directly managed by the Commission and finances projects belonging to the *trans-European networks*<sup>3</sup>.

**5.3.** Under this MFF sub-heading, Member States submit multiannual *operational programmes* (OPs) at the beginning of each *programming period* for the entire duration of an MFF. After the Commission has given approval, responsibility for implementing an OP is shared between the Commission (DG Regional and Urban Policy (DG REGIO) and DG Employment, Social Affairs and Inclusion (DG EMPL)) and the Member State. *Beneficiaries* receive reimbursement through authorities in the Member State, and the EU budget co-finances the eligible costs of operations approved in line with the terms of the OP. *Managing authorities* carry out verifications to prevent ineligible expenditure from being certified to the Commission.

<sup>2</sup> The ERDF, CF and ESF are three of the five *European Structural and Investment Funds*, which together are the subject of [Regulation \(EU\) No 1303/2013](#) of the European Parliament and of the Council (the *common provisions regulation*). The other two ESI funds are covered by **chapter 6** of this report.

<sup>3</sup> Regulation (EU) No 1316/2013 of the European Parliament and of the Council of 11 December 2013 establishing the Connecting Europe Facility, amending Regulation (EU) No 913/2010 and repealing Regulations (EC) No 680/2008 and (EC) No 67/2010 ([OJ L 348, 20.12.2013, p. 129](#)).

**5.4.** The control and assurance framework in place for the 2014-2020 programming period<sup>4</sup> aims to ensure that the *residual error rate*<sup>5</sup> in the OPs' annual accounts remains below the 2 % *materiality threshold* set in the applicable regulation<sup>6</sup>. To ensure that no material level of irregularities remains in the accounts to be certified to the Commission after managing authorities' verifications, the control and assurance framework provides for the following three elements:

- The work performed by *audit authorities* on expenditure included in the annual accounts. This work results in an annual control report which Member States submit to the Commission as part of their *assurance packages*. The report contains the residual error rate for the OP (or group of OPs) and an audit opinion on the regularity of declared expenditure and the effective functioning of management and control systems.
- The annual acceptance of the accounts. For this purpose, the Commission carries out mainly administrative checks of completeness and accuracy of the accounts so that it can accept them and release the amount of 10 % retained earlier as a guarantee<sup>7</sup>.
- Commission desk reviews of each assurance package and selected *compliance* audits in Member States. The Commission makes these checks to conclude on and validate the residual error rates reported by audit authorities; it publishes these, together with a weighted average to serve as a key performance indicator, in its *annual activity reports* (AARs) for the following year.

**5.5.** The process leading up to the *closure* of OPs from the 2007-2013 programming period was largely comparable to that described in paragraph 5.4.

<sup>4</sup> We gave full details of the control and assurance framework for the ESI funds, including a timeline, in our [2017](#) (paragraphs 6.5-6.15) and [2018 annual reports](#) (Figure 6.1).

<sup>5</sup> In its AARs the Commission refers to a 'residual risk rate' (RRR) when dealing with closure for the 2007-2013 programming period and to a 'residual total error rate' (RTER) when dealing with the 2014-2020 programming period. In this chapter, we refer to both as 'residual error rate(s)'.

<sup>6</sup> Article 28(11) of Commission Delegated Regulation No 480/2014 of 3 March 2014 supplementing the common provisions regulation ([OJ L 138, 13.5.2014, p. 5](#)).

<sup>7</sup> See Article 130 of the [common provisions regulation](#), which limits the reimbursement of interim payments to 90 %.

## Audit scope and approach

**5.6.** Our objective was to contribute to the overall statement of assurance as described in **Annex 1.1** and to provide an assessment of the regularity of expenditure under MFF sub-heading 1b. By taking account of the characteristics of the control and assurance framework for this spending area, we also aimed to assess the extent to which the audit authorities' and Commission's work can be relied upon.

**5.7.** Applying the audit approach and methods set out in **Annex 1.1**, we examined the following for this MFF sub-heading in 2020:

- a sample of 227 transactions, designed to be statistically representative of the full range of spending under this MFF sub-heading. The sample consisted of 213 transactions for which expenditure had been certified in assurance and closure packages (all of them previously checked by an audit authority), as well as eight *financial instruments* and six CEF projects directly managed by the Commission;
- the work done by audit authorities to validate the information contained in the 29 assurance/closure packages concerned by the 213 transactions they had previously checked;
- the Commission's work to review and validate the residual error rates reported in assurance packages for 2014-2020, and its audit work on regularity aspects of those packages;
- the regularity information given in the annual activity reports of DG REGIO and DG EMPL and then included in the Commission's *Annual Management and Performance Report (AMPR)*.

**5.8.** Our audit population (€48.4 billion) consisted of expenditure from the 2014-2020 period that was included in accepted assurance packages for the 2018/2019 accounting year, 2007-2013 expenditure in the closure packages for OPs which the Commission closed in 2020, and allocations from the Cohesion Fund to the CEF.

**5.9.** In 2020, the Commission accepted accounts with expenditure for 407 out of 418 approved OPs (€44.5 billion). These accounts came from assurance packages submitted by all 27 Member States and the United Kingdom for the 2014-2020 programming period. The Member States reported disbursements to or for the benefit of *final recipients* through financial instruments in the 2018/2019 accounting year under 87 of those OPs (€1.6 billion). In addition, the Commission closed or partially

closed<sup>8</sup> 24 of the 101 remaining OPs (settling €889 million) from the 2007-2013 programming period. This leaves 77 of the remaining OPs to be closed (of these 63 have been partially closed) three years after the closure of the programming period. The CF contribution to the CEF came to around €1.4 billion.

**5.10.** We took our sample of 213 transactions with expenditure certified in assurance and closure packages in two stages. We first selected 29 packages (26 from the 2014-2020 programming period and three from 2007-2013) covering 41 OPs. From those 29 packages we then sampled transactions which the audit authorities had previously checked.

**5.11.** Part of our sample consisted of eight financial instruments from the 2014-2020 period from which payments had been made to or for the benefit of final recipients in the 2018/2019 accounting year. We examined 60 loans, 18 guarantees, two *equity investments* and nine cost items relating to management fees charged by financial intermediaries.

**5.12.** *Annex 5.2* contains a breakdown of our sample of transactions from the 2014-2020 programming period and the number of quantifiable errors we found in the 27 Member States and the United Kingdom.

<sup>8</sup> If issues having a material impact remain open, the Commission settles only the uncontested amount. The balance is settled and the OP closed once all outstanding issues have been resolved.

## Regularity of transactions, AARs and other governance arrangements

**5.13.** This part of the chapter consists of three sub-sections. The first concerns our testing of this year's sample of 227 transactions with a view to providing insight on the main sources of error. The second sub-section concerns our assessment of audit authorities' work, and the third relates to the Commission's work. Our conclusion on the regularity information on cohesion spending contained in the two responsible DGs' AARs and the AMPR is based on our findings from these three sub-sections.

### Results of our testing of transactions and review/re-performance of audit work

**5.14.** *Annex 5.1* provides an overview of the results of our transaction testing. In the 227 transactions we examined, we identified and quantified 23 errors which had not been detected by audit authorities. Taking account of the 64 errors previously found by audit authorities and corrections applied by programme authorities (worth a total of €834 million for both programming periods combined), we estimate the level of error to be 3.5 %<sup>9</sup>.

**5.15.** Audit authorities had reported quantifiable errors in the assurance/closure packages for 64 of the 213 transactions we sampled from assurance and closure packages. These errors concerned ineligible costs (43), public procurement (21), accounting and calculation errors (six), state aid (two), and missing supporting documents (one)<sup>10</sup>. The Member States had applied financial corrections, extrapolating them as necessary, with a view to bringing the residual error rates to or below the materiality threshold of 2 %.

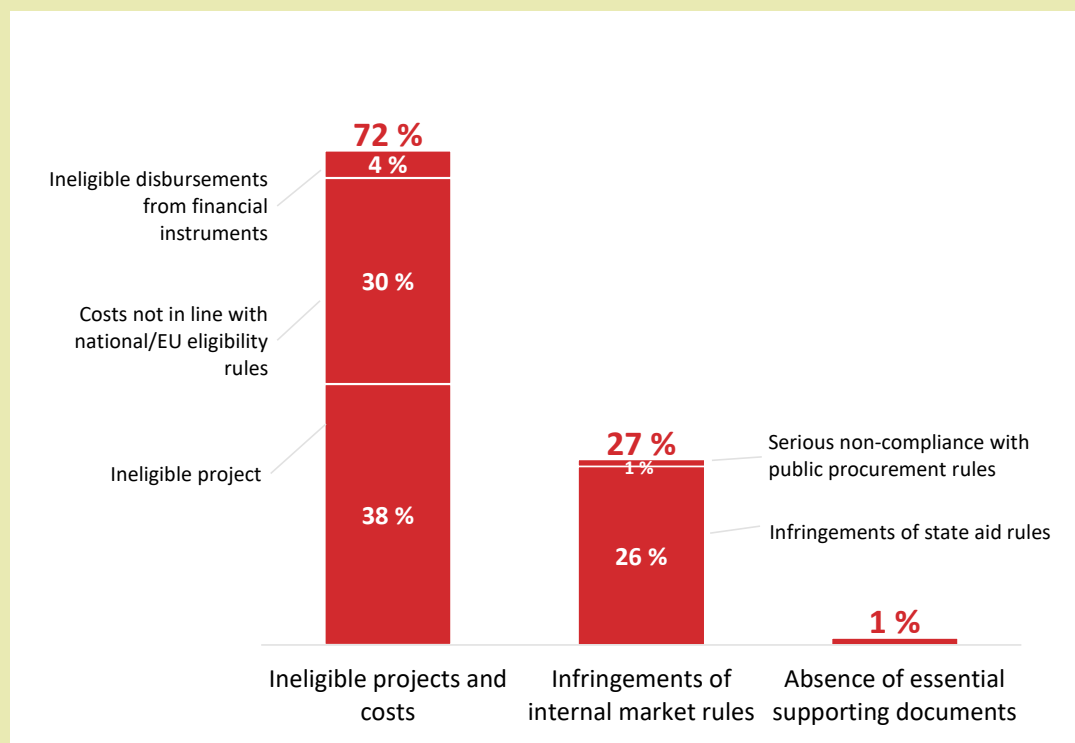
<sup>9</sup> We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the estimated level of error in the population lies between 0.9 % and 6.1 % (the lower and upper error limits respectively).

<sup>10</sup> A single transaction may be affected by more than one type of error.

**5.16.** *Box 5.2* shows how the errors we found break down by category (before taking account of financial corrections). Ineligible projects and costs, infringements of internal market rules (in particular non-compliance with state aid rules) and the absence of essential supporting documents contributed most to our estimated level of error. Paragraphs *5.18-5.36* provide more information on these errors.

### Box 5.2

#### Breakdown of the errors we found



Source: ECA.

**5.17.** The number and impact of the errors detected demonstrate that the controls in place do not yet sufficiently mitigate the high inherent risk of error in this area. This particularly concerns managing authorities whose verifications are ineffective for preventing or detecting irregularities in the expenditure declared by beneficiaries. Other errors are the result of decisions taken by managing authorities themselves.

## Ineligible projects and costs

**5.18.** When Member State authorities declare expenditure to the Commission, they certify that it was incurred in compliance with the applicable EU and national rules and that aid was granted to beneficiaries and operations that met the OP eligibility requirements.

**5.19.** Ineligible projects and costs are the most frequent error found by audit authorities. According to their reporting, using a common typology agreed with the Commission<sup>11</sup>, 46 % of all the errors identified during the 2018/2019 accounting year were of this type.

**5.20.** We found ineligible expenditure in 13 of the transactions we examined, and these cases accounted for 57 % of the number of quantifiable errors we found, or approximately 1.4 percentage points of the estimated level of error. The main causes of ineligible expenditure were cost items or project participants that did not meet the eligibility rules. **Box 5.3** gives an example of this.

### Box 5.3

#### Ineligible staff costs

In a research project in Poland, the staff costs for the project manager were fully declared to the project. However, the grant agreement states that project management is to be covered by a flat rate for indirect costs. For this reason, the costs for the project manager should not have been declared separately and are ineligible.

We also found ineligible costs in cost claims in Portugal and Germany.

**5.21.** We identified three] projects that were granted aid in the 2014-2020 programming period although they did not meet the eligibility conditions of the corresponding OPs. These projects accounted for 13 % of all the quantifiable errors we detected, or approximately 1.5 percentage points of the estimated level of error. **Box 5.4** provides an example of ineligible projects.

<sup>11</sup> See Boxes 6.5 and 5.7 of the [2018](#) and [2019 annual reports](#) respectively.

**Box 5.4****Example with two operations ineligible under the OP**

Article 125(4) of the CPR provides that managing authorities can only select and finance operations that are eligible under the terms of the corresponding OP. We audited the ESF OP in Spain on education, training and employment, for which the aim of the specific objective was to “increase employability and the possibility of hiring people who lack or have very little work experience, through actions that combine training with employment, and through contract types with built-in training”. Therefore, all operations must combine employment with a specific component on training.

Two of the operations we examined concerned the granting of social security exemptions to employers hiring workers with disabilities by virtue of a national law adopted in 2006. Since these two operations did not contain a training component, we consider that they were not eligible under this OP.

These operations might have been eligible under a different ESF OP, on social inclusion and social economy. However, the Spanish authorities had already fully committed the budget for that OP.

**5.22.** In the case of financial instruments, ineligible expenditure mainly takes the form of disbursements either to ineligible final recipients or for ineligible investments. We found errors of this kind in four disbursements from three of the eight instruments we examined. Financial intermediaries had approved three investments without confirming the recipients’ SME status, and we therefore consider these investments to be ineligible. The other investment did not meet other national eligibility requirements. These four irregularities accounted for 0.2 percentage points of our estimated level of error for this chapter.

**5.23.** Beneficiaries made use of *simplified cost options (SCOs)* for 60 operations, or 26 % of our sample, applying either flat rates, standard scales of unit costs or a combination of both. SCOs have the potential to reduce beneficiaries’ administrative workload and are considered to be less prone to error. The EU rules require the methodology for using SCOs to be established in advance, and it must be fair, verifiable and equitable. This year, we found errors relating to SCOs in two operations. None of the errors were quantifiable.

## **The application of Article 14(1) of the ESF Regulation led to an excessive imbalance in favour of a Member State in the first year of implementation**

**5.24.** As a general rule, the Commission reimburses Member States for their payments to beneficiaries of the expenditure they incur when implementing operations. For the ESF, the Commission may also define standard scales of unit costs and lump sums for the reimbursements of these payments<sup>12</sup>. This year, for the first time, our sample included an OP (in Italy) where this reimbursement option was applied. This matter concerned five operations from that OP.

**5.25.** The beneficiaries of these five operations correctly declared eligible costs based on a simplified cost method determined by the managing authority. However, in each case the amount the managing authority declared to the Commission was calculated on the basis of the Commission's standard scales of unit costs<sup>13</sup>. As a result, the amounts certified to the Commission and paid by the EU budget in the 2018/2019 accounting period for each operation concerned were more than 20 % higher than those agreed and paid to the beneficiaries. This arrangement has generated an imbalance in favour of the Member State of more than €43 million in the 2014-2020 period so far.

**5.26.** Although the two calculation methods are different, they essentially cover the same costs. For this reason, the amount of EU funding received by a Member State and then paid on to beneficiaries should not be fundamentally different. As they currently stand, the Commission's standard scales of unit costs for this Italian OP are overly generous for the Member State.

<sup>12</sup> Article 14(1) of Regulation (EU) No 1304/2013 of the European Parliament and of the Council of 17 December 2013 on the European Social Fund and repealing Council Regulation (EC) No 1081/2006 ([OJ L347, 20.12.2013, p. 470](#)).

<sup>13</sup> Commission Delegated Regulation (EU) No 2017/2016 of 29 August 2017 amending Commission Delegated Regulation (EU) 2015/2195 on supplementing Regulation (EU) No 1304/2013 of the European Parliament and of the Council on the European Social Fund, regarding the definition of standard scales of unit costs and lump sums for reimbursement of expenditure by the Commission to Member States ([OJ L 298, 15.11.2017, p. 1](#)).

## Infringements of internal market rules

**5.27.** This year we found 11 infringements of internal market rules, three of which were quantifiable. Five of the infringements related to state aid and six to public procurement.

### Most state aid errors still concern the lack of an incentive effect

**5.28.** Unless below a '*de minimis*' ceiling, state aid is in principle incompatible with the internal market since it may distort trade between Member States. However, there are exceptions to this rule, in particular if the project is covered by the *General Block Exemption Regulation (GBER)*<sup>14</sup> or if the Commission specifically gives its approval.

**5.29.** This year we identified five projects that infringed the EU's state aid rules. We consider that two of them (one CF and one ERDF project), should have obtained no public funding from the EU and/or the Member State. These accounted for 1.0 percentage points of the estimated level of error. We did not quantify the other three errors, which had no impact on the level of public funding. The Commission has developed an action plan (Common State Aid Action Plan 2018-2022) to address the awareness and knowledge of audit authorities. Robust implementation of the plan is essential to address the weaknesses in application of the state aid rules.

**5.30.** Three errors (two of which were quantifiable) concerned the lack of an incentive effect. The EU rules allow state aid only where it subsidises activities which would not have taken place otherwise. Schemes under the GBER are automatically assumed to have an incentive effect if works start after the date of the application for funding<sup>15</sup>. This issue has been a major cause of state aid errors in the last three years. **Box 5.5** gives one example from this year's audit.

<sup>14</sup> Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (OJ L 187, 26.6.2014, p. 1) (GBER).

<sup>15</sup> Article 6 GBER.

**Box 5.5****Example of the lack of an incentive effect**

In Latvia, a large enterprise invested in the recovery of heat energy for use in its production facility. Before submitting the project application, the beneficiary had already completed a procurement procedure, concluded a supply contract and paid a first advance to the supplier. This confirms that the investment started before the beneficiary even applied for EU funding, which therefore had no incentive effect as defined by the EU legislation.

We found one other operation in Portugal that was ineligible because of the lack of an incentive effect.

**Member States had detected many procurement errors**

**5.31.** Public procurement is a key instrument for spending public money economically and efficiently and establishing the internal market. We examined 126 procedures to procure works, services or supplies. The vast majority were for projects co-financed through ERDF/CF OPs.

**5.32.** In six procurement procedures, we identified non-compliance with EU and/or national public procurement rules which the audit authorities had not detected. One case was a serious infringement that affected the outcome of the procedure, and we reported this as a quantifiable error. It accounted for 4 % of all the quantifiable errors we found, or approximately 0.1 percentage points of the estimated level of error. The errors we did not quantify related to the use of criteria or technical specifications that prevented certain companies from bidding.

**5.33.** Procurement is a major source of the irregularities reported by audit authorities. They had detected 21 cases of non-compliance with public procurement rules in the transactions we examined, and had imposed flat-rate corrections ranging from 5 % to 100 %, as provided for in a Commission decision<sup>16</sup>. In terms of frequency, public procurement infringements account for 18 % of all errors audit authorities reported in the 2018/2019 accounting period, but they represent fully 41 % of the value of reported irregularities.

<sup>16</sup> Commission Decision C(2013) 9527, replaced by Commission Decision C(2019) 3452 laying down the guidelines for determining financial corrections to be made to expenditure financed by the Union for non-compliance with the applicable rules on public procurement.

**5.34.** We also found that, as well as infringements being detected through Member State and Commission audits, programme authorities took corrective action in response also to systemic issues. This corrective action enables Member States to replace irregular expenditure. [Box 5.6](#) gives an example.

#### Box 5.6

##### Horizontal flat-rate corrections to correct system deficiencies in public procurement verifications

In 2017, the Commission carried out an early preventive system audit in Hungary to check the suitability of management verifications of public procurement. The audit covered the management and control system which Hungary had set up and was implementing for six OPs. The Commission identified cross-cutting systemic issues with *ex-ante* public procurement verifications. It also found that the programme authorities had failed to identify or inadequately addressed a number of individual irregularities. It concluded by applying a 10 % flat-rate correction to all contracts affected by the lack of appropriate *ex-ante* verifications. The corrections covered a period of four years and had an estimated value of around € 770 million. For the assurance packages we examined, therefore, Hungary withdrew an amount of € 149 million in EU funding in the 2018/2019 accounting year.

#### Absence of essential supporting documents

**5.35.** Beneficiaries and Member State *programme authorities* are required to maintain systems and procedures that ensure an adequate audit trail. This includes the keeping of documentary records. The absence of supporting documents and information made up 19 % of all the errors reported by audit authorities for the 2018/2019 accounting year.

**5.36.** We found that supporting information or documentation was missing in six of the operations we examined. We were compelled to quantify four of these errors because the programme authorities or beneficiaries could not provide essential documents demonstrating compliance with the eligibility conditions. Three of the four cases related to ESF projects from the 2007-2013 programming period. The result accounted for approximately 17 % of the transactions we quantified, and 0.1 percentage points of the estimated level of error.

## Our assessment of the work of audit authorities

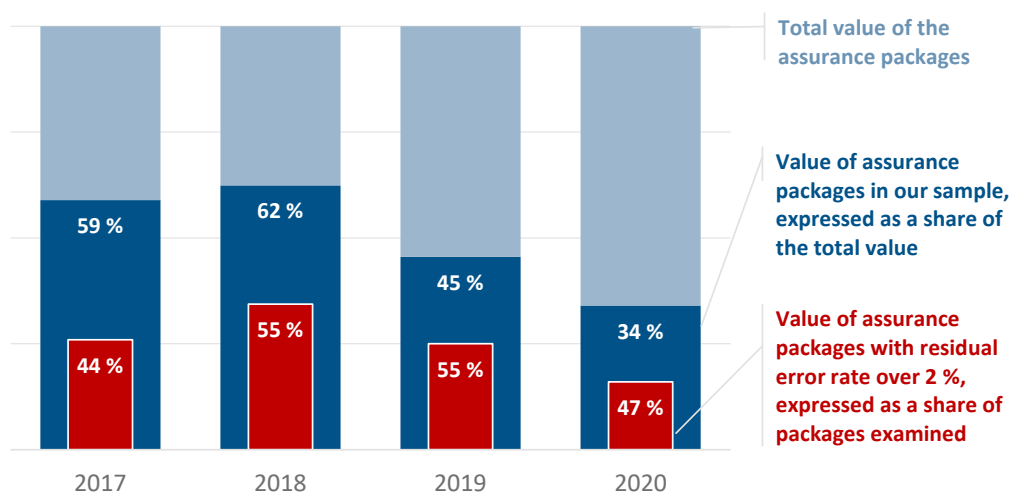
**5.37.** The work of audit authorities is a critical part of the framework for assurance and control of Cohesion spending. Since 2017, we have assessed the work of 34 out of 116 audit authorities, in 22 Member States, including 21 audit authorities in 17 Member States this year.

**5.38.** In all of the assurance and closure packages we examined, the audit authorities had initially reported a residual error rate equal to or below 2 %. The additional errors we detected in our sample of transactions previously checked by audit authorities, and the results of the Commission's review and audit work, indicate that the residual error rates that audit authorities reported were not always reliable. Our work gave us sufficient evidence to conclude that the residual error rate was above 2 % in 12 of the 26 assurance packages (46 %) we examined (47 % of the expenditure sampled).

**5.39.** In its AARs, taking account of its own audit work and the preliminary results of our audits, the Commission adjusted the residual error rate for 11 of the 12 assurance packages in our sample to above 2 %.

**5.40.** In the four years we have been examining 2014-2020 expenditure, the value of assurance packages for which audit authorities have reported unreliable residual rates below 2 % has consistently been around 50 % of the expenditure we have selected for audit (see [Figure 5.1](#)). The share of packages with a residual rate above materiality has also been consistently around half.

**Figure 5.1 – Value of assurance packages with a residual rate above 2 %**



Source: ECA.

**5.41.** Our work on the three closure packages we examined from the 2007-2013 period resulted in a residual error rate for two of them of more than the 2 % materiality threshold.

**Shortcomings remain in the way audit authorities perform and document their work**

**5.42.** The International Standards on Auditing require auditors to document their checks, including clear references to all documents that are most relevant to the audited expenditure<sup>17</sup>. This enables them to be accountable for their work and helps internal or external reviewers to conclude on the extent and sufficiency of the checks. Insufficient or inadequate questions or replies in checklists increase the risk of not detecting irregularities.

**5.43.** For 104 of the transactions in our sample (49 %), we were able to conclude on the basis of our review of audit authorities' work. We identified shortcomings in the scope, quality and/or documentation of that work in 109 transactions (51 %), which required us to re-perform the corresponding audit procedures. The main reason for the shortcomings was the insufficiency of audit documentation held by audit authorities.

**5.44.** In the case of 43 transactions (20 % of the total) we were obliged to approach beneficiaries for the necessary audit documentation. We found quantifiable errors that had not been previously identified by the audit authority in 18 of the 109 transactions (in nine packages, including seven for the 2014-2020 programming period) where we re-performed an audit.

<sup>17</sup> ISA 230 Audit Documentation.

## **Audit authorities need to keep better track of the risk of fraud in their audits of operations**

**5.45.** EU legislation defines fraud as a deliberate infringement that is, or could be, prejudicial to the EU budget. The available information shows that Cohesion presents a higher risk of fraud than other policy areas<sup>18</sup>. While fraud detection is not the auditor's main responsibility, auditors need to be vigilant to the existence of possible indicators of fraud and conflicts of interest. As we concluded in our special report 'Tackling fraud in EU cohesion spending', on-the-spot checks by programme authorities are the most frequent means of detecting fraud<sup>19</sup>.

**5.46.** During our review of the work of the audit authorities, we assessed whether the checklists they used to audit operations adequately addressed the risk of fraud. We found that only 21 % of operations from the 2014-2020 period (40 out of 192) were audited using a checklist with explicit reference to the risk of fraud.

**5.47.** The EU rules require the Member States to report all cases of suspected fraud to the Commission. In two cases in our sample we found that they initially failed to comply with this requirement.

### **It is not easy to follow up amounts under an ongoing assessment**

**5.48.** Under Article 137(2) of the CPR, Member States may exclude from their accounts amounts which have been previously included in a payment claim but for which there is an ongoing assessment of regularity. Any part of such amounts that is subsequently found to be regular may be included in a future payment claim.

**5.49.** The standard form for the reporting of accounts does not include a detailed section for Article 137(2) amounts. Member States are required to disclose these amounts as a total, but not at the level of each operation. It is the certifying authority's responsibility to keep detailed records of operations and amounts under an ongoing assessment, and to monitor whether they are included in subsequent payment claims. Where that is the case, the expenditure concerned should be subject to the same verifications and controls as any other new expenditure<sup>20</sup>. We found that the

<sup>18</sup> 31st annual report on the protection of the European Union's financial interests – Fight against fraud – 2019 (COM(2020) 363 final).

<sup>19</sup> [Special report 06/2019](#).

<sup>20</sup> See the Commission's reply to paragraph 6.34 of our [2016 annual report](#).

Commission does not have adequate information to monitor sufficiently whether these amounts are treated appropriately.

## **The Commission's assurance work and reporting of residual error rate in its annual activity reports**

**5.50.** AARs are the Commission DGs' main tool for reporting whether they have reasonable assurance that control procedures ensure the regularity of expenditure.

### **The Commission has increased the number of its compliance audits**

**5.51.** The reliability of the regularity information reported in the AARs largely depends on the quality of programme authorities' work. The Commission performs compliance audits to review and assess audit authorities' work. As stated by the Commission in the AARs, the objective of these audits is to seek reasonable assurance that no serious weaknesses in management and control systems remain undetected and unreported – and therefore uncorrected – by the time it receives the accounts.

**5.52.** In 2020, the Commission increased the number of its compliance audits to 57 (25 by DG REGIO and 32 by DG EMPL). This compared with 26 in both 2019 and 2018. In 38 of these audits, the Commission concluded that the residual error rates reported in audit authorities' annual control reports for the 2018/2019 accounting year were underestimated; the Commission therefore increased those rates. In 20 cases (11 at DG REGIO and nine at DG EMPL), this raised the residual rate above the 2 % materiality threshold.

**5.53.** The Commission's compliance audits covered 30 of the operations we examined this year (10 in 2019). Before we started our examination, the Commission detected eight quantifiable errors in those operations (six relating to public procurement, one to ineligible costs and one to the wrong application of simplified cost options). We took account of the Commission's capacity to detect these errors and its commitment to correct them in due time, which reduced our estimated level of error by 0.7 percentage points.

**The regularity indicator shows that the overall average error rate was above materiality**

**5.54.** The Commission uses individual residual error rates reported by Member States, the results of its own regularity work and other available information to calculate a weighted average error rate. It reports that rate as a key *performance* indicator (KPI) on regularity. The KPI for 2020 is based on individual rates reported for the 2018/2019 accounting year, but excluding the impact of advances paid to financial instruments.

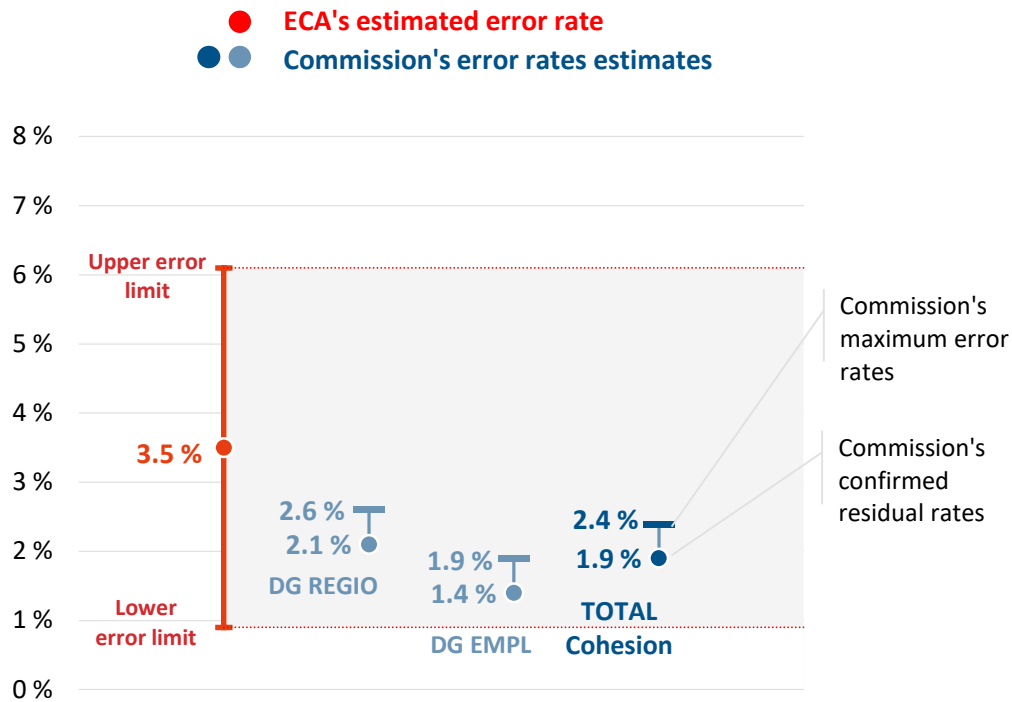
**5.55.** DG REGIO reported a KPI of 2.1 % and a ‘maximum rate’ of 2.6 % (both above the 2 % materiality threshold). The DG EMPL rates were 1.4 % for the KPI and 1.9 % for maximum risk. Both AARs explain that the maximum rates take account of audit results still under discussion with the Member States, as well as any errors lying outside the sample of operations in OPs which either the Commission or we audited during the year. While DG REGIO applied the approach as described in the AAR, DG EMPL did not take full account of possible errors beyond those detected. If DG EMPL had applied the same approach as DG REGIO, its maximum rate would have been 2.1 %.

**5.56.** In our 2018 annual report we concluded that, for various reasons<sup>21</sup>, the overall residual error rate shown as a KPI should be considered a minimum rate. Since it is determined on the basis of the KPI, the risk at closure is also a minimum rate, and future corrections might not be sufficient to ensure that no material level of error remains at closure.

**5.57.** *Figure 5.2* gives an overview of the KPIs reported by the Commission in its 2020 AARs.

<sup>21</sup> Paragraphs 6.62 and 6.63 of the [2018 annual report](#).

**Figure 5.2 – Commission KPIs compared to our estimated error rate**



Source: ECA.

**5.58.** In the 2020 AMPR, the Commission reported a combined overall risk at payment of between 1.9 % and 2.4 %<sup>22</sup> for this MFF sub-heading based on the two DG's estimated amounts at risk and their KPIs. For the second year in a row, the Commission's error estimates therefore fall within our own error range estimate. At the same time, the rates reported in the AMPR (as well as the specific rates reported in both AARs) are below our estimated level of error (see [Figure 5.2](#)).

**5.59.** We are finalising a special report in which we will provide more detail on the relevance, reliability and consistency of the annual level of error reported in the AARs and AMPR for Cohesion expenditure.

<sup>22</sup> Page 72 of Volume II of the 2020 AMPR.

***Reservations might not necessarily cover all material risks***

**5.60.** In our 2019 annual report<sup>23</sup> we concluded that reservations might not cover all material risks, as they were mainly based on the error rates for the 2018/2019 accounts, which had not yet been confirmed in the 2019 AARs. Our analysis this year of the 2018/2019 accounts confirmed that 63 OPs at DG REGIO and 36 at DG EMPL were indeed affected by material errors. However, in the 2019 AARs the Commission did not issue reservations for 39 of these OPs at DG REGIO, or for 28 at DG EMPL in the 2019 AARs.

**5.61.** Last year, both DGs took the same approach to reservations as in the 2019 AARs. It is therefore possible that the 2020 AARs again did not cover all material risks.

<sup>23</sup> Paragraph 5.62 of the [2019 annual report](#).

# Conclusion and recommendation

## Conclusion

**5.62.** The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘Economic, social and territorial cohesion’ was material. For this MFF heading, our testing of transactions produced an estimated overall level of error of 3.5 % (see [Annex 5.1](#)).

**5.63.** The weaknesses found in the work of several audit authorities covered by our sample (see paragraphs [5.37-5.49](#)) currently limit the reliance that can be placed on that work. The recalculated rate was above the 2 % materiality threshold in 12 out of 26 assurance packages for the 2014-2020 period. The Commission adjusted the residual error rates for 11 of these 12 assurance packages to a figure above 2 %. In doing this, it also took account of our audit work. This high rate of adjustments is in line with what we reported in the last four years, as shown in [Figure 5.2](#).

**5.64.** The regularity information figures presented in the AMPR for the 2018/2019 accounting year confirm a material level of error in the Cohesion policy area (2.4 %). Because of the issues reported in paragraph [5.56](#), both Commission rates referred to in paragraph [5.58](#) can only be considered minimum estimates. In this context, we note that the Commission rates fall in the lower half of our error range, below our estimated level of error (see [Figure 5.2](#)).

**5.65.** The control and assurance framework for the 2014-2020 programming period was designed to ensure that annual residual error rates are below the materiality threshold. Our audit showed that further improvements are necessary in the way the framework is applied, by the Member States’ programme authorities and by the Commission.

## Recommendations

**5.66.** [Annex 5.3](#) shows the findings of our follow-up review of the six recommendations we made in our 2017 annual report. Of these, the Commission had implemented four recommendations in most respects and one in some respects, while one had not been acted upon at all.

**5.67.** We also reviewed recommendations from the 2018 and 2019 annual reports that required immediate action or were targeted for implementation during 2020.

**5.68.** Based on this review and our findings and conclusions for 2020, we recommend that the Commission:

### **Recommendation 5.1 – Balanced standard scales of unit costs for reimbursing payments made by Member States**

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Closely monitor Member States using its standard scales of unit costs, to ensure that the scheme does not result in excessive imbalances in favour of Member States. The Commission should ask Member States to adjust excessive rates and correct imbalances to avoid any gains at programme closure.

**Timeframe: Immediate**

### **Recommendation 5.2 – Keeping track of the risk of fraud in audit authorities' audits of operations**

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Encourage audit authorities explicitly to introduce specific questions in their checklists on fraud risks and document the steps taken to address any such risks discovered in the course of an audit.

Audit authorities should work in collaboration with national anti-fraud coordination services (AFCOSs) and take account of cases of suspected or established fraud reported to the Commission via the Irregularities Management System (IMS). We also refer to our recommendations in special report 06/2019.

**Timeframe: June 2022**

### **Recommendation 5.3 – Follow-up of amounts under an ongoing assessment**

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Ask Member States to make available sufficient information available in the annual summary on conclusions and follow-up of operations for which they have withdrawn amounts under an ongoing assessment from the accounts. This would enhance transparency about the way programme authorities monitor these amounts.

**Timeframe: 2022**

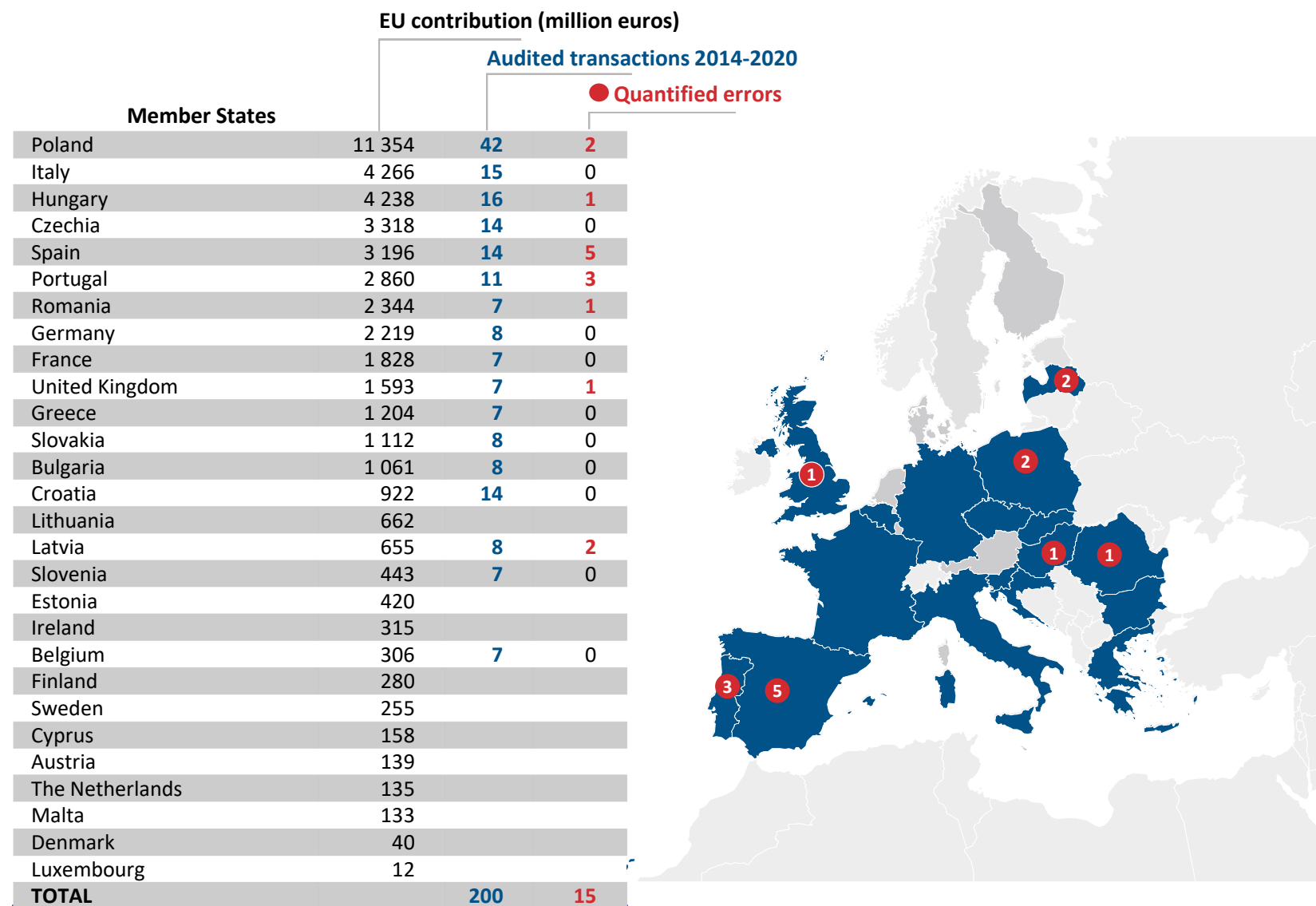
# Annexes

## Annex 5.1 – Results of transaction testing

### RESULTS OF TRANSACTION TESTING FOR 'ECONOMIC, SOCIAL AND TERRITORIAL COHESION'

	2020	2019
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	227	236
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	3.5 %	4.4 %
Upper error limit (UEL)	6.1 %	
Lower error limit (LEL)	0.9 %	

## Annex 5.2 – Information on EU action in the 27 Member States and the UK (2014-2020)



Source: ECA.

### Annex 5.3 – Follow-up of previous recommendations for ‘Economic, social and territorial cohesion’

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2017	<p>We recommend that the Commission:</p> <p><b>Recommendation 1:</b> ensure that the audit arrangements for financial instruments managed by the EIF are adequate at the level of financial intermediaries. When the EIB/EIF uses agreed-upon procedures with external auditors, the Commission should define the minimum conditions of such contracts with a view to the need to provide assurance, in particular the obligation for sufficient audit work at the level of the Member State;</p> <p>(Implementation date: immediate)</p>		X <sup>24</sup>				

<sup>24</sup> The *Omnibus Regulation* introduced a requirement for audit authorities to perform system audits and audits of operations on financial instruments at the level of financial intermediaries, including financial instruments managed by the EIB Group but excluding SME Initiative programmes set up before 2 August 2018. The Commission has taken additional measures by including, in the audit methodology for financial instruments, a recommendation that audit authorities audit financial intermediaries for instruments implemented by the EIB Group, regardless of when they were set up. However, the methodology cannot extend the regulatory mandate of audit authorities. The Commission provided proof that in some Member States the audit authorities already perform checks at the level of financial intermediaries. However, our 2020 audit revealed that these checks are not yet performed consistently (in the Member State we audited, neither the external auditor nor the audit authorities carried out any audits at the level of financial intermediaries).

