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EUROPEAN
COURT
OF AUDITORS

2015

EU audit in brief

Introducing the 2015 annual reports of the European Court of Auditors

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President's introduction

02

The 2015 EU audit in brief sets out the main findings of the European Court of Auditor's (ECA) annual reports on the implementation of the 2015 EU budget and the European Development Funds. We provide an overview of EU financial management during the year and make suggestions on how it could be improved. In so doing, we assist the European Parliament and the Council in their scrutiny of the way EU funds are used.

The 2015 financial year saw considerable pressure placed on the EU budget as Member States and the EU institutions — while continuing funding ongoing EU activities under the 2014-2020 multiannual financial framework — sought to respond to the refugee crisis and to promote higher investment in the economy.

Our audit work covers the different and often complex revenue and spending schemes at all levels of EU, national and regional administrations through to individual beneficiaries. We provide a statement of assurance on the reliability of the accounts and the regularity of the underlying transactions and highlight where EU funds are most at risk of being misspent. And we also report on the framework used by the Commission for managing the performance of EU funds.

As in previous years, we conclude that the 2015 EU accounts are reliable but spending continues to be affected by a material level of irregularity ('error'). Our estimate of the overall level of error in 2015 is 3.8 %, which is an improvement on recent years but still significantly above our materiality threshold of 2 %.

Our analysis shows that grant schemes based on reimbursing beneficiaries' costs tend to have higher levels of error than entitlement schemes. We also draw attention to the risks to financial management associated with providing financial support through loans, guarantees and equity investments, either directly or indirectly from the EU budget.

Our reporting on EU performance management again underlines the need to establish a clearer link between the EU's new political priorities, current strategic objectives and the activities actually funded by the EU. This year's annual report focuses on the performance management of spending on research and innovation.

Finally, our report provides recommendations on how to reduce errors and improve the overall performance of the EU budget. The Commission's mid-term review of the EU's spending plans for 2014 to 2020 now provides an opportunity to make real progress towards simplifying rules of spending schemes and making the budget more flexible and focused on achieving the results that matter most to citizens.

Vítor Manuel da SILVA CALDEIRA
President of the European Court of Auditors

Contents

Contents

Overall results 05

Key findings and messages

Summary of the 2015 Statement of Assurance

The European Court of Auditors gives a clean opinion on the reliability of the 2015 accounts of the European Union.

Revenue for 2015, taken as a whole, is legal and regular.

Payments for 2015 are materially affected by error. We therefore give an adverse opinion on their legality and regularity.

For the full text of our statement of assurance, please refer to Chapter 1 of the 2015 annual report.

- The EU accounts for 2015 were prepared in accordance with international standards and present, in all material aspects, a true and fair view. We were therefore able, once again, to give a clean opinion on their reliability. However, we gave an adverse opinion on the regularity of payments.
- The estimated level of error, which measures the level of irregularity, for 2015 payments is 3.8 %. This is an improvement on recent years but still significantly above our materiality threshold of 2 %.
- Management mode has a limited impact on level of error. We continue to find nearly the same estimated level of error under shared management with the Member States (4.0 %) and for expenditure managed directly by the Commission (3.9 %). We again found the highest estimated levels of error in spending under 'Economic, social and territorial cohesion' (5.2 %) and for 'Competitiveness for growth and jobs' (4.4 %). Administrative expenditure had the lowest estimated level of error (0.6 %).
- The different risk patterns of reimbursement schemes (where the EU reimburses eligible costs for eligible activities on the basis of cost declarations made by beneficiaries) and entitlement schemes (where payments are made on meeting conditions rather than reimbursing costs) have continued to have a major influence on the level of errors in the different spending areas. Reimbursement of costs is linked to a much higher level of error (5.2 %) than spending on an entitlement basis (1.9 %).
- Corrective action by authorities in the Member States and by the Commission had a positive impact on the estimated level of error. Without this action, our overall estimated level of error would have been 4.3 %. Although steps have been taken by the Commission to improve its assessment of risk and the impact of corrective actions, there is still scope for improvement.
- If the Commission, authorities in the Member States or independent auditors had made use of all information available to them, they could have prevented, or detected and corrected a significant proportion of the errors before the related payments were made.

