

## IV

*(Notices)*NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND  
AGENCIES

## COURT OF AUDITORS



In accordance with the provisions of Article 287(1) and (4) of the TFEU and Articles 129 and 143 of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, as last amended by Regulation (EU, Euratom) No 1081/2010 of the European Parliament and of the Council, and Articles 139 and 156 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund

**the Court of Auditors of the European Union, at its meeting of 8 September 2011, adopted its  
ANNUAL REPORTS  
concerning the financial year 2010.**

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

The Members of the Court of Auditors are:

Vítor Manuel da SILVA CALDEIRA (President), David BOSTOCK, Morten Louis LEVYSOHN,  
Ioannis SARMAS, Igors LUDBORŽS, Jan KINŠT, Kersti KALJULOID, Massimo VARI, Juan RAMALLO,  
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Henri GRETHEN, Eoin O'SHEA, Szabolcs FAZAKAS, Louis GALEA, Ladislav BALKO, Augustyn KUBIK, Milan Martin CVIKL,  
Rasa BUDBERGYTĖ, Lazaros S. LAZAROU, Gijs DE VRIES, Harald WÖGERBAUER, Hans Gustaf WESSBERG.



ANNUAL REPORT ON THE  
IMPLEMENTATION OF THE BUDGET

(2011/C 326/01)



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## GENERAL INTRODUCTION

0.1. The European Court of Auditors is the institution established by the Treaty to carry out the audit of European Union (EU) finances. As the EU's external auditor it acts as the independent guardian of the financial interests of the citizens of the Union and contributes to improving EU financial management. More information on the Court can be found in its Annual Activity Report which, together with its special reports on EU spending programmes and revenue and its opinions on new or amended legislation, are available on its website: [www.eca.europa.eu](http://www.eca.europa.eu)

0.2. This is the Court's 34th Annual Report on the implementation of the EU budget. It covers the 2010 financial year. A separate Annual Report covers the European Development Funds.

0.3. The general budget of the EU is decided annually by the Council and the European Parliament. The Court's Annual Report, together with its special reports, provides a basis for the discharge procedure, in which the European Parliament decides whether the European Commission has satisfactorily carried out its responsibilities for implementing the budget. The Court forwards its annual report to national parliaments at the same time as to the European Parliament and the Council.

0.4. The central part of the annual report is the Court's statement of assurance (the 'DAS') on the reliability of the annual accounts of the EU and on the legality and regularity of transactions (referred to in the report as 'regularity of transactions'). The statement of assurance itself begins the report; the material which follows reports mainly on the audit work underlying the statement of assurance.

— Chapter 1 contains the statement of assurance and a summary of the results of the Court's audit on the reliability of accounts and on the regularity of transactions, as well as a summary report on the management of the budget in 2010.

— Chapters 2 to 7 provide detailed audit findings in the form of 'specific assessments' of EU revenue and expenditure. Chapter 2 deals with the revenue side of the EU budget, Chapters 3 to 7 with five groups of policy areas within which spending from the EU budget is authorised and

recorded. These groups of policy areas correspond broadly to the headings used in the 2007-2013 Financial Framework, which sets out the EU's broad multiannual spending plans.

0.5. The specific assessments are mainly based on: the results of the Court's testing of the regularity of transactions; on an assessment of the effectiveness of the principal supervisory and control systems governing the revenue or expenditure involved; and on a review of the reliability of Commission management representations.

0.6. This year's Annual Report differs in a number of significant respects from its predecessors.

— The form and content of the Statement of Assurance reflect revised international audit standards which entered into force at the beginning of 2011 <sup>(1)</sup>.

— The structure of the specific assessments has been altered so as to give a more useful analysis of EU spending. Chapter 4 includes EU expenditure on energy and transport together with spending from the Structural Funds and the Cohesion Fund. Education, citizenship, economic and financial affairs and research, meanwhile, are reported on in Chapter 6 — Research and other Internal Policies.

— A new chapter on performance audit issues (Chapter 8) analyses the assessment of performance set out in the Annual Activity Reports presented by three of the Commission's Directors-General; and identifies significant common themes in the special reports which the Court has adopted in 2010.

0.7. The Commission's replies to the Court's observations — or those of other EU institutions and bodies, where appropriate — are presented within the document. In some of its replies the Commission reinterprets the Court's findings or attributes to the Court conclusions which it has not reached. The Court's description of its findings and conclusions takes into account the comments of the auditee. However it is the Court's responsibility, as external auditor, to report its audit findings, to draw conclusions from those findings, and thus to provide an independent and impartial assessment of the reliability of the accounts as well as of the legality and regularity of transactions.

<sup>(1)</sup> In particular ISSAI 1705 Modifications to the Opinion in the Independent Auditor's Report and ISSAI 4200 Compliance Audit Related to the Audit of Financial Statements.





## CHAPTER 1

**The Statement of Assurance and supporting information**

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## THE COURT'S STATEMENT OF ASSURANCE PROVIDED TO THE EUROPEAN PARLIAMENT AND THE COUNCIL — INDEPENDENT AUDITOR'S REPORT

I. Pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union (TFEU) the Court has audited:

- (a) the annual accounts of the European Union which comprise the consolidated financial statements <sup>(1)</sup> and the consolidated reports on implementation of the budget <sup>(2)</sup> for the financial year ended 31 December 2010; and
- (b) the legality and regularity of the transactions underlying those accounts.

### *Management's responsibility*

II. In accordance with Articles 310 to 325 of the TFEU and the Financial Regulation, management is responsible for the preparation and fair presentation of the annual accounts of the European Union and the legality and regularity of the transactions underlying them:

- (a) Management's responsibility in respect of the annual accounts of the European Union includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies, on the basis of the accounting rules adopted by the Commission's accounting officer <sup>(3)</sup>; and making accounting estimates that are reasonable in the circumstances. According to Article 129 of the Financial Regulation, the Commission approves the annual accounts of the European Union after the Commission's accounting officer has consolidated them on the basis of the information presented by the other institutions and bodies and established a note, accompanying the consolidated accounts, declaring, inter alia, that he has reasonable assurance that they present a true and fair view of the financial position of the European Union in all material aspects.
- (b) The way in which management exercises its responsibility for ensuring the legality and regularity of underlying transactions depends on the method of implementation of the budget foreseen in the Financial Regulation. Implementation tasks have to comply with the principle of sound financial management, requiring designing, implementing and maintaining effective and efficient internal control including adequate supervision and appropriate measures to prevent irregularities and fraud and, if necessary, legal proceedings to recover funds wrongly paid or used. Regardless of the method of implementation applied, the Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the European Union (Article 317 of the TFEU).

### *Auditor's responsibility*

III. The Court's responsibility is to provide, on the basis of its 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 transactions underlying them. The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require that the Court plans and performs the audit to obtain reasonable assurance whether the annual accounts of the European Union are free from material misstatement and the transactions underlying them are legal and regular.

<sup>(1)</sup> The consolidated financial statements comprise the balance sheet, the economic outturn account, the cash flow table, 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 consolidated reports on implementation of the budget comprise the consolidated reports on implementation of the budget and a summary of budgetary principles and other explanatory notes.

<sup>(3)</sup> The accounting rules adopted by the Commission's accounting officer are derived from International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants or, in their absence, International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. In accordance with the Financial Regulation, the consolidated financial statements for the 2010 financial year were prepared (as they have been since the 2005 financial year) on the basis of these accounting rules adopted by the Commission's accounting officer, which adapt accruals based accounting principles to the specific environment of the European Union, while the consolidated reports on implementation of the budget continue to be primarily based on cash movements.

IV. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated accounts and the legality and the regularity of the transactions underlying them. The procedures are selected based on the auditor's judgment, including an assessment of the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the European Union, whether due to fraud or error. In assessing those risks, the auditor considers internal control relevant to the preparation and fair presentation of the consolidated accounts and supervisory and control systems implemented to ensure legality and regularity of underlying transactions, in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made, as well as evaluating the overall presentation of the consolidated accounts and the annual activity reports.

V. In the context of revenue, the Court's audit of Value Added Tax- and Gross National Income-based own resources takes as its starting point the receipt by the Commission of the macroeconomic aggregates prepared by the Member States, and then assesses the Commission's systems for processing the data until they are included in the final accounts and the contributions by the Member States have been received. For traditional own resources, the Court examines the accounts of the customs authorities and analyses the flow of duties until the amounts are recorded in the final accounts and received by the Commission.

VI. The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its statement of assurance.

## Reliability of the accounts

### *Opinion on the reliability of the accounts*

VII. In the Court's opinion, the annual accounts of the European Union present fairly, in all material respects, the financial position of the Union as of 31 December 2010, and the results of its operations and its cash flows for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the Commission's accounting officer.

### *Emphasis of matter in relation to the reliability of the accounts*

VIII. Without calling into question the opinion expressed in paragraph VII, the Court draws attention to a change in the Commission's accounting policy concerning pre-financing payments establishing or contributing to Financial Engineering Instruments which have not yet been used in the form of loans, guarantees or equity investments. This required the Commission to restate the 2009 annual accounts of the European Union on which the Court issued an unmodified opinion<sup>(4)</sup> (see notes 2.5, 2.9, 2.10 and 3.4 to the 2010 annual accounts of the European Union explaining the adjustments made).

## Legality and regularity of the transactions underlying the accounts

### Revenue

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

IX. In the Court's opinion, revenue underlying the accounts for the year ended 31 December 2010 is legal and regular in all material respects.

<sup>(4)</sup> See OJ C 303, 9.11.2010, pp. 10-12.

**Commitments***Opinion on the legality and regularity of commitments underlying the accounts*

X. In the Court's opinion, commitments underlying the accounts for the year ended 31 December 2010 are legal and regular in all material respects.

**Payments***Basis for adverse opinion on the legality and regularity of payments underlying the accounts*

XI. The Court concludes that overall the supervisory and control systems are partially effective in ensuring the legality and regularity of payments underlying the accounts. The policy groups Agriculture and Natural Resources and Cohesion, Energy and Transport are materially affected by error. The Court's estimate for the most likely error rate for payments underlying the accounts is 3,7 %.

*Adverse opinion on the legality and regularity of payments underlying the accounts*

XII. In the Court's opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2010 are materially affected by error.

8 September 2011

Vítor Manuel da SILVA CALDEIRA

*President*

European Court of Auditors

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## THE COURT'S OBSERVATIONS

**INTRODUCTION**

1.1. This Chapter of the Annual Report:

- sets out the background to the Court's statement of assurance and summarises and analyses the audit findings and conclusions which underlie the statement of assurance (see paragraphs 1.2 to 1.25),
- discusses the implications of the increased use of pre-financing in the Union's finances and the Commission's accounts (see paragraphs 1.26 to 1.37),
- summarises the implementation of the 2010 budget (see paragraphs 1.38 to 1.44),
- explains how the Court carries out its DAS audit (see **Annex 1.1**),
- presents the actions taken by the Commission as regards the observations on the reliability of the accounts of previous years. It also includes the Commission's response to the Court's recommendations on recoveries and financial corrections in its 2009 Annual Report (see **Annex 1.2**).

1.2. The Court of Auditors provides the European Parliament and the Council with a Statement of Assurance (DAS) <sup>(5)</sup> concerning the reliability of the accounts and the legality and regularity of the underlying transactions. The Court may supplement this statement with specific assessments of each major area of EU activity <sup>(6)</sup>.

1.3. The aim of the work on the reliability of the accounts of the European Union is to conclude on the extent to which revenue, expenditure, assets and liabilities have been properly registered and that the annual accounts faithfully reflect the financial position as of 31 December 2010, and the results of its operations and cash flows for the year then ended (see paragraphs 1.6 to 1.8).

1.4. The aim of the work on the regularity of the transactions underlying the 2010 accounts is to conclude on whether those transactions are in accordance with the applicable regulations or contractual provisions, and have been correctly calculated (see paragraphs 1.9 to 1.14 for an overview of the results and Chapters 2 to 7 for more details).

<sup>(5)</sup> From French: 'Déclaration d'assurance'.

<sup>(6)</sup> See Article 287 of the Treaty on the Functioning of the European Union.

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THE COURT'S OBSERVATIONS

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1.5. The Court analysed the reliability of Commission management representations, namely the declarations of Directors-General and the annual activity reports of the Commission's services and the related synthesis report to assess the extent to which they provide a fair assessment of the quality of financial management, and contribute to the Court's overall assurance (see paragraphs 1.17 to 1.20 as well as 1.23 to 1.25 and 'Reliability of Commission management representations' in Chapters 2 to 7). The work also involved examining the Commission's internal auditor's overall opinion which has been issued for the first time and covers the financial management of the Commission in the 2010 budgetary year (see paragraphs 1.21 to 1.22).

## AUDIT FINDINGS FOR THE 2010 FINANCIAL YEAR

### Reliability of accounts

1.6. The Court's observations concern the annual accounts of the European Union (hereafter 'the accounts') for the financial year 2010, drawn up by the Commission's accounting officer and approved by the Commission in compliance with Article 129 of the Financial Regulation of 25 June 2002<sup>(7)</sup> and received by the Court on 27 July 2011. The accounts comprise:

- (a) the consolidated financial statements covering the balance sheet (setting out the assets and liabilities at the end of the year), the economic outturn account (covering the income and expenses of the year), the cash-flow table (showing how changes in the accounts affect cash and cash equivalents) and the statement of changes in net assets (explaining the changes in net assets) as well as the related notes; and
- (b) the consolidated reports on the implementation of the budget covering the revenue and expenditure for the year.

1.7. The Commission's accounting officer provided the Court with a representation letter confirming that subject to certain immaterial limitations<sup>(8)</sup> the accounts are complete and reliable.

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<sup>(7)</sup> Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1), last amended by Regulation (EU, Euratom) No 1081/2010 of the European Parliament and of the Council (OJ L 311, 26.11.2010, p. 9), requires that the final accounts shall be sent before 31 July of the following financial year.

<sup>(8)</sup> See **Annex 1.2**, point 1.

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THE COURT'S OBSERVATIONS

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1.8. The Court's audit of the 2010 accounts found that these were free from material misstatements (see however paragraphs 1.26 to 1.37 and information on the follow-up of observations of prior years concerning the reliability of accounts in **Annex 1.2**).

## **Regularity of transactions**

### *Summary of the DAS specific assessments*

1.9. The Court provides specific assessments in Chapter 2 on Revenue and in Chapters 3 to 7 on groups of Activity Based Budgeting (ABB) policy areas (see **Table 1.1**). Each specific assessment provides an introduction, findings and conclusions on the regularity of transactions, the effectiveness of systems and the reliability of Commission management representations, and reports on the Commission's response to the Court's previous recommendations.

1.10. For 2010, the policy group Research and other Internal Policies presented in Chapter 6 consists of policy groups/areas which in the 2009 Annual Report were part of other specific assessments <sup>(9)</sup>.

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<sup>(9)</sup> The Research part of the former policy group Research, Energy and Transport was previously reported in Chapter 5, the former policy group Education and Citizenship was previously reported in Chapter 7 and the former policy group Economic and Financial Affairs was previously reported in Chapter 8 (for details see paragraph 6.1). Moreover, the Energy and Transport parts of the former policy group Research, Energy and Transport are now reported in Chapter 4 together with the former policy group Cohesion.

Table 1.1 — Payments in 2010 by Annual Report chapters

(million euro)

Sections (S) and titles (T) <sup>(1)</sup> corresponding to the 2010 budgetary nomenclature allocated per chapter of the Court's Annual Report	Payments made in 2010 <sup>(2)</sup>
<b>Annual Report chapters</b>	
<b>Agriculture and Natural Resources</b>	56 841
Agriculture and rural development (T.05)	
Environment (T.07)	
Fisheries and maritime affairs (T.11)	
Health and consumer protection (T.17)	
<b>Cohesion, Energy and Transport</b>	40 630
Employment and social affairs (T.04)	
Energy and transport (T.06)	
Regional policy (T.13)	
<b>External Aid, Development and Enlargement</b>	6 543
External relations (T.19)	
Development and relations with ACP States (T.21)	
Enlargement (T.22)	
Humanitarian aid (T.23)	
<b>Research and other Internal Policies</b>	8 953
Economic and financial affairs (T.01)	
Enterprise (T.02)	
Competition (T.03)	
Research (T.08)	
Information society and media (T.09)	
Direct research (T.10)	
Internal market (T.12)	
Education and culture (T.15)	
Communication (T.16)	
Area of freedom, security and justice (T.18)	
Trade (T.20)	
<b>Administrative and other expenditure</b>	9 264
Parliament (S. I)	
Council (S. II)	
Commission (S. III)	
Court of Justice (S. IV)	
Court of Auditors (S. V)	
Economic and Social Committee (S. VI)	
Committee of the Regions (S. VII)	
European Ombudsman (S. VIII)	
European Data-protection Supervisor (S. IX)	
<b>Grand Total</b>	<b>122 231</b>

<sup>(1)</sup> The budgetary titles 14 and 24 to 31 of Section III of the general budget concerning primarily administrative expenditure are reported in the European Commission section of Chapter 7.

<sup>(2)</sup> Administrative expenditure is deducted from policy groups and shown separately under its own heading; this leads to differences in comparison to Chapters 3 to 6.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.11. The Court concludes that Revenue (127 795 million euro) <sup>(10)</sup> and payments in the policy group Administrative and other expenditure (9 264 million euro) were free from material error and that the supervisory and control systems were effective (see **Table 1.2** and paragraphs 2.41 to 2.42 and 7.33 to 7.34). Commitments in all policy groups were also free from material error.

1.12. The Court concludes that the policy group Research and other Internal Policies (8 953 million euro) was free from material error and that the supervisory and control systems were partially effective in ensuring the regularity of payments. However, interim and final payments for the research framework programmes (FPs) were subject to material error (see **Table 1.2** and paragraphs 6.48 to 6.49). The Court also concludes that the policy group External Aid, Development and Enlargement (6 543 million euro) was free from material error and that the supervisory and control systems were partially effective in ensuring the regularity of payments. However, interim and final payments were subject to material error (see **Table 1.2** and paragraphs 5.35 to 5.36).

1.13. The Court concludes that the policy groups Agriculture and Natural Resources (55 990 million euro reimbursed expenditure) and Cohesion, Energy and Transport (37 556 million euro reimbursed expenditure) were affected by material error. However, direct payments to farmers covered by the IACS <sup>(11)</sup> were free from material error. The Court also concludes that the audited supervisory and control systems of the policy group Agriculture and Natural Resources were partially effective. Furthermore, the Court concludes that audit authorities as a whole of the policy group Cohesion, Energy and Transport were partially effective in ensuring the regularity of transactions (see **Table 1.2** and paragraphs 3.55 to 3.56 and 4.47 to 4.48)

1.14. The Court concludes that overall payments were materially affected by error and that supervisory and control systems for payments were, in general, partially effective (see **Table 1.2**).

**1.13.** *The Court's conclusion for Agriculture and Natural Resources confirms the positive trend that in the past years the most likely error rate is close to the materiality threshold of 2%. The Commission further notes that for the European Agricultural Guarantee Fund (EAGF) expenditure, which in 2010 accounted for 77% of total expenditure under this Chapter, the most likely error is well below the materiality threshold and that for direct payments covered by the Integrated Administration and Control System (IACS) it is even lower. Moreover, the risk to the EU budget is adequately covered by the conformity clearance procedure. See also reply to paragraph 3.17.*

*The Commission considers that the IACS is generally an effective control system for limiting the risk of error or irregular expenditure. As regards rural development, the Commission considers that the supervisory and control systems are constantly improving.*

*As to Cohesion, the Commission notes that, for the second consecutive year, the level of error remains well below those reported by the Court in the period 2006-2008. The Commission considers that this positive development reflects the reinforced control provisions of the 2007-13 programming period and its 2008 action plan (see also reply to paragraph 4.24).*

<sup>(10)</sup> For the scope of the audit of revenue, see paragraphs 2.7 to 2.13.

<sup>(11)</sup> Integrated Administration and Control System.

Table 1.2 — 2010 Summary of findings on regularity of transactions

Policy Group	Payments (million euro)	Most likely error (MLE) (%)	Confidence interval (%)		Frequency of errors <sup>(1)</sup> (%)	Assessment of super- visory and control systems <sup>(2)</sup>
			Lower error limit (LEL)	Upper error limit (UEL)		
Agriculture and Natural Resources	55 990 <sup>(3)</sup>	<b>2,3</b>	0,8	3,8	37	Partially effective
Cohesion, Energy and Transport	37 556 <sup>(4)</sup>	<b>7,7</b>	4,7	10,7	49	Partially effective
External Aid, Development and Enlargement	6 543	<b>1,7</b>	0,1	3,3	23	Partially effective
Research and other Internal Policies	8 953	<b>1,4</b>	0,6	2,1	39	Partially effective
Administrative and other expenditure	9 264	<b>0,4</b>	0,0	1,1	7	Effective
<b>Overall audited population</b>	<b>118 306 <sup>(5)</sup></b>	<b>3,7</b>	2,6	4,8	<b>36</b>	<b>Partially effective</b>
Revenue	127 795	<b>0,0</b>	N/A	N/A	N/A	Effective

<sup>(1)</sup> The frequency of errors represents the proportion of the sample affected by quantifiable and non-quantifiable errors.

<sup>(2)</sup> Systems are classified as 'partially effective' where some control arrangements have been judged to work adequately whilst others have not. Consequently, taken as a whole, they might not succeed in restricting errors in the underlying transactions to an acceptable level. For details see the section 'Audit scope and approach' in Chapters 2 to 7.

<sup>(3)</sup> Reimbursed expenditure (see paragraph 3.16).

<sup>(4)</sup> Reimbursed expenditure (see paragraph 4.23).

<sup>(5)</sup> The difference between the payments in 2010 (122 231 million euro — see **Table 1.1**) and the total amount of the overall audited population in the context of the regularity of transactions corresponds to advances paid for the policy groups Agriculture and Natural Resources (851 million euro) and Cohesion, Energy and Transport (3 074 million euro) (see paragraphs 3.16 and 4.23).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Comparison with previous years' results*

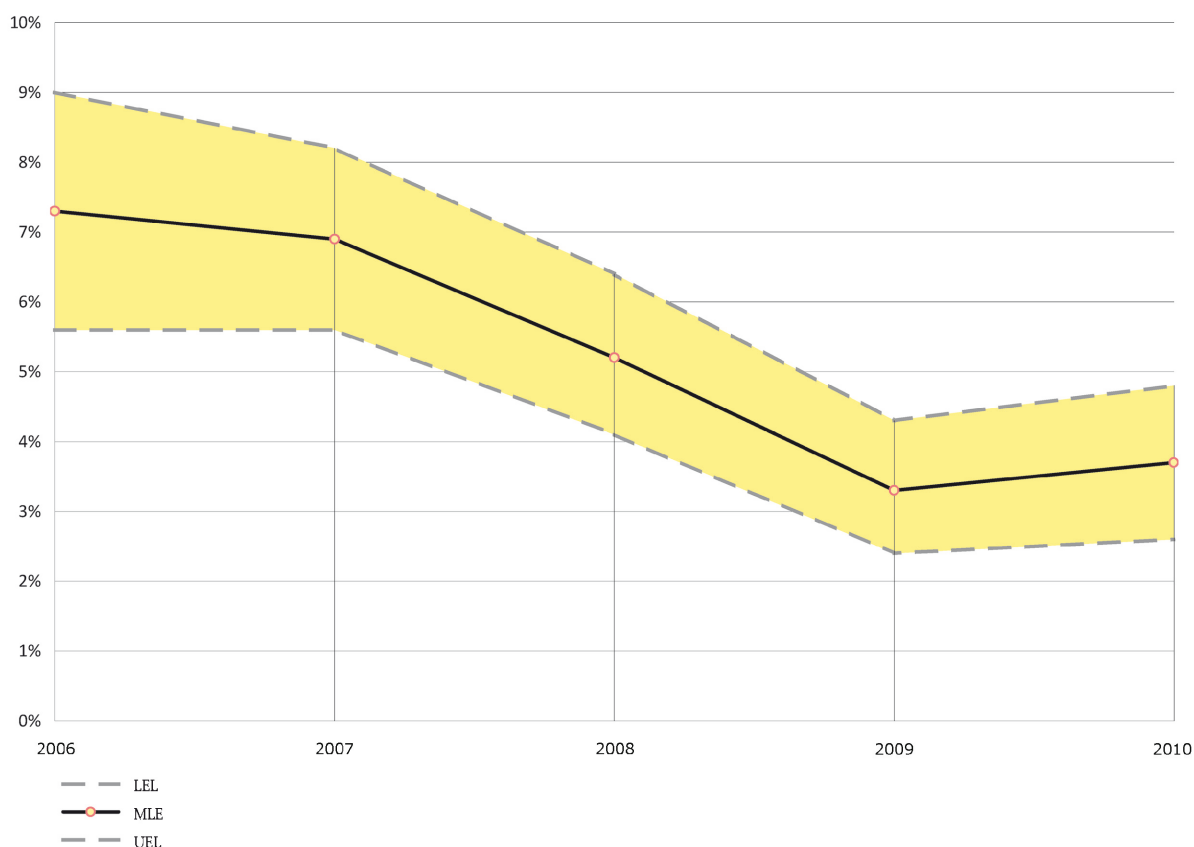
1.15. The Court's audit results for 2010 show an increase in its estimate of the most likely error concerning the payments for the policy group Cohesion, Energy and Transport<sup>(12)</sup> as compared to the policy group Cohesion of 2009<sup>(13)</sup>. The Court's estimate of the most likely error concerning the payments for the other policy groups remained relatively stable.

1.16. Taken together, this leads to an increase of the most likely error estimated by the Court for payments as a whole from 3,3 % in 2009 to 3,7 % in 2010 (see **Graph 1.1**)<sup>(14)</sup>. The Court found around one third of the transactions tested to be affected by error (2009: a quarter of the total number of transactions).

**1.15-1.16.** Over the years, most error rates have either been stable or have decreased. However, for 2010, progress in a number of domains has not compensated for a moderate increase in Cohesion, thereby resulting in a small overall increase for the budget as a whole.

As to Cohesion, the Commission notes that the most likely error rate for 2010 is well below the levels reported in the financial years 2006 to 2008. The lower error limit in 2010, i.e. 4,7 %, compares favourably with 11 % in 2008.

**Graph 1.1 — Evolution of the Court's estimate of the most likely error rate for the audited population of payments (2006-2010)**



<sup>(12)</sup> See **Table 1.2** of this Annual Report and Annexes x.1 for the different policy groups, as well as paragraphs 4.17 to 4.19 for Cohesion, of the 2009 Annual Report.

<sup>(13)</sup> In 2010, Energy and Transport constitute 7 % of the consolidated policy group (see also footnote 9).

<sup>(14)</sup> See also paragraph 1.26 of the 2009 Annual Report.

## Reliability of Commission management representations

### *Annual activity reports and declarations by Directors-General*

1.17. Each Director-General reports annually on the performance of her/his duties in an activity report. It is accompanied by a declaration *inter alia* on the extent to which resources have been used for their intended purpose, and control procedures ensure the legality and regularity of transactions.

1.18. All the Directors-General declared that the requirements mentioned above were respected. Thirteen Directorates-General or services have issued one or more reservations<sup>(15)</sup>, the majority of which refer to weaknesses concerning the regularity of the underlying transactions (see Annexes x.3 to Chapters 2 to 7).

1.19. Directors-General include reservations in their declarations of assurance based upon their assessment of the materiality of weaknesses and/or observations related to the building blocks of their annual activity reports. An element of this assessment which has gained in importance particularly in 2010, is the calculation of a residual risk or residual error rate — generally an estimate of the control mechanisms' impact on the error rate on a multiannual basis — which is compared with the materiality threshold of 2 % to determine whether a reservation is necessary.

**1.19-1.20.** *The Commission's standard practice foresees the calculation of a residual amount at risk as a percentage of the relevant activity-based budgeting (ABB) activity, which is compared to the materiality threshold of 2 % in order to determine whether a reservation is necessary. Furthermore, the Commission underlines that the calculation of a residual error rate is only one of the methods available to the Authorising Officer by Delegation (AOD) for estimating the amount at risk.*

*As management and control systems vary significantly between policy areas, Commission departments have different approaches in considering and calculating residual error rates. The Commission agrees that the existing guidance may not be sufficiently detailed to ensure a consistent use of terminology and criteria by all the services. It has put in place the peer review procedure to ensure that there is consistency, where different Directorates-General implement similar programmes.*

<sup>(15)</sup> The total number of reservations decreased from 20 in 2009 to 17 in 2010. It should be noted that in 2010, Directorate-General for Energy and Transport was split into two directorates-general (Directorate-General for Mobility and Transport and Directorate-General for Energy) and by consequence the 2009 reservation was carried forward as two reservations.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.20. The standing instructions for the annual activity reports issued by the Secretariat-General and Directorate-General for the Budget do not contain guidance on the estimation of this residual risk or residual error rate. This results in an inconsistent application of this concept by the Directorates-General concerned (e.g. anticipation of expected recoveries without a link to actual amounts, for certain programmes non-quantification of risks of error of up to 5 % taking into account the retention rate provided for in the regulation<sup>(16)</sup>, exclusion of negative audit results for newly started audit programmes with limited audit coverage).

*Opinion of the Commission's internal auditor*

1.21. The Commission's internal auditor issued his first overall opinion<sup>(17)</sup> on the state of control in the Commission. It is based, in particular, on assurances given in the annual activity reports and on work carried out by the Commission's internal audit service (IAS) and the internal audit capabilities of the different Directorates-General in 2008 to 2010.

<sup>(16)</sup> See **Annex 4.3**.

<sup>(17)</sup> See point 2.3 of 'Communication from the Commission to the European Parliament, the Council, the Court of Auditors — Synthesis of the Commission's management achievements in 2010', COM(2011) 323 final of 1 June 2011: 'The Commission's Internal Auditor considers that, in 2010, the Commission has put into place governance, risk management and internal control procedures which are adequate to give reasonable assurance over the achievement of its financial objectives, with the exception of those areas of financial management over which Directors-General have expressed reservations in their declarations of assurance and subject to remarks about the management of the risks concerning errors in the underlying transactions'.

*The guidance has to allow the AOD a margin of appreciation in each individual case.*

*While the quantification of risks in the annual activity reports (AAR) is intended to give an indication of amounts at risk and to estimate the potential financial corrections for the payments in the reference year, the Director-General has at his/her disposal other tools to protect the EU funds, such as interruptions and suspensions of payment and financial corrections. The quantification of risk in the AAR does not have the same function as the error rate established by the Court of Auditors and the Commission considers therefore that they cannot and should not be compared. The Director-General can assess whether 'mitigating measures' exist, which limit the risk. In Cohesion, the existing legal requirements are indeed mitigating measures and the assessment of the 2010 exposure to risk should take into account those complementary control mechanisms, which may go well beyond the reference year of the Court's audits (annual audits by the national audit authorities, complementary audits by the Directorates-General for Regional Policy (DG REGIO) and for Employment, Social Affairs and Inclusion (EMPL), and closure audits at the end the programmes).*

## THE COURT'S OBSERVATIONS

1.22. The scope of the overall opinion is limited to the Commission's own internal control framework. However, more than 90 % of all errors are identified outside the Commission at the level of beneficiaries. The Commission's internal auditor assesses this framework to be, taken as a whole, adequate. The Court, however, notes that the supervisory and control systems in place do not prevent or identify and correct errors to such an extent that transactions underlying the budget, taken as a whole, are legal and regular.

*Synthesis report of the Commission*

1.23. The introduction to the synthesis report<sup>(18)</sup> states that, by adopting it, the Commission assumes its political responsibility<sup>(19)</sup> for the implementation of the EU budget by its senior management. The Commission notes that Directors-General were successful in correcting the weaknesses in 25 % of the reservations formulated in 2009. In its view, the related improvements include increased compliance with the eligibility rules for expenditure declared by beneficiaries.

1.24. The Commission acknowledges, however, that there are still areas which require further improvement, in particular in shared management, and proposes actions to address these concerns, such as:

- revision of the Financial Regulation and sectoral regulations for the post-2013 period with a view to improve the design of funding schemes, to address the risk of error, to limit the administrative burden for beneficiaries and other stakeholders and to reduce the operating cost of controls,
- rigorous exercise of Commission's supervisory role and application of systematic and timely interruption of payments, suspension procedures and financial corrections whenever serious control deficiencies are identified,
- enhanced efforts in the area of cohesion to address the significant increase, as compared to 2009, of the rate of error and the volume of erroneous payments caused by the bigger number of transactions and higher amounts of expenditure declared,

<sup>(18)</sup> Communication from the Commission to the European Parliament, the Council, the Court of Auditors — Synthesis of the Commission's management achievements in 2010, COM(2011) 323 final of 1 June 2011.

<sup>(19)</sup> Pursuant to Article 317 of the Treaty on the Functioning of the European Union (TFEU).

## THE COMMISSION'S REPLIES

**1.22.** *The scope of the Internal Auditor's opinion includes the control systems which the Commission puts into place in order to address the issue of the rate of error at the level of beneficiaries.*

*When examining the Commission's control systems, the Commission's Internal Auditor seeks assurance that each service has put into place a control strategy for which the costs of controls are proportionate to the risks of error in the underlying transactions, and which is effective in deterring errors in claims submitted by beneficiaries, and in recovering sums unduly paid when errors do occur.*

**1.24.**

- *See reply to paragraph 1.37.*

- *Effectively, the Commission and its services exercised their supervisory role by interrupting 63 (49 ERDF and 14 ESF) payment deadlines and adopting 1 suspension decision for 2007-13 operational programme and 5 suspension decisions (ESF) on 2000-2006 operational programmes, where serious deficiencies or irregularities have been detected, until necessary corrective measures were implemented by Member States. The Commission is pursuing this strict policy in 2011, with 52 interruptions of payment deadlines decided (40 for ERDF and 12 for ESF) in the first semester of the year.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- modernisation of the EU's public procurement rules which are an important source of error, in particular in the area of cohesion <sup>(20)</sup>,
- further improvement of the readability and comparability of the annual activity reports.

1.25. The Commission took note in its synthesis report of the reports from management and stated that they 'provide comfort to the College as regards the performance of the governance and internal control in place in its services and give reasonable assurance as regards its capacity to achieve its objectives' <sup>(21)</sup>. The Court, however, underlines that it previously identified issues <sup>(22)</sup> which remain unresolved:

- in several areas the scope or scale of reservations should be greater (see paragraphs 1.20; 3.52 to 3.54; 4.45 to 4.46; 5.31 to 5.34; 6.46 to 6.47 and Annexes x.3 to Chapters 2 to 7),
- data from Member States on recoveries or withdrawals is still incomplete or has not yet been audited and/or validated by the Commission (see **Annex 1.2**, point 3),
- the difference between financial correction mechanisms and recoveries (financial corrections are a consequence of weaknesses identified in supervisory and control systems whereas recoveries are related to irregular payments) and their impact (financial corrections are borne by the taxpayers whereas recoveries are paid by the individual beneficiaries) is still not adequately taken into consideration (see **Annex 1.2**, point 3).

## 1.25.

- *The Commission considers that the scope or scale of reservations is appropriate (see replies to paragraphs 1.19 to 1.20, 3.52 to 3.54, 4.46 and 5.33-5.34).*
- *Information related to recoveries is included in note 6 to the accounts.*

*In Cohesion, for the programming period 2000-2006 the Commission verifies that information submitted for the closure of programmes is complete and reliable. For the 2007-2013 programming period, the Commission is carrying out a specific audit enquiry on the Member States' systems for recoveries, in order to gain assurance on the quality of data submitted in the annual statements on recoveries and withdrawals. The first results of this audit are expected to be taken into account in the annual activity reports of 2011.*

- *The Commission reports in its accounts at the level of the EU budget and considers that recoveries are essential in protecting the EU budget. The Commission understands that the Court's reference to recoveries concerns those at the level of beneficiaries in the Member States and requires that information reported should refer to such recoveries. However, in areas of shared management this responsibility lies with the Member States, as explained in the Commission's replies to paragraph 1.39 of the 2009 Annual Report of the Court. As soon as a Member State has reimbursed unduly paid funds (through effective claw back or through setting off), the Commission considers that the EU budget is protected. However, Member States are obliged to recover unduly paid amounts wherever possible and appropriate.*

<sup>(20)</sup> See Green Paper on the modernisation of the EU public procurement policy (directives 2004/18/EC and 2004/17/EC).

<sup>(21)</sup> See point 2.3 of COM(2011) 323 final of 1 June 2011.

<sup>(22)</sup> See paragraph 1.31 of the Court's 2009 Annual Report.

## IMPLICATIONS OF INCREASED USE OF PRE-FINANCING

1.26. A significant component of payments made by the Commission provide funding in advance for costs which will be incurred by outside bodies at a later date. When these payments are correctly identified as pre-financing they are not treated in the Union's accounts as definitive expenditure at the time they are made. Instead they are recorded as an asset in the balance sheet until justification is presented for costs incurred (or, less frequently completion of the required activity). On this basis, the Commission records the related expense in the economic outturn account and clears the balance sheet entry.

1.27. If advances are recognised in the accounts as definitive expenditure, there is no accounting record of the need to present evidence of the final use of the funds. This increases the risk that the use of funds will not be justified, and that irregularities will not be detected or detected only after a considerable delay. This may make it more difficult to recover amounts irregularly paid.

### Substantial increase of pre-financing between 2005 and 2010

1.28. The gross recorded value of accumulated pre-financing has more than doubled over the last six years (from 39 billion to 84 billion euro, see first row of **Table 1.3**). The Commission also estimates, during the cut-off exercise <sup>(23)</sup>, the expenditure incurred at year-end by the beneficiaries for which payment requests have not yet been received. These accrued charges (see second row of **Table 1.3**) are deducted from the related gross outstanding pre-financing. The resulting net pre-financing amount in the balance sheet (see third row of **Table 1.3**) has grown significantly too, but less rapidly (from 29 billion to 49 billion euro).

**1.27.** *The accounting services in the Commission are continuing their work on clarifying the issues related to the recognition and clearing of pre-financing (see also reply to paragraph 1.37).*

*Notwithstanding the validity of the principle stated in the second part of the Court's comment, it should be noted that, for instance, in the case of the financial engineering instruments (FEIs) the legal basis foresees only one eligibility check of the expenses incurred, at the closure of the programme or at the end of the programming period (whichever comes first). Therefore, whatever the accounting treatment applied to cash disbursements by the Commission to Member States, eventual irregularities will only be detected at that time.*

**1.28.** *The Commission is monitoring the situation regarding the growth in pre-financing amounts. Much of this increase is justified by the move to a new programming period (2007-2013) and the pre-financings paid out according to the shared management legislation. Nonetheless the accounting services of the Commission continue to work with the operational Directorates-General (DGs) to try to keep open pre-financing amounts as low as possible, but this work can often be in conflict with the underlying legislation.*

<sup>(23)</sup> The cut-off exercise seeks to ensure that both revenue and expenditure are completely and accurately recorded in the correct accounting period.



**Table 1.3 — Evolution of pre-financing <sup>(1)</sup> and related accrued charges between 2005 and 2010 (in million euro)**

	31.12.2005	31.12.2006	31.12.2007	31.12.2008	31.12.2009	31.12.2010	Difference from 2005 to 2010	
							Amount	in %
<b>Total gross pre-financing (before cut-off)</b>	38 854	43 129	55 099	73 754	84 761	84 387	45 533	117 %
Accrued charges	9 489	12 649	20 501	34 469	35 934	34 966	25 477	268 %
<b>Total net pre-financing (after cut-off)</b>	29 365	30 480	34 598	39 285	48 827	49 421	20 056	68 %

<sup>(1)</sup> Prepaid expenditure for Financial Engineering Instruments amounting to 4 775 million euro in 2010 and 2 153 million euro in 2009 are not included (see paragraphs 1.31 to 1.33).

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 THE COURT'S OBSERVATIONS
 

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**Inaccurate or incomplete data on pre-financing**
*Lack of clearing of pre-financing*

1.29. While some element of estimation for clearing of pre-financing is always likely to be necessary, several Directorates-General in internal policies and external actions continue to record estimates in the accounts even when they have accepted expenditure statements as an adequate basis for making further payments to the beneficiary <sup>(24)</sup>. The use of estimates for accrued charges has increased significantly over time, moving from less than a quarter of the amount advanced in 2005 to nearly a half in 2010 (see second row of **Table 1.3**). The Court has expressed disquiet over the growth of this practice <sup>(25)</sup>.

<sup>(24)</sup> See paragraph 1.28, first indent, of the Court's 2006 Annual Report, paragraphs 1.23, second indent, 1.24, second indent, and 1.26 of the 2007 Annual Report, paragraph 1.14 of the 2008 Annual Report and paragraph 1.12 of the 2009 Annual Report.

<sup>(25)</sup> In its Opinion No 6/2010 on a proposal for a regulation of the European Parliament and the Council on the Financial Regulation applicable to the general budget of the European Union, the Court stated its concerns as to the very high increase of uncleared pre-financing and the need for action.

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 THE COMMISSION'S REPLIES
 

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**1.29.** *The Commission understands the Court's concern in this area and has been making efforts to address this issue. In the context of the current revision of the Financial Regulation, the Commission has proposed to make the regular clearing of pre-financings compulsory.*

*Because of the risk of error in uncertified and/or unaudited statements of expenses, a number of Authorising Officers by Delegation are reluctant to make payments on the basis of such statements. They then use uncertified and/or unaudited expenditure statements as an indication of progress in the action subsidised and pay additional pre-financings, in order to secure a continuous treasury float of payments for the subsidised projects. Clearing is then postponed until the end of the project.*

*It is worth mentioning that both the Commission and beneficiaries/contractors (in particular in internal policies and external aid) will face a challenge in terms of administrative workload when regular clearings of pre-financings become more effective.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Incomplete recording of pre-financing*

1.30. Since 2009, there has been a significant increase in payments mainly in financial engineering instruments (FEIs) for which justification of costs and/or activity is only expected at a later date. The audit has brought to light a significant number of cases where initially the Commission did not properly record payments as giving rise to an asset. Thus, in contradiction to the principle of substance over form<sup>(26)</sup> the accounts gave the impression that recipients have provided full justification for use of the funds, when in practice this was not the case.

## Financial engineering instruments

1.31. Contributions to FEIs form the single most significant element of this problem. The relevant regulations in the areas of Cohesion and Rural development<sup>(27)</sup> provide for the inclusion of payments made from operational programmes to establish or contribute to funds implementing FEIs in the declarations of expenditure. The Commission has adopted the practice of recording the full amounts declared by Member States as expenses in the economic outturn account as if they were definitive settlement of a claim.

**1.30.** This issue was brought to light for the first time early 2011. The legal framework for shared management does not require that the related amounts paid as advances be claimed from the Commission in a separate cost statement, nor does it require a specific periodic reporting on their use by the final beneficiary. See also replies to paragraphs 1.31 and 1.32.

**1.31.** In the absence of any information on payments made to FEIs, which is not requested from Member States in the applicable legal basis, the Commission had initially no other option but to consider these payments as expenses.

On the basis of the information it requested and obtained from Member States in June 2011, the Commission has treated payments to FEIs as assets in the 2010 accounts including the comparative figures for 2009. See notes 2.5, 2.9, 2.10 and 3.4 to the consolidated accounts where all details are provided. See also reply to paragraph 1.32.

<sup>(26)</sup> The International Public Sector Accounting Standard (IPSAS) 1 defines this principle as follows: 'If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with their legal form' (Appendix A, page 70 of 'Handbook of International Public Sector Accounting Pronouncements 2011', Volume 1). See also Article 124 of the Financial Regulation.

<sup>(27)</sup> See Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2010, p. 25), Section 4, Article 44 and Commission Regulation (EC) No 1828/2006 (OJ L 371, 27.12.2006, p. 1), Section 8, Articles 43 to 46 for the European Regional Development Fund, the European Social Fund and the Cohesion Fund, Council Regulation (EC) No 1698/2005 (OJ L 277, 21.10.2005, p. 1), Article 71(5) and Commission Regulation (EC) No 1974/2006 (OJ L 368, 23.12.2006, p. 15), Articles 50 to 52 for the European Agricultural Fund for Rural Development.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.32. However, according to the sectoral regulations, authorities in the Member States are only required to present a final declaration on their use in form of loans, guarantees or equity investments provided to final recipients at a later date (typically at the end of the programme period). This meant that in 2010 the Commission had no comprehensive information on the amounts actually used by the FEIs, and it was only after this problem came to light in early 2011 that it was able to collect the necessary information from the Member States. As a result, around 4,8 billion euro were not recorded as pre-financing in the balance sheet of the 2010 provisional accounts <sup>(28)</sup>.

## Other aid schemes

1.33. Additionally a number of other grant schemes allow cash advances to be made to beneficiaries, prior to presentation of final cost statements. In practice these are treated too as if they were definitive expenditure. Therefore, they are not recognised and presented in the balance sheet. The amount concerned is difficult for the Commission to quantify.

## Action taken by the Commission

1.34. The Commission has sought to obtain sufficient information for the final accounts. According to the information received from the Member States at the end of June 2011, the EU contribution to FEIs amounts to 6,4 billion euro. Based on the estimation of the amounts not used by FEIs as at 31 December 2010, the most significant adjustments to be made were a reclassification from expenses to assets in the 2009 and 2010 accounts (see notes 2.5, 2.9, 2.10 and 3.4 to the 2010 accounts explaining the adjustments made).

## Conclusions and recommendations

1.35. The Commission corrected material problems concerning the completeness of pre-financing through cut-off bookings and adjustments (see paragraph 1.34). Nonetheless, the lack of current information on the EU funds actually used by the Member States reduces significantly the usefulness for management of the accounting information, notably for the Commission in its responsibilities for implementing the budget.

**1.32.** It should be noted that the information requested and obtained from the Member States does not concern the amounts actually spent by the FEIs, but the amounts contributed to the FEIs. Taking into consideration the cost-benefit criterion, the Commission made an estimate of the unused amounts on a straight line basis and reclassified them as assets.

The assets totalling 4,8 billion euro will be entirely depreciated by the end of 2015, by virtue of the application of the current legal basis.

See also reply to paragraph 4.32.

**1.33.** As for the FEIs mentioned above, for the aid schemes the legal basis also does not foresee any specific reporting on the amounts paid and their usage. So far, the Commission has indications that under aid schemes the advances are paid for a period shorter than FEIs. The inherent movements due to the normal activity and the delay in declaring the expenditure actually incurred make it difficult to quantify the financial impact of such advances.

See also reply to paragraph 1.36.

**1.35.** The Commission wishes to emphasise the volume and importance of the information gathered on the contributions paid into the FEIs, which is an important step towards more accurate accounting information.

<sup>(28)</sup> This amount consists of long-term pre-financing (3 820 million euro) and short-term pre-financing (955 million euro).

## THE COURT'S OBSERVATIONS

1.36. The Commission needs to take further action to ensure that necessary information is available, transactions are given consistent treatment in the accounts, and all Directorates-General maintain complete, accurate and up to date accounting records.

1.37. The increased use of pre-financing in the EU budget and of new types of financial instruments makes it urgent for the Commission to revisit the relevant accounting rule in order to provide adequate guidance on the recognition and clearing of pre-financing. This should be accompanied by improved supervision <sup>(29)</sup>.

## THE COMMISSION'S REPLIES

**1.36.** *The accounting treatment applied was consistent in the four shared management DGs and in accordance with the legal basis. Furthermore, it would not be feasible at this stage to change the treatment applied to the cost statements submitted by the Member States. Instead the Commission will continue to calculate an estimate of the unused amounts at year-end and make the necessary accounting adjustment.*

*Cost efficiency needs to be considered as the Commission must avoid that the reporting on advances required from beneficiaries becomes extremely complex and resource-consuming for all parties concerned.*

*The Commission has already proposed an appropriate modification to the current sectoral legal basis in the structural funds regulation. It will also introduce appropriate provisions in the proposals for future legal bases.*

**1.37.** *The Commission highlights that a distinction should be made between pre-financing given under external aid and internal policies and pre-payments made under shared management, in particular concerning financial engineering instruments.*

*The Commission also emphasises that addressing the clearing of pre-financing before the final payments is not simply an issue of accounting guidance. In practice it means reimbursing interim cost statements of which the degree of compliance with complicated eligibility rules needs first to be verified. This cannot be obtained without a substantial increase in administrative workload, both for the beneficiaries and the Commission's services.*

*In addition, it would necessitate changes in the Financial Regulation and in sectoral legislation which, at the moment, allow for successive pre-financings based on progress in the actions subsidised. The Commission has already proposed in the review of the relevant article of the Financial Regulation, that regular clearing of pre-financing becomes obligatory.*

*Finally, the Commission would point out that its accounting services have provided guidance, training and organised workshops on pre-financing during 2010 and 2011 and this will be continued.*

<sup>(29)</sup> See also paragraph 1.43 of the 2008 Annual Report.

## BUDGETARY MANAGEMENT

1.38. This section summarises the implementation of the EU general budget in 2010.

### *Budgetary appropriations for commitments and payments*

1.39. The total appropriations available in 2010, taking into account appropriations carried over<sup>(30)</sup>, assigned revenue<sup>(31)</sup> and amending budgets<sup>(32)</sup>, amount to 147,3 billion euro for commitments and 130,5 billion euro for payments, an increase of 0,9 % and 4,8 % respectively compared to total appropriations available in 2009 (see **Diagrams III** and **IV** in the **Annex** to this Annual Report).

1.40. The budgetary commitment appropriations of the year were 0,6 billion euro above the financial framework ceiling due to the utilisation of funds for which this is allowed<sup>(33)</sup>. The total payment appropriations remained below the ceiling by 11,4 billion euro.

### *Budgetary implementation rates*

1.41. The Commission produces a series of documents containing inter alia the following information on the implementation of the budget of the European Union<sup>(34)</sup>:

- The budgetary surplus at the end of 2010 was 4,5 billion euro (2009: 2,3 billion euro).
- Utilisation rates in 2010 for commitments and payments were 99 % and 97 % respectively.

**1.41.**

<sup>(30)</sup> Appropriations carried over from 2009 amount to 0,3 billion euro for commitments and 1,8 billion euro for payments.

<sup>(31)</sup> Assigned revenue in 2010 (see also footnote 35) amounts to 5,4 billion euro for commitments and 5,8 billion euro for payments.

<sup>(32)</sup> The eight amending budgets approved during 2010 resulted in an overall 99 million euro increase in appropriations for commitments and a 19 million euro increase in appropriations for payments.

<sup>(33)</sup> According to the Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management (OJ C 139, 14.6.2006, p. 1), certain commitment appropriations entered in the budget such as the Emergency Aid Reserve, the European Union Solidarity Fund and the European Globalisation Adjustment Fund may be over and above the ceiling.

<sup>(34)</sup> Detailed information on budgetary implementation for 2010 can be obtained from Part II of the Annual Accounts of the European Union, financial year 2010, the Commission's (Directorate-General for the Budget) documents 'Report on budgetary and financial management accompanying the Community accounts - Financial year 2010' as well as from the Report on the 'Analysis of the budgetary implementation of the Structural and Cohesion Funds in 2010'.

## THE COURT'S OBSERVATIONS

- 3,3 billion euro of accumulated outstanding commitments were decommitted in 2010 (2009: 1,9 billion euro). The increase in decommitments stems mainly from title 04 — Employment and Social Affairs (1,4 billion euro).
  
- 1,5 billion euro of unused payment appropriations (excluding assigned revenues<sup>(35)</sup>) were carried over from 2010 to 2011.
  
- For the policy areas Agriculture and Rural Development (title 05), Cohesion (titles 04 and 13) and Fisheries and Maritime Affairs (title 11), the overall utilisation rate of payment appropriations was 98 %.
  
- In the policy area Regional Policy, payment appropriations were higher than foreseen (106 % of the initial budget). This was financed by transfers amounting to 1,8 billion euro mainly from titles 04 (Employment and Social Affairs) and 05 (Agriculture and Rural Development), for which payments were lower than expected due to interruption and suspension of payments for the European Social Fund (88 % implementation), lower claims in Rural Development (94 % implementation) or slow processing of closures of programmes<sup>(36)</sup>.

1.42. In the course of the financial year 2010 relevant regulations<sup>(37)</sup> were modified in order to provide for additional pre-financings to structural actions for the 2007-2013 period. On the basis of the adapted regulations additional advances for the European Social Fund amounting to 371 million euro, for the Cohesion Fund for an amount of 404 million euro and for the European Fisheries Fund for an amount of 0,8 million euro were paid to those Member States that were particularly affected by the economic crisis. For Agriculture and Rural Development, additional pre-financing of 401 million euro was paid to Member States during the budget year 2010 without an appropriate legal basis. The amount concerned is reported as a legality and regularity error in Chapter 3<sup>(38)</sup>.

## THE COMMISSION'S REPLIES

- *In 2010, DG EMPL has received the final claims for the ESF 2000-2006 programming period. For programmes for which the total amount declared was lower than the financial programming, DG EMPL has de-committed the exceeding commitments outstanding (RAL).*
  
  
  
  
  
  
- *The execution of the ESF in 2010 reached only 88 %, due to some blocked payments following the detection of serious system weaknesses or irregularities as a result of the audit activity for some 2000-2006 (suspensions of payments) and 2007-2013 programmes (interruptions of payment). For some Spanish, French and Italian 2000-2006 programmes, for which payment appropriations were carried forward from 2009 to 2010 and remained blocked at this stage, the financial suspension and correction procedures will be merged with the final payments processed in the context of the 2000-2006 winding up declarations (all cases but one). In accordance with the Financial Regulation, the carry forward of credits cannot be transferred to another budget line, so they remained unused in 2010.*

**1.42.** *The 401 million euro advance payments for rural development do not represent irregular payments to final beneficiaries. Moreover, the recovery of the amounts in question is ongoing and will be completed by the end of 2011.*

<sup>(35)</sup> Assigned revenue cover inter alia refunds arising from recovery of amounts paid in error, which are re-allocated to their budget line of origin, contributions from EFTA members increasing budget lines, or revenue from third parties where agreements have been concluded involving a financial contribution to EU activities.

<sup>(36)</sup> 'Report on budgetary and financial management accompanying the Community accounts — Financial year 2010'.

<sup>(37)</sup> Council Regulation (EC) No 1198/2006 (OJ L 223, 15.8.2006, p. 1) and Regulation (EC) No 1083/2006.

<sup>(38)</sup> See paragraphs 3.13, 3.15 and 3.22.

## THE COURT'S OBSERVATIONS

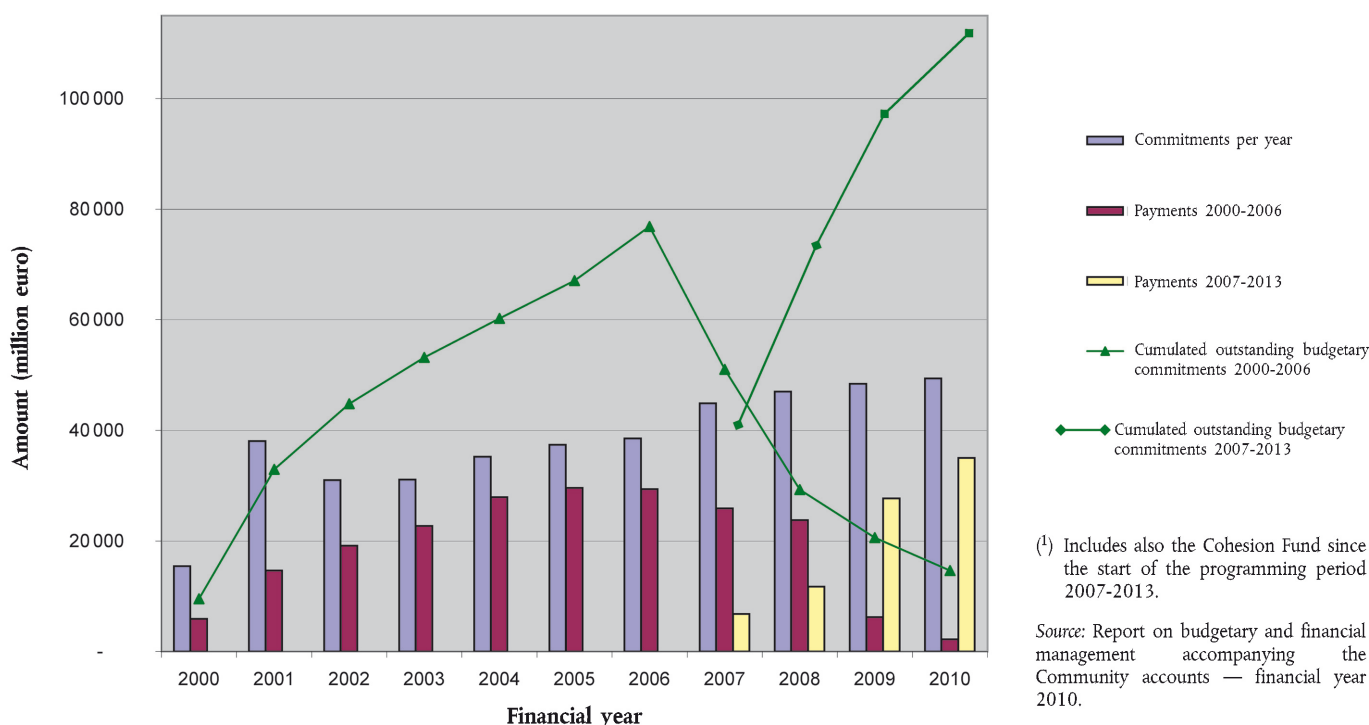
## THE COMMISSION'S REPLIES

*Outstanding budgetary commitments*

1.43. Outstanding budgetary commitments representing open commitments for which payment and/or decommitment have not yet been made<sup>(39)</sup> increased by 17 billion euro (9,7 %) to 194 billion euro, mostly in policy areas financed through differentiated appropriations<sup>(40)</sup>, and represent the equivalent of 2,2 years worth of differentiated commitments or 2,8 years of differentiated payments at the 2010 spending rate in the respective policy areas.

**1.43-1.44.** Outstanding commitments derive from the normal management of multiannual programmes and from the growth in the overall level of new commitments. As far as structural funds are concerned, the size of the RAL is controlled by the  $n + 2/n + 3$  rule defined by the corresponding regulations. Following this rule, the expected level of the RAL must be equivalent to 2 or 3 years of commitments. Consequently, the majority of the current outstanding commitments are 'normal' in the light of the underlying rules. In addition, the budgetary authority is informed each year of potentially abnormal outstanding commitments. The Commission monitors those commitments, which need to be de-committed.

**Graph 1.2 — Development of cumulated outstanding commitments for the structural funds 2000-2006 and cohesion area 2007-2010<sup>(1)</sup>**



<sup>(39)</sup> Outstanding budgetary commitments arise as a direct consequence of differentiated expenditure, where expenditure programmes take a number of years to be completed and commitments are made in earlier years before the corresponding payments. As commitments are liquidated by payments, the long-term effect of commitments significantly exceeding payments results in an inevitable build up of outstanding commitments, with the situation being rolled forward each year.

<sup>(40)</sup> The budget distinguishes between two types of appropriation: non-differentiated appropriations and differentiated appropriations. Non-differentiated appropriations are used to finance operations of an annual nature, e.g. administrative expenditure. Differentiated appropriations were introduced to manage multiannual operations, the related payments can be made during the year of the commitment and during the following years. Differentiated appropriations are used mainly for the structural funds and the Cohesion Fund.

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THE COURT'S OBSERVATIONS

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1.44. Most outstanding commitments are in the Cohesion policy group (see **Graph 1.2**). In this field, outstanding commitments amounted to 128 billion euro <sup>(41)</sup> (around 66 % of the total amount), representing 2,6 years worth of commitments or 3,4 years worth of payments in that area at the 2010 spending rate. The vast majority of these outstanding commitments (113,2 billion euro or 88 % of the total amount) refers to the current period 2007-2013. This shows the impact of the efforts to settle outstanding commitments by payments prior to the application of the automatic decommitment rule (n + 2 rule/n + 3 rule <sup>(42)</sup>).

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<sup>(41)</sup> For Cohesion see 'Report on budgetary and financial management accompanying the Community accounts — Financial year 2010', pp. 23, 36-41.

<sup>(42)</sup> The n + 2/n + 3 deadline requires automatic decommitment of all funds not spent or not covered by a payment request by the end of the second/third year following the year of allocation. As part of the 'third simplification' package, the n + 2/n + 3 rule was last amended for the 2007 commitments in Cohesion (see Regulation (EC) No 1083/2006, amended by Regulation (EU) No 539/2010 of the European Parliament and of the Council (OJ L 158, 24.6.2010, p. 1)). However, this had no significant impact on the utilisation rate of payment appropriations.



## ANNEX 1.1

## AUDIT APPROACH AND METHODOLOGY

**PART 1 — Audit approach and methodology for the reliability of accounts**

1. In order to assess whether the consolidated accounts, consisting of the consolidated financial statements and the consolidated reports on the implementation of the budget <sup>(1)</sup> present fairly, in all material respects, the financial position of the European Union, and the results of operations and cash flows at the year end, the main assessment criteria are:

- (a) *legality and regularity*: the accounts are drawn up in accordance with the rules, and budgetary appropriations are available;
- (b) *completeness*: all revenue and expenditure transactions and all assets and liabilities (including off-balance sheet items) proper to the period are entered in the accounts;
- (c) *reality of the transactions and existence of the assets and liabilities*: each revenue and expenditure transaction is justified by an event which pertains to the entity and is proper to the period; the asset or liability exists at the balance sheet date and is proper to the reporting entity;
- (d) *measurement and valuation*: the revenue and expenditure transaction and the asset or liability is entered in the accounts at an appropriate value, bearing in mind the principle of prudence;
- (e) *presentation of information*: the revenue and expenditure transaction, asset or liability is disclosed and described in accordance with the applicable accounting rules and conventions and the principle of transparency.

2. The audit consists of the following basic elements:

- (a) an update of the evaluation of the accounting control environment;
- (b) checking of the functioning of key accounting procedures and the year end closure process;
- (c) analytical checks (consistency and reasonableness) on the main accounting data;
- (d) analyses and reconciliations of accounts and/or balances; and
- (e) substantive tests of commitments, payments and specific balance sheet items based on representative samples.

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

3. The approach taken by the Court to audit the regularity of the transactions underlying the accounts comprises:

- direct testing of transactions in each revenue or spending area (see **Table 1.1**) in order to ascertain how far they are regular, and
- an assessment of the effectiveness of supervisory and control systems ensuring the regularity of transactions.

4. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of Commission management representations.

*How the Court tests transactions*

5. The direct testing of transactions within each specific assessment (Chapters 2 to 7) is based on a **representative sample** of the receipts (in the case of revenue) and payments contained within the policy group concerned <sup>(2)</sup>. This testing provides a statistical estimation of the extent to which the transactions in the population concerned are irregular.

<sup>(1)</sup> Including the explanatory notes.

<sup>(2)</sup> Additionally to this, a horizontal representative sample of commitments is drawn and tested for compliance with the relevant rules and regulations.

6. In order to determine the sample sizes necessary to produce a reliable result, the Court uses an **audit assurance model**. This involves an assessment of the risk of errors occurring in transactions (inherent risk) and the risk that the systems do not prevent or detect and correct such errors (control risk).

7. Transaction testing involves a **detailed check** of each transaction selected by the samples, including determination of whether or not the claim or payment was correctly calculated and in compliance with the relevant rules and regulations. The Court samples the transactions recorded in the budgetary accounts and traces the payment down to the level of the final recipient (e.g. farmer, organiser of training course, or development aid project promoter) and tests compliance at each level. When the transaction (at any level) is incorrectly calculated or does not meet a regulatory requirement or contractual provision, it is considered to contain an **error**.

*How the Court evaluates and presents the results of transaction testing*

8. **Errors** in transactions occur for a variety of reasons and take a number of different forms depending on the nature of the breach and specific rule or contractual requirement not followed. Errors in individual transactions do not always affect the total amount paid.

9. The Court **classifies errors** as follows:

- whether they are *quantifiable or non-quantifiable*, depending on whether it is possible to measure how much of the amount paid or received from the EU budget was affected by error, and
- in terms of their *nature*, in particular *eligibility* (payment does not meet the eligibility rules), *occurrence* (reimbursement of a cost which is not proven to have been incurred) or *accuracy* (payment incorrectly calculated).

10. Public procurement is one area where the Court often finds errors. EU public procurement law consists essentially of a series of procedural requirements. To ensure the basic principle of competition foreseen in the Treaty the contracts have to be advertised; bids must be evaluated according to specified criteria; contracts may not be artificially split to get below thresholds, etc.