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	<b>Recommendation 2:</b> propose legislative changes for the post-2020 financial framework which would exclude reimbursement of VAT to public bodies from EU funds; (Implementation date: before approval of the post-2020 legislative framework)				X <sup>25</sup>		
	<b>Recommendation 3:</b> address the weaknesses we have identified in its verification of the audit authorities' work in the context of the Commission's regularity audits; (Implementation date: immediate)		X <sup>26</sup>				
	<b>Recommendation 4:</b> address the complexity of the information presented on the 2014-2020 control and assurance framework in the AARs of DGs REGIO and EMPL, by:  (i) focusing on expenditure that has gone through the control cycle, i.e. assurance packages covering expenditure before 30 June 'n-1'. For this	X <sup>27</sup>	X				

<sup>25</sup> In 2018 the Commission made an alternative proposal to make VAT eligible for projects below a total cost of €5 million. The new common provisions regulation for the 2021-2027 period ([Regulation \(EU\) 2021/1060](#)) has not addressed the problem.

<sup>26</sup> See paragraphs 6.58-6.64 of the [2018 annual report](#) and 5.48-5.62 of the [2019 annual report](#). Although the Commission increased the number of compliance audits it carried out in 2020, we still encounter weaknesses in the audit authorities' work.

<sup>27</sup> Points (i) and (ii) are fully implemented since the Commission has adjusted its reporting and adopted a KPI which focuses on expenditure that has gone through the control cycle.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	<p>purpose, the Commission should adjust its reporting to ensure that it does not present provisional estimates;</p> <p>(ii) clearly indicating which expenditure has not yet been examined in depth (including regularity checks). It should indicate which preventive actions protect the EU budget and whether these actions are sufficient to provide assurance, but refrain from calculating a residual rate for expenditure that has not yet been examined.</p> <p>(iii) disclosing an overall residual error rate for MFF subheading 1b for each accounting year. (Implementation date: June 2019)</p>	x <sup>27</sup>					
	<b>Recommendation 5:</b> ensure that audit arrangements are changed in accordance with the proposal made by the Commission for financial instruments in the post-2020 regulatory framework so that only the actual use of funds at final recipient level is used for the calculation of residual error rates.		x <sup>29</sup>				

<sup>28</sup> Point (iii) is implemented in most respects since in the AMPR the Commission provides an overall residual error rate for the policy area which does not fully correspond to MFF sub-heading 1b.

<sup>29</sup> The new common provisions regulation for the 2021-2027 period ([Regulation \(EU\) 2021/1060](#)) provides for a single advance payment for financial instruments to be included in the first payment application. The Commission intends before the end of 2021 to adopt a delegated act requiring audit authorities to exclude this advance from the audit population.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	(Implementation date: before implementation of the post-2020 legislative framework begins)						
	<b>Recommendation 6:</b> carry out sufficient regularity checks to conclude on the effectiveness of audit authorities' work and obtain reasonable assurance on the regularity of expenditure at the latest in the AARs it publishes following the year of accepting the accounts; (Implementation date: immediate)			x <sup>30</sup>			
<b>2018</b>	We recommend that the Commission: <b>Recommendation 6.1 - Audit arrangements for SME Initiative programmes</b> Ensure that: (a) regular checks, based on a representative sample of disbursements to final recipients, are carried out at the level of financial intermediaries either by the audit authority or by an auditor selected by the EIB Group;		x <sup>31</sup>				

<sup>30</sup> See paragraph 6.64 of the [2018 annual report](#). Although the Commission has increased the number of regularity checks, this regularity work cannot be considered finished at the time the Commission publishes its AAR following the year of accepting the accounts.

<sup>31</sup> Our previous audits confirmed that the EIF has already made or is making improvements to its monitoring and control systems and has voluntarily extended the use of reasonable assurance reports to SMEI programmes. While we acknowledge that some audit authorities have already carried out verifications at the level of financial intermediaries, it is still too early to assess the full effectiveness of these measures.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	(b) where such checks were insufficient, develop and implement appropriate control measures to prevent the possibility of material irregular expenditure at closure. (Target implementation date: immediate)						
	<b>Recommendation 6.2 – Irregular withholding of payments</b> Take the necessary steps to ensure that the checklists used by managing and audit authorities include verifications of compliance with Article 132 of the Common Provisions Regulation, which states that beneficiaries must receive the total amount of eligible expenditure due no later than 90 days from the date of submission of the related payment claim. Where relevant, make appropriate recommendations to programme authorities and encourage them to follow correct practice in the future. (Target implementation date: immediate)	X <sup>32</sup>					
	<b>Recommendation 6.3 – 2014-2020 closure arrangements</b> Address weaknesses and ensure that no programme can be closed with a material level of irregular expenditure. The Commission should:	X <sup>33</sup>					

<sup>32</sup> The Commission consistently checks that payments are made to beneficiaries on time and issues corrective recommendations to Member States as necessary.

<sup>33</sup> The Commission has identified the main risks that may affect the closure of programmes and took them into account when drafting closure guidelines.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	(a) identify the main risks that may affect the regular closure of programmes; (b) (...) (Target implementation date: (a) May 2020)						
2019	We recommend that the Commission: <b>Recommendation 5.1 - Project eligibility conditions</b> Clarify what is meant by 'physically completed' and/or 'fully implemented' operations. This would help Member States to verify that operations comply with Article 65(6) of the CPR and avoid the non-detection of ineligible operations. It should be made clear that this condition relates only to works or activities necessary to achieve the operation's output, and not to financial and administrative aspects. (Timeframe: immediate)		X <sup>34</sup>				

Source: ECA.

<sup>34</sup> We acknowledge the measures which the Commission has already initiated in order to clarify the concepts of 'physically completed'/'fully implemented' operations. However, the Commission has not disseminated those clarifications to all Member States.

## Chapter 6

### Natural resources

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<b>Conclusion</b>	6.40.-6.41.
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## **Annexes**

**Annex 6.1 – Results of transaction testing**

**Annex 6.2 – Information on EU action in Member States and the UK**

**Annex 6.3 – Follow-up of previous recommendations**

# Introduction

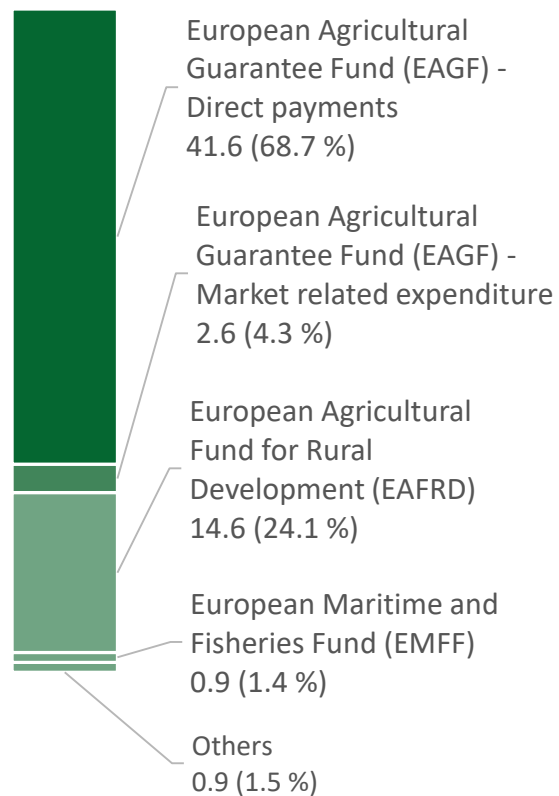
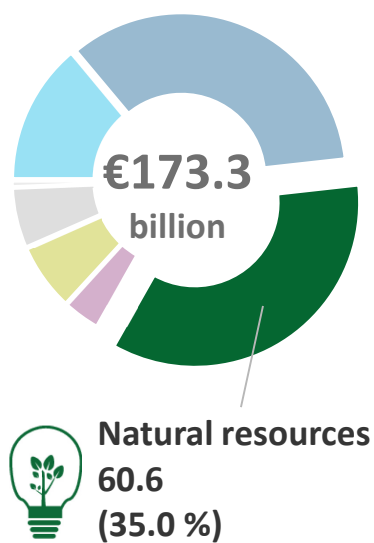
**6.1.** This chapter presents our findings for MFF heading 2 ‘Natural resources’. **Box 6.1** gives an overview of the main activities and spending under this heading in 2020.

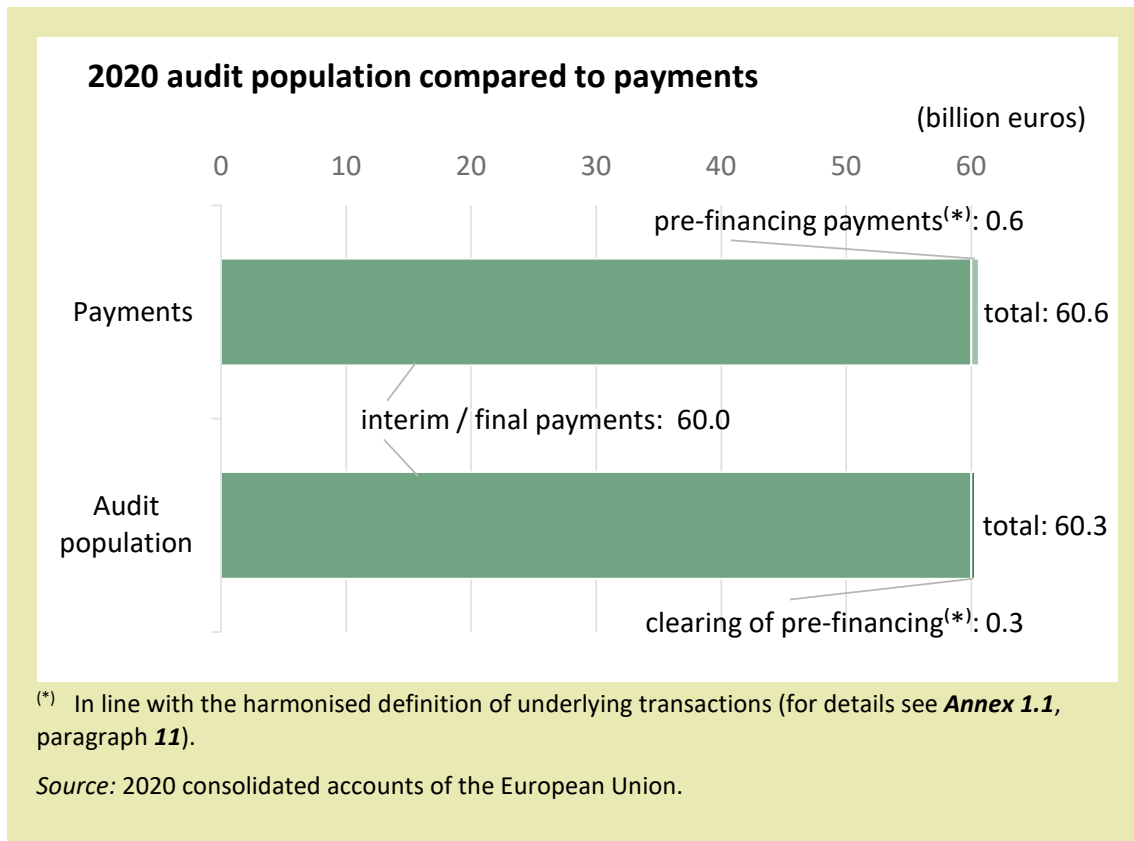
## Box 6.1

### MFF heading 2 ‘Natural resources’ – 2020 breakdown

#### 2020 payments as a share of the EU budget and breakdown

(billion euros)





## Brief description

**6.2.** Agriculture and rural development account for 97 % of spending on 'Natural resources' and are implemented through the *common agricultural policy* (CAP). The CAP has three general objectives<sup>1</sup>:

- viable food production, with a focus on agricultural income, agricultural productivity and price stability;
- the sustainable management of natural resources and climate action, with a focus on greenhouse gas emissions, biodiversity, soil and water;
- balanced territorial development.

<sup>1</sup> Article 110(2) of Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy (OJ L 347, 20.12.2013, p. 549).

**6.3.** While the Commission, in particular the Directorate-General for Agriculture and Rural Development (DG AGRI), is ultimately responsible for the CAP, it shares its management with *paying agencies* in the Member States. Since 2015, independent *certification bodies* in the Member States provide annual opinions on the regularity of the paying agencies' spending.

**6.4.** CAP spending falls into three broad categories:

- *direct payments* to farmers, fully funded by the EU budget;
- agricultural *market measures*, also fully funded by the EU budget, with the exception of certain measures co-financed by the Member States, including promotion measures;
- Member States' national and regional *rural development programmes*, co-financed by the EU budget and the Member States.

**6.5.** This MFF heading also covers EU spending on the *common fisheries policy*, and part of EU spending on the environment and climate action.

## Audit scope and approach

### 6.6. Applying the audit approach and methods set out in **Annex 1.1**, we examined:

- (a) a sample of 218 transactions<sup>2</sup>, in line with paragraph 9 of **Annex 1.1**. The sample was designed to be representative of the full range of spending under this MFF heading. It consisted of transactions from 19 Member States<sup>3</sup> and the United Kingdom. Due to the COVID-19 outbreak, and in order to gain additional insight into the control system, for direct payments we drew our sample from the paying agencies' random on-the-spot inspections. As we had obtained from the Member States a sample of payments to beneficiaries who had been subject to random on-the-spot checks, we had to adjust our error rate to account for claims that had been examined by the paying agencies, on which they did not make payment or had not made payment at the time we drew our sample. Our objective was to contribute to the overall statement of assurance as described in **Annex 1.1**.
- (b) the regularity information given in the annual activity reports (AARs) of DG AGRI and of the Directorate-General for Environment (DG ENV) and then included in the Commission's Annual Management and Performance Report (AMPR).
- (c) selected systems, which concerned the Member States' implementation of 'checks by monitoring'<sup>4</sup>.

<sup>2</sup> The sample consisted of 88 direct payments, 16 market measures, 104 payments under rural development programmes, 1 refund to a Member State by the Commission of a previous financial correction under the CAP and 9 payments for the environment, climate action and fisheries.

<sup>3</sup> Bulgaria, Germany, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Hungary, Netherlands, Austria, Poland, Portugal, Romania, Slovenia, Slovakia, Finland, and Sweden. The sample also included four transactions under *direct management*.

<sup>4</sup> Paragraphs 6.16 to 6.17 of our [2019 annual report](#).

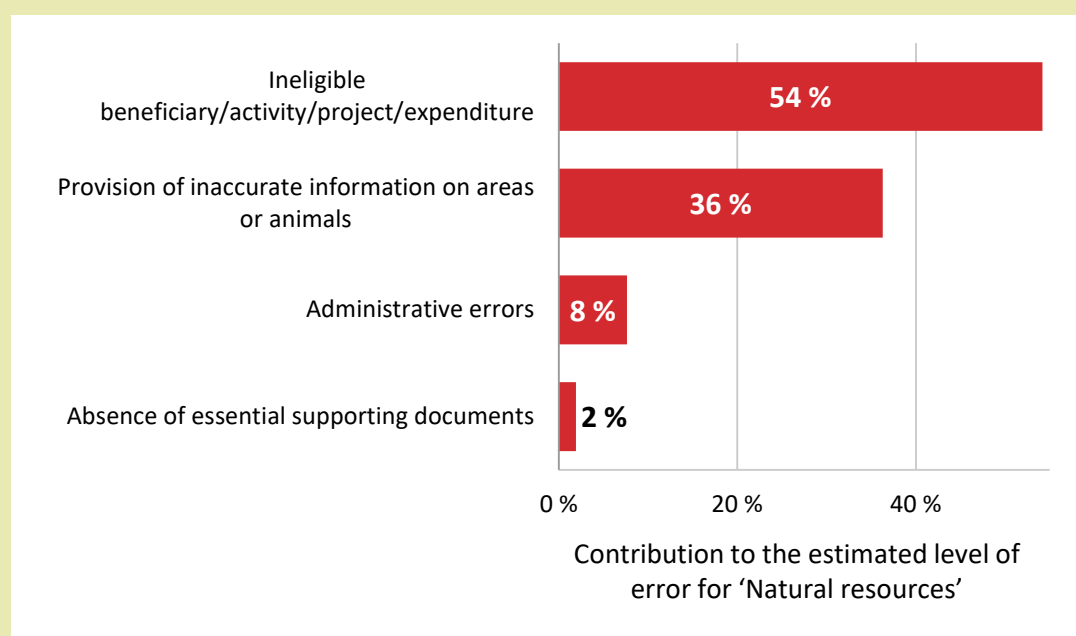
## Regularity of transactions

**6.7.** *Annex 6.1* provides an overview of the results of transaction testing. Of the 218 transactions examined, 180 (83 %) were error-free and 38 contained errors. Based on the 25 errors<sup>5</sup> we have quantified, we estimate the level of error for 'Natural resources' to be 2.0 %<sup>6</sup>.

**6.8.** *Box 6.2* gives a breakdown of our estimated level of error for 2020.

### Box 6.2

#### Natural resources: types of errors



Source: ECA.

**6.9.** The Commission (for direct expenditure) and the Member State authorities had applied corrective measures which reduced our estimated level of error for this chapter by 0.5 percentage points.

<sup>5</sup> We also found 13 compliance issues, which had no financial impact.

<sup>6</sup> We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the estimated level of error in the population lies between 1.0 % and 3.0 % (the lower and upper error limits respectively).

## Direct payments: an effective control system limits the risk of error

**6.10.** Our work supports the conclusion that direct payments as a whole were free from material error. These account for 69 % of spending under the MFF heading 'Natural resources'.

**6.11.** Four schemes account for 90 % of all direct payments in 2020:

- (a) two providing income support based on the area of agricultural land declared by farmers: the 'basic payment scheme' (€17.1 billion) and the 'single area payment scheme' (€4.4 billion);
- (b) one intended to support agricultural practices beneficial for the climate and the environment (the 'greening' payment) (€11.9 billion);
- (c) voluntary coupled support, linked to specific types of agricultural produce (e.g. beef and veal, milk or protein crops) (€4.1 billion).

**6.12.** We tested 88 direct payments, covering the main schemes. We found that 76 transactions were unaffected by error. Direct payments to farmers are entitlement-based: beneficiaries receive payment if they meet certain conditions. Such payments carry a lower risk of error provided the attached conditions are not complex (see paragraph **1.18**).

**6.13.** The 10 quantified errors in these schemes resulted from farmers overstating the eligible area of agricultural land or number of animals in their aid claims.

**6.14.** We detected compliance issues without financial impact in two direct payments.

## The Integrated Administration and Control System restricts the levels of error in direct payments

**6.15.** The main management tool for direct payments is the *Integrated Administration and Control System* (IACS)<sup>7</sup>, which incorporates the *Land Parcel Identification System* (LPIS). IACS interlinks databases of holdings, aid claims, agricultural areas and animal registries, which the paying agencies use to perform administrative cross-checks on all aid applications. LPIS is a geographical information system containing multiple-source spatial data sets, which together form a record of agricultural areas in the Member States.

**6.16.** Our findings confirm our previous observations<sup>8</sup> that IACS, and the LPIS in particular, form an effective management and control system to ensure that direct aid payments as a whole are not affected by material error.

**6.17.** According to EU rules<sup>9</sup>, paying agencies should perform on-the-spot checks of at least 5 % of applicants. Between 1 % and 1.25 % of applicants must be selected randomly. In 2020, we drew our sample of direct payments from the paying agencies' random samples of on-the-spot inspections and reviewed their work to assess the level of error in the payments. This provided additional insight into the paying agencies' work. For the transactions we examined we found that paying agencies had properly updated the LPIS and, with one exception, detected and corrected any over-declaration remaining after their administrative checks.

<sup>7</sup> [https://ec.europa.eu/agriculture/direct-support/iacs\\_en](https://ec.europa.eu/agriculture/direct-support/iacs_en)

<sup>8</sup> Paragraph 6.15 of our [2019 annual report](#).

<sup>9</sup> Articles 30 to 31 and 33 of Commission Implementing Regulation (EU) No 809/2014 of 17 July 2014 laying down rules for the application of Regulation (EU) No 1306/2013 of the European Parliament and of the Council with regard to the integrated administration and control system, rural development measures and cross compliance ([OJ L 227, 31.7.2014, p. 69](#)).

## Checks by monitoring: limited coverage in 2020

**6.18.** Since 2018, Member State paying agencies may perform ‘checks by monitoring’. This approach uses automated processes based on the EU Copernicus programme’s Sentinel satellite data to check compliance with certain CAP rules. So far, paying agencies have mainly used checks by monitoring to assess area-based aid claims under direct payment schemes. Where all eligibility criteria of a given payment scheme can be evaluated from space, it enables paying agencies to monitor the whole population of aid recipients remotely.

**6.19.** In our recent special report on the use of new imaging technologies to monitor the CAP, we recommended the Commission to promote checks by monitoring as a key control system for the post-2020 CAP<sup>10</sup>.

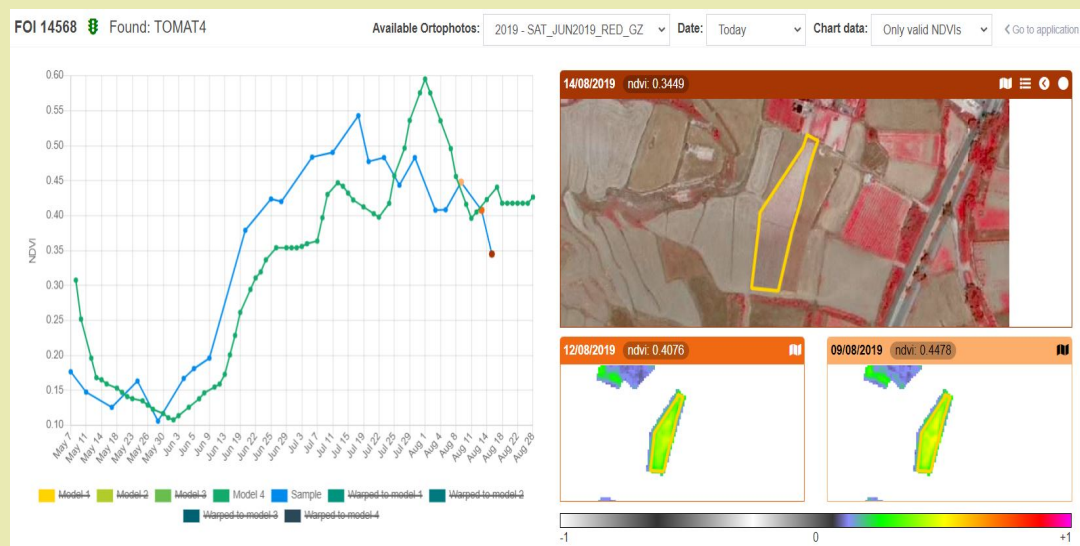
**6.20.** During our 2020 Statement of Assurance work, we reviewed two paying agencies’ use of checks by monitoring, focusing on the voluntary coupled support scheme for tomato farmers in Malta and the basic payment scheme in Belgium (Flanders). We found that these paying agencies had used checks by monitoring to prevent a number of overpayments. **Box 6.3** shows an example of the use of checks by monitoring by the Maltese paying agency.

<sup>10</sup> See our [special report 04/2020](#) ‘Using new imaging technologies to monitor the Common Agricultural Policy: steady progress overall, but slower for climate and environment monitoring’, paragraph 82.

### Box 6.3

#### Checks by monitoring in practice

The Agriculture and Rural Payments Agency in Malta used checks by monitoring to assess tomato farmers' claims for voluntary coupled support. The monitoring system uses regular satellite observations of the agricultural parcels during the growing season to establish a series of crop growth markers (the blue curve in the chart below). These markers can be compared to the expected growth pattern for a crop of tomatoes (the 'vegetation index' shown by the green curve). If there is insufficient correlation between the markers derived from satellite observations and the expected growth pattern, the system automatically flags these parcels for further investigation (e.g. a field visit). The corresponding orthophoto in the LPIS confirms the cultivation of tomatoes.



Source: Agriculture and Rural Payments Agency, Malta.

**6.21.** Checks by monitoring provide regular observations of agricultural activity and can be used to warn farmers of potential non-compliance with the payment scheme rules at any time during the growing season. This provides farmers with more opportunities to rectify their claims before they are finalised.

**6.22.** The Commission has committed itself to providing support to the Member States in developing the new approach of checks by monitoring. At the end of 2020, the area of the main direct aid schemes (basic payments and single area payments) subject to checks by monitoring was 5.7 %<sup>11</sup>.

<sup>11</sup> DG AGRI annual activity report, Annex 2, page 25.

## Rural development, market measures and other 'Natural resources' spending areas: more complex eligibility conditions increase the risk of error

**6.23.** We tested 104 transactions under rural development programmes, 16 transactions related to market measures, a refund to a Member State of a previous Commission financial correction under the CAP<sup>12</sup> and 9 transactions<sup>13</sup> under spending areas outside the CAP. Compared to direct payments, most of the spending for rural development, market measures and other MFF2 policy areas (including reimbursement of costs declared by beneficiaries) is subject to more complex eligibility conditions, which increases the risk of error (see paragraph **1.18**).

**6.24.** [Annex 6.2](#) presents an overview of 2020 payments under shared management and the results of transaction testing in these higher-risk areas for each Member State and the United Kingdom.

### Rural development

**6.25.** The Commission approved 118 rural development programmes in the Member States for 2014-2020<sup>14</sup>. The programmes include 20 measures<sup>15</sup> and 67 sub-measures, falling into two broad categories of spending:

- (a) aid to investment projects intended to support social and economic development in rural areas;

<sup>12</sup> Following the judgment of the General Court of 29 November 2018, Spain v Commission, [T-459/16](#) and the judgment of the General Court of 20 March 2019, Spain v Commission, [T-237/17](#).

<sup>13</sup> We audited four transactions under the European Maritime and Fisheries Fund, one transaction related to a closure payment for the 2007-2013 European Fisheries Fund, two transactions under Fisheries Partnership Agreements, and two transactions related to the LIFE programme for the environment and climate action.

<sup>14</sup> Following delays in adopting the legislation for the post-2020 CAP, the programmes have been extended to the end of 2022. Under the United Kingdom Withdrawal Agreement, the United Kingdom rural development programmes will run until their closure in 2023.

<sup>15</sup> A further measure was added in 2020 to provide exceptional temporary support in response to the COVID-19 outbreak ([Regulation \(EU\) 2020/872 of the European Parliament and of the Council](#)). The first Commission disbursement based on Member States' declared expenditure under the new measure took place in 2021.

- (b) payments to farmers based on environmental and climate-related criteria applied to the agricultural area or number of animals on the holding.

**6.26.** Our transaction testing covered payments under 19 programmes in 15 Member States.

**6.27.** Of the 104 rural development transactions we tested, 87 were unaffected by error. Out of 11 cases where we found and quantified errors, 5 of them had an impact exceeding 20 %. We detected compliance issues without financial impact in six payments.

**6.28.** We examined 54 payments to investment projects, such the modernisation of farms, construction of processing facilities for agricultural products, support for community-led local development, setting-up of young farmers in a rural area, or support for basic services and village renewal in rural areas.

**6.29.** We found quantified errors in seven payments to investment projects, mostly resulting from beneficiaries declaring expenditure or activities, which did not meet the eligibility conditions of their project (see [Box 6.4](#)). In two cases the error was below 2 %, and in two between 2 % and 20 %. We also found three transactions affected by errors exceeding 20 %.

#### **Box 6.4**

##### **Example of ineligible expenditure in a rural development project**

We audited a payment for a rural development project in Croatia that supported blueberry cultivation including the installation of an irrigation system.

Investments in irrigation are only eligible for EU financing if they fulfil the requirements laid down in EU legislation promoting a sustainable use of water. These include the existence or installation of water metering.

The beneficiary had submitted documents indicating that a water meter was part of the project and the paying agency accepted expenditure related to the irrigation system. However, we found that no meter had been installed, making the irrigation component ineligible for EU financing.

**6.30.** We examined 50 payments based on the area or animal numbers declared by farmers, linked to requirements to comply with environmental and climate-related criteria, and to animal welfare. These include compensation payments to farmers in areas with natural constraints and payments for meeting specific *agri-environment-climate commitments*, or for organic farming.

**6.31.** Paying agencies use IACS to check the area-based element of farmers' aid claims under these measures, limiting the risk of errors related to the eligible area. We found two cases of minor (below 2 %) over-declarations of the eligible area. However, we found two transactions affected by errors exceeding 20 %: in one case, the farmer did not comply with the minimum stocking density for animals, and in another case the paying agency incorrectly calculated the penalty for over-declaration.

### Market measures

**6.32.** Agricultural market measures form a number of diverse schemes, subject to a variety of eligibility conditions. We tested 16 transactions and found 3 cases where paying agencies had reimbursed ineligible costs. In two of these cases, the error exceeded 20 %. We detected a non-compliance issue without financial impact in one case.

### Fisheries, the environment and climate action

**6.33.** The selection criteria and eligibility requirements for projects in fisheries, the environment and climate action also vary. Among the nine transactions we examined, we found one quantified error resulting from the declaration and reimbursement of ineligible expenditure. We detected compliance issues without financial impact in four cases.

## Annual activity reports and other governance arrangements

### DG AGRI's reporting on the regularity of CAP spending

**6.34.** Each paying agency director provides DG AGRI with an annual management declaration on the effectiveness of their agency's control systems, and the legality and regularity of their payments. The Member States report on their administrative and on-the-spot checks ('control statistics').

**6.35.** Since 2015, in order to provide additional assurance, certification bodies have been required to give an annual opinion for each paying agency on the legality and regularity of the expenditure for which Member States have requested reimbursement.

**6.36.** DG AGRI uses the error rates reported in the control statistics, making adjustments based on the results of the certification bodies' audits, and its own checks of paying agencies' systems and spending, to calculate a figure for 'risk at payment' for direct payments, rural development and market measures. The adjustments stemming from DG AGRI's own work generally consisted of flat-rate amounts, applying a set of criteria it has to make *financial corrections*, seeking to standardise its treatment of issues identified in the Member States' management and control systems. DG AGRI deducts its estimate of future financial corrections and recoveries from the 'risk at payment' to estimate a 'final amount at risk'.

**6.37.** The control statistics reported by the paying agencies indicated a level of error equivalent to 0.9 % of CAP spending as a whole. DG AGRI, taking into account the work of the certification bodies, calculated the 'risk at payment' to be around 1.9 % for CAP spending as a whole in 2020.

## The Commission's AMPR

**6.38.** The Commission's estimate of risk at payment for 'Natural resources' presented in its AMPR is 1.9 %

## CAP anti-fraud policies and procedures

**6.39.** The paying agencies are required to have systems in place to prevent and detect fraud, and the Commission must obtain reasonable assurance on the operation of those systems. In our 2019 annual report, we identified some weaknesses in CAP anti-fraud policies and procedures, and made a recommendation to tackle the issues<sup>16</sup>. In 2021, we have carried out a performance audit of the Commission and Member States' anti-fraud measures in the CAP. We plan to publish a special report on this issue, also covering the related issue of 'land grabbing', by the end of this year.

<sup>16</sup> Paragraphs 6.34 to 6.41 and paragraph 6.44 of our [2019 annual report](#).

# Conclusion and recommendations

## Conclusion

**6.40.** The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘Natural resources’ was close to materiality. For this MFF heading, our testing of transactions produced an estimated overall level of error of 2.0 % (see [Annex 6.1](#)).

**6.41.** Our results indicate that the level of error was not material for direct payments, representing 69 % of spending under this MFF heading, and that it was, taken as a whole, material for the spending areas we had identified as higher risk (rural development, market measures, fisheries, the environment and climate action), representing 31 % of spending.

## Recommendations

**6.42.** [Annex 6.3](#) shows the findings of our follow-up review of Recommendation 4 we made in our 2017 annual report, which was targeted for implementation in 2020<sup>17</sup>. The Commission had implemented the recommendation in full.

<sup>17</sup> We made three other recommendations in 2017, which we followed up in [Annex 6.3](#) of our 2019 annual report.

# Annexes

## Annex 6.1 – Results of transaction testing

	2020	2019
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	218	251
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	2.0 %	1.9 %
Upper Error Limit (UEL)	3.0 %	
Lower Error Limit (LEL)	1.0 %	

## Annex 6.2 – Information on EU action in Member States and the UK

### Payments and results of transaction testing in 2020 for each Member State and the UK for rural development, market measures and fisheries under shared management

(million euros)

Member States	Total payments				Audited transactions	
	Rural development				Quantified errors	
	Market Measures		Fisheries			
France	2 555	1 934	551	70	13	1
Italy	2 294	1 526	678	90	12	3
Spain	1 960	1 222	600	138	12	2
Germany	1 502	1 356	117	29	6	-
Poland	1 342	1 206	38	98	13	1
Romania	1 243	1 151	66	26	12	1
United Kingdom	837	767	41	29	10	-
Portugal	744	580	108	56	10	1
Greece	628	528	59	41	-	-
Hungary	613	565	40	8	4	-
Austria	596	573	22	1	8	2
Czechia	425	404	17	4	-	-
Ireland	417	334	59	24	4	1
Croatia	412	359	13	40	4	1
Sweden	348	326	12	10	8	2
Bulgaria	332	303	18	11	-	-
Finland	325	305	6	14	4	-
Slovakia	205	194	11	-	-	-
Lithuania	200	190	3	7	-	-
Netherlands	170	129	23	18	2	-
Latvia	167	150	3	14	-	-
Belgium	159	89	61	9	-	-
Slovenia	135	126	7	2	4	-
Denmark	133	96	12	25	-	-
Estonia	116	101	1	14	-	-
Cyprus	33	22	6	5	-	-
Malta	21	18	-	3	-	-
Luxembourg	15	14	1	-	-	-

Member States  
with audited transactions



Source: ECA based on Commission data.

### Annex 6.3 – Follow-up of previous recommendations

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2017	We recommend that the Commission should: <b>Recommendation 4:</b> Monitor progress made by paying agencies in supporting farmers not yet using the GSAA and promote best practices, in order to maximise the benefits and achieve full implementation of the new system within the regulatory deadlines.	X					

Source: ECA.

## Chapter 7

### Security and citizenship

# Contents

	Paragraph
<b>Introduction</b>	7.1.-7.8.
<b>Brief description</b>	7.2.-7.7.
<b>Audit scope and approach</b>	7.8.
<b>Regularity of transactions</b>	7.9.-7.10.
<b>Examination of elements of internal control systems</b>	7.11.-7.13.
<b>Review of audit authorities' work in relation to their annual control reports and audits of expenditure</b>	7.11.-7.13.
<b>Annual activity reports and other governance arrangements</b>	7.14.-7.15.
<b>Conclusion and recommendations</b>	7.16.-7.17.
<b>Conclusion</b>	7.16.
<b>Recommendations</b>	7.17.
<b>Annex 7.1 – Follow-up of previous recommendations for 'Security and citizenship'</b>	

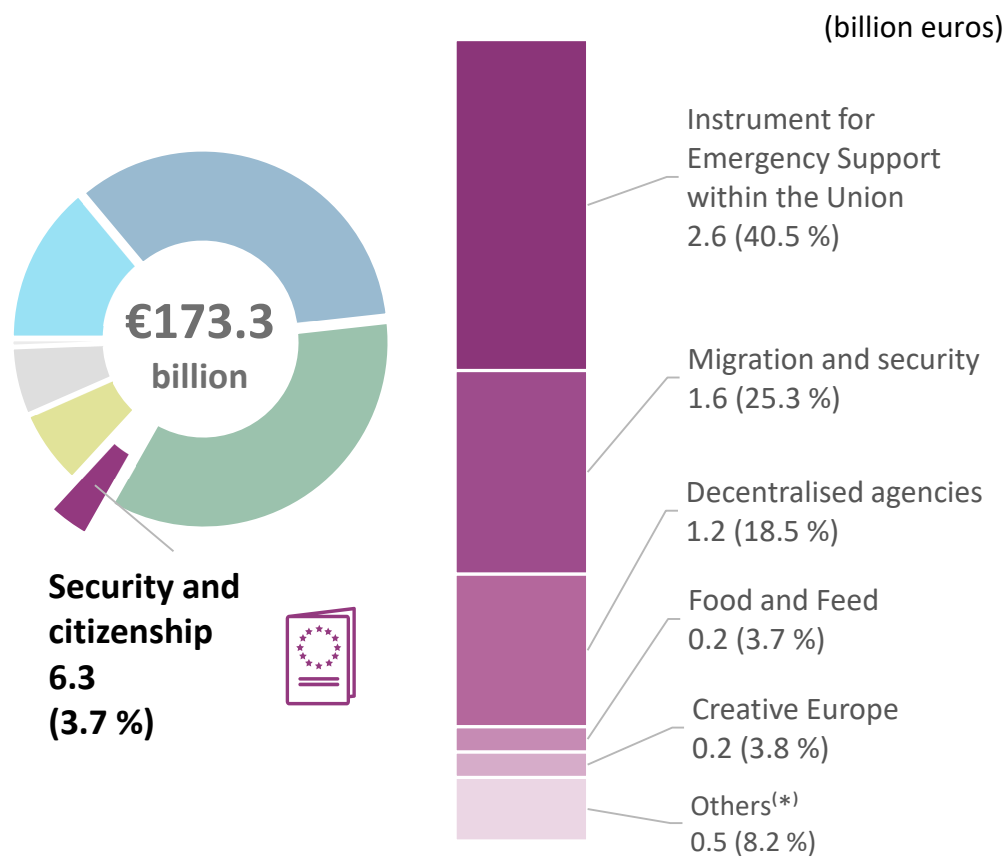
# Introduction

**7.1.** This chapter presents our findings for MFF heading 3 ‘Security and citizenship’. **Box 7.1** gives an overview of the main activities and spending under this heading in 2020.

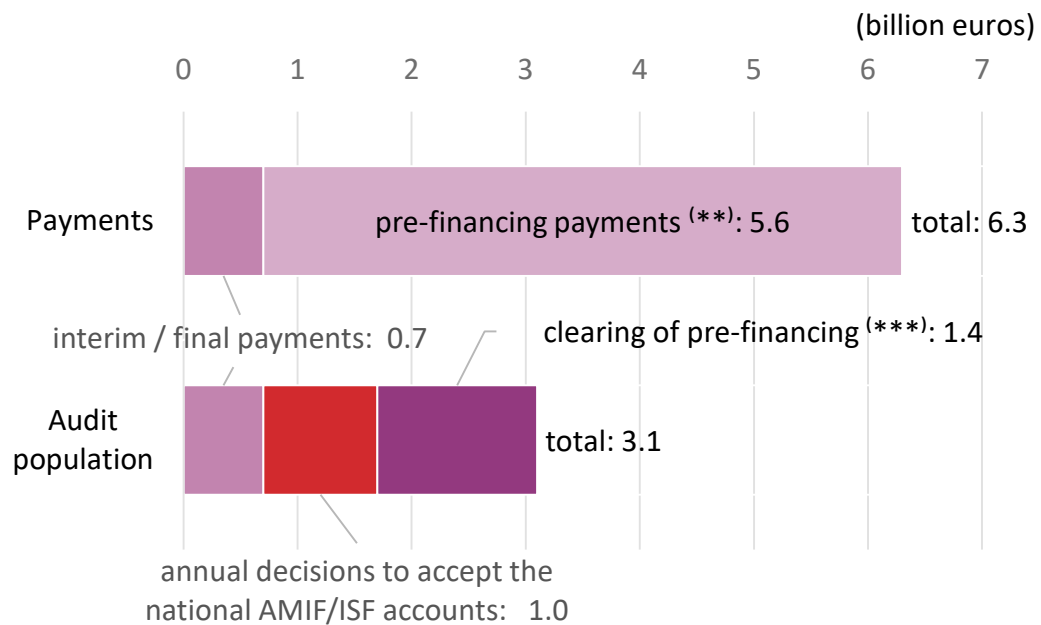
## Box 7.1

### MFF heading 3 ‘Security and citizenship’ – 2020 breakdown

#### 2020 payments as a share of the EU budget and breakdown



### 2020 audit population compared to payments



(\*) Includes spending on 'consumers', 'justice', and 'rights, equality and citizenship'.

(\*\*) Pre-financing includes shared management payments for the 2014-2020 programming period that were not included in the accounts underlying the assurance packages which the Commission accepted in 2020.

(\*\*\*) Clearings of pre-financing are in line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph **11**).

Source: 2020 consolidated accounts of the European Union.

## Brief description

**7.2.** This heading covers a range of policies whose common objective is to strengthen the concept of European citizenship by creating an area of freedom, justice and security without internal borders.

**7.3.** As shown in [Box 7.1](#), the most significant area of expenditure concerns the Emergency Support Instrument (ESI). This was set up in April 2020<sup>1</sup> to help EU Member States address the COVID-19 pandemic by funding, among other things, the cross-border transfer and transport of patients, medical staff and essential medical items; research into and production of vaccines and treatments; and the development, purchase and distribution of testing supplies.