Overall results

- Amounts to be paid in the current and future years remain at a very high level. However, the Commission has not produced a cash flow forecast covering the next 7 to 10 years. Such a forecast would enable stakeholders to anticipate future payment requirements and budgetary priorities.
- The increasing use of financial instruments, not directly funded by the EU budget nor audited by us, poses higher risks for accountability and the coordination of EU policies and operations.
- There has been some progress in the indicators used by the Commission to measure performance, but shortcomings remain. Management objectives also need to be better developed at the level of the Commission's directorates-general.
- In Horizon 2020, we found that although there have been improvements when compared to the Seventh Framework Programme, the Commission is still limited in its ability to monitor and report on the performance of the programme. The links between the Commission's 10 new political priorities and Europe 2020/Horizon 2020's strategic framework need further clarification. This lack of clarity may also be affecting other EU activities.
- Despite an overall reasonable level of awareness of our recommendations to Member States, there is a wide variation in the level of formal follow-up and, as a result, only moderate evidence of changes in national policy and practice.

The full text of our 2015 annual reports on the EU budget and on the activities funded by the 8th, 9th, 10th and 11th European Development Funds can be found on our website (http://www.eca.europa.eu/en/Pages/AR2015.aspx).

Who we are

We are the European Court of Auditors, the EU's external auditor. We are required by Article 287 of the Treaty on the Functioning of the European Union to provide the European Parliament and the Council with a statement of assurance on the reliability of the accounts and on the legality and regularity of the transactions that underlie them. We are independent of the institutions and bodies we audit.

What we audited

EU budget

EU budgetary spending is a significant instrument for achieving its policy objectives. Every year we audit the revenue and expenditure of the EU budget and provide our opinion on the extent to which the annual accounts are reliable, and income and spending transactions comply with the applicable rules and regulations.

Spending totalled €145.2 billion in 2015, or around €285 for every citizen. It represented 2.1 % of the total general government spending of EU Member States.

The EU budget is agreed annually — within the context of 7-year financial frameworks — by the European Parliament and the Council. Ensuring that the budget is properly spent is primarily the responsibility of the Commission. Nearly 80 % of the budget is spent under what is known as 'shared management', with individual Member States distributing funds and managing expenditure in accordance with EU law (for example, in the case of expenditure in the area of 'Economic, social and territorial cohesion' and spending on 'Natural resources').

Where does the money come from?

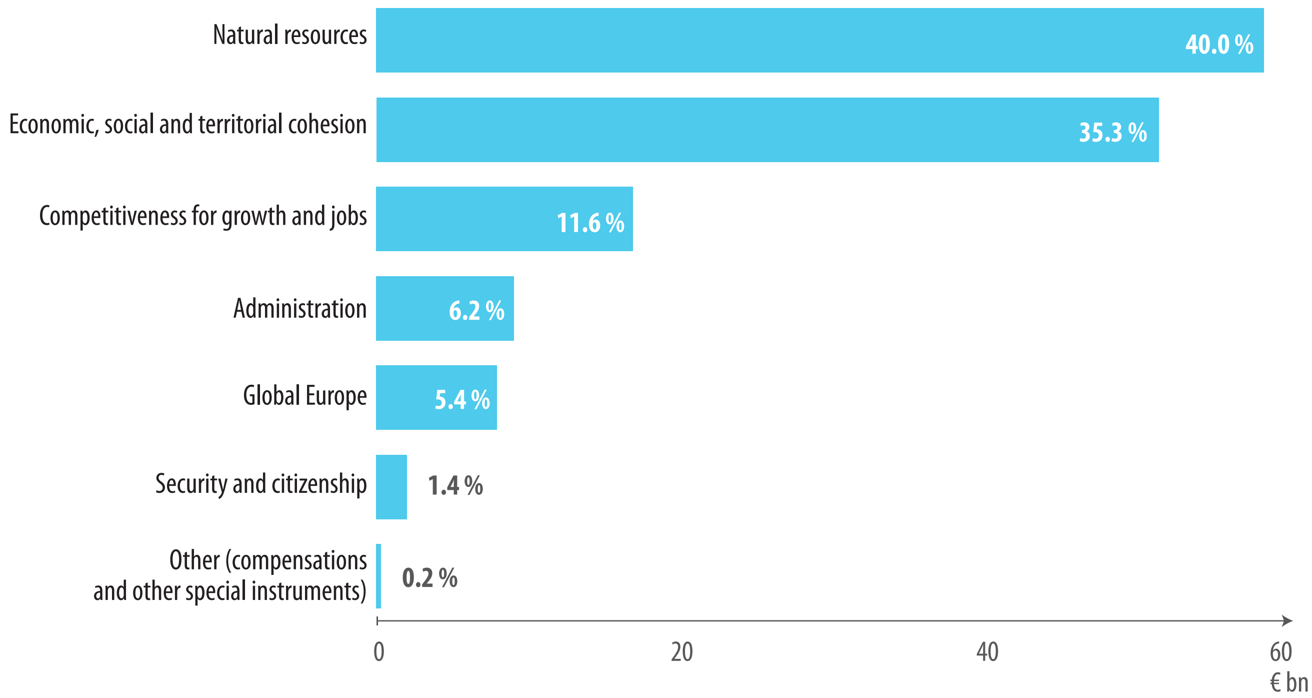
The EU budget is financed by various means. The largest proportion is paid by Member States based on their gross national income (€94.0 billion). Other sources include payments by Member States based on customs and agricultural duties (€18.7 billion), as well as the value added tax they collect (€18.3 billion).