11. For its audit purposes the Court puts a value on failure to observe a procedural requirement. The Court:

- (a) regards as ‘serious’ those errors which frustrate the objectives of the public procurement rules: fair competition and award of the contract to the best qualified bidder <sup>(3)</sup>;
- (b) quantifies the impact of “serious” infringements of the public procurement rules as affecting the entire value of the payment related to the contract — a 100 % quantifiable error <sup>(4)</sup>;
- (c) treats less serious errors which do not affect the outcome of the tendering procedure as non-quantifiable errors <sup>(5)</sup>.

The quantification by the Court may differ from that used by the Commission or Member States when deciding how to respond to misapplication of the public procurement rules.

12. The Court expresses the **frequency** by which errors occur by presenting the proportion of the sample affected by quantifiable and non-quantifiable errors. This indicates how widespread errors are likely to be within the policy group as a whole. This information is given in Annexes x.1 to Chapters 2 to 7 when material error is present.

13. On the basis of the errors which it has quantified, the Court, using standard statistical techniques, estimates the **most likely rate of error** (MLE) in each specific assessment and for spending from the budget as whole. The MLE is the weighted average of the percentage error rates found in the sample <sup>(6)</sup>. The Court also estimates, again using standard statistical techniques, the range within which it is 95 % confident that the rate of error for the population lies in each specific assessment (and for spending as whole). This is the range between the lower error limit (LEL) and the upper error limit (UEL) <sup>(7)</sup> (see illustration below).

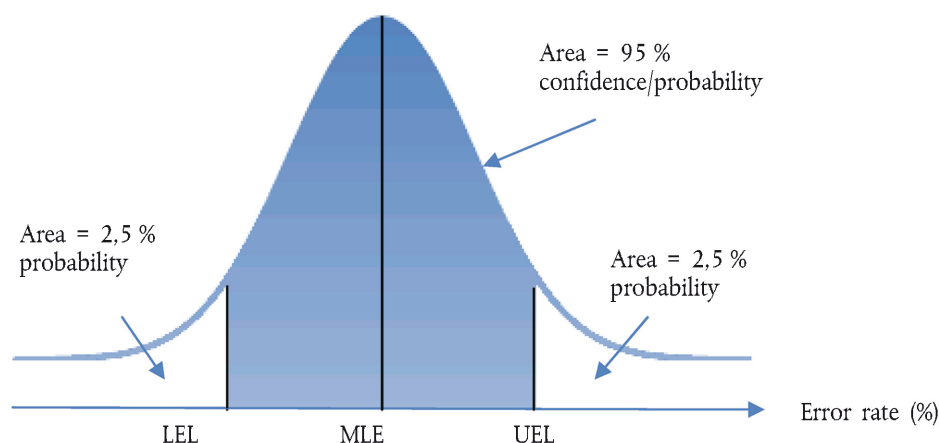
<sup>(3)</sup> There are essentially two award systems: the lowest offer or the most advantageous offer.

<sup>(4)</sup> Examples of a quantifiable error: no or restricted competition (except where this is explicitly allowed by the legal framework) for the main or a supplementary contract; inappropriate assessment of bids with an impact on the outcome of the tender; substantial change of the contract scope; splitting of the contracts for different construction sites, which fulfil the same economical function. The Court applies in general a different approach to misapplication of the public purchasing directives by the EU institutions, on the grounds that the contracts concerned generally still remain valid. Such errors are not quantified in the DAS.

<sup>(5)</sup> Examples of a non-quantifiable error: inappropriate assessment of bids without impact on the outcome of the tender, formal weaknesses of tender procedure or tender specification, formal aspects of the transparency requirements not respected.

<sup>(6)</sup>  $MLE = \frac{1}{\sum ASI} \times \sum_i \left( ASI_i \times \frac{\text{error amount}_i}{\text{audited amount}_i} \right)$ , where ASI is the average sampling interval and  $i$  is the numbering of transactions in the sample.

<sup>(7)</sup>  $LEL = MLE - t_{n,95\%} \times \frac{s}{\sqrt{n}}$  and  $UEL = MLE + t_{n,95\%} \times \frac{s}{\sqrt{n}}$ , where  $t$  is the t-distribution factor,  $n$  is the sample size and  $s$  is the standard deviation of the percentage errors.



14. The percentage of the shaded area below the curve indicates the probability that the true error rate of the population is between the LEL and the UEL.

15. In planning its audit work, the Court seeks to undertake procedures allowing it to compare the estimated rate of error in the population with a planning **materiality** of 2 %. In assessing audit results, the Court is guided by this level of materiality and takes account of the nature, amount and context of errors when forming its audit opinion.

#### *How the Court assesses systems and reports the results*

16. **Supervisory and control systems** are established by the Commission and member and beneficiary states in the case of shared or decentralised management, to manage the risks to the budget, including the regularity of transactions. Assessing the effectiveness of systems in ensuring regularity is therefore a key audit procedure, and particularly useful for identifying recommendations for improvement.

17. Each policy group is subject to a multitude of individual systems, likewise revenue. The Court therefore normally selects a sample of systems to assess each year. The results of the **systems assessments** are presented in the form of a table called 'Results of examination of systems' given in Annexes x.2 to Chapters 2 to 7. Systems are classified as being *effective* in mitigating the risk of error in transactions, *partially effective* (when there are some weaknesses affecting operational effectiveness) or *not effective* (when weaknesses are pervasive and thereby completely undermine operating effectiveness).

18. In addition and when supported by evidence, the Court provides an **overall assessment** of systems for the policy group (also provided in Annexes x.2 to Chapters 2 to 7), which takes into account both the assessment of selected systems, as well as the results of transaction testing.

#### *How the Court assesses Commission management representations and reports the results*

19. As required by international auditing standards, the Court obtains a letter of representation from the Commission, confirming that the Commission has fulfilled its responsibilities, and disclosed all information that could be relevant to the auditor. This includes confirmation that the Commission has disclosed all information in respect to the assessment of the risk of fraud, all information in respect to fraud or suspected fraud of which the Commission is aware, and all material instances of non-compliance with laws and regulation.

20. In addition, Chapters 2 to 7 consider the annual activity reports of relevant Directorates-General. These report on the achievement of policy objectives and the management and control systems in place to ensure the regularity of transactions and sound use of resources. Each annual activity report is accompanied by a declaration of the Director-General on inter alia the extent to which resources have been used for their intended purpose, and control procedures ensure the regularity of transactions <sup>(8)</sup>.

21. The Court assesses the annual activity reports and accompanying declarations in order to determine how far they provide a fair reflection of financial management in relation to regularity of transactions. The Court reports on the results of this assessment in the section 'Reliability of Commission management representations' in Chapters 2 to 7, and — in case of significant findings — by means of an observation following the conclusions on the regularity of transactions and effectiveness of systems.

<sup>(8)</sup> Further information on these processes, as well as links to the most recent reports can be found at [http://ec.europa.eu/atwork/synthesis/index\\_en.htm](http://ec.europa.eu/atwork/synthesis/index_en.htm)

*How the Court arrives at its opinions in the statement of assurance*

22. The Court arrives at its opinion on the regularity of transactions underlying the European Union's accounts, set out in the statement of assurance, on the basis of all its audit work as reported in Chapters 2 to 7 of this report and including an assessment of the pervasiveness of error. A key element is the consideration of the results of testing of spending transactions. Taken together, the Court's best estimate of the rate of error for overall spending in 2010 is 3,7 %. The Court has 95 % confidence that the rate of error for the population is between 2,6 % and 4,8 %. The error rate found in different policy areas varies as described in Chapters 3 to 7. The Court assessed error as pervasive — extending across the majority of spending areas. The Court gives an overall opinion on the regularity of commitments based on an additional horizontal sample.

*Irregularity or fraud*

23. The overwhelming majority of errors arise from misapplication or misunderstanding of the often complex rules of EU expenditure schemes. If the Court has reason to suspect that fraudulent activity has taken place, it reports this to OLAF, the Union's antifraud office, which is responsible for carrying out any resulting investigations. In fact, the Court reports around three cases per year to OLAF, based on its audit work.

## FOLLOW-UP OF OBSERVATIONS OF PRIOR YEARS CONCERNING THE RELIABILITY OF ACCOUNTS

Observations raised in prior years	Progress made	Commission reply	Court analysis
<p><b>1. The accounting officer's letter of representation</b></p> <p>The representation letters of the Commission's accounting officer highlighted that the accounting officers of some consolidated entities had omitted or modified representations. In particular, the required information on the validation of the accounting and local systems was not provided.</p>	<p><b>The accounting officer's letter of representation</b></p> <p>In respect of the 2010 consolidated accounts the Commission's accounting officer:</p> <ul style="list-style-type: none"> <li>— states that the accounting and/or local systems in four agencies and in two first time consolidated joint undertakings have not or only partially been validated and underlines that these validations are the responsibility of the accounting officers concerned,</li> <li>— notes that one executive agency used last year's template for its management representation letter, thus some newly added representations are missing.</li> </ul> <p>However, the Commission's accounting officer emphasised that in his view these points do not have a material impact on the Commission's accounts.</p>	<p><b>The accounting officer's letter of representation</b></p> <p><i>The lack of validations highlighted does not impact the reliability of the accounts.</i></p>	<p><b>The accounting officer's letter of representation</b></p> <p>The Court has taken account of the overall assurance provided by the accounting officer's letter of representation. The Court will follow up on the specific issues identified in the course of its future audits.</p>
<p><b>2. Pre-financing, accounts payable and cut-off procedures</b></p> <p>For pre-financings, accounts payable and related cut-off the Court identified accounting errors with an immaterial financial impact overall but a high frequency. This underlines the need for further improvement in the basic accounting data at the level of certain Directorates-General.</p>	<p><b>Pre-financing, accounts payable and cut-off procedures</b></p> <p>The Commission continued to work on improving the accuracy of its accounting data through ongoing actions like the accounting quality project and the validation of local systems.</p>	<p><b>Pre-financing, accounts payable and cut-off procedures</b></p> <p><i>See the Commission's reply to paragraph 1.29.</i></p> <p><i>The Commission will continue to work on improving the accuracy of the accounting data through ongoing actions like the accounting quality projects.</i></p>	<p><b>Pre-financing, accounts payable and cut-off procedures</b></p> <p>The Court will continue to follow up on the issues identified.</p>

Observations raised in prior years	Progress made	Commission reply	Court analysis
<p>As regards accounting for amounts pre-financed, the Court also identified the following problems:</p> <ul style="list-style-type: none"> <li>— the clearing of outstanding pre-financings is not always carried out correctly. A number of clearings were either not carried out at all or for incorrect amounts, and</li> <li>— some Directorates-General do not process the available information on progress made and related costs incurred and do not clear the corresponding pre-financing according to this progress, but use approximations when determining the cut-off.</li> </ul> <p>Furthermore some Directorates-General did not respect the requirement to register the invoices and cost statements within the five working days after their reception.</p>	<p>Despite the efforts of the accounting officer's services to improve the situation, the Court found that several Directorates-General in internal policies and external actions continue to record estimates in the accounts even when they have an adequate basis for clearing the corresponding pre-financings (see paragraph 1.29).</p> <p>The Court's audit of representative samples of pre-financing and of invoices/cost claims identified again errors with an immaterial financial impact overall but a high frequency. Therefore, the Commission should continue to make further efforts to improve the basic accounting data at the level of certain Directorates-General.</p> <p>Despite improvements noted in the time taken to register new cost claims, some Directorates-General still do not fully respect the requirement of registering their invoices and cost claims promptly.</p>		<p>Furthermore, a new issue arose in the 2010 audit concerning a significant number of cases where initially the Commission did not record properly payments as giving rise to an asset (e.g. financial engineering instruments). This issue has been addressed in the final accounts on receipt of information from Member States in June 2011 — see paragraph 1.32). The Commission has proposed to amend the current legal framework and will make appropriate proposals for the post-2013 period.</p>
<p><b>3. Disclosures concerning recoveries and financial corrections</b></p> <p>Although the Commission has taken steps to increase and improve the information it provides on the corrective mechanisms applied to the EU budget, the information is not yet completely reliable because the Commission does not always receive reliable information from Member States.</p>	<p><b>Disclosures concerning recoveries and financial corrections</b></p> <p>The Commission's on-the-spot controls showed that the systems for recording and reporting data are not yet completely reliable in all Member States. The Commission followed up any inconsistencies in these data and made recommendations to Member States for improvements.</p>	<p><i>Disclosures concerning recoveries and financial corrections</i></p> <p><i>The reliability of data on recoveries received from Member States has improved in comparison to last year, but the Commission agrees it should be further improved. To this effect the Commission has launched beginning of 2011 an audit of the Member States' systems for recoveries, based on the reporting made each year as at 31 March with the objective to improve reporting of national financial corrections to the Commission, and ensure completeness, accuracy and timeliness of reporting.</i></p>	<p><b>Disclosures concerning recoveries and financial corrections</b></p> <p>The Court will continue to follow up on the issues identified. It maintains its position that, wherever it is possible, a reconciliation between errors and related recoveries and/or financial corrections should be provided.</p>

Observations raised in prior years	Progress made	Commission reply	Court analysis
<p>Furthermore, the need to refine the financial reporting guidelines pertaining to what information is to be included and how it should be treated should be examined.</p> <p>For some areas of expenditure, the Commission does not provide information reconciling the year in which the payment concerned is made, the year in which the related error is detected and the year in which the resulting financial correction is disclosed in the notes to the accounts.</p> <p>At year-end 2009, for Cohesion, a total amount of 2,3 billion euro still remained to be implemented (i.e. 'cashed' through the receipt of a repayment by the Commission or the deduction by the member state from payment claims).</p>	<p>Regarding the Court's request to improve the guidelines on disclosure on recoveries and financial corrections, the Commission has issued a closure instruction which, however, should be further improved.</p> <p>Information reconciling payments, errors and financial corrections is not yet presented.</p> <p>In 2010, for Cohesion, the amount not yet implemented has increased by some 0,2 billion euro (i.e. the amounts confirmed/decided but not yet implemented increased from 2 327 million euro in 2009 to 2 516 million euro in 2010). The low implementation rate of 71 % is explained by the ongoing closure process. Payment claims received end 2010 are not yet authorised, which means that the related financial corrections for a total amount of 2,3 billion euro cannot be taken into account in the 2010 implementation figures (see note 6 to the 2010 accounts, Section 6.3.3 'financial corrections — cumulative figures and implementation rate').</p>	<p><i>The Commission will continue to improve the closure guidelines and instructions for the 2011 closure.</i></p> <p><i>The Commission makes controls on all expenditure several years after the actual year of a given payment, primarily at programme closure. Also the financial correction may be the result of the detection of weaknesses in the control systems of Member States, in which case no direct link exists with payments. As a consequence it is neither possible nor relevant to reconcile the year of the payment concerned with the year the financial correction is disclosed in the notes to the accounts.</i></p> <p><i>The supporting documentation to be provided by the Member State at programme closure is defined in the legal framework. All supporting evidence regarding expenditure and audits are kept available to the Commission by the managing authority of the operational programme.</i></p> <p><i>For some 2000-2006 programmes, it comes out from both the Court and the Commission's results that doubts existed about the completeness and reliability of recorded and reported figures on withdrawals and recoveries. Even if improvements have been identified in all Member States over the years 2007-2010 by the Commission audits, the Commission remains prudent at closure and requested from all programmes authorities to report on the follow-up (including financial corrections) that was given at national level to all irregularities registered in the debtor's ledger for each programme. The Commission will not close programmes until it assesses this information as coherent and complete.</i></p> <p><i>For the 2007-2013 regulatory framework, by 31 March of each year the Certifying Authority must send to the Commission a statement in relation to the preceding year, on financial corrections. These new reporting provisions system bring more reliable and uniform information in electronic format (via SFC 2007) on corrections carried out. Moreover, DG REGIO and DG EMPL have revised their audit strategies to include a specific module to audit the most risky national systems for recoveries, starting the second half of 2011.</i></p> <p><i>The Commission maintains its view that due to the multiannual character of the corrective systems for shared management programmes (financial corrections not always implemented the same year of their acceptance by the Member States), a reconciliation of payments, errors and financial corrections brings very little added value. Moreover, as the expenditure declaration system is cumulative over a multiannual period and in some cases they are system corrections, such reconciliation is nearly impossible.</i></p>	

Observations raised in prior years	Progress made	Commission reply	Court analysis
<p>Although the explanatory notes to the consolidated accounts contain information that some payments are likely to be corrected at a later date by the Commission's services or the Member States, the amounts and areas of expenditure which may be subject to further verification and clearance of accounts procedures are still not identified in the notes.</p>	<p>Amounts subject to further verification and clearing are not yet disclosed in the notes to the consolidated accounts (contrary to quantifiable amounts of potential recoveries).</p>	<p>As replied in previous years, the Financial Regulation allows the Commission to make controls on all expenditure for several years after the actual year of expenditure. The accounts should not imply that, because of controls in future years, all the expenditure concerned remains to be accepted. Otherwise, all budgetary expenditure would be considered provisional until an ex post check is made or the said limitation period has lapsed. Where the amounts of potential recoveries are quantifiable, they are disclosed in note 6 to the consolidated accounts. In agriculture, a financial clearance decision is taken around 6 months after the end of the financial year in question, through which the Commission establishes the amount of expenditure recognised as chargeable to the EU budget for that year. This role of the financial clearance decision is not called into question by the fact that subsequently financial corrections may be imposed on Member States through conformity decisions. The amount of expenditure which is likely to be excluded from EU financing by such future conformity decisions is disclosed in a note to the financial statements.</p> <p>Both quantifiable amounts of potential recoveries by the Member States and the amount of expenditure which is likely to be excluded from financing by future conformity decisions are booked as an asset (or disclosed as a contingent asset) in the Commission's accounting system and in a note to the financial statements.</p> <p>The Commission considers that, for agriculture, the information on recoveries which it receives from Member States is reliable because it is certified by independent audit bodies.</p> <p>In Agriculture, the conformity decisions identify, for each financial correction, the year in which the payment concerned by that correction was made.</p> <p>Financial reporting in agriculture includes information on recoveries made by the Member States as well as corrections made by the Commission, on the amount of corrections decided per financial year and per calendar year, on the financial implementation of these corrections as well as on the corresponding amounts cashed, for EAGF as well as for Rural Development.</p>	



Observations raised in prior years	Progress made	Commission reply	Court analysis
<p><b>4. Transfer of assets of Galileo</b></p> <p>The agreements for the transfer to the Union of the ownership of all assets created, developed or acquired for the Galileo programme are not yet fully implemented. As all expenditure incurred so far is treated as research expenses there is no impact on the balance sheet. However, the Commission should ensure that all information is available at the time when the transfer takes place in order to safeguard assets effectively.</p>	<p><b>Transfer of assets of Galileo</b></p> <p>The Commission is working with the European Space Agency to ensure that at the time of the transfer all the necessary accounting and technical information will be available to guarantee a smooth handover. This transfer is foreseen at the end of the in orbit validation phase, expected to be in 2012.</p> <p>However, the Court draws attention to the reservation made by the responsible Director-General in his 2010 annual activity report concerning the reliability of the financial reporting by the European Space Agency.</p>	<p><b>Transfer of assets of Galileo</b></p> <p><i>The Commission is closely monitoring the progress made by the European Space Agency on the implementation of its new accounting system and on the consequent improvement of their financial reporting.</i></p>	<p><b>Transfer of assets of Galileo</b></p> <p>The Court will follow up on this issue.</p>



## CHAPTER 2

**Revenue**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

2.1. This chapter presents the Court's specific assessment of Revenue which comprises own resources and other revenue. Key financial information on Revenue in 2010 is provided in **Table 2.1**. Own resources constitute by far the main source of financing of budgetary expenditure (93,8 %). The chapter also includes a summary of how the Commission has responded to the findings of the Court's Special Report No 2/2008 concerning Binding Tariff Information.

Table 2.1 — Revenue — Key information

Budget Title	Type of Revenue	Description	Revenue 2010	
			million euro	%
1	Traditional own resources (TOR)	Sugar production charge (Chapter 11)	145	0,1
		Customs duties (Chapter 12)	15 514	12,1
	VAT-based own resources	VAT (Value Added Tax)-based resources from the current financial year (Chapter 13)	13 393	10,5
		GNI-based own resources	GNI (Gross National Income)-based resources from the current financial year (Chapter 14)	90 948
	Correction of budgetary imbalances	UK correction (Chapter 15)	- 128	- 0,1
	Gross reduction in the annual GNI-based contribution	Granted to the Netherlands and Sweden (Chapter 16)	- 3	0,0
<b>TOTAL OWN RESOURCES</b>			<b>119 869</b>	<b>93,8</b>
3		Surpluses, balances and adjustments	1 460	1,1
4		Revenue accruing from persons working with the Institutions and other Community bodies	1 123	0,9
5		Revenue accruing from the administrative operation of the Institutions	388	0,3
6		Contributions and refunds in connection with Community agreements and programmes	3 511	2,7
7		Interest on late payments and fines	1 408	1,1
8		Borrowing and lending operations	—	0,0
9		Miscellaneous revenue	36	0,0
<b>TOTAL OTHER REVENUE</b>			<b>7 926</b>	<b>6,2</b>
<b>Total revenue for the year</b>			<b>127 795</b>	<b>100,0</b>

Source: 2010 Accounts of the European Union.

## THE COURT'S OBSERVATIONS

**Specific characteristics of Revenue**

2.2. There are three categories of own resources <sup>(1)</sup>: traditional own resources (customs duties collected on imports and sugar production charge — TOR), own resources calculated on the basis of value added tax (VAT) collected by Member States, and own resources derived from Member States' gross national income (GNI).

2.3. TOR are established and collected by the Member States. Three quarters of these amounts are paid to the Union budget, the remaining quarter being retained to cover collection costs. Each Member State sends the Commission a monthly statement of established duties (the 'A accounts') and a quarterly statement of those established duties which are not included therein (the 'B accounts') <sup>(2)</sup>.

2.4. The VAT- and GNI-based own resources are contributions resulting from the application of uniform rates to Member States' notionally harmonised VAT assessment bases or to the Member States' GNI respectively.

2.5. Certain Member States benefit from a reduced call rate for VAT <sup>(3)</sup> and a gross reduction in their annual GNI contribution <sup>(4)</sup> for the period 2007-2013. In addition, the United Kingdom is granted a correction in respect of budgetary imbalances ('the UK correction') which involves a reduction in its payments of GNI-based own resources.

2.6. After taking into account the total of TOR, VAT-based own resources and other revenue, the GNI-based own resources are used to balance the budget. Any understatement (or overstatement) of GNI for particular Member States — while not affecting the overall GNI-based own resources — has the effect of increasing (or decreasing) the contributions from the other Member States, until the problem is corrected.

<sup>(1)</sup> See Council Decision 2007/436/EC, Euratom of 7 June 2007 on the system of the European Communities' own resources (OJ L 163, 23.6.2007, p. 17), and Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources (OJ L 130, 31.5.2000, p. 1), as last amended by Regulation (EC, Euratom) No 105/2009 (OJ L 36, 5.2.2009, p. 1).

<sup>(2)</sup> When duties or levies remain unpaid and no security has been provided, or they are covered by securities but have been challenged, Member States may suspend making these resources available by entering them in these separate accounts.

<sup>(3)</sup> Germany, the Netherlands, Austria and Sweden.

<sup>(4)</sup> The Netherlands and Sweden.

## THE COURT'S OBSERVATIONS

**Audit scope and approach**

2.7. **Annex 1.1, Part 2**, describes the Court's overall audit approach and methodology. For the audit of Revenue, the following specific points should be noted:

- (a) The audit involved examination at the Commission level of a representative statistical sample of 55 recovery orders covering all types of Revenue (see **Annex 2.1**).
- (b) The assessment of systems covered the
  - (i) systems for TOR, VAT-based and GNI-based own resources;
  - (ii) Commission systems underlying the calculation of the UK correction (including an examination of the calculation of the definitive amount for 2006);
  - (iii) systems for waivers of the amounts which are the subject of recovery orders, based on a sample of 19 waivers (amounting to a total of 11 million euro) authorized by the Commission <sup>(5)</sup> in 2010 out of a total of 22 million euro;
  - (iv) Commission's management of fines and penalties.
- (c) The review on Commission management representations covered the Annual Activity Report of DG BUDG.

*Traditional own resources*

2.8. The Court's audit of transactions underlying the accounts cannot cover undeclared imports or those that have escaped customs surveillance.

2.9. The Court carried out an assessment of supervisory and control systems in Italy, the Netherlands and the United Kingdom which contribute around 38 % of the total of TOR. It reviewed their accounting systems and examined the flow of TOR from establishment to declaration to the Commission in order to obtain reasonable assurance that the amounts

<sup>(5)</sup> EuropeAid Cooperation Office (AIDCO) which will become EuropeAid Development and Cooperation Directorate-General (DG DEVCO) in 2011, Directorates-General Competition (COMP) and Energy (ENER).

## THE COURT'S OBSERVATIONS

recorded were accurate and complete. The auditors carried out testing of key controls relating to the application of preferential duty rates, the granting of the 'super simplification' for users of Local Clearance Procedures (notification waiver) <sup>(6)</sup> and the treatment of freight and insurance costs in these Member States.

2.10. In addition, for the six TOR recovery orders included in the sample referred to in paragraph 2.7 the Court reconciled the selected monthly statement with the underlying accounting records of the Member State concerned <sup>(7)</sup>.

2.11. The Court also assessed the supervisory and control systems at the Commission including its inspections in Member States.

*VAT- and GNI-based own resources*

2.12. VAT- and GNI-based own resources are based on statistical data, for which the underlying transactions cannot be audited directly. For this reason the audit took as its starting point the receipt by the Commission of the macroeconomic aggregates prepared by the Member States, and then assessed the Commission's systems for processing the data in order to determine the amounts to be included in the final budgetary accounts. The Court thus examined the drawing up of the budget and the correctness of the contributions by Member States.

2.13. The Court assessed the Commission's supervisory and control systems which are intended to provide reasonable assurance that these resources are correctly calculated and collected. The audit also covered the Commission's management of VAT and GNI reservations, its verification of GNI inventories in the Member States and its monitoring of the application of the VAT directives. The Court's audit does not provide a judgement on the quality of VAT and GNI data received by the Commission from Member States.

<sup>(6)</sup> Article 266(2) of the Customs Code Implementing Provisions: 'On the condition that checks on the proper conduct of operations are thereby not affected, the customs authorities may: [...] (b) in certain special circumstances, where the nature of the goods in question and the rapid turnover so warrant, exempt the holder of the authorization from the requirement to notify the competent customs office of each arrival of goods, [...]', Commission Regulation (EEC) No 2454/93 (OJ L 253, 11.10.1993, p. 1), as last amended by Regulation (EU) No 430/2010 (OJ L 125, 21.5.2010, p. 10).

<sup>(7)</sup> Belgium, Czech Republic, Germany, France, the Netherlands and Sweden.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**REGULARITY OF TRANSACTIONS**

2.14. **Annex 2.1** contains a summary of the results of transaction testing. The Court's testing of its sample of transactions found them to be free from a material level of error <sup>(8)</sup>. The most likely error estimated by the Court is 0 %. However, some systems weaknesses relating to transaction testing were observed and are set out below.

**Traditional own resources**

2.15. The Court found that overall the Member States' A accounts' statements sent to the Commission were free from material error. However, for one transaction <sup>(9)</sup> out of the six audited, it was not possible to reconcile the amount of TOR declared with the underlying accounting records.

**VAT- and GNI-based own resources**

2.16. The Court's audit found the calculation of Member States' contributions and their payment to be free from material error. However, the Court detected an error in the Commission's calculation of the 2006 definitive amount <sup>(10)</sup> of the UK correction entered in the 2010 budget, resulting in an excessive correction granted to the United Kingdom of 189 million euro (3,5 % of UK correction 2006) (see **Annex 2.5**, in particular its paragraphs 6 and 7). In order to correct the error the Commission has exceptionally proposed to amend the 2011 budget, in agreement with all Member States.

**Other revenue**

2.17. The Court found that overall the transactions tested in respect of other revenue were free from material error.

**EFFECTIVENESS OF SYSTEMS**

2.18. **Annex 2.2** contains a summary of the results of the examination of systems. The Court found that overall systems were effective in ensuring the regularity of transactions.

**2.15.** *The Commission is following up this issue with the Member State authorities.*

**2.16.** *Given the remedial action underway the impact of the error will be non material.*

<sup>(8)</sup> The Court calculates its estimate of error from a representative statistical sample. For the audit of Revenue, the Court has 95 % confidence that the rate of error in the population lies below 2 %.

<sup>(9)</sup> A monthly statement of Belgium. This Member State accounted for 9,5 % of total TOR in 2010.

<sup>(10)</sup> The definitive calculation of the UK correction of year n is entered in the budget of year n+4.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Traditional own resources**

2.19. As in previous years <sup>(1)</sup>, the Court detected problems in the procedures and systems which affect the amounts included in the B accounts' statements. These concern in particular:

- (a) unjustified entries (guaranteed and unchallenged cases) and write-offs <sup>(2)</sup>;
- (b) delays in the establishment of TOR, in the entry into the accounts and/or in the notification of the customs debts <sup>(3)</sup>;
- (c) belated starting of recovery actions to collect the amounts receivable <sup>(4)</sup>.

2.20. The national authorities of Italy, the Netherlands and the United Kingdom were not able to fully justify the amounts reported in the B accounts' statements, because they did not match the underlying documents.

2.21. In the Member States visited the Court's audit also revealed deficiencies in the performance of checks before the release of goods, in particular concerning the application of preferential duty rates, the granting of the 'super simplification' for users of Local Clearance Procedures and the treatment of freight and insurance costs. Partially effective national customs supervision increases the risk that incorrect amounts of TOR are collected.

**VAT-based own resources**

*Long-outstanding reservations still exist but the backlog is being cleared*

2.22. Reservations are a means to keep doubtful elements in the VAT statements submitted by Member States open for correction after the statutory time-limit of four years. In 2010, 52 reservations were placed and 67 were lifted. At the end of the year, a total of 152 were in place (see **Table 2.2**). The net effect of the lifting of the 67 reservations was to increase VAT-based own resources by almost 90 million euro <sup>(5)</sup>.

**2.19.** *The Commission will request the Member States concerned to take remedial action to address the shortcomings found and where necessary Traditional Own Resources underpaid will be requested as well as any late payment interest due. The Commission will continue to examine the B-account in the course of its regular inspections.*

**2.20.** *The findings of the Court will be followed up by the Commission taking account of the Member States replies to them. It will request that the Member States concerned take remedial action, if appropriate.*

**2.21.** *The Commission will follow up the Court's findings with the Member States concerned having due regard to their replies to those findings. Where necessary the Member States will be requested to take remedial action and to make available any outstanding amounts of Traditional Own Resources that are due. Late payment interest will also be sought, where applicable. In recent years the Commission's inspections of Traditional Own Resources have especially focused on Member States' customs controls including those for the Local Clearance Procedure.*

<sup>(1)</sup> For example paragraph 2.20 of the 2009 Annual Report.

<sup>(2)</sup> The United Kingdom.

<sup>(3)</sup> Italy, the Netherlands and the United Kingdom.

<sup>(4)</sup> The United Kingdom.

<sup>(5)</sup> This is made up of an increase of around 105 million euro, and a decrease of nearly 15 million euro.

## THE COURT'S OBSERVATIONS

2.23. The Court noted good progress in the lifting of long-outstanding VAT reservations. Eight of these were still in place at the end of 2010 covering years prior to 2000, compared to 20 at the end of 2009. The Court considers that long-outstanding reservations should be defined as those reservations relating to a year at least ten years previously. This adds a further eight reservations which concern 2001.

## THE COMMISSION'S REPLIES

2.23. As neither the Commission nor Member States can take action to resolve a matter that has not been identified the Commission considers that any definition of a long-outstanding reservation should take account of the period since the reservation was notified. Thus the Commission monitors as long outstanding those reservations which remain unresolved more than five years after notification.

Table 2.2 — VAT reservations as at 31.12.2010

Member State	Number of reservations outstanding at 31.12.2009	Reservations set in 2010	Reservations lifted in 2010	Number of reservations outstanding at 31.12.2010	Oldest year to which reservations apply
Belgium	3	0	3	0	
Bulgaria	1	1	0	2	2007
Czech Republic	9	0	1	8	2004
Denmark	5	5	1	9	2004
Germany	4	0	3	1	2003
Estonia	8	4	3	9	2004
Ireland	17	1	8	10	1998
Greece	11	0	4	7	1999
Spain	2	1	2	1	2003
France	10	0	4	6	2001
Italy	9	5	6	8	1995
Cyprus	3	3	0	6	2004
Latvia	5	2	1	6	2004
Lithuania	7	0	5	2	2005
Luxembourg	3	0	1	2	2004
Hungary	4	1	1	4	2004
Malta	10	0	0	10	2004
The Netherlands	7	4	3	8	2004
Austria	5	1	0	6	2002
Poland	6	1	1	6	2004
Portugal	10	8	4	14	1999
Romania	0	0	0	0	
Slovenia	3	0	3	0	
Slovakia	3	0	3	0	
Finland	10	1	3	8	1995
Sweden	7	9	6	10	1995
United Kingdom	5	5	1	9	1998
<b>TOTAL</b>	<b>167</b>	<b>52</b>	<b>67</b>	<b>152</b>	

Source: European Commission.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Delays in the monitoring of the application of the VAT directives*

2.24. The Commission is responsible for ensuring the correct application of the VAT directives and should monitor the transposition and the conformity of the national implementing measures put in place by Member States. An incorrect or incomplete transposition could affect the amount of VAT received and thus the amount payable in VAT-based own resources. In 2010, three VAT directives came into effect: two concerning the 'VAT package' <sup>(16)</sup> and one relating to the common system of VAT to combat tax evasion for intra-Community transactions <sup>(17)</sup>.

2.25. For seven Member States, the Commission's assessment of national implementing measures of the 'VAT package' was still ongoing at the end of 2010, 12 months after the directives entered into force. By the same date, the Commission's assessment procedure of the implementation of the VAT directive on combatting tax evasion had only started in respect of two Member States.

**2.25.** *As of 16 May 2011, the Commission's monitoring resulted in a completed overall assessment for the whole VAT Package for 22 Member States. The assessment of the 5 remaining Member States is still ongoing and will be finalised by September 2011.*

*Concerning the VAT directive on combating tax evasion, the Commission launched infringement cases in March 2010 for nine Member States in order to be in the position to make a proper assessment.*

*In the course of 2009 and 2010 the Commission raised and discussed the problem of another two Member States in the ATFS (Anti Tax Fraud Strategy Group) and SCAC (Standing Committee on Administrative Cooperation). A full assessment will therefore be available by the end of 2011.*

<sup>(16)</sup> Council Directive 2008/8/EC of 12 February 2008, amending Directive 2006/112/EC as regards the place of supply of services (OJ L 44, 20.2.2008, p. 11), and Council Directive 2008/9/EC of 12 February 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State (OJ L 44, 20.2.2008, p. 23).

<sup>(17)</sup> Council Directive 2008/117/EC of 16 December 2008, amending Directive 2006/112/EC on the common system of value added tax to combat tax evasion connected with intra-Community transactions (OJ L 14, 20.1.2009, p. 7).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**GNI-based own resources***General and specific reservations*

2.26. General reservations<sup>(18)</sup> existed at the end of 2010 on GNI data of EU-15 Member States for the period 2002 to 2006, and on EU-10 Member States for the period 2004 to 2006, pending the completion of the analysis of the updated or new GNI inventories<sup>(19)</sup>.

2.27. At the beginning of 2010, there were four<sup>(20)</sup> open specific GNP reservations<sup>(21)</sup> relating to the period 1995 to 2001. During 2010, the Commission did not lift any of these. As no additional specific reservations were set, the number of outstanding specific reservations at the year-end is unchanged.

*Verification of GNI inventories in the Member States not yet complete*

2.28. In 2010, the Commission carried out visits in six Member States to verify GNI inventories and performed direct verification in four of these, but restricted to a very small number of GNI components. As set out in Eurostat guidelines, this direct verification approach is not normally expected to draw conclusions on all parts of GNI estimates.

2.29. At the end of 2010, Eurostat had not prepared any assessment reports on GNI data of Member States for the period 2002 onwards and could not therefore replace any general reservations (see paragraph 2.26) with specific reservations concerning these years.

**2.27.** *The Commission is continuing its cooperation with the two countries that still have GNP reservations for the period 1995-2001 (1 for Greece and 3 for United Kingdom at end 2010) so that these reservations can be lifted. As a result of these efforts, one reservation for the United Kingdom was lifted in May 2011.*

**2.28.** *For the remaining two countries, direct verification was performed in April 2011 in Romania, and is planned at the end of 2011 in Bulgaria. The Commission conducts direct verification to supplement its verification of the countries' GNI Inventories based on the GNI Inventory Assessment Questionnaire (GIAQ). The Commission's conclusions are based on this complete verification approach. The Commission considers that the number of components it had selected was appropriate for the purposes of direct verification, in accordance with the 'Guidelines for direct verification' approved by the GNI Committee.*

**2.29.** *The Commission will present the assessment reports in 2011 so that the general reservations can be replaced with specific reservations where appropriate, with the possible exception of Bulgaria and Romania which transmitted their GNI inventories at end 2009 according to the timetable agreed in the GNI Committee.*

<sup>(18)</sup> Article 10(7) of Regulation (EC, Euratom) No 1150/2000, as amended, states that, after 30 September of the fourth year following a given financial year, any changes to GNP/GNI shall no longer be taken into account, except on points notified within this time limit either by the Commission or by the Member State. These points are known as reservations. A general reservation covers all the data of a Member State. All GNI data of Bulgaria and Romania are open in accordance with the four-year rule.

<sup>(19)</sup> In accordance with Article 3 of the Council Regulation (EC, Euratom) No 1287/2003 (OJ L 181, 19.7.2003, p. 1), Member States shall provide the Commission (Eurostat) with an inventory of the procedures and statistics used to calculate GNI and its components according to ESA 95.

<sup>(20)</sup> These open reservations concern Greece (1) and the United Kingdom (3) and mainly relate to methodological and compilation aspects.

<sup>(21)</sup> A specific reservation covers discrete elements of GNI (GNP until 2001) such as gross value added of selected activities, total final consumption expenditure or gross operating surplus and mixed income.

## THE COURT'S OBSERVATIONS

2.30. Supervisory and control systems in the National Statistical Institutes (NSI) of Member States should help ensure the comparability, reliability and exhaustiveness of GNI data <sup>(22)</sup>. However, Eurostat has not yet completed its assessment of the supervisory and control systems in the NSI and has not yet adopted guidelines on the application of these systems for the compilation of National Accounts in Member States.

**UK correction**

2.31. In its calculation of the UK correction for reference years from 2007 to 2009 the Commission did not include around 2 % of total payments of EU funds in the figure for total allocated expenditure, a basic element in the calculation of the correction. The Commission excluded these sums because information on where the expenditure was made was not available. The Commission did not check whether this expenditure could have been allocated for the purposes of the calculation (see **Annex 2.5**, in particular its paragraphs 3 to 5 and 10 to 11).

2.32. The Court also noted that in its definition of 'actual payments' for calculating total allocated expenditure the Commission:

- (a) does not include expenditure financed by assigned revenue (earmarked expenditure) which increased significantly from 2007 to 2009, from 1 % to 5 % of total payments from the budget;
- (b) does not deduct from allocated expenditure amounts covered by recovery orders cashed, notably relating to Budget Title 6 'Contributions and refunds in connection with Community agreements and programmes': receipts from this source varied between 3 % and 5 % of payments over the same period.

The consideration of the above-mentioned budgetary transactions would allow the allocation of expenditure to respect the 'substance over form' principle (see **Annex 2.5**, in particular its paragraphs 3 to 5 and 10 to 11).

2.33. The omissions noted in the previous two paragraphs reduce the precision of the calculation of the UK correction. It is not possible to say in which direction they affect the result of the calculation.

## THE COMMISSION'S REPLIES

**2.30.** *The Commission considers that the approach it applies (desk checks of the GNI Questionnaires, the verification of GNI Inventories using the GLAQ supplemented by a direct verification) is appropriate for a final assessment of the Member States' GNI. The Commission considers that the reliability of national accounts depends primarily on the specific statistical sources and methods used and has based its approach to GNI validation on their verification and improvement. In this context, the supervisory and control systems (SCS) in the national statistical institutes of Member States are of an organisational nature and give no specific indication of the reliability of the accounts, even though SCS help mitigate the risks of errors in national accounts. The Commission has already taken account of the Court's observations, and has pursued its efforts to develop guidelines on SCS with a further discussion on the issue by the GNI Committee meeting on 27 October 2010.*

**2.31.** *Attempts to reach 100 % accuracy would be cumbersome in terms of resource effectiveness as it would require manual case-by-case scrutiny of thousands of transactions.*

**2.32.**

- (a) *External assigned revenue (normally around one third of the total) should not be included. The Commission notes that in 2010 the percentage of expenditure financed by assigned revenue returned to its 2007 level.*
- (b) *Ideally these fund sources should be deducted from the expenditure allocated to the beneficiary country but this information is not available other than manually plus there will always be a risk of double-counting. As already remarked there are thousands of such transactions and the process would be very resource-intensive.*

*But only at a cost the Commission finds unjustifiable.*

<sup>(22)</sup> See paragraph 2.28 of the 2009 Annual Report.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Waivers of amounts to be recovered**

2.34. According to the Financial Regulation's implementing rules<sup>(23)</sup>, recovery orders may be waived in cases where the foreseeable cost of recovery would exceed the amount to be recovered, where the amount receivable cannot be recovered in view of its age or of the insolvency of the debtor and where the recovery is inconsistent with the principle of proportionality. The waiver decision must be substantiated.

2.35. The audit of the systems for waivers revealed that in general the Commission applied the procedures set for waiving recovery orders and substantiated the decisions taken. However, the Court found weaknesses in the Commission's management during the period 1995-2008 which increased the risk that the amounts receivable are not recovered. For each of the waiver cases below, one or more weaknesses were identified (Examples 2.1, 2.2 and 2.3).

**Example 2.1****Evaluation of the contractors' financial capacity**

In one case (amounting to about 500 000 euro) relating to the award of a FP5 (5th framework programme on research) grant, the capacity of a company to generate profit in its business was assessed to be negative. However, the Commission did not consider that financial guarantees were necessary to be able to conclude a grant agreement. The eventual waiver was made because the company was declared bankrupt.

In a further 15 cases (6 million euro) relating to grant-awarding procedures for FP5 and external actions, the Commission could not provide evidence that it assessed the financial capacity of applicants. In eight of these cases, waivers were made due to the insolvency of beneficiaries.

2.35. Many of the delays in the establishment of recoveries are due to unavoidable audit and legal processes. The Commission believes that its management has had no material negative impact on the actual recovery of amounts receivable.

**Example 2.1****Evaluation of the contractors' financial capacity**

The case evoked by the Court dates back to 2001 and since then the financial viability checks have significantly improved since they were devised for FP5. More complex ratios were used for FP6 and are being used for FP7. In addition, the Commission adopted rules to ensure consistent verification of the existence and legal status of participants, as well as their operational and financial capacities (Commission Decision C(2007) 2466 of 13 June 2007), which are followed by the DGs concerned.

The Commission considers that the necessary measures are now in place to minimise the risk of a similar situation occurring.

Since the mandatory use of the Call for Proposals mechanism in 2003, the system for assessment of financial capacity of applicants has been reinforced and standardised. Grant applicants are now required to demonstrate that they have stable and sufficient sources of funding to maintain activity throughout the period during which the action is carried out and to participate in its funding, on the basis of supporting documents.

<sup>(23)</sup> Article 87 of Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 357, 31.12.2002, p. 1), as last amended by Regulation (EC, Euratom) No 478/2007 (OJ L 111, 28.4.2007, p. 13).

## THE COURT'S OBSERVATIONS

## Example 2.2

**Contract management**

The coordinator of the FP5 contract referred to above did not distribute the prefinancing payment to the other contractors responsible for the implementation of the project. The Commission did not ensure that the contractual conditions concerning the distribution of prefinancing were fulfilled. A large part of these funds could not be recovered and the amount receivable (500 000 euro) was waived, because of the bankruptcy of the coordinator three years later.

In another case (145 000 euro) concerning the European Community Investment Partners (ECIP) financial instrument, extended periods (1998-2005) of administrative inaction in the Commission's management of the contract were noted.

## THE COMMISSION'S REPLIES

## Example 2.2

**Contract management**

*There had been administrative delays on the ECIP programme prior to 2005, since when EuropeAid's comprehensive liquidation process has recovered 35 million euro on 600 actions. For the case cited, 2/3 of the amount owed was recovered (by offsetting) and 145 000 euro was waived mainly because, despite repeated attempts since 2005 to establish the status of these files, it could not be established with certainty who had inherited the bank's responsibility following a consortium takeover.*

## Example 2.3

**Establishment of recovery orders and recovery procedures**

In five waiver cases (2,5 million euro) there were unjustified delays in the establishment of recovery orders and/or in the starting of recovery procedures. These cases related to FP5 (1) and external actions (4), and the waivers were made due to insolvency of the debtor.

In the above-mentioned case relating to the ECIP financial instrument the Commission did not take into account all the possibilities to offset.

## Example 2.3

**Establishment of recovery orders and recovery procedures**

*Many of the delays in the establishment of recoveries are due to unavoidable audit and legal processes. The Commission believes that its management has had no material negative impact on the actual recovery of amounts receivable.*

*Also, the internal procedures have improved as regards the timely issuing of debit notes.*

*In the ECIP case a potential additional offsetting was technically not possible in 2008 due to end of year accounting procedures.*

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

2.36. *Annex 2.3* contains a summary of the results of the review of Commission management representations. The Court describes significant observations in further detail below.

## THE COURT'S OBSERVATIONS

2.37. The significant system weakness revealed by the Court's audit on the reliability of the accounts for TOR in one Member State (see paragraph 2.15) was also found by the Commission's inspection work. The Court considers that this weakness should have been mentioned in the Annual Activity Report of DG BUDG.

2.38. The error which the Court detected in the Commission's calculation of the 2006 definitive amount of the UK correction (see paragraph 2.16) is described in the Annual Activity Report of DG BUDG, which sets out the additional control measures put in place subsequently. However, taking into account the Commission's own materiality criteria, in the Court's view a reservation should have been made in the declaration of assurance of the Director-General of DG BUDG.

## CONCLUSIONS AND RECOMMENDATIONS

### Conclusions

2.39. Based on its audit work <sup>(24)</sup>, the Court concludes that:

- (a) Member States' declarations and payments of TOR;
- (b) the Commission's calculation of Member States' contributions on the basis of the VAT and GNI data received from Member States; as well as
- (c) other revenue;

for the year ended 31 December 2010 were free from material error.

## THE COMMISSION'S REPLIES

**2.37.** *The problems in this Member State's accounting system have been closely followed up by the Commission since 2008. The Commission has carried out altogether three dedicated TOR inspections on this issue, one in 2008 and two in 2009 and has requested remedial action including the enhancement of internal controls and full scale external audits of the accounting system. The progress made by the Member State will again be discussed in the July 2011 ACOR meeting in relation to the latest Commission's inspection report. As the weaknesses have already been observed previously, are being closely monitored by the Commission, and concern one Member State only with no TOR underpayment identified so far, the issue was not particularly mentioned in the 2010 Annual Activity Report.*

**2.38.** *In view of the correction which is underway, the final impact of the error will be below the Commission's materiality threshold in 2011.*

<sup>(24)</sup> For reasons explained in paragraphs 2.12 and 2.13, this conclusion does not provide an assessment of the quality of VAT or GNI data that were received by the Commission from Member States.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

2.40. Based on its audit work, the Court concludes that the supervisory and control systems were effective in ensuring the regularity of Revenue. However, the Court draws attention to the weaknesses set out below:

- (a) The Court's audits continue to reveal problems with the use of the B accounts (paragraph 2.19) and with the reliability of the A and B accounts' statements (paragraphs 2.15 and 2.20). Weaknesses were also found in national customs supervision (paragraph 2.21). The Court concludes that supervisory and control systems of Member States audited are only partially effective at ensuring that TOR recorded are complete and correct.
- (b) Long-outstanding reservations still exist (paragraph 2.23). The Court also found weaknesses in the Commission's monitoring of the Member States' application of the VAT directives examined (paragraph 2.25).
- (c) The Commission has not yet completed its verification of GNI inventories covering GNI data of Member States for the period 2002 onwards (paragraph 2.29), and has not yet lifted the remaining four open specific GNP reservations on the period 1995-2001 (paragraph 2.27).
- (d) There was an error in the definitive calculation of the 2006 UK correction<sup>(25)</sup> (see paragraph 2.16). There were weaknesses in the calculation of the correction for subsequent years (see paragraphs 2.31 to 2.33). The Court concludes that supervisory and control systems of the Commission are partially effective at ensuring that the UK correction is correctly calculated.

**2.40.**

- (a) *Where necessary, the Commission services will require the Member States concerned to take appropriate action to remedy the deficiencies found by the Court. It will continue to examine the B-account in the course of its regular inspections in order to minimise the number of these deficiencies. As mentioned at point 2.21, the Commission's recent inspections of Traditional Own Resources have focused on Member States' customs supervision and the Commission will continue to monitor that supervision in the course of its inspections.*
- (b) *The Commission actively seeks resolution of those remaining long-outstanding reservations which do not relate to infringement proceedings before the ECJ.*

*Concerning the VAT Package, the assessment of the 5 remaining Member States is still ongoing and the Commission expects to finalise it by September 2011. Concerning the VAT directive on combating tax evasion, the Commission, after having received the late notifications from Member States, is now in a position to finalise the full monitoring of the implementation by the end of 2011 via a report from the Commission to the Council. (see paragraph 2.25).*

- (c) *The Commission will present the assessment reports on Member States' GNI data in 2011 so that the general reservations can be replaced by specific reservations where appropriate. The Commission is continuing its cooperation with the two countries that still have GNP reservations for the period 1995-2001 so that these reservations can be lifted. As a result of these efforts, one reservation for the United Kingdom was lifted in 2011.*
- (d) *The supervisory and control system has been thoroughly revised following the detection of this error by the Court.*

*The Commission considers the methodology for calculating the allocated expenditure to be sufficiently robust to calculate the UK's share therein. The existence of these 'weaknesses' raised by the Court is the result of the assessment that the marginal cost of the search for further refinement in the calculation would not be cost-effective.*

<sup>(25)</sup> Moreover, in December 2009, the Commission detected an error in its calculation of provisional estimates of the UK correction for years 2008 and 2009, representing an overestimation of 138 million euro (2,6 %) and 458 million euro (13 %) respectively. See paragraph 2.17 of the 2009 Annual Report. The corrected amounts have been taken into account in the framework of the calculation of updated estimates of the UK correction, carried out in 2010 (before the definitive amounts will be calculated in 2012 and 2013).

## THE COURT'S OBSERVATIONS

- (e) The losses suffered by the budget relating to the waiver of amounts receivable might have been avoided or at least reduced if the Commission had been more proactive (paragraph 2.35).

**Recommendations**

2.41. **Annex 2.4** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. The following points should be noted:

- in the area of TOR, the Commission has made an assessment of weaknesses relating to simplified customs procedures for imports. The Court maintains its view concerning the entry into the B accounts of customs debts incurred on seized goods,
  
- concerning GNI-based own resources, the guidelines on communications of major statistical revisions are not always applied by Member States and no progress has been made in respect of the implementation of a common revision policy in the EU.

## THE COMMISSION'S REPLIES

- (e) *The Commission's Decisions relating to waivers have not been challenged by the Court. The underlying systems audited by the Court in relation to waivers relate overwhelmingly to a managerial and legislative context of over 10 years ago. Since this period, EuropeAid has been set up (2001), a new Financial Regulation put in place (2003), an IT based Common RELEX Information System established (2003) and the management of external aid has been devolved to delegations in the field (2004).*

**2.41.**

- *The Commission has made an assessment of the weaknesses relating to simplified customs procedures in its Annual Activity Report for 2010. It has also carried out inspections of the Customs Control Strategy in all Member States and has prepared a thematic report on the weaknesses found from these inspections and from the Court's audit. It has presented a draft of this report in the December 2010 ACOR meeting and a final version of the report will be discussed in the July 2011 ACOR meeting.*

*The Commission's position concerning the entry into the B accounts of customs debts incurred on seized goods differs from that of the Court of Auditors. The Commission has examined the rulings of the ECJ in Elshani (Case C-459/07) and Dansk Logistik (Case C-230/08) and concluded that its current position can be maintained.*

*See Commission's reply in Annex 2.4.*

- *Concerning own-resource GNI, the issue of revisions is addressed in document GNIC/085, and revisions to Member States' GNI are monitored via the annual quality reports in the context of the GNI Regulation. As for the CMFB<sup>(1)</sup> guidelines on communications of major statistical revisions, the Commission (Eurostat) will continue to stress the need for Member States to apply these guidelines, particularly at GNI Committee meetings. The Commission is pursuing discussions with the Member States in order to implement a common revision policy in the EU, taking into account the observations made by the Court.*

<sup>(1)</sup> Committee on Monetary, Financial and Balance of Payments Statistics.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

Following this review and the findings and conclusions for 2010, the Court recommends that the Commission:

- continues its efforts to ensure that B accounts are correctly used, that accounting systems allow A and B accounts' statements of Member States to be demonstrably complete and correct, and that national customs supervision is further strengthened (TOR),
- presents to the GNI Committee the assessment reports on GNI data of Member States so as to be able to replace in 2011 all existing general reservations with specific reservations for the period 2002 onwards. In the assessment of Member States' GNI, it should take into account the evaluation of supervisory and control systems in the NSI for the compilation of National Accounts and make clear the scope of the opinion it provides (GNI-based own resources).

- *The Commission will continue its examination of the B-accounts and of the accounting systems in the course of its inspections in order to ensure that the Statements by Member States of the A and B accounts are correct. As mentioned at point 2.21 the Commission's recent inspections of Traditional Own Resources have especially focused on Member States' customs controls and in the course of its future inspections it will continue to verify national customs supervision and Member States' action to strengthen it.*
- *The Commission will present the assessment reports in 2011 so that the general reservations can be replaced by specific reservations where appropriate. The Commission considers that the approach it applies (desk checks of the GNI Questionnaires, the verification of GNI Inventories using the GIAQ supplemented by a direct verification) is appropriate for a final assessment of the Member States' GNI. In this context, the supervisory and control systems (SCS) are of an organisational nature and give no specific indication of the reliability of the accounts, which depends primarily on the statistical sources and methods used, even though SCS may help mitigate the risks of errors in national accounts. The Commission will pursue its efforts to develop SCS guidelines for compilation of their national accounts by Member States, taking into account the observations made by the Court.*

## **FOLLOW-UP OF SPECIAL REPORT No 2/2008 CONCERNING BINDING TARIFF INFORMATION**

### **Introduction**

2.42. In 2008, the Court published its Special Report No 2/2008 concerning Binding Tariff Information (BTI) <sup>(26)</sup>. BTI is a tariff classification decision given in writing by the customs authorities of a Member State at the request of economic operators. It is legally binding on all EU customs authorities vis-à-vis the holder for up to six years from the date of issue.

2.43. Overall, the BTI system was found to be functioning well. Nevertheless improvements were needed.

<sup>(26)</sup> OJ C 103, 24.4.2008, p. 1.

## THE COURT'S OBSERVATIONS

2.44. In its 2007 discharge decision <sup>(27)</sup> the Parliament urged the Commission to endeavour to resolve the outstanding weaknesses and the tariff-classification disputes. The Council invited the Commission to further improve the BTI system and to monitor its implementation and application in the Member States but stressed that the possible financial responsibility of Member States, if any, should be assessed with the utmost caution <sup>(28)</sup>.

**Follow-up of the recommendations**

- (a) *Recommendation:* The Commission should reduce the delays in resolving inconsistent tariff classifications (paragraphs 43 and 44 of Special Report No 2/2008).

*Progress made:* The number of staff dealing with BTI matters has been increased and the delays noted in resolving inconsistent tariff classifications have been reduced.

- (b) *Recommendation:* The Commission should evaluate the full financial impact of incorrect BTI and update the European Binding Tariff Information (EBTI-3) database (paragraphs 45 and 46 of Special Report No 2/2008).

*Progress made:* The Commission was able to demonstrate that it was seeking to hold Member States accountable for losses resulting from the issue of incorrect BTI.

New functions were introduced in the EBTI-3 database to better respect the legal provisions. The user interface of the public EBTI-3 database is now translated into all EU official languages (except Maltese and Irish) and the Thesaurus is being progressively updated.

- (c) *Recommendation:* The legislation, complemented by the administrative guidelines of the Commission, should be strengthened (paragraph 47 of Special Report No 2/2008).

*Progress made:* The obligation for an importer to declare the BTI he has for the goods has been adopted <sup>(29)</sup> but will not be applicable until the IPMCC come into force. These provisions also aim to improve the management of the 'period of grace'.

## THE COMMISSION'S REPLIES

**2.44.****(b)**

*The Commission will continue to examine incorrect use of BTI that has a negative effect on Traditional Own Resources and, where appropriate, will hold the Member States financially responsible.*

<sup>(27)</sup> European Parliament Decision of 23 April 2009 on the discharge for implementation of the European Union general budget for the financial year 2007, section III — Commission.

<sup>(28)</sup> 2881st Council meeting, Luxembourg, 23 and 24 June 2008.

<sup>(29)</sup> Regulation (EC) No 450/2008 of the European Parliament and of the Council of 23 April 2008 laying down the Community Customs Code (Modernised Customs Code) (OJ L 145, 4.6.2008, p. 1).

## THE COURT'S OBSERVATIONS

- (d) *Recommendation:* The Commission should encourage Member States to correct weaknesses detected (paragraph 48 of Special Report No 2/2008).

*Progress made:* During its monitoring visits, the Commission has followed up the instances of non-compliance with legal requirements and the weaknesses reported by the Court.

**Conclusions**

2.45. The Commission has improved the BTI system and monitored its implementation and application in the Member States. However, the key remedial measures will only be effective when the IPMCC come into force and the Commission should continue its efforts to reduce the time taken to resolve classification issues.

## THE COMMISSION'S REPLIES

- (d) *The Commission has carried out full monitoring of Member States within the framework of the BTI management related procedures. That exercise began in mid 2007 and is still ongoing in the form of follow-up actions. In addition, the Commission intends to carry out 5 on-the-spot TOR inspections related to BTI in 2011.*

*The Commission is continuously monitoring the progress of the Member States and regularly addressing weaknesses in application of legal requirements.*

**2.45.** *The Commission takes note and continues in its efforts to speed up the resolution of classification issues.*

## RESULTS OF TRANSACTION TESTING FOR REVENUE

2010				2009	2008	2007
TOR	VAT/GNI, corrections under Budget Title 1	Other revenue	Total			

## SIZE AND STRUCTURE OF THE SAMPLE

Total transactions (of which):	6	43	6	55	62	60	66
recovery orders	6	43	6	55	62	60	66

RESULTS OF TESTING <sup>(1)</sup>

## Proportion of transactions tested found to be:

Free of error	100 %	(6)	100 %	(43)	100 %	(6)	100 %	(55)	95 %	100 %	100 %
Affected by one or more errors	0 %	(0)	0 %	(0)	0 %	(0)	0 %	(0)	5 %	0 %	0 %

## ESTIMATED IMPACT OF QUANTIFIABLE ERRORS

Most likely error rate <sup>(2)</sup>	0 %
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<sup>(1)</sup> Numbers quoted in brackets represent the actual number of transactions.

<sup>(2)</sup> As no material error was found, only the most likely error rate is presented.

## ANNEX 2.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR REVENUE

## Assessment of selected supervisory and control systems

System concerned	Key internal controls (Commission)			Key internal controls in Member States audited	Overall assessment
	Commission checks in Member States	Commission calculation / desk checks of amounts receivable	Commission management of reservations / budget implementation		
TOR	Effective	Effective	N/A	Partially effective	Effective
VAT/GNI	Effective	Effective	Effective	N/A	Effective
UK correction	N/A	Partially effective	N/A	N/A	Partially effective
Waivers	N/A	Effective	Effective <sup>(1)</sup>	N/A	Effective
Fines and penalties	N/A	Effective	N/A	N/A	Effective

N/A: Not applicable (does not apply or not assessed)

<sup>(1)</sup> For the waivers made in 2010, the Court found weaknesses in the Commission's management in prior years which increased the risk that amounts receivable are not recovered.