**7.4.** Migration and security also represents a significant share of the budget heading. Spending in this area comes from two funds – the Asylum, Migration and Integration Fund (AMIF) and the Internal Security Fund (ISF). The management of most AMIF and ISF funding is shared between the Member States (or associated countries) and the Commission’s DG for Migration and Home Affairs (DG HOME). The objective of AMIF<sup>2</sup> is to contribute to the effective management of migration flows and bring about a common EU approach to asylum and immigration. The overall aim of the ISF is to ensure security in the EU while facilitating legitimate travel and respecting fundamental freedoms and human rights. It operates through two instruments<sup>3</sup>: ISF Borders and Visa and ISF Police.

**7.5.** Under the shared management arrangement, Member States implement multiannual AMIF and ISF national programmes that were approved by the Commission. Six years into the seven-year programming period, Member States have again stepped up their national programmes. Despite this, significant amounts remain undisbursed, and the pressure on national authorities may increase still further as programmes head towards closure. [Box 7.2](#) summarises expenditure that Member States have reported to the Commission for reimbursement since the beginning of the programming period.

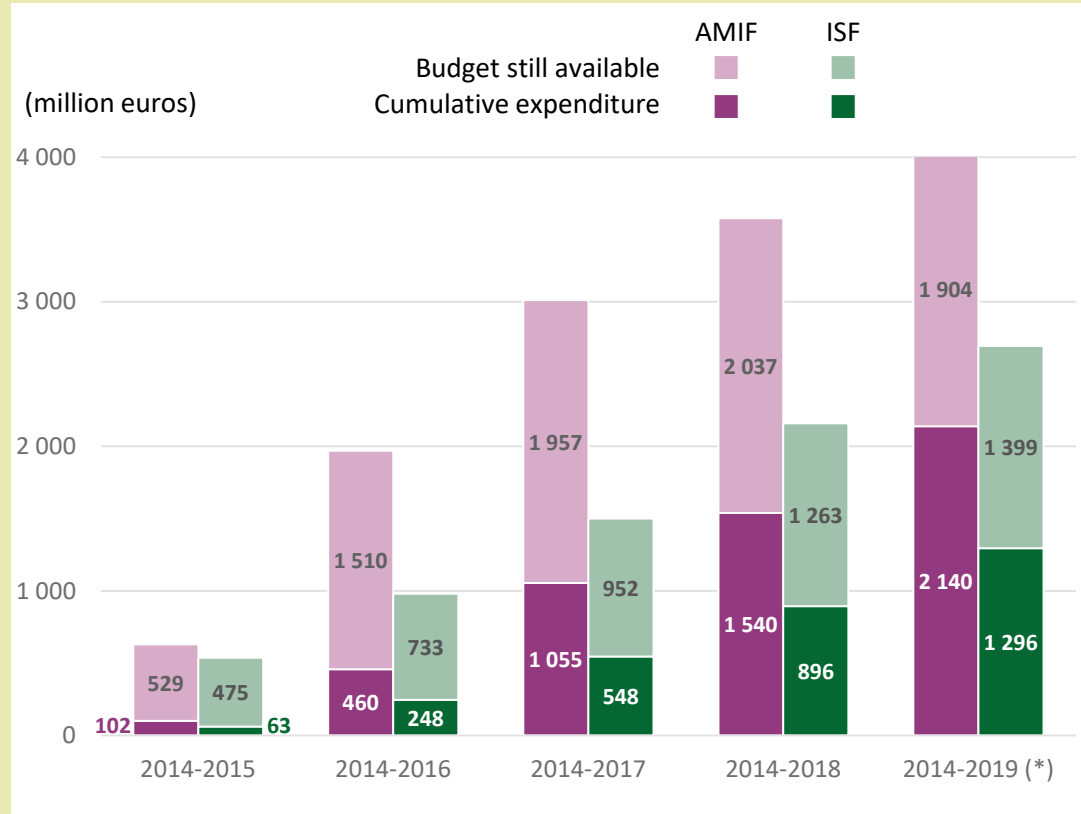
<sup>1</sup> See [Council Regulation \(EU\) 2020/521](#) of 14 April 2020 activating the emergency support under Regulation (EU) 2016/369, and amending its provisions taking into account the COVID-19 outbreak.

<sup>2</sup> See [Regulation \(EU\) No 516/2014](#) of the European Parliament and of the Council of 16 April 2014 establishing the Asylum, Migration and Integration Fund.

<sup>3</sup> See [Regulation \(EU\) No 515/2014](#) of the European Parliament and of the Council of 16 April 2014 establishing, as part of the Internal Security Fund, the instrument for financial support for external borders and visa and [Regulation \(EU\) No 513/2014](#) of the European Parliament and of the Council of 16 April 2014 establishing, as part of the Internal Security Fund, the instrument for financial support for police cooperation, preventing and combating crime, and crisis management.

### Box 7.2

Expenditure on AMIF and ISF national programmes has accelerated, but much of the budget still remains



(\*) AMIF/ISF expenditure at Member State level is declared to and approved by the Commission the year after it is incurred. Thus, the Commission's accounts for 2020 show Member State spending from 2019.

Source: ECA based on European Commission data (national programmes and clearance decisions until end of 2020).

**7.6.** In the case of AMIF and ISF Union actions (transnational actions or actions of particular interest to the EU as a whole), which are directly managed by DG HOME, COVID-19 pandemic restrictions delayed project activities. As a result of this, and of the fact that a large number of advances had been paid in 2019, there were significantly fewer payments in 2020 than in previous years.

### 7.7. Other significant areas of expenditure are:

- o funding for the European Public Prosecutor's Office and 12 decentralised agencies<sup>4</sup> that are active in the implementation of key EU priorities in the areas of migration and security, judicial cooperation and health;
- o the 'Food and Feed' programme, which aims to ensure human, animal and plant health at all stages of the food chain;
- o 'Creative Europe', the EU framework programme of support for culture and the audio-visual sector; and
- o a number of programmes whose common objective is to strengthen security and citizenship in the EU by focusing on justice, consumers, civil protection, or rights, equality and citizenship.

### Audit scope and approach

**7.8.** Applying the audit approach and methods set out in **Annex 1.1**, we examined the following for this MFF heading in 2020:

- (a) a sample of 27 transactions, which was designed to contribute to our overall statement of assurance rather than to be representative of spending under this MFF heading. We were therefore unable to estimate the error rate for this MFF heading. The sample consisted of 14 transactions under 'shared management' with Member States<sup>5</sup> (two transactions per Member State), eight under 'direct management' and two under 'indirect management' by the Commission, as well as three that involved the clearing of advances to agencies.

<sup>4</sup> Health: ECDC, EFSA, EMA. Home affairs: EASO, Frontex, EMCDDA, Europol, CEPOL, eu-LISA. Justice: EIGE, Eurojust, FRA. Specific annual reports with our opinion on the legality and regularity of each of these agencies' operations can be found on the ECA website.

<sup>5</sup> In Germany, Greece, Spain, France, Italy, Poland and the United Kingdom.

- (b) selected systems, which concerned:
  - (i) the annual control reports of four audit authorities<sup>6</sup> accompanying the 2019 annual accounts for AMIF and the ISF, and whether those reports were compliant with the legislation<sup>7</sup>;
  - (ii) the work of the same audit authorities, and whether their audits of expenditure and their procedures for providing reliable audit opinions were appropriate.
- (c) the regularity information given in the annual activity reports of DG HOME and the DG for Communications Networks, Content and Technology (DG CONNECT) and included in the Commission's Annual Management and Performance Report (AMPR).

<sup>6</sup> In Spain, Luxembourg, Austria and Finland.

<sup>7</sup> [Commission Delegated Regulation \(EU\) 2018/1291](#) of 16 May 2018 amending Delegated Regulation (EU) No 1042/2014 supplementing Regulation (EU) No 514/2014 of the European Parliament and of the Council with regard to the designation and management and control responsibilities of Responsible Authorities and with regard to status and obligations of Audit Authorities.

## Regularity of transactions

**7.9.** Of the 27 transactions we examined, eight (30 %) were affected by errors. We identified four transactions with quantifiable errors which had a financial impact on the amounts charged to the EU budget. An example is presented in [Box 7.3](#).

### Box 7.3

#### Overstated costs for transport of medical equipment

One ESI action that we audited was implemented by a ministerial department in the UK<sup>8</sup>. It consisted of the transport of personal protective equipment for medical use from Asia (e.g. China, Singapore) to the UK between April and July 2020 to address the emergency created by the outbreak of the COVID-19 pandemic. The UK authorities procured the services of three air freight carriers for this purpose, using emergency procurement procedures (negotiated procedures without prior publication).

We audited one of these contracts, which increased cargo capacity above that already available under an existing contract, but the UK authorities failed to provide key procurement documents. We were therefore unable to verify whether the UK authorities had actually carried out a procurement procedure in this instance. In the absence of evidence to the contrary, we consider that the contract was awarded directly to the carrier. The transport costs covered by this contract were therefore ineligible for EU funding.

In addition, the UK authorities applied an incorrect exchange rate when converting one carrier's transport costs from dollars to euros. This resulted in an overstatement of the project costs for that carrier of 20 %.

The UK authorities also claimed costs for a flight that had in fact been cancelled and was therefore ineligible for funding.

Overall, the total project costs submitted to DG ECHO were overstated by 30 %. Although the UK authorities submitted an audit certificate to accompany the cost claim, the errors we found had not been detected by the independent external auditor. Furthermore, the checks performed by DG ECHO before making payment did not reveal all the errors in the certified cost claim.

<sup>8</sup> Under the [EU-UK Withdrawal Agreement](#), with some exceptions, EU law was “applicable to and in the United Kingdom” during the transition period. The UK was therefore entitled to EU funding until the end of 2020.

**7.10.** We also found four cases of non-compliance with legal and financial provisions, but without a financial impact on the EU budget. These related to the selection of projects and the application of procurement rules, the submission of incomplete documentation in support of cost claims, and the defective functioning of an IT system (systemic error). Failure to abide by the rules can undermine the sound financial management of EU spending and, potentially, affect the eligibility of the costs claimed. [Box 7.4](#) presents an example of such failure.

#### **Box 7.4**

##### **Documentation of services provided to unaccompanied minors not always satisfactory**

An AMIF-funded project that we audited in Greece was implemented by a non-governmental organisation (NGO). It consisted of the provision of accommodation and other services (meals, personal hygiene products, leisure activities, counselling, etc.) to unaccompanied minors in shelters located in four Greek towns. The NGO received funding based on a standard daily unit cost per accommodated unaccompanied minor.

The internal rules of the shelters did not include clear indicators for how the NGO was to prove that certain services covered by the standard unit cost (e.g. supervision, organisation of activities, cleaning, meals) had been delivered and were of sufficient quality. The NGO was therefore not able to demonstrate that it had actually provided these services at an appropriate level. Another issue is that young people stayed on in the shelters without proper justification (e.g. schooling, health problems) after reaching adulthood.

# Examination of elements of internal control systems

## Review of audit authorities' work in relation to their annual control reports and audits of expenditure

**7.11.** We reviewed the work done by four authorities responsible for auditing their respective Member States' AMIF/ISF annual accounts<sup>9</sup> and providing the Commission with an annual control report (ACR). Our purpose was to assess whether these audit authorities had:

- (a) covered all types of payments made by the bodies responsible for implementing the funds,
- (b) used an appropriate sampling method,
- (c) sampled enough transactions to draw conclusions about the total population,
- (d) correctly calculated<sup>10</sup> the error rate, and
- (e) put in place adequate procedures for providing reliable audit opinions and reports<sup>11</sup>.

**7.12.** All the audit authorities we examined had developed and implemented detailed procedures of sufficient quality to report on their work in the ACR. We identified some shortcomings whose impact on the accounts was not material enough to detract from the audit authorities' conclusions. The Commission had already identified some of these shortcomings in its assessment of ACRs for the 2019 financial year. We present our findings in **Box 7.5**.

<sup>9</sup> Luxembourg and Austria for AMIF; Spain and Finland for the ISF.

<sup>10</sup> As required by [Commission Delegated Regulation \(EU\) 2018/1291](#).

<sup>11</sup> In line with key requirement 14 of management and control systems – see the Annex to [Commission Implementing Regulation \(EU\) 2017/646](#) of 5 April 2017 laying down rules for the application of Regulation (EU) No 514/2014 of the European Parliament and of the Council with regard to the implementation of the annual clearance of accounts procedure and the implementation of the conformity clearance.

**Box 7.5****Shortcomings in annual control reports**

<b>Shortcomings</b>	<b>Member State of the audit authority</b>	<b>Potential impact</b>
Sampling issues: sampling unit not clearly defined, too few items in audit sample.	Luxembourg	Limited assurance from the audit authority's work  Reported data not reliable
The responsible authority submitted the draft accounts to the audit authority before completing its own on-the-spot controls, and before including technical assistance payments. This presented a risk that the audit authority would perform its audits on the wrong set of accounts.  The ACR only partially explained differences between the draft and final accounts.	Spain	
Error rates were calculated and presented inaccurately in the body of the ACR.	Austria	
Value and coverage of the audit sample were incorrectly reported.	Austria	
The ACR did not properly report the results of expenditure and system audits or the overall level of assurance.  Failure to report that some audit work was outsourced.	Luxembourg	

**7.13.** We selected 23 audit files from the same four audit authorities. We did not fully re-perform their audit work but used the files to check that the audit procedures were appropriate and covered all the eligibility criteria set in the AMIF/ISF regulations<sup>12</sup>. Overall, we found that the audit authorities had detailed audit programmes and used checklists to support their conclusions. However, we also detected the shortcomings presented in **Box 7.6**.

### Box 7.6

#### Shortcomings in the work of audit authorities

Shortcomings	Member State of the audit authority	Potential impact
The project selection process was not properly checked.	Luxembourg	Failure to detect ineligible expenditure Audit conclusions not reliable Limited assurance from the audit authority's work
Inadequate testing of the eligibility of expenditure.	Luxembourg	
Insufficient audit trail or poor documentation of audit work.	Spain, Luxembourg, Austria, Finland	
Where detected, ineligible costs were not always reported.	Luxembourg	
Some procurement issues wrongly classified.	Finland	
Inadequate review of outsourced audit work.	Luxembourg	

<sup>12</sup> See key requirement 12 in the Annex to [Commission Implementing Regulation \(EU\) 2017/646](#).

## Annual activity reports and other governance arrangements

**7.14.** We reviewed the annual activity reports of DG HOME and DG CONNECT<sup>13</sup> and found no information that might contradict our findings. However, our limited sample for 2020 (27 transactions) is not sufficient for us to compare our audit results with the information reported by the two DGs on the regularity of spending.

**7.15.** We reviewed the estimates produced by DG HOME and DG CONNECT for the risks at payment and at closure. We found that they were calculated in accordance with internal methodology and correctly reported in the AMPR.

<sup>13</sup> In the case of DG CONNECT, we only reviewed the information given on 'Creative Europe' expenditure.

# Conclusion and recommendations

## Conclusion

**7.16.** The sample of transactions was designed to help us form a view on 2020 spending across the budget as a whole rather than to be representative of spending under MFF heading 3 ‘Security and citizenship’. We did not audit sufficient transactions to estimate the level of error for this MFF heading (see paragraph 7.8). Our examination of transactions and systems nevertheless highlighted two areas where there is scope for improvement (see paragraphs 7.9 and 7.10).

## Recommendations

**7.17.** *Annex 7.1* shows the findings of our follow-up review of the two recommendations we made in our 2017 annual report. The Commission has since implemented both recommendations in full. We also reviewed the recommendation in our 2018 annual report that was targeted for implementation during 2020 and implemented in full. Based on this review and our findings and conclusions for 2020, we recommend that the Commission:

### Recommendation 7.1 – Eligibility of ESI project costs

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Carefully check the eligibility of the costs submitted by the beneficiaries of ESI actions – in particular the regularity of procurement procedures.

**Timeframe: by the end of 2021**

### Recommendation 7.2 – Documentation where funding is based on standard unit costs

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Provide guidance to the Member State authorities responsible for implementing DG HOME funds, in both the 2014-2020 and 2021-2027 MFFs, on documenting the completeness and quality of services when funding is based on standard unit costs.

**Timeframe: by the end of 2022**

## Annex 7.1 – Follow-up of previous recommendations for ‘Security and citizenship’

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2017	The Commission should: <b>Recommendation 1:</b> provide guidance to Member States on using EU funds in accordance with the principle of sound financial management. In particular, the AMIF/ISF implementing guidelines should specify that, when public bodies implement EU actions, the EU co-financing may not exceed the total eligible expenditure excluding VAT.	X <sup>14</sup>					
	<b>Recommendation 2:</b> require Member States, in the annual accounts of their AMIF and ISF national programmes, to break down the nature of the amounts they report into recoveries, pre-financing and expenditure actually incurred; and report in its AAR from 2018 onwards the actual spending per fund.	X <sup>15</sup>					

<sup>14</sup> In August 2019 and July 2020 the Commission sent out communications reminding Member States of the VAT eligibility rules.

<sup>15</sup> The Commission changed the template for the AMIF/ISF annual accounts to take account of our requirements.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2018	<p>We recommend that the Commission ensures that, when making administrative checks of payment claims, it systematically uses the documentation it has required its grant beneficiaries to provide, in order to properly examine the legality and regularity of the procurement procedures these beneficiaries have organised.</p> <p>The Commission should also instruct the Member State authorities responsible for AMIF and ISF national programmes to adequately check the legality and regularity of the procurement procedures organised by the funds' beneficiaries when making administrative checks of their payment claims.</p> <p><b>Timeframe: during 2020.</b></p>	x <sup>16</sup>					

Source: ECA

<sup>16</sup> The Commission updated its control strategy and raised awareness among Member State authorities of procurement issues.

## Chapter 8

### Global Europe

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<b>Annex 8.1 – DG NEAR and DG INTPA payments by delegation</b>	
<b>Annex 8.2 – Follow-up of previous recommendations</b>	

# Introduction

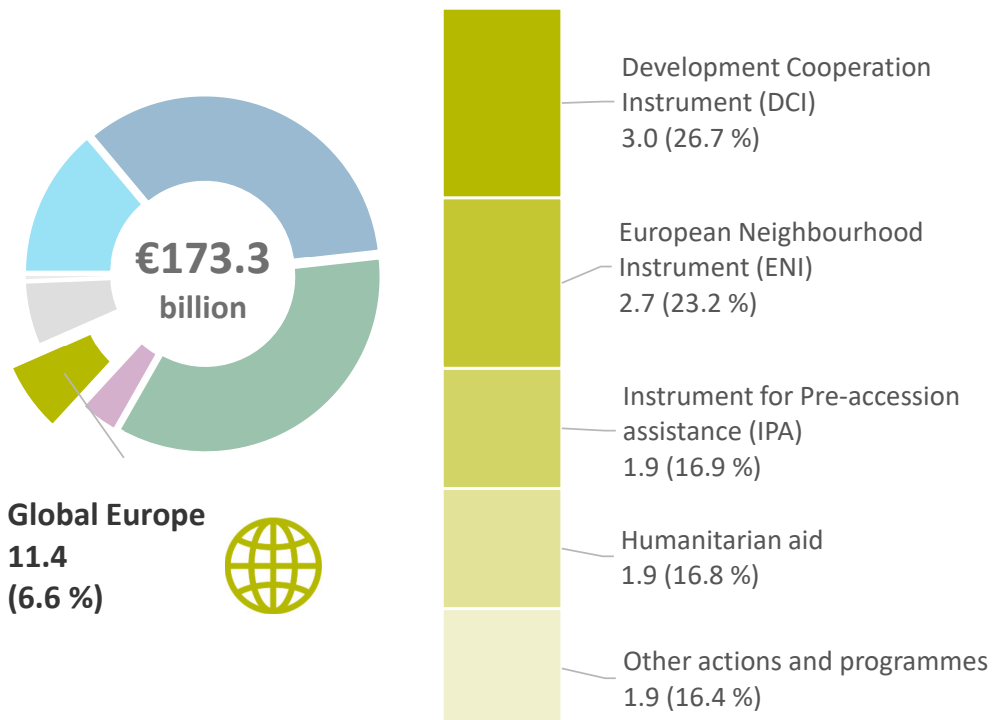
**8.1.** This chapter presents our findings for MFF heading 4 ‘Global Europe’. **Box 8.1** gives an overview of the main activities and spending under this heading in 2020.

## Box 8.1

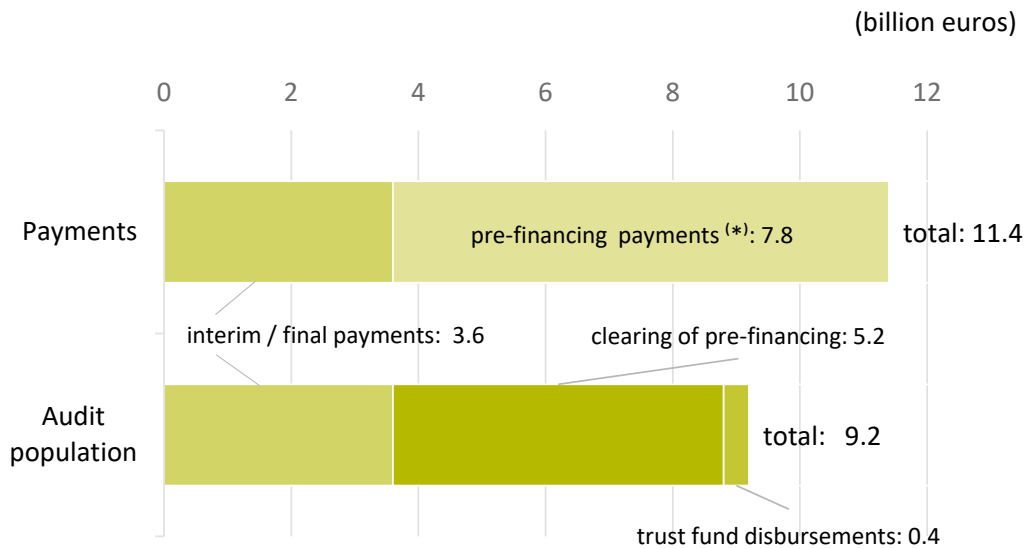
### MFF heading 4 ‘Global Europe’ – 2020 breakdown

#### 2020 payments as a share of the EU budget and breakdown

(billion euros)



### 2020 audit population compared to payments



(\*) In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph **11**).

Source: 2020 consolidated accounts of the European Union.

## Brief description

**8.2.** ‘Global Europe’ covers expenditure on all external action (foreign policy) funded by the EU general budget. These policies aim to:

- promote EU values abroad, such as democracy, rule of law and respect for human rights and fundamental freedoms;
- address major global challenges, such as climate change and biodiversity loss;
- increase the impact of EU development cooperation, with the aim of helping to eradicate poverty and promote prosperity;
- foster stability and security in candidate and neighbourhood countries;
- enhance European solidarity after natural or man-made disasters;
- improve crisis prevention and conflict resolution, preserve peace, strengthen international security and promote international cooperation;
- promote EU and mutual interests abroad by supporting the external dimension of EU policies.

**8.3.** The main directorates-general and services involved in implementing the external action budget are the Directorate-General for International Partnerships (DG INTPA)<sup>1</sup>, the Directorate-General for Neighbourhood Policy and Enlargement Negotiations (DG NEAR), the Directorate-General for European Civil Protection and Humanitarian Aid Operations (DG ECHO), the Directorate-General for Regional and Urban Policy (DG REGIO) and the Service for Foreign Policy Instruments (FPI).

**8.4.** In 2020, payments for ‘Global Europe’ amounted to €11.4 billion<sup>2</sup> and were disbursed using several instruments (see [Box 8.1](#)) and delivery methods such as works/supply/service contracts, grants, special loans, loan guarantees and financial assistance, budget support and other targeted forms of budgetary aid in more than 150 countries (see [Annex 8.1](#)).

### Audit scope and approach

**8.5.** Applying the audit approach and methods set out in **Annex 1.1**, we examined the following for this MFF heading in 2020:

- (a) a sample of 75 transactions, which was designed to contribute to our overall statement of assurance rather than to be representative of spending under this MFF heading. We were therefore unable to estimate the error rate for this MFF heading. We sampled 32 DG NEAR, 14 DG INTPA, 13 DG ECHO, 10 FPI and 6 other transactions.
- (b) the regularity information given in the annual activity reports of DG NEAR and DG INTPA and then included in the Commission’s Annual Management and Performance Report (AMPR).

<sup>1</sup> Former Directorate-General for International Cooperation and Development (DG DEVCO).

<sup>2</sup> Final implementation of payments, including assigned revenue.

## Regularity of transactions

**8.6.** Of the 75 transactions we examined, 28 (37.3 %) were affected by errors. We identified 17 quantifiable errors with a financial impact on the amounts charged to the EU budget. We also found 11 cases of non-compliance with legal and financial provisions.

**8.7.** The general categories of findings for ‘Global Europe’ are ineligible costs, costs not incurred, public procurement errors and absence of supporting documents.

**Box 8.2** presents examples of errors we quantified. **Box 8.3** illustrates an example of delegation and grant agreements not having been implemented properly. In this case, it was not possible to calculate the exact ineligible amount.

**Box 8.2****Supplies not used for the action funded**

DG NEAR

We audited expenditure claimed by a beneficiary under a grant contract signed in October 2016 with the Commission. The action was aimed at improving the health of refugees under the beneficiary country's protection, including through vaccination. The grant was funded entirely by the EU budget and, of its total estimated costs of €300 million, equipment and supplies accounted for 47 % or €142 million. In order to implement the grant contract, the beneficiary signed a contract with a medical supplier in December 2017 to procure vaccines.

For the expenditure reimbursed by the Commission prior to the contract with the medical supplier, we were not provided with evidence in relation to the procurement, the actual cost and the number of vaccine doses administered. Overall, we considered €4.4 million of expenditure ineligible.

**Ineligible costs in the cost claim**

DG NEAR

We audited expenditure claimed by a beneficiary under a grant contract signed with the Commission. The action funded by the grant was aimed at strengthening local communities in the beneficiary country to promote social inclusion of Romany people. The Commission funded the €4 million grant entirely from the EU budget.

We examined the supporting documents and found that the Commission had approved €269 531 of advance payments for reimbursement, even though the beneficiary had not undertaken any corresponding activities. The Commission had also twice accepted a cost claim amounting to €270 537. Overall, we considered 64 % of the audited amount ineligible.

**Box 8.3****Shared cost allocation not based on expenditure actually incurred**

DG ECHO

Part of our audited expenditure related to four specific grant agreements and one delegation agreement with a total estimated cost of €11.2 million.

Some of the expenditure audited concerned costs shared between the EU-funded project and partner organisations. The agreements stated that these costs should be shared on the basis of expenditure actually incurred. We examined the partner organisations' cost allocation policies and supporting documents, which showed that they based their cost allocation on budget or estimated amounts.

For instance, in one case electricity costs for a field office were not calculated on the basis of expenditure actually incurred but as a proportion of the available budget per contract. In another, the allocation of costs for renovating an office warehouse, running vehicles and rent was similarly based on the available budget remaining each month to cover the different types of common costs. However, it was not possible to calculate the exact financial impact.

This cost allocation approach is in breach of the agreement conditions.

**8.8.** In examining these transactions, we identified examples of effective internal control systems, such as the one described in [Box 8.4](#).

#### **Box 8.4**

##### **Effective checks by the Commission on payment claims under direct management.**

DG INTPA

The EU, through a service contract with an international consulting firm specialising in public policy and development cooperation, funded an action worth €13.8 million to support an association promoting regional integration in Asia.

We examined the Commission's payment related to the invoice issued by the consultant under this service contract. When processing the payment claim, the local EU delegation detected ineligible costs of €35 500 reported as expert fees. It therefore asked the consultant to issue a credit note for this amount and reduced the payment.

Over the contract's implementation period, the Commission identified and recovered ineligible costs totalling more than €113 700. We did not identify any further errors.

**8.9.** There are two spending areas where transactions are less prone to error due to payment conditions. These areas are (i) budget support and (see paragraph [8.10](#)) (ii) projects implemented by international organisations and subject to the 'notional approach' (see paragraph [8.12](#)). In 2020, we audited three budget support transactions and 14 projects managed by international organisations, including six notional approach transactions. We did not detect any errors in these areas.

**8.10.** Budget support is a contribution to a state's general budget or its budget for a specific policy or objective. Budget support payments financed by the EU general budget in 2020 amounted to €1.7 billion. We examined whether the Commission had complied with the conditions governing budget support payments to partner countries and had verified that these countries met the general eligibility conditions (such as satisfactory improvement in public-sector financial management).

**8.11.** However, because the legal provisions leave broad scope for interpretation, the Commission has considerable flexibility in deciding whether partner countries meet these general conditions. Our regularity audit cannot cover what happens beyond the moment the Commission pays aid to the recipient country, since these funds then merge with that country's own budget resources<sup>3</sup>.

**8.12.** Under the 'notional approach', when contributions from the Commission to multi-donor projects are pooled with those from other donors and not earmarked for specific, identifiable, items of expenditure, the Commission assumes compliance with the EU eligibility rules provided that the total pooled amount includes sufficient eligible expenditure to cover the EU's contribution. We took this approach into account in our substantive testing.

**8.13.** In 2020, payments to international organisations from the EU general budget amounted to €3.2 billion. We cannot state the proportion of this sum to which the 'notional approach' applied, since the Commission does not monitor it separately.

<sup>3</sup> A number of our special reports consider the efficiency and effectiveness of budget support, the latest ones being [special report 09/2019](#): 'EU support to Morocco – Limited results so far' and [special report 25/2019](#): 'Data quality in budget support: weaknesses in some indicators and in the verification of the payment for variable tranches', (<http://www.eca.europa.eu>).

**8.14.** Some international organisations<sup>4</sup> provided only limited access to documents, such as in read-only format, meaning we could not make copies of the documents reviewed. Furthermore, some international organisations questioned our mandate. These issues hindered the planning and execution of our audit and led to excessive delays in the audit team receiving the requested documentation and carrying out its work. In one case, it took the international organisation more than eight months to provide the requested supporting documents. The Treaty on the Functioning of the EU<sup>5</sup> establishes the ECA's right to be forwarded any document or information necessary to carry out its task. We previously made related observations in our 2018 annual report<sup>6</sup> and in opinion 10/2018<sup>7</sup>.

<sup>4</sup> United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA), United Nations Children's Emergency Fund (UNICEF) and International Bank for Reconstruction and Development (IBRD).

<sup>5</sup> The ECA's right to access documentation is established in Article 287 of the Treaty on the Functioning of the European Union (TFEU): 'Any natural or legal person in receipt of payments from the budget, shall forward to the Court of Auditors, at its request, any document or information necessary to carry out its task.' (OJ C 326, 26.10.2012, p. 170).

<sup>6</sup> See paragraph 9.13 in chapter 9 'Global Europe' of our [2018 annual report](#).

<sup>7</sup> [Opinion 10/2018](#) concerning the proposal for a Regulation of the European Parliament and of the Council establishing the Neighbourhood, Development and International Cooperation Instrument, paragraph 18.

## Annual activity reports and other governance arrangements

### FPI annual activity report

**8.15.** For the 2020 financial year, we reviewed the annual activity report (AAR) of the Service for Foreign Policy Instruments (FPI).

**8.16.** Our analysis focused on whether FPI had presented the regularity information in its AAR in accordance with the Commission's instructions and consistently applied the methodology for estimating future corrections and recoveries.

**8.17.** Of the total expenditure accepted in 2020 (€730 million), FPI estimated the total amount at risk at the time of payment to be €8.0 million (1.10 %). It estimated the value of corrections resulting from its checks in subsequent years at €3.5 million (43.8 % of the total amount at risk). This led the Head of the FPI to declare that the service's financial exposure was below the materiality threshold of 2 %.

**8.18.** The Commission can entrust certain entities with budget implementation tasks provided they are capable of protecting the EU's financial interests to a high level. In such cases, the Financial Regulation requires an assessment of these entities in order to ensure they adhere to the principles of sound financial management, transparency, non-discrimination and visibility of EU action. This is known as the "pillar assessment"<sup>8</sup>. FPI must ensure that all its common security and defence policy (CSDP) missions are accredited in this manner. As of the end of 2020, two<sup>9</sup> out of the 11 ongoing CSDP missions had not yet received a full positive pillar assessment. In particular, the assessment of the EU border assistance mission (EUBAM) in Libya has been in progress for a long time<sup>10</sup>, which indicates a potential internal control

<sup>8</sup> Article 154 of [Regulation \(EU, Euratom\) 2018/1046](#) of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union (the 'Financial Regulation'), as amended. The pillar assessment requirements have evolved over time and have been updated in the Financial Regulation since their initial inclusion in 2002.

<sup>9</sup> EUBAM Libya and the EU advisory mission (EUAM) in the Central African Republic.

<sup>10</sup> The Council approved the EUBAM Libya mission in May 2013. The mission is currently deployed in Tunis due to the political situation in Libya.

weakness. FPI has taken specific measures to mitigate the associated risks. However, pillar assessments are necessary to protect the EU's financial interests<sup>11</sup>.

## DG NEAR's 2020 RER study

**8.19.** In 2020, DG NEAR had its sixth residual error rate (RER) study carried out by an external contractor on its behalf. The purpose of the study is to estimate the rate of those errors that were not detected by all DG NEAR management checks to prevent, detect and correct such errors across its entire area of responsibility, in order to conclude on the effectiveness of those checks. It is an important element on which the Director-General bases the declaration of assurance, and feeds into the regularity information on 'External Action' disclosed in the AMPR.

**8.20.** DG NEAR presented the results of the 2020 RER study in its AAR<sup>12</sup>. The study reviewed a sample of 375 transactions made under contracts closed between September 2019 and August 2020. The estimated overall RER for the DG was 1.36 %, i.e. below the 2 % *materiality threshold* set by the Commission. The previous two years' RERs were 0.72 % in 2018 and 0.53 % in 2019.

**8.21.** The RER study does not constitute an *assurance engagement* or an audit; it is based on the RER methodology and manual provided by DG NEAR. We have identified limitations that may contribute to the underestimation of the RER.

**8.22.** In this year's audit, we again detected several major factors that distorted the RER. The first factor was that DG NEAR did not stratify the population of transactions used for sampling to cover in more detail those areas which are more prone to error or to focus less on those with confirmed lower risk<sup>13</sup>. Budget support transactions are low-risk and in 2020 represented only 26 % (in value) of the total RER population. However, they accounted for 39 % (in value) of the RER sample. They have accounted for an increasing proportion of the RER sample in recent years: 29 % in 2018, 31 % in 2019 and 39 % in 2020.

<sup>11</sup> Article 154 of the [Financial Regulation](#).

<sup>12</sup> The residual error rate (RER) is referred to as the 'global (DG derived) error rate' in the AAR.

<sup>13</sup> See chapter 9 'Global Europe' of our [2017 annual report](#).

**8.23.** In addition, DG NEAR introduced an additional error rate in 2018 for directly managed grants (the ‘grant rate’). This provided an additional basis for the Director-General to maintain the reservation previously made due to the high risk in such grants. Generally, for the RER sample, the contractor applies a materiality level of 2 % and a 95 % confidence level<sup>14</sup>. For the grant rate, however, the confidence level is 80 %, which led to a less precise estimate of the actual error rate for this part of the population. This approach does not reflect the high risk in this area.

**8.24.** The second factor was that the proportion of transactions for which the RER study relied fully or partially on previous control work has increased since 2016, reaching more than 60 % in 2020. For these transactions, the contractor relied on previous work done as part of DG NEAR’s control framework, such as project financial audits and expenditure verifications performed by independent third parties, also taking account of previous control work by the Commission. At the same time, the total number of transactions reviewed under the RER study has decreased by more than 25 %. Overreliance on previous control work is contrary to the purpose of the RER study, which is to identify the errors that have evaded such checks.

**8.25.** Moreover, the RER contractor placed reliance on expenditure verifications performed under the limitations set by financial and administrative framework agreement (FAFA) concluded with certain international organisations. This agreement limits the number of items that can be checked during an expenditure verification, as well as access to audit evidence.

**8.26.** The third factor was DG NEAR’s RER estimation method. Firstly, it gives the contractor broad discretion in deciding whether there are sufficient logistical and legal reasons preventing timely access to the documents for a transaction and, hence, estimating the error rate. Secondly, the Commission added a 5 % risk premium to the residual error rate, as it did in 2019. However, it is not clear how the Commission arrived at a risk premium of 5 %. Consequently, this method does not necessarily reflect the actual residual error for the transaction in question<sup>15</sup>.

<sup>14</sup> Probability that the level of error in the population lies within a certain interval (the ‘confidence interval’).

<sup>15</sup> In 2020, an error was estimated partially in one case.

**8.27.** The fourth factor is the high number of transactions replaced in the sampling population<sup>16</sup>. These replacements, and the reasons given for them, confirm that the data verification required by the instruction manual was not carried out with the necessary diligence in cooperation with the Commission and that the data populations used for sampling in the different phases were only partially reliable or correct. Replacements and adjustments to the sampling population lead to different sampling results.

**8.28.** Furthermore, the regulatory framework governing the RER study and the contract between DG NEAR and the RER contractor do not address or mention the risk of fraud. There is no procedure requiring the contractor to report to the Commission cases of suspected fraud against the EU budget detected during its RER work.

#### **DG INTPA's annual activity report and RER study**

**8.29.** Our review of DG INTPA's 2020 annual activity report and RER study is presented in detail in our annual report on the 8<sup>th</sup>, 9<sup>th</sup>, 10<sup>th</sup> and 11<sup>th</sup> European Development Funds.

<sup>16</sup> There were 36 for the 2020 RER study.

# Conclusion and recommendations

## Conclusion

**8.30.** The sample of transactions was designed to help us form a view on 2020 spending across the budget as a whole rather than to be representative of spending under MFF heading 4 ‘Global Europe’. We did not audit sufficient transactions to estimate the level of error for this MFF heading (see paragraph [8.5](#)). Our examination of transactions and systems nevertheless highlighted three areas where there is scope for improvement (see paragraphs [8.7](#), [8.14](#) and [8.28](#)).

## Recommendations

**8.31.** [Annex 8.2](#) shows the findings of our follow-up review of the four recommendations we made in our 2017 annual report. The Commission had implemented three recommendations in full, while one had not been implemented. We also reviewed those recommendations from our 2018 and 2019 annual reports that had required implementation immediately or before the end of 2020.

**8.32.** Based on this review and our findings and conclusions for 2020, we recommend that the Commission:

### Recommendation 8.1 – Complete and timely access to documents

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Take steps so that international organisations provide the ECA with complete, unlimited and timely access to documents necessary to carry out our task in accordance with the TFEU, and not just in read-only format.

**Timeframe: by the end of 2021**

### **Recommendation 8.2 – Partner organisations’ allocation of shared costs**

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Establish a procedure to ensure that partner organisations base their allocation of shared costs on expenditure actually incurred.

**Timeframe: by the end of 2021**

### **Recommendation 8.3 – RER contractor’s reporting of suspected fraud**

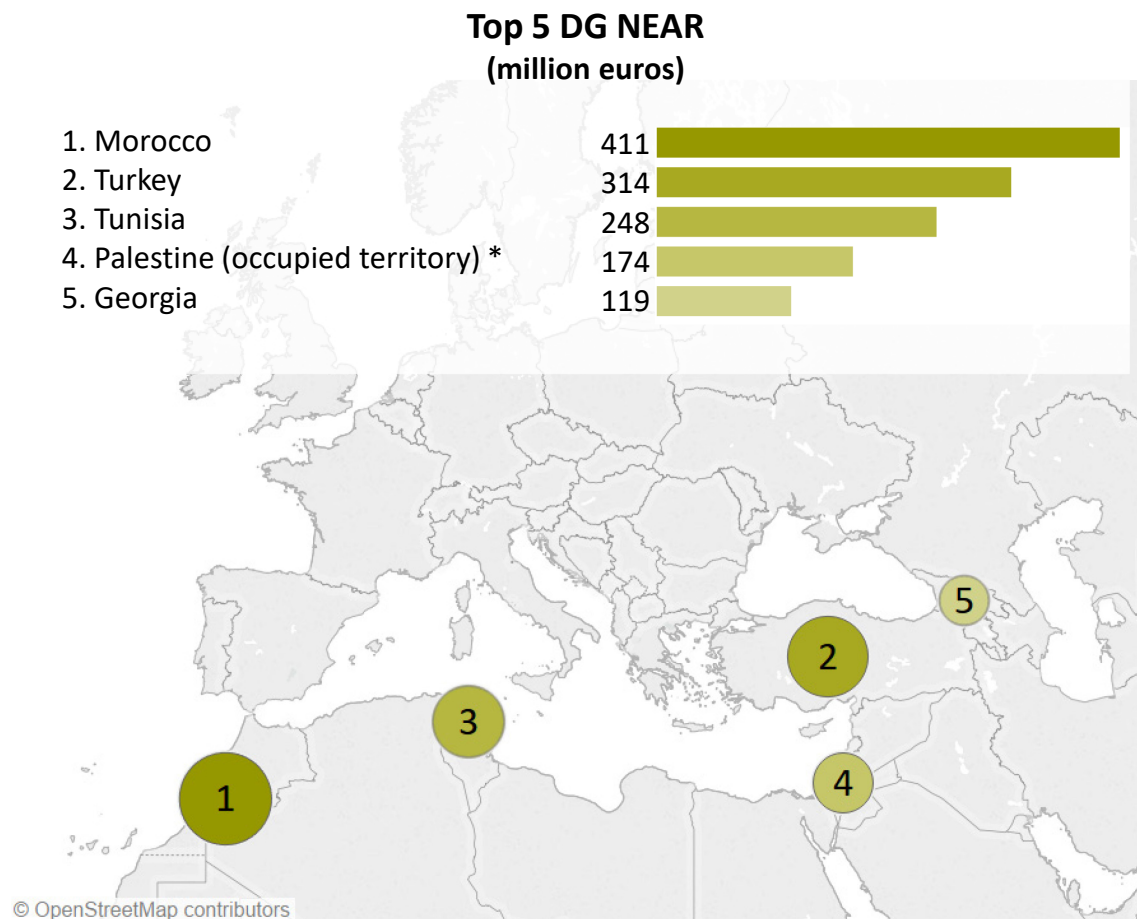
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Establish obligations for the RER study contractor to report to the Commission any suspected fraud against the EU budget detected during its work on the RER study.