What is the money spent on?

The annual EU budget is spent on a wide range of areas (see ***Diagram 1***). Payments are made to support activities as varied as farming and the development of rural and urban areas, transport infrastructure projects, research, training for jobless people, support for countries wishing to join the EU, or aid for neighbouring and developing countries.

Diagram 1

Total EU expenditure 2015 (€145.2 billion)



EU spending is characterised by two types of expenditure programmes involving distinct patterns of risk:

- Entitlement programmes, with payment based on meeting certain conditions, for example student and research fellowships (under competitiveness spending), direct aid for farmers (under 'Natural resources'), direct budget support (under 'Global Europe'), or salaries and pensions (under 'Administration').

- Cost reimbursement schemes, where the EU reimburses eligible costs for eligible activities. Such schemes include, for example, research projects (under competitiveness spending), investment schemes in regional and rural development (covered by expenditure under cohesion and 'Natural resources'), training schemes (under cohesion) and development projects (under 'Global Europe').

What we found

EU accounts present a true and fair view

The EU accounts for 2015 were prepared in accordance with international public sector accounting standards, and present, in all material respects, a true and fair view of the EU's financial results for the year and its assets and liabilities at the end of the year. We were therefore able to give a clean opinion on the reliability of the accounts ('signed off'), as we have done since 2007.

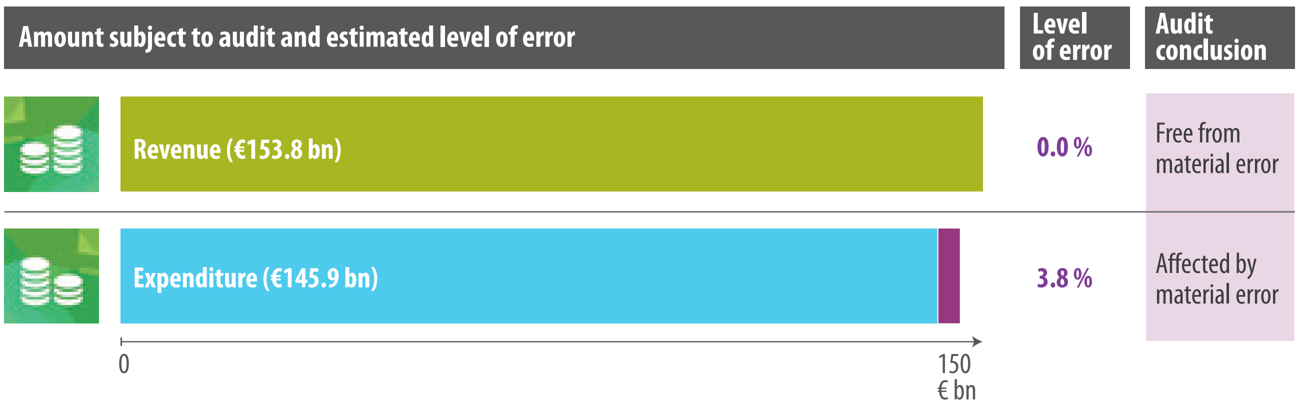
Estimated level of error is still significantly above our materiality threshold of 2 %

A key element of our audit work is the testing of samples of transactions from across the EU budget to provide unbiased and rigorous estimates of the extent to which revenue and the different spending areas are affected by error.