## Overall assessment of supervisory and control systems

Overall assessment	2010	2009	2008	2007
	Effective	Effective	Effective	Effective

## ANNEX 2.3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR REVENUE

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
BUDG	without reservations concerning own resources	N/A	<p>The significant system weakness revealed by the Court's audit on the reliability of the accounts for <b>TOR</b> in Belgium was also found by the Commission's inspection work. The Court considers that this weakness should have been mentioned in the Annual Activity Report of DG BUDG (see paragraph 2.37).</p> <p>The error which the Court detected in the Commission's calculation of the 2006 definitive amount of the <b>UK correction</b> is described in the Annual Activity Report of DG BUDG, which sets out the additional control measures put in place subsequently. However, taking into account the Commission's own materiality criteria, in the Court's view a reservation should have been made in the declaration of assurance of the Director-General of DG BUDG (see paragraph 2.38).</p>	B	A

N/A: Not applicable (does not apply)

(\*) By reference to the declaration of assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: the Director-General's declaration and the Annual Activity Report give a fair assessment of financial management in relation to regularity

B: the Director-General's declaration and Annual Activity Report give a partially fair assessment of financial management in relation to regularity

C: the Director-General's declaration and the Annual Activity Report do not give a fair assessment of financial management in relation to regularity



## RECOMMENDATION FOLLOW-UP TABLE FOR REVENUE

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2009	<p>In its 2009 Annual Report (paragraph 2.32), the Court drew attention to the audit results included in its Special Report No 1/2010 on simplified customs procedures for imports and reported that the Commission would need to take account of the conclusions from this report, together with the follow-up of its own findings from inspections of simplified procedures and Member States' control strategy, in its 2010 Annual Activity Report.</p>	<p>The Commission recognised that weaknesses existed in Member States customs controls on simplified procedures. However, taking into account its ongoing inspection action, the generally positive response by the Member States to the Court's findings and the overall low financial impact of the errors detected, the Commission considered that there was no need to make a reservation in the declaration of the Director-General (included in the Annual Activity Report of DG BUDG) on this issue.</p>	<p><i>The Commission has made an assessment of the weaknesses relating to simplified customs procedures in its Annual Activity Report for 2010. It is following up the action taken by the Member States in response to the findings of its own inspections and those of the Court's audits. Several Member States have already reported on the remedial action they have taken or are in the process of taking to address the control weaknesses found. This action will be verified in future inspections. The Commission has also carried out inspections of the Customs Control Strategy in all Member States and has prepared a thematic report on the weaknesses found from these inspections and from the Court's audit. It has presented a draft of this report in the December 2010 ACOR meeting. The Members States have been given time to furnish their observations on that draft and a final version of the report taking account of these observations will be discussed in the July 2011 ACOR meeting</i></p>	<p><b>The Court takes note of this Commission's assessment and will make its own analysis together with the follow-up of its special report on simplified customs procedures for imports.</b></p>

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2009	<p>In its 2009 Annual Report (paragraph 2.22), the Court took the view that debts incurred on goods seized after going beyond the first customs office situated inside the territory of the Community should be entered into the B accounts. This position, which was in line with the Court of Justice judgement of April 2009 (case number C-459/07), was not shared by the Commission.</p>	<p>The Commission analyzed the recent judgment of the Court of Justice (in April 2010) on a similar issue (case number C-230/08).</p>	<p><i>The Commission's position concerning the entry into the B accounts of customs debts incurred on seized goods differs from that of the Court of Auditors. The Commission position is based on Article 867a of Regulation (EEC) No 2454/93 implementing the EU Customs Code according to which goods seized and confiscated are to be considered to have been entered for the Customs Warehousing procedure in accordance with Article 98 of the Customs Code. For goods entered for this procedure the incurrence of the customs debt is considered as suspended and no entry in the accounts should take place. The Commission has examined the rulings of the ECJ in Elshani (Case C-459/07) and Dansk Logistik (Case C-230/08) and concluded that its current position can be maintained.</i></p>	<p><b>The Court of Auditors maintains its view concerning the entry into the B accounts of customs debts incurred on seized goods. This view is corroborated by the two Court of Justice judgements.</b></p>
	<p>In its 2009 Annual Report (paragraph 2.27), the Court reported that the Commission (in its report of January 2010 on Greek government deficit and debt statistics to the Ecofin Council) called into question the quality of Greek macroeconomic statistics, including those of National Accounts, and that the Commission and the Council raised doubts on the effective functioning of supervisory and control systems at the National Statistical Service of Greece, which also produces GNI data for the calculation of own resources.</p>	<p>The Commission's thorough analysis of the potential impact of the issues which emerged from this deficit and debt verification on Greek data did not reveal a significant impact on GDP/GNI levels. The verification work carried out during 2010 by the Commission (Eurostat) on Greek fiscal data to follow up weaknesses reported in its report of January 2010 revealed an impact of between 0,5 % and 0,9 % on the level of the Greek GDP.</p>	<p><i>The Commission's reply of spring 2010 to the Court's observation at the time of the preparation of the Court's 2009 Annual report referred to the findings of the report of January 2010, which did not address the issue of the reclassification of public corporations. The impact on GDP mentioned by the Court derives from the reclassification of public corporations, which resulted from work completed in November 2010. Therefore, there is no need to reconsider the Commission response to the observation included in the Court's Annual Report relating to the financial year 2009. Revisions to Member States' data for earlier years are followed by the Commission during the following years according well established GNI monitoring procedures.</i></p>	<p><b>The assessment made by the Commission on the impact on GDP/GNI of the weaknesses relating to the Greek government deficit and debt statistics should take into account the results of its work completed in November 2010.</b></p>

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2009	<p>In its 2006 Annual Report, the Court made observations on the revision to Greek GNI (paragraphs 4.24 to 4.26) and recommended in paragraph 4.32 that the Commission:</p> <p>(a) sets rules on communication and is forewarned, together with the GNI Committee, of major revisions,</p> <p>(b) implements a coordinated policy for National Accounts data revisions, including the requirement for a regular benchmarking, and</p> <p>(c) ensures that the conclusions from control of the Greek inventory are available early enough, so as to allow the inclusion of corrected data in accounts for the financial year 2007.</p> <p>In its 2007, 2008 and 2009 Annual Reports the Court followed up these issues respectively in Annex 4.2 (2007 and 2008) and Annex 2.4 (2009).</p>	<p>(a) Four Member States presented major revisions in their 2010 GNI Questionnaires and Quality Reports. In one case (Finland), no prior notification of the revision was made.</p> <p>(b) In the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB) meeting in January 2010, it was concluded that the Commission (Eurostat) and the European Central Bank should launch an impact study regarding a 'revision policy for National Accounts and Balance of Payments' in Autumn 2010 and present the results of the survey relating to this study to the CMFB meeting in January 2011. However, due to the finalisation on the new draft ESA (European System of Accounts) and other tasks, it has been decided to postpone the launching of the survey until early 2011 and to present the results of the impact study at the CMFB meeting in July 2011.</p> <p>(c) The Commission (Eurostat) is continuing its cooperation with the Greek NSI in order to be able to lift the one remaining GNP reservation for the period 1995-2001.</p>	<p>(a) <i>The Commission constantly reminds the Member States of the need to apply the guidelines, particularly during GNI Committee meetings and in bilateral contacts. Although in the case of Finland full information was given in advance during GNI Committee meetings and in a GNI visit to Finland, the Commission will continue to monitor and to stress the importance of Member States' compliance with the CMFB procedure.</i></p> <p>(b) <i>No comment</i></p> <p>(c) <i>The Commission (Eurostat) is continuing its cooperation with the Greek authorities in order to be able to lift the one remaining GNP reservations for the the period 1995-2001.</i></p>	<p><b>(a) The Commission should take appropriate measures in order to ensure that guidelines on communications of major statistical revisions (set up by the CMFB) are always applied by Member States.</b></p> <p><b>(b) The Court notes that there was no progress made by the Commission (Eurostat) in 2010 in respect of the implementation of a common revision policy in the European Union.</b></p> <p><b>(c) See paragraphs 2.26, 2.27 and 2.29.</b></p>

## ANNEX 2.5

## CALCULATION OF THE UNITED KINGDOM CORRECTION FOR 2006 AND SUBSEQUENT YEARS

1. The arrangements for calculating the United Kingdom correction in respect of 2006 are set out in the 2000 Own Resources Decision <sup>(1)</sup> and in a Commission working document endorsed by the Council when adopting the Own Resources Decision <sup>(2)</sup>.
2. The calculation of the United Kingdom correction involves a series of steps.
3. The first step is obtained by
  - (a) calculating the difference between:
    - (i) the percentage share of the United Kingdom in the sum of uncapped <sup>(3)</sup> VAT assessment bases; and
    - (ii) the percentage share of the United Kingdom in total allocated expenditure;
  - (b) multiplying the difference thus obtained under (a) by total allocated expenditure;
  - (c) multiplying the result obtained under (b) by 0,66.
4. 'Uncapped VAT bases' were the basis of the VAT-based own resources as it applied at the time when the United Kingdom correction was introduced.
5. 'Allocated expenditure' is expenditure from the Union budget which can be allocated to recipients in Member States. Thus it excludes expenditure outside the European Union or expenditure that cannot be allocated or identified. An amount corresponding to pre-accession expenditure in the Member States which acceded to the Union in 2004 is deducted from total allocated expenditure.
6. The second stage in the calculation of the correction is to calculate the 'UK advantage' from changes in the VAT-based own resources made since the United Kingdom correction was introduced (reduction in the rate at which the VAT-based own resource is levied, 'capping' of VAT bases to 50 % of a Member State's gross national income (GNI)) and from the introduction of the fourth own resource based on GNI.
7. A detail in the calculation of the 'UK advantage' of relevance to the criticism made in paragraph 2.16 concerns the calculation of the uniform rate of the VAT-based own resources applicable in 2006. This involves deducting from a 'maximum rate of call' for VAT (0,50 % in 2006) a 'frozen rate', itself related to the size of United Kingdom rebate. The error mentioned in paragraph 2.16 is due to the fact that the Commission added the 'frozen rate' to the 'maximum rate of call' rather than deduct it.
8. A further adjustment to the correction deducts 'TOR windfall gains'. Member States retain 25 % of the yield of TOR; when the United Kingdom rebate was introduced the retention was 10 %. The correction is reduced to the extent that this reduces the United Kingdom's own resource payments.
9. The arrangements for calculating the United Kingdom correction in years subsequent to 2006 are set out in the 2007 Own Resources Decision <sup>(4)</sup> and in a new Commission working document endorsed by the Council <sup>(5)</sup>. The post-2006 arrangements differ in some detailed respects from those relevant to the 2006 correction.

<sup>(1)</sup> Council Decision 2000/597/EC, Euratom of 29 September 2000 on the system of the European Communities' own resources (OJ L 253, 7.10.2000, p. 42).

<sup>(2)</sup> Commission working document on calculation, financing, payment and entry in the budget of the correction of budgetary imbalances in accordance with Articles 4 and 5 of Decision 2000/597/EC (Reference 10646/00, Addendum 2 to 'I/A' Item Note dated 21 September 2000 from The General Secretariat of the Council to Permanent Representatives Committee/Council, Adoption of the Council Decision 2000/597/EC, Euratom on the system of the EU's own resources).

<sup>(3)</sup> As set in Article 2(1)(c) of Decision 2000/597/EC, the VAT assessment bases to be taken into account for own resources should not exceed 50 % of GNP (until 2001)/GNI (from 2002).

<sup>(4)</sup> See Decision 2007/436/EC, Euratom.

<sup>(5)</sup> Commission working document on calculation, financing, payment and entry in the budget of the correction of budgetary imbalances in favour of the United Kingdom (Reference 9851/07, Addendum 2 to 'I/A' Item Note dated 23 May 2007 from The General Secretariat of the Council to Permanent Representatives Committee/Council, Adoption of the Council Decision 2007/436/EC, Euratom on the system of the EU's own resources).

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10. In respect of allocated expenditure whose general principles do not change (as compared to the 2000 Own Resources Decision), two details should be noted in particular in the context of the criticisms made in paragraphs 2.31 to 2.33:
- (a) The Commission's working document provides that in those cases where the Commission is aware of expenditure that the recipient in question acts as an intermediary, the payments must be allocated whenever possible to the Member State(s) in which the final beneficiary(ies) is(are) resident, in accordance with their shares in these payments.
  - (b) The concept of expenditure used by the Commission for the calculation of the UK correction corresponds to 'actual payments' relating to the year in question pursuant either to the annual budget or to carry-overs of non-executed appropriations to the following year.
11. Paragraphs 2.31 to 2.33 indicate that the Commission did not take appropriate steps to include in the calculation total allocated expenditure or to allocate payments whenever possible.



## CHAPTER 3

**Agriculture and Natural Resources**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

3.1. This chapter presents the Court's specific assessment of Agriculture and Natural Resources, which comprises policy areas 05 — Agriculture and rural development, 07 — Environment, 11 — Maritime Affairs and Fisheries and 17 — Health and Consumer Protection. Key information on the activities covered and the spending in 2010 is provided in **Table 3.1**.

Table 3.1 — Agriculture and Natural Resources — key information 2010

(million euro)

Budget title	Policy area	Description	Payments	Management mode
5	Agriculture and rural development	Administrative expenditure	131	Centralised direct
		Interventions in agricultural markets	4 314	Shared
		Direct aids	39 676	Shared
		Rural development	11 483	Shared
		Pre-accession measures	14	Decentralised
		Other	(7)	Shared
		<b>55 611</b>		
7	Environment	Administrative expenditure	91	Centralised direct
		Operational expenditure	267	Centralised direct/Centralised indirect
			<b>358</b>	
11	Maritime Affairs and Fisheries	Administrative expenditure	40	Centralised direct
		Operational expenditure	616	Centralised/Shared
			<b>656</b>	
17	Health and Consumer Protection	Administrative expenditure	112	Centralised direct
		Operational expenditure	478	Centralised direct/Centralised indirect
			<b>590</b>	
		Total administrative expenditure <sup>(1)</sup>	374	
		Total operational expenditure	56 841	
		Of which: — advances	851	
		— interim/final payments	55 990	
		<b>Total payments for the year</b>	<b>57 215</b>	
		<b>Total commitments for the year</b>	<b>60 992</b>	

(<sup>1</sup>) The audit of administrative expenditure is reported in Chapter 7.

Source: 2010 Annual Accounts of the European Union.



## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group****Policy area agriculture and rural development**

3.2. The objectives <sup>(1)</sup> of the common agricultural policy as set out in the Treaty are to increase agricultural productivity, thus to ensure a fair standard of living for the agricultural community, to stabilise markets, to assure the availability of supplies and to ensure that supplies reach consumers at reasonable prices.

3.3. The EU budget finances the common agricultural policy expenditure mainly through two Funds <sup>(2)</sup>: the European Agricultural Guarantee Fund ('EAGF'), which fully finances EU direct aid and market measures <sup>(3)</sup>, and the European Agricultural Fund for Rural Development ('EAFRD'), which co-finances at varying rates rural development programmes.

3.4. The main measures financed by EAGF (43 990 million euro) are:

- the *direct aid* 'Single Payment Scheme' (SPS). SPS payments are based on 'entitlements' <sup>(4)</sup> each of which is activated with one hectare of eligible land declared by the farmer. SPS represented in 2010 29 070 million euro of expenditure (73 % of direct aids),
- the *direct aid* 'Single Area Payment Scheme' (SAPS) which provides for the payment of uniform amounts per eligible hectare of agricultural land and is currently applied in ten of the new Member States <sup>(5)</sup> and in 2010 accounted for 4 460 million euro of expenditure (11 % of direct aids),
- other *direct aid* schemes 'coupled payments' linked to specific types of agricultural production. In 2010 those schemes accounted for 6 146 million euro of expenditure (16 % of direct aids),

<sup>(1)</sup> Article 39 of the Treaty on the Functioning of the European Union.

<sup>(2)</sup> Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.8.2005, p. 1).

<sup>(3)</sup> With the exception of certain measures such as promotion measures and the school fruit scheme which are co-financed.

<sup>(4)</sup> The number and value of each farmer's entitlement was calculated by the national authorities according to one of the models provided for under EU legislation. Under the *historical model* each farmer is granted entitlements based on the average amount of aid received and area farmed during the reference period 2000 to 2002. Under the *regional model* all entitlements of a region have the same flat-rate value and the farmer is allocated an entitlement for every eligible hectare declared in the first year of application. The *hybrid model* combines the historical element with a flat rate amount and, if it is *dynamic*, the historical component decreases each year until it becomes a predominantly flat rate-system.

<sup>(5)</sup> Bulgaria, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia.

## THE COURT'S OBSERVATIONS

— *interventions in agricultural markets*: the principal measures are intervention storage and export refunds, both of which have been declining in importance in recent years, and other measures such as specific support for the wine, fruit and vegetable and food programmes (in total amounting to 4 314 million euro in 2010).

3.5. The EAFRD co-finances *Rural Development* expenditure which covers a large number of measures such as agri-environmental schemes, compensatory amounts for farming in less-favoured areas, investments in farms and infrastructure in rural areas (11 497 million euro) <sup>(6)</sup>.

3.6. Under all EAGF direct aid schemes <sup>(7)</sup> and certain EAFRD aid schemes, beneficiaries of EU aid have a legal obligation to fulfil 'cross compliance' requirements relating to the protection of the environment, public health, animal and plant health, animal welfare (Statutory Management Requirements) and to the maintenance of agricultural land in good agricultural and environmental condition (GAEC) <sup>(8)</sup>. EU legislation provides that when non-compliance with those requirements is noted, a reduction or exclusion <sup>(9)</sup> shall be applied on the overall amount of direct payments made in respect of the applications submitted in the course of the calendar year of the finding.

3.7. Only farmers are eligible for EU area aid. A farmer is defined as a natural or legal person who carries out an agricultural activity which is defined as the production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes, or maintaining the land in GAEC <sup>(10)</sup>. The maintenance of land in GAEC constitutes the minimum agricultural activity required of the applicant to be eligible for aid.

## THE COMMISSION'S REPLIES

**3.6.** *Reductions and exclusions apply only if the non-compliance is due to an act or omission directly attributable to farmers and if it is not of a minor nature.*

<sup>(6)</sup> This amount entails expenditure in respect of previous programming period as well as pre-accession instruments.

<sup>(7)</sup> Council Regulation (EC) No 73/2009 (OJ L 30, 31.1.2009, p. 16).

<sup>(8)</sup> Whilst GAEC standards, as referred to in Annex III to Regulation (EC) No 73/2009, apply in all Member States, Statutory Management Requirements (SMRs) as referred to in Annex II to that Regulation are mandatory only in EU-15. For the EU-10, SMRs are being phased in between 2009 and 2013, and for EU-2 between 2012 and 2014.

<sup>(9)</sup> According to Articles 66 and 67 of Commission Regulation (EC) No 796/2004 (OJ L 141, 30.4.2004, p. 18), the level of the reduction per SMR or GAEC not complied with can vary between 1 % and 5 % in case of negligence and can lead to full rejection of the aid in case of intentional non-compliance.

<sup>(10)</sup> See Article 1 and Article 2(a) and (c) of Regulation (EC) No 73/2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.8. Expenditure under both funds is channelled through some 80<sup>(11)</sup> national or regional paying agencies in the 27 Member States. These paying agencies are responsible for making payments to the beneficiaries and prior to doing so, they must, either directly or through delegated bodies, satisfy themselves of the eligibility of the aid applications. The accounts and payment records of the paying agencies are examined by independent audit bodies (certification bodies) which report to the Commission in February of the following year.

**Policy areas Environment, Maritime Affairs and Fisheries, Health and Consumer Protection**

3.9. The Union's policy on the *Environment* is designed to contribute to protecting and improving the quality of the environment, human health, and rational utilisation of natural resources, including at international level. The Financial Instrument for the Environment (LIFE)<sup>(12)</sup> is the most important instrument in terms of funding (205 million euro expenditure in 2010) covering the EU contribution for projects in the Member States in favour of nature and biodiversity, as well as environment policy, governance, information and communication.

3.10. The European Fisheries Fund<sup>(13)</sup> (EFF) is the main instrument (395 million euro expenditure<sup>(14)</sup> in 2010) for the policy area *Maritime Affairs and Fisheries*. In its designated domain the common fisheries policy pursues the same objectives as the common agricultural policy (see paragraph 3.2).

3.11. Concerning *Health and Consumer Protection*, the EU contributes, on the one hand, to human, animal and plant health protection and, on the other hand, to consumer welfare (478 million euro expenditure in 2010).

**Advances and interim/final payments**

3.12. For EAGF the expenditure mainly consists of reimbursements (interim/final payments) by the EU of subsidies paid to farmers and other beneficiaries by the Member States.

3.13. For EAFRD, in 2010, all payments charged concerned advances and interim payments. For the EFF, only interim payments were made.

<sup>(11)</sup> Number of Paying Agencies: 82 at the beginning of financial year 2010, 81 at the end of financial year 2010 (source: AAR DG AGRI, p. 32).

<sup>(12)</sup> Regulation (EC) No 614/2007 of the European Parliament and of the Council (OJ L 149, 9.6.2007, p. 1).

<sup>(13)</sup> The Financial Instrument for the Fisheries Guidance (FIFG) has been replaced by the EFF for the current programming period (2007-2013) — Council Regulation (EC) No 1198/2006 (OJ L 223, 15.8.2006, p. 1).

<sup>(14)</sup> This amount includes expenditure in respect of previous programming periods, in particular for the FIFG.

**3.8.** According to Article 5 of Commission Regulation (EC) No 885/2006, the certification bodies examine, on an annual basis, the internal control procedures of the paying agencies, in addition to their annual accounts.

## THE COURT'S OBSERVATIONS

3.14. There are no advance payments for Health and Consumer Protection, Member States are reimbursed on the basis of their declared expenses. For Environment, pre-financing of up to 40 % of the EU contribution for a LIFE project, as established in the grant agreement, is foreseen.

**Significant reduction in payment appropriations — EAFRD**

3.15. In the area of EAFRD, payment appropriations were decreased by 1 160 million euro (around 9 % of initial payment appropriations) at the end of 2010 <sup>(15)</sup> primarily as a consequence of a slowdown in Member States' expenditure due to difficulties in providing national co-financing in the current economic situation.

**Audit scope and approach**

3.16. **Annex 1.1, Part 2**, describes the Court's overall audit approach and methodology. For the audit of policy group Agriculture and Natural Resources the following specific points should be noted:

- the audit involved the examination of a sample of 238 payments, comprising 146 payments for EAGF, 80 payments for EAFRD and 12 payments as regards Environment, Maritime Affairs and Fisheries, and Health and Consumer Protection, all representing interim and final payments,
- the assessment of systems covered for EAGF IACS audits, selected using a combination of materiality, risk and random (MUS) criteria, in 5 paying agencies in three Member States applying the SPS — Germany (Sachsen and Niedersachsen), Spain (Castilla-La Mancha and Extremadura) and United Kingdom (Wales) — and in one Member State (France) the control system relating to the measure 'restructuring of the sugar industry'. For *Rural Development*, the Court randomly selected and tested the supervisory and control systems in Germany (Mecklenburg-Vorpommern), United Kingdom (Scotland), Romania, Poland, Portugal, Italy (Toscana), Latvia and France. For *Environment* the Court tested the internal control system of DG ENV,
- a follow-up of weaknesses related to Land Parcel Identification System (LPIS) and on-the-spot inspections reported under DAS 2008 and 2009 was carried out for three paying agencies: in Greece, Bulgaria and Romania,

<sup>(15)</sup> Redeployed for other programmes through a Global Transfer of appropriations.

## THE COURT'S OBSERVATIONS

- in addition to the audits of payments and systems mentioned above, for the Netherlands and the Czech Republic co-ordinated audits were undertaken with the Dutch and Czech Supreme Audit Institutions. In the Netherlands, the audit involved the examination of an additional sample of 55 payments of which 53 were made under EAGF measures and two related to Rural Development expenditure and an assessment of the relevant supervisory and control systems. In the Czech Republic the audit involved the examination of 30 payments related to four measures of the Rural Development programme and an assessment of the relevant supervisory and control systems. The results of the examination of these additional samples are included in the error rate calculation<sup>(16)</sup>,
  
- with respect to cross compliance, the Court limited its testing to GAEC obligations (minimum soil cover, avoiding the encroachment of unwanted vegetation) for which evidence can be obtained and a conclusion reached at the time of the audit visit. Certain statutory management requirements (animal identification and registration) were tested in respect of EAFRD payments. Furthermore, in the context of its systems audits, the Court has examined the implementation (at national level) of the GAEC standards and the control systems implemented by Member States. When non-compliance is detected it is currently not included in the error rate calculation,
  
- the review of the Commission's management representations covered the annual activity reports of DG AGRI, DG CLIMA, DG ENV, DG MARE and DG SANCO,
  
- in addition, in order to assess the basis for the Commission's financial clearance decisions the Court reviewed 61 of the certification bodies' certificates and reports related to 56 paying agencies.

<sup>(16)</sup> In arriving at its estimate of error, the Court weighted the results of the Dutch and Czech samples of transactions to reflect the share of CAP spending which took place in the Netherlands and the Czech Republic respectively.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**REGULARITY OF TRANSACTIONS**

3.17. **Annex 3.1** contains a summary of the results of transaction testing. The Court's testing of its sample of transactions found 37 % to be affected by error. The most likely error resulting from transaction testing estimated by the Court is 2,3 %<sup>(17)</sup>. The Court also identified irregular advance payments to Member States of 401 million euro (equivalent to 0,7 % of total payments for the year) by the Commission (see paragraph 3.22)<sup>(18)</sup>.

3.18. The Court's audit confirmed previous years' results that frequency and impact of errors in payments were not distributed evenly across all the policy areas. The Court notes that Rural Development expenditure is particularly prone to error. Direct payments covered by IACS, by contrast, were not found to contain material error.

3.19. In the EAGF, out of 146 transactions sampled, 39 (27 %) were affected by errors. 29 (74 %) of these transactions were affected by quantifiable errors. With regard to Rural Development expenditure, out of 80 transactions sampled, 40 (50 %) were affected by errors. 21 (52 %) of these transactions were affected by quantifiable errors. As regards *Environment, Maritime Affairs and Fisheries* and *Health and Consumer Protection*, out of 12 transactions sampled, 8 (67 %) were affected by errors. 4 (50 %) of these transactions were affected by quantifiable errors.

3.20. In 2010, out of the transactions affected by error 54 (62 %) were affected by quantifiable errors concerning eligibility and, mostly, accuracy (97 % in EAGF and 52 % for EAFRD), particularly due to over-declarations of eligible land.

3.21. Examples of errors found by the Court are outlined hereafter (see example 3.1):

**3.17.** *The Court's conclusion for Agriculture and Natural Resources confirms the positive trend that in the past years the most likely error rate is close to the materiality threshold of 2 %. The Commission further notes that for EAGF expenditure, which in 2010 accounted for 77 % of total expenditure under this Chapter, the most likely error is well below the materiality threshold and that for direct payments covered by the IACS it is even lower.*

*Moreover, the risk to the EU budget is adequately covered by the conformity clearance procedure.*

*The 401 million euro advance payments do not represent irregular payments to final beneficiaries. Moreover, the recovery of the amounts in question is ongoing and will be completed by the end of 2011.*

**3.18.** *The Commission shares the Court's view that some areas of rural development expenditure are affected by a higher incidence of errors, but considers that the supervisory and control systems are constantly improving. The Commission considers that as a result the error rate is decreasing in this area.*

**3.19.** *The Commission notes that most of the quantifiable errors are relatively small in financial terms and mainly concern small differences in the re-measurement of parcels carried out by the Court (see paragraph 3.20).*

<sup>(17)</sup> The Court calculates its estimate of error from a representative statistical sample. The figure quoted is the best estimate (known as the MLE). The Court has 95 % confidence that the rate of error in the population lies between 0,8 % and 3,8 % (the lower and upper error limits respectively).

<sup>(18)</sup> Under the Court's current approach these advance payments were not part of the sampled population. Although irregular these payments have no effect on whether correct amounts are paid to final beneficiaries.

## THE COURT'S OBSERVATIONS

## Example 3.1

**Example of eligibility error — EAGF**

A payment was made to the national authorities of a Member State of an amount of 4,3 million euro for 1 965 tonnes of intervention butter <sup>(19)</sup> delivered as a means of payment (bartering) to successful bidders <sup>(20)</sup> in a second Member State under the EU food aid programme for deprived persons. In exchange for the butter the successful bidders (operators) had offered to supply various types of cheese and other milk products to deprived persons.

Governing EU rules <sup>(21)</sup> provide that the operator is not allowed to put the butter on the market in the Member State where it was placed in intervention but must transfer the product to the second Member State: the objective of this requirement is to prevent the butter returning to the Member State where it was bought into intervention for market management purposes <sup>(22)</sup>. The butter from intervention had been transferred to the border of the second Member State <sup>(23)</sup> where the EU control documents were cleared. The bulk of the butter, however, was not unloaded but immediately transported back to the original Member State where it was offered for sale on the domestic market in circumvention of the EU rules <sup>(24)</sup>.

**Example of accuracy error — EAGF**

The Court found that SPS payments to around 12 500 individual beneficiaries were made on the basis of an outdated LPIS leading to an overall overpayment of 11 million euro. Contrary to EU legislation the national authorities decided to charge the amount to the national budget rather than recovering overpayments from farmers, thus granting unapproved national aid. The individual payments to farmers are overstated and are therefore irregular.

## THE COMMISSION'S REPLIES

## Example 3.1

**Example of eligibility error — EAGF**

*The Commission considers that the objective of the scheme — which is that food be delivered free of charge to most deprived persons — was fully achieved in this case, and the value of the cheese and butter provided to these persons exceeded the financial charge to the EU budget. It further considers that this case primarily concerns the effectiveness of a specific rule in the 2009 scheme which did not prohibit the re-transfer of the products, as in this case, to the first Member State by another operator, in line with the principle of free movement of goods. Therefore, although the underlying purpose of that provision was not fully achieved, the Commission sees no basis for recovery of the amounts in question.*

*The problem was limited to the 2009 programme since no similar rules were included in the subsequent programmes.*

*The Commission will, however, consider options to enhance the transparency of bartering arrangements, which are an essential component of the aid scheme for most deprived people and which the Commission therefore intends to continue in the future.*

**Example of accuracy error — EAGF**

*The Commission is aware of these deficiencies in the LPIS in question and is pursuing them through conformity clearance procedures. It should be noted however, that according to Article 73(4) of Regulation (EC) No 796/2004, the repayment obligation of the farmer shall not apply if the payment was made by error of the competent authority or of another authority and if the error could not reasonably have been detected by the farmer. In any case, the decision of the national authorities to charge the amounts to the national budget ensured that the EU budget did not fund any undue expenditure.*

<sup>(19)</sup> This amount is part of global payments to this Member State of 21,6 million euro for a total quantity of intervention butter of 9 894 tonnes.

<sup>(20)</sup> Bidders are invited to submit their bids for delivery of a product in exchange for butter from intervention stocks.

<sup>(21)</sup> Article 5(2) of Commission Regulation (EC) No 1111/2009 (OJ L 306, 20.11.2009, p. 5).

<sup>(22)</sup> Recital 7 of Regulation (EC) No 1111/2009.

<sup>(23)</sup> The total amount borne by the EU budget for transporting the 9 894 tonnes of butter amounted to 0,9 million euro.

<sup>(24)</sup> In its Special Report No 6/2009 on EU food aid for deprived persons the Court already considered that bartering arrangements using intervention stocks are inappropriate, do not always guarantee transparency, are not always cost effective and that they should be discontinued.

## THE COURT'S OBSERVATIONS

**Examples of eligibility error — EAFRD**

*Disregard of procurement rules:* An EAFRD project for the construction of a cycle path in which the beneficiary directly awarded part of the works. Due to the absence of a public procurement procedure, part of the payments related to this contract is irregular.

*Non-respect of specific eligibility criteria:* a payment was made under the rural development measure 'improvement of the economic value of forests'. The aim of the project was the 'thinning' of the tree density of the forest in order to improve the quality and thus the value of the timber. Two of the eligibility criteria which the beneficiary had to fulfil were: 1. the density of the trees before thinning should be at least 800 stems per hectare and 2. the works should be carried out between October and January so as to reduce plant health risks. These two eligibility criteria were not met: the density of the trees prior to the thinning exercise was 600, and the works were carried out between March and May. The payment is therefore irregular.

**Example of error in Environment, Maritime Affairs and Fisheries, Health and Consumer Protection**

DG ENV incorrectly deducted eligible personnel costs for a LIFE III project. This was partly offset by incorrectly accepting salaries paid outside the eligible project period. Furthermore, there was incomplete supporting documentation for the declared expenditure.

## THE COMMISSION'S REPLIES

**Examples of eligibility error EAFRD**

Disregard of procurement rules:

*The Commission will pursue this case through the conformity clearance procedure.*

Non-respect of specific eligibility criteria:

*The Commission observes that the eligibility condition related to the period of the work seems to have been fixed by the regional authorities without a proper assessment of its justification and impact. It recommends to Member States to establish transparent procedures involving all those concerned when fixing at regional level, in addition to national rules, specific eligibility conditions.*

3.22. From 2007 to 2009, the Council took several decisions to increase the Rural Development budget by 5,43 billion euro mainly to respond to 'new challenges' (e.g. climate change, protection of biodiversity, ...). Out of this amount, 3 billion euro represented a transfer of funds from direct aid measures to rural development measures ('modulation'). As a result, Member States adjusted their rural development programmes upwards and, in 2010, the Commission paid out advances against these additional programmes for an amount of 401 million euro. However, the legislation does not provide for such additional advances (pre-financing is only authorised when the rural development programmes are adopted at the beginning of the programming period, i.e. 2007-2008, not when they are revised). In addition, the legislation explicitly forbids pre-financing of modulation funds. Therefore, there was no legal basis for this payment of 401 million euro.

3.22. *The Commission agrees with the Court's observation, but notes that the 401 million euro advance payments do not represent irregular payments to final beneficiaries. The recovery of the amounts in question is ongoing and will be completed by the end of 2011.*



## EFFECTIVENESS OF SYSTEMS

### Policy area agriculture and rural development

#### *Systems related to regularity of transactions*

3.23. **Annex 3.2** contains a summary of the results of the examination of Integrated Administration and Control System (IACS), the main control system to ensure the regularity of EAGF and EAFRD transactions <sup>(25)</sup>.

3.24. For its 2010 audit of six paying agencies, the Court found the IACS systems to be effective in ensuring the regularity of payments in four agencies and partially effective in the remaining two. Furthermore, the Court carried out follow-up audits in three paying agencies and found out that there are still weaknesses in the LPIS and in the quality of on-the-spot checks.

3.25. Concerning the nine Rural Development supervisory and control systems audited, the Court found that two of the control systems implemented were not effective, six of them were partially effective and one was effective in ensuring the regularity of payments.

3.26. IACS consists, in each Member State, of a database of holdings and applications, systems for identifying agricultural parcels and registering animals, as well as a register of entitlements in those Member States implementing the SPS. The system provides for several eligibility controls: an administrative check of all claims, cross-checks with databases to prevent the same land/animals from being claimed twice and a minimum rate of 5 % on-farm inspections to be carried out by the paying agencies.

**3.24.** As regards the six paying agencies which the Court audited in 2010, the Court's findings represent a significant improvement compared to last year where it considered only one out of eight IACS audited to be effective. Moreover, the weaknesses which the Court found in two of them were all of a minor nature and, in part, did not imply a risk for the EU budget. In any case, the control statistics of these paying agencies, which have been validated by the certification bodies, show that the potential financial impact of the weaknesses was not material at paying agency level.

As regards the three follow-up audits carried out by the Court, the Member States concerned (BG, RO and GR) have completed or are about to complete action plans to remedy the deficiencies in their IACS. As a result, the situation in these Member States has improved considerably.

As regards the assessment of the IACS in general, see also the reply to paragraph 3.29.

**3.25.** The Commission agrees with the Court regarding the two supervisory and control systems which were assessed as not effective. As regards the other Member States, the Commission's audits show that they have put in place systems that are effective or partially effective, with the exception of those for Axis 2 measures in Bulgaria, Portugal and Romania (see AAR 2010 of DG AGRI).

<sup>(25)</sup> Regulation (EC) No 73/2009 and Commission Regulation (EC) No 1122/2009 (OJ L 316, 2.12.2009, p. 65).

## THE COURT'S OBSERVATIONS

3.27. IACS covers the main schemes financed by EAGF, namely SPS, SAPS and all area related coupled aid schemes as well as animal premia schemes. In the case of EAFRD, and especially for agri-environment and less favoured areas, verification of certain key elements such as eligible area and number of animals is made through IACS while other requirements are governed by specifically designed controls <sup>(26)</sup>.

3.28. The Court's IACS audit covered compliance with the provisions of the relevant regulations and an assessment of the effectiveness of the systems in ensuring regularity of transactions. In particular, the following elements were examined:

- (I) administrative procedures and controls to ensure correct payment including quality of databases;
- (II) control systems based on on-the-spot checks;
- (III) systems to ensure implementation and control of cross compliance.

Failing to abide by cross compliance requirements affects the full payment of EU direct aid as the recipients are under legal obligation to respect such requirements (see paragraph 3.6).

3.29. The Court's annual IACS systems audits carried out in recent years showed that the effectiveness of IACS is adversely affected by inaccurate data in the databases, incomplete cross checks or incorrect or incomplete follow up of anomalies. The Court has observed these weaknesses in certain paying agencies. In particular, two key controls, the cross-check of parcels claimed with the LPIS and the on-the-spot checks of those parcels were found to be affected by weaknesses in several of the paying agencies audited by the Court.

## THE COMMISSION'S REPLIES

**3.28.**

**(III)** *The Commission recalls that respect of cross-compliance criteria by farmers does not constitute an eligibility criterion and, therefore, the controls of these criteria do not pertain to the legality and the regularity of the underlying transactions. Farmers not respecting these criteria are entitled to receive payments, but are sanctioned on the basis of the severity, extent, permanence and repetition of the non-compliance found as well as negligence or intent of the beneficiary concerned.*

**3.29.** *The Commission considers that the IACS is generally an effective control system for limiting the risk of error or irregular expenditure.*

*The overall effectiveness and constant improvement of the IACS is confirmed by the results of the conformity audits which the Commission has carried out over the past years in all Member States, by the low error rate indicated in the control statistics which it receives from Member States and which are verified and validated by the certification bodies as well as by the Court's own DAS findings for 2010, which for direct payments indicate an error rate of 1 %.*

*Remaining deficiencies are generally of a lesser nature and do not render the IACS ineffective but, rather, perfectible. All these deficiencies are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered.*

*See also the Commission's reply to point 3.24.*

<sup>(26)</sup> Commission Regulation (EC) No 1975/2006 of 7 December 2006 laying down detailed rules for the implementation of Council Regulation (EC) No 1698/2005, as regards the implementation of control procedures as well as cross compliance in respect of rural development support measures (OJ L 368, 23.12.2006, p. 74).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**(I) Administrative procedures and controls to ensure correct payment including quality of databases**

3.30. Paying agencies must carry out administrative checks to establish whether claims have met the requirements of the scheme<sup>(27)</sup>. The administrative checks must include cross-checks wherever possible and appropriate, inter alia with IACS databases. The Court verified whether databases were complete and reliable, whether checks identified anomalies and whether action was taken to correct errors. The major systems weaknesses found are set out below.

EAGF

3.31. The *Land Parcel Identification System (LPIS)* is a database in which all the agricultural area (reference parcels) of the Member State is recorded including the optional use of ortho-photos<sup>(28)</sup>. In three Member States (Greece, Romania and Spain), the Court found cases where 'permanent pasture'<sup>(29)</sup> reference parcels were recorded in the LPIS to be 100 % eligible despite the fact that they were partially covered with dense forest or other ineligible features and therefore only partially eligible (see example 3.2).

**Example 3.2**

In Spain (Castilla-La Mancha and Extremadura) the Court observed cases of permanent pasture reference parcels which were recorded in the LPIS as being fully eligible although they were only partly covered with grass and the remainder with ineligible elements such as rocks, bush land, dense forest, etc. In Greece, there were cases where entire forests were regarded as permanent pasture and were therefore considered eligible for SPS payments. As a result, the eligible area recorded in LPIS and used for the cross-checks was often overstated. This adversely affected the quality of such cross-checks.

**3.31.** *Where audits found that land has received direct aid in non-compliance with the legal provisions, conformity clearance procedures have been launched.*

**Example 3.2**

*The Commission is aware of the situation in Greece and has requested the Greek authorities to remedy the problems. As regards the situation in Spain, the Commission has found similar problems to those referred to by the Court in other autonomous communities.*

*However, the problems found in both Member States do not always systematically lead to irregular payments and where they have done so, the Commission is pursuing the matter through conformity clearance procedures.*

<sup>(27)</sup> Article 11 of Regulation (EC) No 1975/2006 and Article 24 of Regulation (EC) No 796/2004.

<sup>(28)</sup> Article 17 of Regulation (EC) No 73/2009 provides that the system for agricultural parcels shall be established on the basis of maps or land registry documents or other cartographic references. Use shall be made of computerised geographical information system techniques, including preferably aerial or spatial orthoimagery, with a homogenous standard guaranteeing accuracy at least equivalent to cartography at a scale of 1:10 000.

<sup>(29)</sup> Article 2 of Commission Regulation (EC) No 1120/2009 (OJ L 316, 2.12.2009, p. 1) provides that permanent pasture means land used to grow grasses or other herbaceous forage naturally or through cultivation. This means that areas without grass/herbaceous vegetation cover, such as woods, rocks, ponds, paths are not part of the permanent pasture area and as a result, are to be eliminated from the eligible area as defined by Article 34(2) and Article 2(h) of Regulation (EC) No 73/2009.

## THE COURT'S OBSERVATIONS

3.32. In five Member States (Bulgaria, Netherlands<sup>(30)</sup>, Greece, Romania and Spain) the Court identified weaknesses in keeping the LPIS up to date.

3.33. As regards the non-IACS control system for the measure 'restructuring of the sugar industry' in France, the Court found the system to be partially effective only (see example 3.3).

## Example 3.3

Under an EU restructuring plan sugar producers giving up all or part of their quota receive an aid per tonne of sugar quota in 2008/2009 renounced ranging from 218,75 euro (simple renunciation) to 625 euro (in the case of a full dismantling of a production facility). The producer must assign the abandoned quota to production facilities up to a maximum of the production capacity of those facilities. 10 % of the aid must be paid to the growers who as a result lose their delivery rights for sugar beet to the sugar producer.

In France a sugar producer was granted aid for dismantling a production facility equivalent to 93 500 tonnes of quota renounced. However, immediately before applying for the aid, the beneficiary had applied for upgrading the production capacity of this facility from 72 000 to 93 500 tonnes and his request had been approved. However, the actual production of the plant had never exceeded 60 000 tonnes. The increase in capacity was artificially created to obtain the higher aid rate of 625 euros/tonne for a quantity of at least 21 500 tonnes. In addition, the 10 % of this aid was paid to growers who had never delivered sugar beet to the dismantled facility.

## THE COMMISSION'S REPLIES

**3.32.** As regards the Netherlands, reference is made to the Commission reply to point 3.21 (Example of accuracy error EAGF). For Greece a new, up-to-date LPIS was completed by the end of 2008. For Romania, a remedial action plan was adopted in 2009 and completed at the beginning of 2011. For Bulgaria, a remedial action plan was adopted in 2009 and will be completed by the end of 2011. Spain has an updating plan, but has been requested to enhance its efforts in this respect in the course of 2011.

## Example 3.3

EU rules provide that the competent authority of the Member State decides on the eligibility of each application for restructuring aid. In the framework of the restructuring plan of the producer referred to by the Court, it was agreed that a quantity of sugar production would be renounced and that this would be managed via full dismantlement of one production site with quota renunciation on a further three sites.

EU rules further provide that restructuring plans submitted by applicants must specify for each factory concerned the amount of quota to be renounced, 'which shall be lower than or equal to the production capacity' to be fully or partially dismantled. The rules do not specify how the production capacity has to be established and Member States are therefore in principle free to determine which is the most appropriate method. The French authorities have confirmed that the methodology used was to determine the production capacity of a factory, not its effective production at a given moment in time. However, the Commission is pursuing the case in the context of an ongoing conformity clearance procedure with a view to determining if EU rules have been fully respected.

## EAFRD

3.34. Administrative checks concern the correctness of the declarations made by the claimant and the fulfilment of the eligibility requirements for the granting and the payment of the aid<sup>(31)</sup>. Such controls include cross-checks with data already available to the administration, for example in the IACS databases.

<sup>(30)</sup> These failures had only a limited impact in the Netherlands and the Dutch authorities have taken adequate remedial action as of claim year 2010.

<sup>(31)</sup> For rural development measures under the 2007-2013 programming period, the detailed requirements for administrative checks are defined by Regulation (EC) No 1975/2006.

## THE COURT'S OBSERVATIONS

3.35. One of the key administrative checks of measures <sup>(32)</sup> for improving the competitiveness of the agricultural sector, such as modernisation of farms, and improvement and development of rural infrastructure, aims to assess the reasonableness of the costs claimed. Member States are therefore required to implement suitable systems for evaluating the amounts claimed by beneficiaries. The Court found that this regulatory requirement was not effectively implemented by four of the seven national authorities audited for this aspect.

3.36. For some EAFRD projects the administrative checks shall include a verification of the compliance of the operation with applicable national and EU rules including public procurement. The Court found that, in Portugal, the costs related to the construction of a dam had been split over several contracts which could thus be awarded directly instead of being put out to tender. This was not detected by the administrative checks.

**(II) Control systems based on on-the spot checks**

3.37. Member States must, each year, carry out on-the-spot checks covering, for most aid schemes, at least 5 % of all beneficiaries <sup>(33)</sup>. The Court's audit focussed on the adequacy of risk analysis procedures to select beneficiaries for such checks, the quality of the checks and the adequacy of the corrections made.

3.38. When re-performing on-the-spot checks carried out by paying agencies, the Court frequently found that controls have not been properly executed (see example 3.4).

**Example 3.4**

In Bulgaria, Greece, Romania, the Czech Republic and the Netherlands the Court re-performed parcel measurements carried out by national inspectors. The eligible areas reported by the national inspectors were found to be incorrect for 13 out of 43 parcels in Bulgaria, 6 out of 32 parcels in Greece, 12 out of 29 parcels in Romania, 35 out of 67 parcels in the Czech Republic and 16 out of 174 parcels in the Netherlands. However, in the cases examined the financial effects were limited.

3.39. In EAFRD, the Court found weaknesses in the planning of the on-the-spot checks and the analysis of the results. In Portugal, for instance, almost all checks (97,5 %) were carried out with considerable delays, e.g. 1 or even 2 years after the year for which the payment was claimed, which makes it harder to detect cases of non-compliance.

## THE COMMISSION'S REPLIES

**3.35.** *The Commission shares the view that administrative checks of the reasonableness of costs are essential for ensuring the effectiveness of the whole control system. These essential checks are systematically examined during Commission audit missions. The overall assessment is that, with two exceptions, effective or partially effective systems are in place in the Member States audited by the Commission.*

**3.36.** *The Commission will pursue this case through the conformity clearance procedure.*

**Example 3.4**

*For Greece the problem is limited to the issue of pasture areas and this issue is followed up under the conformity clearance procedure.*

**3.39.** *The Commission discovered the same weaknesses during their audits in Portugal. However, the Portuguese authorities have provided the Commission with information showing that for claim year 2010 the situation has greatly improved and that the vast majority of controls was completed by December 2010.*

<sup>(32)</sup> Referred to in Title II of Regulation (EC) No 1975/2006.

<sup>(33)</sup> Article 12 of Regulation (EC) No 1975/2006 and Article 30 of Regulation (EC) No 1122/2009.

## THE COURT'S OBSERVATIONS

**(III) System to ensure implementation and control of cross compliance**

3.40. Cross compliance requirements consist of Statutory Management Requirements (SMRs) and GAEC standards (see paragraph 3.6). Whilst SMRs are specified in various EU Directives and regulations, GAEC standards are to be defined at national level. With regard to cross compliance the paying agencies must check at least 1 % of applications for direct payments.

3.41. During its on the spot visits the Court observed, on the basis of the limited audit (see paragraph 3.16, fifth indent) cross compliance infringements in around 12 % of the payments subject to cross compliance obligations. The non-compliance observed related to both SMRs (identification and registration of animals), and GAEC (encroachment of unwanted vegetation).

*Systems related to recoveries and financial corrections***Recovery cases**

3.42. The Court published a Special Report on the audit of recoveries of the CAP<sup>(34)</sup> which found that the systems are now more effective in protecting the EU's financial interests and that for cases from 2006 onwards, the recovery rates have improved. However, the systems need to be further improved by clarifying the rules, thereby reducing the scope for interpretation and diverging practices adopted by the Member States.

**The Commission's clearance of accounts procedure**

3.43. Management of most expenditure on agriculture is shared between Member States and the Commission. Aid is paid by the Member States, which are then reimbursed by the Commission<sup>(35)</sup>. The final recognition of expenditure is determined through a two-stage procedure called the clearance of accounts procedure. The two stages consist of an annual financial decision and multiannual conformity decisions taken by the Commission.

3.44. In previous annual reports as well as in the Special Report<sup>(36)</sup> on the audit on the clearance of accounts procedure the Court has criticised the fact that the Member States, and not the final beneficiaries, are charged with the financial corrections and that the conformity adjustments involve considerable use of flat-rate corrections which are not directly related to the real amount of irregular payments. The conformity clearance system continued unchanged in 2010.

## THE COMMISSION'S REPLIES

**3.41.** *The findings of the Court are confirmed by the control statistics which the Commission received from Member States. These statistics show that sanctions are applied.*

**3.42.** *The Commission welcomes the Court's assessment that the management and audit of recoveries of the CAP have improved over the recent years. Regarding the recommendations expressed in the special report to further improve the system, the Commission will consider possible modifications to, where appropriate, reinforce, harmonise or clarify the relevant rules in the context of its legislative proposals for the CAP towards 2020.*

**3.44.** *What the Court criticises in the conformity clearance system is inherent to this system. The conformity clearance is designed to exclude expenditure from EU financing which has not been effected in compliance with EU rules. In contrast, it is not a mechanism by which irregular payments to beneficiaries are recovered, which according to the principle of shared management is the sole responsibility of Member States.*

<sup>(34)</sup> Special Report No 8/2011.

<sup>(35)</sup> On a monthly basis for EAGF and a quarterly basis for EAFRD.

<sup>(36)</sup> Special Report No 7/2010.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Validation of paying agencies' inspection results**

3.45. The certification bodies are requested to give an opinion on the quality of the on-the-spot inspections carried out by the paying agencies and to validate the compilation of the inspection results. The Commission in its AAR uses the inspection results to assess the residual error rate in agriculture expenditure.

3.46. The Commission guidelines leave the certification bodies the choice to either accompany or to re-perform on-the-spot inspections. A vast majority of the certification bodies choose to validate the quality of the inspections not by way of re-performance but by way of accompanying the national inspectors. Based on its experience, the Court considers that the quality of inspections would improve if certification bodies were required systematically to re-perform previous inspections.

Where undue payments to beneficiaries can be identified as a result of the conformity clearance, Member States are required to follow them up with recovery actions against these beneficiaries. However, even where recoveries from beneficiaries are not needed because the financial correction relates only to deficiencies in the Member States' management and control system and not to undue payments, these corrections are an important means to improve the Member States' systems and thus to prevent or detect and recover irregular payments to beneficiaries.

The use of flat rates has been accepted by the Court of Justice as being in conformity with the legal rules governing the conformity work and endorsed, under certain circumstances, by the European Parliament in its 2007 discharge resolution (§ 83).

Finally, the Commission has indicated to Member States that if their certification bodies fully re-perform a representative sample of transactions which the paying agency has checked on-the-spot and, on this basis, confirm the reliability of a Member State's control statistics, then the Commission will accept that the resulting error rate represents the maximum risk possible and that any financial corrections for the year in question will not exceed that level.

**3.46.** Even though the Commission agrees that, if carried out in due time, a re-performance of a previous check provides a better assessment of the quality of on-the-spot checks, it is still possible to evaluate the control environment through inspections accompanied by the certification body. In certain cases it may not even be possible to re-perform a check in due time. These limitations are inherent in many ex-post controls performed by external auditors. In such situations, accompanied inspections are a good alternative. They also have the additional benefit of reducing the administrative burden on the farmer by avoiding an accumulation of controls.

An analysis of the certification bodies' reports, with regard to financial year 2010, shows that the certification bodies checked in total around 3 000 controls. Where the certification bodies carried out the checks required, inspections were re-performed in around 24 % of the cases, accompanied in a further 45 %, while in 12 % both approaches were used. In an additional 19 % of the cases, the certification bodies did not distinguish explicitly between the two methods.

## THE COURT'S OBSERVATIONS

3.47. Whilst the Court's own re-performance of EAGF area inspections carried out in Bulgaria, Romania, Greece and the Netherlands <sup>(37)</sup> showed weaknesses in the quality of national inspections, the respective certification bodies reported that the quality of inspections was good <sup>(38)</sup> or at least adequate <sup>(39)</sup>.

3.48. Furthermore, EU legislation requires the certification bodies to be operationally independent from the paying agencies in order to avoid any potential conflict of interest. Whilst in most Member States the certification body function has been assigned to either the national audit office, a private audit company or the internal audit department of the ministry of finance, the Netherlands have assigned this function to the internal audit department of the Ministry of Agriculture which the Court considers not to be independent from the authorities implementing the CAP.

### Policy areas Environment, Maritime Affairs and Fisheries, Health and Consumer Protection

3.49. Environment, Maritime Affairs and Fisheries as well as Health and Consumer Protection are managed by the Commission under specific control systems. The audit examined the internal control system of DG ENV.

#### Internal Control System of DG ENV

3.50. Thirty randomly selected payments funded by the LIFE+ programme were tested. The audit revealed that key controls were not adequately documented with the risk that such controls are not performed. Furthermore, checks on costs claimed in certain cases were not properly documented.

3.51. Three out of the 30 payments tested relate to grants awarded to the OECD. DG Environment did not check the supporting documents for costs incurred, and considered these costs as eligible on the sole basis of their description in the final report. However, the final report did not provide sufficient information to determine whether the costs had actually been incurred and were eligible.

## THE COMMISSION'S REPLIES

**3.47.** *In the cases of Bulgaria, Romania and the Netherlands, the financial impact of any weaknesses in the inspections carried out by the paying agencies was not material and they were therefore correctly assessed as good or adequate by the certification bodies in accordance with the Commission's guidelines.*

*Regarding Greece, the certification body assessed in its financial year 2010 report certain elements of on-the-spot controls to be poor and others to be adequate.*

**3.48.** *The Commission will follow up the issue with the Dutch authorities with a view to reinforcing the operational independence of the certification body. However, the Commission notes that the Court did not observe anything that would suggest that the independence risk has materialised.*

**3.50.** *Each financial and technical agent acknowledges he/she has performed the necessary controls under his responsibility by signing the transactions. A number of notes for the files, exchange of e-mails and handwritten notes demonstrate that files are checked. The Commission considers its internal control system as reliable. However, it will continue to improve the documentation of some key controls.*

**3.51.** *The accounting, internal control, audit and procurement procedures of OECD have been checked by the Commission in the framework of Article 53d of the Financial Regulation and it offers guarantees equivalent to internationally accepted standards. The final report was considered acceptable taking into account the specific control arrangements defined in the Framework agreement of 2006 between the Commission and OECD.*

<sup>(37)</sup> See example 3.4.

<sup>(38)</sup> Greece and Netherlands.

<sup>(39)</sup> Bulgaria and Romania.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

3.52. **Annex 3.3** contains a summary of the results of the review of Commission management representations, notably the annual activity reports (AAR) and declarations by Directors-General, for Commission DG AGRI, CLIMA, ENV, MARE and SANCO.

3.53. DG AGRI's 2009 AAR contained a reservation regarding expenditure for rural development measures under axis 2 (improving the environment and the countryside). The Director-General did not consider it necessary to carry over this reservation to the 2010 AAR. The Court considers that the lifting of this reservation was not justified (see **Annex 3.3**).

**3.52.** *In this annex the Court states that DG ENV has lifted a reservation based on assumptions that are not proven. DG ENV considers that its assessment is based on the analysis of 4 years of risk based audits and DG ENV is confident that it constitutes a sound basis for the calculation of the error rate and lifting of the reservation. Likewise, the Commission did not consider it necessary to issue a reservation for DG SANCO as the residual error rate after correction of the errors detected was below 2 %.*

DG MARE dropped a reservation although the Member State did not accept the correction entirely because the closure of the programme concerned is ongoing and the necessary (full) financial correction will be made by the Commission in the closure exercise. In these circumstances DG MARE considered that it was appropriate not to maintain the reservation.

*These are management decisions resulting from a careful consideration of the circumstances and an assessment of risks which provides the most reliable basis for the declaration of assurance.*

**3.53.** *The reservation in DG AGRI's AARs 2008 and 2009 regarding expenditure for rural development measures under Axis 2 was justified by the fact that for these measures Member States' control statistics showed an error rate which was significantly above the 2 % materiality threshold currently used by the Court, which in turn was the reason why the error rate for rural development expenditure as a whole, which according to the Commission's standing instructions on making reservations is the basis for assessing the materiality of errors, also remained above 2 %.*

*In 2010, as a result of the joint efforts of the Commission and the Member States, the quality and reliability of these control statistics and the degree of quantification of the errors found and reported improved significantly. These improvements allowed DG AGRI to calculate the residual error rate for rural development as a whole, more precisely than in previous years, when it did not have the necessary assurance that Member States compiled their statistics with the necessary rigor, by now using the same methodology as that used for EAGF expenditure. On the basis of this approach, the residual error rate for rural development as a whole was below the 2 % materiality threshold <sup>(1)</sup>.*

<sup>(1)</sup> The calculation is based on information provided by all Member States with the exception of Cyprus and Portugal, which were not able to comply with the new reporting standards for the financially important agri-environmental measures. However, even if these two Member States should have higher than average error rates, their impact would in all likelihood not increase the residual error rate for rural development as a whole above the 2 % materiality threshold.

## THE COURT'S OBSERVATIONS

3.54. As in 2009 DG AGRI continues to consider that the anomalies found by national inspectors during randomly selected on-the-spot inspections reflect the residual error rates for the aid scheme in question. The Court maintains the observation already made in its 2009 Annual Report that it cannot endorse this approach which is affected by the following deficiencies:

- it is based on inspections the quality of which the Commission's own and the Court's audits show for several paying agencies is insufficient,
- it relies on statistics which the Commission is already aware were incorrectly compiled, and
- it is incomplete because it disregards the residual errors in the administrative management of claims which have been shown to be deficient.

## CONCLUSIONS AND RECOMMENDATIONS

### Conclusions

3.55. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2010 for Agriculture and Natural Resources were affected by material error. However, direct payments covered by IACS were free from material error.

## THE COMMISSION'S REPLIES

Moreover, the action plan set out in the reservation of previous years had been completed, and the error rates reported were, with a couple of exceptions, considered tolerable. Any further reduction of errors could have only been achieved by increasing the level of on-the-spot checks, which would not be cost effective.

Finally, as regards the high error rates for Bulgaria and Romania for measures under Axis 2, the relevant expenditure for these two Member States was covered by the reservation for IACS. Likewise, the new reservation for Portugal due to the serious deficiencies in its IACS also covered the Axis 2 expenditure.

**3.54.** *The Member States' control statistics are verified and validated to a large extent by the certification bodies, as recommended as an option by the Court in its annual report for 2005, and the results of this work are disclosed in DG AGRI's Annual Activity Report.*

*In order to address the risk that the error rates derived from these control statistics could have been understated due to inaccuracies in the databases or inadequate follow up of anomalies, as referred to by the Court, DG AGRI applied a safety margin of a 25 % increase which it considers largely sufficient to cover the risks referred to by the Court. Even with such an increase, the residual error rates for expenditure on direct aids, market intervention and rural development measures would still be far below 2 %.*

*Moreover, for the first pillar, and in particular the direct payments covered by the IACS, the results of the Court's own audits confirm an error rate well below the 2 % materiality threshold which essentially corroborates the results of the control statistics and shows that the supervisory and control systems function efficiently.*

**3.55.** *The Court's conclusion for Agriculture and Natural Resources confirms the positive trend that in the past years the most likely error is close to the materiality threshold of 2 %. The Commission further notes that for EAGF expenditure, which in 2010 accounted for 77 % of total expenditure under this Chapter, the most likely error is well below the materiality threshold and that for direct payments covered by the IACS it is even lower.*

*Moreover, the risk to the EU budget is adequately covered by the conformity clearance procedure.*

## THE COURT'S OBSERVATIONS

3.56. Based on its audit work, the Court concludes that the supervisory and control systems audited for Agriculture and Natural Resources were partially effective in ensuring the regularity of payments.

## Recommendations

3.57. **Annex 3.4** sets out the result of the Court's review of progress made in addressing the recommendations contained in previous Annual Reports (2008 to 2009). The following points should be noted:

- the Commission has taken important remedial action as regards simplification of rural development measures and the reliability and completeness of information recorded in the LPIS,
- as regards the recommendations that minimum annual maintenance requirements for grassland should be set at EU level and that EU legislation should exclude that direct aid is paid to claimants who neither used the land for farming nor maintained it in GAEC the new Council regulation left these issues to the discretion of the Member States.

## THE COMMISSION'S REPLIES

**3.56.** *The Commission considers that the IACS is generally an effective control system for limiting the risk of error or irregular expenditure.*

*As regards rural development, the Commission considers that the supervisory and control systems are constantly improving and that, as a result, the error rate is decreasing in this area.*

**3.57.**

- *In the last 4 years, the Commission and the Member States have implemented an action plan aiming at ensuring a better controllability of the agri-environmental measures, which has resulted in a reduced error rate. Simplification initiatives have been implemented for the current programming period and will continue to be pursued in the future for the CAP reform post-2013. However, it is clear that a right balance needs to be found between the policy goals, the administrative costs and the risk of errors.*

*As of claim year 2010, Member States are obliged to assess the quality of their LPIS. Whilst 2010 is the first year, this exercise has already been helpful for Member States as regards identification of areas requiring attention.*

- *The current system provides for a common legal framework within which the Member States are responsible for defining the maintenance criteria under the GAEC. This allows for the diversity of agricultural areas and traditions in the EU to be taken into account.*

*The issue of the farmer definition referred to by the Court has been addressed in the framework of the Health Check by giving Member States the possibility to exclude natural or legal persons from the direct payment schemes whose principal business objects do not consist of exercising an agricultural activity or whose agricultural activities are insignificant (Article 28(2) of Regulation (EC) No 73/2009).*

*Further reflections on targeting support to active farmers are, as indicated in the Commission Communication on the CAP towards 2020, envisaged in the context of the post-2013 CAP, bearing in mind the need to avoid complicated rules which would result in a complex control system whose implementation would be costly and contrary to the simplification efforts of the Commission.*

## THE COURT'S OBSERVATIONS

3.58. Following this review as well as the findings and conclusions for 2010, the Court recommends that the Commission takes appropriate action to ensure that:

- (a) the use of ortho-photos becomes mandatory and that the LPIS is regularly updated on the basis of new ortho-photos (see paragraph 3.31);
- (b) the paying agencies remedy the weaknesses identified where the control systems and IACS databases were found to be deficient (see paragraphs 3.23 to 3.25);
- (c) the on-the-spot inspections are of the quality necessary to identify the eligible area in a reliable manner (see paragraphs 3.38 and 3.39);
- (d) the quality of inspections is adequately checked and reported by the certification bodies (see paragraphs 3.46 and 3.47).

3.59. In the area of Rural Development, the Court recommends that the Commission and the Member States remedy the weaknesses identified, notably by improving the effectiveness of the checks carried out for non-IACS measures.

3.60. Finally, effective measures need to be taken by the Commission and the Member States so that the issues identified in the policy areas of Environment, Fisheries, Health and Consumer Protection are resolved.

## THE COMMISSION'S REPLIES

**3.58.**

- (a) *The issue of a regular update of the LPIS is taken into account in the newly introduced mandatory quality assessment of the LPIS. Making the use of ortho-photos mandatory is being considered in the context of the CAP reform post-2013.*
- (b) *The Commission works with the Member States to ensure a continuous improvement of the supervisory and control systems. Recommendations are made in this respect as part of the normal audits and action plans are developed and implemented by Member States with serious problems. The Commission considers that these plans have been successful.*

*Moreover, as of claim year 2010, Member States are obliged to assess the quality of their LPIS. Whilst 2010 is the first year, this exercise has already been helpful for Member States as regards identification of areas requiring attention.*

*Any remaining weaknesses are followed up through conformity clearance procedures to protect the EU's financial interests.*

- (c) *Where the Commission finds such weaknesses, recommendations for rectification are made to the Member State and financial corrections are imposed through conformity clearance procedures to protect the EU's financial interests.*
- (d) *The Commission considers the overall structure and reporting requirements with regards to the review of on-the-spot controls by the certification bodies to be appropriate (see also reply to points 3.46 and 3.47). Consequently, no changes in the Commission's guidelines to certification bodies are foreseen for financial year 2011. The Commission will, however, continue to monitor the quality of the work of the certification bodies.*

**3.59.** *The Commission considers that much progress has been made in improving the management and control systems for rural development and that this is borne out by the continuing downward trend in the error rates, in particular for the non-IACS measures where, according to Member States' control statistics, the error rate for 2010 was far below the material level of 2 %.*

**3.60.** *The Commission will examine the errors identified by the Court to determine whether they result from systemic weaknesses and where they do take measures to address them. In addition, when proposing new expenditure programmes, the Commission will seek to simplify the rules while maintaining an appropriate level of control. The aim is to encourage potential beneficiaries to apply for EU financial support and to reduce errors and administrative burden for the beneficiaries, the Commission and the Member States. In shared management the Member States will have to ensure that national eligibility rules are clear, simple and effectively controlled to reduce error rates.*

## ANNEX 3.1

## RESULTS OF TRANSACTION TESTING FOR AGRICULTURE

	2010				2009	2008	2007
	EAGF	RD	SANCO, ENV, MARE	Total			
<b>SIZE AND STRUCTURE OF THE SAMPLE <sup>(1)</sup></b>							
Total transactions (of which):	146	80	12	<b>238</b>	241	204	196
Advances	0	0	0	<b>0</b>	0	0	0
Interim/Final payments	146	80	12	<b>238</b>	241	204	196
<b>RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup> <sup>(3)</sup></b>							
<b>Proportion of transactions tested found to be:</b>							
Free of error	73 % (107)	50 % (40)	33 % (4)	<b>63 % (151)</b>	73 %	68 %	69 %
Affected by one or more errors	27 % (39)	50 % (40)	67 % (8)	<b>37 % (87)</b>	27 %	32 %	31 %
<b>Analysis of transactions affected by error</b>							
<b>Analysis by type of expenditure</b>							
Advances	0 % (0)	0 % (0)	0 % (0)	<b>0 % (0)</b>	0 %	0 %	0 %
Interim/Final payments	100 % (39)	100 % (40)	100 % (8)	<b>100 % (87)</b>	100 %	100 %	100 %
<b>Analysis by type of error</b>							
Non-Quantifiable errors:	26 % (10)	48 % (19)	50 % (4)	<b>38 % (33)</b>	36 %	32 %	36 %
Quantifiable errors:	74 % (29)	52 % (21)	50 % (4)	<b>62 % (54)</b>	64 %	68 %	64 %
Eligibility	3 % (1)	48 % (10)	100 % (4)	<b>28 % (15)</b>	17 %	20 %	36 %
Occurrence	0 % (0)	0 % (0)	0 % (0)	<b>0 % (0)</b>	2 %	2 %	3 %
Accuracy	97 % (28)	52 % (11)	0 % (0)	<b>72 % (39)</b>	81 %	78 %	61 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS <sup>(4)</sup></b>							
<b>Most likely error rate:</b>				<b>2,3 %</b>			
Lower error limit				0,8 %			
Upper error limit				3,8 %			

<sup>(1)</sup> These parts of the table refer only to the sample mentioned in the first indent of paragraph 3.16 and exclude transactions examined in the framework of the coordinated audits.

<sup>(2)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(3)</sup> Numbers quoted in brackets represent the actual number of transactions.

<sup>(4)</sup> The results of the examination of the transactions examined in the framework of the coordinated audits are included in the calculation of the error rate.