**Timeframe: by the end of 2022**

# Annexes

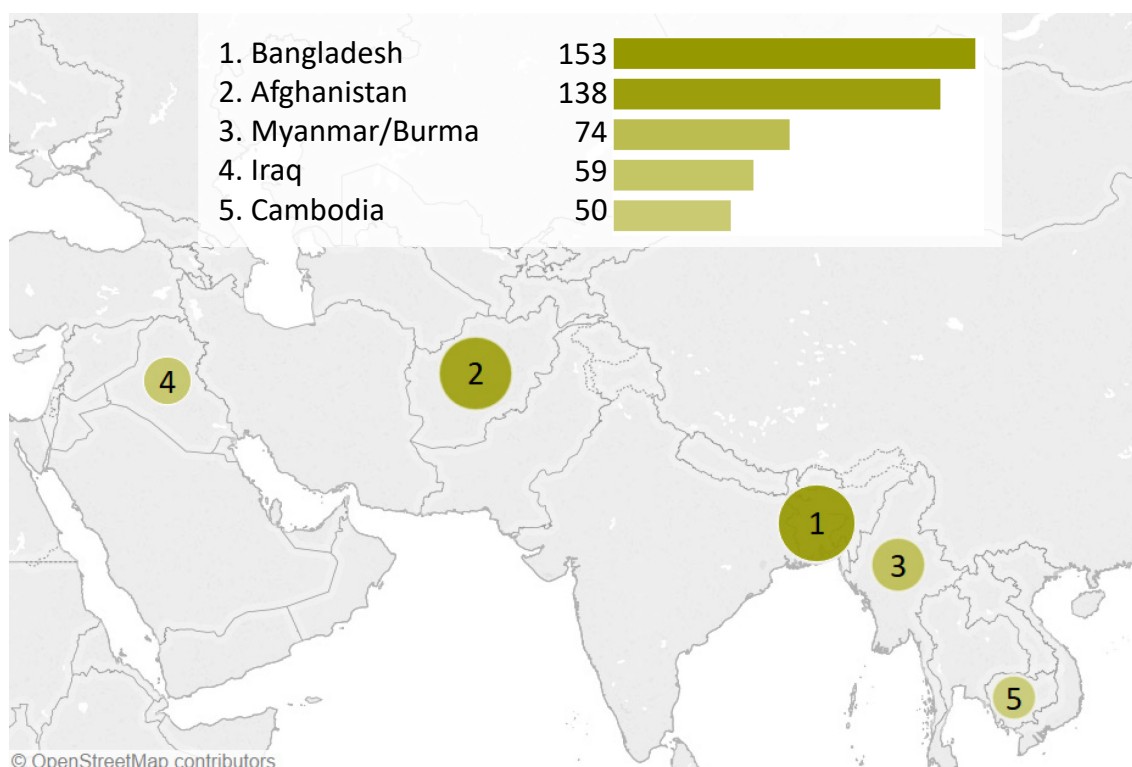
## Annex 8.1 – DG NEAR and DG INTPA payments by delegation



\* This designation shall not be construed as recognition of a State of Palestine and is without prejudice to the individuals positions of the Member States on this issue.

*Sources:* Map background ©OpenStreetMap contributors licensed under the Creative Commons Attribution-Share Alike 2.0 licence (CC BY-SA) and European Court of Auditors, based on the 2020 consolidated annual accounts of the European Union.

### Top 5 DG INTPA (million euros)



*Sources:* Map background ©OpenStreetMap contributors licensed under the Creative Commons Attribution-Share Alike 2.0 licence (CC BY-SA) and European Court of Auditors, based on the 2020 consolidated annual accounts of the European Union.

## Annex 8.2 – Follow-up of previous recommendations

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2017	<p>We recommend that DG NEAR:</p> <p><b>Recommendation 1:</b></p> <p>For the 2019 RER study onwards, provide the RER contractor with more precise guidelines on checking second-level procurement.</p>	X <sup>17</sup>					
	<p><b>Recommendation 2:</b></p> <p>For the 2019 RER study onwards, stratify the RER population based on the inherent risk of the projects, with more weight placed on direct management grants and less on budget support transactions.</p>				X		
	<p><b>Recommendation 3:</b></p> <p>In the 2018 AAR and onwards, disclose the limitations of the RER study.</p>	X <sup>18</sup>					

<sup>17</sup> The Commission included additional instructions to the RER contractor on how to check second-level procurement in the RER Instruction Manuals for 2019 and 2020.

<sup>18</sup> The Commission disclosed limitations of the RER study in the AARs of 2018 and 2020, but not in 2019. It informed us that the failure occurred due to an editing omission.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	<p>We recommend that DG DEVCO:</p> <p><b>Recommendation 4:</b></p> <p>By 2020, revisit existing guidance to beneficiaries of projects implemented under indirect management with the aim of ensuring that planned activities are executed in a timely manner and contribute to the practical use of the projects outputs, so as to obtain the best value for money.</p>	X <sup>19</sup>					
2018	<p>We recommend that the Commission:</p> <p><b>Recommendation 1:</b></p> <p>By 2020, take steps to reinforce the obligation on international organisations to forward the ECA, at its request, any document or information necessary to carry out its task as foreseen in the TFEU.</p>			X			

<sup>19</sup> The Commission brought forward changes to the Financial Regulation of 2018, updated guidelines and issued additional instructions between 2018 and 2021.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	We recommend that DG NEAR: <b>Recommendation 2:</b> By 2020, take steps to adapt DG NEAR's RER methodology to limit full-reliance decisions, and that it monitor its implementation closely.	x <sup>20</sup>					
	We recommend that DG ECHO: <b>Recommendation 3:</b> Revise the DG ECHO's calculation of the 2019 corrective capacity by excluding recoveries of unspent pre-financing.	x <sup>21</sup>					
2019	We recommend that DG NEAR: <b>Recommendation 1:</b> Disclose the limitations of the RER study in DG NEAR's 2020 AAR and future AARs. Timeframe: by the time the next AAR is published in Q1 2021	x <sup>22</sup>					

Source: ECA.

<sup>20</sup> The Commission updated the RER Instruction Manual for 2020.

<sup>21</sup> The Commission updated guidelines and issued additional quality control instructions between 2018 and 2020.

<sup>22</sup> Cf. footnote 19. The Commission disclosed limitations of the RER study in the AAR 2020.

## Chapter 9

### Administration

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	Paragraph
<b>Introduction</b>	9.1.-9.5.
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<b>Annual activity reports and other governance arrangements</b>	9.11.
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<b>Annexes</b>	
<b>Annex 9.1 – Results of transaction testing for ‘Administration’</b>	
<b>Annex 9.2 – Follow-up of previous recommendations</b>	

# Introduction

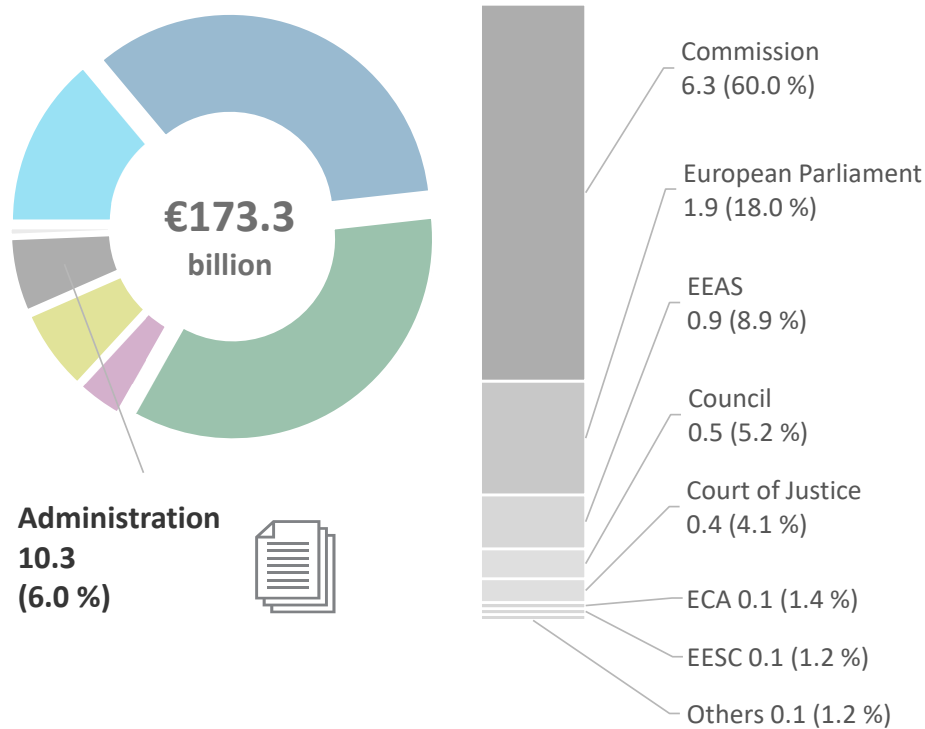
**9.1.** This chapter presents our findings for *MFF* heading 5 ‘Administration’. **Box 9.1** gives an overview of the spending of the EU institutions and bodies under this heading in 2020.

## Box 9.1

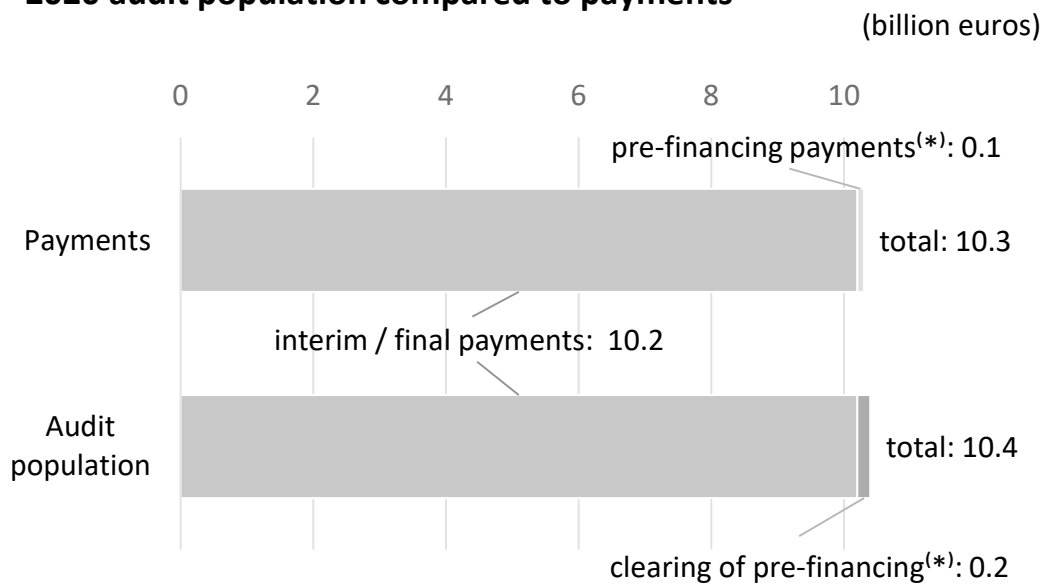
### MFF heading 5 ‘Administration’ – 2020 breakdown

#### 2020 payments as a share of the EU budget and breakdown

(billion euros)



### 2020 audit population compared to payments



(\*) In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph **10**).

Source: 2020 consolidated accounts of the European Union.

**9.2.** We report separately on the EU agencies, other entities and on the European Schools<sup>1</sup>. Our mandate does not cover the financial audit of the European Central Bank.

### Brief description

**9.3.** Administrative expenditure comprises expenditure on human resources, which accounted in 2020 for about 68 % of the total, and on buildings, equipment, energy, communications and information technology. Our work over many years indicates that this spending is low-risk.

<sup>1</sup> Our specific annual reports on agencies, other entities and European Schools are published on our website.

## Audit scope and approach

**9.4.** Applying the audit approach and methods set out in **Annex 1.1**, we examined the following for this MFF heading:

- (a) a sample of 48 *transactions*, designed to be representative of the full range of spending under this MFF heading. We took transactions from each EU institution and body. Our objective was to contribute to the overall *statement of assurance*, as described in **Annex 1.1**;
- (b) the *supervisory and control systems* of the Council and the European Ombudsman, including internal control standards, risk management, ex-ante and ex-post controls, registers of exceptions, management supervision, internal audit reports and anti-fraud measures;
- (c) the *regularity* information in the annual activity reports of all the institutions and bodies, including those of the Commission's directorates-general and offices primarily responsible for administrative expenditure<sup>2</sup>, and then included in the Annual Management and Performance Report;
- (d) *public procurement* procedures organised by the European Parliament, the Council, the Commission, the Court of Justice and the European External Action Service (EEAS) to acquire personal protective equipment (PPE) for their staff.

**9.5.** Our own expenditure is audited by an external firm<sup>3</sup>. The results of its audit of our financial statements for the year ending 31 December 2020 are covered by paragraph **9.7**.

<sup>2</sup> DG Human Resources and Security, Office for the Administration and Payment of Individual Entitlements, Offices for Infrastructure and Logistics in Brussels and Luxembourg, and DG Informatics.

<sup>3</sup> PricewaterhouseCoopers SRL.

## Regularity of transactions

**9.6.** [Annex 9.1](#) provides an overview of the results of transaction testing. Of the 48 transactions examined, 10 (21 %) contained *errors*. Based on the seven errors we have quantified, we estimate the level of error to be below the *materiality threshold*.

### Observations on the sample of transactions

**9.7.** The issues discussed in paragraphs [9.8](#) and [9.9](#) concern the European Parliament and the Commission. We did not identify any specific issues concerning the Council, the Court of Justice, the European Economic and Social Committee, the European Committee of the Regions, the European Ombudsman, the European Data Protection Supervisor or the EEAS. Our external auditor did not report any specific issue based on its work.

#### European Parliament

**9.8.** We detected errors in two payments executed by the European Parliament. One concerned an over-payment for IT services caused by the incorrect application of contract terms. The other concerned an incorrect payment of a subsistence allowance to an MEP, following a mistake in an attendance list. We found that the control system in place did not prevent nor detect such mistakes, but the Parliament is currently working on a new system to improve it.

#### European Commission

**9.9.** We found five errors in payments made by the Commission. One concerned a minor overpayment of costs for software licences. The other four related to allowances of staff who had not declared recent changes in their personal situation or were entitled to claim similar allowances from other sources. Staff are required first to claim such allowances and then to notify them to the Commission so it can take them into consideration when calculating pay. The Commission's consistency checks on its calculation did not detect these four cases. We found similar errors in respect of family allowances in previous years<sup>4</sup>.

<sup>4</sup> See paragraphs 9.9 of the [2019 annual report](#) and 10.8 of the [2018 annual report](#). All errors were later corrected by the Commission.

## **Observations on supervisory and control systems**

**9.10.** We found no significant issues with the supervisory and control systems we examined at the Council and the Ombudsman.

## Annual activity reports and other governance arrangements

**9.11.** The *annual activity reports* we reviewed did not identify material levels of error, which is consistent with our audit findings (see paragraph [9.6](#)).

## Observations on public procurement procedures to acquire personal protective equipment

**9.12.** The EU institutions' measures to safeguard their staff<sup>5</sup> during the COVID-19 pandemic included the purchase of PPE, such as masks, gloves and temperature detectors. We examined fifteen procurement procedures for PPE supplies organised in 2020 by the European Parliament, the Council, the Commission, the Court of Justice and the EEAS. Eight concerned masks and seven concerned other protective equipment. In each case, we examined both the justification given for using a particular type of procurement procedure and the award process itself. Examining these procedures was outside our representative sample and therefore did not contribute to our estimated level of error.

**9.13.** The urgent procurement of PPE in the early stages of the COVID-19 pandemic was challenging, due to surging demand. In most cases we examined, the institutions used negotiated procurement procedures, as provided for in the Financial Regulation, to acquire supplies<sup>6</sup>.

**9.14.** We found some problems in the procedures used by the European Parliament, the Council, the Commission and the EEAS when procuring urgently required protective masks. These institutions had set strict minimum requirements in the tender specifications (including European reference quality standards for medical face masks and delivery dates). However, in four cases, the successful bidder did not include full evidence that all minimum quality requirements were met at the time of contracting, such as evidence related to durability of the masks or documentation on compliance with technical specifications.

<sup>5</sup> Article 1e of the [Staff Regulations](#): "Officials [...] shall be accorded working conditions complying with appropriate health and safety standards [...]."

<sup>6</sup> [Financial Regulation \(EU, EURATOM\) 2018/1046](#), Art. 164 and Art. 11.1(c) of the Annex I – Procurement.

**9.15.** The Commission and the Council subsequently organised laboratory tests on selected mask deliveries. These tests caused the Commission to reject the first batch of masks it received, though a subsequent delivery was of satisfactory quality. Testing for the Council showed that the masks were compliant with the necessary quality requirements.

# Conclusion and recommendations

## Conclusion

**9.16.** The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on ‘Administration’ was not material (see [Annex 9.1](#)).

## Recommendations

**9.17.** [Annex 9.2](#) shows the findings of our follow-up review of the recommendations we made to the European Parliament and the Commission in our 2017 annual report. The institutions concerned have since implemented the recommendations in some respects, but for Recommendation 3, our observation in paragraph [9.9](#) leads us to make a similar recommendation this year (see [Recommendation 9.2](#)).

**9.18.** Based on this review and our findings and conclusions for 2020, we recommend as follows:

### Recommendation 9.1 – European Parliament

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The Parliament should implement the necessary changes to ensure that it only pays daily subsistence allowances to MEPs who qualify for them (see paragraph [9.8](#)).

**Timeframe: by the end of 2022**

### Recommendation 9.2 – Commission

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In order to improve its system for managing statutory family allowances, the Commission should reinforce consistency checks on staff declarations of allowances received from other sources and raise staff awareness of this issue (see paragraph [9.9](#)).

**Timeframe: by the end of 2022**

## Annexes

### Annex 9.1 – Results of transaction testing for ‘Administration’

	2020	2019
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	48	45
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	Free from material error	Free from material error

Source: ECA.

## Annex 9.2 – Follow-up of previous recommendations

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2017	<p>We recommend that:</p> <p><b>Recommendation 1:</b></p> <p>in the context of the revision of the Financial Regulation, the European Parliament improve the guidelines for authorising officers on the design and checks of the selection and award criteria for procurement procedures.</p>	x <sup>7</sup>					
	<p>We recommend that:</p> <p><b>Recommendation 2:</b></p> <p>during the next revision of the rules governing the reception of groups of visitors, the European Parliament strengthen the procedure for submitting declarations of expenditure by requiring groups to provide supporting documentation together with their cost claims.</p>			x			

<sup>7</sup> The Parliament updated the “Public procurement Vademecum” for Authorising Officers and staff, including the guidelines related to selection and award criteria.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	<p>We recommend that:</p> <p><b>Recommendation 3:</b></p> <p>the European Commission improve as soon as possible its systems for managing statutory family allowances by reinforcing consistency checks on the declaration by staff members of allowances received from other sources.</p>			x <sup>8</sup>			

Source: ECA.

<sup>8</sup> Monitoring of allowances received from elsewhere is complex, for example due to increasingly varied family situations and frequent changes in the national allowances in particular Member States. The Commission took action to improve its relevant IT systems and reinforce consistency checks, and recovers amounts it detected were overpaid. Our audit work continued to find errors.

**Institutions' replies to the annual  
report on the implementation of the  
EU budget for the 2020 financial year**

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**REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS’  
2020 ANNUAL REPORT**

**CONTRIBUTION TO ANNUAL REPORT 2020 – CHAPTER 1 – THE STATEMENT OF  
ASSURANCE AND SUPPORTING INFORMATION**

**INTRODUCTION**

1.1 Common Commission reply to paragraphs 1.1. to 1.6:

The year 2020 was marked by one of the most severe global pandemics in recent history. This entailed specific challenges and obstacles the Commission had to overcome in order to implement the budget with the usual diligence, efficiency and effectiveness.

The EU budget contributes to strengthening the European economy, especially in the light of the economic downturn caused by the pandemic, and making it more resilient.

The Commission attaches great importance to ensuring that the EU budget is spent responsibly and correctly, and to working with all parties involved to make sure that it delivers tangible results on the ground.

The Commission carefully monitors the implementation of the EU budget. If Member States, intermediaries or final beneficiaries are found to have spent EU money incorrectly, the Commission takes immediate steps to correct these errors, and recover the funds as necessary.

At the same time, the Commission endeavours to strike the right balance between a low level of errors, fast payments and reasonable costs of controls.

While the financial management of the EU budget has improved over time, some types of expenditure remain more error-prone. These are mostly governed by more complex rules and reimbursement schemes. The Commission continues to take preventive and remedial measures to address the weaknesses identified and ensure that errors are better prevented and detected over time for all programmes.

**AUDIT FINDINGS FOR THE 2020 FINANCIAL YEAR**

**Error continues to be present in specific types of spending**

1.17 a) Concerning the **revenue side** of the EU budget, the Commission welcomes that this area is free from material error.

As regards traditional own resources (TOR) and value added tax-based (VAT) own resources, the Commission is taking action to intensify the follow-up on longstanding open TOR points and lifting VAT reservations where possible, as well as to follow-up on the TOR accounting weaknesses identified by ECA’s audits.

With regard to gross national income-based (GNI-based) own resources, the Commission is taking comprehensive actions on the treatment of globalisation including research and development (R&D), for GNI for own resource purpose.

b) The Commission's own estimate of the **risk at payment**, i.e. the remaining level of error at the time of payment, after its preventive controls, is 1.9% overall for the 2020 relevant expenditure, representing a decrease compared to 2019.

Given the multiannual nature of its expenditure and of its control strategies, the Commission deploys substantial efforts to perform controls after the payments and to continue to make corrections until the closure of the funding programmes. These efforts are reflected in the estimated risk at the closure of the programme<sup>1</sup> that corresponds to the risk at payment minus the Commission's forecasted future corrections, estimated at 1% in 2020.

For 2020, the Commission estimates **the risk at closure** at 0.9% overall. This is well below the materiality threshold of 2% and in line with both the levels reached in previous years since 2016 and with the objective of the Commission.

Based on its detailed and bottom-up approach, the Commission is in a position to demonstrate the differentiated situation for the funds managed. Accordingly, the Commission considers that:

- **lower risk expenditure**, with a risk at payment below 1.9%, represent 56% of the total expenditure,
- **medium risk expenditure**, with a risk at payment between 1.9% and 2.5%, represent 16% of the total expenditure and,
- **higher risk expenditure**, with a risk at payment above 2.5% or serious weaknesses identified, represent 28% of the total expenditures.

This contributes to the Commission's conclusion that for at least more than half of the relevant expenditure, the risk at payment is below the materiality threshold. (*See detail in the Annual Management and Performance Report 2020, Volume II, page 78*).

This detailed level of information, which is comprehensively and transparently reported in the Annual Activity Reports (AARs) and in the Annual Management and Performance Report (AMPR), enables the Commission, as manager of EU funds, to detect system weaknesses, identify their root causes (e.g. complexity of rules) and to take targeted corrective actions. It also enhances preventive actions and ensures that any lessons learned are factored in the design of future financial programmes.

### **The complexity of rules and the way EU funds are disbursed have an impact on the risk of error**

1.18 First indent - The Commission shares the conclusion that the risk of error is lower for expenditure subject to simplified rules (mainly in entitlement-based expenditure).

Second indent - The Commission also considers that the complexity of rules may contribute significantly to a higher risk of error.

In addition to applying financial corrections and recoveries, the Commission is taking action to address weaknesses leading to medium and higher risks. This includes **targeted remedial actions**, such as raising awareness of applicable EU rules among beneficiaries and implementing partners that are more error prone. It also means better use of controls and audit results to adjust and focus the control strategies, increasing the capacity of national authorities that have deficiencies in their management and control systems along with applying the lessons learned to the future programmes.

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<sup>1</sup> As there is no closure of the European Agricultural Guarantee Fund measures, in the area of agricultural expenditure the risk at closure is replaced by the final amount at risk.

The Commission will continue working to **simplify rules** to the extent possible and increase the use of simpler delivery mechanisms such as simplified cost options where it represents the most effective way of reducing costs and burden of control and the risk of errors. At the same time, the Commission also aims at setting ambitious objectives to increase the performance of programmes. Complex conditions and eligibility rules apply where, in order to achieve ambitious policy objectives, targeting of aid is necessary, or in order to respect basic principles of the Single Market (public procurement or State aid rules).

Legality and regularity must therefore be balanced with the achievement of policy objectives while bearing in mind the delivery costs.

1.19 The Commission shares the view of the ECA according to which the way funds are disbursed has an impact on the risk of error. Additionally, based on the detailed information at its disposal, the Commission considers that the risks at payment are not uniformly material for reimbursement based payments.

As can be seen in the analysis made by the Commission in the AMPR, the risk exposure might be low, medium or high within the same policy area and even within the same spending programme, also where the overall error rate for a Member State or policy area is below materiality, for instance between two operational programmes for the ERDF within the same Member State. In addition, for **high-risk expenditure (mainly reimbursement-based-payments)**, risks at payment for a large number of individual programmes and paying agencies are also below the materiality threshold due to the control strategies in place as well as the targeted remedial actions taken.

#### **A substantial proportion of our audit population is affected by material error**

1.21 Detailed management analysis per programme shows that the situation is not homogeneous within particular policy areas, spending programmes or even Member States.

Based on this detailed assessment (see also reply to paragraph 1.17 b) as reported in the AARs and the AMPR 2020, Volume II, p. 78), the Commission splits its expenditure according to their estimated **risk at payment**. On this basis, the Commission considers that for less than 44% of its relevant expenditure, the risk at payment is above 1.9%.

This relates to some operational programmes for ‘Cohesion’ that show serious deficiencies and/or have error rates above 1.9%; the grants for the research programme Horizon 2020; individual CAP paying agencies for direct payments and rural development and for some Member States for market measures that have error rates above 1.9%; and complex grants under the MFF heading ‘Competitiveness’.

1.23 As regards ‘**Cohesion**’, the Commission takes note of the level of error calculated by the ECA, which further improved, compared with previous years. The Commission will follow up on all errors found by the ECA and request additional financial corrections, where appropriate and legally possible.

The Commission further refers to its estimate of the level of error, including maximum risks (worst-case scenarios) disclosed in the 2020 REGIO and EMPL AARs, resulting from a detailed analysis of the situation of each programme. The Commission notes that its estimate falls within the error range calculated by the ECA and believes its detailed assessment reflects a reasonable and fair estimate of the error rates for each programme and cumulatively for all programmes.

Concerning the actions taken to reduce the errors, the Commission addressed updated guidance to Member States for the 2014-2020 programming period that combined with the required use of

simplified costs options, aim at improving further the quality of management verifications. The Commission has elaborated a Public Procurement Action Plan, updated several times since 2014 and a common State Aid Action Plan. These actions aim at helping administrators and beneficiaries of EU funds improve their public procurement practices and reduce the risk of irregularities linked to the application of State aid rules through training programmes and dissemination of relevant information to ESI Funds stakeholders.

As seen above, the Commission has detailed information at its disposal about the risk exposure, which confirms that the situation is not uniform: operational programmes implementing the European Regional Development Fund, the European Social Fund, the Youth Employment Initiative and the Cohesion Fund, fall in the three categories of risk.

1.24 As regards ‘**Natural Resources**’, the Commission is satisfied with the ECA's finding in Chapter 6 that EAGF direct payments, representing 69% of spending under natural resources, continues to be free of material error.

For market measures (2.4 % risk at payment) and rural development (2.9% risk at payment) the Commission considers that, although the error rates have been on a downward trend over recent years, in pursuing lower levels of error it is necessary to balance legality and regularity with the achievement of policy objectives while bearing in mind the delivery costs. In any case, when taking into account the corrective capacity, there is assurance that the remaining final risk to the EU budget is significantly below materiality.

1.25 Concerning ‘**Competitiveness**’, the Commission considers that the higher-risk expenditure under this chapter relates to parts of Horizon 2020 and shares the opinion that personnel costs and other direct costs are the main sources of error.

On the other hand, some parts of research programmes are low risk, for instance the Marie Skłodowska-Curie action and the European Research Council grants.

1.26 Referring to ‘**Global Europe**’, based on its own detailed management assessment per programme (see 2020 Annual Management and Performance Report, p. 61-62), the Commission considers that the lower-risk expenditure under this chapter is not limited to merely the budget support segment. As transparently reported in the Annual Activity Reports of the External Relations DGs, most of the direct and indirect management segments have a low risk at payment except ENI-IPA direct management grants, for which DG NEAR has issued a reservation and set up an action plan.

### **Eligibility errors still contribute most to the estimated level of error for high-risk expenditure**

1.27 The Commission acknowledges that **complex rules** contribute to a higher risk of error. It is therefore continuously working to simplify rules to the extent possible and increase the use of simpler delivery mechanisms such as simplified cost options. Reducing red tape for beneficiaries and reducing complexity is one of the guiding principles for the 2021-2027 Multiannual Financial Framework.

See also Commission reply to paragraph 1.23.

1.28 The Commission is taking preventive action to tackle the most frequent errors and requests remedial measures as soon as deficiencies are detected.

In 2020, for **Cohesion policy** audit authorities reported for the third year irregularities they found in their audits of operations following a common typology agreed with the Commission and shared between the Member States. Most of the irregularities identified by audit authorities and the

Commission concern the same main categories: ineligible expenditure, public procurement, audit trail and State aid.

The typology of audit findings reported year on year to managing authorities by audit authorities should allow them to integrate the more frequent sources of errors in their risk assessments and to adapt their management verifications approaches and tools accordingly.

As regards the **Common Agricultural Policy**, the Commission refers to its replies in Chapter 6, including paragraph 6.31. The Commission is committed to address the main risks for the CAP Funds of the existing root causes of errors by means of audit enquiries and action plans in certain Member States. The Commission is also addressing these issues by ways of preventive measures, like simplification of legislation and capacity building in Member States, as described in DG AGRI's Annual Activity Report.

### **We did not find a material level of error in low-risk expenditure**

1.31 Based on its detailed assessment (see 2020 Annual Management and Performance Report, Volume II, p. 78), the Commission considers that the (parts of) funding programmes that are low risk, meaning that the associated risk at payment is below 1.9%, represent 56% of the relevant expenditure in 2020.

This includes the expenditure of the CAP paying agencies and the European Maritime and Fisheries Fund as well as the operational programmes for 'Cohesion' with a low error rate; expenditure related to the Marie Skłodowska-Curie actions; the European Research Council grants; the European Space Agency and the European GNSS Agency; the Connecting Europe Facility; Erasmus+; the Asylum, Migration and Integration Fund; and budget support, subsidies and administrative expenditure.

As regards the **CAP**, the Commission is satisfied with the ECA's finding in Chapter 6 that EAGF direct payments, representing 69% of spending under natural resources, continues to be free of material error. This finding is in line with the Commission's own findings in the Annual Activity Report of DG AGRI.

### **The Commission's estimate of error is at the lower end of our range**

1.34 The Commission builds its **assurance** from the bottom up and at a detailed level. This means that hundreds of thousands of checks are carried out every year by the Commission and the Member States and used to determine the risk at payment. Based on its in-depth approach, the Commission is in a position to demonstrate the differentiated situation for the funds managed. This allows the Commission to focus its efforts appropriately, to provide its support efficiently and to address specific weaknesses even for policies or programmes which, taken globally, are low risk, such as the Common Agricultural Policy.

The objective of, the Commission remains that the **risk at closure** is below the materiality threshold of 2%. This risk is an estimate of the errors that will remain at the end of the programmes' life cycle, once all ex-post controls and corrections have been made (those that will take place between the time of the reporting and the end of the programme's life cycle).

For 2020, it is estimated at 0.9%, well below 2%, even for each reporting year.

### **Issues remain with the process for preparing the AMPR and the regularity information therein**

1.35 Directors-General receive a delegation from the College to implement their share of the EU budget. The Commissioners are regularly kept informed of the preparation of the AARs. Similarly, the College is regularly informed in the course of the preparation of the AMPR.

1.36 The **adoption of the AMPR** follows a strict and robust procedure, which includes dialogues between DGs and commissioners, inter services consultations, cabinet-level meetings and information notes to the College. The College ultimately takes responsibility for the AMPR after an oral discussion.

At key moments in the preparation of the AMPR, the Corporate Management Board provides the central services with orientations on the content and structure of the AMPR.

The Secretary General and the Director General for Budget provide detailed instructions, guidance and training on the production of the Annual Activity Reports.

The scope of the quality review of draft AARs and of the peer reviews is defined in the instructions issued by the Secretary General and the Director General for Budget. The role played by the central services in the AAR review process reflects the division of responsibility as set out in the Commission's governance arrangements.

1.37 Common reply to paragraphs 1.37 to 1.39:

The Commission is confident about the information regarding the levels of error and risks at payment presented in the AMPR. They are based on the controls and audits carried out by the Commission and Member States on the basis of their carefully established control strategies, tailored to the specificities of the spending programmes.

In addition, the Commission's approach, as manager of the EU budget, is different from that followed by the ECA in its auditor's role. This may result in some differences between the estimation of the level of error by the two institutions.

As regards CAP under '**Natural Resources**', the Commission does not consider that there are issues affecting the Commission's estimate of the risk at payment. The Commission emphasizes that its estimate for the risk at payment, as presented in DG AGRI's AAR and in the AMPR, remains, at 1.9%, consistent with the ECA's estimate of 2% for the Natural Resources chapter, similar to previous years (see also Commission reply to paragraph 1.39). This was made possible by the robust CAP assurance model including the overall well functioning governance systems in the Member States.

Similarly, for '**Cohesion**', the Commission provides assurance in a detailed manner at the level of each operational programme. As explained in Chapter 5, this allows the Directors-General to provide assurance and issue reservations as needed, on each of the 418 individual OPs, as per their obligations. It allows adjusting error rates reported by Member States when needed and thus, reporting a nuanced view of the level of error differentiated for each programme and, overall, across the policy area. The Commission notes that its estimate on the error for 'Cohesion' falls within the interval calculated by the ECA.

This programme specific approach also allows identifying in the AARs the need for potential additional financial corrections for individual programmes, and to identify the specific part(s) of programmes and payments made that are most likely to be affected.

See also Commission reply to 5.37-5.49.

For **‘Competitiveness’**, the Commission considers that the risk of a possible understatement of the error rate is covered and that the aggregated risk at payment, and risk at closure disclosed in the AMPRs are reliable. The Commission followed up on the ECA recommendations from the 2018 and 2019 ECA Annual Reports. In this respect, the Commission has reported a topped up representative error rate in the AARs related to research and innovation. Moreover, the Commission implemented some actions to improve the quality of the audit work and the ECA has acknowledged the improvements as a result of these actions. Nevertheless, a number of cases identified by the ECA had either a non-quantifiable or a non-material financial impact.

In relation to **‘Global Europe’**, the Commission considers that the RER study is fit for purpose. The Commission does not consider that the study is subject to limitations that may lead to an underestimation of errors.

1.39 Second indent - Concerning **‘Cohesion’**, the Commission notes that its estimate of the risk at payment falls within the error interval calculated by the ECA.

Third indent - Concerning **‘Natural resources’**, the Commission welcomes that DG AGRI’s estimate of the risk at payment (1.9 %) is very close to and within the range of the ECA error rate (2.0 %).

### **The Commission’s reporting on financial corrections and recoveries is complex and not always clear**

1.40 The Commission stresses the importance of the **preventive and corrective measures** to ensure that only expenditure made in accordance with the legal framework is financed by the EU budget, thus protecting the financial interest of the Union and demonstrating its corrective capacity. These measures also incentivise the Member States to improve their management and control systems.

While having the same ultimate objective, the mechanisms foreseen in the legal basis of the different programmes may significantly vary between different areas of spending. Furthermore, the impact of corrective measures can also vary since the respective legal bases may foresee the application of net financial corrections and/or the replacement of ineligible amounts with eligible projects.

In order to provide a complete and transparent overview of the preventive and corrective measures, the impact of all these different mechanisms therefore needs to be presented.

The current reporting has been designed to answer the requests of different stakeholders. The Commission will analyse whether the reporting on financial corrections and recoveries can be further streamlined for the 2021-2027 MFF.

1.41 The Commission considers the **‘confirmed’ corrections and recoveries** as the most important information for reporting purposes since they represent the Commission decision or Member State acceptance to apply a correction. However, there might be a time difference between this decision and the implementation of the corrective measure, for reasons stemming directly from the applicable legal frameworks. Therefore, both ‘confirmed’ and ‘implemented’ are important notions.

In addition, the Commission uses both preventive and corrective tools. Ex-ante deductions are the most efficient mechanisms to prevent ineligible expenditure from being financed from the EU budget. Ex-post corrections generally relate to ex-post control or audit findings.

The Commission stresses that both net corrections and replacements are corrective measures that ensure that irregular expenditure is excluded from the EU funding and put pressure on Member States to address weaknesses in their management and control systems.

1.43 Under ‘**Cohesion**’, for the 2014-2020 programming period, the Member States apply financial corrections in their annual programme accounts submitted to the Commission. This information is aggregated in full transparency in AARs, each year (EUR 1.5 billion and EUR 0.5 billion withdrawn from accounts in the accounting year, respectively for ERDF/CF and ESF/YEI in 2020). These financial corrections are not included in the EUR 1 098 million amount. Net financial corrections, despite complex criteria to be met as set by the co-legislator, continue to work as an incentive for Member States to carry out financial corrections in first instance, before submission of the accounts.

1.50 The Commission would like to clarify that the weakness in the **RER study** identified by the ECA in Chapter 8 relates to the fact that the procedure for reporting suspected fraud to the Commission is not sufficiently formalised. The Commission accepts the related recommendation (please see Commission replies to paragraph 8.28 and to recommendation 8.3).

## CONCLUSIONS

1.53 In conclusion, the Commission attaches great importance to sound financial management of the EU budget. As manager of the EU budget, the Commission put in place **robust, multiannual control strategies** designed to prevent, detect and correct weaknesses identified. It also takes action to strive for further simplifications across programmes.

Concerning the revenue side of the EU budget, the Commission considers, in line with the ECA, that it is free from material error.

Concerning the expenditures, the Commission considers that the error rate that represents best all the efforts made, both by the Member States and by its services, is the risk at closure (see also reply in paragraph 1.35) which measures the level of error remaining once all ex-post controls and corrections have been made. For 2020, the overall risk at closure is estimated at 0.9%, well below the 2% materiality threshold, and in line with both previous years’ level (0.7% in 2019).

In addition, thanks to its own **detailed management analysis per programme** (see also reply to paragraph 1.17 b), the Commission is able to have a nuanced picture of the level of risk within the policy areas and within the spending programmes. This demonstrates that the risks at payment on the expenditure per policy areas are not homogeneously low, medium or high (see AMPR 2020, Volume II, p 78). This allows to identify precisely where the risks and their root causes are and to take targeted corrective measures:

- **lower risk expenditure**, those with a risk at payment below 1.9%, represent 56% of the total expenditure,
- **medium risk expenditure**, with a risk at payment between 1.9% and 2.5%, represent 16% of the total expenditure and,
- **higher risk expenditure**, with a risk at payment above 2.5% or serious weaknesses identified, represent 28% of the total expenditures.

This contributes to the Commission's conclusion that the **risk at payment is below the materiality threshold** for more than half of the relevant expenditure.

**REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2020  
ANNUAL REPORT "CONTRIBUTION TO ANNUAL REPORT 2020  
CHAPTER 2 – BUDGETARY AND FINANCIAL MANAGEMENT"**

**INTRODUCTION**

2.1 The EU budget was at the heart of the **EU response to the COVID-19 pandemic**. It took the Commission only three weeks from the designation of the COVID-19 outbreak as a pandemic by the World Health Organisation on 11 March 2020 to put forward **proposals for a coordinated and comprehensive response** through the EU budget. This involved **mobilising financing** quickly and flexibly to address the most pressing needs, without making any compromises on applying the **highest standards of financial management**. That response included the following measures:

- **the Coronavirus Response Investment Initiatives (CRII)** under cohesion policy facilitating flexibility arrangements and mobilising **some EUR 23 billion for Member States**. The initiatives help fighting the COVID-19 pandemic by **supporting healthcare, small businesses and workers**;
- the reactivation of the **Emergency Support Instrument**, with a budget of EUR 2.7 billion - complemented by a further EUR 750 million of **additional contributions from Member States** - to fight the **cross-border health emergency**;
- EUR 415 million in additional financing for the **Union Civil Protection Mechanism / rescEU** to provide **immediate disaster relief** to the most affected areas;
- the **extension of the EU Solidarity Fund** to cover major health crises in addition to natural disasters; and
- a novel financial instrument – the **support to mitigate unemployment risks** in an emergency programme (SURE) – with a budget of up to **EUR 100 billion**.