Diagram 2 summarises the results for 2015. For more information on our audit approach and the estimated level of error see pages 52 and 53.

Diagram 2

2015 results of transaction testing for the EU budget as a whole



The estimated level of error is based on the quantifiable errors found in the statistical sample of transactions we tested.

For 2015, we conclude that revenue was free from material error.

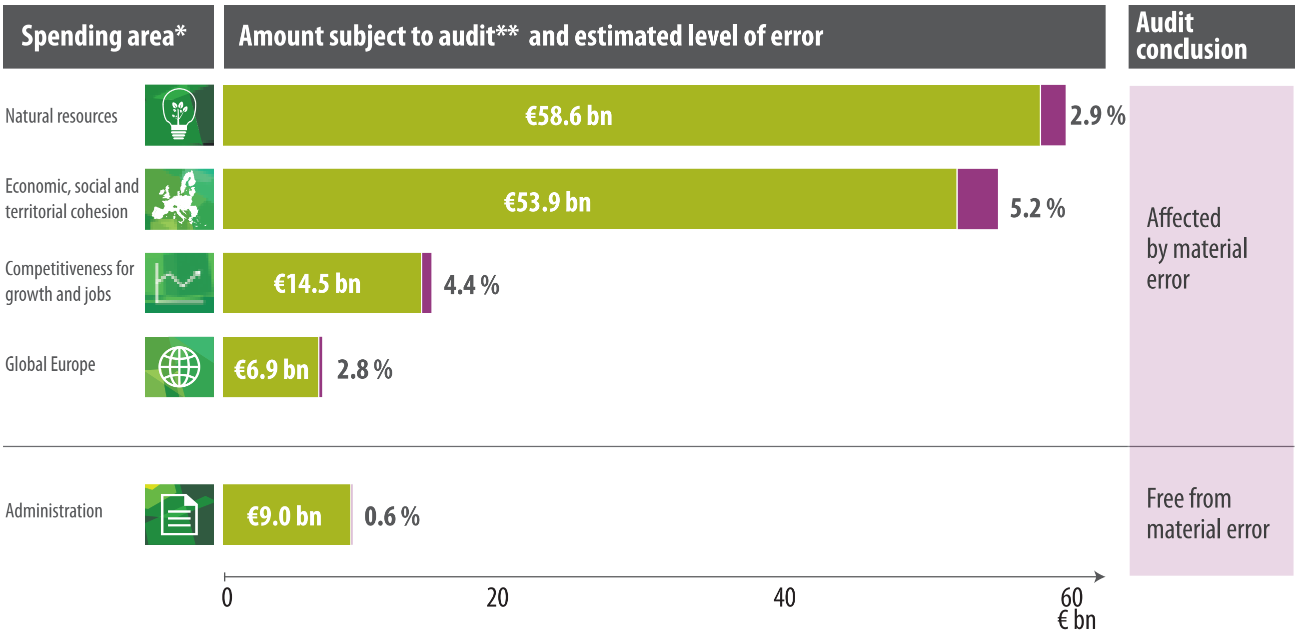
For the expenditure budget as a whole, our estimated level of error of 3.8 % leads us to provide an adverse opinion on the regularity of expenditure (for an explanation of 'regularity' please refer to page 53).

The testing also provides results for each spending area as presented in ***Diagram 3***.

Further information on results in revenue and each spending area is given in pages 29 to 51 and in the related chapters of the 2015 annual report.

Diagram 3

2015 results of transaction testing for EU spending areas



% The estimated level of error is based on the quantifiable errors from our work, notably the testing of a sample of transactions. We use standard statistical techniques to draw this sample and to estimate the level of error (see Chapter 1, Annex 1.1 to the 2015 annual report).

* We do not provide a specific assessment for spending under MFF heading 3 (Security and citizenship) and MFF heading 6 (Compensations), nor for other spending (special instruments outside the 2014-2020 MFF such as Emergency Aid Reserve, European Globalisation Adjustment Fund, European Union Solidarity Fund and Flexibility instrument). Work in these areas contributes, however, to our overall conclusion on spending for the year 2015.