## ANNEX 3.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR AGRICULTURE AND NATURAL RESOURCES

## 3.2.1 Assessment of selected supervisory and control systems (IACS) — EAGF

Member State (Paying agency)	Scheme	IACS related Expenditure (= national ceiling — Annex VIII to Regulation (EC) No 73/2009) (1 000 euro)	Administrative procedures and controls to ensure correct payment including quality of data- bases	On-the-spot inspection methodology, selection, execution, quality control and reporting of individual results	Implement- ation and control of GAEC/Cross- compliance	Overall assessment
Germany (Niedersachsen)	SPS	5 770 254	Effective	Partially effective C	Partially effective b	Effective
Germany (Sachsen)	SPS	5 770 254	Effective	Effective	Partially effective b	Effective
Spain (Castilla-La Mancha)	SPS	4 858 043	Partially effective 1, 2, 3, 4	Partially effective A, B	Effective	Partially effective
Spain (Extramadura)	SPS	4 858 043	Partially effective 1, 4, 5, 6	Partially effective C	Partially effective a	Partially effective
United Kingdom (Wales)	SPS	3 985 895	Effective	Partially effective B, D	Partially effective b	Effective
The Netherlands	SPS	853 090	Effective	Partially effective D	Partially effective a	Effective

N.B. The overall assessment cannot be any better than the assessment of the administrative procedures and controls.

- 1 Ineligible areas on permanent pasture covered with dense forest are not reliably identified.
- 2 Overdeclaration penalties not correctly applied.
- 3 Underdeclaration penalties not correctly applied.
- 4 Incorrect treatment of claim modifications.
- 5 LPIS not correctly updated after on-the-spot checks.
- 6 The obvious error concept is not correctly applied.

- A The allocation of the controlled population to risk based or random selection in the control statistics is made *ex post*.
- B Rapid field visits are treated as on-the-spot controls.
- C The eligible area for a crop group is not determined correctly.
- D Insufficient quality of on-the-spot checks.

- a Insufficient national GAEC requirements for grassland and poor pasture.
- b Inadequate requirements for maintenance of land taken out of agricultural production.

## 3.2.2 Assessment of selected supervisory and control systems — Rural development

Member State (Paying agency)	Administrative procedures and controls to ensure correct payment including quality of databases	On-the-spot inspection methodology, selection, execution, quality control and reporting of individual results	Implementation and control of GAEC/ Cross-compliance	Overall assessment
France	Not effective 1, 2, 3	Partially effective A, B, C	Partially effective c	<b>Not effective</b>
Germany (Mecklenburg-Vorpommern)	Effective	Effective	Partially effective b	<b>Effective</b>
Italy (Tuscany)	Partially effective 2, 3	Partially effective A, B, C	Partially effective a	<b>Partially effective</b>
Latvia	Not effective 2, 3, 4	Effective	Effective d	<b>Not effective</b>
Poland	Partially effective 2, 3, 4	Effective B	Partially effective b	<b>Partially effective</b>
Portugal	Partially effective 3, 4	Partially effective B, C, D	Partially effective a	<b>Partially effective</b>
Romania	Partially effective 2, 3, 4	Partially effective 3, C	Effective	<b>Partially effective</b>
UK (Scotland)	Partially effective 1	Partially effective 1, C, D	Partially effective 1, c, d	<b>Partially effective</b>
Czech Republic	Partially effective 2, 3, 5	Partially effective C, E, a	Partially effective a, c, e, E	<b>Partially effective</b>

1 Payments before finalisation of compulsory controls.

2 Incorrect rules, calculations and payments (overpayment, tolerance rules, non-eligible expenditure, reductions).

3 Lack of evidence, deficiencies and ineffective checks related to eligibility conditions and commitments.

4 Absence of suitable system to evaluate the reasonableness of the costs proposed.

5 Failure in administrative checks of aid applications totally or partially withdrawn.

A No evaluation of the on-the-spot control results and failure to increase the sample of beneficiaries to be checked.

B Deficiencies in selection methodology and non-respect of the regulatory minimum rate for on-the-spot controls.

C Weaknesses related to the quality of the on-the-spot controls carried out and of the ex-post checks.

D Delays and inconsistencies concerning the statistics and the checks results communicated to Commission.

E Sanction rules not compliant with EU legislation.

a Checks carried out with delays and not spread over the year.

b Non-compliance with the identification and registration of animals and non-respect of the compulsory notifications.

c Lack of evaluation of non-compliances found and inconsistencies in the control reports examined.

d Compulsory rate of checks for SMR7 not achieved and discrepancies in statistics on cross-compliance checks.

e Insufficient national GAEC standards.

## Overall assessment of supervisory and control systems

Overall assessment	2010	2009	2008	2007
	Partially effective	Partially effective	Partially effective	Partially effective

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR AGRICULTURE AND NATURAL RESOURCES

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
DG AGRI	<b>with reservations</b>	Serious deficiencies in the IACS in Bulgaria, Portugal and Romania	<p>The maintenance of the reservations is consistent with the Court's finding in these Member States.</p> <p>The declaration of assurance in DG AGRI's 2009 AAR contained a reservation on the expenditure for rural development measures under Axis 2 (improving the environment and the countryside) of the 2007-2013 programming period. In the 2010 AAR, DG AGRI did not carry over this reservation. The Court found that this reservation should have been maintained because:</p> <p>(a) the Commission's methodology to calculate the error rate was not fully transparent and was based on a number of choices. Different choices could have been made which would have led to an error rate above the 2 % threshold;</p> <p>(b) the data used to calculate the error rate showed shortcomings and was in some cases not reliable. In particular the quality of the Member States' control statistics, which formed the basis for calculating the error rate, was found to be of insufficient quality.</p>	B	B
DG CLIMA	<b>with reservation</b>	Reservation on reputational grounds related to a significant security breach identified in the national registries of the EU Emissions Trading System.		A	
DG ENV	<b>without reservations</b>		DG ENV did not maintain its reservation although the error rate of <i>ex-post</i> audits, which caused the reservation in 2009, increased from 5,97 % to 7,14 %. DG ENV justified this with assumptions on the effect of the sampling method on the error rate which could not be proven.	B	



Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
DG MARE	<b>with reservations</b>	Management and control systems for the FIFG Operational Programmes in Germany Objective 1.	DG MARE dropped its reservation for UK — Wales and Valleys although the UK authorities did not accept the correction entirely.	<b>B</b>	B
DG SANCO	<b>without reservations</b>		Although audits of the Court and of IAC revealed significant weaknesses, DG SANCO did not issue a reservation.	<b>B</b>	

(\*) By reference to the Declaration of Assurance of the Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: the Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity.

B: the Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

C: the Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR AGRICULTURE AND NATURAL RESOURCES

Year	Court Recommendation	Progress made	Commission reply	Court analysis
	The Court recommends that the systems weaknesses identified are resolved. In this regard, the most urgent deficiencies to be addressed for the SPS and SAPS are (paragraph 3.73 of the 2009 AR (1));			
2008 and 2009	(a) to overcome the systems weaknesses leading to errors relating to ineligible land or over-declarations of land as well as inaccurate entitlements, notably by improving the reliability and completeness of the data recorded in the LPIS (e.g. most recent ortho-photos);	As of claim year 2010 Commission Regulation (EU) No 146/2010 introduced the requirement for Member States to annually assess the quality of their LPIS. The result of the assessment and eventual remedial actions have to be reported annually to the Commission.  As regards the reliability of the entitlement database the new regulation provides that entitlements allocated before 2009 shall be deemed legal and regular as of claim year 2010.	(a) <i>The Commission shares the Court's evaluation. It will continue to monitor the results in the following years.</i>	<b>This new requirement is a useful step towards a better quality of the LPIS in the Member States. The Court will follow the implementation of this requirement in its future audits.</b>  <b>The Court welcomes the new provision which introduces legal certainty.</b>
	(b) to ensure that all IACS databases provide a reliable and full audit trail for all modifications made;	No progress has been made.	(b) <i>As part of its audits, the Commission makes recommendations to Member States so as to improve the situation on a continued basis. Over the years, the results of audits show progress as regards the quality of the information in the databases.</i>	
	(c) to clarify and enforce further the rules so that EU direct aid is not paid to claimants who have neither used the land for farming nor maintained it in GAEC;	Council Regulation (EC) No 73/2009 stipulates that from 2010 Member States may establish appropriate objective and non-discriminatory criteria to ensure that no direct payments are granted to a natural or legal person:  (a) whose agricultural activities form only an insignificant part of its overall economic activities; or  (b) whose principal business or company objects do not consist of exercising an agricultural activity.	(c) <i>The issue of the farmer definition referred to by the Court will be addressed in the framework of the post-2013 CAP, as mentioned in the Commission Communication 'CAP towards 2020' of 18 November 2010.</i>	<b>As this requirement has been left to the discretion of the Member States, the Court considers that the risk of payments to claimants who have neither used the land for farming nor maintained it in GAEC still exists.</b>

Year	Court Recommendation	Progress made	Commission reply	Court analysis
	(d) to set at EU level minimum annual maintenance requirements for grassland to be eligible for EU direct aid.	No progress has been made.	(d) <i>The current system provides for a common legal framework within which the Member States are responsible for defining the maintenance criteria under the GAEC. This allows for the diversity of agricultural areas and traditions in the EU to be taken into account.</i>	
2008 and 2009	Further efforts are required in the area of rural development to further simplify the rules and conditions (paragraph 3.74 of the 2009 AR and 5.66 of the 2008 AR).	Simplification received significant attention in 2010. Apart from discussions in the more general context of the debate on the future of the CAP, the following actions took place for pillar 2. Simplification was discussed in six of the eight meetings of the committee on rural development held in 2010. These discussions were based on contributions from the Member States and working documents prepared by the Commission. A key item of these discussions concerned eligibility rules. Such issues were also being considered at the simplification experts group. In September 2010, a seminar took place on 'ensuring good management of rural development programs 2007-2013'. In addition, a study was launched on 'red tape for beneficiaries in the second pillar' aiming to reduce administrative burdens associated with rural development.	<p><i>In response to the list of 39 simplification suggestions, put forward by Member States during the Council meeting of April 2009, the Commission carried out the following simplification related activities:</i></p> <p><i>First, in October 2010 the Commission adopted a proposal to amend Council Regulation (EC) No 1698/2005 in order to:</i></p> <ul style="list-style-type: none"> <li><i>— reduce the number of Rural Development Strategic Monitoring reports from three to two,</i></li> <li><i>— facilitate tailor made advice of farm advisory services,</i></li> <li><i>— allow Member States to apply follow-up checks for minor infringements and the 'de-minimis' rule only on the basis of a risk sample instead of 100 % systematic checks.</i></li> </ul> <p><i>The proposal is currently pending before the EP and the Council.</i></p> <p><i>Secondly, also in response to the list of 39 simplification suggestions, the provisions on control procedures and cross-compliance have been clarified and precise obligations have been spelled out in the implementing rules, in the context of a recast (Regulation (EU) No 65/2011).</i></p> <p><i>Other significant simplification efforts in the area of rural development are indeed targeting the next programming period, which can be explained by the fact that it is difficult to introduce major changes while the programs are running.</i></p> <p><i>Finally, once the results of the study on administrative burden in the II Pillar are known, these could be taken into account by the Commission and Member States in order to further reduce the level of red tape to beneficiaries.</i></p>	<b>Considerable efforts were undertaken in 2010 to discuss and analyse the simplification of rules and conditions. This will provide a useful input to streamline rural development in the next programming period. This has, however, not yet led to concrete simplification actions in the current programming period.</b>

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2008 and 2009	Effective measures need to be taken, together with the concerned national authorities, to avoid the payment of ineligible expenditure for fisheries projects (paragraph 3.76 of the 2009 AR <sup>(2)</sup> ).	The controls over eligible expenditure required under the European Fisheries Fund have been strengthened compared with the controls carried out under the previous Financial Instrument for Fisheries Guidance.	DG MARE Audit activity in 2010 did not detect a material amount of ineligible expenditure.	<b>The Court will follow the revised control arrangements in its future audits.</b>
	Internal controls on payments for animal disease eradication and monitoring programmes to the Member States require a clear segregation of functions between the Commission services and the development of appropriate formal control procedures (paragraph 3.76 of the 2009 AR).	The Commission services clarified the segregation of functions and started a project to simplify the legal base for the programmes.	Clarifications and simplifications were already introduced into Commission Decision 2010/712/EU on the financial contribution for the eradication programmes. In 2012, the Commission will also propose modifications to Council Decision 90/424/EEC which is the legal base for reimbursing eligible costs under the eradication programmes.	<b>The Court will follow the revised control arrangements in its future audits.</b>

<sup>(1)</sup> Similar recommendations were made in paragraph 5.65 of the 2008 AR.

<sup>(2)</sup> Similar recommendations were made in paragraph 5.67 of the 2008 AR.

## CHAPTER 4

**Cohesion, Energy and Transport**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

4.1. This chapter presents the Court's specific assessment of Cohesion, Energy and Transport, which comprises policy areas 04 — Employment and Social Affairs, 06 — Energy and Transport and 13 — Regional Policy. This chapter also reports on the Commission's response to the recommendations in three of the Court's Special Reports. Key information on the activities covered and the spending in 2010 is provided in **Table 4.1**.

**Table 4.1 — Cohesion, Energy and Transport — Key information 2010**

(million euro)

Budget title	Policy area	Description	Payments	Management mode
4	Employment and social affairs	Administrative expenditure	97	Centralised direct
		European Social Fund	7 066	Shared
		Working in Europe — Social dialogue and mobility	56	Centralised direct
		Employment, social solidarity and gender equality	155	Centralised direct
		European Globalisation Adjustment Fund	104	Shared
		Instrument for Pre-Accession Assistance (IPA, formerly ISPA)	3	Decentralised
			<b>7 481</b>	
6	Energy and Transport	Administrative expenditure	153	Centralised direct
		Inland, air and maritime transport	149	Centralised direct
		Trans-European Networks (TENs)	858	Centralised direct
		Conventional and renewable energies	773	Centralised direct
		Nuclear energy	237	Centralised direct/Centralised indirect/joint
		Research related to energy and transport (Framework Programmes)	226	Centralised direct
		Security and protection of energy and transport users	3	Centralised direct
		EU satellite navigation programmes (EGNOS and Galileo)	460	Centralised direct
			<b>2 859</b>	
13	Regional Policy	Administrative expenditure	83	Centralised direct
		European Regional Development Fund (ERDF) and other regional operations	22 091	Shared
		Cohesion Fund (CF)	7 957	Shared
		Instrument for Pre-Accession Assistance (IPA, formerly ISPA)	479	Decentralised
		Solidarity Fund	13	Indirect
			<b>30 623</b>	
		Total administrative expenditure <sup>(1)</sup>	333	
		Total operational expenditure	40 630	
		Of which: — advances	3 074	
		— interim/final payments	37 556	
		<b>Total payments for the year</b>	<b>40 963</b>	
		<b>Total commitments for the year</b>	<b>55 223</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in chapter 7.

Source: 2010 annual accounts of the European Union.

## THE COURT'S OBSERVATIONS

4.2. The European Regional Development Fund (ERDF), European Social Fund (ESF) and Cohesion Fund (CF) are implemented in multiannual programming periods. In 2010, payments of the ERDF (22,1 billion euro), the ESF (7,1 billion euro) and the CF (8,0 billion euro) amounted to more than 90 % of operational expenditure for the policy group as a whole<sup>(1)</sup>. Energy and Transport payments in 2010 were 2,9 billion euro.

### Specific characteristics of the policy group

#### *Policy objectives*

##### **Cohesion policy**

4.3. Cohesion policy aims at strengthening economic and social cohesion within the European Union by reducing the gap in the level of development between different regions.

##### **Energy and Transport**

4.4. Energy and transport policies aim to provide European citizens and businesses with secure, sustainable and competitive energy and transport systems and services and to develop innovative solutions that contribute to the formulation and implementation of these policies.

#### *Policy instruments*

##### **Regional policy**

4.5. Regional policy accounts for 75 % of spending in this policy group. Spending on regional policy is principally accounted for by the ERDF and the CF (which together amount to 98 % of regional policy expenditure in 2010). The ERDF finances infrastructure works, the creation or preservation of jobs, regional economic development initiatives and, mainly through Financial Engineering Instruments (FEIs), activities supporting small and medium-sized enterprises (SMEs). In Member States whose gross national income per capita is below 90 % of the EU average, the CF finances investments in infrastructure in the fields of environment and transport.

<sup>(1)</sup> In 2010, 32,8 billion euro or 88 % related to the 2007-2013 programming period, while 4,3 billion euro (12 %) were for the 2000-2006 period. For the CF and the ESF, additional prefinancing payments of 0,4 billion euro and 0,37 billion euro respectively were made in 2010 as part of measures to address the financial crisis. Also, prefinancing payments of 0,6 billion euro were made to energy projects under the European Energy Programme for Recovery (EEPR).

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THE COURT'S OBSERVATIONS

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4.6. Regional policy instruments also include regional and cross-border cooperation measures under the Instrument for Pre-Accession Assistance (IPA) and the EU Solidarity Fund, which provides support in the event of natural disasters in the Member States.

#### **Employment and Social Affairs**

4.7. Employment and social affairs accounts for 18 % of spending in this policy group. The vast majority of expenditure for employment and social affairs (94 % in 2010) is made under the ESF, which funds investments in human capital through training and other employment measures.

4.8. Other spending in this policy area includes subsidies and grants to organisations implementing social and employment actions; the European Globalisation Adjustment Fund, which supports workers in the EU made redundant as a result of major structural changes in world trade patterns or the financial crisis, and a contribution to IPA.

#### **Management and control of spending by ERDF, ESF and CF**

4.9. The ERDF, ESF and CF are governed by common rules and are subject to shared management by the Commission and the Member States.

4.10. The Commission approves multiannual Operational Programmes (OPs), together with indicative financial plans which include the EU contribution, on the basis of Member States' proposals. Projects within the OPs are implemented by private individuals, associations, private or public undertakings or local, regional and national public bodies.

4.11. Member States allocate responsibility for day-to-day administration to Managing Authorities (MAs) and Intermediate Bodies (IBs) <sup>(2)</sup>. This includes the selection of individual projects, the implementation of controls to prevent, detect and correct errors within the declared expenditure and the verification that projects are actually implemented ('first level checks'). Certifying Authorities (CAs) verify that 'first level checks' are effectively carried out and, where appropriate, undertake additional checks prior to submitting expenditure declarations to the Commission.

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<sup>(2)</sup> IBs are public or private bodies acting under the responsibility of a MA and carrying out duties on their behalf vis-à-vis beneficiaries implementing operations.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.12. Audit Authorities (AAs) in the Member States are responsible for carrying out system audits and audits of operations (i.e. projects or group of projects) in order to provide reasonable assurance on the effective functioning of the management and control systems of the programmes and on the regularity of the expenditure certified for each OP. They report on these audits to the Commission through annual control reports and annual opinions.

4.13. At the start of each programming period the Commission makes prefinancing payments to the Member States. The financing of a project generally takes the form of the reimbursement of costs based on expenditure declarations by the project promoters. These individual declarations are aggregated for each priority axis of the OP into periodic expenditure declarations certified by the Member State authorities and submitted to the Commission. This expenditure is then co-financed from the EU budget.

4.14. The eligibility rules are laid down at national (or sometimes regional) level, subject to exceptions in the specific regulations for each Fund. Member States bear primary responsibility for preventing or detecting and correcting irregular expenditure, and for reporting on this to the Commission.

4.15. The Commission has to obtain assurance that the Member States have set up management and control systems which meet the requirements of the regulations, and that the systems function effectively. If the Commission finds that a Member State has failed to correct irregular expenditure or that there are serious failings in the management and control systems, it may interrupt or suspend payments<sup>(3)</sup>. If the Member State does not withdraw the irregular expenditure (which may be replaced by expenditure which is eligible) or does not remedy the detected system failures, the Commission may apply financial corrections, leading to a net reduction in EU funding<sup>(4)</sup>.

**4.14.** *The establishment of eligibility rules at national level (Article 56 of Council Regulation (EC) No 1083/2006) was one of the main elements of simplification introduced in the 2007-2013 programme period. It aimed at providing Member States with more flexibility in adapting eligibility rules to the specific needs of regions or programmes and to harmonise them with rules in force for other, national public schemes.*

**4.15.** *The annual activity reports of DG REGIO and DG EMPL provide detailed assessments of the Commission assurance on the set up and subsequent functioning of management and control systems for each co-financed programme as well for the first time in the report for 2010 an overall assessment of national control systems.*

<sup>(3)</sup> Article 39(2) of Council Regulation (EC) No 1260/1999 (OJ L 161, 26.6.1999, p. 1); Articles 91 and 92 of Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25).

<sup>(4)</sup> Article 99 of Regulation (EC) No 1083/2006.

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THE COURT'S OBSERVATIONS

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### Energy and transport

4.16. Energy and transport accounts for 7 % of spending in this policy group. Around 30 % of energy and transport expenditure is for major projects under the Trans-European Networks (TEN) programme. The other main category of expenditure (27 %) is for projects concerning conventional and renewable energies, largely in the form of grants and subsidies under the European Energy Programme for Recovery (EPR). Another 8 % of the spending is for research projects mainly funded by the Research framework programmes.

### Management and control of energy and transport spending

4.17. The Commission implements Energy and Transport expenditure under direct and indirect centralised management (through two Executive Agencies and a Joint Undertaking<sup>(5)</sup>), but also by joint management (such as nuclear decommissioning funds).

4.18. The Commission generally makes calls for project proposals. Payments for approved projects are made directly by the Commission to beneficiaries, based on grant agreements or Commission financing decisions. These are usually Member State authorities but may also be public or private companies. Payments are made in instalments: an advance (pre-financing) upon signature of the grant agreement or financing decision, followed by interim and final payments to reimburse eligible expenditure reported by beneficiaries.

4.19. The principal elements of control of the expenditure by the Commission include the evaluation of proposals against specified selection and award criteria; the provision of information and guidance to beneficiaries; monitoring and verification of the implementation of projects based on financial and technical progress reports submitted by beneficiaries (including where required by the financing agreement the submission of financial statements certified by an independent external auditor); and *ex-post* audits in order to detect and correct errors which may not have been prevented by earlier controls and to provide reasonable assurance of the regularity of the expenditure.

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<sup>(5)</sup> TEN-Transport Executive Agency, Executive Agency for Competitiveness & Innovation and SESAR (Single European Sky Air Traffic Management Research) Joint Undertaking.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Risks to regularity**ERDF, ESF and CF*

4.20. For Cohesion expenditure the main risk to regularity is that beneficiaries declare ineligible costs. If this is not detected by the different layers of control in the Member State, it leads to an incorrect certification of expenditure by the Member State. If not corrected by the Commission at the latest by the end of the programming period, this results in an overpayment from the EU budget to the OP concerned.

4.21. Those involved in implementing OPs and projects at national or regional level may be unaware of the applicable rules or unsure about their correct interpretation. Additional risks result from the large number and diversity of the co-financed activities and the involvement of multiple, often small-scale, partners in the implementation of projects.

*Energy and transport*

4.22. For Energy and Transport expenditure the main risk to regularity is that beneficiaries may include ineligible costs in their cost statements, which are not detected by the controls of the Commission before reimbursement of the declared costs. For TEN-Transport and TEN-Energy projects, however, it is mitigated by the fact that eligible expenditure often exceeds the co-financing threshold. EEPR funding in particular may support large, complex and transnational projects, and the need to disburse these funds rapidly may be detrimental to the application of adequate controls.

**4.20.** *Since the management and control system has a multi-annual character, an overpayment detected in a payment claim reimbursed by the Commission may not have been yet subject to the entire control chain at national and EU level at the time of certification.*

*The Commission focuses its supervisory role in providing guidance and training to the managing authorities on the appropriate way to carry out management verifications in detecting errors at beneficiary level before certification and closely cooperates with national audit authorities to rapidly audit the most risky programmes or authorities.*

**4.21.** *The 2007-2013 regulatory framework provides that beneficiaries are informed on specific conditions for funding and that the managing authorities satisfy themselves that beneficiaries have the capacity to fulfil those conditions (Article 13(1) of Commission Regulation (EC) No 1828/2006). This condition is checked through the regular audit work conducted by Commission auditors.*

*The Commission has also organised bilateral and multilateral training, and in particular seminars to 'train the trainers' to ensure that Member States continuously train, inform, advise and guide beneficiaries and implementing bodies. Such training is considered to be particularly useful in mitigating the risks associated with small-scale partners, such as NGOs working at regional and local level. Moreover, the Commission has initiated actions in 2011 aiming at providing specific, focussed information and training to Member States, for which operational programmes were subject to reservations in the annual activity reports on a recurrent basis.*

## THE COURT'S OBSERVATIONS

**Audit scope and approach**

4.23. **Annex 1.1, part 2**, describes the Court's overall audit approach and methodology. For the audit of Cohesion, Energy and Transport, the following specific points should be noted:

- the Court's audit involved examination of a sample of 243 interim and final payments <sup>(6)</sup>,
- the assessment of systems focused on Audit Authorities for the 2007-2013 programming period in Cohesion, and
- the review on Commission management representations covered the Annual Activity Reports of DG Regional Policy, DG Employment, Social Affairs and Inclusion, DG Mobility and Transport, and DG Energy.

**REGULARITY OF TRANSACTIONS**

4.24. **Annex 4.1** contains a summary of the results of transaction testing. The Court's testing of its sample of transactions found 49 % of the 243 payments audited to be affected by error. The most likely error estimated by the Court is 7,7 % <sup>(7)</sup>.

<sup>(6)</sup> This sample comprises 243 payments made to 229 Cohesion projects (ERDF: 143, ESF: 60, CF: 20 and Instrument for Structural Policies for Pre-Accession (ISPA): 6), 6 non-ESF social and employment projects and 8 Energy and Transport projects. 205 of the payments to Cohesion projects relate to the 2007-2013 programming period and 24 to the 2000-2006 period. The sample was drawn from all payments, with the exception of advances which amounted to 3,1 billion euro in 2010.

<sup>(7)</sup> The Court calculates its estimate of error from a representative statistical sample. The figure quoted is the best estimate (known as the MLE). The Court has 95 % confidence that the rate of error in the population lies between 4,7 % and 10,7 % (the lower and upper error limits respectively).

## THE COMMISSION'S REPLIES

**4.24.** *The Commission notes that, for the second consecutive year, the level of error remains well below those reported by the Court in the period 2006-2008 <sup>(1)</sup>. The Commission considers that this positive and promising development reflects the reinforced control provisions of the 2007-2013 programming period and its 2008 Action Plan.*

*This result is particularly important since almost all operational programmes declared expenditure as from 2010, thus more than doubling the amount of declared expenditure for cohesion and increasing the inherent risk of error through the large number of actors now involved. The Commission notes that not all the errors reported by the Court will have a financial impact.*

*The Commission notes that the large majority of high quantifiable errors with strong impact identified by the Court are concentrated in seven ERDF operational programmes of three Member States, out of the 16 Member States included in the Court's sample. The Commission is taking measures to correct the errors detected by the Court and focuses its actions on the most risky programmes.*

<sup>(1)</sup> A lower error limit of 11-12 % compared to 4,7 % in 2010.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.25. The Court considers that sufficient information was available for the Member State authorities to have detected and corrected at least some of the errors (prior to certifying the expenditure to the Commission) for 58 % of the transactions affected by error.

**One fifth of transactions affected by breaches of public procurement rules**

4.26. The Court found errors related to non-compliance with EU and national public procurement rules in 19 % of the 243 transactions audited. Serious failures to respect these rules were identified in 5 % of the transactions audited. They account for 24 % of all quantifiable errors and make up approximately 31 % of the estimated error rate for this policy group (see example 4.1).

4.25. The Commission is strictly following up these cases to ensure that the concerned systems better prevent errors before certification in the future.

*Managing authorities are required to perform documentary checks on all claims submitted by beneficiaries, before certification of expenditure. However, on-the-spot verifications on operations may also intervene at a later stage of project implementation, after certification and up to closure, which explains why part of the errors in the Court's sample could not be detected (see Commission reply to paragraph 4.20). The impact of the control system in reducing error rates is usually only seen in subsequent years, after all layers of controls have been implemented.*

4.26. While the Commission and the Court audit compliance with public procurement rules in the same way, the Commission applies proportionate flat-rate corrections thereby properly addressing the risk of damage to the EU budget (see point 11 of Annex 1.1 to Chapter 1).

*These rates are applied by the Commission and generally by national authorities when imposing financial corrections for infringements of public procurement rules, including when following up the errors reported by the Court.*

Example 4.1

**Serious failures to respect public procurement rules**

- (a) Unlawful award of a contract to an offer with an abnormally low price: In the case of an ERDF project, the Court found that a contract for the construction of harbour quays was awarded to a bidder whose price offer was abnormally low. According to the national legislation this should have led to the rejection of the bid since the feasibility of the offer was not assured at the price proposed. The bidder with the second lowest offer successfully appealed against the award decision in a national administrative court. Nevertheless, despite this ruling by a national court, the expenditure was certified to the Commission following completion of the project in 2009.

## THE COURT'S OBSERVATIONS

- (b) Artificial split of works and services in several tenders: In the case of several ERDF projects in the same OP, works and services related to making a river navigable for cruise ships were contracted out in an irregular manner. The contracting authority apportioned the works and services in such a way as to reduce the contract values below the thresholds specified in EU and national public procurement rules, circumventing thus the normal tendering requirements. Subsequently, several of these contracts were awarded to the same contractor.
- (c) Absence of tendering for additional works foreseen by initial tender documentation: In the case of an ERDF project, works related to the renovation of a university building were awarded directly to a contractor. Although these works had been planned in the preliminary terms of reference, the contracting authority treated them as additional works that could not have been foreseen when tendering the main contract.

## THE COMMISSION'S REPLIES

4.27. Moreover, the Court found other compliance and non-quantifiable errors related to tendering and contracting procedures in a further 14 % of the 243 transactions audited. These errors include cases of non-compliance with the information and publicity requirements (such as late publication of award notices), shortcomings in the tender specification or procedural weaknesses in the evaluation of offers. They also cover cases of incorrect transposition of EU Directives into national public procurement laws. These errors are not included in the estimation of the error rate<sup>(8)</sup>.

**Ineligible projects account for more than a third of the estimated error rate**

4.28. In addition, the Court found projects which were wholly ineligible in 3 % of the 243 transactions audited. Such errors account for 14 % of all quantifiable errors and make up approximately 43 % of the estimated error rate for this policy group (see example 4.2).

4.27. *The Commission will follow up all errors reported by the Court. However, for some of these errors which are formal, such as late publication of award notices, the Commission would not impose financial corrections.*

4.28. *The Court identified different types of ineligible projects under this category. This shows that management verifications need to be improved in both quality and quantity by the concerned programme authorities in order to detect such projects already at the stage of their selection. The Commission will follow up these cases with the concerned programme authorities.*

<sup>(8)</sup> Further information regarding the Court's approach to the quantification of public procurement errors is set out in **Annex I.1**, paragraphs 1.10 and 1.11.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## Example 4.2

**Ineligible projects**

- (a) Project not eligible according to national eligibility rules: In the case of an ERDF project, expenditure for a project which had been approved and completed under the previous 2000-2006 programming period was certified to the Commission under the 2007-2013 OP. This was not in line with the national eligibility rules and the project was therefore ineligible.
- (b) Revenue generating project not eligible according to the outcome of a feasibility study: In the case of an ERDF project, the feasibility study which formed part of the project application, showed that the project was expected to generate revenues exceeding the cost of the project, rendering the project ineligible for ERDF co-financing.
- (c) Funding of a project where State aid conditions for public co-financing were not fulfilled: In the case of an ERDF project the project would have been carried out even in the absence of EU support. Therefore the conditions set out in the EU regulations with regard to State aid were not met.

**More than half of all quantifiable errors are due to the declaration of various ineligible costs**

4.29. The Court found various ineligible costs in 12 % of the transactions audited. Such errors account for 59 % of all quantifiable errors and make up approximately 23 % of the estimated error rate for this policy group (see example 4.3).

*4.29. The Commission seeks to ensure through training and guidance that programmes managing authorities are well aware of eligibility rules, and that they carry over this knowledge to all bodies in charge of managing the funds. The Commission will continue its training actions and will focus them on programme authorities where risks have been identified. Reference is made to actions quoted in the answer to paragraphs 4.20 and 4.21.*

## Example 4.3

**Declaration of various ineligible costs**

- (a) Equipment deployed (vendor tooling) outside the eligible area: in an ERDF project the expenditure declaration comprised costs related to the purchase of new equipment. Some of the equipment co-financed was used abroad or in a non-convergence region within the Member State concerned. This is not in line with the eligibility rules for the OP. While this was detected by the IB, the expenditure was still declared to the Commission.

## THE COURT'S OBSERVATIONS

- (b) Use of an incorrect co-financing rate: in the case of an ESF project providing training courses for short-time workers, a company benefited from a higher co-financing rate applicable to small and medium-sized enterprises (SMEs), although it was not an SME.
- (c) Excessive costs charged to project: in the case of an ESF labour market project implemented by a partnership of several organisations, the partners declared costs for co-financing which significantly exceeded the actual costs incurred.
- (d) Lack of supporting evidence for claimed costs: in the case of an ESF education and training project, costs were claimed on the basis of achieved outcomes for the participants. However, for several audited participant files, there was no evidence to support the claimed outcome.

## THE COMMISSION'S REPLIES

**Specific weaknesses in the set-up of financial engineering instruments**

4.30. Financial engineering instruments (FEIs) can be used to provide assistance by way of equity investment, loans or guarantees <sup>(9)</sup>. Funds implementing FEIs receive a contribution from the OP once their legal structure is set up. Subsequently financial support can be provided to final recipients and projects for activities which fall within the scope of the OP. These FEIs are designed to have a revolving character. Any resources returned from investments or loans made, including profits, are to accrue to the fund during its existence and after that must be used again for similar purposes.

4.31. The Regulation specifies that FEIs can be used for three purposes: funds for the support of SMEs (including JEREMIE (Joint European Resources for Micro to Medium Enterprises) <sup>(10)</sup>); for urban development (including JESSICA (Joint European Support for Sustainable Investment in City Areas) <sup>(11)</sup>) and for the promotion of energy efficiency.

**4.30.** *In general, payments to funds are made according to the provisions of funding agreements. In its guidance notes the Commission recommended that managing authorities should proceed prudently with payment of contributions from operational programmes to holding funds and financial engineering instruments in phases and in line with the underlying investment strategy and/or business plan (COCOF note II-2008: Q&A annex reply to question 10; COCOF note III-2011: points 2.4.5, 2.5.5, 2.5.6 and 5.3.6).*

<sup>(9)</sup> Article 44 of Regulation (EC) No 1083/2006.

<sup>(10)</sup> JEREMIE is an initiative of the Commission together with the European Investment Bank (EIB) and the European Investment Fund (EIF) to support additional financing sources for micro, small and medium-sized enterprises.

<sup>(11)</sup> JESSICA is an initiative developed by the Commission and the EIB to make repayable investments (in the form of equity, loans or guarantees) in urban development. These investments are delivered to projects via Urban Development Funds and, if required, Holding Funds.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.32. The Commission does not have detailed information on the funding of FEIs. It estimates that FEIs with a total endowment of approximately 8,1 billion euro have been set up, which by the end of 2010 had received payments of 5,2 billion euro from 2007-2013 OPs. According to Commission estimates this represents approximately half of the envisaged payments from OPs to funds for the current programming period.

4.33. In 2010 13 of the 203 ERDF and ESF payments in the sample audited were to funds implementing FEIs. The Court found compliance errors in seven of these 13 transactions. Most of these errors were due to the non-respect of regulatory requirements for making the contribution from the OP to the fund (see example 4.4).

**4.32.** Article 44 of Council Regulation (EC) No 1083/2006 does not require the Member States to provide such detailed data on FEIs to the Commission. Nevertheless, the Commission obtained information on payments made to funds implementing FEIs from the managing authorities by the end of 2010, on a voluntary basis, to estimate progress of FEIs in supporting businesses. The Commission intends to propose to amend the regulation to include appropriate reporting requirements for the rest of the 2007-2013 period.

## Example 4.4

**Compliance errors in relation to financial engineering instruments**

- (a) Excessive endowment of a guarantee fund managed by a regional financial body: In the case of an ERDF project, the Court found that several required elements (such as the investment strategy and planning, the description of an exit policy and the winding-up provisions) were not in place when the funding agreement was signed by the regional government and the regional agency implementing the fund. Following the signature of this funding agreement, in the last week of December 2009, the endowment of the fund was increased from 17 million euro to 233 million euro (corresponding to 14 % of the total budget of the OP for the entire programming period). Only in June 2010 was a business plan finally prepared and approved, albeit based on unrealistic assumptions. A significant part of the OP's funding committed by the MA in 2007 had not been spent at the end of 2009. Increasing the amount allocated to the guarantee fund made it possible to circumvent the n+2 rule in place at the time by which unused funds must be de-committed after 2 years. By mid-2011, 1,5 million euro out of a total endowment of 233 million euro had been pledged against this fund.

## THE COURT'S OBSERVATIONS

- (b) Delays in establishing a JEREMIE holding fund managed by the European Investment Fund (EIF): for this ERDF project a JEREMIE holding fund had been set up through a complex structure involving three OPs and four different Ministries contributing to a Special Purpose Vehicle (SPV) to be managed by the EIF. After the signature of initial funding agreements with the EIF in October 2009, the MAs concerned declared expenditure which was certified to the Commission in December 2009. This expenditure was related to the contribution to the holding fund from two of the three OPs to a transitional account managed by the EIF. Negotiations regarding the SPV were, however, still ongoing with one of the Ministries in charge of managing the third OP. The final holding fund agreement between the EIF and the SPV was therefore signed only in late December 2010. As a consequence, the structure set up to implement the FEI was not operational during 2010 and the transfer of funds from the transitional account to the SPV took place only in 2011.
- (c) Irregular winding-up provision: In the case of an ERDF project, the agreement signed by the national ministry and the regional agency implementing the JEREMIE fund specified that, in the case of the winding-up of the fund, the remaining capital would be at the disposal of the regional government and should be transferred to the regional treasury. This provision is in breach of the regulatory requirement that resources returned can only be used for the benefit of small and medium-sized enterprises.

4.34. Financial contributions from the OPs to funds implementing FEIs for the whole period are generally made through a single payment as soon as the legal structure of the holding fund has been set up. Alternative financing arrangements can be specified in the funding agreements. In accordance with the regulation, these payments are certified to the Commission as expenditure incurred.

4.35. *Ex-post* verifications of such payments by Audit Authorities generally relate to the financial year in which the payment has been made. By the end of 2010 these checks have had a limited scope since, in the best case, only a few operations had been selected for support and limited amounts had been disbursed to final recipients and projects.

4.36. Unless specific verifications are envisaged, the actual implementation of FEI operations is therefore unlikely to be checked by Audit Authorities until the closure of the 2007-2013 programming period in 2015.

## THE COMMISSION'S REPLIES

4.34. For the 2010 final accounts, on the basis of information provided by the Member States, the Commission reclassified part of the amounts reimbursed to Member States for FEIs as pre-paid expenditure (see Commission reply to Chapter 1, paragraphs 1.33 to 1.36).

4.35. In their joint audit strategy, DG REGIO and DG EMPL have planned thematic audits on FEIs. As specified in the Commission's draft audit manual shared with Member States' audit authorities, these thematic audits should cover both the constitution of the fund and the actual implementation of the FEI projects.

4.36. Audit authorities and the Commission may carry out thematic audits, for example on FEIs. As mentioned in its reply to paragraph 4.35, the Commission has proposed an audit approach to audit authorities that includes the testing of implementation of FEIs through the audit of a sample of projects carried out.

## EFFECTIVENESS OF SYSTEMS

4.37. For the 2007-2013 programming period, Audit Authorities (AAs) in the Member States play a key role in seeking to ensure the regularity of Cohesion expenditure, through their responsibility to verify the effective functioning of the national management and control systems and to submit annual control reports and audit opinions to the Commission (paragraph 4.12). In the current period Member States have set up 112 AAs for ERDF, CF and ESF <sup>(12)</sup>.

### **The work of most of the AAs examined is considered to be partially effective**

4.38. The Court examined a sample of eight AAs (and any delegated audit bodies) in six Member States. For each of them the Court reviewed:

- their organisational arrangements and audit methodology,
- their working documents for up to four systems audits,
- their working documents for a sample of up to 30 audits of operations, including a re-performance of at least eight of those 30 audits, and
- their annual control reports and audit opinions for 2010, together with the related working papers.

4.39. **Annex 4.2** contains a summary of the results of the Court's examination and of the key requirements tested. The Court found that seven of the selected Audit Authorities were at least partially effective in ensuring the regularity of payments.

4.40. The audit highlighted several weaknesses:

- delays in the performance of audits of systems and projects,
- checklists which did not sufficiently cover all risks to the regularity of expenditure, in particular with regard to public procurement and State aid rules, FEIs and publicity requirements. Unlike for system audits, there is no specific guidance by the Commission on the scope of verifications and the extent of checks to be undertaken for the audit of projects,

**4.39.** *The Commission takes the Court's findings into account for its assessment of the national audit authorities, with a view to encourage improvements where still necessary and in order to ensure conditions for single auditing in the coming years in accordance with Article 73 of Council Regulation (EC) No 1083/2006.*

**4.40.**

- *The Commission detected in its review of audit authorities that delays in audit work was in some cases linked to delays in the implementation of operations on the ground.*
- *The Commission also identified as a result of its extensive review of audit authorities and during systems audits the need to reinforce, in some cases and on particular issues, the existing checklists used by national audit authorities for the audit of operations. For this purpose, the Commission has now shared its own checklist for audits on operations, which take into account the check lists established by the Court, with the Member States audit authorities.*

<sup>(12)</sup> 81 AAs for 317 ERDF and CF OPs and 94 AAs for 117 ESF OPs. 63 of these AAs are common for all three funds.

## THE COURT'S OBSERVATIONS

- the use of a sampling methodology which was not in accordance with the guidance on project sampling agreed between the Commission and the Member States or the incorrect application of an agreed sampling methodology, and
- for all AAs, the Court's re-performance of audits of projects identified findings previously not reported by the AA. For six AAs this resulted in a higher overall error rate than reported by the AA in the annual control report.

4.41. The annual control reports and audit opinions are based on the findings of the AAs' audits of operations related to expenditure certified to the Commission in the year preceding and audits of systems completed by the end of June of the financial year of the EU subject to audit by the Court. Moreover, the Court considers that the audit approaches of the AAs differ (even within the same Member State) to such an extent that their results cannot be aggregated to reach an overall opinion by Fund at national or EU level.

## THE COMMISSION'S REPLIES

Moreover, since the beginning of the programming period, the Commission has provided detailed and technical guidance, offered training and conducted technical meetings with auditors of national audit authorities. Furthermore, guidance on the scope and extent of audits on operations that was delivered under the 2000-2006 programming period is still valid since such audits do not differ significantly between both programming periods.

- The Commission underlines that its technical guidance note on sampling serves as a recommendation to audit authorities. It contains illustrative methods, which are neither legally binding nor limitative as regards the choice for the audit authorities of alternative acceptable statistical methods which would be equally valid.
- The Commission notes that the outcome of the recalculation made by the Court is in some cases strongly influenced by the quantification of errors on public procurement (see Commission reply to paragraph 4.26).

4.41. Council Regulation (EC) No 1083/2006 provides for a six-month period between the end of the audit period (June) and the establishment of the annual control report and opinion (December). In its guidance on annual control reports, the Commission, taking into account international audit standards, invited audit authorities to report on subsequent audit events that may occur during this period (July to December).

The Commission would like to underline that taking into account the number of audit authorities in 27 Member States for all cohesion programmes (see paragraph 4.37), the audit approaches may well differ to allow them to adapt to the specificities of the various operational programmes and management and control systems. The regulatory provisions setting out the obligations for audit work are intended to create a situation where an audit authority is in a position to provide an annual audit opinion by programme or by system to the Commission, based on systems audits and on the results of audits drawn on a statistical sample of operations. Directors-General in charge of DG EMPL and REGIO then disclose in their annual activity reports audit and management information, including the one reported by national audit authorities, at appropriate levels of aggregation for the purpose of the annual assurance of the Commission.

In their 2010 annual activity reports, DG EMPL and DG REGIO decided to disclose the error rates communicated for the first year by the Member States in relation to 2009 expenditure (which are consistent with the 2009 DAS results), as well as the audit opinions provided by programme.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**The Commission's examination of AAs was generally satisfactory**

4.42. The Commission completed examinations of 17 AAs (for DG Regional Policy) and of 36 AAs (for DG Employment, Social Affairs and Inclusion). Most AAs experienced delays in implementing their 2010 audit strategy and, as a result, the Commission was in a further five cases not able to finalise its examination as planned.

4.43. The Commission audits found similar weaknesses to those observed by the Court in its own examination of AAs, and the Commission has taken corrective action where appropriate. Based on its own work, the Commission has concluded that the AAs' audit opinions are generally reliable.

4.44. The Court reviewed the working papers and additional supporting documentation for 35 of these 53 Commission audits of AAs. Although DG Regional Policy and DG Employment, Social Affairs and Inclusion have developed a common audit plan for their examination of AAs, differences in approach were noted. Despite these differences the Court considers that overall the Commission has drawn appropriate conclusions from its examination.

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

4.45. The Court assessed the 2010 Annual Activity Reports and accompanying declarations of the Directorates-General for Regional Policy, DG Employment, Social Affairs and Inclusion, DG Mobility and Transport, and DG Energy.

**4.42.** For its examination of audit authorities, DG REGIO carried out 97 audit missions in 13 Member States. This examination is continuing in 2011.

In addition to the examinations of the 36 audit authorities mentioned by the Court, some of the DG EMPL system audits also covered aspects related to audit authorities.

**4.43.** In its 2010 annual activity report, DG REGIO drew the preliminary conclusions from its audit activities that, pending some improvements for some audit authorities, it could fully or to a large extent rely on their audit opinion for 14 audit authorities. For another three audit authorities, substantial improvements are needed for DG REGIO to be able to rely on their opinion.

DG EMPL's supervisory systems envisaged a combination of system audits for high risk operational programmes in combination with a review of a number of audit authorities. In most cases the results were positive. However, these audits have also led to a number of interruptions and suspensions of payments.

**4.44.** The Commission will continue its review of audit authorities and when gaps are identified, it will complete this approach by carrying out specific audits focussed on the more risky areas and programmes.

## THE COURT'S OBSERVATIONS

4.46. **Annex 4.3** contains a summary of the results of the review of Commission management representations.

## THE COMMISSION'S REPLIES

**4.46.** The Commission considers that DG REGIO's annual activity report also merits to maintain the 'A' rating given by the Court in 2009. Indeed, DG REGIO's AAR not only kept the same level of transparency and quality of the information disclosed in 2009, but also improved certain aspects (disclosure of amounts at risk per OP).

The Commission notes that the Court has satisfied itself during its audit that the scope of reservations expressed by the Director-General for DG REGIO (as this is also the case for DG EMPL) is proportionate to problems found in the underlying programmes. The Commission considers that the quantification of reservations in the Directors-General's annual activity reports cannot be compared with the Court's annual estimated error rate. The annual activity reports' estimation of the risk is closer to an estimation of the potential financial corrections for the payments in the reference year of the annual activity reports, following the reservations expressed by the Directors-General concerned and pending all contradictory procedures to be carried out by the Commission. This estimated amount at risk is based on an evaluation of the financial impact for the operational programmes under reservation on the basis of Directors-General's own analysis that includes, between other aspects, the work of the national audit authorities (single audit principle). As in previous annual activity reports, this quantification of the risk relies on the evaluation of the financial impact of expressed reservations on the basis of the imputed risk per operational programme, taking also into account the 5 % security net provided by Regulations (EC) No 1260/1999 (for 2000-2006) and (EC) No 1083/2006 (for 2007-2013). The regulations set the maximum threshold for interim payments in the course of the programming period at 95 % of the amount to be financed under operational programmes. The remaining 5 % of Commission payments are thus subject to the Commission's decision at closure, which clearly limits the financial risk of non-recovery.

## CONCLUSIONS AND RECOMMENDATIONS

### Conclusions

4.47. Based on its audit work, the Court concludes that the interim and final payments for the year ended 31 December 2010 for the policy group Cohesion, Energy and Transport were affected by material error.

4.48. The Court also concludes that Audit Authorities as a whole were partially effective in ensuring the regularity of payments.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Recommendations**

4.49. **Annex 4.4** shows the result of the Court's review of progress in addressing recommendations made in previous Annual Reports (2008 to 2009). The following points should be noted:

- since the adoption of its Action Plan in February 2008, the Commission has reinforced its supervision of the national management and control systems for the 2007-2013 programming period, in particular through its monitoring of the work of AAs and its increased use of interruptions and suspensions of payments, and
- the Commission has continued its efforts to provide guidance to national authorities implementing OPs and to simplify the eligibility rules for Structural Funds.

4.50. Following this review and the findings and conclusions for 2010, the Court recommends that the Commission:

- **Recommendation 1:** continues to monitor compliance with the eligibility requirements for EU funding, including in particular the correct application of EU and national public procurement rules (2009),
- **Recommendation 2:** encourages national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission (2008-2009). Whenever significant deficiencies in the functioning of the management and control systems are identified by national or EU bodies, the Commission should continue to interrupt or suspend payments to the OP until corrective action has been taken by the Member State,

**4.49.**

- *The Commission welcomes the assessment of the Court on the implementation and consequence of its 2008 Action Plan.*

*The Commission exercised its supervisory role in 2010 by interrupting 63 (49 ERDF and 14 ESF) payment deadlines and adopting one suspension decision for 2007-2013 operational programmes and five suspension decisions (ESF) on 2000-2006 operational programmes where serious deficiencies or irregularities have been detected. These measures are maintained until the necessary corrective actions are put in place by the Member States. The Commission is pursuing this strict policy in 2011, with 54 interruptions of payment deadlines decided (40 for ERDF and 14 for ESF) by 30 June 2011.*

**4.50.**

- *The Commission continues to monitor compliance with eligibility rules through its regular audit activity and the follow-up of all EU and national audits. Adequate information is reported in the annual activity reports of Directors-General of DG REGIO and DG EMPL. When necessary the Commission will continue to take the necessary corrective measures.*

*As far as public procurement is concerned, the correct implementation of EU directives is continuously monitored by the Commission. The Commission has shared with Member States an analysis of the types of errors detected in cohesion by EU audits in the previous years and has launched an exercise to collect best practices and possible answers by Member States to remedy such errors and reduce their occurrence.*

- *The Commission already took the commitment, under the 2009 discharge resolution, to carry out a specific, risk based audit on the corrective mechanism in the Member States and to continue to timely interrupt or suspend payments, when necessary. This strict policy is reflected in the 2010 annual activity reports of Directors-General of DG EMPL and DG REGIO. The shift envisaged to a system of annual clearance of accounts for the programming period post-2013 is intended to further improve the assurance for Structural Funds. The Commission also refers to its replies to the recommendations of the Court in its annual reports for 2008 and 2009.*

## THE COURT'S OBSERVATIONS

- **Recommendation 3:** on the basis of its experience gained during the first years of the 2007-2013 programming period, carries out an assessment of the use of national eligibility rules in view of identifying possible areas for further simplification and to eliminate potential sources of errors for the period after 2013,
  
- **Recommendation 4:** proposes an amendment to the Structural Funds regulations for the current programming period, in order to require Member States to report on the financial implementation of FEIs. The implementation of the funds should also be checked by the Commission on a regular basis,
  
- **Recommendation 5:** provides further guidance to AAs for the current programming period, in particular on sampling, the scope of verifications to be undertaken for audits of projects and the reporting of audit findings,
  
- **Recommendation 6:** proposes to align the reporting periods of the annual control reports with the financial year of the EU budget in the Structural Funds regulations for the period after 2013 and to harmonise the approaches, so that the AAs' audit opinions can be aggregated for each Fund at the national and EU levels.

## THE COMMISSION'S REPLIES

- *The Commission agrees with the recommendation provided that it is targeted on those Member States experiencing recurrent problems in the implementation of their operational programmes.*
  
- *The Commission agrees with the recommendation and intends to propose to make reporting on the use of FEI in the Member States compulsory. The audit of the implementation of FEIs is done through thematic audits as set out in the joint audit strategy for Structural Funds.*

*An annual report by the Member States on the financial implementation of FEIs could be envisaged in the Structural Funds Regulation for the next programming period.*

- *The Commission agrees with the recommendation. The Commission is continuously providing guidance and advice to audit authorities on a wide range of technical and regulatory issues. The Commission review on audit authorities started in 2009 was also an opportunity to develop capacity-building actions towards national audit authorities, as further explained in the 2010 annual activity reports of Directors-General of DG REGIO and DG EMPL.*

*As a result of the analysis of the annual control reports, audit opinions and error rates reported by the national audit authorities at the end of 2010, the Commission committed itself to provide additional, improved guidance to audit authorities on the issues raised by the Court. Such draft guidance has already been discussed in technical meetings held so far and will be completed before the next exercise for the annual control report.*

- *The Commission agrees with the first part of the Recommendation. The Commission's proposal for the revision of the financial regulation includes a timely clearance of accounts that will favour an alignment of the respective reporting periods by the Member States (annual control report and annual audit opinion), the Commission (annual activity reports) and the Court (DAS exercise/annual report) on the corresponding budgetary year (see also Commission reply to paragraph 4.41).*



## FOLLOW-UP OF PREVIOUS SPECIAL REPORTS

### Follow-up of Special Report No 1/2006 on the contribution of the European Social Fund in combating early school leaving

4.51. In Special Report No 1/2006, the Court assessed the adequacy of the procedures for the 2000-2006 programming period intended to ensure the efficiency and effectiveness of ESF co-financed actions addressing early school leaving. The Court stressed that Member States' management systems should be efficient, effective and economical in conformity with Community Regulations. The Court recommended in particular that, so as to maximise the potential impact of Community resources, Member States authorities should carry out an analysis of expected economic benefits and that the allocation of funding should be based on objective and relevant criteria. The Court noted that reasonable annual targets for the reduction of early school leaving would help to meet objectives fixed by the European Council.

4.52. The Court's recommendations have been partially addressed (see **Annex 4.5a**). Elements of the management systems for ESF as a whole have been updated for the 2007-2013 programming period and this has affected measures addressing early school leaving. Specifically concerning early school leaving, in June 2011 the Council approved a recommendation concerning 'Policies to reduce early school leaving'.

4.53. The effect of these actions has not yet been demonstrated, not least because the main action aimed specifically at early school leaving was adopted only in 2011. The Court notes that a clear link between the specific priorities and objectives regarding early school leaving and the level of funding allocated is still not present in the Operational Programmes. Although the Commission has recently expressed the intention to analyse the added value of EU financing within the scope of its own audits, it does not yet do so.

*4.52. The Commission considers that the recommendations of the Court have been fully implemented taking into account the regulatory framework already settled for 2007-2013 at the date of the publication of the Court's audit report. In the context of the Europe 2020 Strategy, the Commission launched in early 2011 an action plan to reduce early school leaving, including a proposal for a Council recommendation on policies to reduce early school leaving (approved in June 2011).*

*4.53. ESF operational programmes contain a clear link between the retained priorities, the objectives to be achieved, which are also translated into quantified targets at priority axis level, as foreseen in the regulatory framework and the level of funding required for achieving the objectives. The Commission proposals for the post-2013 period will build on the current provisions on programming and ex-ante evaluation. Operational programmes will need to respect the regulatory provisions and demonstrate the link between priorities, objectives and level of funding.*

*Within the preparation of the draft regulations for the next programming period, it is envisaged to put a greater emphasis on the output. Part of the DG EMPL's audit resources would therefore need to be re-oriented towards performance audit instead of the current compliance/financial audits.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Follow-up of Special Report No 10/2006 on ex-post evaluations of Objectives 1 and 3 programmes 1994-1999 (Structural Funds)**

4.54. In Special Report No 10/2006, the Court assessed whether *ex-post* evaluations carried out by the Commission in connection with Structural Funds interventions over the 1994-1999 programming period yielded adequate estimates of the impact of the Structural Funds interventions and whether this analysis had provided useful recommendations. The audit identified weaknesses in the evaluation process which limited the assessment of the impact of the Structural Funds.

4.55. DG Regional Policy and DG Employment, Social Affairs and Inclusion addressed most of the key issues raised in Special Report No 10/2006 in their 2000-2006 *ex-post* evaluations (see **Annex 4.5b**). They initiated a shift from a country approach to a key thematic areas approach in order to better focus on strategic issues in a Union of 27 Member States. *Ex-post* evaluations should have been facilitated by the requirement introduced in the 2000-2006 legal framework for a mandatory mid-term evaluation. However, when the mid-term evaluations were carried out, there were significant weaknesses in monitoring systems in the Member States and it was too early to assess effectiveness of spending (see also Special Report No 1/2007 on the mid-term processes). To improve the quality control of *ex-post* evaluations, both DGs allocated more dedicated resources, defined better Terms of Reference for the evaluation packages and strengthened quality control procedures.

4.56. For 2007-2013, both DGs would benefit from strengthening the mechanisms to improve the quality of Member States own evaluations and the use of counterfactual analysis (DG Employment, Social Affairs and Inclusion) or from its expansion (DG Regional Policy). Concerning the assessment of Structural Funds' efficiency, the recently established infrastructure unit cost database should continue to be populated to enable its use (DG Regional Policy). National databases on training projects unit cost and key features would help Member States to prepare and approve projects preparation and approval. Other improvements in the efficiency of Structural Funds could be achieved by further exploring, mainly for regional policy, the reasons why private sector contributions differ markedly between Member States and the potential for providing finance via instruments other than grants.

**4.54.** See Commission's reply to Special Report No 10/2006.

**4.55.** For Commission's reply, see table in **Annex 4.5b**.

**4.56.** DG Regional Policy agrees with the Court on most points. Concerning support for enterprises, substantially more evidence is still needed before firm conclusions on leverage effects and the relative merits of grants and other instruments can be drawn. The current evaluation work programme of the Commission and evaluations undertaken by several Member States will contribute to this.

DG EMPL is currently working on counterfactuals. Several information sessions have already taken place in the ESF evaluation partnership meetings including presentations by Member States and an academic expert. The challenges in applying counterfactuals in cohesion policy are being examined. DG EMPL guidance on ESF evaluation for the 2014-2020 period will encourage Member States to carry out counterfactual/control group evaluations.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Follow-up of Special Report No 7/2009 on the management of the Galileo programme's development and validation phase**

4.57. In Special Report No 7/2009 the Court recommended *inter alia* that the Commission should adapt its resources and its legal and financial instruments to the specificities of the development and management of an industrial programme. The Court also recommended that the Commission should urgently clarify the programme's political objectives and translate them into strategic and operational objectives including defining user needs, technical parameters and the commercial model <sup>(13)</sup>.

4.58. The Court's recommendations have been partially implemented by the Commission (see **Annex 4.5c**). The Commission has assumed the role of a programme manager and has concluded formal delegation agreements with the European Space Agency (ESA). Whilst the Commission has requested the Member States to clarify the programme's political objectives so that they can be translated into final strategic and operational objectives, a common position has not been agreed. Although the Commission has provided an estimate of the mid- and long-term project costs, the sources of the necessary financing have not yet been secured. Based on the Commission's figures, the Court notes that these mid- and long-term project costs could reach more than 20 billion euro up to 2030.

4.59. Prior to launching the full fleet of operational satellites, a clear plan should be established covering the programme costs post 2013 and sources of finance should be identified. Concerning governance structure and human resources, the Court recommends that the Commission continues its efforts to implement the recommendations set out in Special Report No 7/2009.

**4.58.** *The Commission is in the process of implementing these recommendations.*

*In the framework of the preparations for the new Multiannual Financial Framework, the Commission will present a new legislative proposal for further implementation of the Galileo and EGNOS programmes. It will include, inter alia, the framework for their governance and an updated definition of the budgetary resources needed.*

*The GNSS programmes' overall political and strategic objectives were defined in Regulation (EC) No 683/2008 <sup>(2)</sup> of the European Parliament and of the Council and they are gradually being translated into operational objectives (Public Regulated Service, Safety-of-Life service, Search and Rescue service, Commercial Service), noting the technical complexity of the initiative*

*An extrapolation of the programmes' budget, without knowing the future financing public support, does not provide an adequate overall image for drawing conclusions about the total net financial costs.*

**4.59.** *The Commission is currently elaborating an impact assessment that identifies the technical options for the further implementation and exploitation of the European GNSS programmes, including their related costs and their direct and indirect benefits.*

<sup>(13)</sup> In view of the state of progress of the programme, Recommendations 2(b), 3, 4(c), 4(d) and 5 were not included to this follow-up.

<sup>(2)</sup> Regulation (EC) No 683/2008 of the European Parliament and of the Council of 9 July 2008 on the further implementation of the European satellite navigation programmes (EGNOS and Galileo).

## ANNEX 4.1

## RESULTS OF TRANSACTION TESTING FOR COHESION, ENERGY AND TRANSPORT

2010							2009	2008	2007
Employment and social affairs		Regional policy			Energy and Transport	Total			
ESF	Other social matters	ERDF	CF	ISPA					

## SIZE AND STRUCTURE OF THE SAMPLE

Total transactions (of which):	60	6	143	20	6	8	<b>243</b>	209	189	217
Advances	0	0	0	0	0	0	<b>0</b>	20	9	10
Interim/Final payments	60	6	143	20	6	8	<b>243</b>	189	180	207

RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup>

## Proportion of transactions tested found to be:

Free of error	70 % (42)	100 % (6)	47 % (67)	25 % (5)	17 % (1)	37 % (3)	<b>51 % (124)</b>	67 %	58 %	50 %
Affected by one or more errors	30 % (18)	0 % (0)	53 % (76)	75 % (15)	83 % (5)	63 % (5)	<b>49 % (119)</b>	33 %	42 %	50 %

## Analysis of transactions affected by error

## Analysis by type of expenditure

Advances	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	<b>n.a.</b>	3 %	0 %	1 %
Interim/Final payments								97 %	100 %	99 %

## Analysis by type of error

Non-Quantifiable errors:	39 % (7)	0 % (0)	55 % (42)	93 % (14)	80 % (4)	20 % (1)	<b>57 % (68)</b>	50 %	42 %	33 %
Quantifiable errors:	61 % (11)	0 % (0)	45 % (34)	7 % (1)	20 % (1)	80 % (4)	<b>43 % (51)</b>	50 %	58 %	67 %
Eligibility	91 % (10)	0 % (0)	100 % (34)	100 % (1)	100 % (1)	75 % (3)	<b>96 % (49)</b>	69 %	89 %	78 %
Occurrence	9 % (1)	0 % (0)	0 % (0)	0 % (0)	0 % (0)	0 % (0)	<b>2 % (1)</b>	0 %	0 %	12 %
Accuracy	0 % (0)	0 % (0)	0 % (0)	0 % (0)	0 % (0)	25 % (1)	<b>2 % (1)</b>	31 %	11 %	10 %

## ESTIMATED IMPACT OF QUANTIFIABLE ERRORS

## Most likely error rate:

7,7 %

Lower error limit

4,7 %

Upper error limit

10,7 %

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

n.a.: not applicable.