The European Parliament, the Council of the European Union and the Commission worked together seamlessly and rapidly to **adopt these measures in record time** and they had entered into force **by the end of April 2020**. The highly innovative SURE programme came into force on 19 May 2020.

Financing these measures required the mobilisation of all means and flexibilities. In total, the **2020 budget was increased by over EUR 10 billion in payments**, activating all remaining resources under the 2014-2020 multiannual financial framework **and made available up to EUR 70 billion in commitment appropriations towards addressing the COVID-19 crisis**. In particular, the coronavirus response investment initiatives made it easier for Member States to access funding quickly, while the Emergency Support Instrument allowed the Commission to coordinate and assist procurement efforts necessary to combat the crisis.

**Proactive budgetary management** ensured the speedy and effective implementation of the 2020 budget. **Nine amending budgets were adopted** as proposed by the Commission, more than in any other year in the 2014-2020 period and often in record time. Moreover, 28 budgetary authority transfers and hundreds of autonomous Commission transfers were made. **As a result, the 2020 EU budget was spent almost entirely**, in both commitments and payments – the best outcome since 2014, and achieved despite the challenging environment.

## Budgetary and financial management in 2020

2.3 The Commission underlines that **the reinforcements** introduced with the amending budgets in 2020 - which aimed to provide a response to the COVID-crisis - to a large extent **related also to the mobilisation of ‘non-thematic’ special instruments**, e.g. **the Flexibility Instrument** (EUR 1.1 billion) and the **Global Margin for Commitments** (EUR 2.7 billion). As such, the additional financing also addressed other challenges, in particular relating to **migration and security**.

2.7 Since the outbreak of the pandemic, the European Parliament, the Council of the EU and the Commission have agreed on an **unprecedented recovery instrument (Next Generation EU) of around EUR 800 billion** (in current prices) as a targeted response to the pandemic; this will be the subject of **regular reporting** as laid down in legislation.

2.8 The Commission points out that the report on the Covid-19 immediate response expenditure the ECA referred to in this paragraph covered programmes and instruments for which pledges, redeployments and/or reinforcements were made during 2020 for COVID-19 related purposes. For example, commitments marked under Heading 5 have not been included in this report.

The **coronavirus dashboard** provides an overview of EU cohesion policy response to the COVID-19 crisis, including **thematic reprogramming** (showing reallocations of available cohesion policy resources to health actions, business support, support for people to combat the effects of the pandemic) together with the **quantified targets set for new COVID-19 specific indicators**, as well as a take up of financial flexibility and liquidity **CRII(+)** measures.

2.11 After a delayed start, the implementation of Cohesion policy programmes is **progressing well**. The Commission stresses that the **high absorption rates in 2019 and 2020** show that part of the delay at the start of the programmes is being recovered.

2.17 After a delayed start, the implementation of the 2014-2020 Cohesion policy programmes is progressing well. The **project selection rate** for ERDF and Cohesion Fund at the end of 2018, which the Commission considers to be one of the pre-conditions and indications of future absorption, got ahead of the same reference period in 2007-2013. This **positive trend** has been confirmed at the end of December 2020, with the selection rate for overall cohesion policy **reaching 107%** (i.e. about 10 percentage points higher than for 2007-2013).

The Commission stresses furthermore that the high absorption rates in 2019 and 2020 show that part of the delay at the start of the programmes is being recovered.

The **overall impact** of factors linked to the COVID-19 crisis is yet to unravel and **will be** fully discernible in 2021.

The Commission considers that conclusions from comparisons made with the previous MFF should be drawn with caution as certain relevant **differences between** the Common Provision Regulation (CPR) for the 2007-2013 and 2014-2020 **programming periods** (such as high level of annual prefinancing, the n+3 rule and the annual acceptance of accounts process) imply that the **payment rate for the latter** is liable to be slower.

The Commission also underlines that the year **2013** of the previous MFF **was an exceptional year due to transitional arrangements** for the new Member States of the 2004 and 2007 EU

enlargements. To a majority of these Member States<sup>1</sup> the “n+3” rule applied to 2008-2010 commitments, as well as in parallel the “n+2” rule to 2011-2013 commitments. This **significantly raised the level of payments** needed to avoid de-commitment. There was no comparable effect at the end of 2020. In addition, the situation is not fully comparable also due to **different ending date for eligibility of expenditure**: while in 2013 there were only two years left for the implementation (until 31 December 2015), in 2020, there were three years left for 2014-2020 ESIF programmes (31 December 2023) – except for the European Agricultural Fund for Rural Development (EAFRD), where the existing programmes will continue until the end of 2025. Furthermore, as also pointed out by the ECA in paragraph 2.15 of this report and also of its Annual Report 2019, **the implementation rates of the EAFRD (65%) were higher than for other ESI Funds**. The Commission therefore points out that the **implementation delays** described in this paragraph of the report **do not relate to the European Agricultural Fund for Rural Development (EAFRD)**.

2.20 The lessons learnt from the **Task Force for Better Implementation** set up to improve the implementation of the Structural Funds and the Cohesion Fund with respect to 2007-2013 period have been mainstreamed for programmes in difficulty in the current period.

The Commission is **closely monitoring the programmes** considered to be at risk of delays **to help prevent under-absorption** and potential decommitment. It is **in close dialogue with the Member States concerned** to improve the situation.

The Commission reiterates that performance issues are addressed throughout the programming period, as it has already stated in its replies to ECA special report 17/2018.

In 2014-2020, a **strong focus on result orientation** has been put in place and on a performance framework **with milestones and targets** to ensure that progress is made as planned. In the course of the **2019 performance review**, particular attention was paid to programmes at risk of underperformance and/or decommitment, so as to support the identification and implementation of corrective actions on the ground.

The Commission provides substantial support to Member States including **technical assistance and advisory services** to improve their absorption capacities and the results achieved (e.g. Peer2Peer exchange of good practices and expertise under “REGIO TAIEX”; “JASPERS” helping to prepare quality projects that can improve absorption for 2014-2020).

Furthermore, the Commission proposed several measures to help Member States cope with the COVID-related crisis, including **legislative changes** under the Coronavirus Response Investment Initiative (CRII) and under the Coronavirus Response Investment Initiative Plus (CRII+). These amendments were adopted and provided for **additional flexibility and liquidity** to deploy cohesion policy support rapidly and were aimed at reducing the administrative burden.

In March 2020, the Commission set up the CRII Task Force to assist Member States in implementation of the anti-crisis measures. By the end of 2020, nearly 500 CRII-related **interpretation questions were answered** by DG REGIO and DG EMPL **in a speedy manner** and the responses were published on a dedicated website accessible to all managing authorities.

A significant **reprogramming** effort took place in 2020. The Commission adopted the relevant programme amendments **in record time** in order **to address the urgent needs** of each Member State

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<sup>1</sup> The exceptions were Croatia, Romania and Slovakia, to which the “n+3” rule applied for the whole period.

due to the coronavirus crisis. In addition to reprogramming of funds, **other simplifications** are available and **are being used by the Member States** such as the extension of deadlines, accelerated payments, retroactive eligibility of COVID-related expenditure, etc. Measures proposed by the Commission for the “The **Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU)**” should also **speed up implementation** of these additional resources; such measures include provisions whereby the EU co-financing may reach 100%, provisions defining the scope of support wide enough **to cover the needs comprehensively**, and a number of restrictions normally applicable to cohesion policy which will not apply to REACT-EU.

Furthermore, as the Member States are channeling REACT EU resources into the existing delivery system for cohesion policy, it should ensure **smooth implementation**.

## Risks and challenges

2.21 The Commission refers to its reply to paragraph 2.20.

2.22 The introduction of a number of **simplification measures**, as well as the **significant reduction of the pre-financing**, may provide an incentive for quicker submissions of interim payment claims in the new programming period. As regards the risk of delayed start to the implementation of shared management funds in the 2021-2027 MFF referred to in the first indent of this paragraph, providing for **a period of overlapping eligibility of expenditure between the two programming periods** is necessary given that many operations take several years to be implemented and that there will always be a start-up phase and wrapping up phase. The Commission enhances continuity between periods through a number of measures, including **phasing of larger projects**.

2.24 The pandemic in 2020 and the consequential **priority given to the approval of the European Union Recovery Instrument** is the main reason of the delayed adoption. However, since the conclusions of negotiations between the co-legislators on the content of the cohesion policy legislative framework in February 2021, the Commission and the Member States have carried out an **intense informal dialogue**. This will allow a **rapid formal submission** of partnership agreements and programmes upon entry into force, **as well as their approval**.

2.25 The Commission refers to its replies to paragraphs 2.22 and 2.24.

The Commission’s proposal for 2021-2027 cohesion policy legislation was made in May 2018, **almost half a year earlier** than the equivalent in 2011.

2.26 The Commission points out that the implementation delays described in this paragraph do not relate to the European Agricultural Fund for Rural Development (EAFRD).

See also Commission reply to paragraph 2.18.

2.27 EU cohesion policy funding invests in **administrative capacity building in Member States** under "Thematic Objective 11" in the 2014-2020 programming period and under Technical Assistance for strengthening the administrative capacity for the management of the funds. The investments in the administrative capacity of the Member States will continue to be funded in the 2021-2027 programming period. Furthermore, **Member States can complement** "standard" technical assistance **with a second type** of technical assistance, i.e. ‘**financing not linked to costs** technical assistance’ (Article 37 CPR). In addition, several Member States will develop administrative capacity building roadmaps for the 2021-2027 period including a **reorientation to encompass a broader range of capacity building activities**. This, coupled with significant simplifications of cohesion policy in 2021-2027, should allow for solid implementation of EU funds.

2.29 The Commission refers to its reply to paragraph 2.22.

As regards the EAFRD, the Commission points out that although at the time of drafting this reply there was no agreement on the CAP Regulations, the European Council conclusions on the MFF from July 2020 agreed on the n+2 rule for the EAFRD.

2.30 The Commission stresses that **it is the prerogative of each Member State to choose which programme to use for a specific investment or reform**. Moreover, in the implementation of the RRF, the Member State is a beneficiary and not an implementing partner of the Commission.

The RRF requires Member States to propose national recovery and resilience plans with reforms and investments and will **only receive funding upon progress** in implementing those.

The Commission considers that the fact that **RRF provides full financing of the estimated cost** of the plan (up to the maximum allocation) is appropriate given the dire funding need of the Member States in the aftermath of COVID. Furthermore, RRF funding **requires the respect of a set of conditions** (assessment criteria and milestones and targets) and may be more suitable for Member States in certain situations which may altogether result in a more targeted use of the different funding instruments available.

In light of the above, the Commission is of the opinion that the **attractiveness of a funding instrument** compared to another (e.g. RRF vs shared management funds) **cannot be assessed solely on the basis of the share of costs** that would be covered by one or the other. In any case, Member States are required to ensure the absence of double funding.

2.32 The Commission, confronted with the **COVID-19 pandemic**, has provided further **targeted support to programme authorities** to address the situation and worked with the audit authorities to ensure a robust and harmonised approach. In the face of the situation, a clear message was passed to programme authorities that **compliance with rules remains a prerequisite**. **Possible new risks** introduced by the policy response to the COVID-19 pandemic, including inherent risks linked to the new types of expenditure or agreed procedures, **are assessed with audit authorities**. Furthermore, the Commission proactively put in place **CRII Q&A platform website** to support managing and audit authorities with concrete answers to their questions in the uptake of the CRII measures. Several hundreds of questions were answered. The Commission has also provided audit authorities with a dedicated reflection to analyse possible scenarios which arise from the crisis context and **update the assessment of risks** in view of their audit planning and work. Finally the Commission, as part of the **continuous update of its internal control system**, has revised its risk register and identified specific new risks with concrete **mitigating initiatives** being put in place in the ongoing and future annual management exercises.

As **for the EAFRD**, the Commission adopted Regulation (EU) No 2020/532 which provides rules with **realistic and attainable control requirements** for the Member States. The **amended rules were limited in time and scope** and proposed alternative methods to carry out the controls by the Member States under the COVID-19 restrictions and as such, together with the work of the Certification Bodies, continued to provide a good basis for assurance.

2.33 The RRF is a **performance-based instrument**, where payments are made based on the fulfilment of milestones and targets. Accordingly, the legality and regularity of the payments is exclusively linked to the successful achievement of the agreed milestones and targets.

Article 22 of the Regulation imposes on **Member States**, as beneficiaries of the EU funds, an obligation to **provide an effective and efficient internal control system**, including the check of

compliance with applicable EU and national law and the **avoidance of double funding**. In that context, the **Commission may conduct systems audits** of the Member States' internal control setup during the lifetime of the instrument in order to ensure that the Member States comply with their obligations under Article 22. In addition, the Commission will also, during the implementation of the plan, perform risk-based controls and **audits in cases of suspicion of serious irregularities** not corrected by the Member States (i.e. fraud, corruption or **conflicts of interest**) or **serious breaches** of obligations of the financing agreement or the loan agreement.

Ultimately, the Commission is empowered to **proportionately reduce and to recover** amounts of the non-repayable support or to ask for early repayment of loans **in cases of fraud, corruption, conflict of interest** affecting the financial interests of the Union that have not been corrected by the Member State, and/or serious breaches of obligations laid down in the financing and/or loan agreement (which include double funding).

See also Commission reply to paragraph 2.30.

2.37 Although the SURE instrument has increased the EU budget's nominal exposure to financial risks by raising the volume of EU lending by almost €90 billion by the end of May 2021, its construction was **designed** so that **the risk to the EU budget is minimised** in practice.

In addition to the guarantees provided by all Member States, there are a number of **prudential rules** in the SURE Regulation such as i) **a concentration limit** on the three largest loans of 60% of the maximum amount granted under SURE, ii) **a maximum annual exposure of 10%** (i.e. payment due each year does not exceed €10 billion) and iii) the possibility for the Commission to roll over its borrowings if necessary.

2.39 The annual risk exposure of the EU budget for 2020 and 2021 as discussed in this paragraph shall be divided into two components: **exposure** for which provisioning is **provided by a guarantee fund** (e.g. payments related to third countries) and **exposure without provisioning** (e.g. payments due by Member States).

However, these figures include the risk linked to **exposure to third countries** (EUR 3.1 and 3 billion for 2020 and 2021, respectively) which is **borne** in the first place **by the Guarantee Fund for External Action**.

2.40 Besides enhancing its framework to manage the risk arising from the different sources of contingent liabilities, the Commission is already implementing a new **diversified funding strategy** to respond adequately to the more demanding approach to finance NGEU **on capital markets**<sup>2</sup>.

The Commission refers to its reply to paragraph 2.37.

## CONCLUSIONS AND RECOMMENDATIONS

2.42 The Commission stresses that the **reinforcements** introduced with the amending budgets in 2020 were partly **aimed to provide a response to the COVID-crisis**, as well as to mobilise a number of special instruments to address other challenges, in particular those related to **migration and security**.

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<sup>2</sup> Communication on a new funding strategy to finance Next Generation EU, COM(2021) 250 final of 14.4.2021

2.44 The Commission underlines that its **internal report on the COVID-19 immediate response expenditure** – showing the commitment of EUR 12.9 billion under direct and indirect management as the amount that had been made available for COVID-19-related purposes by the end of 2020 – has been limited to programmes and instruments for which pledges, redeployments and/or reinforcements were made during 2020 for COVID-19 related purposes. As such, certain commitments – such as, for example, those marked under Heading 5 – have not been included in it.

The Commission has started **tracking internally EU funds used for COVID-19-related purposes** as from the first half of 2020, including for commitments already made beforehand.

2.45 The Commission underlines that the level of outstanding commitments (**RAL**) always **increases if** the difference between the level of commitments and the level of payments is positive and it is **not mitigated by de-commitments**. The level of payments depends on the **spending needs of programmes**. The main driver is the implementation by the Member States of the funds in shared management. Payments also depend on the **Budgetary Authority** granting the necessary means in the annual budgets.

Furthermore, the Commission refers to its reply to paragraph 2.11.

2.46 Common Commission reply to paragraphs 2.46 and 2.47:

The Commission points out that the **implementation delays** described in this paragraph **do not relate to the European Agricultural Fund for Rural Development (EAFRD)**.

After a delayed start, the implementation of the 2014-2020 Cohesion policy programmes is **progressing well**.

See also the Commission's replies to paragraphs 2.17, 2.18 and 2.20.

2.48 Concerning the **risk of delays in the implementation of shared management funds** in 2021-2027 MFF, the Commission refers to its reply to paragraph 2.22.

Concerning the **increased risk due to RRF**, the Commission refers to its reply to paragraph 2.33.

Furthermore, as noted in its reply to paragraphs 2.19 and 2.26 and as indicated by the ECA in paragraph 2.24, the Commission points out that the **delays in the adoption** of the required legislation **and the slow absorption** (and other associated risks) described in this paragraph **do not relate to the European Agricultural Fund for Rural Development (EAFRD)**, due to the adoption of a transition regulation (Regulation (EU) 2020/2220 of the European Parliament and of the Council of 23 December 2020) and the extension of the rural development programmes.

2.49 The Commission points out that, in order to cater for the increasing amount of **contingent liabilities** (and the related risk to which the EU budget is exposed), it is developing **new risk management tools** including, inter alia, the establishment of a cross-DG Steering Committee on contingent liabilities<sup>3</sup>.

The Commission refers to its reply to paragraph 2.37.

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<sup>3</sup> Commission Decision of 24.7.2020 on establishing the Steering Committee on Contingent Liabilities arising from Budgetary Guarantees, (C(2020) 5154

### Recommendation 2.1 – Reporting on EU funds for COVID-19-related purposes

The Commission **partially accepts** the recommendation.

From 2021, the Commission **will focus on the recovery from the COVID-19 pandemic** and fulfill its **reporting** obligations, in particular, **for Next Generation EU**. The Commission does not intend to prepare further reporting on the immediate response beyond the **already existing reports** of the various instruments.

### Recommendation 2.2 – Gradually reducing outstanding commitments

The Commission **accepts** the recommendation.

The Commission will **monitor the implementation of the budget** and the evolution of the overall level of outstanding commitments (RAL), as well as the related underlying factors. It **regularly informs the Council and the European Parliament** of the forecast needs and potential risks for the future. This information is included notably in an **annual report on a long-term forecast** for the EU budget payments. The Commission prepares its **forecast based on a wide range of available data** (the execution of the previous years' budgets, the implementation and latest developments of the actual budget and the future needs presented in the draft budget for the following year). In addition, the Commission takes into account Member States' forecasts for the implementation of the European Structural and Investment Funds (**ESI Funds**) – **the main driver** behind the overall payment estimates under the MFF.

For the 2021-2027 period, the Commission proposed a series of **simplification measures** to facilitate and accelerate the implementation of cohesion policy. While most of those have been retained in the political agreement reached between the co-legislators, the Commission regrets that the **return to the n+2 decommitment rule has not been approved**. At this early stage of the new budgetary cycle, the Commission considers that **the effects of keeping the n+3 decommitment rule**, in combination with the late agreement on the legislation governing most of the funds in shared management, and the focus of national authorities on the implementation of Next Generation EU in the next years given its more limited time frame, **will lead to maintaining the trend of nominally growing RAL during the 2021-2027 MFF**.

Moreover, the Commission recalls, on the one hand, that the **adoption** of the budget **lies** ultimately **within the remit of the budgetary authority**, which involves the granting of sufficient level of payment appropriations, and on the other hand, that implementation, in particular for the funds in shared management, is managed by **national authorities** and largely depends on the rules set by the co-legislators in the relevant basic acts. In this context, the Commission will continue to **cooperate closely** with the European Parliament and the Council, as well as with national authorities in the Member States.

### Recommendation 2.3 – Promoting the sound use of EU funding

The Commission **accepts** the recommendation and has already begun to implement it.

As regards **cohesion policy** in shared management, the Commission is already providing significant **advisory support to Member States**, and will continue to do so. As regards additional risks that could arise in the context of the crisis and of the additional funds allocated to Member States, the Commission stresses that it has provided further **targeted support to programme managing authorities** to address the situation and worked in parallel with the audit authorities to ensure a

**robust** and harmonised **audit approach**. Despite the situation, a clear message was passed to programme authorities that **compliance with rules** remains a prerequisite.

The Commission **continues to carefully assess the situation and** the possible **impact of a prolonged crisis** on the assurance process and provides support to all programme authorities on an ongoing basis **to improve their administrative capacities**.

As for the **EAFRD**, the Commission continues to support Member States through technical assistance available in the EAFRD and in the European Union Recovery Instrument (EURI) as well as through existing **CAP networks** and capacity building activities, including guidelines and best practices dissemination.

The Commission refers to its reply under paragraph 2.32.

Regarding the **RRF**, as the largest new funding instrument, the beneficiaries are the **Member States** which bear in turn the **principal responsibility** for sound use of funds - see also paragraph 2.33. The Commission services have **provided guidance** and worked with Member States to put in place **sound monitoring and control systems**.

This was done in particular through general guidance on drafting **Recovery and Resilience Plans** (RRPs) with dedicated sections on controls and audit and on monitoring of implementation, answers to specific Member State questions, feedback to first outlines or drafts of monitoring and control systems, and the provision of a self-assessment checklist on control and audit systems for the Member States.

The **Commission will further assess the control systems** described by the Member States in their final Recovery and Resilience Plans. During the implementation of the Facility, the Commission can initiate checks and audits and **recover funds** if Member States breach their obligations or fail to **correct any serious irregularities**.

Member States may also request technical support from the **Technical Support Instrument** throughout the implementation period. Additionally, **European Semester officers** in the Member States will be able to provide assistance during the implementation of the RRF.

Concerning **SURE**, the Commission provided **advisory support to Member States** by engaging with them early at technical level to determine which expenditures would be eligible for SURE funding, and their costing, **prior to formal funding requests**. The Commission regularly **monitors the use of SURE loans** through bi-annual reports, and also on the basis of Member States' reporting obligations when financial assistance was granted ex-ante for planned expenditure. The Commission has paid attention to reporting gaps by Member States in order **to improve the quality of information reported**. Where the Commission identifies potential absorption issues in Member States, it engages bilaterally with these Member States to **discuss potential solutions** and ensure the full financial assistance is used appropriately.

**REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF  
AUDITORS' ANNUAL REPORT  
CONTRIBUTION TO ANNUAL REPORT 2020 CHAPTER 3 – REVENUE**

**INTRODUCTION**

3.1 The Commission welcomes that the **revenue chapter is free of material error** and that **revenue-related systems examined were generally effective**.

As regards **traditional own resources (TOR)** and **value added tax-based (VAT)** own resources, the Commission is taking action to intensify the follow-up on longstanding open TOR points and lifting VAT reservations where possible and to follow-up on the TOR accounting weaknesses identified by ECA's audits in France, Spain and the Netherlands. Non-recovered amounts in the B account will continue to be closely monitored in all Member States. The weaknesses identified by the ECA in its special report 4/2021 "*Customs controls: insufficient harmonisation hampers EU financial interests*" will be addressed by strengthening EU-wide risk assessment and data mining and developing joint analytics capability. Further action will be taken to improve risks assessment for TOR inspection planning and the Commission is considering yearly desk reviews on TOR accounting separate from its normal inspection programme. New approaches and tools to address risks related to e-commerce will be explored and the enforcement strategy on undervaluation implemented in line with the Court of Justice's judgment in the case against the United Kingdom, which is expected in early 2022.

With regard to **gross national income-based (GNI-based)** own resources, the Commission is taking comprehensive actions on the treatment of globalisation including research and development (R&D), for GNI for own resource purpose. The Commission takes the view that the actions taken are proportionate by balancing the assurance already gathered with the risks identified for the globalisation issues.

**EXAMINATION OF ELEMENTS OF INTERNAL CONTROL SYSTEMS**

3.8 The Commission noticed, during its TOR inspection in March 2021, lack of real progress to remedy the shortcomings of the **TOR statements in the Netherlands**.

The Commission is of the opinion that the weaknesses mentioned by the ECA do not call into question the **overall effectiveness of the systems in place** to protect the financial interests of the EU and of its Member States in the context of own resources.

3.9 The Commission considers that **reservations** allow protecting the financial interests of the EU and its Member States so that, should it be needed, the required data corrections are made by the country concerned in accordance with EU legislation.

In the particular case mentioned by the ECA, it was necessary for the Commission to notify a reservation to protect the financial interests of the EU and its Member States, and ask for the delivery of a description of the GNI compilation procedures that follows the agreed GNI Inventory Guide. The revised description was delivered on 31 March 2020 and its verification is well advanced.

3.10 The implementation of ESA (European system of national and regional accounts) 2010 led to important methodological improvements in National Accounts, requiring in-depth scrutiny by the Commission. Where needed, reservations were placed, keeping the GNI data for the years from 2010 onwards open for potential changes. In order to limit the number of **GNI reservations**, the Commission placed action points early in the verification cycle, many of them already implemented,

and issued the above-mentioned reservations on specific issues only. The efforts in this direction will be pursued.

3.11 During the past cycle, the Commission took comprehensive actions on the **treatment of globalisation including R&D, for GNI for own resource purposes**. Firstly, the Commission checked that R&D expenditure was capitalised in national accounts and valued according to the applicable rules. Where needed, transaction-specific reservations were placed for some countries. Secondly, it established an Early Warning System to capture the impact in National Accounts of significant restructuring of multinational enterprises (MNEs). Thirdly, a scrutiny of MNEs was launched in 2016 followed by an in-depth review of a selection of MNEs, and no evidence of major distortions to value added was identified. Based on those actions, the Commission placed a transversal reservation on globalisation from 2018 onwards. The Commission takes the view that this timing is proportionate by balancing the assurance already gathered with the risks identified.

3.12 The Commission will continue to intensify **the follow-up of open TOR points** with priority of longstanding points with a potential financial impact. In the first quarter of 2021 alone, 41 additional points (out of 326) were closed. However, it should be stressed that accelerating the closing of open points also depends on Member States' cooperation.

Reservations are a protective measure to mitigate the risk that an incorrect VAT-based own resource calculation becomes time-barred.

The Commission works in close partnership with Member States, actively identifying ways for solving issues and taking action whenever possible. This is done in accordance with Commission procedures and applicable legislation, aiming at closing outstanding reservations.

### **Box 3.2 - Persistent weaknesses in the national control systems for compiling TOR statements**

The Commission will follow up on the problems identified by the **ECA's audits in Spain, France and the Netherlands** in its usual follow-up to the ECA's findings and these Member States will be required to take appropriate measures to address and resolve the shortcomings identified.

The follow up of the ECA's audit findings identified in Spain has by now started and the Netherlands has already been asked to take remedial actions. The Commission noticed, during its TOR inspection in March 2021, lack of real progress to remedy the shortcomings of the TOR statements in the Netherlands.

If no or insufficient progress is made within a set timeframe to remedy accounting shortcomings the Commission services will not hesitate to consider the file under the infringement proceedings laid down in Article 258 TFEU.

3.16 The Commission recalls that in an account of this type there is by nature a high risk of shortcomings and complexity involved. The Commission will continue examining the B account in its **TOR inspections**. In addition, the 2020/2021 TOR inspection programmes focus in particular on TOR accounting to respond to the ECA's recommendation made in previous years.

3.17 The Commission **follows up on the issues identified** by the ECA in Spain, France and the Netherlands in its usual follow-up to the ECA's findings and these Member States will be required to take appropriate measures to address and resolve the shortcomings identified. As the ECA rightly points out identical and similar shortcomings were identified by the Commission and will equally be followed-up through its inspection reports.

3.18 As to the **special report No 04/2021 on customs controls**, the Commission refers to its replies provided in that report. On the development and implementation of a fully-fledged analysis and coordination capacity at EU level, the Commission accepted the recommendation. The Commission will make the necessary proposals and seek the support and, where necessary, the approval of the Member States. Regarding the creation of a central function, as announced in the **Customs Action Plan**, the Commission intends to strengthen its analysis capacity by developing **Joint Analytics Capability (JAC)**.

3.19 The Commission recognises the weaknesses identified by the ECA in its special report No 04/2021 and refers to its replies provided in that report. The Commission will seek the support and, where necessary, the approval of the Member States in order to implement ECA's recommendations.

The Commission is planning to strengthen the legal framework, as well as explore new approaches and tools to address risks related to e-commerce, and strengthen its analysis capacity by developing Joint Analytical Capabilities, thus creating an EU analytics hub for collecting, analysing and sharing key customs data.

The New Risk Management Strategy will promote a new structured approach to risk management including, among others, elements to share more systematically information related to operators of interest, e-commerce related issues, new tools and practices to improve the analysis and management of risks and the associated controls.

See also reply to Box 3.3.

### **Box 3.3**

**The Commission's assessment of Member States' control strategies for tackling the undervaluation risk is that they are still inadequate overall**

The Commission agrees with ECA that the EU financial interests were not properly protected in the past due to Member States' inadequate control strategies on **customs value**. However, the Commission follow-up inspections and all further actions taken in 2020 to address the undervaluation risks at EU level have paid off, as there is a significant decline at EU level in potential TOR losses due to undervaluation for 2020.

Furthermore, the Commission has taken further steps for quantifying previous **TOR losses** in all Member States and informed them of their respective preliminary amounts of estimated TOR losses.

The undervaluation work will continue in the future and the Commission has carefully considered the **undervaluation risks for e-commerce and low value consignments** when establishing its 2021 annual TOR inspection programme. A pilot audit on e-commerce is scheduled in two Member States and might be rolled out in 2022 depending the results of the pilots.

### ANNUAL ACTIVITY REPORTS

3.20 The Commission acknowledges that **TOR accounting in the Netherlands** is a longstanding issue and that similar observations on the reliability of the A- and B-accounts' statements were previously raised by ECA and in the Commission inspection reports. However, for the year 2020 a proper assessment of the accounting issues in the Netherlands could not be carried out, as the Commission services' inspection of TOR accounting scheduled for 2020 had to be postponed to March 2021 because of the COVID-19 pandemic. It is being followed up and reporting on the persistent weaknesses relating to the TOR accounting and the compilation of the TOR statements in the Netherlands will take place in 2021.

3.21 See Commission reply to box 3.3.

3.22 The Commission would like to inform that the Advocate General's opinion is expected for 9 September 2021. Therefore, a **judgement by the Court of Justice** on the United Kingdom case before 2022 is unlikely.

## CONCLUSION AND RECOMMENDATIONS

3.23 The Commission will **follow up** on the issues identified by the **ECA's audits in Spain, France and the Netherlands** in its usual follow-up to the ECA's findings and these Member States will be required to take appropriate measures to address and resolve the shortcomings identified.

The Commission is of the opinion that the weaknesses mentioned by the ECA do not call into question the **overall effectiveness of the systems in place** to protect the financial interests of the EU and of its Member States in the context of own resources.

3.24 See Commission reply to point 3.18 and 3.19.

### 3.25 Recommendation 1 of ECA's 2018 annual report

It is the Commission's view that the **inspections covering the years 2017-2021** on valuation fraud in textiles and shoes (including follow-up inspections), control strategy of Anti-Dumping Duties (ADD), including evasion of ADD on solar panels, TOR accounting and pilots on e-commerce and low value consignments address the highest current TOR risks.

Nevertheless, the Commission recognises that there is room for further improvement to its **risk assessment for TOR inspection planning**, in particular as regards the documentation thereof. Hence, the Commission is considering establishing country fiches indicating the track record of each Member State in complying with TOR legislation. Compiling risk indicators in a one or two pager country fiche would certainly be useful and facilitate the risk assessment for each country. Nevertheless, the Commission does not expect that such country fiches would alter the selection of inspection topics or the Member State to be inspected.

Anyhow, the Commission will continue to examine this theme and will take into account the ECA's observations and recommendations to further improve its risk assessment and TOR inspection planning.

### Recommendation 2 of ECA's 2018 annual report

The **reliability of the TOR accounting** is the main inspection topic in the 2020 and 2021 TOR inspection programmes. By the end of 2021, the Commission intends to finalise the inspections on this topic in all Member States and the shortcomings detected will contribute to the risk assessment for the following years

### **Recommendation 3.1 – Review and update the verification approach with a view to shortening the length of time GNI data remain open**

The Commission accepts this recommendation.

The Commission is of the opinion that the **2016-2019 verification cycle** was significantly enhanced in particular with extended use of horizontal verification and cross country analyses as well as reinforced direct verification taking into account the past recommendations of the ECA. Nevertheless, the Commission will continue to explore, together with the GNI Expert Group, ways to further improve the process and reduce the period over which GNI data remain open, where feasible.

**Recommendation 3.2 – Further action needed to properly address the impact of globalisation on GNI**

- a) The Commission accepts this recommendation and considers that it is already implementing it in cooperation with Member States using the mechanism of the globalisation reservation.
- b) The Commission does not accept this recommendation. It considers that the timing of the reservation on globalisation, i.e. for the years 2018 onwards, is appropriate.

During the past cycle, the Commission took comprehensive actions on the **treatment of globalisation, including R&D, for GNI for own resource** purposes as explained in paragraph 3.11. In particular, a scrutiny of MNEs was launched in 2016, followed by an in-depth review of a selection of MNEs, and no evidence of major distortion of value added was identified. The Commission takes the view that the timing of the **GNI reservation on globalisation** is proportionate, considering the assurance already gathered on this issue with regard to the risks identified, avoiding unjustified burden on the Member States. The reservation on globalisation itself makes reference to a robust statistical methodology. In addition, the work to be undertaken by Member States to address this GNI reservation is well defined and has been discussed in the GNI Expert Group.

**Recommendation 3.3 – Reliability of Dutch TOR statements**

The Commission takes note that this recommendation is addressed to the Netherlands.

See reply to Box 3.2.

**THE NETHERLANDS' REPLIES TO THE 2020 ANNUAL REPORT OF THE EUROPEAN COURT OF AUDITORS,**

**CHAPTER 3 – REVENUE**

*Recommendation 3.3 – Reliability of the Netherlands' TOR statements*

*We accept your recommendations with the commitment that the Dutch Tax and Customs Administration's IT systems will meet the requirements laid down within the deadline that you have set.*

**REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2020  
ANNUAL REPORT CONTRIBUTION TO ANNUAL REPORT 2020**

**“CHAPTER 4 – COMPETITIVENESS FOR GROWTH AND JOBS”**

**INTRODUCTION**

4.1 In Horizon Europe, the biggest research and innovation programme globally, with a budget of EUR 95.5 billion, the Commission will capitalise on experience gained under Horizon 2020 and will continue to enforce its simplification policy. It will, among others, use a standard model grant agreement for all EU funding programmes; make extensive use of simplified costs options (unit cost, flat rate and lump sums) and simpler cost reimbursement schemes in appropriate areas and implement a streamlined audit system.

**REGULARITY OF TRANSACTIONS**

4.6 The error rate reported by the ECA for year 2020 is similar to the error rates reported in past years (with the exception of the 2018 Annual Report).

The ECA estimates the error rate on an annual basis accounting only for corrections introduced by the Commission, as a result of its own controls, until the launch of the audit. On the other hand, the Commission implements a multiannual control strategy for research expenditure. On this basis, its services estimate a residual error rate, which does account for recoveries, corrections and the effects of all the controls and audits carried out throughout the implementation of the programme.

In this respect, the Commission's objective for Horizon 2020 is to bring the error rate below or as close as possible to 2% at the closure of the programme, see Commission reply to paragraph 4.32.

4.7 The Commission acknowledges that although Horizon 2020 is simpler than Framework Programme 7, it is still subject to complex rules. During the last stages of Horizon 2020, the Commission intensified its simplification effort and made wider use of simplified cost options such as lump sum funding, strengthening its communication with beneficiaries and constantly improving its control mechanisms. Horizon Europe will take these a step further, building on the experience acquired in Horizon 2020.

4.8 Simplification is a continuous effort. However, despite Commission actions centred on systematic, widespread and targeted communication campaigns, there remain certain types of beneficiaries such as small and medium-sized enterprises and newcomers, which are more error prone.

4.10 Reply to paragraphs 4.10 and 4.11

As part of its comprehensive control strategy, the European Commission pays special attention to the auditors contracted by beneficiaries to certify their cost claims. Although these certifying auditors are not part of the Commission structure, they play an important role within its internal control.

The Commission takes note that in [10 of 14] cases of quantifiable errors made by the beneficiaries, the Commission services were not aware of the errors as the auditors contracted by beneficiaries did not detect them.

The observation of the ECA has been addressed in previous reports. In this respect, the Commission has organised a series of meetings targeting beneficiaries and the auditors contracted by the beneficiaries to raise awareness of the most common errors that stem from the audits carried out on beneficiaries. The Commission has created an online webinar training for CFS providers. In addition to the self-explanatory template for Horizon 2020 audit certificates, the Commission provides feedback to the auditors contracted by beneficiaries on the errors identified. Moreover, it is important

to point out that although the auditors contracted by beneficiaries do not identify every single error in the cost claims, they play an important role in reducing the overall error rate.

4.12 Although unit costs used in Horizon 2020 have been proven to be less prone to errors, the Commission is closely monitoring the deployment of unit costs and other simplified cost options.

4.13 Horizon 2020 was a step forward in the simplification and harmonisation of the rules for reimbursement of costs incurred. Nevertheless, personnel costs has remained the main source of errors. This seems to be, at least partially, a logical consequence of the fact that personnel costs account for the largest share of the total cost declared by Horizon 2020 beneficiaries.

For the current MFF (2021-2027), which includes the Horizon Europe programme, the Commission has established a corporate Model Grant Agreement that foresees a very simple method for charging personnel costs, based on a daily rate calculation (*annual personnel costs for the person divided by 215*).

The concept of productive hours and the various prescriptive methods that proved to be prone to errors in Horizon 2020 will be discontinued in Horizon Europe.

4.14 Despite clear guidance on the use of the single “annual hourly” rate (calculated on the full financial year), errors still were made by beneficiaries. As already noted above (see reply to paragraph 4.13), personnel costs under Horizon Europe will be calculated on the basis of a daily rate formula using the calendar year. The use of the last closed financial year will be discontinued in Horizon Europe.

4.15 The Commission has established a new system for declaring annual salary costs under Horizon Europe (see reply to 4.13)

4.17 The Commission has simplified Horizon Europe’s formal requirements related to the time recording for personnel costs related to the project. However, deficiencies in time recording may still occur in Horizon 2020 grants as the examples reported by the ECA show. Deficiencies found did not always have a material financial impact (e.g. signature missing on the time sheet). In such instances, the Commission issues a recommendation to the beneficiary and applies corrections if needed.

4.18 The cases detected by the ECA related to the observations reported in this chapter will be duly followed up by the Commission.

4.19 Reply to 4.19 and 4.20

Despite the detailed guidance available, beneficiaries erroneously assume that all persons that they hire to work in the action can be automatically declared as personnel costs. Only when the contractual relationship and working arrangements between the external consultant and the beneficiary fulfil the conditions of the Horizon 2020 grant agreement (natural persons working under a direct contract) can the costs be declared under personnel costs.

#### **Box 4.3 - Example of subcontracting costs declared as direct personnel costs resulting in ineligible indirect costs**

The Commission will closely follow up the case reported by the ECA, which is due to a wrong declaration of subcontracting costs as personnel costs.

As acknowledged by the ECA, the introduction in Horizon 2020 of a single flat rate for indirect costs has been one of the main simplification measures applied to a pool of eligible direct costs (including personnel costs).

The eligibility of the indirect cost is, therefore, solely dependent on the eligibility of the direct costs upon which the flat rate is applied. The actual indirect costs of the beneficiary are irrelevant, and even if the beneficiary would not have any actual indirect cost, by application of the flat rate it would be nonetheless entitled to the corresponding EU contribution.

4.21 The difference between subcontracting of action tasks and the provision of “other goods and services” is clearly explained in the Horizon 2020 Annotated Model Grant Agreement. This difference is highlighted in all relevant Horizon 2020 communication campaigns.

#### REVIEW OF THE REGULARITY INFORMATION PROVIDED BY AUDITEES

Reply to paragraphs 4.24 and 4.25:

The Commission took note of the results of the work of the ECA as presented in the 2018 and 2019 annual reports. It stresses the fact that a number of cases identified by the ECA as not reliable had either a non-quantifiable or a non-material financial impact. In addition, for some of these cases the methodology used by the ECA in re-performing these audits was different from the one used by the Commission.

Nevertheless, the Commission took concrete actions to improve the quality of its audits. The Commission takes note that the ECA acknowledges the improvements in the audit process as a result of these actions.

4.27 The Commission is following up the cases raised by the ECA.

With regard to externalised (outsourced) audits, the CAS does not systematically perform a detailed review of the audit working papers prepared by the External Audit Firms. This would diminish the efficiency of outsourcing. However, the external auditors explicitly confirm in the audit report that the tests were performed according to the indicative audit programme (including sampling). Instead of a systematic review of working papers, in case of any doubt or discussion, the Commission requests additional information and supporting documentation from the audit firms. This has been demonstrated to the ECA with concrete examples.

With regard to in-house audits, the audit work of the lead auditor is verified/reviewed in detail by a second auditor (four eyes principle). Both auditors explicitly confirm in the audit report that the tests were performed according to the indicative audit programme (including sampling).

Reply to paragraphs 4.28 and 4.29:

Regarding the calculation of the error rate and its top-up, the Commission takes note that the ECA did not find any significant differences in its re-performance of calculations. This provides assurance not only on the correctness of the calculations but also on the methodology used to calculate the top-up error rate.