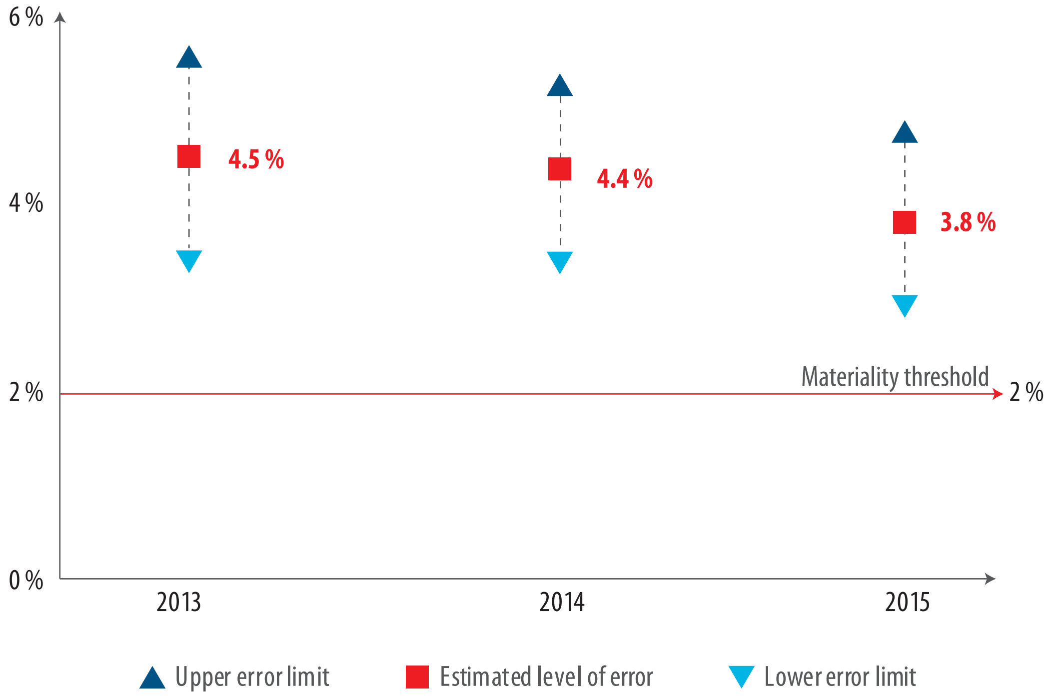
** The difference in amounts in diagram 1 and 3 arise because we examine payment transactions when expenditure has been incurred, recorded and accepted. Advance payments are only examined when the recipients of funds justify their use of the money and the payment is cleared or becomes recoverable.

Analysis of audit results

The estimated level of error, which measures the level of irregularity in transactions, for payments in 2015 is 3.8 %, lower than that of 2014 (4.4 %) and of 2013 (4.5 %). This is an improvement on recent years but still significantly above our materiality threshold of 2 % (see ***Diagram 4***). The audit results are broadly consistent with those of previous years.

Diagram 4

Estimated level of error for the EU budget as a whole (2013 to 2015)



Notes:

We use standard statistical techniques to estimate the level of error. We are 95 % confident that the level of error for the population lies in the range between the lower and upper error limits (for more details, see Chapter 1, Annex 1.1 to the 2015 annual report).

Due to a change in the legal framework of the common agricultural policy in 2015, we no longer include cross-compliance in our transaction testing. Such errors were taken into account in previous years (see box below on updating our audit approach).

Updating our audit approach: exclusion of cross-compliance errors in MFF heading 2 'Natural resources', as from 2015

Due to a change in the legal framework of the common agricultural policy in 2015, we no longer include cross-compliance in our transaction testing. In 2014, such errors contributed 0.6 percentage points to the overall estimated level of error for MFF heading 2 'Natural resources'. Their annual contribution to the overall estimated level of error was between 0.1 and 0.2 percentage points over the period 2011-2014.