## RESULTS OF EXAMINATION OF SYSTEMS FOR COHESION, ENERGY AND TRANSPORT

## Assessment of selected supervisory and control systems: Audit authorities (AA) — Compliance with key regulatory requirements and effectiveness in ensuring the regularity of operations

Key requirements tested by the Court		Audit Authority ERDF/ESF — France	Audit Authority ERDF/ESF — UK/Northern Ireland	Audit Authority ERDF/ESF — Italy (Sardinia)	Audit Authority ERDF/CF — Poland	Audit Authority ERDF/CF — Spain (Andalucía and Valencia)	Audit Authority ESF — Poland	Audit Authority ESF — Spain (Andalucía)	Audit Authority ESF — Germany (Bund)
General aspects	The set up of the management and control systems of the operational programme provides for an appropriate definition, allocation and separation of functions within the AA and between the AA and other competent management and control bodies	Compliant	Compliant	Partially compliant	Compliant	Compliant	Compliant	Partially compliant	Partially compliant
Audit manual coverage	Existence of audit manual (for both audits on systems and audits on operations), which is in accordance with internationally accepted audit standards and clearly describes the audit procedures	Compliant	Partially compliant	Compliant	Compliant	Compliant	Compliant	Compliant	Compliant
Audit methodology for systems audit	The audit work carried out by the AA to evaluate the effective functioning of the management and control system is based on a checklist that contains questions that verify key requirements of the applicable regulations (specified for MAs, IBs and CAs) and appropriate assessment criteria for each of these key requirements	Compliant	Compliant	Compliant	Compliant	Compliant	Compliant	Compliant	Compliant
Review of audits on systems	The AA's audit plan had been implemented in accordance with the approved audit strategy for the period, audits on systems were carried out in accordance with the methodology established by the AA and all phases of the audits on systems were properly documented	Effective	Partially effective	Partially effective	Effective	Effective	Effective	Effective	Effective
Sampling methodology for audits of operations	An appropriate sampling methodology for audits of operations has been specified to draw the sample of operations to be audited for the period under review	Partially compliant	Compliant	Partially compliant	Compliant	Compliant	Compliant	Partially compliant	Partially compliant

Key requirements tested by the Court		Audit Authority ERDF/ESF — France	Audit Authority ERDF/ESF — UK/Northern Ireland	Audit Authority ERDF/ESF — Italy (Sardinia)	Audit Authority ERDF/CF — Poland	Audit Authority ERDF/CF — Spain (Andalucia and Valencia)	Audit Authority ESF — Poland	Audit Authority ESF — Spain (Andalucia)	Audit Authority ESF — Germany (Bund)
Drawing of sample for audits of operations	The sampling methodology for audits of operations has been used as specified to draw the sample of operations to be audited for the period under review	Effective	Effective	Not effective	Effective	Effective	Effective	Effective	Partially effective
Audit methodology for audits of operations	The audit work carried out to examine the regularity of operations is based on a checklist that contains questions that verify the requirements of the applicable regulation at a sufficient level of detail to address the associated risks	Partially compliant	Partially compliant	Partially compliant	Partially compliant	Partially compliant	Compliant	Compliant	Partially compliant
Review of audits of operations	The audits of operations had been implemented in accordance with the sample selected for the period, were carried out in accordance with the methodology established by the AA and all phases of the audits of operations were properly documented	Effective	Partially effective	Not effective	Effective	Partially effective	Effective	Effective	Effective
Re-performance of audits on operations	A re-performance by the Court of the AA's audits of operations resulted in findings similar to those of the AA, as reported to the Commission	Effective	Partially effective	Partially effective	Effective	Partially effective	Effective	Effective	Partially effective
Annual control report and audit opinion	The annual control report and audit opinion were established in accordance with the regulatory requirements and the guidance agreed between the Commission and the Member States, and the report and opinion are consistent with the results of the audits on systems and audits on operations carried out by the AA	Compliant	Partially compliant	Partially compliant	Compliant	Compliant	Compliant	Partially compliant	Partially compliant
<b>Overall assessment</b>		<b>Effective</b>	<b>Partially effective</b>	<b>Not effective</b>	<b>Effective</b>	<b>Partially effective</b>	<b>Effective</b>	<b>Partially effective</b>	<b>Partially effective</b>

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR COHESION, ENERGY AND TRANSPORT

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
REGIO	with a reservation	<p>Reservation on the legality and regularity of the underlying transactions for expenditure declared for ERDF and CF in several Member States, based on deficiencies in key elements of the management and control systems for both funds which have not been subject to sufficient control and corrective measures by the national authorities.</p> <p>For the 2000-2006 period, the reservation concerns 21 OPs in six Member States (INTERREG excepted) and two CF projects in two Member States and is quantified at 679,4 million euro or 15,8 % of the interim payments of the year. For this programming period, the EU contribution at risk is estimated in the range between 32,5 and 68,8 million euro, i.e. between 0,8 % and 1,5 % of the interim payments of the year (4 297,3 million).</p> <p>For the 2007-2013 period, the reservation concerns 69 OPs in 10 Member States and 11 ETC OPs. This is quantified at 3 417,1 million euro or 13,4 % of the interim payments of the year. For this programming period, the EU contribution at risk is estimated in the range between 203,7 and 423,9 million euro, i.e. between 0,8 % and 1,6 % of the interim payments of the year (25 527,8 million euro).</p>	<p>The Court considers that the Director-General's declaration and the Annual Activity Report are as a whole established according to the applicable Commission guidelines.</p> <p>The Court recognises that DG REGIO provided additional information as compared to 2009 regarding disclosure of amounts at risk per OP.</p> <p>The Court notes however that its own error rate is significantly higher than the reservations quantified by the Director-General.</p> <p>DG REGIO issued reservations with a quantifiable impact for both programming periods. The quantification is based on the assumption that, whenever the estimated amount at risk is below the 5 % payment retention in place for any operational programme, the controls in place for the OP closure would appropriately mitigate the risk. The Court considers that this approach may lead to an underestimation of the amounts at risk.</p> <p>Finally, 2 823 million euro of financial corrections were reported as implemented in 2010. However, concerning in particular closures of 2000-2006 OPs, not all validation and verification procedures were completed at year end. Indeed, in the Commission's note 6 to the 2010 accounts only 563 million euro were classified as implemented (see also <b>Annex I.2</b>, Point 3).</p>	B	A

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
EMPL	<b>with a reservation</b>	<p>Reservation on the legality and regularity of the underlying transactions for expenditure declared for specific ESF OPs in several Member States, based on deficiencies in key elements of the management and control systems for OPs which have not been subject to sufficient control and corrective measures by the national authorities.</p> <p>For the 2000-2006 period, the reservation concerns 13 OPs in four Member States and is quantified as 0,4 million euro or 0,14 % of the interim payments of the year.</p> <p>For the 2007-2013 period, the reservation concerns 30 OPs in nine Member States and is quantified as 71,6 million euro or 1,13 % of the interim payments of the year.</p>	<p>The Court considers that the Director-General's declaration and the Annual Activity Report are as a whole established according to the applicable Commission guidelines.</p> <p>The Court recognises that DG EMPL provided additional information as compared to 2009 regarding disclosure of amounts at risk per operational programme.</p> <p>DG EMPL issued reservations with a quantifiable impact for both periods. The quantification is based on the assumption that, whenever the estimated amount at risk is below the 5 % payment retention in place for any operational programme, the controls in place for the OP closure would appropriately mitigate the risk. The Court considers that this approach may lead to an underestimation of the amounts at risk.</p>	A	A
MOVE	<b>with a reservation</b>	<p>Reservation concerning the rate of residual errors with regard to the accuracy of cost claims in Research Sixth Framework Programme (FP6) contracts: the residual error rate observed by <i>ex-post</i> controls is higher than the control objective (2 %).</p> <p>The residual error rate of 4,42 % corresponds to an amount of 1,15 million euro potentially at risk, representing 1,95 % of the FP6 payments and 0,5 % of total payments made by DG MOVE in 2010.</p>	<p>The Court considers that the Director-General's declaration and the Annual Activity Report are established according to the applicable Commission guidelines.</p>	A	A <sup>(1)</sup>
ENER	<b>with a reservation</b>	<p>Reservation concerning the rate of residual errors with regard to the accuracy of cost claims in Research Sixth Framework Programme (FP6) contracts: the residual error rate observed by <i>ex-post</i> controls is higher than the control objective (2 %).</p> <p>The residual error rate of 4,42 % corresponds to an amount of 1,7 million euro potentially at risk, representing 1,12 % of the FP6 payments and 0,15 % of total payments made by DG ENER in 2010.</p>	<p>The Court considers that the Director-General's declaration and the Annual Activity Report are established according to the applicable Commission guidelines.</p>	A	A <sup>(1)</sup>

<sup>(1)</sup> Annex 5.3 to the 2009 Annual Report presented the results of the review of DG TREN's Annual Activity Report. DG TREN was split into DG MOVE and DG ENER in February 2010.

(\*) By reference to the declaration of assurance of the Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: the Director-General's declaration and the Annual Activity Report give a fair assessment of financial management in relation to regularity.

B: the Director-General's declaration and Annual Activity Report give a partially fair assessment of financial management in relation to regularity.

C: the Director-General's declaration and the Annual Activity Report do not give a fair assessment of financial management in relation to regularity.



## RECOMMENDATIONS FOLLOW-UP TABLE FOR COHESION, ENERGY AND TRANSPORT

Year	Court Recommendation	Progress made	Commission reply	Court analysis
<b>Cohesion:</b>				
2009	<p>The Commission should monitor compliance with the eligibility requirements for EU funding, including the correct application of the EU and national public procurement rules</p> <p>(see the 2009 Annual Report, paragraph 4.38)</p>	<p>Audits on the implementation of public procurement rules are currently carried out under a specific enquiry for the Cohesion Fund for 2000-2006 projects and an enquiry for the 2007-2013 OPs. The Commission has also issued guidance and provided training to Member States' managing and audit authorities (e.g. 'train the trainers seminars', bilateral training sessions for MAs and AAs).</p> <p>In January 2011 the Commission has published a Green Paper on the modernisation of EU public procurement policies (COM(2011) 15 final).</p> <p>The Commission's evaluation of the EU public procurement legislative framework is expected to be finalised in 2011.</p>	<p><i>The Commission considers that this recommendation has been implemented through the various ongoing actions as described by the Court.</i></p> <p><i>See Commission reply to paragraph 4.50, <b>Recommendation 1.</b></i></p> <p><i>Please see also the Commission replies to paragraphs 4.20, 4.21 and 4.29 on the provision of training and guidance.</i></p>	<p><b>The Court considers that the recommendation is implemented with regard to training and guidance, as long as the Commission continues its current policy.</b></p> <p><b>The Court will follow up the specific measures specified for public procurement (see also Opinion No 4/2011 <sup>(1)</sup>).</b></p>
<b>Cohesion:</b>				
2008	<p>The Commission should ensure, through its supervision, an effective functioning of the national management and control systems</p> <p>(see the 2008 Annual Report, paragraphs 6.37(a) and (c); the 2009 Annual Report, paragraph 4.37(c))</p>	<p>Subject to general provisions set out in the Structural funds Regulations, eligibility rules are specified at national and, in some cases, OP level. The Commission has reviewed changes to such rules introduced by Member States in 2010.</p> <p>The Commission examined Audit Authorities for the 2007-2013 OPs in 2010 and continued to carry out specific audits of systems and projects.</p> <p>The 2010 AARs provide a detailed assessment per 2007-2013 OP, mainly based on the information contained in the Annual Control Reports established by the AAs and the audit work carried out by the Commission.</p>	<p><i>The Commission considers that this recommendation has been implemented (see Commission reply to paragraph 4.50, <b>Recommendation 2.</b>)</i></p> <p><i>Please see also the Commission replies to paragraphs 4.42, 4.43 and 4.44 regarding its examination of AAs.</i></p> <p><i>DG REGIO and DG EMPL consider they have properly followed up all reservations expressed for the 2007-2013 programmes in their respective AARs.</i></p>	<p><b>The Court considers that the recommendation is implemented, as long as the Commission continues its current policy.</b></p>

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2008	<p><b>Cohesion:</b></p> <p>The Commission should encourage national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission</p> <p>(see the 2008 Annual Report, paragraphs 6.37(b) and (d); the 2009 Annual Report, paragraphs 4.37(a) and (b))</p>	<p>The Commission has increased its use of the provision in the 2007-2013 Structural Funds Regulations to interrupt or suspend payments when there is evidence to suggest significant deficiencies (or irregularities not yet corrected) in an audit report. This provides a further incentive to Member States to take all necessary corrective actions in a timely manner.</p> <p>The Commission also introduced changes to the reporting by Member States of recoveries and withdrawals under the 2007-2013 programmes (Annex XI to Commission Regulation (EC) No 1828/2006).</p> <p>Detailed information on payment interruptions and suspensions is disclosed in the 2010 AAR for both DG REGIO and DG EMPL.</p>	<p><i>The Commission considers that this recommendation has been implemented (see Commission reply to paragraph 4.50, Recommendation 2).</i></p>	<p><b>The Court considers that the recommendation is implemented, as long as the Commission continues its current policy.</b></p>

(<sup>1</sup>) Opinion No 4/2011 on the Commission's Green Paper on the Modernisation of Public Procurement Policy (OJ C 195, 2.7.2011, p. 1).

## FOLLOW-UP OF SPECIAL REPORT No 1/2006: ANALYSIS OF ACTIONS TAKEN TO ADDRESS THE COURT'S RECOMMENDATIONS

Initial recommendations	Overall assessment of actions taken	Remaining or additional weaknesses	Commission's reply
<ul style="list-style-type: none"> <li>— The Commission should, where necessary, give appropriate guidance to Member States, so as to ensure that Community funding is efficient, effective and economic, and</li> <li>— Member States, in cooperation with the Commission, should establish or strengthen existing procedures within co-financed measures for project selection and identifying and targeting those most at risk of leaving school prematurely.</li> </ul>	<p>These recommendations have been mostly implemented, albeit several years after the Court's Report. In June 2011, the Council adopted a Recommendation on 'Policies to reduce early school leaving' which aims to help policy makers in Member States understand the phenomenon and factors contributing to it. General guidance concerning the Structural Funds is also provided to Member States.</p>	<p>The main corrective action aimed specifically at early school leaving, which was adopted by the Council only in 2011, has not yet produced significant effect.</p>	<p><i>In the context of the Europe 2020 Strategy, the Commission launched in early 2011 an action plan to reduce early school leaving including a proposal for a Council Recommendation (approved in June 2011) on policies against early school leaving. This recommendation contains guidelines to help Member States develop comprehensive and evidence-based policies to reduce early school leaving. The work on the action plan started effectively already in 2006 with establishing the cluster on 'Access and Social Inclusion in Lifelong Learning' and with defining the work programme of this cluster. The action plan as adopted by the Commission in 2011 is based on the cluster's work and several comparative studies on early school leaving in Europe (conducted between 2006 and 2009).</i></p>
<ul style="list-style-type: none"> <li>— The Commission should verify that Member States' management systems adhere to the principles of economy, efficiency and effectiveness in conformity with Community regulation.</li> </ul>	<p>This recommendation has not yet been implemented. For the next programming period, the Commission expects that the added value of the EU financing will also be subject to analysis in its audits <sup>(1)</sup>.</p>	<p>The Commission has not yet expanded the scope of its audit activity to also analyse the added value of EU financing.</p>	<p><i>Within the preparation of the draft regulations for the next programming period, it is envisaged to put a greater emphasis on the output, funding mechanisms being, to a large extent, aimed at rewarding output/output rather than input. A part of the Commission's audit resources would therefore need to be re-oriented towards performance audit instead of the current compliance/financial audits.</i></p>
<ul style="list-style-type: none"> <li>— Member States, in cooperation with the Commission, should carry out an analysis of expected economic benefits, which should include a documented and reasoned justification for the level of funding being allocated and the areas of activities being prioritised, and</li> <li>— make sure that the allocation is based on objective and relevant criteria so as to maximise the potential impact of the funds.</li> </ul>	<p>This recommendation has been implemented only insofar as the Commission has made a statement of principle. The general provisions on programming and <i>ex-ante</i> evaluation for 2007-2013 address in principle the Court's recommendation. The issue has been also addressed in the context of the recent Budget review. However, a clear link between the specific priorities and objectives regarding early school leaving and the level of funding allocated is still not present in the Operational Programmes.</p>	<p>The issue remains relevant for the next financial framework.</p>	<p><i>ESF operational programmes contain a clear link between the retained priorities, the objectives to be achieved, which are also translated into quantified targets at priority axis level, as foreseen in the regulatory framework and the level of funding required for achieving the objectives.</i></p>

Initial recommendations	Overall assessment of actions taken	Remaining or additional weaknesses	Commission's reply
<p>— Member States, in cooperation with the Commission, should establish reasonable annual targets for the reduction of early school leaving in order to meet the objectives of the Lisbon Strategy.</p>	<p>This recommendation has been largely implemented. In the context of the Europe 2020 strategy, four 4 after the publication of the Special Report, Member States agreed to set national targets, taking into account their starting position and national circumstances.</p>	<p>One Member State has not defined its specific target.</p>	<p><i>The preparation of the programming period post-2013 was the first opportunity for the Commission to implement this recommendation. Within the 2020 Strategy, the definition of national targets is the product of a dialogue with the European Commission in order to check consistency with EU headline targets. Each country sets its national targets in its national reform programme which is due in April each year. All Member States, except the UK, have set national targets on early school leaving in the 2011 National Reform Programmes submitted to the Commission in April/May 2011).</i></p>
<p>— Member States, in cooperation with the Commission, should encourage the exchange of information and best practice between all local and national organisations responsible for tackling early school leaving, where permitted by law.</p>	<p>This recommendation has been implemented. Under the Open Method of Coordination, a group of experts from Member States specialising in 'Access and Social Inclusion in Education' was set up within the work programme 'Education and Training 2010', adopted in 2003. Since 2006, the group conducted peer-learning activities in different Member States. The Commission has recently proposed the setting-up of a new thematic working group on early school leaving.</p>	<p>The new thematic group on the topic of early school leaving has yet to be set up.</p>	<p><i>Under the Open Method of Coordination, a 'Cluster' of experts from Member States specialising in 'Access and Social Inclusion in Education' was set up within the work programme Education and Training 2010, adopted by the Council in 2003. The Commission will set up a European-level expert group (in the framework of EU 2020). This group will continue the work of the former cluster on 'Access and Social Inclusion in Lifelong Learning', focussing on early school leaving and further developing the existing guidance documents.</i></p>
<p>— Member States, in cooperation with the Commission, should actively promote the innovative use of ESF funding in tackling early school leaving.</p>	<p>This recommendation has been implemented. Since the publication of the Special Report, Member States have organised conferences on the integration of young people into the labour market, including early school leaving, where new models have been presented.</p>	<p>The Commission should continue to encourage actions promoting innovative use of ESF.</p>	<p><i>The Commission continues its activities to promote the innovative use of ESF.</i></p>

(<sup>1</sup>) This orientation is reflected in the Communication of the Commission of 19 October 2010 on the EU Budget review (COM(2010) 700 final) and in the 5th report on Economic, Social and Territorial Cohesion.

## FOLLOW-UP OF SPECIAL REPORT No 10/2006: ANALYSIS OF ACTIONS TAKEN TO ADDRESS THE COURT'S RECOMMENDATIONS

Initial recommendations (Paragraphs 119 to 123 of the Special Report)	Overall assessment of actions taken (2000-2006 <i>ex-post</i> evaluations)	Remaining or additional weaknesses (upcoming 2007-2013 <i>ex-post</i> evaluations)	Commission's reply
<p><b>Recommendation 1</b></p> <p>A reappraisal of the scope, procedures and approach used in <i>ex-post</i> assessments needs to be done with some urgency, before the next batch of contracts for <i>ex-post</i> evaluations are issued (...).</p>	<p>For both DGs, there has been a shift from an approach analysing Member States to one based on key thematic areas in order to better focus on strategic issues in a Union of 27 Member States. For DG EMPL, analysis is summarised via key evaluation questions.</p>	<p>DG REGIO's analysis should be summarised according to issues of strategic interest to stakeholders. Energy should be included as a theme. The Europe 2020 goals should be taken into account.</p>	<p><i>The ex-post evaluation 2000-2006 includes a synthesis report that brings together essential findings from the significant number of evaluations undertaken as part of the ex-post exercise.</i></p> <p><i>For a future ex-post evaluation the most important features of the current programming period will be taken into account. DG REGIO recalls that the Europe 2020 strategy was adopted only in 2010, several years after the current programmes had been approved by the Commission. The issue of renewable energy has been addressed in a recent work undertaken by DG REGIO.</i></p>
<p><b>Recommendation 2</b></p> <p>To improve the evaluation process, better quality control procedures need to be introduced and effectively applied by the Commission (...). Such procedures should ensure:</p> <p>(a) that relevant and reliable data is collected regularly and is available at each stage of the evaluation process;</p> <p>(b) that terms of reference are adequate and provide for the application of appropriate methodologies by the contractors;</p> <p>(c) that adequate resources and time are allocated to the evaluation processes;</p> <p>(d) that there are appropriate monitoring and supervision by the Commission so as to ensure the overall quality of the process.</p>	<p>A series of measures targeted to entities carrying out <i>ex post</i> were taken.</p> <p>Both DGs included key evaluation considerations in the 2000-2006 Terms of Reference.</p> <p>Appropriate resources were allocated by both DGs to <i>ex-post</i> evaluation.</p> <p>Both DGs improved quality control by issuing guidance notes, allocating more resources, setting up panels of independent experts, and holding regular steering group meetings.</p>	<p>Further efforts are required to improve the availability, relevance and reliability of information concerning project performance.</p>	<p>(a) DG REGIO agrees with the assessment. Improvements on data have already been implemented in the programming period 2007-2013: Member States are required to provide participants data along a list of harmonised characteristics (e.g. on employment status, disadvantaged, education).</p>

Initial recommendations (Paragraphs 119 to 123 of the Special Report)	Overall assessment of actions taken (2000-2006 <i>ex-post</i> evaluations)	Remaining or additional weaknesses (upcoming 2007-2013 <i>ex-post</i> evaluations)	Commission's reply
<p><b>Recommendation 3</b></p> <p>Particular attention needs to be reserved to the choice of appropriate techniques for assessing and measuring the economic impact (...).</p>	<p>DG REGIO used two macro-economic models and introduced counterfactual analysis as a method of impact evaluation (<sup>1</sup>).</p>	<p>The current practice of using macro-economic models derived GDP growth for measuring the success of Cohesion Policy should be complemented by the use of social and environmental indicators.</p> <p>DG REGIO should expand its use of counterfactual analysis and DG EMPL should introduce it. The Commission should support its use by Member States.</p>	<p><i>DG REGIO agrees that macroeconomic models will continue to play an important role in understanding the effects of cohesion policy. DG REGIO is looking into the question which models are best suited to reflect the range of its policy objectives.</i></p> <p><i>DG REGIO agrees on the further expansion of the use of counterfactual analysis.</i></p> <p><i>DG EMPL works on counterfactuals is ongoing (see reply to paragraph 4.56).</i></p>
<p><b>Recommendation 4</b></p> <p>Greater emphasis needs to be placed on establishing linkages between the <i>ex-post</i> assessments and thematic studies and to ensure that results are consistent with each other.</p>	<p>See Recommendation 1.</p>	<p>See Recommendation 1.</p>	
<p><b>Recommendation 5</b></p> <p>A number of recommendations for future assessments more particularly for Objective 1 Regions may be made, namely:</p> <p>(a) there needs to be a specific focus on the reasons why private sector contributions to the structural funds projects differ markedly between Member States (...);</p> <p>(b) another worthwhile topic to explore is whether there should be a shift in the future from grant expenditure to financial engineering measures, (...), which may prove to be more sustainable and efficient in the long term;</p> <p>(c) greater attention needs to be given to the establishment of unit costs and benchmarks for various types of projects;</p>	<p>This issue mainly concerns Regional Policy. DG REGIO carried out an assessment of the impact of Structural Funds on private sector spending, however, this was limited to investments in research and development.</p> <p>In the 2007-2013 period, an emphasis was put on financial engineering techniques in the fields of venture capital, loans and interest rate subsidies and urban regeneration.</p> <p>DG REGIO set up a database of infrastructure unit costs but it is not yet in use.</p>	<p>DG REGIO should continue to explore how private sector investment can be stimulated.</p> <p>The Commission should further explore the potential for providing finance via instruments other than grants.</p> <p>DG REGIO should complete the unit costs database. DG EMPL should encourage Member States to establish databases about training project unit cost and key features.</p>	<p><b>(a)</b> <i>The available empirical evidence on the effects of support to enterprises, inside and outside the Commission, is still scarce. DG REGIO will continue its efforts to add to the evidence.</i></p> <p><b>(b)</b> <i>DG REGIO will continue its efforts to add to the evidence (see reply to previous paragraph).</i></p> <p><b>(c)</b> <i>The ex-post evaluation 2000-2006 of the Cohesion Fund will enrich the current database with a substantial number of projects.</i></p>

Initial recommendations (Paragraphs 119 to 123 of the Special Report)	Overall assessment of actions taken (2000-2006 <i>ex-post</i> evaluations)	Remaining or additional weaknesses (upcoming 2007-2013 <i>ex-post</i> evaluations)	Commission's reply
<p>(d) additional attention also needs to be given to the project application and approval process as the evaluators pointed out;</p> <p>(e) there should be greater focus on internal evaluations by the relevant ministries or regional authorities in future <i>ex-post</i> assessments.</p>	<p>DG REGIO commissioned a Workpackage on management and implementation systems which it intends to take into account for the design of the period starting in 2014.</p> <p>Although mid-term evaluations were mandatory, Member States' evaluations were mostly compliance-oriented rather than outputs- and outcomes-oriented.</p>	<p>The Commission should require Member States make performance driven internal evaluations, and, to this end, facilitate the exchange of good practice.</p>	<p>(e) <i>In the current programming period the obligatory mid-term evaluation has been replaced by a needs-oriented process of ongoing evaluations. A similar approach is envisaged for the future period after 2013. See Commission's reply to paragraph 4.55.</i></p>

(<sup>1</sup>) Counterfactual analysis is a comparison between what actually happened and what would have happened in the absence of the intervention.

## FOLLOW-UP OF SPECIAL REPORT No 7/2009: ANALYSIS OF ACTIONS TAKEN TO ADDRESS THE COURT'S RECOMMENDATIONS

Initial recommendations	Overall assessment of actions taken	Remaining or additional weaknesses	Commission's reply
<p><b>Recommendation 1</b></p> <p>To gain authority as a programme manager, the Commission should adapt its resources and its legal and financial instruments to the specificities of the development and management of an industrial programme:</p> <p>(a) the quantity and expertise of its human resources should be commensurate with its task as programme manager;</p> <p>(b) an appropriate EU-ESA cooperation framework should be established;</p> <p>(c) the Commission should ensure it has the financial instruments to fund infrastructure (other than via grants) and to commit itself to bearing the yearly operating and replenishment costs of this infrastructure over a long time horizon;</p> <p>(d) programme governance should be such as to enable the programme manager to perform its tasks coherently (define expectations, grant powers and verify performance).</p>	<p>This recommendation has been partially implemented.</p> <p>(a) The staff working on GNSS programmes at the Commission has increased from 13 persons in 2007 to 75 in March 2010. The next challenge will be to ensure continuity of human resources after 2013.</p> <p>(b) The Commission has signed the EGNOS and Galileo Delegation Agreements with ESA expiring in the end of 2015.</p> <p>(c) Whilst the Commission has estimated the mid- and long-term project costs, the sources of the necessary financing have not been secured. Based on the Commission's figures, the Court notes that these project costs could reach 20,4 billion euro up to 2030 and that future commercial revenues are expected to cover less than 10 % of estimated annual operational costs.</p> <p>(d) The delegation agreements and project management plans that have been put into place provide a basis for the programme manager to perform its tasks.</p>	<p>There are a number of decisions that are important for the success of the programme which have not yet been taken (namely, a clear definition of strategic and operational objectives, and overall programme financing and cost-sharing models).</p>	<p><i>The European Commission, being responsible for the management of the GNSS programmes, put in place the required legal and technical framework to implement it, taking into account the Court's recommendations.</i></p> <p><i>In the framework of the preparations for the new Multi-annual Financial Framework (MFF), the Commission will present a new legislative proposal for further implementation of the Galileo and EGNOS programmes. It will include, inter alia, the framework for their governance and an updated definition of the budgetary resources needed.</i></p> <p><i>The Transport Council conclusions of March 2011, as well as the European Parliament Resolution of June 2011, both support the financing of the programmes from the EU budget.</i></p> <p><i>An extrapolation of the programmes' budget, without knowing the future financing public support, does not provide an adequate overall image for drawing conclusions about the total net financial costs.</i></p>



Initial recommendations	Overall assessment of actions taken	Remaining or additional weaknesses	Commission's reply
<p><b>Recommendation 2</b></p> <p>The Commission should urgently clarify the programme's political objectives and translate them into strategic and operational objectives that will provide Galileo with a solid roadmap from now until beyond full deployment. For example:</p> <p>(a) How should Galileo be positioned as a commercial system? Is it required to break even financially or will it require continuing public-sector support? Is it about maximising revenue generation, or maximising macro-economic benefits and serving the whole Galileo value chain through services and goods generated by its applications?</p>	<p>This recommendation has not been implemented.</p> <p>The Commission has requested Member States to clarify the programme's political objectives (particularly the Public Regulated Services and Safety-of-Life services) so that they can be translated into final strategic and operational objectives. However, a common position has not yet been agreed and this is delaying important decisions for the detailed planning of the programme.</p>	<p>The programme's political objectives should be urgently clarified and translated into strategic and operational objectives.</p>	<p><i>The Commission considers that the overall political and strategic objectives for the Galileo programme have been clarified with Regulation (EC) No 683/2008 <sup>(1)</sup>.</i></p> <p><i>The operational objectives, as Public Regulated Service, Safety-of-Life service, Search and Rescue service and Commercial Service are currently under preparation and will be adopted in 2011 and 2012.</i></p>
<p><b>Recommendation 4</b></p> <p>The Commission should ensure that the following issues are addressed:</p> <p>(a) analysis, consolidation and validation of relevant and stable user requirements;</p> <p>(b) development of enabling actions (such as the necessary legal and regulatory framework).</p>	<p>This recommendation has been partially implemented.</p> <p>(a) As user needs (namely Public Regulated Services, Safety-of-Life services and Search and Rescue services) have not yet been fixed, the Commission has not yet communicated them to ESA so that Mission Design Requirements can be finalised.</p> <p>(b) The Public Regulated Services regulation is currently being debated at the European Parliament.</p>	<p>In order to allow technical testing, the final specification of Galileo services needs to be fixed.</p> <p>The legal and regulatory framework should be completed, including a third-party liability policy.</p>	<p><i>In the framework of the preparations for the new Multi-annual Financial Framework (MFF), the Commission will present a new legislative proposal for further implementation of the Galileo and EGNOS programmes. It will include, inter alia, the framework for their governance and an updated definition of the budgetary resources needed.</i></p> <p><i>The detailed regulations are currently under preparation and will be adopted by the end of 2011 and 2012.</i></p>

<sup>(1)</sup> Regulation (EC) No 683/2008 of the European Parliament and of the Council of 9 July 2008 on the further implementation of the European satellite navigation programmes (EGNOS and Galileo).



## CHAPTER 5

**External aid, Development and Enlargement**

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## THE COURT'S OBSERVATIONS

**INTRODUCTION**

5.1. This chapter presents the Court's specific assessment of External aid, Development and Enlargement, which comprises policy areas: 19 — External relations, 21 — Development and Relations with African, Caribbean and Pacific (ACP) States <sup>(1)</sup>, 22 — Enlargement, and 23 — Humanitarian aid. Key information on the activities covered and the spending in 2010 is provided in **Table 5.1**. The chapter also reports on the response of the Commission to the recommendations set out in two special reports.

**Specific characteristics of the policy group**

5.2. External relations and Development expenditure was implemented in 2010 by the EuropeAid Cooperation Office (EuropeAid) <sup>(2)</sup> and also by the Directorate-General for External Relations (DG RELEX) <sup>(3)</sup>. Enlargement expenditure was implemented by the Directorate-General for Enlargement (DG ELARG), and Humanitarian aid, including food aid, by the Directorate-General for Humanitarian Aid (DG ECHO).

5.3. Most of the expenditure managed by the four DGs is implemented on the basis of pre-financing payments, which only require compliance with a limited number of conditions, while interim and final payments are conditional upon submission and validation of expenditure actually incurred for the project and are therefore in general subject to greater risks than pre-financing payments.

*EuropeAid*

5.4. Expenditure implemented by EuropeAid relates to:

- (a) development assistance to, and economic cooperation with, countries in Asia, Latin America and ACP States;
- (b) European neighbourhood policy, including the strategic partnership with Russia;
- (c) thematic programmes, including food security, non-state actors and local authorities, environment, health and education, democracy and human rights.

<sup>(1)</sup> Aid provided through the European Development Funds is reported separately as it is not financed from the General Budget.

<sup>(2)</sup> As of 1 January 2011, EuropeAid and the Directorate-General for Development (DG DEV) merged under the new name of Directorate-General for Development and Cooperation — EuropeAid (DG DEVCO).

<sup>(3)</sup> As of 1 January 2011, DG RELEX ceased to exist and was, to a large extent, integrated into the European External Action Service (EEAS). In addition, a new service was created to manage the Foreign Policy Instruments (FPI).

Table 5.1 — External Aid, Development and Enlargement — key information 2010

(million euro)

Budget Title	Policy area	Description	Payments	Management Mode
19	External relations	Administrative expenditure	443	Centralised direct
		Cooperation with third countries in the areas of migration and asylum	50	Centralised direct
		Common foreign and security policy	256	Centralised indirect/joint
		European Instrument for Democracy and Human Rights (EIDHR)	152	Centralised direct
		Relation and cooperation with industrialised non-member countries	20	Centralised direct
		Crisis response and global threats to security	242	Centralised direct
		European Neighbourhood Policy and relations with Russia	1 520	Centralised direct/decentralised
		Relations with Latin America	287	Centralised direct/decentralised
		Relations with Asia, Central Asia and Middle Eastern countries	678	Centralised direct/decentralised/joint
		Policy strategy and coordination	35	Centralised direct/decentralised/joint
		<b>3 683</b>		
21	Development and relations with ACP States	Administrative expenditure	386	Centralised direct
		Food security	537	Centralised direct
		Non-State actors in development	250	Centralised indirect
		Environment and sustainable management of natural resources, including energy	105	Centralised direct
		Human and social development	131	Centralised direct/joint
		Geographical cooperation with African, Caribbean and Pacific (ACP) States	254	Centralised direct/decentralised/joint
		Development cooperation actions and ad hoc programmes	29	Centralised direct
		Policy strategy and coordination	16	Centralised direct
		<b>1 708</b>		
22	Enlargement	Administrative expenditure	91	Centralised direct
		Enlargement process and strategy	1 005	Centralised direct/indirect/decentralised
		Post-accession financial support	22	Centralised direct/decentralised
		Information and communication strategy	12	Centralised direct
		<b>1 130</b>		
23	Humanitarian aid	Administrative expenditure	29	Centralised direct
		Humanitarian aid	942	Centralised direct/joint
		<b>971</b>		
Total administrative expenditure <sup>(1)</sup>			949	
Total operational expenditure			6 543	
Of which: — advances			4 067	
— interim/final payments			2 476	
<b>Total payments for the year</b>			<b>7 492</b>	
<b>Total commitments for the year</b>			<b>8 126</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in chapter 7.

Source: 2010 annual accounts of the European Union.

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THE COURT'S OBSERVATIONS

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5.5. The majority of the expenditure is subject to direct centralised management by Commission services either from Commission headquarters or at the EU delegations in the third countries concerned. Aid delivered through international organisations is subject to joint management.

5.6. Development projects are dispersed through more than 150 countries, and the implementing organisations vary greatly both in size and experience. To be eligible for EU support, projects are required to comply with complex rules including tendering and contract award procedures.

#### *DG RELEX*

5.7. Expenditure managed by DG RELEX mainly relates to actions implemented under the Common Foreign and Security Policy, the Instrument for Stability and the Industrialised Countries Instrument. The main objectives relate to: peace maintenance; the prevention of conflicts; the strengthening of international security and the promotion of EU interests with main industrialised and high income partners on foreign policy, economic integration and global issues. DG RELEX also manages other operational expenditure related to policy strategy and coordination for the external relations policy area.

5.8. In the case of the Common Foreign and Security Policy, the expenditure mainly relates to the operation of the European Security and Defence Policy through civilian missions established in various countries and territories usually subject to high political risk and instability.

#### *DG ELARG*

5.9. DG ELARG manages expenditure linked to the enlargement strategy mainly under the instrument for pre-accession assistance, the Phare programme including post-accession aid, Cards<sup>(4)</sup>, and pre-accession financial assistance for Turkey.

5.10. A significant part of the expenditure is implemented on the basis of payments made directly to the national authorities in the beneficiary countries (decentralised management). As a rule the first transfer of funds is made upon signature of the financing agreements related to the national programmes concerned. The release of subsequent tranches of pre-financing is conditional upon the approval of a progress report stating that a certain percentage of the funds previously transferred have already been paid.

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<sup>(4)</sup> Phare was the main financial instrument of the pre-accession strategy for Central and Eastern European countries. The Cards programme is Community Assistance for Reconstruction, Development and Stability in the Balkans.

## THE COURT'S OBSERVATIONS

*DG ECHO*

5.11. DG ECHO is responsible for the implementation of EU humanitarian aid <sup>(5)</sup> which it manages from headquarters. Approximately one half of the appropriations committed are provided to non-governmental organisations (NGOs) (direct centralised management) and the other half to UN or other international organisations (joint management). Funding agreements are only concluded with NGOs that have signed the Framework Partnership Agreement (FPA) or UN organisations that have signed the Financial Administrative Framework Agreement (FAFA). Since 2010 DG ECHO is also in charge of the European Civil Protection <sup>(6)</sup> taking over the implementation of that expenditure from DG ENV.

**Audit scope and approach**

5.12. **Annex 1.1, Part 2**, describes the Court's overall audit approach and methodology. For the audit of External aid, Development and Enlargement, the following specific points should be noted:

- (a) The audit involved examination of a sample of 165 payments, comprising 75 pre-financing payments and 90 interim and final payments;
- (b) The assessment of systems covered the supervisory and control systems of EuropeAid and DG ELARG at headquarters, as well as at EU delegations, including:
  - (i) *ex-ante* controls;
  - (ii) monitoring and supervision;
  - (iii) external audits and clearing procedures <sup>(7)</sup>;
  - (iv) internal audit.
- (c) The review on Commission management representations covered the annual activity reports of EuropeAid and DG ELARG.

<sup>(5)</sup> Council Regulation (EC) No 1257/96 (OJ L 163, 2.7.1996, p. 1).

<sup>(6)</sup> It is aimed at supporting the efforts of the Member States, EFTA, candidate countries and third countries on response, preparedness and prevention actions with regard to natural and man-made disasters, acts of terrorism and technological, radiological or environmental accidents.

<sup>(7)</sup> Clearing procedures include follow-up of corrective actions and *ex-post* controls.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**REGULARITY OF TRANSACTIONS**

5.13. **Annex 5.1** contains a summary of the results of transaction testing. The Court's testing of its sample of transactions found 23 % to be affected by error. The most likely error estimated by the Court is 1,7 % <sup>(8)</sup>. All the quantifiable errors have been found in the interim and final payments. Furthermore, the Court found a high frequency of non quantifiable errors.

5.14. Most of the quantifiable errors identified concern eligibility expenditure incurred outside the eligibility period, inclusion of ineligible expenditure in the project cost claims, expenditure not backed by adequate supporting documents, payments made by the Commission not foreseen in the relevant contracts. Examples of errors are provided hereafter (see example 5.1).

**Example 5.1****Works carried out outside the implementation period (Serbia)**

One of the transactions audited was an interim payment made under a works contract for the rehabilitation and extension of a waste water treatment plant. The operational deadline for the works to be completed was 5 March 2009. However, the works related to the audited payment were carried out outside the implementation period established by the contract and in a different period than the one mentioned in the expenditure certificate. The payment of over 800 000 euro is therefore considered ineligible.

**Interim payments higher than foreseen in the contract**

The special conditions of a contract for technical on-site assistance in Ukraine stipulated that interim payments should not exceed 90 % of the total value of the contract. The Commission made interim payments up to 96 % of the amount contracted, leading to an overpayment of 309 478 euro.

**5.13.** *The Commission welcomes the Court's conclusion that transactions in the policy group External Aid Development and Enlargement were free from material error in 2010.*

**Example 5.1****Works carried out outside the implementation period (Serbia)**

*In case of works where at the end of the contractual deadline the Engineer considers that the works have not been carried out or do not meet the required specifications, the employer is entitled to ask for the completion of the works.*

*In this specific case, the Commission retained the outstanding payments until the works met the standards required in the contract.*

**Interim payments higher than foreseen in the contract**

*The Commission accepts that a calculation error was made. However this payment — which brought the total of advances to 96 % rather than the correct 90 % ceiling — would have no residual financial impact on the EC Budget as, at the final payment stage, the payment would be reduced by a commensurate amount or a recovery initiated (supported by the bank's financial guarantee). This example reflects the multiannuality of the Commission's control architecture.*

<sup>(8)</sup> The Court calculates its estimate of error from a representative statistical sample. The figure quoted is the best estimate (known as MLE). The Court has 95 % confidence that the rate of error in the population lies between 0,1 % and 3,3 % (the lower and upper error limits respectively).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.15. Most of the non quantifiable errors identified concern errors in procurement procedures and extension of contracts by the Commission which were detected in 14 <sup>(9)</sup> of the 53 payments subject to a tendering procedure.

5.16. One third of the quantifiable errors detected concern interim payments which may be corrected by subsequent checks in the internal control process. Two third of the errors were found in final payments which had not been detected by Commission controls. An example is provided hereafter (see example 5.2).

## Example 5.2

**Errors in a final payment not detected by Commission controls**

For a final payment to a project providing support to rural families in the production and marketing of organic cashew nuts in Nicaragua, there were several types of errors concerning the expenditure declared: amounts declared in the final report not documented in the accounting records; missing invoices and proofs of payment; non-compliance with procurement rules and missing certificates of origin. Based on the errors found, 157 629,89 euro or 21,7 % of the total costs of the project were considered to be ineligible. None of these errors were detected by the Commission at the stage of final payment.

5.16. The Commission believes that detective and corrective measures prior to final payments (e.g. submission of reports, external audits, expenditure verifications and transactional checks by Commission staff) are effective. In addition, potential irregularities can still be corrected ex-post through the launching of ex-post audits and appropriate recoveries. Nevertheless, controls cannot realistically reduce the risk of financial error to zero.

## Example 5.2

**Errors in a final payment not detected by the Commission**

In the example given EuropeAid's planned controls had not yet finished. The contract in question had already been earmarked for an additional ex-post audit (on top of the mandatory auditors' expenditure verification at final payment) in the 2010 Audit Plan based on the Delegation's own risk assessment (in 2009). This audit (which found 0,28 million euro of expenditure to be ineligible) had not yet been finalised at the time of the Court's visit (which found 0,16 million euro to be ineligible). A recovery process has already been initiated by the Delegation based on its own audit as well as the ECA visit. This example demonstrates both the substantial coverage of EU controls (given that this 0,7 million euro project received three sets of auditors for the EU during 2009/2010) and the effectiveness of EuropeAid's mandatory audit methodology including the annual risk assessment.

## EFFECTIVENESS OF SYSTEMS

5.17. **Annex 5.2** contains a summary of the results of the examination of EuropeAid and DG ELARG systems. The Court found that the systems of both DGs were partially effective in ensuring the regularity of transactions. The detailed results of EuropeAid systems assessment are presented in the Court's annual report on the 8th, 9th and 10th European Development Funds (report on the EDFs).

5.17. The Commission welcomes the Court's conclusion in the Court's Annual Report on the 8th, 9th and 10th European Development Funds (report on the EDFs) that 'EuropeAid's control environment is assessed as effective' (paragraph 30).

<sup>(9)</sup> One of the procurements with error was carried out by the former European Agency for Reconstruction.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## DG ELARG

**Ex-ante controls**

5.18. Positive initiatives have been taken in 2010 in order to improve the internal control procedures. However, it was not yet possible to confirm the full effectiveness of the improvement of the internal control procedures, which are considered as partially effective.

5.19. In 2009, DG ELARG established a comprehensive 'Internal Control Strategy' which was followed in 2010 by subsequent development of new<sup>(10)</sup> and revised<sup>(11)</sup> procedures.

5.20. The guidance provided by the Commission on the application of the accreditation criteria leading to the conferral of management to national authorities is not sufficiently detailed (e.g. benchmarks to be met before lifting *ex-ante* controls or conditions under which conferral of management powers could be suspended).

5.21. The reviews of payments at headquarter and delegations continue to reveal weaknesses in the audit trail of the checks carried out by the Commission to validate the underlying expenditure (see example 5.1 — Serbia).

5.22. In seven<sup>(12)</sup> out of the 17 transactions audited subject to procurement procedure, errors were found in the tendering stage (e.g. inappropriate definition or application of the selection criteria and wrong type of procurement), or in subsequent amendments to contracts (e.g. irregular negotiated procedures after the deadline of implementation).

**5.18.** *The Commission accepted the recommendations made by the Court in its 2009 Annual Report and swiftly adopted a set of measures and instructions. These measures started to become operational in 2010 and full impact is expected to be reached in 2011.*

**5.20.** *The criteria for conferring management powers to national authorities (and, a contrario, the conditions for suspending the conferral of management) are spelled out in the IPA Implementing Regulation (EC) No 718/2007.*

*Further conditions (or benchmarks) can be agreed with the beneficiary country for this and these could be included in the financing agreements signed under decentralised management.*

**5.21.** *Steady efforts continue to be made in order to eliminate remaining weaknesses pointed out by the Court in the context of the verification of payment transactions.*

<sup>(10)</sup> Annual Assurance Strategies defined and designed by each Authorising officer by sub-delegation (Directors in headquarter and Heads of delegation) and a policy of *ex-post* controls for centrally managed contracts.

<sup>(11)</sup> Guidelines for the accreditation leading to the conferral of management in decentralised management; checklists for the 'certified correct' of payments and final declarations and policy for clearance of accounts.

<sup>(12)</sup> One of the procurements with error was carried out by the former European Agency for Reconstruction.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Monitoring and supervision**

5.23. The monitoring and supervision performed by DG ELARG is considered as effective.

5.24. In 2010 DG ELARG continued the development of a new management information system. The Court found that the quality of the data entered in the information systems (CRIS and i-Perseus)<sup>(13)</sup>, which will be used by the new management information system, is not sufficiently ensured. This was evidenced by encoding errors detected in the course of the Court's transaction testing.

5.25. DG ELARG has issued guidelines for the delegations' on-the-spot visits of projects. It has not, however, complemented these with a tool to facilitate the consolidation of the visit outcomes related to legality and regularity issues.

5.26. For decentralised management, DG ELARG monitors the effectiveness of the national systems and the fulfilment of all requirements for the maintenance of their accreditation. Systems audits carried out by headquarter test only the design of the national systems, including the internal control systems, whilst the delegation in place is responsible for monitoring the functioning of the system. This can still be improved by systematic on-the-spot controls by delegations.

**External audits and clearing procedures**

5.27. The external audits and clearing procedures are assessed as effective.

5.28. For centralised management, DG ELARG, following the Court's recommendations, implemented a specific strategy to introduce *ex-post* audits in the centrally managed contracts. Only one audit report was available by the end of 2010. The guidance and follow-up for the preparation of Annual Audit Plans at delegation level was found not detailed enough (e.g. DG ELARG did not define a minimal coverage ratio of expenditure to be audited by delegations and delegations are not obliged to inform headquarters on the follow-up actions to the audit reports).

**Internal audit**

5.29. The internal audit function is assessed as effective. The audit reports produced in 2010 were found relevant and substantiated, helping the Director-General identifying the main risky areas in the internal control systems of DG ELARG.

5.24. DG ELARG verifies data encoded in CRIS by: (a) the financial circuits (8 eyes review), based on the manuals of procedures, checklists and regular trainings provided to staff; (b) automatic data controls embedded in CRIS and (c) accounting data quality checks performed by the Accounting Correspondent of DG ELARG.

5.25. DG ELARG has issued detailed instructions for monitoring visits which are only one of the means to gain reasonable assurance as to the legality and regularity of underlying transactions. The outcomes of monitoring visits are systematically documented in mission reports attached to the relevant project file.

5.26. Delegations in beneficiary countries under decentralised management (in 2010 Croatia and Turkey) carry out systematic on-the-spot controls as part of the annual assurance strategy for all delegations and systematically review the functioning of the national systems in regular meetings with the relevant national authorities. DG ELARG receives annual statements of assurance accompanied by a detailed report on remaining weaknesses from the National Authorising Officer. Where appropriate, detailed action plans are agreed with the beneficiary country to remedy weaknesses or shortcomings in the national systems.

5.28. The remaining issues pointed out by the Court within the context of the Annual Audit Plans were taken into consideration and addressed.

<sup>(13)</sup> 17 out of 35 (49 %) of the reviewed transactions were affected by encoding errors in CRIS. The most frequent errors relate to the incomplete or inaccurate encoding of the dates of implementation and wrong classification of the types of payments.

## THE COURT'S OBSERVATIONS

## DG ECHO

5.30. The Court did not perform a specific assessment of DG ECHO supervisory and control systems in 2010. However, substantive testing revealed some systems specificities linked to ECHO's responsibilities which provide for a considerable degree of flexibility in the determination of what is acceptable as eligible expenditure, as presented in the example 5.3. Therefore, the payments audited are seldom affected by ineligible expenditure.

## Example 5.3

**Extended eligibility criteria**

The general conditions for contribution agreements under the FAFA and FPA accept as eligible some expenditure incurred outside the action's specific implementation period. Fixed assets (e.g. cars) financed under one project are eligible even though they may be mainly used for a subsequent EU project. Asset depreciation can also be eligible, which means that controls are necessary to address the risk that the fixed asset itself has not been covered by another source of funds. Therefore it can be difficult to know the total real costs of a specific action.

**Flexible interpretation of eligibility for co-financed actions**

In the case of multi-donors actions implemented by UN organisations, the Commission applies the 'notional approach'. Under this approach, the Commission's contribution — generally a fixed amount — is paid in full as long as there is sufficient eligible expenditure to cover it and the overall objectives of the action have been attained. If another donor has the same eligibility conditions than the Commission, there might be a risk that the same expenditure is presented twice (double-eligibility risk), to the Commission and to the other donor.

## THE COMMISSION'S REPLIES

**5.30.** DG ECHO works in the framework of the existing legislation in force and is fully compliant with it.

*Humanitarian activities are results based, leading to DG ECHO analysis in the field, that the expected results have been reached. This is of an utmost importance in the framework of humanitarian aid where one of the key Commission's mandates is to save lives. That is why the needed degree of flexibility is recognised by the Financial Regulation and applied in the field.*

*The effective implementation of supervisory and control systems as assessed, for DG ECHO, by the Court in its Annual Report 2009, was continued in 2010, resulting in very low level of errors detected by the controlling bodies, be it the Court or the Commission's auditors.*

## Example 5.3

**Extended eligibility criteria**

*Expenditures incurred outside the action specific implementation period relate mainly to the constitution of food or humanitarian equipment stocks, which is considered by the Commission as an acceptable practice in order to ensure rapid initiation and distribution of humanitarian aid.*

*As regards the purchase at a late stage of a project is concerned, this is due to the very nature and short duration of humanitarian action. However, in each and every case where there is a purchase near the end of a project, the facts are examined on a case by case basis, including the dimension of donation/transfer at the end of the running project, in order to assess whether the purchase is necessary and reasonable.*

**Flexible interpretation of eligibility for co-financed actions**

*The notional approach has been developed to guarantee that the legal requirements applicable to EU funding in external actions are met while reconciling the obligation to spend EU funds in the most efficient way, in accordance with the principle of sound financial management.*

*The Commission mitigates the mentioned risk by its coordinating role in the humanitarian field, the presence of its experts in the field and the review of global action's financial overview provided by the UN organisation.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

5.31. **Annex 5.3** contains a summary of the results of the review of Commission management representations. The Court describes significant observations in further detail below.

5.32. Despite the efforts made by EuropeAid and DG ELARG in the preparation of their annual activity reports and some improvements introduced, there remain matters that still need to be addressed by the Commission.

5.33. In the case of DG ELARG, the calculation provided in the AAR for the residual error rate (RER) is limited to decentralised management, which in 2010 represented only 30 % of the payments carried out.

5.34. The results of the review of the representation made by the Director-General of EuropeAid are included in the report on the EDFs. The Court considers that the Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity for the EDFs and the General Budget of the European Union.

**CONCLUSIONS AND RECOMMENDATIONS****Conclusions**

5.35. Based on its audit work, the Court concludes that the payments for External aid, Development and Enlargement for the year ended on 31 December 2010 were free from material error. However, interim and final payments were subject to material error <sup>(14)</sup>.

5.36. Based on its audit work, the Court concludes that the supervisory and control systems for External aid, Development and Enlargement were partially effective in ensuring the regularity of payments.

**5.33.** *The fact that DG ELARG calculated in the AAR 2010 the residual error rate only for decentralised management does not put in question the reliability of management representation. As explained in the AAR, the mode of decentralised management, (accounting in 2010 for some of 30 % of the payments carried out) is the one presenting the highest level of risks. The same indicator will be developed for centralised management once the newly introduced ex-post controls for that management mode will have produced a statistically significant basis.*

**5.34.** *The Commission believes that the qualitative and quantitative indicators set out in the four assurance building blocks of the EuropeAid Annual Activity Report do indeed provide the necessary evidence to underpin the Director-General's Statement of Reasonable Assurance.*

**5.35.** *The Commission notes that payments in 2010 in the policy group External Aid, Development and Enlargement were free from material error. It is continuing to improve the operation of its multiannual control architecture in order to reduce the errors in interim and final payments.*

**5.36.** *The Commission has designed its controls to cover the full lifecycle of its multiannual projects. It believes that these supervisory and control systems are effective and have significantly improved year on year. The recommendations made by the Court in previous years have been acted on. Many of the improvements made have been recognised by the Court, resulting in significant elements of the key control system being judged 'effective'. Despite the challenges of a high risk external aid environment, a non-material level of error was found on the EDF portfolio in 2009 and on the Budget financed portfolio in 2010.*

<sup>(14)</sup> See paragraphs 5.13 to 5.16.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Recommendations**

5.37. **Annex 5.4** shows the result of the Court's review of the Commission's progress in addressing recommendations made in the previous annual report (2009). The recommendations regarding EuropeAid are included in the report on the EDFs. Following this review and the findings and conclusions for 2010, the Court recommends that:

- DG ELARG defines in more detail the criteria for lifting *ex-ante* control and suspending the 'conferral of management' to decentralised countries and tests the performance of the systems used by national authorities (see paragraphs 5.20 and 5.26),
- DG ELARG continues to improve the quality of the data entered in its management information system (see paragraph 5.24),
- DG ELARG should develop a tool to facilitate the consolidation of the visit outcomes related to legality and regularity issues (see paragraph 5.25),
- DG ELARG increases *ex-post* reviews of transactions for centralised management (see paragraph 5.29),
- the Commission defines a coherent methodology for the calculation of the residual error rate by the external relations directorates based on which Directors-General deliver their management representation (see paragraphs 5.33 and 5.34).

5.37.

- *The Commission will look into the most appropriate way to refine the criteria.*
- DG ELARG and the delegations under its control are already testing the performance of national systems.*
- *DG ELARG is taking appropriate measures to continuously improve data quality in close cooperation with the system owner.*
- *The Commission will look into the most appropriate way to consolidate the visit outcomes.*
- *The remaining issues pointed out by the Court within the context of the Annual Audit Plans were taken into consideration and will be further addressed, including the increase of *ex-post* reviews of transactions for centralised management.*
- *EuropeAid started work on a residual error rate methodology in 2010. The outcome of this new initiative will be shared with the other external relations DGs to lay the foundations of a possible wider approach (see also the reply to paragraph 1.22 and paragraphs 55 and 62(a) of the EDF report).*

## **FOLLOW-UP OF SPECIAL REPORT No 9/2008 ON THE EFFECTIVENESS OF EU SUPPORT IN THE AREA OF FREEDOM, SECURITY AND JUSTICE FOR BELARUS, MOLDOVA AND UKRAINE**

**Introduction**

5.38. In 2008, the European Court of Auditors (ECA) published Special Report (SR) No 9/2008 concerning the effectiveness of European Union support in the area of freedom, security and justice for Belarus, Moldova and Ukraine.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.39. The audit covered the assistance provided to the three countries to improve their capacity in the areas of border control, migration/asylum management, the fight against organised crime and the judiciary and good governance. The greater part of the assistance was delivered through international organisations (United Nations agencies, the International Organisation for Migration, the Council of Europe, etc). Until 2007 the TACIS programme financed most of the assistance, since then the principal source of funds is the European Neighbourhood and Partnership (ENP) Instrument.

5.40. The recommendations made by the Court in SR No 9/2008 tackled concrete weaknesses related to the specific projects audited, as well as general issues related to the planning and the implementation of the cooperation aid to these countries. All the recommendations were fully adopted by the Council <sup>(15)</sup> and the Parliament <sup>(16)</sup>.

5.41. In October 2009, the Commission issued a working document on the follow-up to the 2007 Discharge Decision of the European Parliament <sup>(17)</sup> making reference to the recommendations of SR No 9/2008.

### Follow-up of the recommendations

5.42. The Commission provided evidence that the EU delegations in Chisinau and in Kiev supported the cooperation between the European Union border assistance mission to Moldova and Ukraine (EUBAM) and Frontex at policy and operation level.

*5.42. The Commission would like to underline the good collaboration between Frontex and the EU Delegation in Kiev and EUBAM.*

<sup>(15)</sup> Council of the European Union: Draft Council conclusions 6932/09 of 26 February 2009.

<sup>(16)</sup> European Parliament: Resolution of the European Parliament of 23 April 2009 with observations forming an integral part of the Decision on the discharge for implementation of the European Union general budget for the financial year 2007, Section III — Commission and executive agencies (P6\_TA(2009) 289).

<sup>(17)</sup> European Commission: Commission staff working document accompanying the report from the Commission to the European Parliament on the follow-up to 2007 Discharge Decision (SEC(2009) 1427 final, 16.10.2009).

## THE COURT'S OBSERVATIONS

5.43. The Commission has accepted that before releasing further funds for centres for illegal migrants and asylum seekers it should make sure that the recipient government is committed to pay at least the running costs in order to ensure sustainability. Nevertheless, as highlighted by a recent Result Oriented Monitoring (ROM) report, there are some concerns about insufficient co-financing by partner countries. Indeed, an evaluation report commissioned by the Joint Evaluation Unit found that the resources allocated by the government of Ukraine to the running and maintenance of the migrant accommodation centres and the temporary holding facilities have been insufficient. The Civil Society Organisations (CSOs) have denounced violations of the rights of refugees and asylum seekers. In response, the Commission, before releasing further funds in this policy area, requested the recipient country to confirm in writing that they will cover the running costs of the financed infrastructure.

5.44. There is no comprehensive evaluation of the progress that the three countries have made on focusing the project activities on the issue of effective prosecution and on systematic information sharing between law enforcement bodies.

5.45. The Commission has presented evidence regarding the involvement of the civil society in the development of an anti-corruption policy in Ukraine. However, it has not provided assessments on the efficiency, effectiveness and sustainability of these projects. The individual projects implemented by the CSOs were not included in the ROM sample.

5.46. The EU delegations in Ukraine and Moldova have reorganised and strengthened their staff managing these operations. The delegation in Belarus has taken over partial responsibility for programme management from the Kiev delegation. Nevertheless, the audit and evaluation of the aid interventions were not effectively managed by the delegations.

5.47. Since 2007, Sector Budget Support (SBS) and programme aid have increased while there are fewer Technical Assistance (TA) projects. SBS requires Public Financial Management (PFM) to be at a certain level. If PFM is weak, as identified in the Public Expenditure and Financial Accountability assessment, and there is political instability in an environment of financial crisis, there are significant risks for the effective and efficient implementation of aid interventions<sup>(18)</sup>. No donors have to date adopted grant budget support to these countries although some development partners give budget support through loans.

## THE COMMISSION'S REPLIES

**5.43.** *Prior to launching the tender, the EU Delegation in Kiev provided the beneficiaries under the readmission assistance programme, namely the Ukrainian Ministry of Interior and the Ukrainian State Border Guards Service, with a cost estimate regarding the running costs for the infrastructure to be built with EU funds (water, electricity, gas etc.). Only after both beneficiaries confirmed in writing that they will be able to provide the necessary funds for running the buildings and also pay for the necessary services and trained personnel to operate the facilities, the EU Delegation launched the tender in December 2010.*

**5.44.** *Despite the absence of comprehensive evaluation, the Commission continuously monitors progress made in this area and 6 million euro are planned as accompanying measures to the 2010 'Support to the Border Management Sector Policy' budget support, which includes information sharing between individual entities of law enforcement bodies.*

**5.45.** *The purpose of the Commission's Results Orientated Monitoring — which assesses projects following five criteria: relevance, efficiency, effectiveness, impact and sustainability — is to support and improve the quality of selected projects, not to measure the quality of projects based on a sample. The operation of the ROM in the region has been fundamentally revised since the Court's audit.*

**5.47.** *The Commission agrees that there has been a major shift to sector budget support in the ENPI. Although there are certain risks inherent to budget support, this modality has the advantage to provide an overview of the whole sector and to release funds only if there are concrete results and progress in the sector. Furthermore it has the advantage to engage with the Government in a continuous sector policy dialogue and is accompanied by complementary technical assistance as needed.*

<sup>(18)</sup> See Special Report No 11/2010 on the Commission's management of General Budget Support in ACP, Latin American and Asian Countries.



## THE COURT'S OBSERVATIONS

5.48. The Commission is exercising more rigorous control over international organisations that it has contracted to implement actions. It has introduced a systematic assessment of their compliance with the international standards of accounting, auditing, procurement and internal control systems. At the level of individual projects, the framework agreements with international organisations normally provide for verification missions. However, the relevant guidelines concerning on-the-spot monitoring visits are not applied effectively and the audit plan was not fully implemented. Also there is still a high number of open projects covering a wide range of areas, notwithstanding the efforts of the three delegations to close them.

5.49. With regard to donor's coordination there is evidence that EU delegations work together with EU Member States and other donors. However, administrative reform and the frequent changes of personnel and interlocutors in the recipient countries significantly diminish the efficiency of the donor coordination, notably in Ukraine.

5.50. The Commission has analysed the political, economical and social situation in the recipient countries and has reflected better the partners' priorities in the strategic documents of the EU. Nonetheless, political instability and unplanned changes in the institutional framework, staff and procedures, affect adversely the efficiency of the planned aid interventions. The Commission has improved the definition of objectives for individual programmes, but in order to facilitate the monitoring and provide a useful feedback, more work is needed to define clear and measurable objectives and indicators, as well as of implementation milestones.

5.51. Lessons learnt are considered in the planning documents of the Commission (including the country strategy papers, the national indicative programmes and the annual action plans). Experience, however, is not systematically exchanged between delegations with similar aid interventions. The evaluation report covering the period from 2002 to 2008 in Ukraine commissioned by the Joint Evaluation Unit was submitted only in December 2010, after the approval of the National Indicative Programme 2011-2013.

## THE COMMISSION'S REPLIES

**5.48.** *Guidelines for on-the-spot monitoring visits are not mandatory. However the methodology for audit (including the planning of verification missions to international organisations) is a mandatory instruction, and the follow-up of the audit plan is closely followed by delegations and HQ.*

**5.50.** *EuropeAid is planning to introduce multiannual monitoring and evaluation plans and strengthen monitoring guidance and reporting — notably in the 2011 redesign of the External Assistance Management Reports (submitted twice yearly by delegations) and the new Programme and Project Cycle Management Guidelines.*

**5.51.** *Conclusions and recommendations of the in-country evaluation are used on a daily basis. To facilitate exchange of best practice and lessons learned, a database for project evaluations and ROM is under development as part of the Project and Programme Cycle Management (PPCM) platform. This database will facilitate the planning, management, consultation and analysis of external project monitoring, evaluations and their results.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Conclusions**

5.52. The Commission has accepted the recommendations of the Court and it provided evidence of making progress in implementing them. The EU delegation in Belarus opened in 2008, and the EU delegations in Moldova and Ukraine were reorganised to have the expertise required to conduct efficient policy dialogue, to promote civil society involvement in the policy formulation and to improve the sustainability of aid interventions. The EU delegations promoted the cooperation between Member States, EU agencies and the other donors in a particularly unstable political and administrative environment.

5.53. Not all the recommendations of the Court, however, have been implemented. There is no action plan to monitor and coordinate the efforts of the three delegations to implement the recommendations and promote the systematic exchange of experience. A full evaluation of the progress made to focus on effective prosecution and on systematic information sharing between law enforcement bodies is pending. There is still considerable scope for integrating in the planning documents proper performance indicators and strategic objectives that would allow an efficient impact assessment of aid interventions. Also, the decisive shift towards sector budget support as the predominant aid modality involves considerable risks given the adverse current financial and administrative situation. No other donors have to date adopted grant budget support to these countries although some development partners give budget support through loans.

**FOLLOW-UP OF SPECIAL REPORT No 10/2008 ON EC DEVELOPMENT ASSISTANCE TO HEALTH SERVICES IN SUB-SAHARAN AFRICA****Introduction**

5.54. In 2009, the Court of Auditors published Special Report (SR) No 10/2008 concerning EC Development Assistance to Health Services in Sub-Saharan Africa. The audit examined whether the financial and human resources actually allocated to the health sector reflected EC's strong policy commitments in this area. The audit also assessed how effectively the Commission had used the various instruments available to it for assisting the health sector, notably general and sector budget support, projects and the Global Fund to Fight AIDS, Tuberculosis and Malaria (Global Fund).