In addition, the Commission takes note that the ECA acknowledges the efforts made to quantify the impact of the specific cases identified by the ECA on the multiannual error rate. This has been a significant challenge, because not all the ECA’s findings could be fully quantified. Given that the non-quantified errors identified by the ECA are not included in the error rate calculations, the Commission considers that the multiannual error rate is not understated.

In conclusion, based on its revised methodology and the IAS limited review on the H2020 error rate calculation, the Commission considers that the multiannual error rate as presented in the Annual Activity Report represents fairly and in all material respects the actual level of error in the programme.

4.30 The Commission welcomes the observation from the ECA that the examined Annual Activity Reports provide a fair assessment of the respective DGs’/Executive Agency’s financial management in relation to the regularity of underlying transactions.

4.32 The Commission does not issue reservations for H2020 because the implementing bodies strive to provide reasonable assurance of a risk of error (over the course of the multiannual expenditure period), on an annual basis, within a range of 2-5 %. The ultimate aim, however, remains to achieve a

residual level of error as close as possible to 2 % at the closure of the programme, once the financial impact of all audits, corrections and recovery measures have been taken into account.

4.35 The Commission is committed to fully implementing the recommendations of the Internal Audit Service in a timely manner.

The number of open recommendations referred to by the ECA is related to the audit reports issued by the internal auditor. In this respect, DG RTD has already approved an action plan for their implementation.

At the end of 2020, DG RTD had only 2 open recommendations. An additional 20 were submitted to DG RTD in January 2021.

4.36 The recommendation made to INEA has led to the establishment of an action plan. The corrective actions were implemented fully and in a timely manner in 2021 and the IAS considers that the underlying risk has been addressed.

4.37 The Commission considers that the risk of possible understatement of the error rate is covered and that the aggregated risk at payment, and risk at closure disclosed in the AMPRs are reliable.

### CONCLUSION AND RECOMMENDATIONS

4.38 The estimated error rate reported by the ECA, calculated on annual basis, is one indicator of the effectiveness of the implementation of EU expenditure. As previously mentioned, the error rate in 2020 reported by the ECA (3.9%) is similar to the error rates reported in past years (with the exception of year 2018).

At the same time, the Commission implements a multiannual ex-post audit control strategy for research expenditure. On this basis, its services estimate a residual error rate, which takes account of recoveries, corrections and the effects of all their controls and audits over the period of implementation of the programme.

4.39 The Commission has estimated the impact of the ECA observations in the past Annual Reports and it has been taken into account for the 2020 error rate reported in the Annual Activity Reports.

The Commission welcomes that the ECA acknowledges the action undertaken by the Commission to increase the quality of its ex post audits. At the same time, the Commission will continue its targeted measures (training to auditors, communication campaigns, etc.) with a view to further improvement.

#### **Recommendation 4.1**

The Commission accepts the recommendation.

The Commission is committed to increase the level of detection and correction of the errors committed by the beneficiaries when they claim for the reimbursement of the costs incurred.

In this respect, the Commission will review the scope of the certificates on financial statements in the current control strategy and for Horizon Europe.

#### **Recommendation 4.2**

The Commission accepts the recommendation.

The Commission has intensified its communication campaign on funding rules during the first half of 2021, paying special attention to the most recurrent errors found in the ex post audits.

Moreover, the Commission will continue to provide specific guidance to auditors, both internal and external, as well as to beneficiaries, in the form of training, communication campaigns, written guidelines, etc.

#### **Recommendation 4.3**

The Commission accepts the recommendation and takes note that the ECA acknowledges the action undertaken by the Commission to increase the quality of its ex post audits. At the same time, the Commission will continue its targeted measures (training to auditors, communication campaigns, etc.) with a view to further improvement.

The Commission Horizon Europe ex post audit strategy will be based on the experience gained during the implementation of the current one for H2020 and on the observations issued by the European Court of Auditors on it.

**REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2020  
ANNUAL REPORT  
CONTRIBUTION TO ANNUAL REPORT 2020 CHAPTER 5 – ECONOMIC, SOCIAL AND  
TERRITORIAL COHESION**

**INTRODUCTION**

5.4 Third indent - As part of its two-step approach involving systematic desk review and risk based on-the-spot audits, the Commission carries out annually an **update of its risk-assessment** to determine which audit authorities and programmes will be subject to **on-the-spot audits** or further **extended desk review**. The main objective of these audits is to seek reasonable assurance that no serious system deficiency remained undetected or unreported by Member States and that the **reported audit opinions and residual error rates are reliable**. Where considered necessary the Commission applies **additional financial corrections** to bring the residual error rate of the concerned programmes below 2%.

**REGULARITY OF TRANSACTIONS, AARS AND OTHER GOVERNANCE  
ARRANGEMENTS**

5.14 The Commission takes note of the **level of error calculated by the ECA** which further improved compared with previous years. The Commission will follow-up all errors found by the ECA and request additional financial corrections, where appropriate and legally possible.

The Commission further refers to its **estimate of the level of error**, including maximum risks (worst-case scenarios) **disclosed in the 2020 AARs** of DGs REGIO and EMPL, resulting from a detailed analysis of the situation of each programme instead of an extrapolation of errors across 418 programmes. The Commission notes that its estimate falls within the interval calculated by the ECA and believes its detailed assessment reflects a reasonable and fair estimate of the error rates for each programme and cumulatively for all programmes.

5.15 The Commission stresses the importance of **the work performed by audit authorities** in detecting errors which led to significant **financial corrections** and withdrawals before the 2018-2019 accounts were submitted to the Commission. The thorough audit work by audit authorities at and up to closure also led to significant financial corrections for the 2007-2013 programming period.

Through their audits of over 11.000 operations or parts of operations under Cohesion policy, **audit authorities reported a total error rate above 2% for around one third of programmes**, thus demonstrating their detection capacity (without prejudice to other programmes in which the rate was below 2%). The Commission agrees that some errors remained undetected or were inappropriately considered in the calculation of the reported error rate. It is continuously **working with** the concerned **audit authorities** to improve their detection capacity and understanding of applicable rules.

5.16 In 2020, **audit authorities reported** for the third year **irregularities** they found in their audits of operations (over 6.600 irregularities) following **a common typology** agreed with the Commission and shared between the Member States.

Most of the irregularities identified by audit authorities and the Commission **concern the same main categories**: ineligible expenditure, public procurement, audit trail and State Aid. This **also corresponds to** the most common types of irregularities identified by the ECA for its additional findings, as shown in Box 5.2. This shows that audit authorities detect the different types of irregularities contributing to the error rate, but not entirely in all cases. The **Commission will follow up all errors** reported by the ECA and will apply financial corrections where appropriate and legally possible. The Commission notes that in some cases **national or regional rules** applied to expenditure under programmes co-funded by the ESI Funds **are more demanding than those foreseen** in the national legislation for similar expenditure nationally funded. Therefore, **these additional requirements can be seen as an instance of gold plating**, self-imposing unnecessary administrative burden and complexity to Cohesion funded expenditure.

5.17 The Commission agrees that **management verifications** are the first line of defence against errors and should be more effective in **preventing and detecting errors in the first instance**.

The Commission addressed updated **guidance to Member States** for the 2014-2020 programming period which, combined with the required use of **simplified costs options**, aim to improve further the efficiency of management verifications. This depends however on staff available to deal with increasing amounts of declared expenditure in the course of the programming period, and to the required **stability of experienced staff** in the concerned administrations.

The Commission is taking preventive action to **tackle the most frequent errors** and **requests remedial measures** as soon as deficiencies are detected. It ensures a close **follow-up to verify** that those measures are effectively and timely **implemented** to fix the system and mitigate any risk for future expenditure. The requested remedial measures entail improvement of **methodological tools**, **recruitment** of additional staff including experts, **training** activities on newly developed tools or on the correct interpretation of most frequent errors, **improvement of the quality of selection procedures** or **management verifications** to filter out irregularities.

In addition, the **typology of audit findings reported** year on year to managing authorities by audit authorities should allow them to integrate the more frequent sources of errors in their **risk assessments** and to adapt their management verifications approaches and tools accordingly. To make management verifications more efficient and targeted in the 2021-2027 programming period, the Commission has proposed to the co-legislators that verifications become risk-based in order to better focus the administrative resources available to **targeted sources of errors**. This requires the careful definition and continuous adjustment of **risk management approaches by managing authorities**, based on all available previous control and audit results.

5.20 As regards the errors detected by the ECA, the **Commission will do the necessary follow up** and take any actions it deems necessary.

#### Box 5.4

The Commission considers that the operations are specifically described as an action “Incentives for temporary contracts for persons with disabilities” to be supported under the

specific objective in the OP. The Commission also considers that **the selected operations**, as originally planned, **are contributing to the objectives of the programme and comply with the selection criteria**.

On-the-job training can be presumed under such employment measures and contributes to the expected results “Increase the professional competences or qualifications, through professional experience for groups that lack or have little experience”.

5.22 The Commission will follow up with the concerned programme authorities. **Eligibility** is ultimately assessed **at closure**, in line with the CPR. Therefore, the programme can still substitute ineligible loans and the Commission services will assess the eligibility of all declared loans at closure of the programme.

5.23 The Commission has actively worked since the introduction of the **simplified cost options** to progressively extend their use and considers that these efforts have already led to positive results.

The Commission **will continue to actively promote** the use of simplified cost options in the 2021-2027 programming period, where they have been further strengthened in the recently adopted Common Provisions Regulation (Regulation (EU) 2021/1060), in order to reduce the administrative burden on the beneficiaries, promote result-orientation and further reduce the risk of error.

5.24 Common Commission reply to paragraphs 5.24 to 5.26:

Under the CPR, there is **no direct link** between the contribution from the Funds **to** an operational programme and **the financing to a specific operation**. Accordingly there is in principle no direct correspondence between the methods applied at national level for determining the eligible costs of the beneficiaries for reimbursement of specific operations and the calculation methods applied between the Member State and the Commission to determine the amount of eligible expenditure in view of receiving the contribution from the ESI Funds.

An adjustment method is explicitly foreseen in the delegated regulation in application of Article 14(1) of the ESF regulation, and the **Commission has already requested the programme authorities to adjust** the SCO, so that such imbalance does not recur in subsequent accounting years.

5.29 Common Commission reply to paragraphs 5.29 and 5.30:

The Commission notes that over the past years errors related to **State aid** identified by Member States authorities and the Commission have remained less frequent, as shown by the **joint typology of errors** agreed with audit authorities (however, their impact may be high if an operation is found to be entirely ineligible due to the incentive effect not being respected, for example, as was the case in previous years due to a non-compliant national State aid law, since then appropriately corrected).

For the most recent accounting year 2019 – 2020, **only 3% of the findings** identified by Member States, and 4% of those identified by the Commission, concerned State aid.

The Commission continues to implement the measures designed under its **State aid action plan** identifying and **disseminating good practices and offering training** to all ESI fund stakeholders.

5.31 **Public procurement** remains an important source of error findings reported by audit authorities. The Commission itself identified more than half of its compliance audit error findings in the area, meaning that **continuous actions** need to be taken to ensure that beneficiaries (contracting authorities) and programme authorities improve compliance with these complex rules. The Commission continues to systematically implement its **public procurement action plan** thereby helping administrators and beneficiaries of ESI Funds to further improve their procurement practices and increase the related administrative capacity. With this objective in mind, DGs REGIO and EMPL have organised in December 2020 with audit authorities **a workshop dedicated more specifically to Commission audit findings in public procurement and to how the sharing of experience** between auditors can contribute to a lessons learnt process, avoiding recurrent audit findings on procurement in the future. A presentation was also offered by Commission and OECD colleagues at the **technical meeting to audit authorities** explaining the potential of public procurement as a strategic policy instrument to further increase compliance and performance in the implementation of projects under the ESI Fund programmes.

5.32 The Commission will follow up cases that remained undetected and apply the necessary additional financial corrections when the relevant conditions apply.

5.33 The Commission highlights the **guidance for financial correction on public procurement errors** which was updated in 2019 to **offer a harmonised approach** to the Commission and Member States' programme authorities **when dealing with public procurement irregularities** (Decision C (2019) 3452). These guidelines aim at achieving a **homogeneous implementation practice and equal treatment** among Member States. The Commission notes that Member States detected and reported all but one quantified errors in this area, showing an overall good detection capacity for public procurement errors.

5.36 As regards the errors detected by the ECA, the Commission will do the necessary follow up and will apply financial corrections, as deemed necessary.

5.37 Common Commission reply to paragraphs 5.37 and 5.38:

Under shared management, the **managing authorities control expenditure** declared by beneficiaries in first instance, and **audit authorities perform second level audits** to test the quality of management verifications. The Commission has continued in 2020 to consistently and extensively **cooperate** with the programme audit authorities **to ensure a consistent and robust control framework**, including under conditions of practical restrictions for audits **under the pandemic**, and **to improve the quality of the assurance work** as needed, strengthening the necessary detection and corrective capacities. As reported in DG REGIO's and DG EMPL's AARs, the Commission has in particular identified weaknesses and requested improvements for seventeen audit authorities or bodies in charge of audits out of 116 audit authorities.

5.40 The Commission considers that it has **reasonable assurance on the work of most audit authorities, except for** a minority that require major improvements of their audit capacities to remedy the weaknesses found (see Commission reply to paragraphs 5.37 and 5.38 above). Concrete improvements were achieved based on **targeted remedial actions** recommended in several cases, including for bodies carrying out audits for the audit authorities in France, Poland and Portugal as illustrated in the respective AARs.

Indeed, the Commission assesses the **reliability of audit authorities not only on** the basis of the recalculated **error rates** (which can be influenced by single errors having an important statistical impact) **but on the basis of a number of criteria** which, if not satisfactorily assessed, reflect the presence of systemic weaknesses in their work and in the control systems. Where relevant, the Commission **recalculates** the error rates reported by the audit authorities **on the basis of all available information** and reports these rates in the respective AARs. The Commission **continues to work with the concerned audit authorities** to further improve their controls, in particular to appropriately detect the type of errors found by the ECA or Commission re-performance audits. In addition, the Commission ensures a strong continued cooperation with all audit authorities. This includes the sharing of common audit tools, such as detailed checklists, sharing of good practices between peers and a continuous professional development of the staff of programme authorities.

5.42 Missing supporting information or documentation continues in a certain number of cases to be a weakness **detected in Commission compliance audits**.

As indicated in its reply to paragraph 5.40, the Commission is **continuously working with the audit authorities** in order to strengthen their capacity to prevent and correct errors, to better document their audit work and therefore to contribute to the assurance process.

An illustration of this cooperation is the coordinated efforts the Commission has put in place with the audit authorities in 2019 and 2020, with the support and expertise of the ECA, to improve audit documentation (even where there are no findings) and ensure a proper and documented quality review of audit findings (see the “**Reflection paper on audit documentation**” elaborated jointly by a working group composed of audit authorities and Commission representatives, as reported in ECA’s 2019 annual report in Box 5.8). The Commission will continue **to promote the good practices** reported in this joint reflection paper.

5.45 The Commission has **zero tolerance for fraud**. Several initiatives were taken in 2020 to implement the Commission Anti-Fraud Strategy as well as the **Joint Anti-Fraud Strategy** developed by DGs REGIO, EMPL and MARE.

5.46 The Commission considers that checklists used for the audit of operations should contain an indication of whether a fraud suspicion was identified.

The Commission notes that the audit authorities ensure a specific verification of the effective functioning of key requirement 7 (Effective implementation of proportionate anti-fraud measures) through **dedicated system audits**, using specific checklists. Under their joint Anti-Fraud Strategy, DGs REGIO and EMPL added in April 2021 a reference to the

Irregularities Management System (IMS) in these audit checklists, aiming at **ensuring clear reporting mechanisms** on both suspicions of fraud and on control weaknesses.

In both cases referred to by the ECA the concerned Member State authorities have in the meantime corrected their initial mistake and reported the instances of irregularities and possible fraud in the IMS.

5.49 Under shared management of programmes in Cohesion policy, **the implementation of operations under the programmes, including accounting, is the responsibility of the Member States**. Indeed, **managing authorities** carry out management verifications on annual expenditure up to the preparation of annual accounts. **Audit authorities** perform audits of operations (almost 11000 operations or parts of operations audited for the accounting year 2018-2019). Part of these verifications and audits may result in the use by the Member State of the provisions of Article 137(2) (putting expenditure aside from the accounts until when the legality and regularity of such expenditure declared during the year is confirmed). This means that such expenditure is **excluded from the acceptance of accounts and payment of the balance** by the Commission.

The **amounts under ongoing assessment** are indeed encoded in the accounting systems of the programmes **certifying authorities** and are included in the audit population if reintroduced in subsequent payment claims once their legality and regularity has been confirmed. Therefore, the Commission considers that the control mechanisms inbuilt in the **management and control systems provide reasonable assurance concerning** the monitoring and follow-up of **such amounts**.

5.51 In addition to comprehensive compliance audits to re-perform the work of audit authorities, the Commission also carried out pre – and post- annual control report **fact-finding missions** that **complete** the tools available under **compliance audits**. These audits indeed also contribute to the review and assessment of the work of audit authorities (in addition to the extensive desk assessment of each annual control report submitted) since **they allow to clarify questions** on the annual control reports but also to detect errors in the quantification and projection of errors.

5.52 In addition to its compliance audits, the Commission also carries out fact-finding missions and deskwork that led it to adjust residual error rates above 2% in another two cases.

The Commission's **compliance audits are risk-based**. It therefore considers that its audit results as reported by the ECA in this paragraph indicate that its **risk assessment** on the work of audit authorities **was pertinent**. The Commission validates its audit findings with audit authorities in a **contradictory procedure** and monitors its final results with a view to identifying the root-causes of the additional errors it has identified, and to improve the detection capacity of the concerned audit authorities. This led it to issue **preventive letters** to some audit authorities ahead of the 2021 annual control reports, in some cases. In other cases, additional errors detected are more occasional and despite a possible important extrapolated impact on the error rate **do not point to a systemic weakness** at the level of the audit authority.

As a result of its desk and on the spot audit activities, the Commission **reported in the respective AARs** of DGs REGIO and EMPL that for seventeen audit authorities serious weaknesses in the work of audit authorities or their control bodies needed to be corrected.

5.56 The Commission has designed its **assurance system to allow the Directors-General to provide assurance** on each of the 418 individual OPs, as per their obligation as authorising officers by delegation. The Commission considers **it has reasonable assurance on the legality and regularity of the underlying expenditure, except for** programmes for which it reported the need for potential additional financial corrections in the AARs, based on a thorough and robust methodology applied for each operational programme.

Moreover, an **aggregated KPI** is reported in the AARs as a **weighted average of all confirmed error rates**. The Commission also reported a maximum level of this KPI (worst-case scenario), taking into account all pending information still under validation. Finally, the applicable provisions provide for the possibility for national authorities and the Commission **to carry out audits** and implement any required additional financial corrections in a multiannual period (including through audits carried out **up to three years after the year in which accounts were accepted**). This possibility offered by the co-legislator is important for the Commission to be able **to discharge its responsibilities** in relation to implementation of the EU budget under multiannual programmes.

For the previous accounting years, following the conclusion of the contradictory procedures and, when necessary, the implementation by the national authorities of the relevant financial corrections, both DG REGIO and DG EMPL can conclude that the **risk at closure is estimated between 1.2% and 1.5%**.

5.60 The Commission underlines that **both DGs have to issue reservations in their respective AARs** in relation to the relevant expenditure in the year, in line with the Financial Regulation and corporate instructions, as explained in its reply to paragraph 5.62 of the ECA 2019 annual report.

**Reservations** made in the AAR **are linked to** the reporting year of expenditure with a view of **protecting the EU budget** if risks are identified. Such risks are based on all available audit information, previous year's confirmed error rates with a possible impact on the adjustment of error rates reported in the latest annual control report where deemed necessary, as well as latest available assessments of management and control system taking account of possible improvements carried out or, on the contrary, new weaknesses identified and Commission audit opinions at the time of the AAR. These opinions cover the accounts, the effective functioning of management and control systems and legality and regularity of expenditure, **based on all information cumulated** since the previous AAR. The Commission therefore considers its criteria to issue reservations to be comprehensive and based on all and most updated audit information available, **fully and transparently disclosed** in the AAR. **Reservations are maintained until** all remedial actions have been applied (including financial corrections if necessary) and **the issue has been addressed**.

In addition, with regard to previous accounting years, the Commission reports in the AARs in full transparency the **financial corrections applied or launched** / to be launched after acceptance of the accounts, in full respect of the applicable legal procedures for thorough contradictory procedures.

5.61 The Commission needs a stable framework in place to be able to report in a consistent way its assurance process over time.

**Taking into account the comments made by the ECA** last year (paragraph 5.62), both DG REGIO and DG EMPL took better account of the results of their compliance audits on the previous 2018/2019 accounts for their assessment of the newly submitted 2019/2020 accounts, with possible impact on the reportable error rates. This has led in some cases to **additional reservations**.

## CONCLUSION AND RECOMMENDATION

5.62 The Commission takes note of the **level of error calculated by the ECA** which further improved compared with previous years. The Commission **will follow-up all errors** found by the ECA and request additional financial corrections, where appropriate and legally possible.

The Commission further refers to its estimate of the level of error, including **maximum risks (worst-case scenarios)** disclosed in the 2020 AARs of DGs REGIO and EMPL, resulting from a detailed analysis of the situation of each programme instead of an extrapolation of errors across 418 programmes. The Commission notes that **its estimate falls within the interval calculated by the ECA** and believes its detailed assessment reflects a reasonable and fair estimate of the error rates for each programme and cumulatively for all programmes.

5.63 The Commission considers that, overall **reliance** can be placed **on the work of audit authorities** and their control bodies, with the exception of a few instances as clearly spelt out in the AARs based on all audit information available.

In some cases, additional errors detected are occasional and despite a possible important extrapolated impact on the error rate do not point to a systemic weakness at the level of the audit authority.

The Commission will continue to closely **work with the managing and audit authorities** of the programmes concerned, to follow up on agreed conclusions and to achieve over time a residual level of error below 2% for all programmes, using the regulatory instruments to apply additional financial corrections where deemed necessary.

5.64 Given its more detailed segmentation of expenditure according to risk profiles and control systems, the Commission, when detecting errors, and taking also account of the ECA's work, is able to identify the specific part of the programme population that is most likely to be affected. It is thus **able to give a nuanced view of the level of error across the payments** made and to clearly identify the areas where improvements are needed.

Moreover, the Commission notes that **its estimate fully falls within the interval calculated by the ECA** (see Commission reply to paragraph 5.62).

5.65 The objective of the current **assurance model** is indeed **to have a residual error rate below 2% for each programme individually**, rather than on average, and the Commission has the tools to apply the necessary **financial corrections** when the confirmed individual residual errors are above 2%.

5.66 On the recommendations which are reported by the ECA as not been acted upon at all or implemented in some respects, the Commission refers to its reply to Annex 5.3.

**Recommendation 5.1 – Balanced standard scales of unit costs for reimbursing payments made by Member States**

The Commission **accepts** this recommendation.

**Recommendation 5.2 – Keeping track of the risk of fraud in audit authorities' audits of operations**

The Commission **accepts** this recommendation and **will work with audit authorities** with a view to completing the checklists for audit operations and better documenting the steps taken to address any fraud risks discovered.

**Recommendation 5.3 – Follow-up of amounts under an ongoing assessment**

The Commission **accepts** this recommendation, although **it has no legal basis to impose** such additional reporting obligation on programme authorities.

**Annex 5.3– Follow-up of previous recommendations for 'Economic, social and territorial cohesion'**

In relation to recommendation 2 of 2017, the Commission notes that it has proposed for 2021-2027 to make VAT eligible for projects below a total cost of 5 million euro. This is an alternative approach to the one recommended by ECA.

In relation to recommendation 6 of 2017, the Commission underlines that the regulatory framework gives the possibility to audit programmes at least three years after submission of the accounts, where needed. The Commission endeavours to conclude on the regularity of expenditure in the AAR following the year of submission of the accounts, and transparently reports for all concerned programmes in annex of the AARs, but this is not always possible.

## REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' ANNUAL REPORT

### “CONTRIBUTION TO ANNUAL REPORT 2020 CHAPTER 6 - NATURAL RESOURCES”

#### INTRODUCTION

6.1 The **Common Agricultural Policy (CAP)** is a genuinely European policy as Member States pool resources to operate a single common policy with a single European budget. The CAP objectives as set out in the Treaty and the CAP regulations are: to increase agricultural productivity; to ensure a fair standard of living for the agricultural community; to stabilise markets; to assure the availability of supplies; to ensure that supplies reach consumers at reasonable prices.

With **6.7 million beneficiaries** of the CAP, the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD) expenditure is **implemented under shared management** through a **comprehensive management and control system**, which is designed to ensure the legality and regularity of the underlying transactions at the level of the final beneficiaries. Where the Commission implements the budget under shared management, implementation tasks are shared with the Member States. The latter are required to take all the necessary measures to ensure that actions financed from the EU budget are implemented correctly and effectively and in accordance with EU rules. They are obliged to have systems in place which prevent, detect and correct irregularities and fraud. The CAP legislation provides that they shall **accredit paying agencies which are dedicated bodies** responsible for the management and control of Union funds, notably payments to beneficiaries and financial reporting to the Commission.

**Certification bodies** designated by Member States shall provide every year an opinion covering the completeness, accuracy and veracity of the annual accounts of the paying agency concerned, the proper functioning of its internal control system and the legality and regularity of the expenditure declared to the Commission.

**In 2020, Europe was strongly impacted by the COVID-19 pandemic.** Thanks to the long-standing solid policy framework of the CAP as well as the good cooperation established over the years across the EU, the agricultural sector proved to be sufficiently resilient to deal with the COVID-19 crisis.

**The Commission also adapted its working methods** and addressed the impact of the COVID-19 pandemic on the CAP assurance through a series of measures. The Commission adopted Regulation (EU) No 2020/532, which provides rules with realistic and attainable control requirements for the Member States. Furthermore, the certification bodies continued to do their audit work whilst also using alternative methods, as the paying agencies, and reported to the Commission on their findings as in previous years.

6.6 a) The Commission notes the change in the sampling approach of the ECA for direct payments, and the inclusion in the calculation of the overall error rate for the chapter of a technical adjustment of 0.12% related to the direct payments. The Commission also notes that the adjustment is based on errors found by the paying agencies (see also reply to paragraph 6.13).

6.10 The Commission welcomes ECA's finding that **EAGF direct payments, representing EUR 41.6 billion in financial year 2020, continue to be free of material error.** The Commission notes with satisfaction that this positive result, in line with DG AGRI's Annual activity report, was confirmed despite the change in the sampling methodology by the ECA (see also reply to paragraph 6.13).

6.13 The Commission would like to clarify that, **in all but one of the cases** indicated by the ECA, the errors mentioned were **over-declarations which had been duly identified by the paying agencies during their on-the-spot controls** and therefore no undue payment to beneficiaries was effected. The

Commission would also like to note that the change in the ECA's methodology this year led to a dual approach:

The ECA continued to use its own results when producing its statistical estimate of the error rate for a transaction based on a sample of 10 parcels for each beneficiary. Therefore, the Commission does not agree with ECA's assessment in one case where this extrapolated error rate at transaction level was significantly over-stated compared to the actual result of the paying agency's on-the-spot control covering all parcels for that beneficiary. ECA and the paying agency came to the same result for the parcels selected but ECA extrapolated its error rate in the sampled parcels for the full transaction.

At the same time, ECA used the results of the paying agencies' controls to estimate the impact in cases where the paying agencies concluded that no payment should be effected to the beneficiary, by applying a calculated adjustment of 0.12% for the direct payments in the overall error rate for the chapter.

6.16 The Commission welcomes ECA's positive assessment of the **role of Integrated Administration and Control System (IACS) and Land Parcel Identification System (LPIS)** in preventing and reducing levels of error.

6.18 The Commission points out that the legal framework for the **checks by monitoring** approach foresees on the one hand the checking of samples of farmers when criteria cannot be evaluated remotely, and on the other hand also the possibility to carry out targeted field visits in case the analysis of the satellite data was inconclusive.

All in all, the Commission considers that the checks by monitoring is a very good example of how technology can be applied to make management and control systems more effective.

Common reply to 6.21-6.22:

The Commission applies **continuous efforts to support Member States in the uptake of checks by monitoring**, among others by collecting implementation issues via bilateral, expert or committee meetings, and addressing emerging issues either via implementation guidelines or where relevant amendments to the legal framework. Furthermore, Result indicator 3.5: Area under Satellite Monitoring, defined as the ratio between the basic payment scheme (BPS)/ single area payment scheme (SAPS) hectares covered with checks by monitoring or the Area Monitoring System, has an interim milestone equal to 10% in 2022. Based on Member States' notifications for checks by monitoring in 2021, the uptake is well on track to meet this interim milestone. Beyond 2022, the use of the Area Monitoring System becomes mandatory which is expected to rapidly increase the area under satellite monitoring.

6.23 **Complex conditions and eligibility rules apply where**, in order to achieve ambitious policy objectives, **targeting of aid is necessary**. It is needed to balance legality and regularity with the achievement of policy objectives while bearing in mind the delivery costs. Simplification, e.g. simplified cost options, is sought where it represents the most effective way of reducing costs and burden of control and the risk of errors.

6.27 The Commission does not agree with ECA assessment in one transaction (see reply to paragraph 6.31).

6.31 The Commission does not agree with the ECA's finding that in one case the paying agency has incorrectly calculated the penalty for over-declaration.

In the Commission's view, the **paying agency has correctly applied the relevant legislation during their checks** (before the ECA's audit), specifically Article 19a(1) of Regulation 640/2014 and Article 10 of the national Ministerial Decree No 24/2015, and correctly established the amount to be paid to the farmer. In addition, the paying agency rightly concluded that there is no amount to be recovered in accordance with the de minimis rule, as the amount overpaid was EUR 31.94. Even the total amount

paid (EUR 91.01), considered as a 65 % error by ECA and contributing significantly to the error rate of the chapter, was below the de minimis threshold of EUR 100.

#### ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

6.35 In this sixth year of delivering an opinion on legality and regularity of expenditure, the **certification bodies delivered sound and substantial results** on the legality and regularity of the expenditure for all populations. Based on the substantial certification bodies' work performed and the increased number of findings, DG AGRI took reliance from the results of the certification bodies' work on legality and regularity. The certification bodies' results were the basis for the calculation of DG AGRI's adjusted error rate for financial year 2020. In cases where deficiencies were identified during the audits, their impact on the reliability of the results was assessed as limited. Moreover, in all cases, DG AGRI auditors proposed immediate corrective actions, which were implemented during the financial year by the certification bodies. The results of the corrective actions' implementation was assessed during the financial clearance exercise and DG AGRI could still place reliance on their work and could still take into account the errors reported.

6.37 The Commission welcomes that **DG AGRI's estimate of risk at payment (1.9 %) is very close to and within the range of the ECA error rate (2.0 %)** (see also paragraph 1.39 and the Commission reply).

The Commission further notes that the risk at payment rates (around 1.6 % for direct payments, 2.9 % for rural development and 2.4 % for market measures) reported in the DG AGRI Annual activity report for 2020, like ECA, show that direct payments are free of material errors, whereas the higher risk is for rural development and market measures (see also reply to paragraph 6.23). As a result of all corrective actions, the Commission estimates the final amount at risk for the CAP in 2020 at 0.5 %.

6.38 The Commission welcomes that the **risk at payment for 'Natural resources' in its AMPR is in line** with the ECA estimated level of error for this chapter.

6.39 DG AGRI gets assurance about the appropriate operation of the systems put in place by the paying agencies to prevent and detect fraud through the work of the certification bodies. These independent bodies annually assess the paying agencies' compliance with the accreditation criteria, including those aspects specifically related to fraud issues, i.e. they must ensure that paying agencies have systems in place to prevent, detect and correct fraud.

In September 2020, **DG AGRI has updated its Anti-Fraud Strategy**, also to take into account the 2019 new overall Commission Anti-Fraud Strategy.

A review of the fraud risk assessment is foreseen in the context of the CAP reform (2023 – 2027), with target date 1.1.2023.

Concerning the **use of Arachne in the CAP**, the Commission has supported extending the use and capabilities of such a tool, as also recognized by ECA in the 2019 Annual report. The negotiations of the CAP reform has resulted in it being mandatory for the Commission to make this tool available to Member States from 1 January 2023 and Member States will be encouraged to use this tool.

#### CONCLUSION AND RECOMMENDATIONS

6.40 The Commission positively notes that the **overall error rate for the chapter as set out in Annex 6.1 is close to materiality (2.0 %)**. See also reply to paragraph 6.37.

## REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' ANNUAL REPORT

### CONTRIBUTION TO ANNUAL REPORT 2020 CHAPTER 7 – SECURITY AND CITIZENSHIP

#### REGULARITY OF TRANSACTIONS

##### ***Box 7.3 - Overstated costs for transport of medical equipment***

Regarding the ‘Overstated costs for transport of medical equipment’, the implemented ESI action took place in the early days of the COVID-19 pandemic where personal protective equipment for medical use was urgently needed. For the audited contract, the contracting authority did not make use of the possibility, as stated in Regulation 72 of the UK Public Contracts Regulations which would have allowed for a modification of existing contracts of up to 50% of the initial value of the negotiated procedure without prior publication, which in this case was justified on grounds of extreme urgency.

The Commission considers important to indicate that the services were delivered. Furthermore, the procedural error in the award of the contract did not result in a change in the price per cubic meter of personal protective equipment as it was exactly the same as the one of the original awarded contract. All these factors need to be considered as part of the very difficult context in which this emergency action was carried out.

##### **Box 7.4 - Documentation of services provided to unaccompanied minors not always satisfactory**

The Commission took note of the deficiencies mentioned in Box 7.4, which are being closely monitored.

The Responsible Authority prepared a roadmap tackling these identified issues, whereby the Greek authorities initiated the implementation of a series of actions with focus to updating the legal framework and Standard Operating Procedures of accommodation facilities for the forthcoming programming period, as well as promoting methodologies of quality recording and assessment of services provided by the implementing actors and adopting best practices and continuous improvement procedures.

In addition, steps are taken to improve the referral and reporting system through a centralised approach, particularly through the involvement of the Special Secretary for the Protection of Unaccompanied Minors in Greece. Administrative procedures needed for the transition of a young adult to another accommodation scheme begin 4 months before the concerned reaches adulthood. Specific cases are assessed on a case-by-case basis, including children who need to finish school, but also young adults for whom the administrative procedures are not finalised yet.

#### EXAMINATION OF ELEMENTS OF INTERNAL CONTROL SYSTEMS

7.12 The potential impact of weaknesses at the MS level did not materialise.

##### ***Box 7.5 shortcomings in annual control reports***

The Commission takes note that such shortcomings are not material enough to detract from the Audit Authorities’ conclusions, as noted in paragraph 7.12.

- *Sampling issues: sampling unit not clearly defined, too few items in audit sample. (Luxembourg)*

In the case of Luxembourg, the shortcoming had been already identified by the Commission and reported to the Luxembourg authorities as documented in the accounts assessment checklist and in the partial clearance letter.

See further comments below.

- The Responsible Authority submitted the draft accounts to the Audit Authority before completing its own on-the-spot controls, and before including technical assistance payments (Spain).

The ACR and complementary information submitted upon request of the Commission during its assessment provided a complete reconciliation with adequate description of the differences between the draft accounts on which sampling was performed and the final accounts. In the clearance letter, the Commission reminded the authorities that the draft accounts should be composed of payments for which the Responsible Authority has completed its controls.

- Error rates were calculated and presented inaccurately in the body of the ACR. (Austria)

The question of the accurate reporting of the error rate had been identified during DG HOME auditors review of the ACR for FY2019 accounts as documented in the auditors checklist and in the clearance letter to the Member State.

As the Total Residual Error Rate (TRER) was below the materiality threshold, it did not affect the clearance of FY2019 AMIF accounts. DG HOME auditors continue to monitor the transparent reporting of the error rate of the EU contribution and paid again special attention to this in the review of the ACR for FY2020 accounts (carried out in 2021, i.e. outside the scope of the statement of assurance 2020). The AA was requested again to explain its underlying calculations in a comprehensive manner.

Value and coverage of the audit sample were incorrectly reported. (Austria)

The Austrian authorities selected the projects for audit from the monitoring lists and not from the financial system. This explains the incorrect calculation of the audit coverage. Nevertheless, actual audit coverage exceeds the minimum requirement of 10 %. In its assessment of ACR for FY2020 (carried out in 2021, i.e. outside the scope of the statement of assurance 2020), DG HOME auditors requested additional information from the AA on its audit sample. DG HOME auditors identified that the AA had excluded a project from the calculation of the TER. A recommendation was issued to the AA in the ACR for FY2020 follow up letter to amend this practice for the next clearance of accounts.

- The ACR did not properly report the results of expenditure and system audits or the overall level of assurance and failure to report that some audit work was outsourced. (Luxembourg)

The Luxembourgish authorities developed an action plan to rectify the concerns raised by ECA. This action plan was followed-up by DG HOME in the context of the FY2020 clearance of accounts. The ACR for FY2020 contains clear information on:

- The scope and results of systems audits carried out during the financial year;
- Clear definition of the sampling unit used;
- The results of the audits of negative payments, including the presence in the sample of any interim or final payments clearing advances declared to the EC in previous years accounts;
- A clear indication of the level of assurance in accordance with the model defined in the annex to Regulation (EU) 2018/1291 of 16 May 2018.

The Commission considers this sufficient.

However, reporting on the audit work that is outsourced requires further improvement and this was communicated to the Luxembourgish authorities in the context of the clearance of accounts for FY2020.

7.13 The Commission considers that the identified shortcomings did not impact the conclusions of the Audit Authorities.

***Box 7.6 Shortcomings in the work of audit authorities.***

- *The project selection process was not properly checked. (Luxembourg)*

The Audit Authority updated its checklist with a specific section dedicated to the selection procedures. This was reviewed in the context of the clearance of accounts procedure for FY2020, carried out in 2021, i.e. outside the scope of the statement of assurance 2020.

- *Inadequate testing of the eligibility of expenditure. (Luxembourg)*

This issue was followed up in the context of the clearance of accounts procedures for FY2020, carried out in 2021, i.e. outside the scope of the statement of assurance 2020. It was found that the Audit Authority updated the checklist used to check the eligibility of expenditure and to ensure that all deviations are reported for action by the responsible authority.

- *Insufficient audit trail or poor documentation of audit work. (Spain, Luxembourg, Austria, Finland)*

The Commission considers that these reveal isolated weaknesses in the documentation of specific checks and/or audits. Furthermore, these isolated cases do not, in any way, put in question the audit work performed by the Audit Authorities, nor the reliability of their conclusions, as confirmed by ECA itself.

In addition, and in response to previous findings and ECA's recommendations (statement of assurance 2019) DG HOME shared with the Audit Authorities for HOME Funds a "Reflection Paper on Audit Documentation – Good practices from and for auditors". This paper is the result of a working group between Commission audit services for shared management and Member States national AAs to identify and develop best practices to improve the documentation of their audit work.

- *Where detected, ineligible costs were not always reported. (Luxembourg)*

The issue of ineligible costs reported was followed up in the context of the clearance of accounts procedures for FY2020 carried out in 2021, i.e. outside the scope of the statement of assurance 2020. It was found that the Audit Authority updated the checklist used to check the eligibility of expenditure and to ensure that all deviations are reported for action by the Responsible Authority.

- *Some procurement issues wrongly classified. (Finland)*

The Commission continues to monitor public procurement procedures in the context of an on-going audit in Finland.

- *Inadequate review of outsourced audit work. (Luxembourg)*

The Commission considers that this point has no impact on the assurance provided by the AA. Nevertheless, we have observed an improvement in the ACR on the FY2020 (carried out in 2021, i.e. outside the scope of the statement of assurance 2020). The Audit Authority held a closing meeting with the service provider before the finalisation of the ACR for FY2020 in order to assess the quality of the work performed and for the service provider to share any specific working papers or other documents with the audit authority.

## CONCLUSION AND RECOMMENDATIONS

### **Recommendation 7.1 – Eligibility of ESI project costs**

The Commission accepts the recommendation.

The Commission is committed to carefully checking the eligibility of the costs submitted by the beneficiaries of ESI actions. It is noted that in depth checks are part of the ex-ante controls and the internal control system. Regarding procurement procedures and the corresponding documentation, they are checked on a sample basis during ex-post audits.

### **Recommendation 7.2 – Documentation where funding is based on standard unit costs**

The Commission accepts the recommendation and considers that it is already being implemented.

On 28 April 2021, the Commission adopted a revised Guidance note on Simplified Cost Options (SCOs) within the European Structural and Investment Funds.

Although this guidance note is applicable essentially to ESI funds, the principles are carried forward to the 2021-2027 programming period where (under the CPR) they will be equally applicable to DG HOME administered funds.

In this context, on 27/5/2021, Member State authorities received the updated guidance through the expert group on CPR (EGESIF). In view of the upcoming 2021-2027 period, this group was extended to also include Member State authorities responsible for DG HOME funds.

The Commission will also inform Member State authorities of the updated guidance and remind them on the importance of ensuring compliance with the conditions for SCO as part of the scope of management verifications and audits.

**REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2020  
CONTRIBUTION TO ANNUAL REPORT 2020 - CHAPTER 8 - GLOBAL EUROPE"**

REGULARITY OF TRANSACTIONS

**Box 8.2:**

**- Supplies not used for the action funded**

The Commission would like to highlight the efforts made to ensure the refugees' access to essential health services in the volatile context prevailing in the beneficiary country at the start of project implementation. This context significantly affected the project's operations.