Errors, waste and fraud

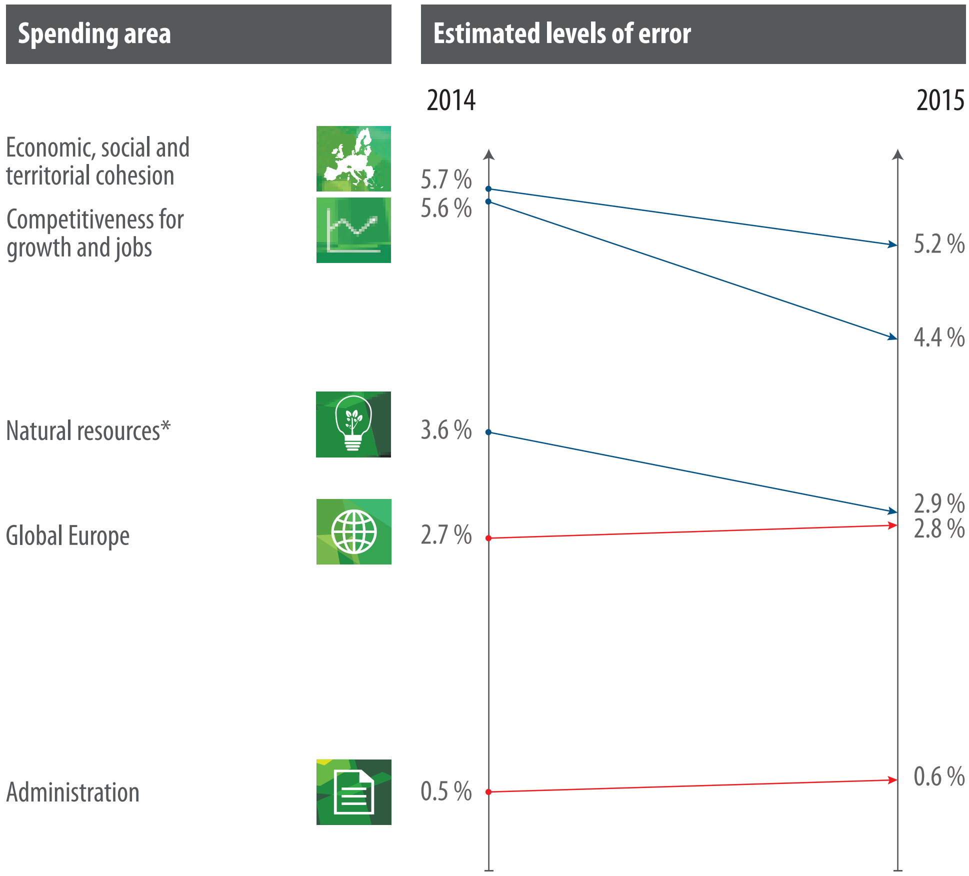
Our estimate of the level of error in the EU budget is not a measure of fraud, inefficiency or waste. It is an estimate of the money that should not have been paid out because it was not used in accordance with the applicable rules and regulations. Typical errors include payments for expenditure which was ineligible, or for purchases without proper application of public purchasing rules.

Fraud is an act of deliberate deception to gain a benefit. We report suspected fraud cases detected during our audit work to OLAF, the European Union's anti-fraud office, which investigates and follows up as necessary in cooperation with authorities in the Member States. Out of some 1 200 transactions that we assessed for legality and regularity during the 2015 audit, we found 12 instances of suspected fraud (2014: 22) which we forwarded to OLAF. The most frequent instances of suspected fraud concerned conflicts of interest and the artificial creation of conditions to receive subsidy, followed by declarations of costs not meeting the eligibility criteria. During the year, we also identify cases of suspected fraud in our work not related to the statement of assurance.

Diagram 5 compares the estimated levels of error between 2014 and 2015, taking into account the headings for the various spending areas of the multiannual financial framework (MFF). There has been a noteworthy decrease in the estimated level of error for 'Economic, social and territorial cohesion'; 'Competitiveness for growth and jobs' and 'Natural resources'. Slightly higher levels of error than in 2014 were detected for 'Global Europe' and 'Administration'. Administrative expenditure had the lowest estimated level of error (0.6 %) and was free from material error.

Diagram 5

Comparison between estimated levels of error for EU spending areas (2014-2015)