*5.52. The Commission welcomes the Court's recognition of the significant progress made.*

*5.53. The EU Delegation to Ukraine and Belarus is introducing a Risk Register allowing a proper assessment of the risk levels in project implementation, following the recommendations made by the Court.*

*This instrument facilitates continuous attention to the main risk factors likely to affect the success of the projects.*

*More exchange of experience are planned through regional seminars, including on improving internal monitoring methods.*

*See also replies to paragraphs 5.43, 5.44, 5.45, 5.47, 5.48, 5.50 and 5.51.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.55. In SR No 10/2008 the Court made a number of recommendations to the Commission. Some of them concerned the allocation and prioritisation of resources. In this regard, the Court suggested to the Commission to review the balance of funding and consider increasing its support to the health sector in order to fulfil the EC's health policy commitments. In addition to that, the Commission should ensure sufficient health expertise to implement its health sector policies.

5.56. Other recommendations made in that report focus on improving the management and effectiveness of aid instruments. Among others, the Court recommended to the Commission to make greater use of sector budget support and strengthen the sectoral dimension of general budget support. In the Court's opinion the Commission should also work more closely with the Global Fund to support and monitor its interventions at country level. In addition, more extensive use of the project approach was needed, as well as guidance on the optimal complementary use of the instruments available. Finally, the Commission was advised to take more account of the country situation when choosing instruments and to align interventions more closely with SWAps.

5.57. The recommendations set out in the report were welcomed by the Council of the European Union<sup>(19)</sup> and the European Parliament<sup>(20)</sup> and generally accepted by the Commission.

### Follow-up of the recommendations

#### *Recommendations on the allocation and prioritisation of resources*

5.58. As part of the Mid-Term Review of the 10th EDF, the Commission has taken steps to increase funding to the health sector through its Millennium Development Goal (MDG) Initiative which has a total allocation of 1 billion euro and which it launched in September 2010. This Initiative recognises that many Sub-Saharan countries are seriously off-track in their efforts to achieve two of the three health MDGs, namely MDG 4: Reduce Child Mortality, and MDG 5: Improve Maternal Health, as well as two further key MDGs<sup>(21)</sup>. However, it is not yet clear how much of the MDG Initiative funding will actually be allocated to health.

**5.56.** *The Commission accepted all the Court of Auditors' recommendations in relation to this Special Report on Health in sub-Saharan Africa.*

**5.58.** *Given the strong representation of health related proposals in the framework of the MDG Initiative (deadline June 2011), in which 20 of the 43 countries which submitted concept notes focussed on health issues (i.e. 47%) it is likely that health will figure prominently in the overall distribution of the funding available.*

<sup>(19)</sup> Council conclusions of 23 April 2009 on Special Report No 10/2008 concerning EC Development Assistance to Health Services in Sub-Saharan Africa together with the Commission's replies.

<sup>(20)</sup> European Parliament resolution of 12 March 2009 on an approach to 'EC development assistance to health services in sub-Saharan Africa'. (P6\_TA PROV(2009) 138).

<sup>(21)</sup> MDG 1c): Reduce by half the people who suffer from hunger and MDG 7c): Halve the proportion of people without sustainable access to safe drinking water and basic sanitation.

## THE COURT'S OBSERVATIONS

5.59. In 2010 the Commission in conjunction with the Member States issued a policy communication on 'The EU Role in Global Health' <sup>(22)</sup> which emphasised health systems support as the central focus of EU policy. There remains though a need to establish an action programme to implement the policy and ensure sufficient funding for it.

5.60. The Commission has continued to make large annual contributions (2008-2010: 300 million euro) to the Global Fund in order to address the three specific diseases covered by its mandate. The Global Fund has sought to give a higher priority to health systems support and the Commission has followed a policy of encouraging the Global Fund to move more in this direction. Overall, it is estimated that about 15 % of its funds have been used for health systems strengthening and this percentage is expected to increase. Nevertheless, it should also be recognised that given its mandate and organisation, there are limits on the extent to which the Global Fund can directly contribute to health systems strengthening.

5.61. The Commission has strengthened its human resources working on health in its headquarters through the recruitment of additional national experts from Member States. However, important issues remain in terms of the health expertise available at delegation level. A 2009 Commission survey on this subject showed that while in countries where health was a focal sector for EDF support delegations generally had some degree of in-house health expertise, this was not the case in other countries, even where the Commission also had significant interventions in relation to the health sector. Thus, for example, the Commission had generally not allocated health experts to support the new 'MDG Contract' budget support programmes it launched in 2007 <sup>(23)</sup>. The Commission has so far made only limited progress in addressing this recommendation by drawing more on Member State health expertise to support delegations although it has increased cooperation with the World Health Organisation (WHO) at country level. The possibility of setting up regional health adviser posts to cover a number of delegations is still under discussion. The Commission's generally limited capacity in its delegations is problematic at a time when the MDG Initiative has recognised the need to intensify health policy dialogue in order to better identify and overcome the obstacles to the achievement of MDG 4 and MDG 5.

## THE COMMISSION'S REPLIES

**5.59.** *The Communication on 'The EU Role in Global Health' issued in 2010 aims to promote better coordination, complementarity and effectiveness of the actions supported by the Commission and the Member States in the field of health, in developing countries. A Commission Inter Service Group is responsible for implementing the Communication and monitoring its outcomes. A 'Global Health Action Plan' was developed in 2011.*

**5.61.** *The presence of qualified staff on the ground is essential to pursuing the regular policy dialogue that is fundamental to the general budget support instrument. However, each delegation cannot be staffed with all necessary expertise at any moment.*

*Specialised expertise on health is provided from HQ to delegations by the 'Education, Health, Research and Culture' unit, providing operational guidance and developing implementation strategies, including training, as well as by providing assurance on the use of quality systems and tools in programme design and implementation for this sector. Thematic networks are being developed linking thematic and geographical directorates in HQ to delegations, in order to disseminate existing expertise.*

*Concerning the regional focal points for health, as for other sectors of activity, the needs, advantages and disadvantages of this approach are under analysis. This reflection will be informed by the results of the workload assessment of delegations currently on going, and will take into account the present framework of budgetary constraints and 'zero growth' Commission HR policy.*

<sup>(22)</sup> COM(2010) 128 final, Brussels, 31.3.2010.

<sup>(23)</sup> The Commission allocated approximately 1 500 million euro to MDG Contracts in eight countries. These programmes provide general budget support over an extended six-year period and are intended to have a strong focus on the MDGs.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Recommendations on the management and effectiveness of instruments*

5.62. The Commission has two sector budget support programmes financed through the EDF in Sub-Saharan Africa although the possibility of implementing part of the MDG Initiative's funding for the health sector through sector budget support is being considered. The Commission is in the process of reviewing its approach to general budget support, including the instrument's role in the health sector, having issued a Green Paper on the subject<sup>(24)</sup>.

5.63. The Commission issued guidelines for delegations in 2009 on working with the Global Fund. The objective of the guidelines was to make the Commission's support to the Global Fund more effective through an increased participation by delegations in Global Fund mechanisms and through improvements in delegation reporting to Commission headquarters.

5.64. An important part of new health sector interventions continues to be implemented through projects. However, the Commission has still to develop guidance on how to best use projects to support other aid instruments. The Commission has issued several practical guidance notes on subjects relating to the health sector (see, for example, paragraph 5.63) but has also not yet drawn up a comprehensive set of guidelines for its health sector development assistance.

5.65. One important tool developed by the international community, including through inputs from the Commission, is the Joint Assessment of National Strategies (JANS) methodology. This is intended to provide a common basis for the assessment of national health strategies with a view to allowing greater use of sector wide approaches and alignment of donor support with national systems.

**Conclusions**

5.66. Overall, the Commission has made some good progress in implementing the Court's recommendations. It is making significant new resources available to address health MDGs through its MDG Initiative in the context of the 10th EDF Mid-Term Review. It has played a central part in establishing a new policy on the EU role in Global Health which emphasises the importance of health systems support. The Commission has continued to provide substantial funding to the Global Fund but has encouraged the Global Fund's efforts to give increased attention to health systems. The Commission has also taken some steps to improve the effectiveness of its support to the Global Fund.

**5.62.** *The Commission has to respect the ownership of beneficiary countries in relation to the selection of their programming 'focal sectors' (7 EDF sub-Saharan countries currently have a health focal sector). In addition budget support has clear eligibility criteria. Health sector budget support is therefore currently being used in the maximum number of countries possible. In addition three health sector budget support proposals have been received within the framework of the MDG initiative (from countries where health is a non-focal sector).*

**5.64.** *EuropeAid is currently developing a set of Programme and Project Cycle Management guidelines which include a focus on better context analysis. Against this background, Commission and Member States have also embarked on a harmonised and comprehensive set of guidelines for EU health sector development assistance in the follow-up to the May 2010 Council Conclusions on Global Health.*

**5.66.** *The Commission welcomes the Court's recognition of its substantial progress on health related initiatives in pursuit of the MDGs.*

<sup>(24)</sup> Green Paper: 'The future of EU Budget support to third countries' (COM(2010) 586 final), Brussels, 19.10.2010.

## THE COURT'S OBSERVATIONS

5.67. Nevertheless, a number of key areas still require more attention. The Commission needs to make the new EU Global Health Policy operational by establishing an action programme which can be used in programming future EDF funding. The Commission also has not yet access to sufficient health expertise at delegation level to meet the need for intensified focus and dialogue on the health MDGs, which still lag behind in Sub-Saharan Africa as 2015 approaches. The Commission should continue to promote the use of sector budget support in the health sector, while further defining the role of general budget support programmes in assisting the health sector. Similarly, work remains to be completed on guidelines concerning the choice and coherence of different aid instruments for the health sector.

## THE COMMISSION'S REPLIES

**5.67.** *The Commission has an obligation to respect both budget support eligibility criteria and the agreed programming of focal sectors (inc. aid effectiveness principles of principles division of labour among donors).*

*The Commission has:*

- *established an Action Plan for 2011 to implement the EU Global Health Policy,*
- *committed itself in the medium term to the mapping of HR expertise in delegations,*
- *engaged in a major revision of the Budget Support Guidelines,*
- *started work on developing EuropeAid's new Programme and Project Cycle Management Guidelines which will focus inter alia on guiding operational staff on optimal choices for aid mechanisms,*
- *together with EU Member States, embarked on a harmonised and comprehensive set of guidelines for EU health sector development assistance in follow-up of the May 2010 Council Conclusions on Global Health.*

## RESULTS OF TRANSACTION TESTING FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

	2010						2009	2008	2007
	EuropeAid	RELEX	ELARG	ECHO	DEV	Total			
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>									
Total transactions (of which):	92	14	35	22	2	165	180	180	145
Advances	43	12	8	12	0	75	83	71	46
Interim/Final payments	49	2	27	10	2	90	97	109	99
<b>RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup></b>									
<b>Proportion of transactions tested found to be:</b>									
Free of error	79 % (73)	100 % (14)	74 % (26)	64 % (14)	0 % —	77 % (127)	87 %	73 %	74 %
Affected by one or more errors	21 % (19)	0 % —	26 % (9)	36 % (8)	100 % (2)	23 % (38)	13 %	27 %	26 %
<b>Analysis of transactions affected by error</b>									
<b>Analysis by type of expenditure</b>									
Advances	16 % (3)	0 % —	11 % (1)	0 % —	0 % —	11 % (4)	17 %	19 %	19 %
Interim/Final payments	84 % (16)	0 % —	89 % (8)	100 % (8)	100 % (2)	89 % (34)	83 %	81 %	81 %
<b>Analysis by type of error</b>									
Non-Quantifiable errors:	53 % (10)	0 % —	78 % (7)	38 % (3)	0 % —	53 % (20)	74 %	60 %	73 %
Quantifiable errors:	47 % (9)	0 % —	22 % (2)	62 % (5)	100 % (2)	47 % (18)	26 %	40 %	27 %
Eligibility	67 % (6)	0 % —	100 % (2)	100 % (5)	0 % —	72 % (13)	100 %	79 %	100 %
Occurrence	22 % (2)	0 % —	0 % —	0 % —	50 % (1)	17 % (3)	(0)	21 %	(0)
Accuracy	11 % (1)	0 % —	0 % —	0 % —	50 % (1)	11 % (2)	(0)	(0)	(0)
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>									
Most likely error rate							1,7 %		
Lower error limit							0,1 %		
Upper error limit							3,3 %		

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

## ANNEX 5.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

## Assessment of selected supervisory and control systems of EuropeAid

	Control environment	Ex-ante controls	Monitoring and supervision	External audits and clearing procedures	Internal audit	Overall assessment
Central Systems	Effective	Partially effective	Effective	Effective	Effective	Partially effective
Delegation	Effective	Partially effective	Partially effective	Partially effective	N/A	

## Assessment of selected supervisory and control systems of DG ELARG

Ex-ante controls	Monitoring and supervision	External audits and clearing procedures	Internal audit	Overall assessment
Partially effective	Effective	Effective	Effective	Partially effective

## Overall assessment of supervisory and control systems

Overall assessment	2010	2009	2008	2007
	Partially effective	Partially effective	Partially effective	Partially effective



## ANNEX 5.3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

Main DGs concerned	Nature of declaration given by the Director-General (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
ELARG	<b>without reservations</b>	N/A	The calculation of the residual error rate (RER) is limited to decentralised management mode which represents only 30 % of the payments carried out in 2010 by DG ELARG. The Court's audit found that there remain matters that still need to be addressed.	B	A
EuropeAid	<b>without reservations</b>	N/A	EuropeAid has set up a comprehensive control strategy and continued to bring significant improvements to the design and implementation of its supervisory and control systems. However, the Court's audit found that there remain weaknesses in certain controls and that the payments were affected by material error.	B	B

(\*) By reference to the declaration of assurance of the Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: the Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity.

B: the Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

C: the Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

Year	Court Recommendation	Progress made	Commission reply	Court analysis
	DG RELEX should consolidate its <i>ex-post</i> control methodology and promptly address the recommendations made by the internal auditor in that respect.	Following an Action Plan DG RELEX has introduced improvements to the <i>ex-post</i> control methodology. However, part of the foreseen mitigating measures can only be implemented in 2011 under the management of the new Service for Foreign Policy Instruments (FPI).		
	DG RELEX should devote sufficient resources to the analysis and closure of the old RRM and the CFSP contracts for which the implementation deadlines have already expired.	A considerable number of old RRM files were closed. For CFSP, although the problem has been addressed (25 of the 133 projects open beginning 2010 were closed) there is still a significant backlog.	<i>Close follow-up of the closure of old projects is part of the action plan which was established following the IAS/IAC audit of CFSP. The situation of all old and ended contracts is reviewed on a regular basis and appropriate action is taken in order to close projects which have ended. The number of CFSP projects has been increasing steadily together with the substantial increase of the CFSP budget over the last years (e.g. there were 51 new contracts in 2010) and this might give the false impression that the situation is not improving.</i>	<b>The Court takes note of the Commission's reply.</b>
2009	DG ELARG should provide more specific guidance for the 'conferral of management powers' procedure to clarify better the roles of the different Commission actors in the process.	DG ELARG developed new guidance by the end of 2010. However that new guidance will only be applicable in 2011 and the Court considers that they are not sufficiently detailed.	<i>The initiatives that were taken after the recommendations were issued in July involved very intensive coordination and mutual consultation, and resulted in a set of instructions that was published timely in order to meet the 2010 deadline.</i>	<b>The Court takes note of the Commission's reply.</b>
	DG ELARG should review its internal control checklists in order to document all the checks carried out.	New internal control checklists were developed in DG ELARG headquarters, but their full use at EU delegations in the enlargement countries still needs to be ensured.	<i>The necessary efforts have been made to ensure their full use in the Delegations.</i>	
	DG ELARG should take measures to improve the quality of the data entered in its management information systems (e.g. regular analysis and verification of the quality of the data).	The Court's review of systems and transactions did not note relevant improvements in the data quality. DG ELARG should establish an action plan to properly implement this recommendation.	<i>Staff at HQ and Del has been motivated to ensure proper encoding of the data, but in general, the problems noted go beyond the scope of the ELARG-owned information systems, so that solutions need to be sought at a Commission-wide level.</i>	<b>The Court takes note of the Commission's reply.</b>
	DG ELARG should develop and put in place mechanisms to facilitate the analysis and follow up of the results of the monitoring missions carried out.	This recommendation has not yet been addressed by DG ELARG. In 2010, this weakness was confirmed in all the visited EU delegations in enlargement countries.	<i>The recommendation started to be addressed in 2010 but, according to its very nature, its results cannot be witnessed as such from the outset.</i>	<b>The Court takes note of the Commission's reply.</b>

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2009	DG ELARG should continue to devote sufficient resources to the analysis of the outstanding final declarations submitted under PHARE and the Transition Facility in the new Member States.	The Court welcomes the effort of DG ELARG, but the backlog of final declarations has been reduced only partially.	<i>As a result of the priority given to the assessment of Final Declaration from the 12 new Member States, the backlog has been further considerably reduced in 2010, more than compensating the slight slowdown observed in 2009.</i>	<b>The Court takes note of the Commission's reply.</b>
	DG ECHO should improve the documentation of assessments of proposals for humanitarian aid actions (e.g. the introduction of standardised evaluation reports).	DG ECHO started the development of a standardised procedure to justify the assessments of proposals. However, it is envisaged to introduce a new procedure only in 2011 introduced and the standardised evaluation report is one of the options under consideration.	<i>A working group on the assessment of humanitarian aid proposals has been launched in early February 2011. It is aiming, amongst others, at harmonising and streamlining the documentation of the assessment process by giving a better overview of the entire process throughout a dashboard and establishing common assessment criterion. This will be implemented in 2011.</i>	<b>The Court takes note of the Commission's reply.</b>
	DG ECHO should define and put in place a mechanism for collecting and analysing the data concerning the use of the 'Humanitarian Procurement Centres' (HPCs) by its partners.	DG ECHO found the Court's recommendation useful but did not consider it as a priority. HPCs were informed about the need to provide detailed information on the extent to which their services are used by ECHO's partners. A new procedure will be developed in the future.		



## CHAPTER 6

**Research and other Internal Policies**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

6.1. This chapter presents the Court's specific assessment of Research and other Internal Policies, which comprises policy areas 01 — Economic and Financial Affairs, 02 — Enterprise, 03 — Competition, 08 — Research, 09 — Information Society and Media, 10 — Direct Research, 12 — Internal Market, 15 — Education and Culture, 16 — Communication, 18 — Area of Freedom, Security and Justice and 20 — Trade. This is followed by the results of the Court's recurrent audit of the Guarantee Fund for external actions <sup>(1)</sup>. Key information on the activities covered and the spending in 2010 is provided in **Table 6.1**.

**Table 6.1 — Research and other Internal Policies — key information 2010**

(million euro)

Budget title	Policy area	Description	Payments	Management mode
8	Research	Administrative expenditure	308	Centralised direct
		FP7	2 981	Centralised direct
		FP7 Euratom	318	Centralised indirect
		Completion of previous framework programmes (FPs)	848	Centralised direct
		Research programme of the research fund for coal and steel	51	Centralised direct
		<b>4 506</b>		
9	Information Society and Media	Administrative expenditure	137	Centralised direct
		FP7	1 226	Centralised direct
		Completion of previous framework programmes (FPs)	160	Centralised direct
		Media	111	Centralised direct
		CIP and Others	152	Centralised direct
		<b>1 786</b>		
15	Education and Culture	Administrative expenditure	122	Centralised direct
		Lifelong learning, including multilingualism	1 223	Centralised indirect
		Developing cultural cooperation in Europe	47	Centralised indirect
		Encouraging and promoting cooperation in the field of youth and sports	145	Centralised indirect
		Fostering European Citizenship	35	Centralised indirect
		<b>1 572</b>		

<sup>(1)</sup> Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009 establishing a Guarantee Fund for external actions (OJ L 145, 10.6.2009, p. 10) stipulates in its recitals that the financial management of the Guarantee Fund should be subject to audit by the Court of Auditors in accordance with the procedures agreed upon by the Court of Auditors, the Commission and the European Investment Bank.

(million euro)

Budget title	Policy area	Description	Payments	Management mode
18	Freedom Security and Justice	Administrative expenditure	63	Centralised direct
		Solidarity — External borders, visa policy and free movement of people	276	Shared/Centralised direct
		Migration flows — Common immigration and asylum policies	156	Shared/Centralised direct
		Fundamental rights and citizenship	51	Centralised direct
		Security and safeguarding liberties	123	Centralised direct
		Justice in criminal and civil matters	54	Centralised direct
		Drugs prevention and information	18	Centralised direct
		Policy strategy and coordination	4	Centralised direct
		<b>745</b>		
2	Enterprise	Administrative expenditure	112	Centralised direct
		Competitiveness, industrial policy, innovation and entrepreneurship	75	Centralised direct/centralised indirect via EACI
		Internal market for goods and sectoral policies	114	Centralised direct
		FP7 — Cooperation — space and security	357	Centralised direct
		<b>658</b>		
10	Direct Research	Staff, running costs and investments	345	Centralised direct
		FP7	44	Centralised direct
		Historical liabilities resulting from nuclear activities	22	Centralised direct
		Completion of previous framework programmes (FPs) and other activities	27	Centralised direct
		<b>438</b>		
1	Economic and Financial Affairs	Administrative expenditure	66	Centralised direct
		Economic and monetary union	12	Centralised direct
		International economic and financial affairs	101	Centralised direct
		Financial operations and instruments	110	Centralised direct/Joint management with EIF/centralised indirect via EIF
		<b>289</b>		
16	Communication	Administrative expenditure	114	Centralised direct
		Communication and the media	34	Centralised direct
		Going Local communication	35	Centralised direct
		Analysis and communication tools	23	Centralised direct
		<b>206</b>		

(million euro)

Budget title	Policy area	Description	Payments	Management mode
3	Competition	Administrative expenditure	92	Centralised direct
		Cartels, anti-trust and liberalisation	0	Centralised direct
			<b>92</b>	
20	Trade	Administrative expenditure	68	Centralised direct
		Trade policy	9	Centralised direct/joint management with IO
			<b>77</b>	
12	Internal Market	Administrative expenditure	60	Centralised direct
		Policy strategy and coordination for the Directorate-General for the Internal Market	11	Centralised direct
			<b>71</b>	
Total administrative expenditure			1 487	
Framework programmes (FPs)			5 643	
Lifelong learning, including multilingualism (LLP)			1 223	
Other operational expenditure			2 087	
Total operational expenditure			8 953	
Of which: — advances <sup>(1)</sup>			6 404	
— interim/final payments <sup>(2)</sup>			2 549	
<b>Total payments for the year</b>			<b>10 440</b>	
<b>Total commitments for the year</b>			<b>12 169</b>	

<sup>(1)</sup> Advances under the Seventh Framework Programme (2007-13) and under the Lifelong Learning Programme amounted to 3 166 million euro and 1 139 million euro respectively.

<sup>(2)</sup> Interim/final payments under the Seventh Framework Programme (2007-13) and the Lifelong Learning Programme amounted to 1 442 million euro and 83 million euro respectively.

Source: 2010 annual accounts of the European Union.



## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group**

6.2. The main programmes in this policy group are the Framework Programmes for research and technological development, accounting for 63 % of the total operational expenditure (or 5 643 million euro) and the Lifelong Learning Programme, accounting for 14 % (or 1 223 million euro).

*Research Framework Programmes*

6.3. Research policy seeks to foster investment in research and the transition towards a knowledge-based economy. It also aims to reinforce the scientific and technical base of the European Research Area <sup>(2)</sup>, improve the excellence of research in Europe and maximise benefits from international cooperation. Most of the payments relating to research policy are made under the 6th and 7th multiannual Framework Programmes (FP6 and FP7 <sup>(3)</sup>), which have multiple funding schemes, supporting various thematic areas and types of projects.

6.4. The FPs are for the most part implemented by the Commission under direct centralised management. Increasingly, research expenditure is implemented by indirect centralised management through Executive Agencies and Joint Undertakings <sup>(4)</sup>.

6.5. The activities supported by the FPs are implemented by a large number of public and private entities in various Member States or third countries associated with the FPs. Beneficiaries may be research centres, universities, individuals, commercial firms or public administrations. The beneficiaries usually work as a consortium of partners, on the basis of a grant agreement with the Commission. For FP7, each project has on average six partners, although, depending on the funding scheme, it can be as many as 64.

<sup>(2)</sup> The European Research Area is composed of all research and development activities, programmes and policies in Europe which involve a transnational perspective. Together, they enable researchers, research institutions and businesses to increasingly circulate, compete and cooperate across borders.

<sup>(3)</sup> The Seventh Framework Programme bundles all research-related EU initiatives together under a common roof playing a crucial role in reaching the goals of growth, competitiveness and employment. It is also a key pillar for the European Research Area.

<sup>(4)</sup> The European Union JUs involved in the management of research FPs are: (i) the European JU for ITER and the Development of Fusion Energy; (ii) the Clean Sky JU; (iii) the ARTEMIS JU; (iv) the Innovative Medicines Initiative JU; (v) the ENIAC JU and (vi) the Fuel Cells and Hydrogen JU. The European Union Executive Agencies involved in the management of research FPs are: (i) the Executive Agency for Competitiveness and Innovation; (ii) the Education, Audiovisual and Culture Executive Agency; (iii) the Research Executive Agency and (iv) the European Research Council Executive Agency.

## THE COURT'S OBSERVATIONS

6.6. Potential beneficiaries respond to calls for project proposals and approved projects are selected for co-financing. Once the grant agreement (or Commission Decision) has been signed, payments are made in the form of advances, followed by interim and final payments which reimburse expenditure declared in cost claims submitted by the beneficiaries.

6.7. The main risk of irregularity is that beneficiaries may include ineligible costs in their claims, which may not be detected and corrected by the supervisory and control systems of the Commission before reimbursement. The risk is exacerbated by the complexity of the rules for calculating eligible costs and the requirement for beneficiaries to allocate personnel and indirect costs to projects, while deducting various items considered ineligible for EU co-financing such as VAT.

### *The Lifelong Learning Programme*

6.8. The Lifelong Learning Programme (LLP) aims to enable people at all stages of their lives to take part in learning experiences; it also seeks to develop the education and training sector across Europe. The LLP consists of four sub-programmes, Erasmus for higher education, Leonardo da Vinci for vocational education and training, Grundtvig for adult education and Comenius for schools. Three quarters of the LLP budget is implemented through centralised indirect management by 40 National Agencies (NAs) in participating countries, designated and supervised by National Authorities (NAUs), usually Ministries of Education. The National Agencies<sup>(5)</sup> have the role of managing the numerous but relatively small amounts that are paid out as grants.

6.9. The funding in this area mostly consists of advances to NAs, and quarterly contributions to their operating costs. The first advances are made once a contract has been signed and a work programme accepted. In the case of second and third advances, the Commission pays on the basis of a declaration from the NA that at least 70 % of the funds already advanced have been disbursed. These advances normally accumulate to 100 % of the maximum allowed.

## THE COMMISSION'S REPLIES

6.7. The Commission shares the view of the Court that the complexity of the rules is a major source of errors related to the eligibility of costs claims. In this respect, the Commission adopted a Decision on 24 January 2011 containing three measures for simplifying the implementation of the framework programme. This decision allows beneficiaries to apply their usual accounting methods when requesting reimbursement for average personnel costs — one of the most recurrent errors reported by the Court of Auditors — and the possibility of using flat-rate payments to reimburse owner-managers of SMEs. It is expected that these options will lead to a lower error rate.

*In addition, the Commission's anti-fraud strategy (COM(2011) 376-2 final) refers to the risks concerning cost claims made by beneficiaries and proposes several action points for the detection/correction of fraud (including training).*

<sup>(5)</sup> National Agencies are structures set up at national level for the management of the implementation of the Lifelong Learning programme at Member State level. They have legal personality and are governed by the law of the Member State concerned. They are responsible for the management of the decentralised parts of the programme, namely for the evaluation, selection and management of projects.

## THE COURT'S OBSERVATIONS

6.10. The NAs enter into grant agreements with participating organisations<sup>(6)</sup>, and in turn make advances to them (between 80 % and 100 %, depending on the type of programme). The principal risks to legality and regularity are that the individual grant payments made to teachers and students are incorrect, or that costs declared by beneficiaries are over-stated or not substantiated. Such errors risk to remain undetected.

### Audit scope and approach

6.11. **Annex 1.1, Part 2**, describes the Court's overall audit approach and methodology. For the audit of Research and other Internal Policies, the following specific points should be noted:

- the audit involved an examination of a sample of 150 payments, 61 of which were FP6 and FP7 interim or final payments, 10 were advances to national agencies under the LLP, 36 were advances for FP6 and FP7 and 43 payments covered all other measures in this policy area<sup>(7)</sup>,
- for the research FPs, the assessment of the Commission's supervisory and control systems, which was also based on the sampled 97 payments<sup>(8)</sup> relating to the research FPs covered:
  - *ex-ante* desk checks,
  - audit certificates of project cost claims provided by independent auditors,
  - *ex-ante* certification of beneficiaries' costing methodologies,
  - *ex-post* financial audits of projects, and
  - implementation of recoveries and financial corrections,

<sup>(6)</sup> Participating organisations are usually universities, schools or colleges, who manage payments to beneficiaries such as students or teachers.

<sup>(7)</sup> The 43 payments consist of 31 advances, eight interim and final payments, three single and one regularisation payment.

<sup>(8)</sup> 61 interim or final payments and 36 advances for FP6 and FP7.

## THE COURT'S OBSERVATIONS

- for the other Internal Policies, the assessment of systems covered the supervisory and control systems of the Erasmus programme in 10 Member States including:
  - the primary controls carried out by the national agencies,
  - the secondary controls implemented by the national authorities to provide assurance and support to the yearly *ex-post* declaration,
  - the procedures in three Higher Education Institutions (HEIs) in each of the Member States, which was also based on a sample of 10 payments to students and/or teaching staff for each HEI,
  - the *ex-post* audits carried out by private auditors on behalf of the Commission, and
  - the Commission's monitoring system for following up reservations,
- the audit of the Guarantee Fund focused on compliance with the agreement between the Commission and the EIB for the management of the Fund's assets as well as the Commission's monitoring procedures. The work performed by a private firm of auditors was also reviewed,
- the review of Commission management representations covered the annual activity reports of the Directors-General for DG Research and Innovation (RTD), DG Information Society and Media (INFSO), DG Enterprise and Industry (ENTR), DG Education and Culture (EAC) and two Executive Agencies: the European Research Council Executive Agency and the Research Executive Agency.

**REGULARITY OF TRANSACTIONS**

6.12. **Annex 6.1** contains a summary of the results of transaction testing. The Court's testing of its sample of transactions found 39 % to be affected by error. The most likely error estimated by the Court is 1,4 % <sup>(9)</sup>. However, the Court found a significant level and frequency of error in FP6 and FP7 interim and final payments.

<sup>(9)</sup> The Court calculates its estimate of error from a representative statistical sample. The figure quoted is the best estimate (known as the MLE). The Court has 95 % confidence that the rate of error in the population lies between 0,6 % and 2,1 % (the lower and upper error limits respectively).

## THE COURT'S OBSERVATIONS

6.13. In total, the Court found that 58 of the sample of 150 transactions were affected by error. The majority of the interim and final payments affected by error (48 out of 51) concerned FP6 or FP7. In 37 cases, these errors concerned the reimbursement of ineligible or inaccurately declared costs to projects funded by the research FPs. This result is consistent with the reservations made by the Director-Generals of DG RTD and DG ENTR concerning the material level of error in FP6 grants (see **Annex 6.3**). Similarly to the last 3 years, the principal source of error remains the incorrect calculation of personnel and indirect costs. Other types of errors included ineligible indirect taxes, the incorrect application of the depreciation of non-current assets methodology<sup>(10)</sup> and interest generated by the pre-financing held on bank accounts being underdeclared or not declared at all. Example 6.1 illustrates the type of findings mentioned above. Six transactions relating to Internal Policies other than Research were affected by errors. These included errors related to reimbursement of non-eligible costs and errors in time reporting.

## Example 6.1

**Ineligible costs and incorrectly calculated costs**

A beneficiary managing an FP6 project claimed overheads using a flat rate which was based on direct staff costs. Following an *ex-post* audit carried out in 2007, the beneficiary changed its allocation of overheads methodology without fully and correctly implementing the recommendations made by the *ex-post* auditors. Errors and inconsistencies, noted during the Court's audit led to an over-claim of 731 652 euro.

The beneficiary also claimed reimbursement of ineligible subsistence costs and ineligible indirect taxes, and charged the costs of computer equipment to the project without applying its normal accounting policy for depreciation. These resulted in an over-claim of 10 079 euro.

The overall error, net of an underdeclaration in staff costs, amounted to 13 % of the declared costs.

## THE COMMISSION'S REPLIES

**6.13.** *The Commission shares the view of the Court that the most recurrent source of errors found in the beneficiaries' cost claims for interim and final payments remains the incorrect calculation of personnel costs and indirect costs. In this respect, the Commission has taken steps to tackle this risk (see paragraph 6.7).*

## Example 6.1

**Ineligible costs and incorrectly calculated costs**

*The Commission is proceeding with the usual contradictory procedure with the beneficiary.*

*The beneficiary has informed the Commission that it does not agree with some of the findings of the Court, in particular concerning the overhead rate calculation. The Commission has asked the beneficiary for additional information so that it can decide whether it needs to make financial adjustments and for which amount.*

**EFFECTIVENESS OF SYSTEMS**

6.14. **Annex 6.2** contains a summary of the results of the examination of systems. The Court found that the systems were partially effective in ensuring the regularity of transactions.

<sup>(10)</sup> Overall, the findings on the regularity of transactions are consistent with the results of the Commission's own representative audits (see paragraph 6.32).

## Research Framework Programmes

### Ex-ante desk checks

6.15. The objective of the *ex-ante* desk checks is to verify the regularity of the payments and to ensure compliance with contractual requirements before payment is made. In line with the Commission's efforts to simplify as far as possible its *ex-ante* control procedures in order to facilitate the processing of payments, the *ex-ante* desk checks are often limited to ensuring that formal administrative requirements are met and that the amounts included in the beneficiaries' cost claims are correctly calculated.

6.16. The audit of the sample of 97 research FP payments revealed some weaknesses in the *ex-ante* desk checks in 47 cases, which are however not considered to be substantial <sup>(11)</sup>.

6.17. The Court also noted that, although in the case of doubt about the eligibility of the costs declared, detailed *ex-ante* desk checks were carried out <sup>(12)</sup>, most of them were limited to arithmetical verification of the cost claim even when there was evidence that the costs declared did not meet the eligibility requirements (see example 6.2).

#### Example 6.2

##### **Ex-ante weakness**

The beneficiary of an FP6 project calculated the staff costs charged to the project on the basis of budgeted average hourly rates for three categories of staff: senior engineer, scientific graduate engineer and technician.

The recalculation of staff costs using the actual hourly rate showed a significant divergence in the hourly rate, leading to an over-claim of 65 185 euro for total declared staff costs of 508 452 euro.

Despite the fact that it was evident from the documentation that the beneficiary was using average hourly rates, the Commission did not query the amount declared.

**6.15.** *The checks that can be carried out ex ante are necessarily limited. This is why there is a programme of ex-post audits. The control system has to be considered in its entirety.*

<sup>(11)</sup> Type of weaknesses noted: (i) authorisation of the project start date without a written request from the beneficiary before the grant agreement was signed; (ii) the late notification of the Commission funding decision to the unsuccessful applicants and (iii) failure to check the interest generated by the pre-financing.

<sup>(12)</sup> These detailed *ex-ante* desk checks involve requesting and examining supporting documentation.

## THE COURT'S OBSERVATIONS

6.18. Concerning the payment delays, the Court noted a general improvement compared to last year. In certain specific programmes of the FP such as, 'People', however, the average time needed to make interim and final payments is still above the Commission's target. In the Court's sample of FP6 or FP7 interim or final payments nine out of 61 payments were made late. The Court also noted abnormal payment suspensions<sup>(13)</sup>. For example, one payment relating to the reporting period 2005/2006 was suspended for 1 280 days mainly due to an issue linked with the status of one of the beneficiaries of the contract. The payment was finally made in October 2010.

*Audit certification of cost claims*

6.19. Grant agreements stipulate that the beneficiaries' cost claims should be accompanied by an audit certificate issued by an independent auditor. The auditor should confirm the accuracy, occurrence and eligibility of the declared costs, the amount of interest generated by the pre-financing, and any other project receipts. These audit certificates are a key control under both FP6 and FP7.

6.20. Whereas for FP6 the submission of an audit certificate was in principle mandatory at the end of each reporting period, for FP7 beneficiaries are only required to submit audit certificates when the EU funding is greater than or equal to 375 000 euro<sup>(14)</sup>. For FP7 as a whole, the Commission estimates that over 80 % of all participations will remain below this threshold. Whilst this change reduces the administrative burden on beneficiaries, it also increases the risk of errors not being detected in a timely manner for grants below the threshold.

6.21. For the 33 cost claims audited at beneficiary level for which a certificate had been provided, the Court compared the results of its own audit with the certificate provided. In 27 cases for which the independent auditor had issued an unqualified opinion the Court detected errors. In 14 of the cases the errors had significant financial impact (above 2 %) and/or concerned a cost methodology not in compliance with the applicable rules. In cases with a significant financial impact, the Commission DGs (except for DG ENTR) do not formally communicate with the external auditors by providing feedback and requesting explanations when it is clear that the certificate issued was unreliable.

## THE COMMISSION'S REPLIES

**6.18.** *The Commission welcomes the positive assessment of the progress made in payments. This matter is being continuously monitored by the Commission services, especially since the Commission's Communication of April 2009, which set targets below the deadlines set out in the Financial Regulation.*

*Payments are only processed when the cost claims submitted by the beneficiaries are complete and allow the Commission to assess compliance with the rules. Should this not be the case the Commission has an obligation to suspend the payments.*

*This suspension is always withdrawn when the beneficiary provides the missing documentation or the information specifically requested by the Commission.*

*The case reported by the Court is extreme, and does not reflect the normal operations of the Commission.*

**6.20.** *In FP7 the legislative authority decided to reduce the administrative burden on beneficiaries regarding the obligation to submit audit certificates in order to increase the attractiveness of the EU research FP.*

*Moreover, this aspect should be seen together with the overall FP7 audit strategy.*

**6.21.** *A formal feedback process is in place to urge the audited beneficiaries to make their certifying auditors aware of the Commission's audit findings and referring them to the publicly available eligibility requirements and interpretations.*

<sup>(13)</sup> The Commission can suspend a payment by informing the beneficiary in writing that the report or the invoice/request for payment cannot be approved and stating the reason why (e.g. explaining that the supporting documents are incomplete).

<sup>(14)</sup> As a cumulative figure for all previous payments to a beneficiary within a given project for which a certificate has not been submitted.

## THE COURT'S OBSERVATIONS

6.22. In line with the findings of last year, this control is still only partially effective.

*Ex-ante certification of beneficiaries' costing methodologies under FP7*

6.23. The general conditions of the FP7 grant agreement introduced two types of *ex-ante* certificates of costing methodologies: the certificate of average personnel costs (CoMAv) <sup>(15)</sup> and the certificate of the methodology for personnel and indirect costs (CoM) <sup>(16)</sup>.

6.24. These certificates aim to: (i) promote the use of correct methodologies by beneficiaries when calculating personnel and indirect costs; (ii) reassure the beneficiaries that the methodology they use meets the FP7 grant agreement requirements, and (iii) reduce the administrative burden on beneficiaries by waiving the obligation to provide certificates for interim cost claims.

6.25. As at the end of December 2010, only 16 beneficiaries out of an estimated population of 500 received approval for a CoM, and only 36 beneficiaries out of an estimated population of 4 000 received approval for a CoMAv. The low participation/acceptance rates are disappointing and undermine the Commission's efforts to simplify procedures.

<sup>(15)</sup> Optional for any beneficiary intending to declare average personnel costs in its cost claims. On 24 January 2011, the Commission adopted new criteria for the use of average personnel costs. Beneficiaries are no longer required to submit a certificate on average personnel costs for approval as a prior condition for the eligibility of the personnel costs. Nevertheless, the certificate on average personnel costs remains as an option, offering beneficiaries the possibility of obtaining prior assurance as to the compatibility of the methodology in place with FP7 rules.

<sup>(16)</sup> Optional for a limited number of beneficiaries of multiple grants fulfilling certain eligibility criteria.

## THE COMMISSION'S REPLIES

**6.22.** Although FP6 audit certificates did not provide the level of assurance initially expected, this *ex-ante* control made a substantial contribution in reducing FP6 error rates compared with FP5.

For FP7 the approach, based on 'agreed upon procedures', should lead to fewer errors in interpreting the eligibility rules.

The Commission has developed a strategy to ensure that certifying auditors fully understand the requirements and provisions of grants. This notably includes extensive guidance notes in addition to the legal basis and the implementing documents.

**6.25.** The Commission has recognised that the acceptability criteria for receiving certification of the costing methodologies are too stringent for most beneficiaries <sup>(1)</sup>.

The Commission has introduced substantial simplification to facilitate the use of average personnel costs within the overall existing legal framework.

Overall, however, the disappointing experience with *ex-ante* certification of cost methodologies will be taken into account in preparing the rules for the next funding period.

<sup>(1)</sup> COM(2010) 187 final of 29 April 2010 — Simplifying the implementation of the Research Framework Programmes.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.26. The Court's work included a review of the certification process at the Commission. No exceptions were noted. Commission controls were applied as intended.

6.27. The applications for the certificates of the methodology include a 'report on factual findings' issued by an independent auditor on the basis of 'agreed upon procedures' verifying the correctness of the information submitted by the beneficiaries. The independent auditor's report on factual findings should provide assurance to the Commission that the beneficiary meets the criteria for obtaining the certification. In the case of the two beneficiaries visited on the spot, the Court noted exceptions which called into question the reliance that the Commission can place on such reports<sup>(17)</sup>.

6.28. The very low acceptance rates and the fact that weaknesses were identified in the reports provided by the independent auditor indicate that this procedure, whilst good in principle, has had limited effectiveness.

#### *The Commission's ex-post audit strategy*

6.29. The main element of the Commission's control system for ensuring that the declared costs meet the eligibility requirements is its programme of *ex-post* financial audits at beneficiaries.

6.30. The FP7 *ex-post* audit strategy (2009-2016) covers in essence: (i) audits selected on a random basis and designed to establish an error rate representative of the whole population, and (ii) 'corrective audits' which aim to target risk areas<sup>(18)</sup>. The coverage of expenditure by *ex-post* audits and the value of identified ineligible costs significantly increased from 2009 to 2010 (see **Table 6.2**). Overall, the *ex-post* strategy put in place by the Commission was assessed as effective even though some further improvements are desirable concerning the residual error rates and reliance on the work of the external auditors.

**6.27.** For one case mentioned by the Court, the Commission is following up the matter with the beneficiary and will take appropriate measures. For the other case, the Commission, before approving the certificate, obtained additional information providing assurance over and above simple reliance on the *pro forma* financial statement. Accordingly, the issue raised by the Court is of a formal nature and does not affect the reliability of the cost methodology approval.

<sup>(17)</sup> The Court noted that in one case personnel and indirect costs included ineligible costs according to FP7 criteria or average personnel costs were in fact not calculated according to the methodology presented by the beneficiary. In the other case, the external auditor certified that the audit procedures were carried in connection with a specific grant whereas in reality the audit work was based on another sample.

<sup>(18)</sup> For example, in the area of corrective audits, DG INFSO has developed elaborate risk-based auditing methods which are based on intelligent data gathering, risk assessment and risk-specific audit procedures. In 2010, the average error rate of DG INFSO's risk-based audits was 30 %.

**Table 6.2 — Implementation of the Commission's ex-post audit strategy**

	2010		2009	
	FP 6	FP 7	FP 6	FP 7
Number of audits	2 323	349	1 906	16
Value of audited declared costs (in million euro)	2 183	111	1 807	2
Value of identified ineligible costs (in million euro)	91	5	69	—
Commission funding to be recovered (in million euro)	45	4	33	—

## THE COURT'S OBSERVATIONS

**Residual error rates**

6.31. Since Directors-General provide a Declaration of Assurance on separate parts of the FP7 budget, each Commission service takes its own sample and thus reports a representative error rate. The representative error rate for each DG forms the basis for the calculation of the residual error rate <sup>(19)</sup>, which is an important 'building block' for the annual Declaration of Assurance.

6.32. The calculation of the residual error rate is based on the assumption that all the errors detected, including the systematic ones, will be corrected. The Commission does not systematically ensure that the resubmitted cost claims are corrected, so the reliance that can be placed on the residual error rates is limited (see example 6.1).

**Reliance on the work of external auditors**

6.33. The audits are performed by Commission auditors or by external audit firms under its supervision. At the end of 2010, 73 % (921 out of 1 267) of DG RTD's and 76 % (431 out of 568) of DG INFSO's FP6 and FP7 closed audits were performed by external auditors.

## THE COMMISSION'S REPLIES

**6.31.** In order to properly support the Director-General's Declaration of Assurance, the Commission has established the formula for calculating the representative and residual error rate that is applied homogeneously by the Commission services and the Executive Agencies.

*It is not the only input for the Declaration of Assurance although it is one of the most important for this purpose.*

**6.32.** The Commission's residual error rate is reliable. It is based on several figures that stem from the control system in place — mainly the audit strategy — and the results of extrapolation.

*As regards the control of resubmitted cost claims, the Commission has set up a system which includes plausibility and exhaustiveness checks and, if necessary, carries out follow-up audits in order to ensure that any systematic errors are indeed corrected by beneficiaries. In this respect, since extrapolation procedures based on flat-rate percentages have become available (December 2009) and widely used by contractors, the necessity of follow-up audits has been substantially limited.*

*In a multiannual perspective, the system in place therefore ensures that the residual error rate is reliable.*

*As an example of the functioning of this system, DG Research and Innovation recovered 14,51 million euro up to 31 March 2011.*

<sup>(19)</sup> I.e. the level of errors which remain undetected and thus uncorrected.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.34. Relying on the work of other auditors is an accepted audit practice. International accepted audit standards have been developed to ensure a common understanding of the general principles involved. The Commission has put in place a number of procedures which aim to ensure that the results of these external audits can be relied upon. One of the main risks is when the audit work performed by the external auditors is not sufficient or adequate and thus errors in the cost claims are not detected. To minimise this risk, the standards require that periodic quality reviews of working methods and of audit procedures should be carried out to ensure that the audit reports and findings can be fully relied upon. The Commission procedures do not cover this aspect.

**6.34.** *Outsourced audits are planned and controlled entirely by the Commission.*

*The external auditors are selected after thorough scrutiny that they are using a unique audit approach on a pan-European basis. The Commission provides them with an audit manual and guidance papers to make their audit approach consistent and to avoid quality issues.*

*Commission audit staff accompany the external audit firms on a number of audit missions. This ensures collaboration in the areas of planning, conduct of audit work and reporting, and thereby permits monitoring working methods and audit procedures of the external audit firms concerned.*

*Accordingly, the Commission does not consider that straightforward application of the Auditing Standards on reliance on work of other auditors is appropriate in this case.*

#### *Systems related to recoveries and financial corrections*

6.35. As a result of the Commission's considerable *ex-post* audit effort, the amount to be recovered had significantly increased as at the end of 2010 compared with 2009 (see **Table 6.2**). The Court examined the Commission's follow-up actions to the DAS 2008 and 2009 cases with a quantifiable error and to the Commission's *ex-post* audits and found that the Commission's procedures were adequate in ensuring that ineligible costs were recovered.

6.36. In terms of contract-specific penalties, where the beneficiary was found to have misrepresented its costs, the Commission can provide for an early termination of the contract and/or apply liquidated damages. The Court noted that the Commission had made a more extensive use of these corrective measures, and during 2010 the amounts of liquidated damages increased significantly (from 223 000 euro as at the end of 2009 to 1 536 000 euro as at the end of 2010).

### **Other Internal Policies**

#### *Systems for the Lifelong Learning Programme — Erasmus*

6.37. The responsibilities within the LLP control environment are:

- primary controls managed by the NA including the analysis of final reports, desk-checks of supporting material for costs claimed, on-the-spot checks, *ex-post* audits and systems audits of recurrent beneficiaries such as universities. NAs must send a yearly report to the Commission and NAU which includes information on the primary controls performed,

## THE COURT'S OBSERVATIONS

- secondary controls implemented by the NAU, to provide assurance and support for a yearly *ex-post* declaration that the systems and primary controls are effective <sup>(20)</sup>,
- controls implemented by the Commission, mainly the assessment of yearly *ex-post* declarations and systems monitoring visits, as well as financial and supervisory audits.

6.38. The Court performed a systems audit relating to 10 of the NAs and their supervising NAUs responsible for the Erasmus Programme. The Erasmus programme funds cooperation between Higher Education Institutions (HEIs) across Europe, and notably support for students to spend a period of study of three to 12 months in another participating country. A student will typically receive a grant of between 250 and 500 euro a month depending on the country. It also supports professors and business staff who want to teach abroad for short periods, and helps university staff to receive training. Erasmus also supports short Intensive Programmes of study which bring together students and teaching staff from HEIs of at least three participating countries. Overall, the systems examined were considered to be partially effective in ensuring the regularity of transactions.

**Primary controls**

6.39. The Court found a high level of compliance with the requirements set out by the Commission in its 'Guide for National Agencies'. However, in eight cases primary controls were not fully implemented. In some cases there was no evidence of desk-checks performed, or too few individual mobility participant files had been checked. With regard to other key control requirements concerning LLP systems, weaknesses found included the inexistence of exceptions registers, or exceptions registers that were not followed up, a treasury policy which did not ensure that funds were placed on interest-bearing accounts and late submission of yearly reports to the Commission.

## THE COMMISSION'S REPLIES

**6.39.** *The Commission is pleased that the Court found a high level of compliance with the Guide for NAs in the National Agencies, which confirms the Commission's assessment.*

*The Commission agrees that primary controls remain an area for attention as confirmed by the AAR 2010. The Commission will continue to stress the importance of attaining the set levels and documenting the process.*

<sup>(20)</sup> Commission Decision C(2007) 1807, Article 8(3), stipulates that 'the national authority shall establish the system of secondary controls whose objective is to give reasonable assurance that the systems and primary controls are effective. It may entrust performance of secondary controls to an external audit body'.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.40. At the level of the HEIs, the Court found that the systems for selecting students to participate in the Erasmus programme worked partially in 22 out of 27 cases. The main problems were a lack of transparency in the selection procedure: selection criteria not published and there was inadequate documentation of the evaluation process. In 15 out of the 30 HEIs visited, incorrect payments were made e.g. payments were made to individual students for longer periods than stated in the grant agreement, or ineligible costs were reimbursed.

**Secondary controls**

6.41. In seven of the 10 NAUs the secondary controls were performed satisfactorily, with either an external audit body or NAU agents thoroughly testing that the systems and primary controls put in place by the NA complied with Commission guidelines. In the other NAUs, controls were inadequately documented or there was no evidence of follow-up of observations made by the NAU or the Commission.

6.42. Seven of the 10 yearly *ex-post* declarations for 2009 were sent to the Commission after the 30 April 2010 deadline.

**Checks implemented by the Commission**

6.43. The Court audited the Commission's checks for the Erasmus Programme which form part of its assessment process for the *ex-post* declarations for 2009. The Court previously examined this system in its 2008 Annual Report <sup>(21)</sup>. At that time the Court considered that the Commission's procedures provided limited assurance for the quality of the management of the expenditure and that only in some cases did the Commission verify the reality and the quality of the primary and secondary controls.

6.44. The Court considers that the Commission's procedures have since improved. In 2010 the Commission's assessment was based on a desk review of systems, visits to eight Member States and financial *ex-post* on-the-spot audits of 15 agreements with National Agencies. The systems audits performed by the Commission included verification of the reality and the quality of both primary and secondary controls.

**6.40.** *With regard to the student selection procedures at the level of the HEIs, the Commission underlines that given the mass mobility nature of the action, the formal requirements have to be proportional and take due account of the demand situation. Considering that the Commission did not receive any complaints from students on the selection by their HEI, it concludes that the system operates well generally.*

*With regard to the duration of student stays for study or placements, the Commission underlines that it has already clarified the calculation method in the 2011 Guide for National Agencies, following the Court's comments in the DAS 2009 exercise.*

**6.41.** *The Commission organises each year activities (seminars, updates guidelines, etc.) to improve National Authorities' understanding of the secondary control process. The DAS 2010 audit shows an improvement of the situation in comparison to the DAS 2008 exercise. The Commission will continue its support activities.*

<sup>(21)</sup> Chapter 9, paragraphs 9.22 to 9.24.

## THE COURT'S OBSERVATIONS

6.45. Every year the Commission establishes a list of qualifications to be remedied by NAUs and NAs. Although overall there are still a high number of open observations: in 2010 28 for NAUs (as compared to 29 in 2009) and 114 for NAs (as compared to 146 in 2009), the gravity of qualifications has diminished <sup>(22)</sup>.

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

6.46. **Annex 6.3** contains a summary of the results of the review of Commission management representations. The Court describes significant observations in further detail below.

6.47. The Court noted in the case of DG INFSO that although the cumulative rate detected and the residual error rates on cost claims under FP6 grants reached 3,94 % and 2,2 % respectively, the reservation regarding the accuracy of FP6 cost claims was lifted. In the Court's view a reservation should have been maintained given that there is no solid evidence that all errors detected have been corrected (see paragraph 6.32).

## THE COMMISSION'S REPLIES

**6.45.** *With regard to the number and gravity of qualifications to be remedied by NAUs and NAs, the Commission is pleased that both have improved considerably from 2009 to 2010, in particular at the level of the National Agencies.*

**6.47.** *In line with the Commission's current accountability framework, the final decision on whether to make a reservation or not is made by the Authorising Officer by Delegation (AOD). It is thus a management opinion, based on the AOD's risk assessment, given the information on likely future developments available at the time of making the decision.*

*In the 2010 AAR, the Director-General of DG INFSO reported transparently and in detail to the Commission on the reasons why the reservation regarding the accuracy of FP6 cost claims (which was at 2,2 % at the end of 2010) was lifted. This decision was based on a thorough analysis of all additional elements available at the time and on a simulation of the expected residual error rate development taking into account the remaining ongoing FP6 audits and the ongoing extrapolation exercises. On 30 June 2011, the update of the simulation based on the latest data available confirmed that the residual error rate in line with expectations has been reduced to 2,1 %. This error rate should drop below 2 % by the end of the year, as projected previously. Furthermore, if the real financial impact of the audit findings (errors which require financial follow-up) is taken into account, the residual error rate equals 1,6 %, well below the materiality level of 2 %. As already highlighted in the Commission's answer to paragraph 6.32, the Commission's residual error rate calculation is reliable. The reliability of the underlying data has been verified on the basis of a substantial number of follow-up audits. Taking into account the above-mentioned considerations, there was therefore no need for DG INFSO to maintain a reservation on FP6 expenditure.*

<sup>(22)</sup> For NAUs 13 qualifications have been classified as very important and 14 important, while in 2009 three were critical, 15 very important and three important. For NAs the numbers are respectively: one critical, 44 very important and 66 important in 2010 against 75 very important and 35 important in 2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**CONCLUSIONS AND RECOMMENDATIONS****Conclusions**

6.48. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2010 for Research and other Internal Policies were free from material error <sup>(23)</sup>. However, interim and final payments for the research FPs were subject to material error.

6.49. Based on its audit work, the Court concludes that the supervisory and control systems for Research and other Internal Policies were partially effective in ensuring the regularity of payments.

**Recommendations**

6.50. **Annex 6.4** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports (2008 to 2009).

6.51. Following this review and the findings and conclusions for 2010, the Court recommends that the Commission should:

- in the area of the research FPs: (i) draw on the lessons learnt from the good practice of DG INFSO's risk-based *ex-post* auditing method to further enhance the Commission's *ex-ante* controls with the aim of identifying payments with a relatively high-risk profile, and (ii) with the aim to further increase the reliability of the audit certificates, intensify its actions to raise the independent auditors' awareness of the eligibility of expenditure rules, notably by actively informing the auditors about instances of failure to identify ineligible costs,
- in the area of the LLP, continue to give emphasis to the implementation of primary controls. In particular attention should be given to ensuring that National Agencies check at least the minimum number of files required by the Commission and that all checks are properly documented.

**6.48.** *The Commission notes that payments in 2010 in the policy group Research and other Internal Policies were free from material error.*

*It is continuing to improve the operation of its multiannual control architecture in order to reduce the errors in interim and final payments.*

**6.51.**

- *The Commission agrees with the recommendations, and is working on a number of possible improvements to its processes, both for FP7 and for the future Common Strategic Framework for EU Research and Innovation funding.*
- *The Commission agrees that primary controls remain an area for attention as confirmed by the AAR 2010. The Commission will thus continue to stress the importance of attaining the set levels and documenting the process to National Agencies and will continue to remind the National Authorities of their supervision responsibilities in this domain.*

<sup>(23)</sup> See paragraphs 6.12 and 6.13.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**RESULTS OF THE AUDIT OF THE GUARANTEE FUND FOR EXTERNAL ACTIONS**

6.52. The purpose of the Guarantee Fund for External Actions <sup>(24)</sup> (the Fund) is to reimburse the Union's creditors <sup>(25)</sup> in the event of a beneficiary's defaulting on a loan and to avoid direct calls on the Union budget. The administrative management of the Fund is carried out by the Directorate-General for Economic and Financial Affairs (DG ECFIN) while the European Investment Bank (EIB) is responsible for its treasury management.

6.53. At 31 December 2010, the Fund's total resources were 1 347 million euro, compared with 1 240 million euro at 31 December 2009. No guarantee calls were made on the Fund in the year under review.

6.54. The EIB and the Commission use a benchmark index to review the Fund's annual performance. The return on the Fund's portfolio in 2010 amounted to 1,06 %, compared with a benchmark return of 1,19 %.

6.55. The investment portfolio of the Guarantee Fund is managed by the EIB on behalf of the European Union <sup>(26)</sup>. To avoid a forced sale of downgraded Member States' securities in June 2010, the Commission retrospectively introduced a new provision allowing such investments to be held in the Fund's portfolio.

**6.54.** *During the current market environment of high volatility, short term deviations from the benchmark can happen. Nevertheless, the portfolio has delivered positive excess return for the first 10 months of the year, whereas the slightly negative cut-off figure (compared to the benchmark) reported at the end of 2010, resulting from the November and December underperformance, was already recuperated in January 2011.*

**6.55.** *This decision was formalised in the supplementary agreement No 4 which was signed on 9 November 2010, as soon as the institutional procedures required for its signature had been completed.*

<sup>(24)</sup> Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions (OJ L 293, 12.11.1994, p. 1), as last amended by Regulation (EC, Euratom) No 89/2007 (OJ L 22, 31.1.2007, p. 1).

<sup>(25)</sup> Principally the EIB, but also Euratom external lending and EC macro financial assistance (MFA) loans to third countries.

<sup>(26)</sup> Article 6 of Regulation (EC, Euratom) No 2728/94 and the EIB receives an annual management fee for the services provided.



## ANNEX 6.1

RESULTS OF TRANSACTION TESTING FOR RESEARCH AND OTHER INTERNAL POLICIES <sup>(1)</sup>

	2010					2009	2008	2007
	FP6	FP7	LLP	Other	Total			
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>								
Total transactions (of which):	28	69	12	41	150	351	361	348
Advances	4	32	12	29	77	125	237	159
Interim/Final payments	24	37	0	12	73	226	124	189
<b>RESULTS OF TESTING <sup>(2)</sup> <sup>(3)</sup></b>								
<b>Proportion of transactions tested found to be:</b>								
Free of error	29 % (8)	54 % (37)	100 % (12)	85 % (35)	61 % (92)	72 %	86 %	68 %
Affected by one or more errors	71 % (20)	46 % (32)	0 % (0)	15 % (6)	39 % (58)	28 %	14 %	32 %
<b>Analysis of transactions affected by error</b>								
<b>Analysis by type of expenditure</b>								
Advances	5 % (1)	9 % (3)	0 % (0)	50 % (3)	12 % (7)	9 %	19 %	17 %
Interim/Final payments	95 % (19)	91 % (29)	0 % (0)	50 % (3)	88 % (51)	91 %	81 %	83 %
<b>Analysis by type of error</b>								
Non-Quantifiable errors:	15 % (3)	37 % (12)	0 % (0)	67 % (4)	33 % (19)	35 %	34 %	41 %
Quantifiable errors:	85 % (17)	63 % (20)	0 % (0)	33 % (2)	67 % (39)	65 %	66 %	59 %
Eligibility	100 % (17)	95 % (19)	0 % (0)	100 % (2)	97 % (38)	55 %	65 %	80 %
Occurrence	0 % (0)	0 % (0)	0 % (0)	0 % (0)	0 % (0)	6 %	3 %	2 %
Accuracy	0 % (0)	5 % (1)	0 % (0)	0 % (0)	3 % (1)	39 %	32 %	18 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>								
Most likely error rate						1,4 %		
Lower error limit						0,6 %		
Upper error limit						2,1 %		

<sup>(1)</sup> For 2010, the new policy group Research and other Internal Policies consists of policy groups/areas which in the 2009 Annual Report were part of other specific assessments. For details refer to Chapter 1, paragraph 1.12.

<sup>(2)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(3)</sup> Numbers quoted in brackets represent the actual number of transactions.

## ANNEX 6.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR RESEARCH AND OTHER INTERNAL POLICIES

## Assessment of selected supervisory and control systems

System concerned	Ex-ante desk checks	Audit certification	Ex-ante certification	Ex-post financial audits	Implementation of recoveries and financial corrections	Overall assessment
Research Framework Programmes	Partially effective	Partially effective	Partially effective	Effective	Effective	Partially effective

System concerned	Secondary controls	Primary controls	Commission's controls	Commission's monitoring system	Overall assessment
Lifelong Learning Programme	Partially effective	Partially effective	Effective	Effective	Partially effective

## Specific assessment for Lifelong Learning Programme per Member State and controls

Member State concerned	DAS 2010			DAS 2008
	Secondary controls	Primary controls	Overall assessment	Overall assessment
Belgium (EPOS <sup>(1)</sup> )	Effective	Partially effective	Partially effective	Partially effective
Poland (FRSE <sup>(2)</sup> )	Partially effective	Effective	Partially effective	Partially effective
Germany (DAAD <sup>(3)</sup> )	Effective	Effective	Effective	Partially effective
Spain (OAPEE <sup>(4)</sup> )	Effective	Partially effective	Partially effective	Partially effective
United Kingdom (British Council)	Effective	Partially effective	Partially effective	N/A
France (2e2f <sup>(5)</sup> )	Partially effective	Effective	Partially effective	N/A
The Netherlands (Nuffic <sup>(6)</sup> )	Effective	Effective	Effective	N/A
Greece (IKY <sup>(7)</sup> )	Partially effective	Partially effective	Partially effective	N/A
Austria (OEAD <sup>(8)</sup> )	Effective	Effective	Effective	N/A
Sweden (Internationella programkontoret)	Effective	Partially Effective	Partially Effective	N/A

Overall assessment	2010	2009	2008	2007
	Partially effective	Partially effective	Partially effective	Partially effective

<sup>(1)</sup> Europese Programma's voor Onderwijs, Opleiding en Samenwerking — Agentschap.

<sup>(2)</sup> Fundacja Rozwoju Systemu Edukacji.

<sup>(3)</sup> Nationale Agentur für EU Hochschulzusammenarbeit Deutscher Akademischer Austauschdienst e. V.

<sup>(4)</sup> Organismo Autónomo Programas Educativos Europeos.

<sup>(5)</sup> Agence Europe Éducation Formation France.

<sup>(6)</sup> Nederlands Nationaal Agentschap voor het Leven Lang Leren programma.

<sup>(7)</sup> Greek State Scholarship's Foundation I.K.Y.

<sup>(8)</sup> Österreichischer Austauschdienst — GmbH.