The vaccines administered during the first year were drawn from the beneficiary's pool storage and distribution system to vaccinate children from the start of the action. This was in line with Annex I to the Specific Conditions of the grant contract – Activity 1.5. Improving Immunisation Services. The grant was a continuation of the extended immunisation programme already underway.

The beneficiary has provided evidence to the Commission that the same type of vaccines were administered to the target group. The number of leftover vaccines is less than 1 % of the number of procured vaccines.

The beneficiary has committed to report on the use of the remaining EU-funded vaccines.

**- Ineligible costs in the cost claim**

No amounts have been paid unduly by the Commission or by the beneficiary. What occurred is a double clearing of an amount and a clearing of another amount for which no expenses had yet been incurred in the Commission's accounting system. The final amount chargeable to the EU budget will be determined with the final payment.

Remedial actions have been implemented:

- Unduly cleared amounts, "un-cleared".
- The contract has been included in the annual control plan and there will be an additional verification by independent auditors prior to the final payment.
- Advice provided to the beneficiary on the preparation of financial reports.
- Training on clearing for EU Delegation staff.
- Checklists modified to address problems encountered.

**Box 8.3:**

**- Shared cost allocation not based on expenditure actually incurred**

The Commission agrees that shared costs have to be claimed based on actual and not budgeted costs. Based on this principle, the methodology used to claim shared costs has been assessed at the end of 2020 as a part of the ex-ante assessment that all the organisations underwent to obtain the Commission's Humanitarian Aid partner certification for the period 2021-2027. The verification of shared costs is also part of the scope of the Commission's ex-post controls and audits.

8.11 The Commission would like to point out that each of the four eligibility criteria is subject to a thorough assessment both at the design and at the disbursement phases, in line with Article 236 of the EU Financial Regulation and as per guidance provided under the 2017 budget support guidelines.

In addition, the Commission considers that budget support improves accountability and helps to tackle corruption, by focusing on progress in public finance management and budgetary transparency and oversight. The financing provided through budget support becomes part of the state budget and therefore subject to external audit and parliamentary control.

8.13 The Commission would like to clarify that when the notional approach applies, the Commission does not have a legal obligation to monitor it separately, and does not see the added value in monitoring it.

8.14 The Commission would like to highlight that there are contractual provisions that cover the access to documents. The Commission will continue to draw the partner organisations' attention to the need to provide the ECA with the necessary information.

## ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

### **FPI annual activity report**

8.18 The pillar assessment of CDSP missions remains a priority for FPI.

The current status of the two CDSP missions not yet pillar assessed at the end of 2020, is

1. EUBAM Libya: FPI is currently analysing the draft pillar assessment report received from the external auditor on 28th May 2021. The draft report concludes that the mission is fully compliant.
2. EUAM Central African Republic: The mission was only fully deployed in August 2020, and is not yet ready for a pillar assessment. FPI will evaluate the maturity of the mission in the autumn with a view to decide the appropriate timing of the pillar assessment.

### **DG NEAR's 2020 RER study**

8.19 The RER study is an important element underpinning the declaration of the Director General, but it is not the only source of assurance. DG NEAR has a **comprehensive internal control framework and control strategy** covering the full implementation cycle. As described in its Annual Activity Report, all elements of the control framework serve as **building blocks for assurance**.

8.21 The Commission does not and has never characterised the RER study as an assurance engagement or an audit. It serves a specific purpose and is built on a distinct methodology.

This is disclosed in the RER study and in DG NEAR's Annual Activity Report, which presents complete management information in a true and fair manner. The Commission does not consider that the study is subject to **limitations** that may lead to an **underestimation** of errors.

8.22 The Commission considers that the RER is **fit for purpose** and highly **representative**. The probability of selecting a contract closed in the period is exactly proportionate to its value.

The purpose of the RER is to provide a **representative error rate** for the entire population of the DG. Stratification would not lead to this result.

**Budget Support** (BS) transactions represented 45 transactions out of a total of 375 transactions included in the RER study. The error rate is not a function of the value of the transaction. The RER methodology involves a projection of the error rate into the global error rate and the projection is independent of the value of the transaction. An error rate in a low value transaction has the same impact as an error in a high value transaction.

Whilst BS transactions have been subject to measured error less often in comparison to other contract types in DG NEAR (and INTPA) RER studies, such errors have been identified and reported. Due to the value of BS transactions (usually, in tens of millions), such errors can have a significant impact on the DG error rate.

Excluding over 25% of DG NEAR's population of closed contracts from the RER study would therefore not be justified and could potentially contribute to underestimating the error rate.

8.23 The number of grants included in the RER study was increased in response to a recommendation issued by the Court in its annual report for 2017.

The Commission is of the view that this **additional grant sample** was a suitable and adequate response that reflects the high risk associated with grants.

The RER includes an additional grant sample, the purpose of which is to provide the Commission with corroborative information complementing the grant-related information provided by the main sample. This provides a basis to decide whether a reservation is required in respect of grants. The additional sample of 96 sampling intervals (representing 1/3 of the entire population of the RER study) fulfils that requirement. A higher confidence level would necessitate a much larger sample (additional 88 transactions for a confidence level of 95%). This would not make a substantial contribution to the core objective pursued by having an additional grant sample, namely corroboration of the main sample findings. The current approach responds to the key priorities of building assurance and cost-efficiency of controls.

8.24 The Commission considers that **overreliance on the control work of other auditors should be avoided** and that there has been no such overreliance in the 2020 RER study. Indeed, the overall level of reliance has gone down by 2% points from 2019 to 2020.

**Full reliance** is only placed on work performed by qualified auditors under the audit framework contract signed with the Commission, or on work performed by the ECA. The percentage of cases of full reliance fell to 13% in 2020.

There are two types of reliance: **partial and full reliance**. Full reliance for an individual transaction means that no substantive testing on the transaction is required. Nevertheless, all other procedures remain applicable (reconciliation between amounts cleared and paid, the follow-up/recovery order and first-level procurement when applicable). The tests carried out in the case of **partial reliance** are more extensive and include substantive testing, which needs to achieve a minimum level of coverage, with the aim being to identify any error where possible.

If the control work of other auditors is not relied upon when considered sound, this would subject the beneficiary to two audits/verifications of the same transaction.

In no case will control work only by the Commission be sufficient to justify reliance.

They review the reports from such prior control work and take them into account as part of the overall control environment, but do not place reliance solely on such control work.

**A decreased sample size has no relevance to the percentage of reliance.** The calculation is number of cases/number of transactions.

8.25 The Commission notes that:

- The **limitation** is not specific to the RER study; it comes from an **overarching framework agreement between the UN organisations and the European Commission**.
- When the contractor is not given access to the necessary documentary evidence, they raise an error.

The Financial Regulation requires that entities entrusted with implementation of EU funds in indirect management demonstrate a level of financial management and protection of the EU's financial interest, which is equivalent to that of the Commission. This is verified by carrying out an **ex-ante pillar assessment** of the entity.

Concerning reliance and international organisations, the data shows that controls took place. In fact, **43 transactions were selected where the FAFA applied**. Out of these, the contractor placed full reliance in 18 cases, partial reliance in 6 cases and did not rely upon other control work in the remaining 19 cases. In 17 instances, a measured error was raised.

When **full reliance** is placed on prior control work, the contractor reviews the findings and, where the error was not isolated by the auditor and/or not recovered with appropriate justification by the EU Delegation, a notional error is raised, which extrapolates the findings identified by the prior control work over the unsampled part of the population. When the contractor places partial reliance on the prior control work, they perform the same procedure as above, in addition to performing substantive testing.

8.26 The Commission does not consider **estimations** are a "*major factor that distorts the RER*". As reported by the Commission already in 2019, estimations are extremely rare: two in 2018, none in 2019 and only one partial estimation in 2020. Hence, three out of 1144 items in the three RER studies were estimations. The only (partial) estimation reported in 2020 was due to an accident that destroyed the archives of a beneficiary. Documents provided by the beneficiary substantiated the facts, which were also known to the EU Delegation.

The decision to estimate an error is not based on a simple case of non-provision of documentation, (this will give rise to a measured error). An estimation is made only when the specific circumstances described in the RER manual, which do not confer broad discretion, are met and duly documented.

An observation on the **risk premium** was already raised in the Annual Report 2019 on the EDFs and the Commission replies. The risk premium was adopted by both NEAR and INTPA to improve the provisions for estimation in the RER methodology.

The **risk premium of 5% represents a highly prudential approach**, designed to ensure that the error rate is not underestimated.

8.27 There is always a certain level of **replacements** in the RER studies. The number of replacements was higher in the 2020 RER study due to the inclusion of novel transactions. The RER methodology for replacements was followed and the circumstances justified the replacements. The Commission will endeavour to keep replacements to a minimum in the future. The Commission has no reason to believe that the replacements had an impact on the calculation of the error rate under the 2020 RER study.

8.28 The Commission is prepared to look at the introduction of changes to the **RER methodology** or the terms of reference, to formalise the **communication of suspicion of fraud** by the contractor to the Commission. In the few instances of major irregularities or cases of non-compliance that could indicate the presence of fraud, the contractor reported these to the Commission which took the appropriate actions, including notification to OLAF if warranted.

The regular meetings (generally weekly) between the contractor and the Commission allow the contractor to report on progress with their control work and on any issue encountered in dealing with the beneficiaries, including fraud.

All individuals working for the contractor have a duty to report suspicions of fraud, as per the Money Laundering Regulations.

## CONCLUSIONS AND RECOMMENDATIONS

### **Recommendations**

8.31 In relation to the **recommendation** qualified by the ECA as not implemented, the Commission indicated in its reply to the recommendation that it would “explore with the RER contractor ways of stratifying the RER population, while still taking into consideration the need to maintain a sound and representative sample overall”. As described in more detail in section 8.22, the sampling methodology is designed to ensure that the results of the RER study can be considered representative for all of DG NEAR’s closed contracts. The probability of a contract closed in the period being selected is exactly proportionate to its value. A risk-based, stratified sample would reduce the representativeness of the sample.

#### **Recommendation 8.1**

The Commission accepts this recommendation.

The Commission will continue to draw the partner organisations' attention to the need to provide the ECA with the documents or information necessary to carry out its task. See also Commission reply to paragraph 8.14.

#### **Recommendation 8.2**

The Commission accepts this recommendation.

Since 2021, the obligation to base the shared cost allocation on actual and not budgeted costs is part of the scope of the ex-ante assessment that any organisation has to comply with before being certified as a Commission’s Humanitarian Aid partner.

In addition to this ex ante assessment, the Commission currently prepares a guidance document on eligibility on Humanitarian Aid grants. Finally, the eligibility of shared costs is part of the scope of Commission’s ex-post controls and audits.

#### **Recommendation 8.3**

The Commission accepts this recommendation.

The Commission will look into the possibility of introducing a reference in the RER methodology or terms of reference to formalise the communication of suspected risks of fraud to the Commission at the appropriate level.

**REPLIES TO THE OBSERVATIONS OF THE COURT OF AUDITORS : YEAR 2020****OBSERVATIONS OF THE COURT OF AUDITORS  
RELATED TO THE EUROPEAN PARLIAMENT  
REPLIES FROM THE PARLIAMENT****Observations on the sample of transactions**

**9.8.** We detected errors in two payments executed by the European Parliament. One concerned an over-payment for IT services caused by the incorrect application of contract terms. The other concerned an incorrect payment of a subsistence allowance to an MEP, following a mistake in an attendance list. We found that the control system in place did not prevent nor detect such mistakes, but the Parliament is currently working on a new system to improve it.

*Parliament takes note of the Court's observations and refers, for the issue of the daily subsistence allowance, to the response to Recommendation 1.*

**Conclusion and recommendations****Recommendation 9.1 – European Parliament**

The Parliament should implement the necessary changes to ensure that it only pays daily subsistence allowances to MEPs who qualify for them (see paragraph 9.8).

**Timeframe: by the end of 2022**

*Parliament accepts this recommendation. In 2019 Parliament launched a project to automate the registration of attendance with biometric technology in the central attendance register and in the plenary chambers. This technology would eliminate mistakes and ensure that only MEPs entitled to the daily subsistence allowance actually receive it. Due to the COVID-19 pandemic the project has had some delays. Parliament's administration, as mandated by its Bureau, signed a contract for this project end 2020. Additionally, Parliament's data controller is currently assessing the European Data Protection Supervisor's recommendations received end of March 2021.*

**Annexes****Annex 9.2 Follow-up of previous recommendations****Recommendation 2:**

during the next revision of the rules governing the reception of groups of visitors, the European Parliament strengthen[s] the procedure for submitting declarations of expenditure by requiring groups to provide supporting documentation together with their cost claims.

*The Internal Audit Service established its final report on the audit carried out on visitors' groups early 2021, which includes an action plan that asks for the submission to the Secretary-General, for adoption by the Bureau, of a proposal for a revision of the rules governing visitors groups. Steps are now being taken to prepare for a revision of the rules on the visitors groups. The recommendation of the Court of Auditors will be integrated in the proposal for the revision of the rules.*

## REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2020 ANNUAL REPORT

### “CONTRIBUTION TO ANNUAL REPORT 2020 – CHAPTER 9 – ADMINISTRATION”

#### INTRODUCTION

9.1 The Commission welcomes the ECA's overall conclusion that the level of error in spending on 'Administration' was not material. The Commission will follow up on the issues identified by the ECA, where appropriate. With regard to the family allowances perceived from other sources, the Commission has reinforced the controls carried out; at the same time, it has improved the platform used and the communication addressed to the agents.

#### REGULARITY OF TRANSACTIONS

9.9 With regard to the cost related to software licences, the Commission negotiated with the software vendor a lump sum agreement. The Commission paid the amount, which was negotiated and agreed with the software vendor.

#### CONCLUSION AND RECOMMENDATIONS

9.17 The issue of family allowances is extremely complex and not entirely within the Commission's jurisdiction: national family allowances depend on increasingly complex and varied family situations, in some cases also on family income ceilings, and even on specific situations of children.

Important organisational changes have recently occurred in Belgium (which represents 80% of the staff potentially benefiting from national allowances), whereby the competence in family benefits has been transferred from the federal State to the Communities and Regions, taking into consideration the residence of the child, different amounts depending on the date of birth of the children, etc. To counteract these changes, the Commission has reinforced the controls carried out; at the same time, it has improved the platform used and the communication addressed to the agents.

#### **Recommendation 9.2 – Commission**

The Commission accepts the recommendation and has already taken the necessary measures to encourage agents to fulfil their obligations by:

- making improvements in its IT tool SYSPER for encoding declarations;
- systematically informing agents of their obligations to update their personal data, either during exchange with the Office responsible for the Payment of Individual Entitlements (PMO) in relation to family allowances or through newsletters regularly sent to all staff.

The Commission has also reinforced the relevant team in charge of allowances perceived from other sources to, among other things, carry out regular checks based on lists extracted from internal databases in order to target/identify all files that are not up to date, or where the expected declarations have not yet been made.

**Annual report on the activities funded  
by the 8th, 9th, 10th and 11th  
European Development Funds for the  
2020 financial year**

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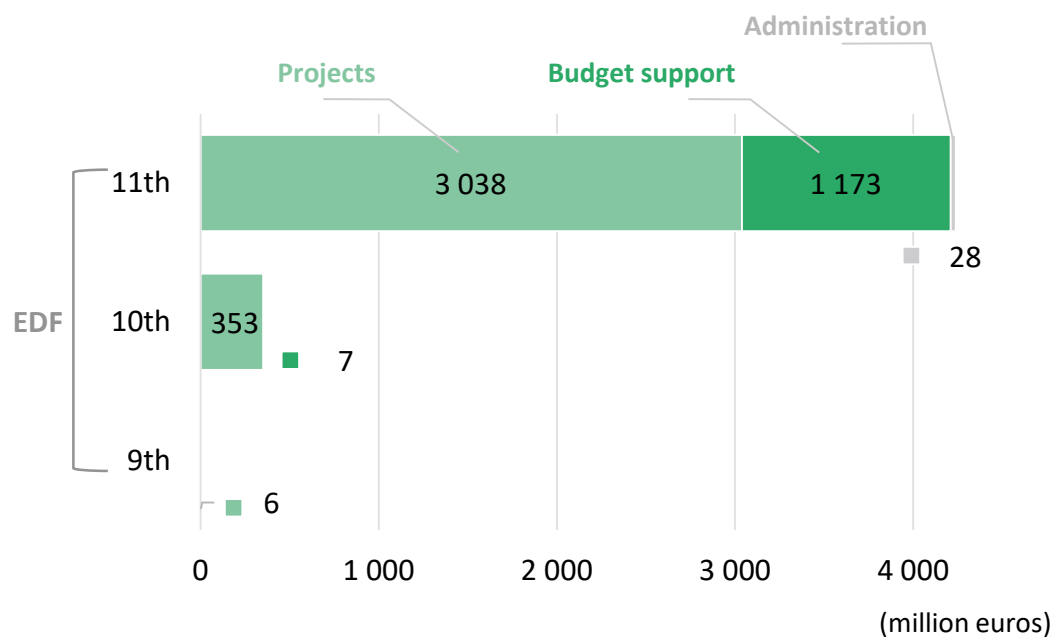
# Introduction

**01** This annual report presents our findings on the 8th, 9th, 10th and 11th European Development Funds (EDFs). **Box 1** gives an overview of the activities and spending in this area in 2020.

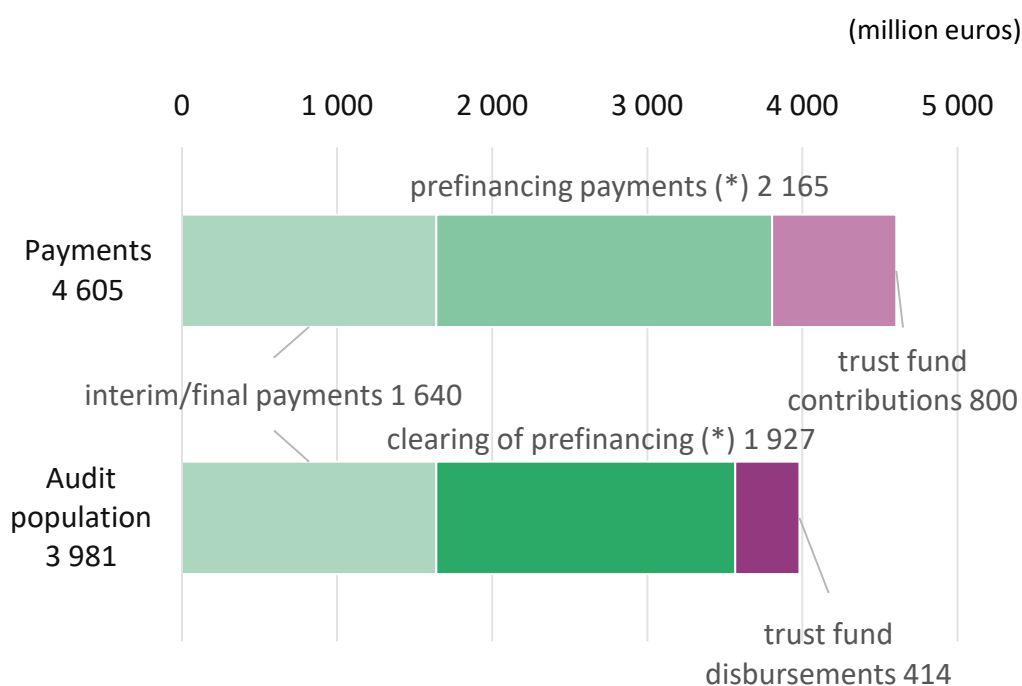
## Box 1

### European Development Funds – 2020 financial overview

European Development Funds (EDF) payments by budget line and type



### EDF Payments and audited population



(\*) In line with the harmonised definition of underlying transactions (for details see **Annex 1.1** to the ECA's 2020 annual report on the implementation of the budget, paragraph 11).

Source: 2020 consolidated accounts of the 8th, 9th, 10th and 11th EDFs.

## Brief description of the European Development Funds

**02** Launched in 1959, the EDFs were the main instruments by which the European Union (EU) provided development cooperation aid to the African, Caribbean and Pacific (ACP) countries and overseas countries and territories (OCTs) until the end of 2020. The *partnership agreement* signed in Cotonou on 23 June 2000 for a period of 20 years ('the Cotonou Agreement') was the framework governing the EU's relations with ACP countries and OCTs<sup>1</sup>. Its primary objective was to reduce and ultimately eradicate poverty. For the 2021-2027 multiannual financial framework (MFF), development cooperation aid to the African, Caribbean and Pacific is integrated into the Neighbourhood, Development and International Cooperation Instrument (NDICI/Global Europe) and development cooperation aid to the OCTs is integrated into the Overseas Association Decision. However, the 8th, 9th, 10th and 11th EDFs will not

<sup>1</sup> The provisions of the Cotonou agreement were extended until 30 November 2021.

be integrated into the EU general budget and will continue to be implemented and reported on separately until their closure.

### 03 The EDFs are particular in that:

- (a) the Member States' contributions are based on quotas, or 'contribution keys', which are set by the national governments at the Council of the European Union;
- (b) they are managed by the Commission, outside the framework of the EU general budget, and the European Investment Bank (EIB);
- (c) due to the intergovernmental nature of the EDFs, the European Parliament plays a more limited role in their functioning than it does for the development cooperation instruments financed by the EU general budget; notably, it is not involved in establishing and allocating EDF resources. However, the European Parliament is the *discharge* authority, except for the Investment Facility, which is managed by the EIB and is therefore outside the scope of our audit<sup>2 3</sup>;
- (d) the principle of *annuality* does not apply to the EDFs: EDF agreements are usually concluded for a commitment period of five to seven years, and payments can be made over a much longer time frame.

**04** The EDFs are managed almost entirely<sup>4</sup> by the Commission's Directorate-General for International Partnerships (DG INTPA), formerly the Directorate-General for International Cooperation and Development (DG DEVCO)<sup>5</sup>.

**05** The expenditure covered in this report is delivered in 79 countries using a wide range of methods such as works, supply and service contracts; grants; budget support; *delegation and contribution agreements* and programme estimates (see [Annex II](#)).

<sup>2</sup> See Articles 43, 48-50 and 58 of Council Regulation (EU) 2015/323 of 2 March 2015 on the financial regulation applicable to the 11th European Development Fund ([OJ L 58, 3.3.2015, p. 17](#)).

<sup>3</sup> In 2012, a tripartite agreement between the EIB, the Commission and the ECA (Article 134 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th EDF ([OJ L 78, 19.3.2008, p. 1](#))) set out the rules for the audit of these operations by the ECA.

<sup>4</sup> With the exception of the 1.44 % of the 2020 EDF expenditure managed by the Directorate-General for Humanitarian Aid and Civil Protection (DG ECHO).

<sup>5</sup> DG DEVCO became DG INTPA in January 2021.

## Chapter I – Financial implementation of the 8th, 9th, 10th and 11th EDFs

**06** The budget of the 8th EDF (1995-2000) was €12.8 billion, that of the 9th EDF (2000-2007) €13.8 billion, and that of the 10th EDF (2008-2013) €22.7 billion.

**07** The Internal Agreement establishing the 11th EDF<sup>6</sup> (2015-2020) came into force on 1 March 2015. Between 2013 and 2015, funds were committed via a *bridging* facility to ensure continuity pending ratification of the 11th EDF. The 11th EDF holds €30.5 billion, of which €29.1 billion is allocated to the ACP countries and €364.5 million to the OCTs, with €1.1 billion for administrative costs.

**08** *Box 2* shows the use of EDF resources both in 2020 and cumulatively for the 8th, 9th, 10th and 11th EDFs.

<sup>6</sup> OJ L 210, 6.8.2013, p. 1.

## Box 2

### Use of EDF resources at 31 December 2020\*

	Situation at end of 2019		Budgetary implementation during the 2020 financial year (net) <sup>6</sup>					Situation at end of 2020					
	Total amount	Implement. rate <sup>2</sup>	8 <sup>th</sup> EDF <sup>3</sup>	9 <sup>th</sup> EDF <sup>3</sup>	10 <sup>th</sup> EDF	11 <sup>th</sup> EDF <sup>3</sup>	Total amount	8 <sup>th</sup> EDF	9 <sup>th</sup> EDF	10 <sup>th</sup> EDF	11 <sup>th</sup> EDF	Total amount	Implement rate <sup>2</sup>
<b>A – RESOURCES<sup>1</sup></b>	<b>76 764</b>		<b>-2</b>	<b>-69</b>	<b>-368</b>	<b>123</b>	<b>-316</b>	<b>10 376</b>	<b>15 279</b>	<b>21 061</b>	<b>29 731</b>	<b>76 447</b>	
<b>B – USE</b>													
1. Global commitments <sup>4</sup>	73 309	95.5 %	0	-68	-110	2 798	2 620	10 375	15 268	20 978	29 309	75 929	99.3 %
2. Individual commitments <sup>5</sup>	67 683	88.2 %	0	-48	256	3 413	3 621	10 374	15 253	20 567	25 110	71 304	93.3 %
3. Payments	57 414	74.8 %	0	6	360	4 239	4 605	10 374	15 208	19 645	16 791	62 018	81.1 %
<b>C – Outstanding commitments (B1-B3)</b>	<b>15 896</b>	<b>20.7 %</b>						<b>0</b>	<b>60</b>	<b>1 333</b>	<b>12 518</b>	<b>13 911</b>	<b>18.2 %</b>
<b>D – Available balance (A-B1) <sup>7</sup></b>	<b>3 454</b>	<b>4.5 %</b>						<b>1</b>	<b>12</b>	<b>83</b>	<b>422</b>	<b>518</b>	<b>0.7 %</b>

\* Rounded figures

<sup>1</sup> Include initial allocations to the 8th, 9th, 10th and 11th EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.

<sup>2</sup> As a percentage of resources.

<sup>3</sup> Negative amounts correspond to *decommitments*.

<sup>4</sup> Global commitments relate to financing decisions.

<sup>5</sup> Individual commitments relate to individual contracts.

<sup>6</sup> Net commitments after decommitments. Net payments after recoveries.

<sup>7</sup> Balance available includes 'non-mobilisable reserve'" (unusable without unanimous decision from the Council)

*Source:* ECA, based on the 2020 consolidated accounts of the 8th, 9th, 10th and 11th EDFs. The figures presented do not cover the part of the EDF managed by the EIB.

**09** Every year, DG INTPA sets itself key performance indicators (KPIs) on sound financial management and the efficient use of resources. These indicators show that, in 2020, despite the difficulties related to the COVID-19 crisis, DG INTPA reached its targets of reducing old pre-financing and unspent commitments by 35 % and expired contracts by 15 %. This was the result of an improvement in procedures in recent years (see [Box 3](#)). Both targets were set as an overall target for DG INTPA's entire area of responsibility and as a specific target for the EDFs.

### **Box 3**

#### **KPIs on reducing old pre-financing, unspent commitments and expired contracts**

In 2020, DG INTPA decided to set a new target (increasing it from 25 % to 35 %) for KPIs on reducing old pre-financing and unspent commitments. It exceeded these targets for both indicators in 2020: old pre-financing was more than halved, both for the EDF (56 %) and the entire area of responsibility (55 %). Old unspent commitments were reduced by 40 % for the EDF and by 41 % across DG INTPA's entire area of responsibility.

DG INTPA also reached its target of having no more than 15 % of expired contracts still open in the system for the EDF (14 %) and across its entire area of responsibility (11 %). The KPI for the EDF has consistently improved since 2017 (19 % in 2017, 17 % in 2018 and 15 % in 2019) as a result of new procedures established in 2017.

## Chapter II – The ECA’s statement of assurance on the EDFs

### The ECA’s statement of assurance on the 8th, 9th, 10th and 11th EDFs to the European Parliament and the Council – independent auditor’s report

#### Opinion

**I.** We have audited:

- (a) the annual accounts of the 8th, 9th, 10th and 11th EDFs, which comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets and the report on financial implementation for the financial year ended 31 December 2020, approved;
- (b) the legality and regularity of the underlying transactions of which financial management falls to the Commission<sup>7</sup>.

#### Reliability of the accounts

##### Opinion on the reliability of the accounts

**II.** In our opinion, the annual accounts of the 8th, 9th, 10th and 11th EDFs for the year ended 31 December 2020 present fairly, in all material respects, their financial position as at 31 December 2020, the results of their operations, their cash flows and the changes in their net assets for the year then ended, in accordance with the EDF Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

<sup>7</sup> Pursuant to Articles 43, 48-50 and 58 of the Financial Regulation applicable to the 11th EDF, this statement of assurance does not extend to the EDF resources managed by the EIB.

## Legality and regularity of the transactions underlying the accounts

### Revenue

#### *Opinion on the legality and regularity of revenue*

**III.** In our opinion, the revenue underlying the accounts for the year ended 31 December 2020 is legal and regular in all material respects.

### Expenditure

#### *Adverse opinion on the legality and regularity of expenditure*

**IV.** In our opinion, owing to the significance of the matter described under ‘Basis for adverse opinion on the legality and regularity of expenditure’, the expenditure accepted in the accounts for the year ended 31 December 2020 is materially affected by error.

#### *Basis for Opinion*

**V.** We have conducted our audit in accordance with the IFAC International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under these standards and codes are described in more detail in the ‘Auditor’s responsibilities’ section of our report. We have also met independence requirements and fulfilled our ethical obligations under the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *Basis for adverse opinion on the legality and regularity of expenditure*

**VI.** The expenditure recorded in 2020 under the 8th, 9th, 10th and 11th EDFs is materially affected by error. Our *estimated level of error* for expenditure accepted in the accounts is 3.8 %.

### Key audit matters

**VII.** Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters.

### Accrued charges

**VIII.** We assessed the accrued charges presented in the accounts which are subject to a high degree of estimation. At year-end 2020, the Commission estimated that eligible expenses incurred but not yet reported by beneficiaries amounted to €5 452 million (year-end 2019: €5 074million).

**IX.** We examined the calculation of these accrual estimates and reviewed a sample of 30 individual contracts to address the risk that the accrual was misstated. The work performed led us to conclude that the accrued charges recognised in the final accounts were appropriate.

### Potential impact on the 2020 EDF accounts of the United Kingdom's withdrawal from the European Union

**X.** On 1 February 2020, the United Kingdom (UK) ceased to be an EU Member State. Following the conclusion of the agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (the 'Withdrawal Agreement') between the two parties, the UK committed to remain party to the EDF until the closure of the 11th EDF and all previous unclosed EDFs. The UK will assume the same obligations as the Member States under the internal agreement by which the 11th EDF was set up, as well as the obligations arising from previous EDFs until their closure.

**XI.** The Withdrawal Agreement also states that, where the amounts from projects under the 10th EDF or from previous EDFs have not been committed or have been decommitted on the date of entry into force of this agreement, the UK's share of those amounts will not be reused. The same applies to the UK's share of funds not committed or decommitted under the 11th EDF after 31 December 2020.

**XII.** Based on this, there is no financial impact to report on the 2020 EDF accounts. We conclude that the EDF accounts as at 31 December 2020 correctly reflect the state of the withdrawal process at that date.

### Responsibilities of management

**XIII.** In accordance with Articles 310 to 325 of the TFEU and with the 11th EDF Financial Regulation, management is responsible for preparing and presenting the EDF annual accounts on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the underlying transactions. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or

error. The Commission is ultimately responsible for the legality and regularity of the transactions underlying the EDF accounts.

**XIV.** When preparing the EDF accounts, the Commission is responsible for assessing the EDFs' ability to continue as a going concern, disclosing any relevant matters and using the going concern basis of accounting unless it either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

**XV.** The Commission is responsible for overseeing the EDFs' financial reporting process.

#### **Auditor's responsibilities for the audit of the EDF accounts and underlying transactions**

**XVI.** Our objectives are to obtain reasonable assurance as to whether the EDF accounts are free from material misstatement and the underlying transactions are legal and regular, and to provide, on the basis of our audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. Reasonable assurance is a high level of assurance, but it is not a guarantee that the audit has necessarily detected all instances of a material misstatement or non-compliance that may exist. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence any economic decisions taken on the basis of these EDF accounts.

**XVII.** As part of an audit in accordance with ISAs and ISSAIs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the EDF accounts and of material non-compliance of the underlying transactions with the requirements of the EDF legal framework, whether due to fraud or error. We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.
- Obtain an understanding of internal control relevant to the audit in order to design appropriate audit procedures, but not for the purpose of expressing an opinion on the effectiveness of the internal control.

- Evaluate the appropriateness of the accounting policies used by management and the reasonableness of management's accounting estimates and related disclosures.
- Conclude as to the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, as to whether material uncertainty exists owing to events or conditions that may cast significant doubt on the EDFs' ability to continue as a going concern. If we conclude that such material uncertainty exists, we are required to draw attention in our report to the related disclosures in the EDF accounts or, if these disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual accounts, including all disclosures, and assess whether the annual accounts fairly represent the underlying transactions and events.

**XVIII.** We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including findings of any significant deficiencies in internal control.

**XIX.** For revenue, we examine all contributions from Member States and a sample of other types of revenue transactions.

**XX.** For expenditure, we examine payment transactions once expenditure has been incurred, recorded and accepted. This examination covers all categories of payments (other than advances) at the point they are made. Advance payments are examined once the *recipient* of funds has provided evidence of their proper use and the institution or body has accepted that evidence by clearing the advance payment, which might not happen until a subsequent year.

**XXI.** Of the matters discussed with the Commission, we determine which were of most significance in the audit of the EDF accounts and are therefore the key audit matters for the current period. We describe these matters in our report unless law or regulation precludes public disclosure or, as happens extremely rarely, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh any public interest benefits.

8 July 2021

Klaus-Heiner LEHNE  
*President*

European Court of Auditors  
12, rue Alcide De Gasperi – L-1615 Luxembourg

## Information in support of the statement of assurance

### Audit scope and approach

**10** *Annex 1.1* to the ECA’s 2020 annual report on the implementation of the budget sets out our audit approach and methods, which also apply to the audit of the EDF.

**11** Our observations on the reliability of the EDF accounts are based on the financial statements<sup>8</sup> of the 8th, 9th, 10th and 11th EDFs, approved by the Commission<sup>9</sup>, together with the accounting officer’s letter of representation received on 30 June 2021. We tested amounts and disclosures, and assessed the accounting principles used, as well as any significant estimates made by the Commission and the overall presentation of the accounts.

<sup>8</sup> See Article 39 of [Regulation \(EU\) 2018/1877](#).

<sup>9</sup> In compliance with the EDF Financial Regulation; see Article 38 of [Regulation \(EU\) 2018/1877](#).

**12** To audit the regularity of transactions, we examined a sample of 140 transactions representative of the full range of spending within the EDF. This comprised 21 transactions related the Emergency Trust Fund for Africa, 102 transactions authorised by 21 EU delegations<sup>10</sup> and 17 payments approved by Commission headquarters<sup>11</sup>. The total sample size of 140 transactions was in line with our assurance model. Where we detected errors in the transactions, we analysed the underlying causes to identify potential weaknesses.

**13** We also examined the following for 2020:

- (a) all Member State contributions and a sample of other types of revenue transactions, such as other countries' co-financing contributions;
- (b) certain systems used by DG INTPA and the EU delegations, covering: (i) *ex ante* checks by Commission staff, external auditors (contracted by the Commission or the beneficiaries) or supervisors before payments were made, (ii) monitoring and supervision, notably the follow-up of external audits and the RER study<sup>12</sup>;
- (c) the reliability of the regularity information in the annual activity report (AAR) of DG INTPA, the consistency of the methodology for estimating amounts at risk, future corrections and recoveries, and their inclusion in the Commission's Annual Management and Performance Report (AMPR);
- (d) the follow-up of our previous recommendations.

**14** As stated in paragraph 04, DG INTPA implements most of the external aid instruments financed from both the EU general budget and the EDFs. Our observations on systems and the presentation of information in the AAR refer to DG INTPA's entire area of responsibility.

<sup>10</sup> African Union, Benin, Burkina Faso, Burundi, Cabo Verde, Central African Republic, Democratic Republic of Congo, Djibouti, Timor-Leste, Ghana, Guyana, Côte d'Ivoire, Jamaica, Mali, Mauritania, Niger, Nigeria, Senegal, Sudan, Tanzania and Zimbabwe.

<sup>11</sup> DG INTPA: 138 payments; DG ECHO: two payments for humanitarian aid.

<sup>12</sup> DG INTPA has an RER study carried out annually by a contractor to estimate the level of error which has evaded all management checks to prevent, detect and correct errors across its entire area of responsibility. The RER study does not constitute an assurance engagement or an audit; it is based on the RER methodology and manual provided by DG INTPA.

**15** Due to the COVID-19 pandemic, it was not possible to carry out on-the-spot visits to EU delegations<sup>13</sup>. This prevented us from carrying out certain audit procedures, in particular verifying contract implementation for the transactions selected, and therefore limited our audit work. We had to adapt our approach, carrying out desk reviews of transactions and projects and liaising remotely with our auditees.

## Reliability of accounts

**16** Our audit found that the accounts were not affected by material misstatements.

## Regularity of transactions

### Revenue

**17** Revenue transactions did not contain a material level of error.

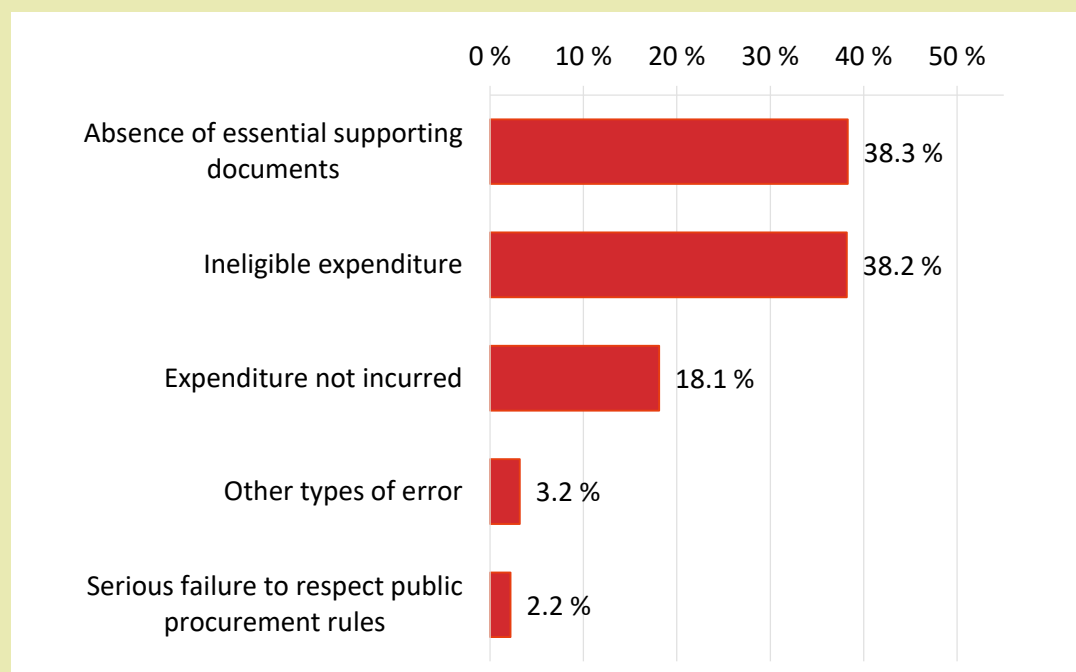
### Expenditure

**18** *Annex I* provides an overview of the results of transaction testing. Of the 140 transactions examined, 36 (25.7 %) contained errors. On the basis of the 31 errors we have quantified, we estimate the level of error to be 3.8 %<sup>14</sup>.

**19** *Box 4* gives a breakdown of our estimated level of error for 2020 by error type.

<sup>13</sup> All nine audit visits (Mali, Jamaica, Ghana, Sudan, Guyana, Djibouti, Timor-Leste, African Union and Zimbabwe) were replaced by desk reviews.

<sup>14</sup> We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the estimated level of error in the population lies between 1.8 % and 5.8 % (the lower and upper error limits respectively).

**Box 4****Breakdown of estimated level of error by error type**

Source: ECA.

**20** **Box 5** presents examples of errors we quantified, likewise by error type.

**Box 5****Expenditure not incurred: claimed expenditure overstated**

The Commission endorsed a works contract with a private company for the development of an irrigation network in Mali. The total contract value was €15.6 million, with an EU contribution of 100 %. Interim payments under the contract should have been based on actual measurements reported by the contractor and verified by the contract supervisor. We compared the measurement reported by the contractor for one item in the October 2019 invoice: disposal of excavated material, for a total reported amount of €288 729. The actual measurements verified by the contract supervisor showed that the amount declared for this item had been overstated by €32 304 (11 %). This was due to a clerical error in reporting by the contract supervisor.

### **Expenditure incurred outside the eligibility period**

The Commission concluded a grant agreement with an international organisation to finance the implementation of the Ceasefire and Transitional Security Arrangement Monitoring Mechanism in South Sudan. The total cost of the action was estimated at €9.2 million, with an EU contribution of 100 %.

We examined the staff insurance premium and observed that it had been renewed for a full year (1 May 2017 to 30 April 2018) despite the fact that the project ended on 31 January 2018.

The Commission considered the full insurance premium amount (€221 340) to be eligible even though 25 % of the amount (equivalent to three months or €49 069.52) was outside the project implementation period and therefore not eligible.

### **Procurement error – lack of transparency in public procurement procedure**

The Commission signed a works contract to strengthen food security in a region of Cameroon. The beneficiary of the project subcontracted part of the works to a non-governmental organisation (NGO), which awarded the contract worth €5 131.66 through an open procedure based on the 'most economically advantageous tender' criterion. The auditors found that the evaluation criteria used for the award differed from those published in the tender notice. The tender was therefore ineligible.