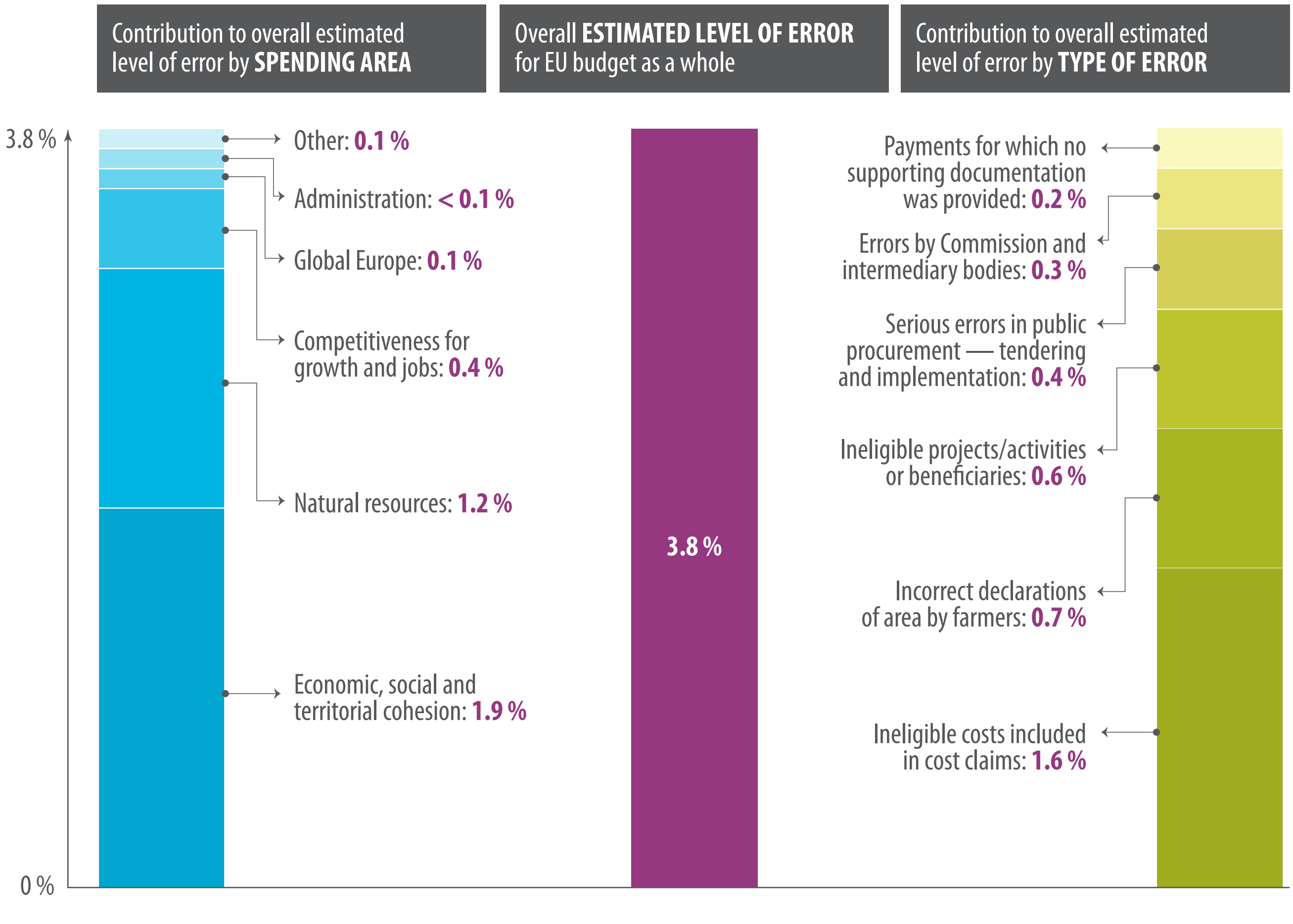
% The estimated level of error is based on the quantifiable errors from our work, notably the testing of a sample of transactions. We use standard statistical techniques to draw this sample and to estimate the level of error (see Chapter 1, Annex 1.1 to the 2015 annual report).

* Due to a change in the legal framework of the common agricultural policy in 2015, we no longer include cross-compliance in our transaction testing. In 2014, such errors contributed 0.6 percentage points to the overall estimated level of error for MFF heading 2 (3.6 %).

We analyse in ***Diagram 6*** the contribution of specific spending areas by MFF heading to the overall estimated level of error. The expenditure for 'Economic, social and territorial cohesion policy' is the second largest in the EU budget and has the highest estimated level of error. This makes it the biggest contributor to the overall estimated level of error (half of the total). Almost all of the expenditure takes the form of cost reimbursement. Ineligible expenditure in the beneficiaries' cost declarations and the selection of ineligible projects, activities or beneficiaries contribute to three-quarters of the estimated level of error for 2015 for this spending area. Errors due to the infringement of public procurement rules represent one-seventh.

Diagram 6

Breakdown of the overall estimated level of error by spending area and type of error (2015)



% Portion of the overall estimated level of error, expressed in percentage points.