## ANNEX 6.3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR RESEARCH AND OTHER INTERNAL POLICIES

Main DGs concerned	Nature of declaration given by director-general (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
RTD	<b>with reservation</b>	Reservation concerning the rate of residual error with regard to the accuracy of cost claims under FP6 grants.		A	A
INFO	<b>without reservation</b>	—	Although in 2010 the cumulative rate detected and the residual error rate on cost claims under FP6 grants reached 3,94 % and 2,2 % respectively, the reservation regarding the accuracy of FP6 cost claims was lifted.	B	A
ENTR	<b>with reservation</b>	(i) Reservation concerning the rate of residual error with regard to the accuracy of cost claims under FP6 grants. (ii) Reservation concerning the reliability of the financial reporting by the European Space Agency.	—	A	A
EAC	<b>with reservation</b>	Too high error rate in centralised direct management, due to lack of justifying documents for cost claims, mainly concerning projects from the previous generation of programmes (continuation of 2009 reservation).	—	A	A
ERCEA	<b>without reservation</b>	—	—	A	N/A
REA	<b>without reservation</b>	—	—	A	

(\*) By reference to the declaration by the assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: the Director-General's declaration and the Annual Activity Report give a fair assessment of financial management in relation to regularity.

B: the Director-General's declaration and Annual Activity Report give a partially fair assessment of financial management in relation to regularity.

C: the Director-General's declaration and the Annual Activity Report do not give a fair assessment of financial management in relation to regularity.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR RESEARCH AND OTHER INTERNAL POLICIES

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2009	The Commission should raise the certifying auditors' awareness of the eligibility of expenditure with the aim of improving the reliability of the audit certificates they issue (paragraph 8.32).	<p>The inherent complexity of the eligibility criteria impacts on the work performed by the external auditors mandated by the beneficiaries to issue audit certificates. The Commission considers that for FP7 the introduction of 'agreed upon procedures' will increase the certifying auditors' awareness of the eligibility of expenditure and thus improve the reliability of the audit certificates. This remains to be confirmed.</p> <p>Except for DG ENTR, the Commission does not formally communicate with the external auditors by providing feedback when it has been proved, either as a result of the Court's audits or its own, that the certificate issued was unreliable. This is an effective way of raising the certifying auditors' awareness of the expenditure eligibility issues which the auditors may have overlooked.</p>	<p><i>The Commission monitors the reliability of the audit certificates. However, at this stage it is still too early to conclude if there is a significant decrease in errors.</i></p> <p><i>The Commission recently approved a decision to simplify the acceptance of average costing methodologies for claiming personnel costs. This decision is indeed expected to significantly simplify and facilitate the management of the research programmes.</i></p> <p><i>A formal feedback process is in place to urge the audited beneficiaries to make their certifying auditors aware of the Commission's audit findings and also referring them to the relevant information where the eligibility requirements and interpretations are publicly available.</i></p>	<b>The Court takes note of the Commission's reply</b>
	The Court recommends that the Commission continues to reinforce the checks on closures to ensure that errors are detected and corrected and prevent the recurrence of previously identified errors (paragraph 7.20).	<p>The Commission has made efforts in this area, particularly with the introduction of the Lifelong Learning Programme for the period 2007-2013. The errors detected by the Court for 2009 related to the Socrates II programme which was the predecessor of the Lifelong Learning Programme.</p> <p>The Commission has followed up all quantifiable errors and recovered non-eligible amounts.</p>	<p><i>The Commission welcomes the progress noted by the Court.</i></p>	
2008	The Commission should ensure rigorous application of the controls, in particular by imposing penalties where appropriate and making recoveries or adjustments in cases of undue reimbursement of claimed costs (paragraph 7.42).	<p>The Commission made considerable efforts in this area. This included an increased <i>ex-post</i> audit effort, which is the key element of the control strategy, and issuing recoveries or setting off against future payments any amounts found to have been overpaid to beneficiaries.</p> <p>During 2010, the Court observed a significant increase in the amounts of liquidated damages due to the Commission as a result of a beneficiary overstating its declared costs.</p>	<p><i>The Commission continues with its efforts to implement audit results, by recovering over-claimed amounts, imposing liquidated damages and furthermore, constantly monitoring the progress made in this area. Moreover, the Commission following the recommendation of the Court is consistently imposing liquidated damages in all cases in which overstated costs claims have resulted in unjustified financial contributions.</i></p>	

Year	Court Recommendation	Progress made	Commission reply	Court analysis
2008	The Commission should engage in closer supervision of the annual <i>ex-post</i> declaration process with direct verification that the controls described are adequate and fully applied (paragraph 9.34).	Overall, the Commission has made efforts in this area. Although systems audit visits and monitoring visits have decreased somewhat, there has been a significant increase in the number of financial audits. In 2010 DG EAC conducted systems audit visits to 8 countries (11 countries in 2009) and financial <i>ex-post</i> on-the-spot audits of 15 agreements with the National Agencies (5 financial audits in 2009). It also performed 47 monitoring visits in 2010 (against 58 in 2009).	<i>The Commission welcomes the progress noted by the Court.</i>	<b>The Court takes note of the Commission's reply</b>



## CHAPTER 7

**Administrative and other expenditure**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

7.1. This chapter presents the Court's specific assessment of the administrative and other expenditure of the Institutions and bodies of the European Union. Key information on the Institutions and bodies covered, and on the spending in 2010 is provided in **Table 7.1**.

**Table 7.1 — Administrative and other expenditure of the Institutions and bodies — Key information**

(million euro)

Budget Title	Policy group	Description	Payments	Management Mode
Sections I, II and IV-IX. For Section III, Chapter I of all Titles and Titles 14, 24-27 and 29	Administrative and other expenditure	European Parliament	1 509	Centralised direct
		European Council and Council	620	Centralised direct
		Commission	6 407	Centralised direct
		Court of Justice	323	Centralised direct
		Court of Auditors	182	Centralised direct
		European Economic and Social Committee	121	Centralised direct
		Committee of the Regions	89	Centralised direct
		European Ombudsman	8	Centralised direct
		European Data Protection Supervisor	5	Centralised direct
Total administrative expenditure			9 264	
Total operational expenditure				
<b>Total payments for the year</b>			<b>9 264</b>	
<b>Total commitments for the year</b>			<b>9 428</b>	

Source: 2010 annual accounts of the European Union.

7.2. This chapter also covers expenditure considered in the general budget as operational although its purpose is in most cases the functioning of the Commission's administration rather than policy delivery. This expenditure includes the following titles of the general budget: Title 14 (Taxation and customs union), Title 24 (Fight against fraud), Title 25 (Commission's policy coordination and legal advice), Title 26 (Commission's administration), Title 27 (Budget) and Title 29 (Statistics).

7.3. The Court reports separately on the EU agencies and executive agencies and on the European Schools<sup>(1)</sup>. The Court's mandate does not cover the financial audit of the European Central Bank.

<sup>(1)</sup> The Court's Specific Annual Report on the European Schools is submitted to the Board of Governors of the European Schools, and is copied to the European Parliament, the Council and the Commission.



## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group**

7.4. Administrative and other expenditure mainly comprises expenditure on human resources (salaries, allowances and pensions), which accounts for 63 % of total administrative and other expenditure, and expenditure on buildings, equipment, energy, communications, and information technology.

7.5. The main risks in the administrative and other expenditure policy group are non-compliance with the provisions on procurement, the implementation of contracts, recruitment procedures and the calculation of salaries and allowances.

**Audit scope and approach**

7.6. **Annex 1.1, Part 2**, describes the Court's overall approach and methodology. For the audit of administrative and other expenditure, the following specific points should be noted:

- the audit involved examining a sample of 58 transactions, comprising 4 advances and 54 final payments,
- the assessment of systems covered the compliance of the supervisory and control systems <sup>(2)</sup> applied by each Institution and body with the requirements of the Financial Regulation,
- the review of Commission management representations covered the annual activity reports of four of the Commission's Directorates-General and Offices primarily responsible for administrative expenditure.

7.7. The Court also audited the following selected topics in all Institutions and bodies:

- (a) calculation and payment of basic salaries, allowances, pensions and mission expenses;
- (b) procedures for recruiting permanent, temporary and contract staff;
- (c) procurement contracts.

7.8. The Court of Auditors is audited by an external audit firm <sup>(3)</sup> which issued an audit report on the financial statements for the financial year from 1 January 2010 to 31 December 2010 and an assurance report concerning the regularity of the use of the Court's resources, and the control procedures in place for the financial year from 1 January 2010 to 31 December 2010 (see paragraph 7.24).

<sup>(2)</sup> *Ex-ante* and *ex-post* controls, internal audit function, exception reporting and internal control standards.

<sup>(3)</sup> PricewaterhouseCoopers, Société à responsabilité limitée, réviseur d'entreprises.

## THE COURT'S OBSERVATIONS

**REGULARITY OF TRANSACTIONS**

7.9. *Annex 7.1* contains a summary of the results of the transaction testing. The Court's testing of its sample of transactions found 7 % of the 58 payments audited to be affected by error. The most likely error estimated by the Court is 0,4 %.

**EFFECTIVENESS OF SYSTEMS**

7.10. *Annex 7.2* contains a summary of the results of the examination of systems. The Court found that the systems <sup>(4)</sup> were effective in ensuring the regularity of transactions with the provisions of the Financial Regulation (see paragraph 7.6).

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

7.11. *Annex 7.3* contains a summary of the results of the review of Commission management representations.

**OBSERVATIONS ON SPECIFIC INSTITUTIONS AND BODIES**

7.12. The specific observations that follow are presented by Institution or body of the European Union and do not call into question the assessments set out in paragraphs 7.9 and 7.10. Whilst they are not material to administrative expenditure as a whole, they are significant in the context of the individual Institution or body concerned.

**Parliament****Management of the subsidy scheme for visitors' groups**

7.13. The Rules governing the reception of groups of visitors, adopted on 16 December 2002, provide that groups of visitors can be granted subsidies for compensation for travel expenses. The amount is calculated on the basis of the number of visitors and the average return distance the group has to travel, valued at the standard cost of an individual trip by private car. It should not exceed the actual cost of travel. The procedures in place do not require groups to provide evidence of the actual travel costs incurred, resulting in a risk of overpayment as most groups use cheaper collective transport rather than individual means of transport.

## REPLY OF THE EUROPEAN PARLIAMENT

*7.13. Controlling the actual cost of the journeys would be complex, time-consuming and would entail the deployment of a significant amount of additional human resources within the concerned unit, which Parliament considers to be disproportionate to the risk of overpayment entailed. In addition, before receiving any subsidy, group leaders must sign the following statement: 'The subsidy paid by the European Parliament is not higher than the actual cost of the journey minus any other contributions received. I undertake to declare any such contributions.'*

*Parliament will examine what form of checks might be appropriate which would give reasonable assurance and would not represent an excessive administrative burden. Parliament will also examine whether to introduce an obligation for group heads to preserve, for a predetermined period, supporting documents relating to the journeys' costs.*

<sup>(4)</sup> Systems are taken as a whole across the Institutions and bodies referred to in paragraph 7.1.

## THE COURT'S OBSERVATIONS

7.14. In addition, the practice of allowing the compensation to be paid to the designated leader of the group in cash rather than by bank transfer limits the possibility of applying internal control procedures to these transactions. Payments amounting to a total of 55 236 euro were made in cash in four cases out of a sample of six audited and payments made in cash represented 78 % of total payments made to groups of visitors in 2010.

**Employment of contract agents**

7.15. An examination of the procedures for recruiting contract staff established that, in four out of the five cases audited, documents evidencing the examination of applications, the performance of interviews and the decision made to select those staff were not on file. Best practice is to ensure that there is full documentation for internal control purposes.

**Procurement**

7.16. In five procurement procedures out of 20, the audit found errors and inconsistencies in the definition and application of award criteria and in the analysis of tender documentation. These cases also evidenced weaknesses in: the drafting of contractual conditions; the authorising officers' and the evaluation committees' performance of their respective roles; and the formal communication to the tenderers of the outcome of the procedure. The same weaknesses were noted, to a lesser extent, in nine other cases.

**Organisation and functioning of political groups**

7.17. Articles 2.1.1 and 2.5.3 of the Parliament's Internal Rules for the implementation of the budget managed by political groups, adopted by the Bureau on 30 June 2003, provide that the years in which European elections are held (as was the case in 2009) include two distinct budgetary and financial periods. Article 2.1.6 of these Internal Rules states that any unused appropriations exceeding 50 % of those received from the Parliament's budget for each period shall be paid back to the Parliament. This rule has not been applied and 2 355 955 euro should have been deducted from the appropriations paid to the political groups by the Parliament in 2010.

## REPLY OF THE EUROPEAN PARLIAMENT

7.14. In its resolution of 10 May 2011 accompanying the discharge decision, Parliament wished 'that a study should be conducted to examine whether the system for the reimbursement of travel expenses incurred by official visitor groups is adequate'. This study will give the opportunity to evaluate a new system in which the travel expenses would be split into travel costs, depending on the journey's length, and accommodation costs based on the number of visitors and a ceiling per visitor/night. Also the use of systematic bank transfers, for the part of the subsidies representing the travel costs, will be assessed.

## REPLY OF THE EUROPEAN PARLIAMENT

7.15. For the selection of contract agents, the internal applicable rules require neither minutes of the interviews to be drawn up, nor the reasons justifying the selection to be formally stated, as the selected people passed the selection for EPSO CAST database. Consequently, there is no formal documentation on file, underlying such procedures.

## REPLY OF THE EUROPEAN PARLIAMENT

7.16. The individual analysis of the cases mentioned has demonstrated that none of the potential risks has materialised and that the complexity of the applicable regulations may lead to diverging interpretations, especially in the context of ex-post evaluations of tendering procedures, on which the Court bases its conclusions.

In addition, different measures have been taken in order to improve the organisation of procurement procedures. Apart from the creation of resource directorates, measures proposed by the Procurement Forum aiming at a better organisation of procurement procedures have been endorsed, and the Procurement Forum is to prepare specific training for draftspersons of tender documents and members of evaluation committees.

## REPLY OF THE EUROPEAN PARLIAMENT

7.17. The split into two periods of the year in which elections take place provided for by Article 2.1.1 of the Regulation on Article 400 is a specificity that takes into consideration the specific needs of political groups during such a year. This specificity has been inserted in Regulation 400 to take into account possible dissolutions of groups after the elections, leading to a closing of the accounts at mid-year. For groups that go on existing after the elections, their existence continues and their allocation for appropriations is revised according to the number of MEPs that are members of the group after the election. The regulation insists on the annual nature of the appropriations as it provides that 'Appropriations that are not used during the financial year may be carried over to the following financial year up to a maximum of 50 % of the annual appropriations received from the European Parliament's budget.'

## THE COURT'S OBSERVATIONS

**Performance of the *ex-ante* verification**

7.18. Article 47 of the Implementing Rules of the Financial Regulation provides that every act implementing the budget must be subject to an *ex-ante* verification. In the case of payments made to groups of visitors (see paragraphs 7.13 and 7.14), procurement procedures (see paragraph 7.16) and payments made under the Parliament's Internal Rules for the implementation of the budget managed by political groups (see paragraph 7.17), the programme for performing *ex-ante* checks does not include checks tailored to the nature and risk profile of the operations examined. In the case of recruitment procedures (see paragraph 7.15), specific checks are applied but do not cover the selection phase. The effectiveness of the *ex-ante* verification is thus limited.

**European Council and Council****Financing of the 'Residence Palace' building project**

7.19. The convention for the construction of the Residence Palace Building in Brussels, signed with the Belgian State in 2008 for planned completion in 2013 and for a total estimated cost of 310 million euro (estimated prices 2013), provides for the possibility of making advance payments. In the period 2008-2010, the Council made advance payments totalling 235 million euro, of which 30 million euro were included in the budget line for the acquisition of buildings in the Council's initial budget. The additional funds of 205 million euro (i.e. 87% of the total funds paid in advance) came from budgetary transfers made at the end of each year from 2007 to 2010 (mostly from budget lines for interpretation costs and delegations' travel expenses).

7.20. The repeated under-utilisation of these budget lines throughout the 2008-2010 period and the size of the amounts transferred with respect to total advance payments made does not comply with the principle of budget accuracy. In addition, the payment in the first 3 years of 235 million euro out of the convention's total value of 310 million euro did not match payments to the progress of the building work.

*Because of this continuity, the spirit of the regulation and the constant practice is to consider, for groups that go on existing after the elections, the sum of the two halves of the financial year as a single financial year and to apply carry forward rules on this basis. In order to lift the ambiguity of interpretation noted by the Court, an adequate clarification of the regulation will be proposed in a timely manner for the next electoral year.*

## REPLY OF THE EUROPEAN PARLIAMENT

**7.18.** *Ex-ante verification will be adapted to ensure systematic control of the specific provisions applicable to the different activities mentioned by the Court, and to include checks tailored to the nature and risk profile of the operations examined.*

*Given the special rules for the financing of the political groups, detailed controls are meaningful only after the closure of the financial year, i.e. during the following year, on the basis of their financial statements. For this reason, an ex-post control was made in 2009 (financial year 2008) and another ex-post control is included in the Work Plan of the Service for 2011 (financial year 2010).*

## REPLY OF THE COUNCIL

**7.19.** *The appropriations made available by budget transfers were submitted to the budget authority in accordance with the procedures foreseen in Articles 22 and 24 of the Financial Regulation.*

## REPLY OF THE COUNCIL

**7.20.** *The General Secretariat of the Council agrees with the Court's analysis that the amounts for the budget lines for interpretation and delegations' travel expenses should be more in line with the real consumption. In this context the provisions for these categories have been significantly reduced in the draft budget for 2012. In addition, the amount foreseen in the budget for 2012 for the advance payments for the Residence Palace building has been reduced.*

## THE COURT'S OBSERVATIONS

**Commission****Procurement**

7.21. The selection criteria applied in a call for expressions of interest (CEI) for security services organised by the Directorate-General for External Relations (DG RELEX) in 2008 and valid until April 2011 are not precise enough to ensure an objective and appropriate selection of companies. For instance, no lower limits are set for the annual turnover or for the manpower required for the candidate to be selected for the CEI list. Furthermore, the CEI does not reflect the diversity of security conditions in the various parts of the world which it covers (North and South America, most of Africa, Asia, Central and Eastern Europe and Oceania).

7.22. In three tendering procedures organised by Delegations belonging to the Directorate-General for External Relations, the audit found inconsistencies and misinterpretation of the rules regarding the need for a separate report by the tender opening committee, the use of award criteria and the obligation for the evaluation committee to produce a formal evaluation report.

**Court of Justice**

7.23. The Court has no observation to make on the Court of Justice.

**Court of Auditors**

7.24. The external auditor's report <sup>(5)</sup> states that, in the auditors' opinion, 'the financial statements give a true and fair view of the financial position of the European Court of Auditors as of December 31, 2010, and of its cash flows for the year then ended in accordance with Council Regulation (EC, Euratom) No 1605/2002 of June 25, 2002, Commission Regulation (EC, Euratom) No 2342/2002 of December 23, 2002 laying down detailed rules for the implementation of the said Council Regulation and the Accounting Rules of the European Union'. The report will be published in the Official Journal.

## REPLY OF THE COMMISSION

**7.21-7.22.** *The European External Action Service (EEAS) is responsible for the financial management regarding the administrative expenditure of the Delegations. According to Article 1(2) of the Financial Regulation, it is a service treated as an institution for the purposes of this Regulation. In addition, Article 147a provides for that the EEAS is fully subject to the procedures related to discharge.*

<sup>(5)</sup> See the audit report on the financial statements referred to in paragraph 7.8.

## THE COURT'S OBSERVATIONS

**European Economic and Social Committee****Reimbursement of travel expenses to Members of the Committee**

7.25. The rules on the reimbursement of travel costs allow Members of the Committee to choose between Option A, based on actual travel costs incurred on production of the supporting documents, and Option B (60 % of missions performed between January and November 2010), which is the payment of a flat-rate allowance based on the distance in kilometres. Under Option B, the meeting must be held in Brussels and the compensation cannot exceed the standard price of a first-class train or airline ticket determined under Option A.

7.26. The payment of a flat-rate allowance, under Option B, is generally higher than the actual price of the economy-class train or airline ticket used by beneficiaries most of the time. Reimbursement under Option B can thus generate a payment higher than the actual travel costs incurred. Although legal and regular, this procedure does not correspond to the practice of the other European Institutions and bodies, which is to reimburse travel costs on the basis of actual costs incurred.

**Procurement**

7.27. In one restricted procedure out of the seven procedures examined, the tenderers which had submitted offers in two different lots were not treated equally when submitting clarifications about their offer. In two negotiated procedures, errors and inconsistencies were noted for the drafting of the tender specifications and of the award criteria, the contacts with the tenderers, the evaluation of offers and the formalities for the outcome of the procedure.

## REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

**7.25.** *By rule and definition, option B can only be applied if the amount does not exceed the costs calculated under option A. The IATA full business fares for the countries referred to by the Court of Auditors have all been checked and are all above Option B flat-rate reimbursement, in some instances quite considerably above.*

## REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

**7.26.** *In line with earlier discussions within the EESC as well as with the reform the EP itself recently undertook, the EESC Bureau confirmed, in its meeting of 3 May 2011, that the EESC Members' financial statute will be reformed, taking into account the following principles:*

- *respect of the Members' dignity, equity amongst Members, transparency and financial sustainability,*
- *reimbursement of transport tickets on the basis of real costs only; transport arrangements must provide sufficient flexibility and comfort, at a reasonable cost,*
- *daily allowances and travel allowances aligned to the MEP's allowances,*
- *allowances to compensate for the time spent and administrative cost, calculated in agreement with the EP and the Council and at a reasonable level.*

## REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

**7.27.** *The EESC has taken good note of the Court's observations and a reminder of important elements to be observed in procurement procedures has been sent to all authorising officers by sub-delegation. Also, efforts to ensure that the necessary public procurement expertise is present in evaluation committees will be stepped up.*

## THE COURT'S OBSERVATIONS

**Committee of the Regions****Employment of permanent staff**

7.28. The vacancy notice for the recruitment of one official stipulated as an eligibility criterion that candidates external to the Committee be officials or be on an European Personnel Selection Office (EPSO) successful candidates' reserve list for a competition of the appropriate grade for the recruitment of officials. The selected candidate was recruited on the basis of an inter-institutional transfer. At that point, he had not formally been appointed as a probationary official in his Institution of origin and his personal file did not include evidence that this transfer was formally endorsed at the appropriate hierarchical level in the Institution of origin.

**Procurement**

7.29. The audit found that, in two negotiated procedures out of four concluded under the provisions of Article 129 of the Implementing Rules, which allows the use of the negotiated procedure for contracts with a value less than or equal to 60 000 euro, the authorising officers did not draw up a formal estimate of the contract value in order to justify the use of the negotiated procedure.

7.30. In the same two negotiated procedures, provisions relating to the application of the award criteria, the consideration of the price quoted, the confidentiality of offers and contacts with the tenderers were not correctly applied.

**European Ombudsman**

7.31. The Court has no observation to make on the European Ombudsman.

## REPLY OF THE COMMITTEE OF THE REGIONS

7.28. *The Committee of the Regions has improved its procedure to ensure that prior to the appointment of a probationary official from another institution, he or she will have been formally appointed as a probationary official in that institution and formally transferred to the Committee of the Regions. As far as the specific case is concerned, a formal decision of appointment and transfer has since been received from the Court of Justice and classified in the individual file of the official.*

## REPLY OF THE COMMITTEE OF THE REGIONS

7.29. *The two low-value contracts for which the negotiated procedures were applied cover the purchase of services to accommodate interpretation for politically oriented seminars held outside Belgium. Although the estimates of the contract values were not formally included in a document, such estimations were carried out having in mind experiences with call for tenders for comparable services within the European Union. In order to improve its system for supervision and control over contract value estimations even further when it comes to coherence between its services, the Committee of the Regions will develop and implement a standard format for documentation of the estimates.*

## REPLY OF THE COMMITTEE OF THE REGIONS

7.30. *For one of the interpretation contracts, the price for the service was fixed and not subject to revision. The preparation of the seminar experienced a lot of changes and had a large and complex linguistic regime with 10 languages and with 10 interpretation booths. In order to ensure the supply of the services, the Committee of the Regions had no option but to accept a small increase in the quoted price. Due to the difficulties experienced when applying the best-value-for-money award criteria, the Committee of the Regions will change the criteria with the objective of using only the lowest price for such seminars. As a result of the Court's observation on the confidentiality of offers, the Committee of the Regions' supervisory and control system for receiving offers has been improved through the creation of a functional mailbox with restricted access.*

## THE COURT'S OBSERVATIONS

**European Data Protection Supervisor****Organisation of an internal competition**

7.32. An internal competition in four different fields (legal field with experience in data protection, technological field with experience in data protection, human resources and secretarial assistance) was organised by the European Data Protection Supervisor (EDPS)'s Office in 2009. While the specialised nature of the functions performed by the EDPS's Office may justify the organisation of an internal competition, this policy should not be considered as the norm. Best practice is to use the services of the European Personnel Selection Office (EPSO), which organises open competitions on a regular basis.

**CONCLUSIONS AND RECOMMENDATIONS****Conclusions**

7.33. Based on its audit work, the Court concludes that the payments as a whole for the year ended on 31 December 2010 for administrative and other expenditure of the Institutions and bodies were free from material error (see paragraph 7.9).

7.34. Based on its audit work, the Court concludes that the supervisory and control systems for administrative and other expenditure were effective in ensuring the regularity of payments. The observations made in paragraphs 7.13 to 7.32 do not call this conclusion into question. The Court however draws attention to the errors and weaknesses detected in the examination of a sample of procurement procedures (see paragraphs 7.16, 7.21, 7.22, 7.27, 7.29 and 7.30), and to the repeated under-utilisation of certain budget lines, resulting in budgetary transfers designed to finance building projects (see paragraphs 7.19 and 7.20).

**Recommendations**

7.35. The observations made as a result of the examination of human resources management and procurement contracts (see paragraph 7.12) lead to the following recommendations:

- in the area of recruitment, the Institutions and bodies concerned (see paragraphs 7.15 and 7.28) should ensure that appropriate documentation is established to justify the recruitment decisions made and that eligibility criteria set out in vacancy notices are respected,
- the Institutions and bodies concerned (see paragraphs 7.16, 7.21, 7.22, 7.27, 7.29 and 7.30) should ensure that authorising officers have appropriate checks and better guidance at their disposal so as to improve the design, coordination and performance of procurement procedures.

7.36. **Annex 7.4** shows the result of the Court's review of progress in addressing recommendations made in the 2009 Annual Report.

## REPLY OF THE COMMISSION

7.35. See Commission reply to paragraphs 7.21-7.22.

## REPLY OF THE COMMISSION

7.36. See Commission reply to paragraphs 7.21-7.22.



## ANNEX 7.1

## RESULTS OF TRANSACTION TESTING FOR ADMINISTRATIVE EXPENDITURE

	2010				2009	2008	2007
	Expenses related to staff	Expenses related to buildings	Other expenses	Total			
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>							
Total transactions (of which):	33	7	18	<b>58</b>	57	57	56
Advances	0	1	3	<b>4</b>	2	0	0
Interim/final payments	33	6	15	<b>54</b>	55	57	56
<b>RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup></b>							
<b>Proportion of transactions tested found to be:</b>							
Free of error	94 % (31)	100 % (7)	89 % (16)	<b>93 % (54)</b>	93 %	91 %	95 %
Affected by one or more errors	6 % (2)	0 % (0)	11 % (2)	<b>7 % (4)</b>	7 %	9 %	5 %
<b>Analysis of transactions affected by error</b>							
<b>Analysis by type of expenditure</b>							
Advances	0 % (0)	0 % (0)	50 % (1)	<b>25 % (1)</b>	N/A	N/A	N/A
Interim/Final payments	100 % (2)	0 % (0)	50 % (1)	<b>75 % (3)</b>	N/A	N/A	N/A
<b>Analysis by type of error</b>							
Non-Quantifiable errors:	50 % (1)	0 % (0)	100 % (2)	<b>75 % (3)</b>	N/A	N/A	N/A
Quantifiable errors:	50 % (1)	0 % (0)	0 % (0)	<b>25 % (1)</b>	N/A	N/A	N/A
Eligibility	0 % (0)	0 % (0)	0 % (0)	<b>0 % (0)</b>	N/A	N/A	N/A
Occurrence	0 % (0)	0 % (0)	0 % (0)	<b>0 % (0)</b>	N/A	N/A	N/A
Accuracy	100 % (1)	0 % (0)	0 % (0)	<b>100 % (1)</b>	N/A	N/A	N/A
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>							
Most likely error rate				<b>0,4 %</b>			
Lower error limit				0,0 %			
Upper error limit				1,1 %			

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions

## ANNEX 7.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR ADMINISTRATIVE EXPENDITURE

**Overall assessment of supervisory and control systems**

Overall assessment	2010	2009	2008	2007
	Effective	Effective	Effective	Effective

## ANNEX 7.3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR ADMINISTRATIVE EXPENDITURE

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability	
				2010	2009
PMO	<b>without reservations</b>	N/A	—	A	A
OIB	<b>without reservations</b>	N/A	—	A	A
OIL	<b>without reservations</b>	N/A	—	A	A
DIGIT	<b>without reservations</b>	N/A	—	A	A

(\*) By reference to the declaration of assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: the Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity.

B: the Director-General's declaration and the annual activity report give a partially fair assessment of financial management in relation to regularity.

C: the Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity.

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR ADMINISTRATIVE EXPENDITURE

Year	Court Recommendation	Progress made	Institution reply	Court analysis
2009	<p><b>Parliament</b></p> <p><i>Payment of social allowances to staff members</i></p> <p>Staff should be requested to deliver at appropriate intervals documents confirming their personal situation. In addition, the Parliament should implement a system for the timely monitoring and control of these documents.</p>	<p>Parliament implemented measures to mitigate the risk: launching of a campaign to check eligibility for some allowances, which led to the recovery of more than 70 000 euro; implementation of an automated control tool ('electronic fiche') allowing an annual verification of the staff's personal and administrative data; and performance of checks on the establishment of individual entitlements during recruitment procedures or when staff change category.</p>	<p><i>Parliament will continue to monitor closely these issues, particularly the efficiency of the yearly verification.</i></p>	<p><b>The Court takes note of the measures taken by the Parliament.</b></p>
	<p><b>Commission — DG Relex</b></p> <p><i>Payment of social allowances and benefits to staff members</i></p> <p>Staff should be requested to deliver at appropriate intervals to the Commission's services documents proving their personal situation. In addition, DG RELEX should implement a system for the timely monitoring and control of these documents.</p>	<p>For the Commission, DG RELEX stated that the creation of the EEAS will be an opportunity to remind staff of the obligations to update files when rights are concerned. Staff have been informed about this. Further checks will be made and there will be contacts between the ex-post control function and the units responsible to see if the recently introduced ACL software will allow the extraction of statistical samples for checks to be made by the units dealing with staff in Delegations.</p>		<p><b>The Court takes note of the measures taken by the Commission.</b></p>
	<p><b>European Data Protection Supervisor</b></p> <p><i>Payment of social allowances to staff members</i></p> <p>Staff should be requested to deliver at appropriate intervals documents proving their personal situation. In this respect, the European Data Protection Supervisor should improve its system for the timely monitoring and control of these documents.</p>	<p>The EDPS has corrected the errors noted in the 2009 DAS and in 2010 and 2011 has implemented tools for better management of the allowances (formal contacts within the EDPS and with the PMO and yearly information fiche).</p>	<p><i>The form relating to household allowance without child is sent to the PMO for checking and updating of the information. A copy is kept in the personal file. The EDPS will continue improving the management of those allowances.</i></p>	<p><b>The Court takes note of the measures taken by the EDPS.</b></p>

## CHAPTER 8

**Getting results from the EU budget**

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## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**INTRODUCTION**

8.1. This Chapter presents the Court's observations on the Commission's self-assessment on performance as stated in the Annual Activity Reports of the Commission's Directors-General<sup>(1)</sup> <sup>(2)</sup> and the main performance audit results for the last financial year as presented in the Court's Special Reports<sup>(3)</sup>.

8.2. Performance is assessed on the basis of the sound financial management principles (economy, efficiency and effectiveness)<sup>(4)</sup>. Its measurement is key throughout the public intervention process, covering inputs (financial, human, material, organisational or regulatory means needed for the implementation of the programme), outputs (the deliverables of the programme), results (the immediate effects of the programme on direct addressees or recipients) and impacts (long-term changes in society that are, at least partly, attributable to the EU's action).

**THE COMMISSION'S SELF-ASSESSMENT ON PERFORMANCE****Introduction**

8.3. The Directors-General of the Commission set performance objectives in the yearly Management Plans of the Directorate-General and then report on the achievements in the Annual Activity Reports.

**8.1.** *The Commission welcomes the audit undertaken by the Court on performance information, at a time when increased attention is put on the need to demonstrate the added value and the impact of EU spending.*

**8.2.** *Measuring the effects of complex policies is not always easy, given the range of contributing factors, as well as the combined effects of integrated programmes. Monitoring captures what can be observed (and reported, among others, through the Annual Activity Reports), and evaluation is needed to determine effects due to the policy.*

<sup>(1)</sup> Including, in paragraphs 8.5 to 8.14, a summary of the Directors-General's reporting in the Annual Activity Reports for the selected sample.

<sup>(2)</sup> Article 60(7) of the Financial Regulation provides that the Annual Activity Reports 'shall indicate the results of the operations by reference to the objectives set, the risks associated with these operations, the use made of resources provided and the efficiency and effectiveness of the internal control system'.

<sup>(3)</sup> The Court's Special Reports cover the EU budget, as well as the European Development Funds.

<sup>(4)</sup> Article 27 of the Financial Regulation states that:

'1. Budget appropriations shall be used in accordance with the principle of sound financial management, namely in accordance with the principles of economy, efficiency and effectiveness.

2. The principle of economy requires that the resources used by the institution for the pursuit of its activities shall be made available in due time, in appropriate quantity and quality and at the best price.

The principle of efficiency is concerned with the best relationship between resources employed and results achieved.

The principle of effectiveness is concerned with attaining the specific objectives set and achieving the intended results.'

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.4. The Court assessed the performance information provided in the Annual Activity Reports of the Directorates-General for Agriculture and Rural Development (DG AGRI), for Regional Policy (DG REGIO) and for Research and Innovation (DG RTD) <sup>(5)</sup>. These are respectively the two largest areas of shared management expenditure and the largest area of expenditure directly managed by the Commission. The Court focussed particularly on objectives and related performance indicators, assessing their relevance <sup>(6)</sup>, comparability <sup>(7)</sup> and reliability <sup>(8)</sup>.

**8.4.** *The Annual Activity Report (AAR) is only one of the tools to report on performance. The Commission has reinforced its evaluation capacity and useful conclusions are presented and explained in evaluation reports (see reply to paragraph 8.23) carried out by all actors involved, e.g. Member States under shared management arrangements, external evaluators, etc.*

### The Directorates-General's reporting on the achievements of the year

#### *Agriculture and Rural Development*

8.5. In its Annual Activity Report, DG AGRI presented in a table, for each 'general objective', figures on the current situation of the 'impact indicators' against the targets set. DG AGRI reported positive results in the field of sound financial management. The DG referred to the new obligation for Member States to assess their Land Parcel Identification Systems, and to the possibility for Member States to ask their certification bodies to confirm, after re-performance checks, the reliability of the control statistics. In such cases, the Commission would limit any financial corrections to the error rate derived from the control statistics concerned.

8.6. For Rural Development, DG AGRI reported progress in the implementation of the 94 programmes, with 33,9 billion euro of a total budget of 96,2 billion euro executed, although at a various pace between Member States and measures. As 2010 was the midpoint of the programming period, DG AGRI mentioned that a stocktaking exercise provided input to the reflections on the future of the rural development policy, including 90 mid-term evaluations of the Rural Development programmes submitted to the Commission by the end of the year.

8.7. The 'specific objectives', the related 'results indicators', and the main policy outputs delivered for each Activity-Based Budgeting activity (ABB) were included in Annex 6 to the Annual Activity Report.

<sup>(5)</sup> The sample of three Directorates-General represented more than 70 % of the payments made by the EU in 2010 (DG AGRI: 55,5 billion euro, DG REGIO 30,6 billion euro, DG RTD 3,5 billion euro).

<sup>(6)</sup> Whether the indicators were coherent with the policy objectives and management mode, and linked to quantified target.

<sup>(7)</sup> Whether indicators selected at planning stage were later used for reporting and any change explained.

<sup>(8)</sup> Whether the Director-General could support having reasonable assurance on the information reported.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Regional policy*

8.8. In the Annual Activity Report, the Director-General reported that DG REGIO delivered on its operational priorities set for the year in its Management Plan and continued to make significant progress towards its long term and multiannual objectives. More generally, DG REGIO reported that Cohesion Policy<sup>(9)</sup> had demonstrated its effectiveness and consolidated evidence on its added value.

8.9. DG REGIO provided further information on the controls in place to ensure economy, efficiency and effectiveness. Regarding the implementation of operational programmes, DG REGIO assessed that 73 % of the amounts decided for 2007-2013 had been implemented satisfactorily based on four criteria (progress in project selection procedures, major projects preparation and implementation, financial engineering instruments: setting-up and investment, payments to beneficiaries). In addition, DG REGIO presented recent evidence of the added value of the Cohesion Policy quoting the *ex post* evaluations of ERDF programmes 2000-2006, the conclusions of the 'Experts evaluation network' on the 2007-2013 programming period and the fifth Cohesion Report<sup>(10)</sup>.

8.10. DG REGIO presented the latest developments regarding the implementation of the relevant programming periods separately for the European Regional Development Fund (ERDF), the Cohesion Fund, the pre-accession interventions and the European Union Solidarity Fund and included related performance indicators in Annex 7 to the Annual Activity Report.

*Research and Innovation*

8.11. In the Annual Activity Report, the Director-General recalled the objective of the Commission and the Member States to drive forward an integrated and world-class research system in Europe. The situation presented was that overall the EU scientific and technological competitiveness remained strong, accounting for 23,4 % of the world's total research investment, 22 % of the researchers, 32,4 % of all the high impact publications and 31,3 % of all patents. However, there was a decline in favour of the rise of the emergent economies research investments.

**8.8.** *In its Annual Activity Report, the Directorate-General for Regional Policy (DG REGIO) reports performance on several aspects: budgetary execution, policy development, operational achievement linked to the quality of intervention and the implementation of the recovery package, sound financial management, etc. The operational priorities, defined in the Management Plan (MP), are one of the elements to assess performance.*

<sup>(9)</sup> Cohesion Policy regroups Regional Policy managed by DG REGIO and the European Social Fund managed by DG Employment, Social Affairs and Inclusion.

<sup>(10)</sup> [http://ec.europa.eu/regional\\_policy/sources/docoffic/official/reports/cohesion5/index\\_en.cfm](http://ec.europa.eu/regional_policy/sources/docoffic/official/reports/cohesion5/index_en.cfm)



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.12. Regarding the Seventh Framework Programme for Research and Technological Development (FP7), the EU's main instrument to implement and support EU research policy, DG RTD reported to have concluded a total of 38<sup>(1)</sup> calls for proposals in 2010 and to have committed over 5,2 billion euro.

8.13. The 2010 interim evaluation of FP7 concluded that it contributed to the development of European Research Area and its geographical outreach in cross-border cooperation and its promotion of research excellence continued to make a difference to the European research landscape.

8.14. The Annual Activity Report also presented the main achievements for each activity and reported on objectives and related indicators in its Annex 8.

### The Court's observations on Directorates-General's reporting

#### *Relevance of performance information*

#### **A coherent set of objectives, indicators and targets focussing on effectiveness, but results need to be more thoroughly analysed**

8.15. The DGs examined presented in the Management Plans a set of objectives, indicators and targets, focussing mainly on effectiveness. General objectives were defined at strategic policy level. Their achievement was measured using impact indicators and related targets. Specific objectives defined at operational level were linked to results indicators and targets.

**8.15.** *The Commission considers that the Annual Activity Reports (AARs) examined by the Court are in compliance with the requirements of Article 60(7) of the Financial Regulation.*

*The set of objectives, indicators and targets in the Management Plan has been designed to focus on policy or programme effectiveness.*

<sup>(1)</sup> This figure refers to the period from January to October 2010 (see footnote 4 of the Annual Activity Report).

## THE COURT'S OBSERVATIONS

8.16. In the Annual Activity Reports however, the differences between the targets and the achieved results were not analysed (DG REGIO, DG RTD) or only partially (DG AGRI). Thus, the information presented in the Annual Activity Reports was not sufficient to understand why a target was not achieved or significantly exceeded.

**Currently the Management Plan does not foresee objectives and indicators to measure economy and efficiency**

8.17. In the Management Plan, the DGs did not set objectives and related indicators to assess economy (costs of inputs) or efficiency (relation between inputs, outputs and results), either at the level of the EU policy, or at the level of expenditure under direct control of the DG. Thus, it was not possible in the Annual Activity Report to assess whether the achievements presented were the result of an economic and efficient management of resources or whether any progress had been recorded in this area.

## THE COMMISSION'S REPLIES

**8.16.** *The standing instructions ask the Commission services to justify any discrepancy between results achieved and planned.*

*For some cases, although a full assessment of the differences between the targets and the achieved results was not presented, data on the current situation is provided annually showing clearly the trend towards attainment of the objectives.*

*The Commission agrees that departure of actual achievements from the planned targets could be better explained in future Annual Activity Reports, and, in the future, particular attention will be paid to further developing the analysis of the achievements against the targets set.*

**8.17.** *Within the implementation of Activity Based Management, the MP was the tool chosen by the Commission for its services to translate the Commission's long-term strategy into general and specific objectives.*

*Concerning the general objectives, the standing instructions invite the services to limit their number, to align them in particular with the EU 2020 Strategy and to define priorities amongst them.*

*On the side of the specific objectives, services are instructed to set objectives that are aligned with the general objectives and that address the direct effect of the EU actions on the targeted population.*

*In conclusion, the MP focuses on policy effectiveness (the degree to which objectives are achieved).*

*On the side of the reporting, the Commission services report, in their AARs, on effectiveness, efficiency and economy aspects of their control systems, in line with Article 60(7) of the Financial Regulation. Part 2 of the AAR focuses on the effectiveness of the internal control system while Part 3 includes key indicators on legality and regularity which are established under the format 'inputs, outputs, results and impact'.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**In some areas targets not sufficiently quantified or specific**

8.18. For DG AGRI four out of 10 targets for impact indicators, and for DG RTD three out of ten, were not quantified, mentioning only a trend. Explanations were not provided for the basis on which the targets were set for five impact indicators out of 10 in DG AGRI, and for four out of 10 impact indicators as well as all results indicators for cooperation in the different research areas in DG RTD. For DG REGIO, while the targets for impact and results indicators were quantified, most operational priorities and outputs for 2010 set in the Management Plan were not specific<sup>(12)</sup> or measurable.

8.19. DG RTD used similar indicators in seven different Activity-Based Budgeting activities financed and did not consolidate their results. Overall assessment was therefore difficult. DG RTD's Annual Activity Report did not clearly separate the impacts of projects financed through Framework Programme under its direct responsibility from those of its action to coordinate the research efforts of Member States under a common and coherent EU policy for research, where the Commission's influence is indirect only.

**Interim milestones for multiannual targets not defined in some areas**

8.20. In regional policy, research and to a lesser extent parts of agriculture, while DGs had set objectives and targets over multiannual programming periods, they did not use appropriate interim milestones.

**8.18.** *The Commission standing instructions do not require all indicators to be quantitative nor to explain the targets as the MP is primarily a tool for management. Indicators need to be measurable to monitor progress towards achieving the set goals; and trends are adequate for this purpose.*

*For DG REGIO, general and specific objectives linked to the activity-based budgeting (ABB) activities are 'SMART' and the definition of policy outputs is also clear. DG REGIO has introduced so-called 'operational priorities'. These are aimed at introducing a management style based on a 'systems thinking' approach focusing on increasing quality. As such, the focus is more on processes and progress, rather than on achieving specific outputs and targets.*

**8.19.** *Even though the same indicators are used for several activities, the standing instructions ask the Commission services to present their objectives and indicators by ABB activity, and not consolidate information across activities.*

*It is extremely difficult to separate the impacts according to the nature of the Directorate-General for Research and Innovation (DG RTD) intervention, since impacts refer to ultimate changes in EU society. These societal changes depend essentially from the action of other actors (Member States, regions, undertakings ...).*

**8.20.** *For multiannual programmes it is not always meaningful to set interim milestones, as impacts will only be reached in a non-linear way at the end of the programming period. According to the Commission standing instructions, milestones are only needed for general objectives. The annual reporting on inputs, outputs and results, i.e. the monitoring of the progress in programme implementation, does allow for a regular assessment of the progress towards the attainment of the objectives.*

*In addition, in the area of rural development, the mid-term evaluation of the rural development programmes (RDPs) provides a further in-depth independent quantitative and qualitative view of whether programmes are on track to achieve their objectives and what adjustments might be needed.*

<sup>(12)</sup> Such as, for instance, operational priorities 2010 '1.1 To take actions to facilitate the high quality implementation of programmes by national and regional bodies' or '1.2 To take actions together with Member States and candidate countries to ensure a good absorption and use of resources'.

## THE COURT'S OBSERVATIONS

8.21. For multiannual programmes, the standard pace of progress might be relatively slow, so that an achievement of less than 10 % of the target after a number of years could in certain cases be considered normal, while in other cases signal delays. For example in the area of ERDF, the target for additional population covered by broadband access in six Member States was set at 10 million over 2007-2013. The latest known result was 550 000 for 2007-2009, representing 5,5 % of the overall target after 3 years out of 7. There was no indication on whether this level was considered sufficient to reach the multiannual target. In such instances, it will not be possible, till the very end of the period, to check whether the DGs are still on track towards the achievement of multiannual targets.

**Description of policy achievements provided limited information on results and impacts**

8.22. Along with performance indicators, Directors-General described in the Annual Activity Reports the year's 'policy achievements'. The text tended to focus more on outputs (what the DG did, describing actions taken, their purpose, the products delivered), and on inputs (gross amounts of resources involved), rather than on the assessment of the outcomes of the actions (results on direct addressees and/or impact of the programmes).

## THE COMMISSION'S REPLIES

*For indicators measuring the ultimate goals of the research and innovation policy at EU level and for those of the Activity 'ERA Development', data are usually updated yearly but with a certain time lag of 2 or more years depending on the indicator. The Court's suggestion to provide more explicit explanations on whether achievement of objectives is considered on track could be explored in the future.*

*See also reply to paragraph 8.21.*

**8.21.** *The pace of progress for multiannual programmes can indeed be relatively slow. The reasons are twofold: the implementation of the programmes entails initial capacity building and the required impact takes several years to gather speed.*

*Regarding the European Regional Development Fund (ERDF) support to broadband access, the 2007-2013 targets mentioned for the various result indicators will not be achieved in 7 years but at the end of the eligibility period 2 years later. DG REGIO's has highlighted in key documents, all mentioned in the Annual Activity Report, the need for Member States to accelerate achievement of the EU 2020 objectives for broadband access<sup>(1)</sup>.*

*See also reply to point 8.20.*

**8.22.** *It is inherent to the annual nature of the annual activity report cycle that, within the multiannual period during which the policy and/or programme is being implemented, in the management part of the annual activity report the Authorising Officer by Delegation (AOD) focuses on the inputs and outputs which are under his management scope rather than already on the long term results and impacts of the policies and programmes, which can only be known at the end of the programme and which may also be influenced by other factors outside his management scope.*

*See also reply to paragraph 8.23.*

<sup>(1)</sup> Communication 'Cohesion policy: Strategic Report 2010 on the implementation of the programmes 2007-2013' (COM(2010) 110 final, 31.3.2010), p. 13; Communication 'Regional Policy contributing to smart growth in Europe 2020' (COM(2010) 553 final, 6.10.2010), p. 7.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.23. This was especially the case for DG AGRI, which provided, in its description of its policy achievements, almost no indication on the outcomes of its actions<sup>(13)</sup>. In comparison, some more significant information on results and impacts was provided by DG REGIO (qualitative assessment of the implementation of the operational programmes), and, to a lesser extent, by DG RTD (presentation of key results of the FP7 interim evaluation).

**8.23.** Extensive evaluation assessments are more appropriately done via dedicated evaluation reports, which are made across DGs and involve more than one Authorising Officer by Delegation (AOD). The format of the AAR, because of its nature as a management report, is not suited to include extensive reporting on the results of evaluation activities. Nevertheless, if one of those evaluations would provide indications that policy and/or management aspects should be reconsidered, then action would be taken. Only in such cases, this would then also be signalled via the AAR (cf. exception-based reporting).

In the description of the Directorate-General for Agriculture and Rural Development (DG AGRI) policy achievements the focus was set in reporting on the achievement of the priorities while adding some quantifiable data and also some relevant qualitative examples to illustrate such achievements per ABB activity. However, the information was presented taking into account the target audience — the general public — and therefore some concessions were made for easier readability, with the bulk of the performance information on results given in Annex 6 to the AAR.

### Comparability of performance information

**For DG AGRI and DG RTD, the objectives, indicators and targets set in the Management Plan were generally the ones used for reporting**

8.24. Regarding DG AGRI and DG RTD, the objectives, indicators and targets announced in the Annual Management Plan were generally the ones used to report on performance in the Annual Activity Report. There was however a small number of instances<sup>(14)</sup> in which there was no explanation for the modification of indicators or targets, resulting from various reasons, like the choice of a more specific and measurable indicator, new policy priorities, or updated information.

**8.24.** DG AGRI considers that there is a good overall stability over the years as regards indicators and targets. As underlined by the Court, the change in indicators and targets is an exception resulting from various reasons such as the choice of a more specific and measurable indicator and/or updated information. In the future, it will be paid particular attention to make the rationale for changes in indicators/revision of targets more explicit.

All instances of changes between objectives, indicators, and targets in the Management Plan and in the Annual Activity Report of DG RTD are justified. This justification could indeed be made more explicit in future AARs.

<sup>(13)</sup> Except in the area of the legality of expenditure, where the achievement of an error rate oscillating around 2% was mentioned as an outcome of the systems set in place.

<sup>(14)</sup> Out of the 11 impact indicators in DG AGRI's Management Plan, two were replaced by another and one target was modified in the Annual Activity Report. DG RTD modified two results indicators and dropped another. None of these changes were explained in the respective Annual Activity Reports.

## THE COURT'S OBSERVATIONS

**For DG REGIO, explanations were often not provided in the Annual Activity Report on the adjustments made to indicators and targets**

8.25. The objectives announced in the 2010 Management Plan were the ones used to report on performance in the Annual Activity Report. However, when DG REGIO wanted to reflect policy evolution and adjusted the indicators and targets, the corresponding explanations were not presented in the following 14 out of 16 adjustments examined:

- At the level of the seven impact indicators, one target had changed between the Management Plan and the Annual Activity Report without providing explanations for the difference.
- Regarding the ERDF results indicators, for instance, six <sup>(15)</sup> were added and one <sup>(16)</sup> was dropped without explaining the reasons for these adjustments.

## THE COMMISSION'S REPLIES

**8.25.** *In general, there is a good stability over years as regards indicators and targets for DG REGIO. In the 2010 Annual Activity Report, efforts have been made to present evolution of the known results to progressively attain the multiannual targets.*

*Revisions of indicators and targets reflect the ongoing progress towards reporting on and using up-to-date information available in official documents — and are identified by corresponding footnotes, with as much information as deemed appropriate. This process was explained in the 2009 AAR (page 21) stating that the core-indicators would be progressively used to follow-up the achievements of Cohesion Policy.*

*As a result of the crisis, some programmes adapted their strategies and funding allocations across priorities which had consequences for the related targets, as explained in page 7 of the Annual Activity Report. DG REGIO will seek to ensure that such modifications are captured in the AAR.*

- *Several environmental result indicators have been added for the ERDF activity (reduction of greenhouse gas emissions, flood protection, etc.). It is a positive revision in line with paragraph 8.18.*

<sup>(15)</sup> Reduction in greenhouse gas emissions, additional capacity of renewable energy production, number of people benefiting from flood protection measures, number of people benefiting from forest fire protection, additional population covered by broadband access, number of projects respecting two of cross-border criteria.

<sup>(16)</sup> Number of schools reconstructed.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

— Six ERDF targets were changed without explanation. They included the addition of a target of 170 000 SME support projects co-financed over the 2007-2013 period. For the five other changed targets for ERDF indicators <sup>(17)</sup>, different Member States were covered than at the planning stage. For instance, the target for 'additional population served by new/renovated wastewater projects' was set at 31,5 million for 16 Member States in the Management Plan, and became 12,5 million for 13 Member States in the Annual Activity Report. The differences were not explained in the report.

— *The Management Plan figures refer to figures at the time of negotiations, while in the Annual Activity Report, DG REGIO was able to report on targets and actual achievements as reported in the 2009 Annual Implementation Reports. Where appropriate, footnotes have been added to give additional data and keep the perimeter mentioned in the 2010 MP).*

*The new target of 170 000 SMEs represents an improvement of the reporting process as it was initially not possible to set a target when the Management Plan had been drafted.*

*In the absence of complete indicators at EU level, it is acceptable to present indicators for some Member States only according to Commission instructions and this situation has been accepted by the budgetary authority in the past.*

*In the Management Plan, the targets and the latest known results were sometimes presented for two different series of Member States. In order to improve the comparability of the latest known results and the targets DG REGIO has adjusted the figures using the same group of Member States.*

### Reliability of performance information

#### 17 out of 31 indicators traced back to a reliable source of information

8.26. The Court examined a sample of 31 indicators selected over the three DGs <sup>(18)</sup>. For 17 of these, the information on achieved results could be traced back to a reliable source. Generally it concerned data coming from external and recognised providers for statistics or internally managed databases, including accounting information.

**8.26.-8.27.** *Footnote 19: The indicator mentioned by the Court indeed refers to the 'Number of research infrastructures of world class relevance launched jointly at EU level' and will be amended accordingly.*

<sup>(17)</sup> The setting up of enterprises, the accessibility gain (kilometres of reconstructed rail and roads), the additional population served by new/renovated wastewater projects, the Research jobs created and the number of benefiting students from improved education infrastructure.

<sup>(18)</sup> The indicators were selected so as to ensure a high coverage of the main objectives of each DG.

## THE COURT'S OBSERVATIONS

**Weaknesses in the control system impairing reliability in the areas of regional policy and rural development**

8.27. Out of the 14 other indicators, eight results indicators for the European Regional Development Fund (ERDF) and four impact indicators for rural development <sup>(19)</sup> were consolidated by the respective DGs on the basis of information which the Member States provided on the implementation of the programmes. The Commission's ability to ensure that information supplied was reliable and comparable was hampered by legal limitations (see paragraph 8.28) and practical constraints (see paragraph 8.29).

8.28. In the area of the ERDF, there was no legal requirement to implement a *common* set of performance indicators, so that managing authorities were not obliged to use the set of 'Core indicators for ERDF and Cohesion Fund' defined in the 'Indicative guidelines on evaluation methods: monitoring and evaluation indicators' by the Commission in August 2006. Consequently, there was a high risk that the data collected on the Core indicators and used in Annex 7 to the Annual Activity Report might not be exhaustive or comparable <sup>(20)</sup>.

8.29. For both ERDF and rural development data, the Commission did not verify the reliability of the data provided by the bodies in charge in the Member States, beyond plausibility checks <sup>(21)</sup>. The information received through the information technology systems used for reporting to the Commission by the Member States was aggregated at programme or measure level. The Commission had no direct access to data at the level of the projects so that it could not perform more systematic in-depth checks.

## THE COMMISSION'S REPLIES

**8.27.** See reply to paragraph 8.29.

**8.28.** *The constraints identified by the Court relate to matters that should be put in perspective. DG REGIO has continuously developed and improved arrangements for reporting on performance. It has gone beyond regulatory requirements intended by the legislator, in particular with the establishment of 'core indicators'. However, DG REGIO is fully aware of those weaknesses and has been working to improve reporting on the recommended core indicators through working collaboratively with the Member States. Adjustments will be introduced in the future legal bases.*

**8.29.** *DG REGIO is checking the figures received from Member States (MS) and using its strong partnership with them and Regions to encourage and convince them to report more reliable figures. Nonetheless the legal requirements place the main responsibilities on Managing authorities in terms of project selection, objective setting and detailed monitoring. In terms of tracking the thematic use of EU financing the results of the 2009 annual programme reporting exercise has been discussed in different forums involving national authorities (COCOF, technical, annual meetings or monitoring committees) resulting in corrections in the data. The Commission's quality checking of the reporting in this information system will be continued and intensified.*

*For rural development, the Commission established a Common Monitoring and Evaluation Framework (CMEF) for the 2007-2013 programming period. It provides for the first time a single framework for monitoring and evaluation of all rural development interventions on the basis of common indicators.*

<sup>(19)</sup> The other two indicators were an indicator on the convergence towards Lisbon objectives in the regions based on Eurostat data that was significantly revised over the year, and an indicator on the number of research infrastructure built and operated jointly at EU level, that included data on infrastructure not yet built.

<sup>(20)</sup> This issue did not concern the indicators for rural development for which a common set of indicators had been defined in Article 62 of Commission Regulation (EC) No 1974/2006 (OJ L 368, 23.12.2006, p. 15).

<sup>(21)</sup> Verifying unit scales, identifying typing errors, and comparing data reported at programme or measure level with other information provided in the reporting.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

The Commission devoted a lot of efforts, in cooperation with the Member States, to fine-tune the quality and reliability of the information provided under this framework. The mid-term evaluation of rural development programmes suggests that difficulties persist in quantifying the impact indicators for several programmes. Further work on these is ongoing, in close cooperation with Member States, both in relation to the current programming period, and in preparation for the future.

Within this framework, the responsibility for the provision of reliable monitoring data relies on the Member States, in line with the repartition of competences under shared management. Considering the high number of projects and the broad range of Member States' project specificities, it is neither feasible nor cost effective for the Commission to verify at project level data provided by the Member States.

## THE COURT'S SPECIAL REPORTS ON PERFORMANCE

### Introduction

8.30. The Court's Special Reports examine whether the EU's intervention was managed in accordance with the principle of sound financial management. When choosing the topics for Special Reports, the Court considers the materiality of the audited area, the risks to sound financial management, previous coverage of related topics by the Court and other evaluations, and the relevance of the subject, i.e. the extent to which the audit results will help improve the effectiveness, efficiency and/or economy of EU expenditure.

8.31. The Special Reports adopted by the Court in 2010 are presented as following:

*Special Reports adopted by the Court of Auditors in 2010* <sup>(22)</sup>

- No 1/2010 'Are simplified customs procedures for imports effectively controlled?'
- No 2/2010 'The effectiveness of the Design Studies and Construction of New Infrastructures support schemes under the Sixth Framework Programme for Research'
- No 3/2010 'Impact Assessments in the EU institutions: do they support decision-making?'

<sup>(22)</sup> The Special Reports are available on the Court's website at the following address: <http://eca.europa.eu/portal/page/portal/publications/auditreportsandopinions/specialreports>

## THE COURT'S OBSERVATIONS

- No 4/2010 'Is the design and management of the mobility scheme of the Leonardo da Vinci programme likely to lead to effective results?'
- No 5/2010 'Implementation of the Leader approach for rural development'
- No 6/2010 'Has the reform of the sugar market achieved its main objectives?'
- No 7/2010 'Audit of the clearance of accounts procedure'
- No 8/2010 'Improving transport performance on trans-European rail axes: Have EU rail infrastructure investments been effective?'
- No 9/2010 'Is EU Structural Measures spending on the supply of water for domestic consumption used to best effect?'
- No 10/2010 'Specific measures for agriculture in favour of the outermost regions of the Union and the smaller Aegean islands'
- No 11/2010 'The Commission's management of General Budget Support in ACP, Latin American and Asian Countries'
- No 12/2010 'EU Development Assistance for Basic Education in Sub-Saharan Africa and South Asia'
- No 13/2010 'Is the new European Neighbourhood and Partnership Instrument successfully launched and achieving results in the Southern Caucasus (Armenia, Azerbaijan and Georgia)'
- No 14/2010 'The Commission's management of the system of veterinary checks for meat imports following the 2004 hygiene legislation reforms'

8.32. The 14 Special Reports adopted by the Court in 2010 made the following observations concerning the performance achieved and the process of producing results by spending EU funds, from the initial planning to reporting on performance.

## Court's observations concerning the process of producing results

### *Strategic planning*

8.33. In a number of its Special Reports (SRs) <sup>(23)</sup>, the Court highlighted the principles which govern good planning: initiatives should be set in a strategic context and prioritised; specific, measurable, achievable, relevant and timed (SMART) objectives should be established, and consistently articulated in the various planning documents; good *ex-ante* impact assessment can play an important role in the decision-making process.

8.34. In this respect, the Court found in the area of development assistance for basic education inappropriate strategic planning in capacity development initiatives (SR No 12/2010, paragraph 69), insufficient prioritisation and articulation of objectives in the neighbourhood policy (SR No 13/2010, paragraph 68), and, for the Leader approach, a lack of specific, measurable objectives, achievable within a set time frame (SR No 5/2010, paragraph 26). In its report on the Leonardo da Vinci mobility scheme, the Court found that the Commission had not finalised the setting up of SMART objectives and impact indicators to evaluate the success of the programme against its objectives and as a result the Commission had not been in a position to measure how the objectives were being met 3 years into the programme (SR No 4/2010, paragraphs 48, 50, 61 and 62).

8.35. The Court reported, however, improvements in the definition of objectives in the area of budget support to developing countries (SR No 11/2010, paragraphs 56 and 96), and an instance of good practice in the area of 'better regulation' where impact assessments had effectively supported decision-making in the EU (SR No 3/2010, paragraph 87).

### *Identification of needs*

8.36. In some of its observations <sup>(24)</sup>, the Court also illustrated that, if good results are to be produced, it is important clearly to identify the needs which the programmes are intended to fulfil.

**8.34.** *Strategic planning in capacity development is reliant on a clear demand from the partner country and government leadership. Lessons learnt in this area show that, without this ownership, external institutional support is unlikely to be used as the foundation for effective capacity development.*

*With regard to the Leonardo da Vinci mobility scheme, the Lifelong Learning Programme Committee adopted the indicators in its meeting of 17 June 2010. The Commission will provide a first report on these indicators to the Committee in the course of 2011.*

*As regards the Leader approach, the Commission agrees that the objectives of the individual local development strategies should be established in line with SMART criteria to the extent possible. In order to help local action groups in this task, rural development funding supports through the sub-measure 'acquiring skills', both assistance and training activities.*

**8.35.** *The Commission welcomes the recognition of the improvements made in the definition of budget support objectives. The EDFs' Annual Report also confirms the significant progress made by the Commission in demonstrating compliance with the eligibility criteria set by the Cotonou Agreement and in introducing formal assessment frameworks for public finance management performance.*

<sup>(23)</sup> SR No 12/2010, paragraph 69; SR No 13/2010, paragraph 68; SR No 5/2010, paragraph 26; SR No 11/2010, paragraphs 56 and 96; SR No 3/2010, paragraph 87; SR No 4/2010, paragraphs 48, 50, 61 and 62.

<sup>(24)</sup> SR No 8/2010, paragraph 63; SR No 9/2010, paragraph 72; SR No 13/2010, paragraph 70; SR No 5/2010, paragraph 48.

## THE COURT'S OBSERVATIONS

8.37. Thus the Court observed that the definition of Priority Projects for the trans-European rail axes should reflect present and anticipated needs (SR No 8/2010, paragraph 63).

8.38. It also pointed out that a good analysis of needs avoids fixing objectives which go beyond what is really required, while, at the same time, encourages alternative, less costly solutions (SR No 9/2010, paragraph 72).

*Link between objectives and measures*

8.39. In a number of its reports<sup>(25)</sup> the Court highlighted that the link must be clear between the objectives pursued and the measures chosen to reach those objectives.

8.40. When this link is not specified, it is unlikely that the design of the measures selected will be capable of achieving the objectives pursued (see SR No 10/2010, paragraph 34, concerning the specific case of the smaller Aegean islands). In the area of 'better regulation', the Court observed that the impact assessment reports did not provide a standardised presentation of how the objectives and expected outcomes of the proposed intervention could be achieved with the intended delivery mechanisms, and with regard to expenditure programmes, the estimated budget (SR No 3/2010, paragraph 60).

*Relevant, sufficient and proportionate means*

8.41. Some observations of the Court<sup>(26)</sup> underline the importance of an adequate selection of means to obtain set objectives.

## THE COMMISSION'S REPLIES

**8.37.** *With regard to the definition of Priority Projects for the trans-European rail axes, experience has shown that arriving at a definitive description of the main trans-European rail axes, while correct as an aspiration, is particularly difficult as they are in a constant state of flux depending on migration, trade patterns and the geopolitical context. Studies to analyse existing and expected traffic flows have been carried out, both for individual projects and for the network and have yet to lead to conclusive results. As a result, such a definition is not currently possible and Priority Projects should continue to be based on political agreements between the Council and the European Parliament based on the best available evidence.*

**8.40.** *The Commission agrees that the support programme for the smaller Aegean islands could be improved and is working in cooperation with the Greek authorities to this end.*

<sup>(25)</sup> SR No 10/2010, paragraph 34; SR 3/2010, paragraph 60; SR No 6/2010, paragraphs 94 and 96.