### **Ineligible costs charged to the project**

The Commission concluded a delegation agreement with an international organisation to promote actions to eliminate violence against women and girls and harmful practices worldwide.

We reviewed the expenditure incurred by the international organisation and confirmed that they had declared the equivalent of €70.1 million of expenditure, which had been accepted by the Commission. Our checks revealed that actual expenditure for the period had been €37.0 million. The difference, €33.1 million, consisted of commitments booked by the international organisation which had not yet been spent. This amount was therefore ineligible.

**21** The Commission and its implementing partners this year committed more errors in transactions relating to *grants* and to *contribution and delegation agreements* with international organisations than they did with other forms of support (such as those covering works, supply and service contracts). Of the 67 transactions of this type that we examined, 27 (40.3 %) contained quantifiable errors, which accounted for 94.2 % of the estimated level of error.

**22** In five cases of quantifiable error and three cases of non-quantifiable error, the Commission had sufficient information to prevent, or to detect and correct, the error before accepting the expenditure. Had the Commission made proper use of all the information at its disposal, the estimated level of error would have been 1.19 percentage points lower. We found five other transactions with errors which external auditors and supervisors should have detected. These cases contributed 0.1 percentage points to the estimated level of error.

**23** In addition, three transactions containing a quantifiable error<sup>15</sup> were subjected to an audit or expenditure verification. DG INTPA's control system is based on *ex ante* checks<sup>16</sup>. The information provided in the audit/verification reports on the actual work done did not allow us to assess whether the errors could have been detected and corrected during these *ex ante* checks<sup>17</sup>.

**24** As in previous years, the frequency of the errors found – including some contained in final claims which had been subjected to *ex ante* external audits and expenditure verifications – points to weaknesses in these checks.

<sup>15</sup> Contributing 0.24 percentage points to the estimated level of error.

<sup>16</sup> The overall control system consists of *ex ante* and *ex post* checks. *Ex ante* checks assess the eligibility of the expenditure prior to contracting and prior to accepting the expenditure, whereas *ex post* checks take place after expenditure has been accepted. For example, an external audit can be done either *ex ante* (before accepting a payment) or *ex post* (after a project has been completed). Both types can result in the recovery of funds paid to the beneficiary; in the case of *ex ante* checks, such recoveries concern pre-financing previously paid.

<sup>17</sup> The reports do not cover 100 % of the reported expenditure; nor do they give sufficient detail to confirm whether the items where we identified errors had been part of their sample.

**25** In three areas, the transactions we examined contained no errors. These were budget support (nine transactions), administrative expenditure (three transactions) and transactions where the ‘notional approach’ had been applied in multi-donor projects implemented by international organisations (13 transactions). Paragraphs **8.9-8.12** in **chapter 8** of the ECA’s 2020 annual report on the implementation of the budget give more details on the nature of budget support and notional approach.

**26** Some international organisations<sup>18</sup> provided only limited access to documents, such as in read-only format, meaning we could not make copies of the documents reviewed. Furthermore, one international organisation questioned our mandate. These issues hindered the planning and execution of our audit and led to excessive delays in the audit team receiving the requested documentation and carrying out its work. In one additional case, it took the international organisation more than nine months to provide the requested supporting documents. The Treaty on the Functioning of the EU<sup>19</sup> establishes the ECA’s right to be forwarded any document or information necessary to carry out its task. We previously made related observations in our 2018 annual report<sup>20</sup> and in opinion 10/2018<sup>21</sup>.

## Annual activity report and other governance arrangements

**27** In every annual activity report from 2012 to 2018, DG INTPA issued reservations on the regularity of underlying transactions. In 2019, it adopted an action plan to address the weaknesses in the implementation of its control system.

<sup>18</sup> The United Nations Educational, Scientific and Cultural Organization (UNESCO), the International Development Association (IDA) and the United Nations Children’s Emergency Fund (UNICEF).

<sup>19</sup> The ECA’s right to access documentation is established in Article 287 of the Treaty on the Functioning of the European Union: ‘Any natural or legal person in receipt of payments from the budget, shall forward to the Court of Auditors, at its request, any document or information necessary to carry out its task.’

<sup>20</sup> See paragraph 19 of our [2018 annual report](#) on the EDFs.

<sup>21</sup> [Opinion 10/2018](#) concerning the proposal for a Regulation of the European Parliament and of the Council establishing the Neighbourhood, Development and International Cooperation Instrument, paragraph 18.

**28** Last year, we reported on the satisfactory progress achieved on the 2018 action plan; out of 13 actions, seven were completed, one partially implemented, two were ongoing, two were cancelled and one action had not been implemented but instead merged with another action.

**29** In its action plan for 2019, DG INTPA had adjusted the number of actions to nine. Eight of these actions were carried over from previous years, and there was a new measure aimed at improving the methodology and manual for DG INTPA's RER study. By April 2021, seven actions were completed and two were ongoing.

**30** In the 2020 action plan, DG INTPA similarly adjusted the number of actions, this time to seven. Five of these actions were carried over from previous years and two new actions were added: reducing the excess clearing of pre-financing and conducting an evaluation on the use of the new terms of reference for expenditure verifications. Some actions were affected by technical issues with IT systems, an example being the simplification of contractual conditions for grants. Others, such as the action on maintaining awareness of frequently occurring errors, were impacted by the COVID-19 pandemic. By April 2021, three actions were completed and four were ongoing (see [Annex III](#)).

#### **2020 RER study**

**31** In 2020, DG INTPA had its ninth residual error rate (RER) study carried out by an external contractor on its behalf. The purpose of the study is to estimate the rate of those errors that have evaded all DG INTPA management checks to prevent, detect and correct such errors across its entire area of responsibility, in order to conclude on the effectiveness of those checks. It is an important element on which the Director-General bases the declaration of assurance, and feeds into the regularity information on 'External Action' disclosed in the AMPR.

**32** For the 2020 RER study, DG INTPA applied a sample size of 480<sup>22</sup> transactions (exactly the same as in 2019). This meant it could again present separate error rates for expenditure financed from the EU general budget and for spending financed by the EDF, in addition to the overall error rate for both combined. For the fifth year in a row, the study estimated the overall RER to be below the 2 % *materiality threshold* set by the Commission (2016: 1.67 %; 2017: 1.18 %, 2018: 0.85 %; 2019: 1.13 % and 2020: 0.95 %).

**33** The RER study does not constitute an *assurance engagement* or an audit; it is based on the RER methodology and manual provided by DG INTPA. We identified limitations that may contribute to the underestimation of the residual error rate.

**34** In this year's audit, we again detected several major factors that distorted the RER. The first factor was the limitations set by the financial and administrative framework agreement (FAFA) concluded with certain international organisations. This agreement limits the number of items that can be checked during an expenditure verification, as well as access to audit evidence. In 2020, the Commission agreed to limit the size of samples for expenditure verifications, as well as to allow only remote access to electronic copies and prohibit the retention of copies of supporting documents under the international organisations' custody. Thus, if a contract with one of these international organisations had already been audited, the RER contractor did not systematically investigate any further and relied on previous work, regardless of this work's level of coverage and/or the contractor's confidence in it.

**35** The second factor was the share of transactions for which the RER relied fully or partially on previous control work. This share was 17 % for full reliance and 37 % for partial reliance<sup>23</sup>. For these transactions, the contractor relied on previous work done as part of DG INTPA's control framework, such as project financial audits and expenditure verifications performed by independent third parties and checks by the Commission. Overreliance on previous control work is contrary to the purpose of the RER study, which is to identify the errors that have evaded such checks.

<sup>22</sup> Some of the sampled transactions have a value higher than the *sampling interval*; therefore, the final sample size was 412.

<sup>23</sup> In 2019, 20 % for full reliance and 38 % for partial reliance.

**36** Thirdly, an analysis of the work performed shows that 97 % of the error rate declared for the RER was derived from grants and contracts with international organisations and Member State agencies<sup>24</sup>. These can be considered high-risk for errors. Conversely, the budget support instrument was error-free and can be considered low-risk for errors. Excluding the transactions on which full or partial reliance was placed, only 6 grant transactions (totalling €6.3 million or 0.3 % of the total sample value<sup>25</sup>) were reviewed in their entirety while 58 budget support transactions (€809.6 million or 30.5 % of the total sample value) received this level of review<sup>26</sup>. Focusing on low-risk areas of the population reduces the possibility of finding actual errors.

**37** The fourth factor was DG INTPA's RER estimation method. Firstly, it gives the contractor broad discretion in deciding whether there are sufficient logistical and legal reasons preventing timely access to the documents for a transaction and, hence, estimating the error rate. Secondly, the Commission added a 5 % risk premium to the residual error rate, as it did in 2019. However, it is not clear how the Commission arrived at a risk premium of 5 %. Consequently, this method does not necessarily reflect the actual residual error for the transaction in question.

**38** Furthermore, the regulatory framework governing the RER study and the contract between DG INTPA and the RER contractor do not address or mention the risk of fraud. There is no procedure requiring the contractor to report to the Commission cases of suspected fraud against the EU budget detected during its RER work.

### **Review of the 2020 annual activity report**

**39** The Director-General's declaration of assurance in the 2020 AAR does not include any reservations, as the two reservations remaining in 2018 have been lifted and no new ones have been issued. In 2018 and 2019, DG INTPA significantly reduced the scope of reservations (i.e. the share of expenditure covered by them). **Box 6** shows the scope of reservations presented in the AARs each year from 2010 to 2020.

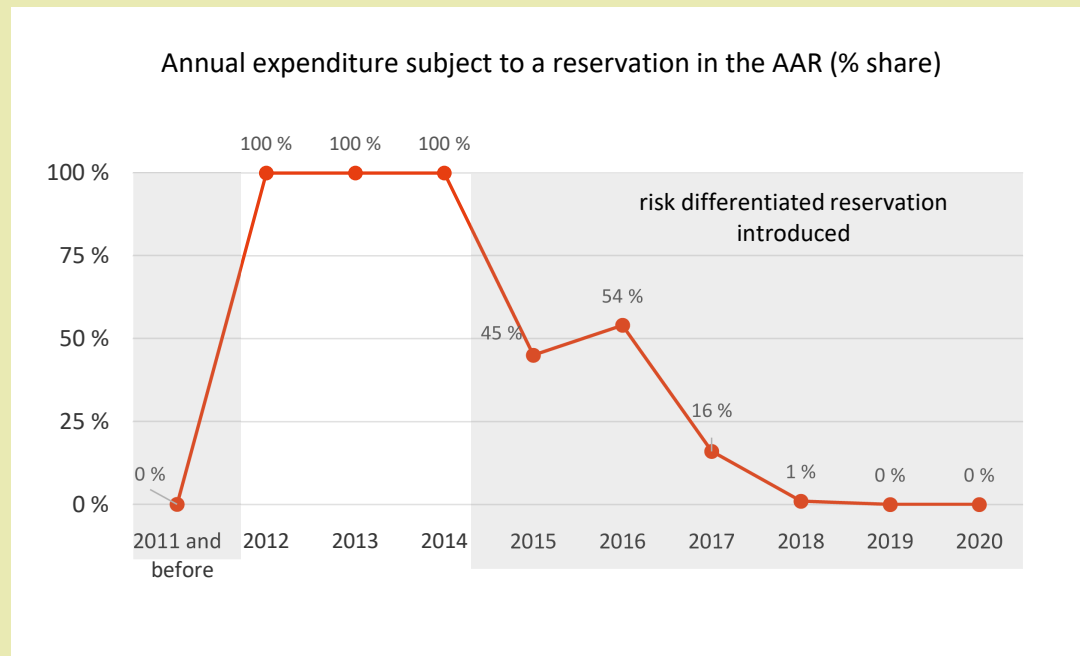
<sup>24</sup> Direct management grants provided 37 % of the error rate, while indirect management with international organisations and Member State agencies provided 60 %.

<sup>25</sup> 412 transactions with a value of €2 099 million.

<sup>26</sup> There were a total of 108 grants in the sample; therefore, only 5.6 % were reviewed. Conversely, there were only 61 budget support transactions in the sample, meaning 95 % were fully reviewed.

## Box 6

## DG INTPA AAR reservations 2010-2020



Source: ECA.

**40** As in the 2019 annual report, we find the lack of reservations in the 2020 AAR unjustified and consider that it results partly from the limitations of the RER study.

**41** Another reason for the absence of reservations is that, in 2019, the Commission introduced the '*de minimis* rule'<sup>27</sup>, which states that a reservation is not needed if the individual spending area it would cover represents less than 5 % of total payments and has a financial impact of less than €5 million. Consequently, reservations are no longer made in some cases where they were made in previous years, even if the corresponding risk remains. An example is grants under direct management, which are considered a high-risk area as per DG INTPA's risk analysis. Such absence of reservations does not give a true and fair view of the risks in DG INTPA's overall area of responsibility.

<sup>27</sup> In the context of the AAR, '*de minimis*' refers to the decision by the Commission's corporate management board to introduce a threshold for financial reservations.

**42** Our observations on the RER study also affect the estimates of the amounts at risk, since these estimates are based on the study. DG INTPA estimates the overall amount at risk at payment to be €66.24 million<sup>28</sup> (1 % of 2020 expenditure) and the overall amount at risk at closure to be €52.82 million<sup>29</sup>. Of the amount at risk at payment, DG INTPA estimates that €13.4 million (20 %) will be corrected by its checks in subsequent years (this amount is known as the ‘corrective capacity’).

**43** In line with our recommendation in the 2019 EDF annual report, DG INTPA reduced the above corrective capacity amount by the value of recoveries triggered by the RER study’s findings.

**44** DG INTPA is also working to improve the quality of its data for calculating the corrective capacity. In 2020, it continued its training and awareness-raising activities on recoveries and accounting data quality<sup>30</sup>. As in previous years, DG INTPA performed targeted checks on recovery orders to correct the discrepancies identified. We reviewed the calculation of the corrective capacity for 2020. Having tested 54 % (by value) of the total population of recoveries, we identified no errors in our sample.

**45** In order to further improve the Commission's coherence in financial reporting across the DGs, a ‘financial scorecard’ was created in 2020, comprising six indicators<sup>31</sup>. Two of these indicators namely, ‘*global commitment absorption*’ and ‘timely payments’, were applicable to the EDF and the trust funds in 2020. For ‘*global commitment absorption*’, DG INTPA achieved a result of 95 % for the EU budget and 94 % for the EDF. For ‘timely payments’, DG INTPA reached 98 % for the EU budget and 97 % for the EDF.

<sup>28</sup> This is the best conservative estimation of the amount of relevant expenditure during the year but not compliant with the contractual and regulatory provisions applicable at the time payment was made.

<sup>29</sup> See DG INTPA’s 2020 AAR, p. 37.

<sup>30</sup> Specific training local staff of the EU delegations on guidelines for entering recovery orders.

<sup>31</sup> The financial scorecard is a set of six standard financial indicators for the European Commission as a whole. Its purpose is to benchmark each Commission service. The indicators are: 1) implementation of *commitment appropriations*, 2) implementation of *commitment appropriation* forecasts, 3) implementation of *payment appropriations*, 4) implementation of *payment appropriation* forecasts, 5) *global commitment absorption*, 6) timely payments.

# Conclusion and recommendations

## Conclusion

**46** The overall audit evidence indicates that the EDFs' accounts for the financial year ending 31 December 2020 present fairly, in all material respects, their financial position, the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the accounting officer.

**47** The overall audit evidence indicates that, for the financial year ending 31 December 2020:

- (a) the revenue of the EDFs was not affected by a material level of error;
- (b) EDF payment transactions were affected by a material level of error (see paragraphs [18-24](#)). We estimate the level of error to be 3.8 % based on our transaction testing (see [Annex I](#)).

## Recommendations

**48** [Annex IV](#) shows the findings of our follow-up review of the six recommendations we made in our 2017 annual report<sup>32</sup> of which DG INTPA had implemented<sup>33</sup> five recommendations in full and one in most respects.

**49** We also present the findings of our follow-up review of those recommendations we made in our 2018 and 2019 annual reports<sup>34</sup> which had to be implemented by the

<sup>32</sup> We chose our [2017 annual report](#) for this year's follow-up exercise as, typically, enough time should have elapsed for the Commission to have implemented our recommendations.

<sup>33</sup> The aim of this follow-up was to verify whether corrective measures had been taken in response to our recommendations, and not to assess the effectiveness of their implementation.

<sup>34</sup> Both recommendations made in our [2018 annual report](#) and recommendation 2 of our [2019 annual report](#) had to be implemented by the end of 2020. They are therefore presented in [Annex III](#).

end of 2020. We consider our two 2018 recommendations implemented in some respects. Recommendation 2 of our 2019 annual report has not been implemented.

**50** Based on this review and our findings and conclusions for 2020, we recommend that the Commission:

### **Recommendation 1 – Complete and timely access to documents**

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Take steps so that international organisations provide the ECA with complete, unlimited and timely access to documents necessary to carry out its task in accordance with the TFEU, and not just in read-only format (see paragraph 26).

**Timeframe: by the end of 2021**

### **Recommendation 2 – Reservations for all high-risk areas**

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Issue reservations for all areas found to have a high level of risk, regardless of their share of total expenditure and their financial impact (see paragraph 41)<sup>35</sup>.

**Timeframe: by the time the 2021 AAR is published**

### **Recommendation 3 – RER contractor's reporting of suspected fraud**

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Establish obligations for the RER study contractor to report to the Commission any suspected fraud against the EU budget detected during its work on the RER study (see paragraph 38).

**Timeframe: by the end of 2022**

<sup>35</sup> This recommendation was also included in the [2019 EDF annual report](#). Its implementation deadline was “by the publication of the 2020 DG INTPA AAR”.

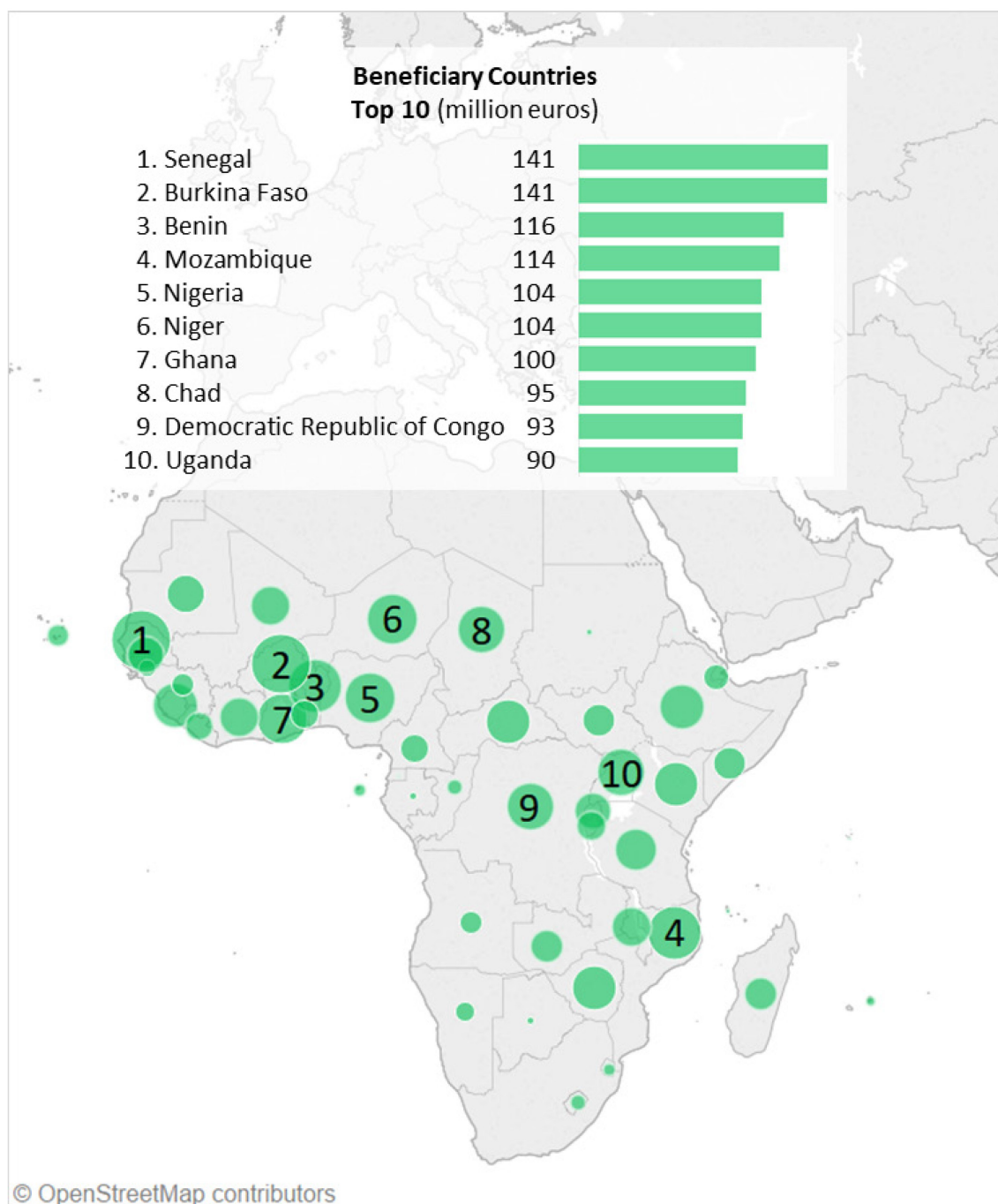
# Annexes

## Annex I – Results of transaction testing for the EDF

	2020	2019
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>		
Total transactions:	140	140
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>		
Estimated level of error	3.8 %	3.5 %
Upper Error Limit (UEL)	5.8 %	
Lower Error Limit (LEL)	1.8 %	

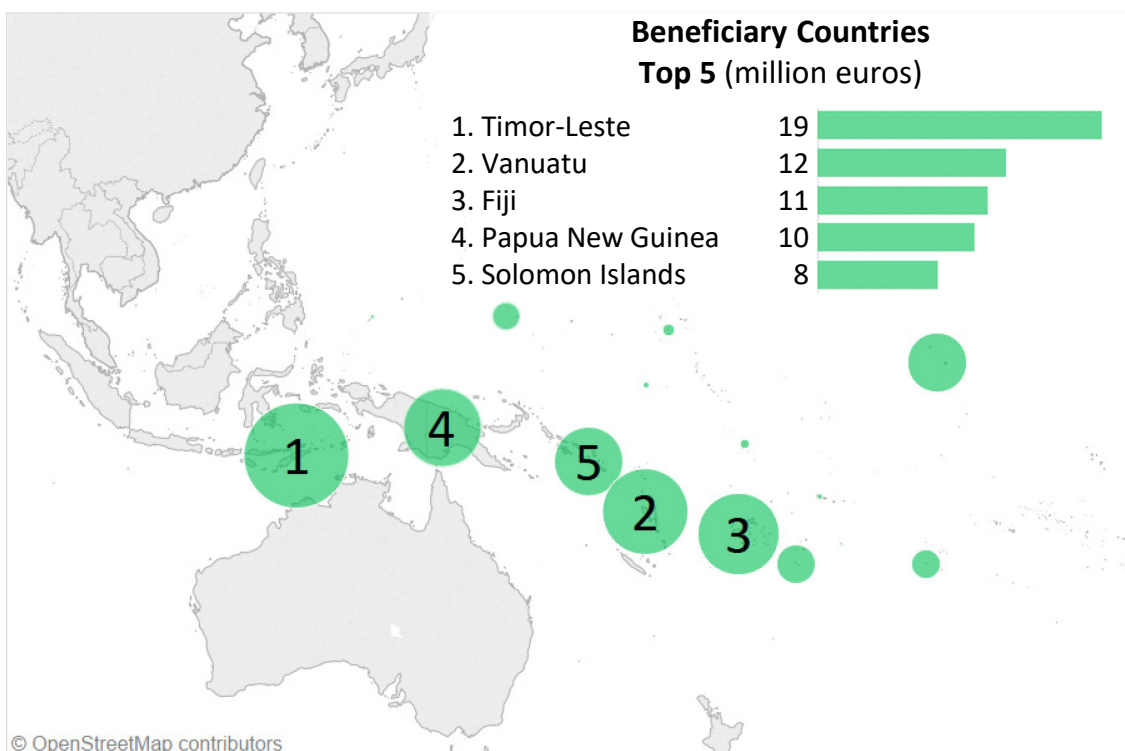
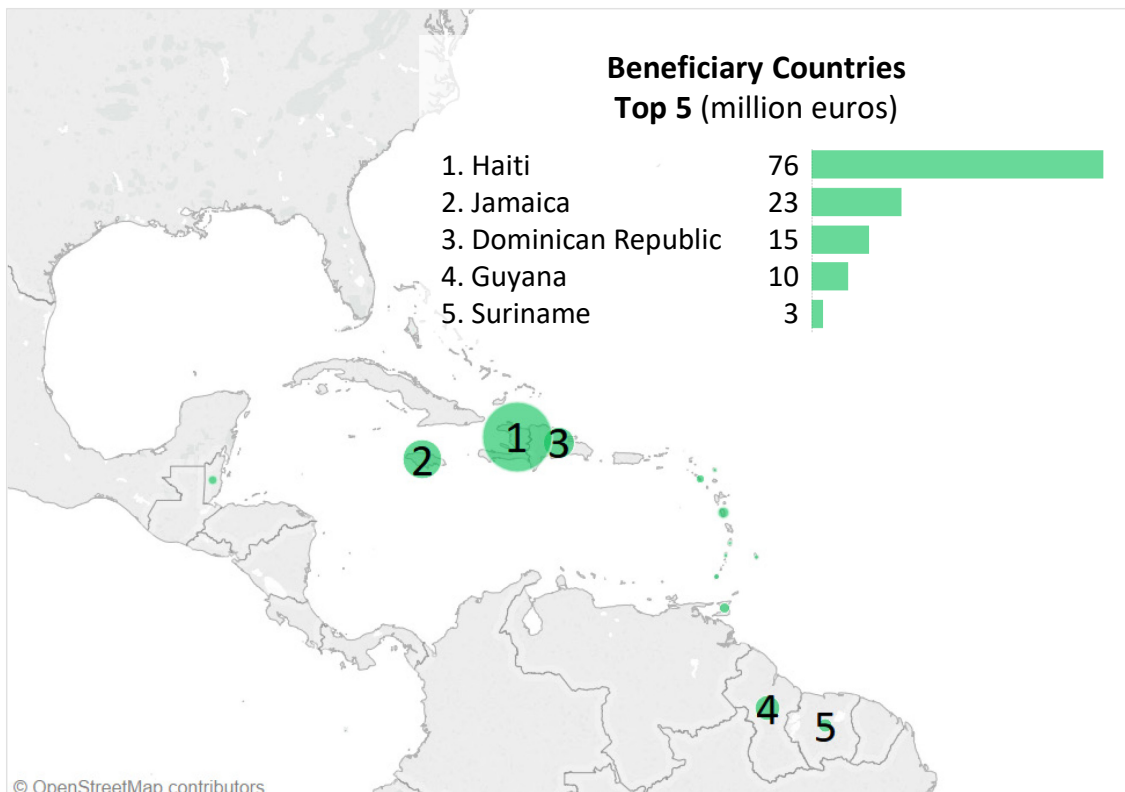
## Annex II – EDF payments in 2020 by main region

### European Development Fund Payments – Africa
















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## European Development Fund Payments – Caribbean and Pacific



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### Annex III – Status of implementation of the action plans

2018 action plan		Status for 2020 AR (April 2021)	
A.1	Simplify and clarify procedures and contractual conditions for grants.		ongoing
A.2	Maintain awareness on frequently occurring errors in financial and document management for the implementation of grant contracts.		implemented
B.1	Develop a strategy for the reduction of the use of the Programme Estimate and promotion of alternatives, in view of simplification and cost-effectiveness		cancelled (considered implemented)
B.2	Implement "Roadmap for Reinforcements of Controls under Programme Estimates"		cancelled
C.1	Reinforce the mandate of the focal point unit A3 for coordination of relations with international organisations at all levels (including control relations).		cancelled
C.2	Work towards use of ToR for Expenditure Verifications: for verification of expenditure incurred by IOs under indirect management.		implemented
C.3	Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.		implemented
C.4	Adaptation of ToRs for PAs to the requirements of the FR revision.		implemented
C.5	Introduce effective and cost-effective framework for assessment and acceptance of cost accounting practices.		not implemented (merged with action D2)
C.6	Phase in cross-reliance on audits for operations under indirect management with at least two major IO partners.		partially implemented (merged with D1)
D.1	Increase consistency and coherence of the functioning of audit and verification tasks.		implemented
D.2	Clarify and promote use of simplified cost options (new action 2018).		implemented
D.3	Clarify and promote use of results-based financing (new action 2018).		ongoing

2019 action plan			
A.1	Simplify and clarify procedures and contractual conditions for grants.	●	ongoing
A.2	Maintain awareness on frequently occurring errors in financial and document management for the implementation of grant contracts.	●	implemented
B.1	Develop a strategy for the reduction of the use of the Programme Estimate and promotion of alternatives, in view of simplification and cost-effectiveness.	●	implemented
C.2	Work towards use of ToR for Expenditure Verifications: for verification of expenditure incurred by IOs under indirect management.	●	implemented
C.3	Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.	●	implemented
D.1	Increase consistency and coherence of the functioning of audit and verification tasks.	●	implemented
D.2	Clarify and promote use of simplified cost options	●	implemented
D.3	Clarify and promote use of results-based financing	●	ongoing
D.4	Improve the methodology and manual of the RER study (new action 2019)	●	implemented
2020 action plan			
A.1	Simplify and clarify procedures and contractual conditions for grants.	●	ongoing
A.2	Maintain awareness on frequently occurring errors in financial and document management for the implementation of grant contracts.	●	implemented
B.1	Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.	●	implemented
C.1	Clarify and promote use of results-based financing	●	ongoing
C.2	Improve the methodology and manual of the RER study (new action build on AP 2019/D4)	●	implemented
C.3	Reduce excess clearing of pre-financing (new action)	●	ongoing
C.4	Conduct an evaluation on the use of ToR for Expenditure Verifications (EV) (new action)	●	ongoing

Source: European Commission 2018, 2019 and 2020 action plans.

## Annex IV – Follow-up of recommendations

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2017	We recommend that the Commission: <b>Recommendation 1:</b> monitor closely the implementation of the RER study, particularly that the full reliance decisions are fully in line with the methodology and justified.	X <sup>36</sup>					
	<b>Recommendation 2:</b> disclose again in the AAR the limitations of the RER study.	X <sup>37</sup>					
	<b>Recommendation 3:</b> take decisive steps to de facto enforce the guidance on accepting expenditure to avoid excess clearings.		X				

<sup>36</sup> To avoid the application of full reliance to a large number of transactions, the Commission provided the RER contractor with guidance in 2018 and additional instructions in 2019.

<sup>37</sup> DG INTPA discloses the limitations of the RER study in its AAR.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
	<b>Recommendation 4:</b> take measures to ensure that only incurred costs are accepted as expenditure for AITF transactions.	X <sup>38</sup>					
	<b>Recommendation 5:</b> set up a KPI to monitor the ageing of the advance contributions made to trust funds.	X <sup>39</sup>					
	<b>Recommendation 6:</b> propose a relevant solution to the EDFs budgetary and accountability inconsistencies as part of the current post-Cotonou studies.	X <sup>40</sup>					

<sup>38</sup> On the one hand, the Commission made corrections to ongoing contracts, taking into account as accepted expenditure only costs incurred; on the other hand, the Commission took measures to prevent the acceptance of commitments and estimations reported as expenditure in the financial statements of the Africa Infrastructure Trust Fund (EU-AITF).

<sup>39</sup> The ageing of the advance contributions made to trust funds is monitored through the ageing balance prepared by DG BUDG and the net contributions presented in the trust fund annual accounts.

<sup>40</sup> The Commission made a proposal for a new NDICI/Global Europe regulation, which includes integrating the EDF into the EU general budget and therefore also allows the European Parliament to oversee EDF assistance to ACP countries.

Year	ECA recommendation	ECA's analysis of the progress made					
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence
			In most respects	In some respects			
2018	<b>Recommendation 1:</b> Take steps to reinforce the obligation on international organisations to forward to the ECA, at its request, any document or information necessary to carry out its task as foreseen in the TFEU.			X			
	<b>Recommendation 2:</b> Improve the RER study's methodology and manual so that they give more comprehensive guidance on the issues we have identified in this report and, therefore provide appropriate support for DG DEVCO's risk assessment for the reservations.			X			
2019	<b>Recommendation 2:</b> Issue reservations for all areas found to have a high level of risk, regardless of their share of total expenditure and their financial impact.				X		

Source: ECA.

**European Commission's replies to the  
annual report on the activities funded  
by the 8th, 9th, 10th and 11th  
European Development Funds for the  
2020 financial year**

**REPLIES OF THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2020  
ANNUAL REPORT**

**"ANNUAL REPORT ON THE ACTIVITIES FUNDED BY THE 8<sup>th</sup>, 9<sup>th</sup>, 10<sup>th</sup> AND 11<sup>th</sup>  
EUROPEAN DEVELOPMENT FUNDS"**

REGULARITY OF TRANSACTIONS

Expenditure

**Box 5:**

**- Expenditure not incurred: claimed expenditure overstated**

The Commission acknowledges the finding that was due to a clerical error by the contractor's supervisor, who has the primary responsibility of controlling the measurements and quantities linked to the works carried out. The Commission points out that a final review is performed following the presentation of the final statement of accounts at the end of the works contract.

**- Expenditure incurred outside the eligibility period**

The Commission acknowledges the finding, but would like to highlight the fact that the Ceasefire and Transitional Security Arrangement Monitoring Mechanism's contracts are part of a bigger project and the yearly insurance was renewed at the moment of the extension amendment.

Given the nature of the African Peace Facility actions, there is a continuity between one action and the following one. The rationale here is that the part of the insurance that is beyond the eligibility period of the sampled contract will benefit the following one.

**- Procurement error - lack of transparency in public procurement procedure**

The Commission acknowledges the finding and would like to highlight that the reality on the ground may sometimes requires urgent decisions necessary for the operational success of the tendering procedure.

**- Ineligible costs charged to the project**

The Commission acknowledges this error in the accounting but underlines that the errors on the excess clearing are normally corrected at the end of the contract.

26. The Commission would like to highlight that there are contractual provisions in the contribution and delegation agreements with international organisations that cover the access to documents. The Commission will continue to draw the partner organisations' attention to the need to provide the ECA with the necessary information.

**2020 RER study**

31. The RER study is an important element underpinning the declaration of the Director General, but it **is not the only source of assurance**. DG INTPA has a **comprehensive internal control framework and control strategy** covering the full implementation cycle. As described in its Annual Activity Report, all elements of the control framework serve as **building blocks for assurance**.

33. The Commission does not and has never characterised the RER Study as an assurance engagement or an audit. It serves a specific purpose and is built on a distinct methodology.

This is disclosed in the RER study and in DG INTPA's Annual Activity Report, which presents **complete management information** in a **true and fair manner**. The Commission does not consider that the study is subject to limitations that may lead to an underestimation of errors.

34. The Commission considers that the RER is fit for purpose and highly representative.

The Commission notes that:

- There is indeed an **overarching framework agreement between the UN organisations and the European Commission** that frames controls under verifications.
- When the contractor is not given access to the necessary documentary evidence, they raise an error.
- The Financial Regulation requires that entities entrusted with implementation of EU funds in indirect management demonstrate a level of financial management and **protection of the EU's financial interest**, which is equivalent to that of the Commission. This is verified by carrying out an ex ante pillar assessment of the entity.

In the context of **reliance on previous control work**, the **FAFA arrangements** should not be interpreted by the RER contractor as a limitation for further substantive testing in the framework of the RER study.

Several reported errors relate to transactions where previous verification work took place, but where the errors detected would be likely to have been duplicated in the untested population. Accordingly, the risk of under-reporting of errors for such transactions is substantially reduced.

35. The Commission considers that **overreliance on previous control work of other auditors should be avoided** and that in the case of the 2020 RER study there has been no such overreliance.

**Full reliance** is only placed on work performed by qualified auditors under the audit framework contract signed by the Commission, or on work performed by the ECA. Full reliance for an individual transaction means that no substantive testing on the transaction is required. Nevertheless, all other procedures remain applicable. The percentage of cases of full reliance fell to 17% in 2020 from 20% in 2019.

The tests carried out in the case of **partial reliance** are more extensive and include substantive testing, and the aim is to isolate the error where possible.

36. The purpose of the RER is to provide a **representative error rate for the entire population** of the EDF. Focusing on high risk areas of this population would not lead to this result. This is the reason why the RER sample is selected based on monetary unit sampling. This means that the probability of a contract closed in the period being selected is exactly proportionate to its value. This enables the results of the RER study to be considered representative of all of INTPA's closed contracts.

The higher risk of error relating to grant contracts and contribution agreements with international organisations is reflected in the significant number of verification control procedures performed during the life of the contract. It is important to emphasise that additional control procedures are performed in respect of all grant and contribution agreement transactions, including those subject to **full and partial reliance**. Indeed, errors are frequently reported in respect of transactions where reliance has been placed.

Reducing the number of **transactions less prone to errors** (e.g. Budget support) would defeat the purpose of the RER study.

37. The Commission does not consider **estimations** are a “major factor that distorts the RER”. As reported by the Commission already in 2019, estimations are extremely rare: there were seven such cases in 2020 over 412 sampled transactions. In two cases, there were confidential contracts; in one case, the delegation was not operational in the country; in three cases, the organisation did not exist anymore and was therefore unable to provide the documentation; in another case, the documentation was destroyed by a fire.

The decision to estimate an error is not based on a simple case of non-provision of documentation. Such instances will give rise to a measured error. An estimation is made only when the specific circumstances described in the RER manual, which do not confer broad discretion, are met and duly documented.

The observation on the **risk premium** was already raised in the Annual Report 2019 on the EDFs and the Commission’s related replies. The risk premium was adopted by both NEAR and INTPA to improve the provisions for estimation in the RER methodology.

The **risk premium of 5%** represents a highly prudential approach, designed to ensure that the error rate is not underestimated.

38. The RER Methodology and Manual establish that the Contractor needs to classify the final errors into ten different categories, one of them being “**Fraud and irregularities**”.

Furthermore, all individuals working for the current RER contractor have a duty to report suspicions of fraud, as per the Money Laundering Regulations. Therefore, the contractor is required by law to report on any such activity.

39. Apart from the introduction of the “**de minimis**” **rule for reservations**, the methodology to determine whether reservations due to error rates should be issued did not change between the AAR 2017 and the AAR 2020. The absence of reservations in the 2020 AAR does not represent a scope reduction, but is the result of the rigorous application of the methodology.

40. The RER study is one of several instruments in the assurance-building process. The limitations are well known to the Commission and are taken into account by the Commission when assessing the strength and weaknesses of its management system. The Commission considers that all of these elements taken together ensure that the DG INTPA’s Annual Activity Report presents the management information in a true and fair view.

41. The Commission considers that the “**de minimis**” **rule** for issuing **reservations** in the Directors-General Annual Activity Reports (AARs) should continue to apply. Its purpose is to focus the number of reservations on the significant ones only, while maintaining the transparency in management reporting.

Reservations related to cases with a residual error rate above the 2% materiality threshold are deemed not substantial for segments that represent less than 5% of the department’s total payments and have a financial impact of less than EUR 5 million. Therefore, **quantified reservations** which do not exceed both thresholds, are not needed.

When deciding on the **absence of reservations**, all the Commission services apply a thorough review of all aspects of assurance, while implementing all guidelines and instructions of the Commission's central services.

Nevertheless, **full transparency** of the management reporting remains ensured: the cases for which the rule has been applied are duly mentioned in the AAR. These cases are being closely followed-up.

Considering all the above, the Commission is of the opinion that DG INTPA gives **a true and fair view of its risks in its AAR** and that the introduction of the “de minimis” rule does not affect negatively its overall assessment of the financial management and its declaration of assurance.

## CONCLUSIONS AND RECOMMENDATIONS

### **Recommendations**

49. The Commission underlines that while the two recommendations from 2018 are not fully implemented, DG INTPA continues to take action to address the issues identified by the ECA related to the RER study and cooperation with international organisations in the context of the current and past statement of assurance exercise (see also the Commission's reply to Recommendation 1). The Commission notes that Recommendation 2 of the ECA's 2019 Annual Report has not been implemented because this recommendation could not be accepted.

#### **Recommendation 1**

The Commission accepts this recommendation.

The Commission will continue to draw the partner organisations' attention to the need to provide the ECA with documents or information necessary to carry out its task. See also Commission reply to paragraph 26.

#### **Recommendation 2**

The Commission does not accept this recommendation.

Since the 2019 financial year, a “de minimis” rule for issuing reservations in the Directors-General Annual Activity Reports (AARs) has been introduced. Its purpose is to focus the number of reservations on the significant ones only, while maintaining the transparency in management reporting.

Nevertheless, full transparency of the management reporting remains ensured (as the cases for which the rule has been applied are duly mentioned in the AAR). See also Commission reply to paragraph 41.

#### **Recommendation 3**

The Commission accepts this recommendation.

The Commission will look into the possibility of introducing a reference in the RER methodology or terms of reference to formalise the communication of suspected risks of fraud to the Commission at the appropriate level.

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Chapter 6 – Box 6.3

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Chapter 8 – [Annex 8.1](#), EDF – [Annex II](#):

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