<sup>(26)</sup> SR No 12/2010, paragraph 66; SR No 7/2010, paragraph 90; SR No 9/2010, paragraph 53.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.42. In the area of development assistance for basic education in sub-Saharan Africa the Court pointed to the difficulty that the Commission has experienced in assigning staff with the appropriate profiles to the delegations, which weakens their ability to manage the programmes effectively (SR No 12/2010, paragraph 66). In the different context of the clearance of accounts procedure, the Court signalled that the corrections imposed, to be really effective, should have directly preventative or dissuasive consequences on those responsible for the irregularity (SR No 7/2010, paragraph 90).

**8.42.** *The Commission acknowledges that adequate qualified expertise in the field of education is essential. When education is a priority for a delegation, the Commission takes steps to ensure that adequate expertise is available, for example by delegating under the EU division of labour policy responsibility to a Member State which has relevant sectoral expertise, or by providing appropriate expertise from Headquarters through the geographical directorates with the support of thematic units. It is also planned that thematic networks will be developed to better link expertise in the thematic and geographical directorates in Headquarters with Delegations.*

*The conformity clearance is designed to exclude from EU financing expenditure which does not comply with EU rules. It is not a mechanism by which irregular payments to beneficiaries are recovered, which according to the principle of shared management is the sole responsibility of Member States.*

*Where undue payments to beneficiaries can be identified as a result of the conformity clearance, Member States are required to follow them up with recovery actions against these beneficiaries. Where recoveries are not needed because the financial correction relates to deficiencies in a Member State's management and control systems, the corrections are an important means to improve those systems and thus to prevent or detect and recover irregular payments to beneficiaries.*

*Moreover, agricultural legislation provides for effective, dissuasive and proportional sanctions to be imposed on beneficiaries who have received irregular payments.*

*Budget and time frame*

8.43. The Court pointed out in its reports<sup>(27)</sup> the importance of planning during the implementation phase of projects, to avoid overspending or delays.

8.44. In this respect, the Court observed that, regarding EU rail infrastructure investment, projects with less thorough and detailed preparation faced a higher risk of experiencing more significant cost escalations (SR No 8/2010, paragraph 46). The Court also noted that delays in implementing projects concerning domestic water supplies caused by additional requests imposed by environmental impact assessments, difficulties in obtaining administrative permits, inaccurate estimates or calculations could have been partly avoided by better planning (SR No 9/2010, paragraph 51).

**8.44.** *The Commission has repeatedly emphasised the importance of project planning by national and regional authorities in the context of Cohesion Fund projects and major projects under the Structural Funds. In the context of the 2007-2013 structural funds programming period the technical assistance facility JASPERS has been established specifically to support, mainly in the EU 12, better project design and planning.*

*However, planning is just one element affecting overspending and delays. As the Court also concluded in paragraph 45 of its Special Report on EU rail infrastructure investment that, 'In nearly all cases, these [cost] escalations arose for reasons linked to unforeseeable factors that came to light during the construction phase, such as unexpectedly difficult geographical conditions, environmental protection requirements, safety requirements and higher than expected bids from contractors'.*

<sup>(27)</sup> SR No 8/2010, paragraph 46; SR No 9/2010, paragraph 51; SR No 5/2010, paragraph 71.

## THE COURT'S OBSERVATIONS

*Controls and performance monitoring*

8.45. Some of the Court's observations<sup>(28)</sup> encouraged managers to improve systems of internal control, and to monitor performance by setting up appropriate mechanisms to record information and data on the achieved outcomes or on the level of performance.

8.46. For example, the Court observed that the reviews carried out to monitor EU-funded interventions in basic education in sub-Saharan Africa focussed in general on the processes and financial issues linked to specific disbursement conditions rather than on education outcomes (SR No 12/2010, paragraph 62). Similarly, it observed that the Local Action Groups responsible for implementing the Leader programme did not collect data on or assess whether local strategy objectives were met (SR No 5/2010, paragraph 31).

8.47. The Court also noted, however, efficient aspects of the supervisory and control systems, such as the role of the verifications carried out by the Food and Veterinary Office for maintaining a necessary control pressure (SR No 14/2010, paragraph 67), or the development by the Commission of a sound approach for controls on simplified customs procedures (SR No 1/2010, paragraph 81).

8.48. The Court underlined in one of its reports (SR No 10/2010, paragraph 40) the usefulness of an annual assessment of the programmes' implementation, indicating that such assessment enabled managers to bring effective modifications to ongoing programmes.

## THE COMMISSION'S REPLIES

**8.46.** *In relation to education sector policy support programmes financed by sectoral budget support, progress against outcome indicators (enrolment, completion, survival, and learning achievements in some cases) is assessed in Joint Reviews with other donors, led by the partner country. When agreeing performance monitoring arrangements with partners, the Commission considers that a good mix of outcome and process indicators provides the necessary comprehensive picture of the progress of the country in implementing its sector policy.*

*In relation to Leader, the Commission has provided further guidance to Member States on how to better monitor, assess and improve the Local Action Groups' (LAGs) strategies and their respective achievements. It has also launched in early 2011 a Focus Group on the quality of local development strategies, including monitoring and evaluation issues, under the European Network for Rural Development. The results, which will be available by the end of the year, will provide further tools and good practice to both Member States and LAGs.*

**8.47.** *The Food and Veterinary Office is constantly assessing both the effectiveness and the efficiency of its control work to ensure that resources are put to the best use.*

**8.48.** *The Commission has set common performance indicators whose assessment will help further improving the POSEI and the smaller Aegean Islands schemes.*

<sup>(28)</sup> SR No 12/2010, paragraph 62; SR No 5/2010, paragraph 31; SR No 10/2010, paragraph 79; SR No 10/2010, paragraph 40.

## Court's observations concerning achievements and reporting

### *Achievement of the objectives set*

8.49. Two of the Court's reports conclude positively on results achieved through interventions financed by the EU budget (SRs No 8/2010 and No 10/2010). The Court found that EU co-financed rail infrastructure projects delivered the planned infrastructure to specification, and, once completed, have created new and improved rail transport possibilities on key sections of the Priority Projects (SR No 8/2010, paragraph 65). Regarding specific measures for agriculture in favour of the outermost regions of the Union and the smaller Aegean islands, the programmes were in general implemented effectively and thus met the needs of these regions (SR No 10/2010, paragraph 82).

8.50. Other special reports present more mixed results, with some important objectives not met (SRs No 6/2010, No 9/2010, No 12/2010 and No 13/2010). The Court observed that where there are conflicting objectives it is difficult for them to be achieved simultaneously (SR No 6/2010, paragraphs 93 and 99). Whilst structural measures spending has contributed to improving the supply of water for domestic use, better results could have been achieved at a lower cost to the EU budget (SR No 9/2010, paragraph 71).

### *Reporting on performance*

8.51. In its reports, the Court drew attention<sup>(29)</sup> to the need for appropriate reporting structures and relevant, comparable and reliable data to enable assessment of the correspondence between the objectives fixed and the results obtained.

8.52. In its report on the Leonardo da Vinci mobility scheme, the Court noted that as the annual work programme was structured differently from the annual activity report, it was not possible to make a meaningful comparison of results against planned performance (SR No 4/2010, paragraph 41). The Court also observed that the Commission and the Member States were not able to establish the effectiveness of Leader programmes in delivering of rural development outcomes in the absence or unreliability of data either in absolute terms or in relation to the effectiveness of other delivery methods (SR No 5/2010, paragraph 100).

**8.50.** *The objectives of the 2006 reform of the EU sugar market are directly linked to the objectives of the common agricultural policy (CAP), which are enshrined in the Treaties. It is not a shortcoming of the reform to have partly diverging objectives, but rather a result of its comprehensive scope. The Commission considers that the sugar reform has successfully managed the restructuring of the sector, providing it with a long-term policy framework and considerably improving its competitiveness.*

**8.52.** *With regard to the Leonardo da Vinci mobility scheme — as announced in the action plan in reply to the Court's report — an internal working group of DG Education and Culture revised the requirements and form of the Yearly National Agency Report in the second quarter of 2011. The revised report form is now in line with the structure and content of the National Agency work programme revised for 2011. As a consequence the Yearly NA Report on the year 2011 (to be received by the Commission in 2012) will allow meaningful comparison of results against planned performance.*

<sup>(29)</sup> SR No 4/2010, paragraph 41; SR No 5/2010, paragraph 100.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**CONCLUSIONS AND RECOMMENDATIONS**

8.53. As noted at the beginning of this chapter, the Financial Regulation provides that the Annual Activity Reports shall indicate the results of the operations by reference to the objectives set, the risks associated with these operations, the use made of resources provided and the efficiency and effectiveness of the internal control system<sup>(30)</sup>. The Court observed that the differences between planned targets and achievements were often not analysed (see paragraph 8.16) and that the framework for reporting on effectiveness did not cover economy and efficiency of the spending (see paragraph 8.17).

8.54. The absence of appropriate interim milestones hindered the assessment of whether the progress made could be considered on track towards the achievement of multi-annual objectives (see paragraphs 8.20 and 8.21).

8.55. The Court noted that the objectives, indicators and targets set in the Management Plans were generally those used for reporting in the Annual Activity Reports (see paragraphs 8.24 and 8.25).

8.56. Legal limitations and practical constraints impaired the reliability of the planning and reporting information collected by the DGs from Member States regarding programmes under shared management (see paragraphs 8.27 to 8.29).

*The mid-term evaluation of Leader+ took place at an early stage in LAG strategy implementation. However, the ex-post evaluation of Leader+, which was finalised in December 2010, provides useful information on the effectiveness and efficiency of Leader interventions. This information will be useful in the context of the ongoing work on the post-2013 CAP policy framework.*

**8.53.** *The Commission agrees that departure of actual achievements from the planned targets could be better explained in future Annual Activity Reports.*

*According to Article 60(7) of the Financial Regulation, it is the efficiency and effectiveness of the internal control system which has to be reported in the AAR and not the efficiency and effectiveness of the EU actions. The content of the AAR is defined according to the requirements of this provision. In any case, thanks to the line of consistency provided by the ABB nomenclature, the human and financial resources (as shown in Annexes 2 and 3) allocated to each ABB activity are clearly identified and can be linked with the indicators in the corresponding Annex, thus making it possible to assess the economy and efficiency in the management of the resources available.*

**8.54.** *For multiannual programmes it is not always meaningful to set interim milestones, as impacts will only be reached in a non-linear way at the end of the programming period. The annual reporting on inputs, outputs and results, i.e. the monitoring of the progress in programme implementation, does allow for a regular assessment of the progress towards the attainment of the objectives.*

**8.56.** *For rural development, the Commission established a Common Monitoring and Evaluation Framework (CMEF) for the 2007-2013 programming period. It provides for the first time a single framework for monitoring and evaluation of all rural development interventions on the basis of common indicators.*

*Within this framework, the responsibility for the provision of reliable monitoring data relies on the Member States, in line with the repartition of competences under shared management. Considering the high number of projects and the broad range of Member States' project specificities, it is neither feasible nor cost effective for the Commission to verify at project level data provided by the Member States.*

*See also reply to point 8.29.*

<sup>(30)</sup> Article 60(7), second subparagraph, of the Financial Regulation.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.57. The Court concludes that the quality of the planning phase is important in determining how the intended results can be obtained. Insufficient or weak planning, including the absence of SMART objectives, may produce delays, additional costs, and affect the results achieved (see paragraphs 8.33 to 8.44).

8.58. It is important for the management's accountability that the results reported correspond to the objectives and indicators set in the management plan and that appropriate monitoring and control systems are in place to obtain reliable information for reporting on results (see paragraphs 8.45 to 8.48 and 8.51 to 8.52).

8.59. The Court makes the following recommendations:

- **Recommendation 1:** Increased focus should be put on performance in the DG Annual Activity Reports, in particular by analysing differences between planned targets and achievements as well as by reporting on the economy and efficiency of EU funding (see paragraph 8.53).
- **Recommendation 2:** The Commission services should define appropriate interim milestones for multiannual targets, so that progress can be assessed adequately (see paragraph 8.54).
- **Recommendation 3:** The Commission and the Member States within the context of their respective responsibilities under shared management should agree on consistent performance indicators and ensure the reliability of information on planned targets and achieved results (see paragraph 8.56).

**8.57.** *The Commission agrees on the importance of the planning phase and the need to rely on SMART objectives.*

**8.58.** *The Commission agrees that it is important for the management's accountability that the results reported correspond to the objectives and indicators set in the management plan and that appropriate monitoring and control systems should be in place to obtain reliable information for reporting on results.*

*The Commission is committed to constantly improving its monitoring and control systems to ensure that they are appropriate and adequate to deliver the necessary information reliably.*

**8.59.**

- *Differences between planned targets and actual achievement against objectives set could indeed be better explained.*

*However, MP and AAR are not intended to provide detailed information on economy and efficiency (See replies to paragraphs 8.17 and 8.53).*

*For the programmes in the area of structural funds, the assessment of the economy and efficiency of the funding schemes is highly dependent on the willingness and the ability of Member States to report on issues like the unit costs or the links between outputs and categories of expenditure. This is not possible across all the programmes in a synthetic way under the current legal framework.*

- *For output, result and, where appropriate, impact indicators, interim milestones could indeed be defined.*

*For outputs, it is possible to define milestones for multiannual targets at least at programme level. However, this seems more artificial for results indicators due to the different contributing factors. Nevertheless, the Commission is willing to include some further requirements in the future regulations asking for progress reports of the newly proposed partnership contracts in particular in respect of milestones set out in the performance framework.*

- *Under shared management, the Commission plays a supervisory role by satisfying itself that the arrangements governing management and control systems are compliant, and by verifying the effective functioning of the systems.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- **Recommendation 4:** During the planning of EU expenditure programmes, the Commission and the Member States should pay greater attention to defining SMART objectives, as well as to identifying and mitigating the risks which may occur during implementation (see paragraph 8.57).
  
- **Recommendation 5:** Accountability of the management should also be understood to include reporting on results with a correspondence between achievements expected in the management plan and achievements reported in the Annual Activity Report (see paragraph 8.58).
  
- **Recommendation 6:** The Commission, together with the Member States where appropriate in the context of shared management, should design and operate monitoring and control systems to produce complete and accurate information on results (see paragraph 8.58).

*In this context, the Commission has already engaged such a process with Member States.*

*For rural development, the Commission has already established a Common Monitoring and Evaluation Framework (CMEF) for the 2007-2013 programming period which provides for the first time a single framework for monitoring and evaluation of all rural development interventions on the basis of common indicators.*

*The Commission intends to work more closely with the Member States to further improve the CMEF for the next programming period. A first seminar on CAP monitoring and evaluation is already scheduled for September 2011.*

*For the Structural Funds, the Commission will propose to agree on common output indicators for the future regulation post 2013 and will agree a methodology for the identification of appropriate result indicators which must be context specific. The verification of planned targets and the reporting of achieved results will still be under the responsibility of Member States (see reply to recommendation 6).*

- *The Commission always endeavours to define SMART objectives and to pay attention to identifying and mitigating the risks which may occur during implementation. These efforts would be further re-enforced in the future.*
  
- *The Commission agrees that it is important for the management's accountability that the results reported correspond to the objectives and indicators set in the management plan, as is already the case for the large majority of them, and that appropriate follow-up and control systems should be in place to obtain reliable information for reporting on results.*

*The Commission should maintain a flexible approach to be able to disclose in the Annual Activity Report the latest data even if they were not anticipated in the Management Plan. However, it will present data so as to allow the comparability of the two exercises.*

- *For the programmes under shared management, the Commission will propose some key requirements for the design of the systems to produce information on results in the frame of the future regulations post 2013. The responsibility for operating those systems in order to provide complete and accurate information on results lies with the Member States in line with the division of competences under shared management.*

## ANNEX

**Financial information on the general budget**

## CONTENTS

## BACKGROUND INFORMATION ON THE BUDGET

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6. Types of budget appropriation
7. Implementation of the budget
  - 7.1. Responsibility for implementation
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  - 7.4. The consolidated statements on budgetary implementation and determination of the balance of the financial year
8. Presentation of the accounts
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## DIAGRAMS RELATED TO THE BUDGET AND THE CONSOLIDATED ACCOUNTS FOR THE FINANCIAL YEAR 2010

## BACKGROUND INFORMATION ON THE BUDGET

### 1. ESTABLISHMENT OF THE BUDGET

The budget comprises the revenue and the expenditure of the European Union as approved by the Council and the European Parliament. It also includes the common foreign and security policy, as well as all other expenditure that the Council considers should be borne by the budget for the purpose of implementing these policies.

### 2. LEGAL BASIS

The budget is governed by the financial provisions of the Treaties (Articles 310 to 325 TFEU and 106a EAEC) <sup>(1)</sup> and by the financial regulations <sup>(2)</sup>.

### 3. BUDGETARY PRINCIPLES LAID DOWN IN THE TREATIES AND THE FINANCIAL REGULATION

All items of European Union revenue and expenditure are to be included in a single budget (unity and accuracy). The budget is authorised for one financial year only (annuality). Budgetary revenue and expenditure must balance (equilibrium). The accounts are established, implemented and presented in euro (unit of account). Revenue is to be used without distinction to finance all expenditure and, like the expenditure, is to be entered in full in the budget and subsequently in the financial statements without any adjustment of one item against another (universality). The appropriations are earmarked for specific purposes by title and chapter; the chapters are further subdivided into articles and items (specification). The budgetary appropriations are to be used in accordance with the principles of economy, efficiency and effectiveness (sound financial management). The budget is established and implemented and the accounts are presented in observance of the principle of transparency (transparency). There are some exceptions to these general principles.

### 4. CONTENT AND STRUCTURE OF THE BUDGET

The budget consists of a 'Summary statement of revenue and expenditure' and sections divided into 'Statements of revenue and expenditure' for each institution. The nine sections are: (I) Parliament; (II) Council; (III) Commission; (IV) Court of Justice; (V) Court of Auditors; (VI) Economic and Social Committee; (VII) Committee of the Regions; (VIII) European Ombudsman and (IX) European Data-protection Supervisor.

Within each section, items of revenue and expenditure are classified under budget headings (titles, chapters, articles and, where applicable, items) according to their type or the use to which they are to be applied.

### 5. FINANCING OF THE BUDGET (BUDGETARY REVENUE)

The budget is mainly financed from the European Union own resources: GNI-based own resources; own resources accruing from VAT; customs duties; agricultural duties and sugar and isoglucose levies <sup>(3)</sup>.

Besides own resources, there are other items of revenue (see **Diagram I**).

### 6. TYPES OF BUDGET APPROPRIATION

To cover estimated expenditure, the following types of budget appropriation are distinguished in the budget:

(a) differentiated appropriations (DA) are used to finance multiannual activities in certain budgetary areas. They comprise commitment appropriations (CA) and payment appropriations (PA):

- commitment appropriations make it possible to enter into legal obligations during the financial year for activities whose implementation extends over several financial years,
- payment appropriations make it possible to cover expenditure arising from commitments entered into during current and preceding financial years;

<sup>(1)</sup> See list of abbreviations in the Explanatory Notes.

<sup>(2)</sup> Mainly the Financial Regulation (FINREG) of 25 June 2002 (OJ L 248, 16.9.2002).

<sup>(3)</sup> Principal legal acts relating to own resources: Council Decision 2007/436/EC, Euratom (OJ L 163, 23.6.2007, p. 17); Council Decision 2000/597/EC, Euratom (OJ L 253, 7.10.2000, p. 42); Council Regulation (EC, Euratom) No 1150/2000 (OJ L 130, 31.5.2000, p. 1).

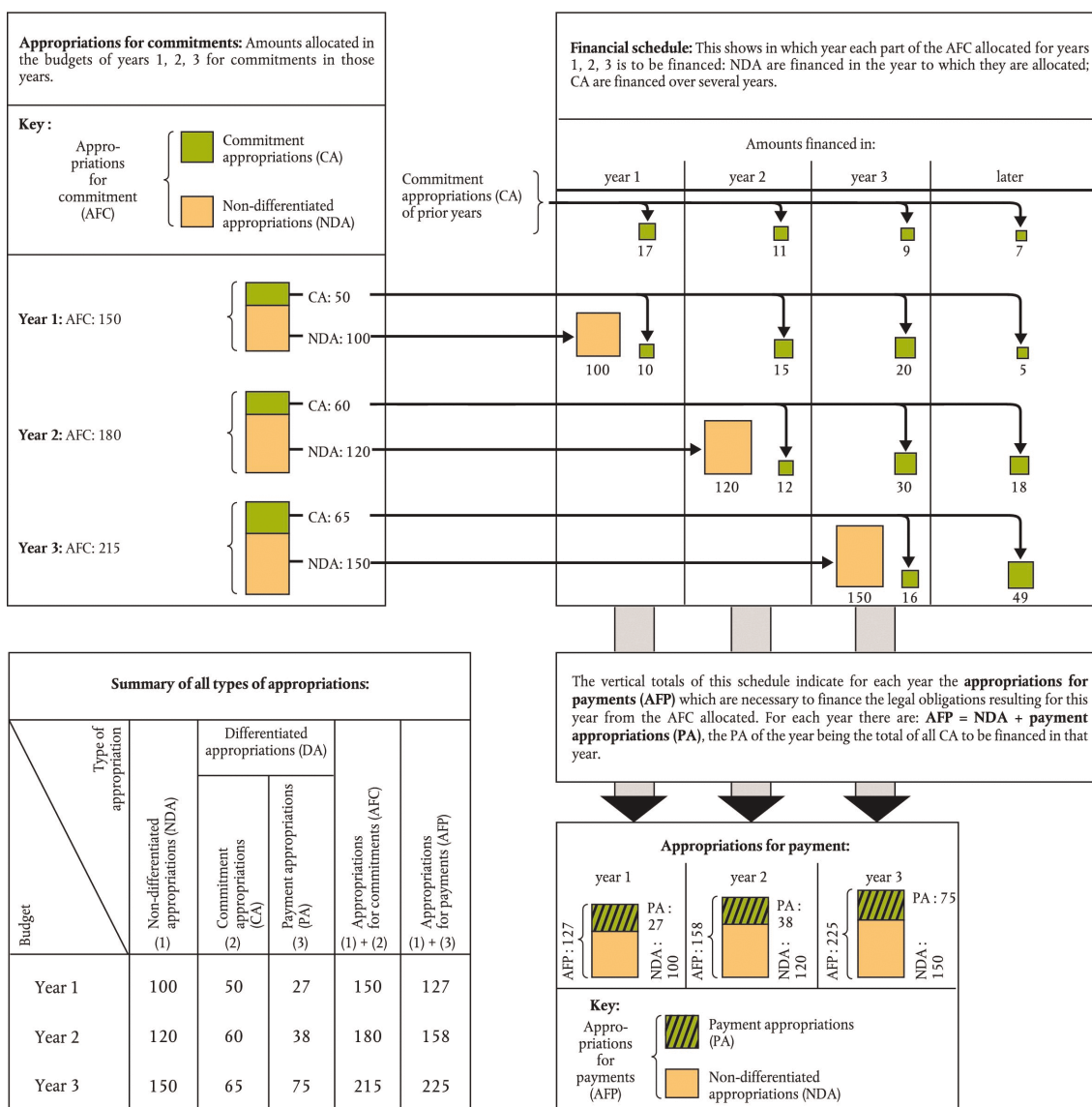
(b) non-differentiated appropriations (NDA) make it possible to ensure the commitment and payment of expenditure relating to annual activities during each financial year.

It is thus important to establish the following two totals for each financial year:

- (a) the total of appropriations for commitments (AFC) <sup>(4)</sup> = non-differentiated appropriations (NDA) + commitment appropriations (CA) <sup>(4)</sup>;
- (b) the total of appropriations for payments (AFP) <sup>(4)</sup> = non-differentiated appropriations (NDA) + payment appropriations (PA) <sup>(4)</sup>.

Revenue raised in the budget is intended to cover the total appropriations for payments. Commitment appropriations do not need to be covered by revenue.

The following simplified presentation (with illustrative amounts) shows the impact of these types of appropriations in each budget year.



<sup>(4)</sup> It is important to note the differences between 'appropriations for commitments' and 'commitment appropriations' and between 'appropriations for payments' and 'payment appropriations'. The two terms 'commitment appropriations' and 'payment appropriations' are used exclusively in the context of differentiated appropriations.

## 7. IMPLEMENTATION OF THE BUDGET

### 7.1. Responsibility for implementation

The Commission implements the budget on its own responsibility in accordance with the Financial Regulation and within the limits of the allotted appropriations; it also confers upon the other institutions the requisite powers for the implementation of the sections of the budget relating to them<sup>(5)</sup>. The Financial Regulation lays down the implementation procedures and, in particular, the responsibilities of the authorising officers, accounting officers, administrators of imprest accounts and internal auditors of the institutions. In the two largest areas of expenditure (EAGF and Cohesion) the management of European Union funds is shared with the Member States.

### 7.2. Implementation of revenue

The estimated revenue is entered in the budget subject to changes deriving from amending budgets.

The budgetary implementation of revenue consists of establishing the entitlements and recovering the revenue due to the European Union (own resources and other revenue). It is governed by certain special provisions<sup>(6)</sup>. The actual revenue of a financial year is defined as the total of sums collected against entitlements established during the current financial year and sums collected against entitlements still to be recovered from previous financial years.

### 7.3. Implementation of expenditure

The estimated expenditure is entered in the budget.

The budgetary implementation of expenditure, i.e. the evolution and utilisation of appropriations, may be summarised as follows:

#### (a) appropriations for commitments:

- (i) *evolution of appropriations*: the total appropriations for commitments available in a financial year are made up as follows: initial budget (NDA and CA) + amending budgets + assigned revenue + transfers + appropriations for commitments carried over from the preceding financial year + released commitment appropriations from preceding financial years which have been made available again;
- (ii) *utilisation of appropriations*: the final appropriations for commitments are available in the financial year for use in the form of commitments entered into (appropriations for commitments utilised = amount of commitments entered into);
- (iii) *carry-overs of appropriations from one financial year to the next financial year*: appropriations belonging to the financial year which have not been utilised may be carried over to the next financial year following a decision by the institution concerned. Appropriations available as assigned revenue are automatically carried over;
- (iv) *cancellation of appropriations*: the balance is cancelled;

#### (b) appropriations for payments:

- (i) *evolution of appropriations*: the total appropriations for payments available in a financial year are made up as follows: initial budget (NDA and PA) + amending budgets + assigned revenue + transfers + appropriations carried over from the previous financial year in the form of automatic carry-overs or non-automatic carry-overs;
- (ii) *utilisation of appropriations of the financial year*: the appropriations for payments of the financial year are available in the financial year for use as payments. They do not include appropriations carried over from the previous financial year (utilised appropriations for payments = amount of payments made against the appropriations of the financial year);
- (iii) *carry-overs of appropriations from one financial year to the next financial year*: unutilised appropriations of the financial year may be carried over to the next financial year following a decision by the institution concerned. Appropriations available as assigned revenue are automatically carried over;

<sup>(5)</sup> See Articles 317 TFEU, 106a EAEC and 50 of the FINREG.

<sup>(6)</sup> See Articles 69 to 74 of the FINREG and Regulation (EC, Euratom) No 1150/2000.

- (iv) *cancellation of appropriations*: the balance is cancelled;
- (v) *total payments during the financial year*: payments against appropriations for payments of the financial year + payments against appropriations for payments carried over from the preceding financial year;
- (vi) *actual expenditure charged to a financial year*: expenditure in the consolidated statements on budgetary implementation (see paragraph 7.4) = payments against appropriations for payments of the financial year + appropriations for payments of the financial year carried over to the following financial year.

#### **7.4. The consolidated statements on budgetary implementation and determination of the balance of the financial year**

The consolidated statements on budgetary implementation are drawn up after the closure of each financial year. They determine the balance of the year, which is entered in the budget of the next financial year through an amending budget.

#### **8. PRESENTATION OF THE ACCOUNTS**

The accounts for a given financial year are forwarded to the Parliament, the Council and the Court of Auditors; these accounts comprise financial statements and statements on budgetary implementation, together with a report on the budgetary and financial management. The provisional accounts are forwarded not later than 31 March of the following year; the final accounts are due on 31 July of that year.

#### **9. EXTERNAL AUDIT**

Since 1977 the external audit of the budget has been carried out by the Court of Auditors of the European Union <sup>(7)</sup>. The Court of Auditors examines the accounts of all revenue and expenditure of the budget. It must 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. It also considers whether revenue has been received and expenditure incurred in a lawful and regular manner, and whether the financial management has been sound. The audits may be carried out before the closure of the financial year in question and are performed on the basis of records and, where necessary, on the spot in the institutions of the Union, in the Member States and in third countries. The Court of Auditors draws up an annual report for each financial year and may also, at any time, submit its observations on specific questions and deliver opinions at the request of any of the institutions of the Union.

#### **10. DISCHARGE AND FOLLOW-UP**

Since 1977 the following provisions have been applicable <sup>(8)</sup>: Parliament, on the recommendation of the Council, gives, before 30 April of the second year following the financial year in question, discharge to the Commission in respect of its implementation of the budget. To this end, the Council and Parliament in turn examine the accounts presented by the Commission and the annual report and special reports of the Court of Auditors. The institutions must take appropriate action in response to the comments appearing in the decisions giving discharge and report on the measures taken.

<sup>(7)</sup> See Articles 285 to 287 TFEU, 106a EAEC and Articles 139 to 147 of the FINREG.

<sup>(8)</sup> See Articles 319 TFEU and 106a EAEC.

**EXPLANATORY NOTES****SOURCES OF FINANCIAL DATA**

The financial data contained in this Annex have been drawn from the annual accounts of the European Union and from other financial records provided by the Commission. The geographical distribution is in accordance with the country codes in the Commission's system of accounting information (ABAC). As the Commission points out, all the figures given by Member State — for both revenue and expenditure — are the result of arithmetic that gives an incomplete view of the benefits that each State derives from the Union. They must therefore be interpreted with circumspection.

**MONETARY UNIT**

All the financial data are presented in millions of euro. The totals are rounded from each exact value and will not therefore necessarily represent the sum of the rounded figures.

**ABBREVIATIONS AND SYMBOLS**

AFC	Appropriations for commitments
AFP	Appropriations for payments
AT	Austria
BE	Belgium
BG	Bulgaria
CA	Commitment appropriations
CY	Cyprus
CZ	Czech Republic
DA	Differentiated appropriations
DE	Germany
DIA	Diagram referred to within other diagrams (e.g. DIA III)
DK	Denmark
EAEC or Euratom	European Atomic Energy Community
EC	European Community(ies)
EE	Estonia
EFTA	European Free Trade Association
EL	Greece
ES	Spain
EU	European Union
EU-27	Total for the 27 Member States of the European Union
FI	Finland
FR	France
FINREG	Financial Regulation of 25 June 2002
GNI	Gross National Income
HU	Hungary
IE	Ireland



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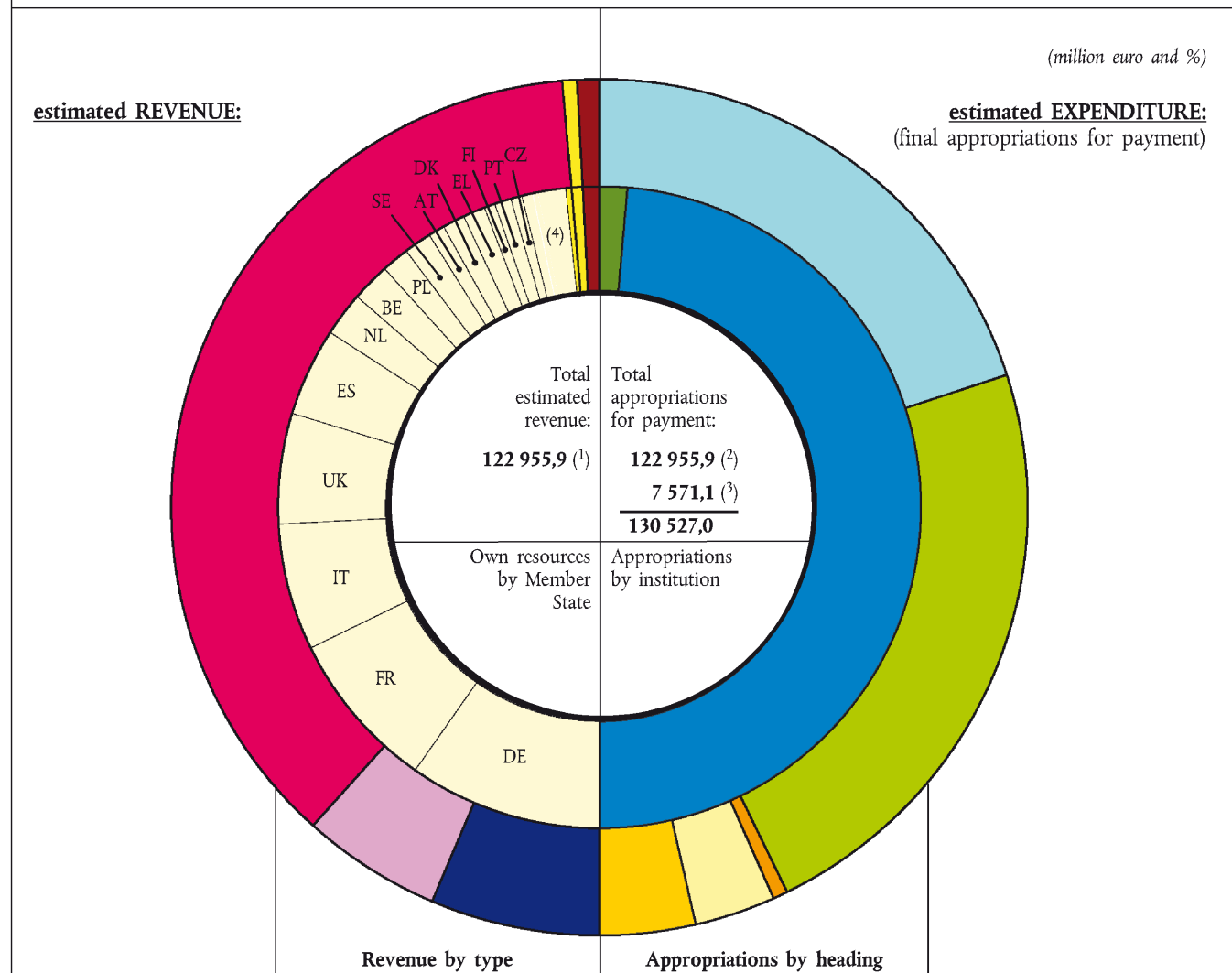
IT	Italy
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NDA	Non-differentiated appropriations
NL	Netherlands
OJ	<i>Official Journal of the European Union</i>
PA	Payment appropriations
PL	Poland
PT	Portugal
RO	Romania
S	Budgetary section
SE	Sweden
SI	Slovenia
SK	Slovakia
T	Budgetary title
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
VAT	Value-added tax
0,0	Data between zero and 0,05
—	Lack of data

**DIAGRAMS RELATED TO THE BUDGET AND THE CONSOLIDATED ACCOUNTS FOR THE FINANCIAL YEAR 2010**

DIA I	Budget 2010 — Estimated revenue and final appropriations for payments
DIA II	Budget 2010 — Appropriations for commitments
DIA III	Appropriations for commitments available in 2010 and utilisation thereof
DIA IV	Appropriations for payments available in 2010 and utilisation thereof
DIA V	Own resources in 2010, by Member State
DIA VI	Payments made in 2010, in each Member State
DIA VII	Consolidated balance sheet
DIA VIII	Consolidated economic outturn account

**Diagram I**  
**Budget 2010 — Estimated revenue and final appropriations for payments**

[for revenue criteria, see 'Background information on the budget', paragraph 7.2; for expenditure criteria, see 'Background information on the budget', paragraph 7.3, and for more detailed information, see Diagram IV, column (a)]



#### Revenue key

Total own resources (by Member State)		
Agricultural duties	—	(0 %)
'Sugar' and 'isoglucose' levies	123,4	(0,1 %)
Customs duties	15 595,8	(12,7 %)
Own resources accruing from VAT	13 277,3	(10,8 %)
GNI-based own resources	90 273,5	(73,4 %)
Other revenue	1 432,3	(1,2 %)
Surplus available from the previous year	2 253,6	(1,8 %)

#### Expenditure key

##### Financial framework headings

1. Sustainable Growth	52 103,0	(39,9 %)
2. Preserv. and Management of Natural Resources	59 630,4	(45,7 %)
3. Citizenship, freedom, security and justice	1 616,6	(1,2 %)
4. EU as a global player	8 101,2	(6,2 %)
5. Administration	9 075,8	(7 %)
6. Compensation	—	(0 %)
Appropriations available for other institutions	3 495,9	(2,7 %)
Appropriations available to the Commission	127 031,1	(97,3 %)
of which operating appropriations	121 451,2	(93 %)

(1) After amending budgets.

(4) Revenue contribution by IE, RO, HU, SK, SI, BG, LT, LU, CY, LV, EE, MT was grouped together.

(2) After amending budgets and transfers between budget headings.

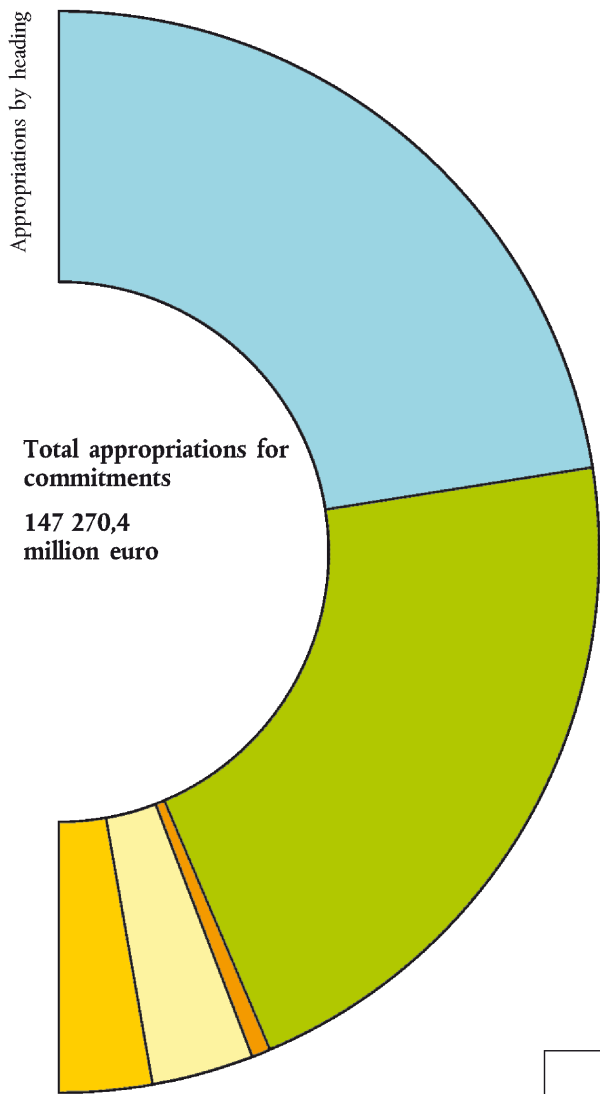
(3) Assigned revenue and appropriations carried over.









**Diagram II**  
**Budget 2010 — Appropriations for commitments**

[after amending budgets; for more detailed information, see Diagram III, column (a)]

(million euro and %)



**Note:**  
 The total appropriations for commitment are not balanced by the budgetary revenue of 2010 as the commitment appropriations also include amounts to be financed by budgetary revenue from subsequent years.

Expenditure key		
Financial framework headings		
	1. Sustainable Growth	66 243,2 (45 %)
	2. Preserv. and Managem. of Natural Resources	62 311,6 (42,3 %)
	3. Citizenship, freedom, security and justice	1 905,8 (1,3 %)
	4. EU as a global player	8 417,9 (5,7 %)
	5. Administration	8 391,9 (5,7 %)
	6. Compensation	— (0 %)



**Diagram III**  
**Appropriations for commitments available in 2010 and utilisation thereof**

(million euro and %)

Sections (S) and titles (T) corresponding to the 2010 budgetary nomenclature and financial framework headings	Final appropriations	Utilisation of appropriations					
	Amount (1)	Commitments entered into	Utilisation rate (%)	Carry-overs to 2011	Rate (%)	Cancellations	Rate (%)
	(a)	(b)	(b)/(a)	(c)	(c)/(a)	(d) = (a) - (b) - (c)	(d)/(a)
<b>Budgetary nomenclature</b>							
I Parliament (S. I)	1 752,4	1 585,8	90,5	110,6	6,3	55,9	3,2
II Council (S. II)	703,3	633,5	90,1	29,1	4,1	40,7	5,8
III Commission (S. III)	144 100,2	139 832,5	97,0	3 645,3	2,5	622,4	0,4
III.1 Economic and financial affairs (T.01)	455,0	450,8	99,1	1,5	0,3	2,7	0,6
III.2 Enterprise (T.02)	907,0	844,7	93,1	51,5	5,7	10,7	1,2
III.3 Competition (T.03)	95,3	92,3	96,9	2,1	2,2	0,9	1,0
III.4 Employment and social affairs (T.04)	11 414,0	11 378,1	99,7	25,9	0,2	10,0	0,1
III.5 Agriculture and rural development (T.05)	60 878,5	58 880,4	96,7	1 967,2	3,2	30,8	0,1
III.6 Energy and transport (T.06)	5 089,4	4 863,9	95,6	215,3	4,2	10,1	0,2
III.7 Environment (T.07)	494,3	458,7	92,8	12,9	2,6	22,8	4,6
III.8 Research (T.08)	5 911,7	5 544,6	93,8	366,0	6,2	1,1	0,0
III.9 Information society and media (T.09)	1 816,9	1 692,0	93,1	121,0	6,7	4,0	0,2
III.10 Direct research (T.10)	847,2	461,7	54,5	385,2	45,5	0,4	0,0
III.11 Maritime affairs and fisheries (T.11)	1 005,2	977,1	97,2	3,2	0,3	25,0	2,5
III.12 Internal market (T.12)	77,6	76,2	98,2	1,3	1,6	0,1	0,1
III.13 Regional policy (T.13)	39 020,1	38 980,7	99,9	23,4	0,1	16,0	0,0
III.14 Taxation and customs union (T.14)	139,0	132,8	95,5	1,6	1,1	4,6	3,3
III.15 Education and culture (T.15)	1 816,7	1 641,0	90,3	173,0	9,5	2,7	0,2
III.16 Communication (T.16)	222,8	217,3	97,5	1,8	0,8	3,7	1,7
III.17 Health and consumer protection (T.17)	703,5	676,0	96,1	8,7	1,2	18,7	2,7
III.18 Area of freedom, security and justice (T.18)	1 128,1	1 070,0	94,8	53,1	4,7	5,0	0,4
III.19 External relations (T.19)	4 449,7	4 358,8	98,0	85,8	1,9	5,0	0,1
III.20 Trade (T.20)	80,5	78,2	97,1	1,3	1,6	1,1	1,4
III.21 Development and relations with ACP States (T.21)	1 737,1	1 686,2	97,1	49,1	2,8	1,8	0,1
III.22 Enlargement (T.22)	1 035,2	1 023,4	98,9	10,1	1,0	1,6	0,2
III.23 Humanitarian aid (T.23)	1 069,7	1 058,0	98,9	2,1	0,2	9,6	0,9
III.24 Fight against fraud (T.24)	77,7	76,7	98,8	0,0	0,0	0,9	1,2
III.25 Commission's policy coordination and legal advice (T.25)	198,6	192,9	97,1	4,4	2,2	1,4	0,7
III.26 Commission's Administration (T.26)	1 111,3	1 070,4	96,3	38,2	3,4	2,6	0,2
III.27 Budget (T.27)	67,0	63,5	94,7	2,7	4,0	0,9	1,3
III.28 Audit (T.28)	11,6	11,2	96,3	0,3	2,6	0,1	1,2
III.29 Statistics (T.29)	152,9	138,7	90,7	7,8	5,1	6,4	4,2
III.30 Pensions and related expenditure (T.30)	1 209,6	1 205,2	99,6	0,0	0,0	4,5	0,4
III.31 Language Services (T.31)	461,7	431,2	93,4	28,8	6,2	1,7	0,4
III.40 Reserves (T.40)	415,3	—	—	—	—	415,3	100,0
IV Court of Justice (S. IV)	331,5	324,5	97,9	1,5	0,4	5,5	1,7
V Court of Auditors (S. V)	148,6	138,2	93,0	0,4	0,3	10,0	6,7
VI Economic and Social Committee (S. VI)	127,2	124,7	98,0	0,2	0,1	2,4	1,9
VII Committee of the Regions (S. VII)	90,8	90,3	99,4	0,0	0,0	0,5	0,6
VIII European Ombudsman (S. VIII)	9,3	8,4	89,7	—	—	1,0	10,3
IX European Data Protection Supervisor (S. IX)	7,1	5,9	82,7	—	—	1,2	17,3
<b>Grand total appropriations for commitments</b>	<b>147 270,4</b>	<b>142 743,8</b>	<b>96,9</b>	<b>3 787,0</b>	<b>2,6</b>	<b>739,6</b>	<b>0,5</b>
<b>Financial Framework</b>							
1 Sustainable Growth	66 243,2	64 453,3	97,3	1 311,9	2,0	478,0	0,7
2 Preservation and Management of Natural Resources	62 311,6	60 250,8	96,7	1 969,9	3,2	91,0	0,1
3 Citizenship, freedom, security and justice	1 905,8	1 795,2	94,2	97,5	5,1	13,1	0,7
4 EU as a global player	8 417,9	8 247,2	98,0	154,2	1,8	16,5	0,2
5 Administration	8 391,9	7 997,3	95,3	253,7	3,0	141,0	1,7
6 Compensation	—	—	—	—	—	—	—
<b>Grand total appropriations for commitments</b>	<b>147 270,4</b>	<b>142 743,8</b>	<b>96,9</b>	<b>3 787,0</b>	<b>2,6</b>	<b>739,6</b>	<b>0,5</b>
<b>Grand total appropriations for payments</b>	<b>130 527,0</b>	<b>122 230,7</b>	<b>93,6</b>	<b>5 557,4</b>	<b>4,3</b>	<b>2 739,0</b>	<b>2,1</b>

(1) Final budget appropriations after taking account of transfers between budget headings, appropriations relating to assigned revenue or similar and appropriations carried over from the previous financial year.





**Diagram IV**  
**Appropriations for payments available in 2010 and utilisation thereof**

(million euro and %)

Sections (S) and titles (T) corresponding to the 2010 budgetary nomenclature and financial framework headings	Final appropriations (1)	Utilisation of appropriations					
		Payments made in 2010	Utilisation rate (%)	Carry-overs to 2011	Rate (%)	Cancellations	Rate (%)
		(a)	(b)	(b)/(a)	(c)	(c)/(a)	(d) = (a) - (b) - (c)
<b>Budgetary nomenclature</b>							
I Parliament (S. I)	1 938,1	1 506,6	77,7	350,9	18,1	80,7	4,2
II Council (S. II)	748,4	620,3	82,9	80,5	10,8	47,5	6,3
III Commission (S. III)	127 031,1	119 373,9	94,0	5 073,0	4,0	2 584,2	2,0
III.1 Economic and financial affairs (T.01)	400,5	288,8	72,1	67,4	16,8	44,3	11,1
III.2 Enterprise (T.02)	770,9	658,0	85,4	98,7	12,8	14,2	1,8
III.3 Competition (T.03)	103,5	91,9	88,8	9,8	9,5	1,8	1,7
III.4 Employment and social affairs (T.04)	8 543,3	7 481,1	87,6	43,4	0,5	1 018,9	11,9
III.5 Agriculture and rural development (T.05)	58 421,2	55 611,3	95,2	2 324,8	4,0	485,1	0,8
III.6 Energy and transport (T.06)	3 369,2	2 858,9	84,9	187,2	5,6	323,1	9,6
III.7 Environment (T.07)	438,0	358,2	81,8	23,8	5,4	56,0	12,8
III.8 Research (T.08)	5 369,2	4 506,5	83,9	848,2	15,8	14,5	0,3
III.9 Information society and media (T.09)	1 986,3	1 786,3	89,9	196,9	9,9	3,1	0,2
III.10 Direct research (T.10)	789,3	438,2	55,5	344,0	43,6	7,2	0,9
III.11 Maritime affairs and fisheries (T.11)	827,4	655,6	79,2	39,2	4,7	132,6	16,0
III.12 Internal market (T.12)	79,9	70,8	88,7	7,0	8,8	2,0	2,5
III.13 Regional policy (T.13)	30 709,4	30 622,6	99,7	79,1	0,3	7,7	0,0
III.14 Taxation and customs union (T.14)	135,7	125,6	92,5	9,5	7,0	0,7	0,5
III.15 Education and culture (T.15)	1 782,8	1 571,7	88,2	205,3	11,5	5,9	0,3
III.16 Communication (T.16)	230,8	206,0	89,2	14,1	6,1	10,8	4,7
III.17 Health and consumer protection (T.17)	664,5	590,4	88,8	44,5	6,7	29,6	4,5
III.18 Area of freedom, security and justice (T.18)	839,8	744,9	88,7	71,2	8,5	23,7	2,8
III.19 External relations (T.19)	3 867,5	3 683,0	95,2	83,5	2,2	101,0	2,6
III.20 Trade (T.20)	90,4	76,9	85,1	6,3	7,0	7,2	7,9
III.21 Development and relations with ACP States (T.21)	1 818,8	1 707,8	93,9	55,2	3,0	55,8	3,1
III.22 Enlargement (T.22)	1 152,5	1 130,2	98,1	16,0	1,4	6,3	0,5
III.23 Humanitarian aid (T.23)	977,8	970,9	99,3	5,9	0,6	0,9	0,1
III.24 Fight against fraud (T.24)	82,3	72,7	88,3	7,0	8,5	2,6	3,1
III.25 Commission's policy coordination and legal advice (T.25)	214,5	188,7	87,9	22,3	10,4	3,6	1,7
III.26 Commission's Administration (T.26)	1 239,4	1 044,0	84,2	176,8	14,3	18,5	1,5
III.27 Budget (T.27)	77,2	64,7	83,8	11,2	14,5	1,3	1,7
III.28 Audit (T.28)	12,3	10,6	86,6	1,4	11,8	0,2	1,6
III.29 Statistics (T.29)	148,0	125,8	85,0	16,6	11,2	5,6	3,8
III.30 Pensions and related expenditure (T.30)	1 209,6	1 205,2	99,6	0,0	0,0	4,5	0,4
III.31 Language Services (T.31)	486,1	426,5	87,7	56,6	11,6	2,9	0,6
III.40 Reserves (T.40)	192,9	—	—	—	—	192,9	100,0
IV Court of Justice (S. IV)	349,7	323,1	92,4	18,3	5,2	8,3	2,4
V Court of Auditors (S. V)	209,8	182,4	86,9	16,7	7,9	10,8	5,2
VI Economic and Social Committee (S. VI)	134,4	121,5	90,4	9,3	7,0	3,6	2,7
VII Committee of the Regions (S. VII)	97,2	89,4	92,0	6,7	6,9	1,0	1,1
VIII European Ombudsman (S. VIII)	10,1	8,5	84,3	0,5	5,2	1,1	10,5
IX European Data Protection Supervisor (S. IX)	8,2	5,0	61,1	1,4	16,8	1,8	22,1
<b>Grand total appropriations for payments</b>	<b>1 30 527,0</b>	<b>122 230,7</b>	<b>93,6</b>	<b>5 557,4</b>	<b>4,3</b>	<b>2 739,0</b>	<b>2,1</b>
<b>Financial Framework</b>							
1 Sustainable Growth	52 103,0	48 828,0	93,7	1 905,3	3,7	1 369,7	2,6
2 Preservation and Management of Natural Resources	59 630,4	56 647,3	95,0	2 381,9	4,0	601,2	1,0
3 Citizenship, freedom, security and justice	1 616,6	1 373,0	84,9	199,3	12,3	44,4	2,7
4 EU as a global player	8 101,2	7 486,5	92,4	114,1	1,4	500,6	6,2
5 Administration	9 075,8	7 895,8	87,0	956,8	10,5	223,1	2,5
6 Compensation	—	—	—	—	—	—	—
<b>Grand total appropriations for payments</b>	<b>1 30 527,0</b>	<b>122 230,7</b>	<b>93,6</b>	<b>5 557,4</b>	<b>4,3</b>	<b>2 739,0</b>	<b>2,1</b>

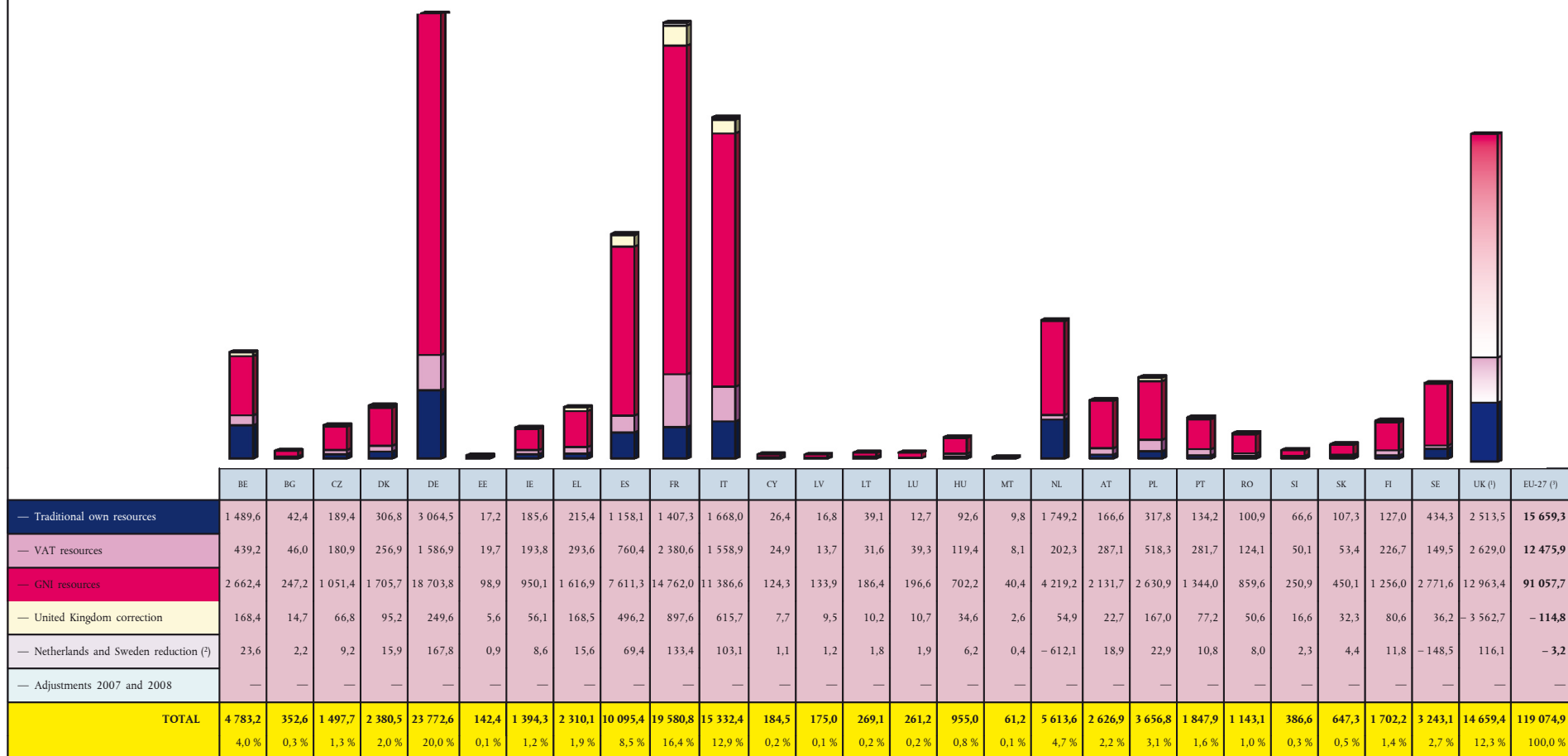
(1) Final budget appropriations after taking account of transfers between budget headings, appropriations relating to assigned revenue or similar and appropriations carried over from the previous financial year.



Diagram V  
Own resources in 2010, by Member State

Revenue Outturn

(million euro and %)



(1) For the United Kingdom a correction (3 562,7 million euro) is applied to the gross amount of own resources (18 222 million euro). The financing of this adjustment is borne by the other Member States.

(2) For the Netherlands and Sweden a gross reduction in their annual GNI contribution is granted for the period 2007-2013. For 2010 their amounts are respectively 612,1 and 148,5 million euro.

(3) The differences between the amounts presented in the diagram and the ones presented in chapter 2 - table 2.1 represent the adjustments for VAT balances, GNI balances and the UK correction allocated to the corresponding titles and countries.



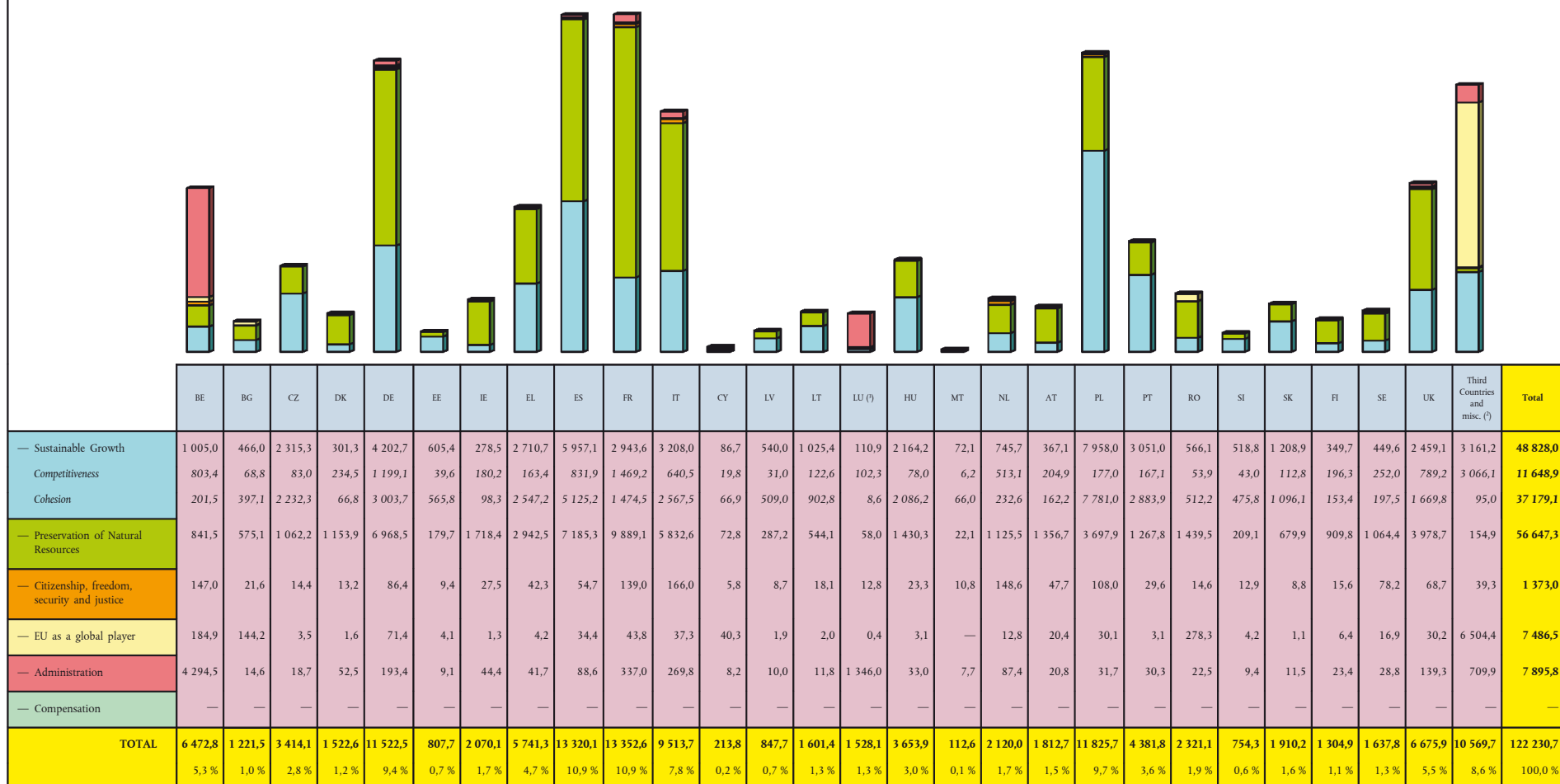
Diagram VI

Payments made in 2010, in each Member State <sup>(1)</sup>

Note: Payments made in 2010 = payments against 2010 operating appropriations plus payments against carry-overs from 2009.

## Financial framework headings

(million euro and %)

<sup>(1)</sup> The geographical breakdown is not by payments made to the Member States but by expenditure according to the data in the Commission's computerised accounting system ABAC (except for the heading Administration which was provided directly by DG Budget).<sup>(2)</sup> The amounts under 'Third Countries and miscellaneous' mainly include expenditure related to the projects implemented outside the Union and participation by third countries. Expenditure in respect of which the geographical distribution could not be made is also included.<sup>(3)</sup> The amount presented for Luxembourg includes a negative adjustment of 136 million euro, representing operational payments for which Luxembourg is not the actual beneficiary.



<b>Diagram VII</b>		
<b>Consolidated balance sheet <sup>(1)</sup></b>		
<i>(million euro)</i>		
	31.12.2010	31.12.2009
<b>Non-current assets:</b>		
Intangible assets	108	72
Property, plant and equipment	4 813	4 859
Long-term investments	2 555	2 379
Loans	11 640	10 764
Long-term pre-financing	44 118	41 544
Long-term receivables	40	55
	<b>63 274</b>	<b>59 673</b>
<b>Current assets:</b>		
Inventories	91	77
Short-term investments	2 331	1 791
Short-term pre-financing	10 078	9 436
Short-term receivables	13 501	8 958
Cash and cash equivalents	22 063	23 372
	<b>48 064</b>	<b>43 634</b>
<b>Total assets</b>	<b>111 338</b>	<b>103 307</b>
<b>Non-current liabilities:</b>		
Employee benefits	(37 172)	(37 242)
Long-term provisions	(1 317)	(1 469)
Long-term financial liabilities	(11 445)	(10 559)
Other long-term liabilities	(2 104)	(2 178)
	<b>(52 038)</b>	<b>(51 448)</b>
<b>Current liabilities:</b>		
Short-term provisions	(214)	(213)
Short-term financial liabilities	(2 004)	(40)
Accounts payable	(84 529)	(93 884)
	<b>(86 747)</b>	<b>(94 137)</b>
<b>Total liabilities</b>	<b>(138 785)</b>	<b>(145 585)</b>
<b>Net assets</b>	<b>(27 447)</b>	<b>(42 278)</b>
Reserves	3 484	3 323
Amounts to be called from Member States	(30 931)	(45 601)
<b>Net assets</b>	<b>(27 447)</b>	<b>(42 278)</b>

<sup>(1)</sup> The balance sheet is presented using the layout as in the Annual Accounts of the European Union.





<b>Diagram VIII</b>		
<b>Consolidated economic outturn account <sup>(1)</sup></b>		
<i>(million euro)</i>		
	2010	2009
<b>Operating revenue</b>		
Own resource and contributions revenue	122 328	110 537
Other operating revenue	8 188	7 532
	<b>130 516</b>	<b>118 069</b>
<b>Operating expenses</b>		
Administrative expenses	(8 614)	(8 133)
Operating expenses	(103 764)	(102 504)
	<b>(112 378)</b>	<b>(110 637)</b>
<b>Surplus from operating activities</b>	<b>18 138</b>	<b>7 432</b>
Financial revenue	1 178	835
Financial expenses	(661)	(594)
Movement in employee benefits liability	(1 003)	(683)
Share of net surplus (deficit) of associates and joint ventures	(420)	(103)
<b>Economic outturn for the year</b>	<b>17 232</b>	<b>6 887</b>

<sup>(1)</sup> The economic outturn account is presented using the layout as in the Annual Accounts of the European Union.