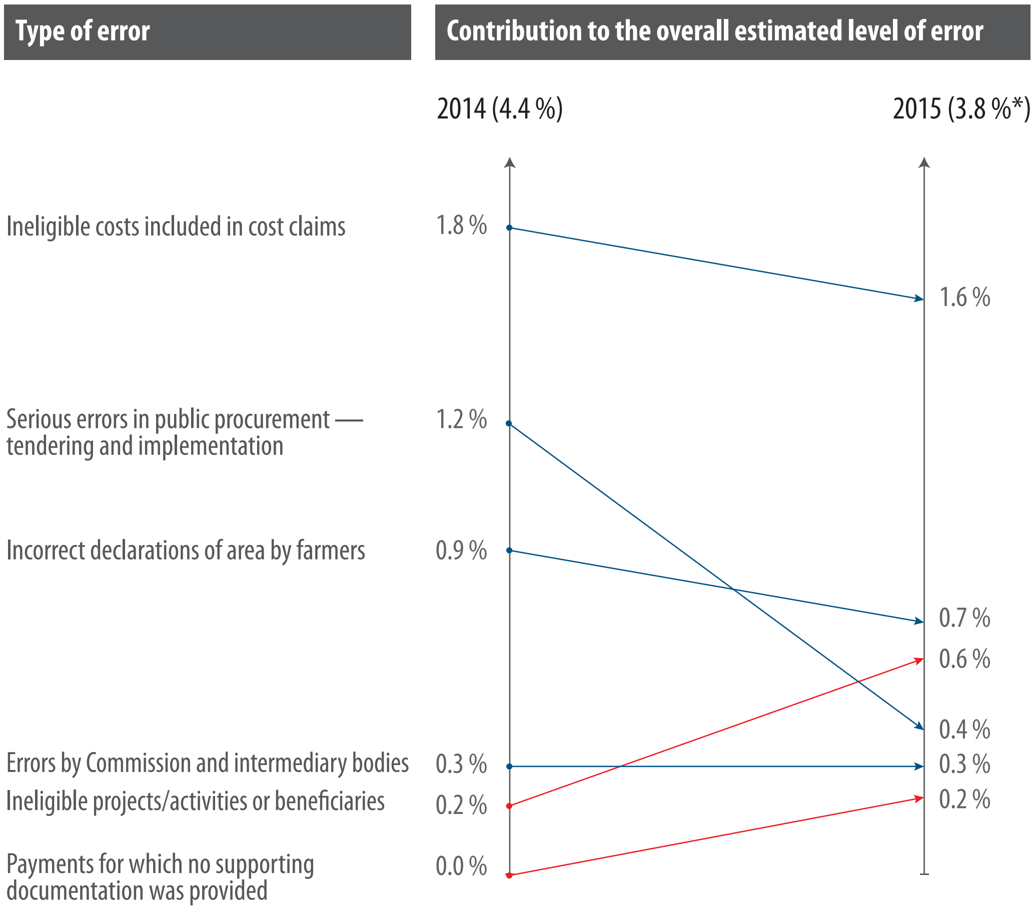
'Natural resources' has the largest share of the EU budget and also contributes significantly to the overall estimated level of error due to its high estimated level of error for 2015 (nearly a third of the total). Overstated claims of agricultural areas were the highest contributor to the estimated level of error in this spending area (more than half). Errors related to ineligible beneficiaries, activities or expenditure contributed to one-fifth. The European Agricultural Guarantee Fund (EAGF) accounts for more than three-quarters of expenditure under 'Natural resources' but is significantly less affected by error (2.2 %) than rural development (5.3 %). The latter is characterised by higher levels of error in investment spending, where agricultural businesses are subsidised on the basis of reimbursement of eligible spending.

The estimated level of error in spending on 'Competitiveness for growth and jobs' remains relatively higher than other spending areas. Much of the expenditure is made on a cost reimbursement basis and most of the errors were related to the reimbursement of ineligible personnel or indirect costs declared by beneficiaries. For 'Global Europe', the Commission's acceptance of payments for works, services or supplies that had not been delivered, together with ineligible costs reimbursed by the Commission account for two-thirds of the total estimated level of error.

Expenditure that did not fulfil the necessary conditions to be charged to EU-funded projects continues to make the greatest contribution to the overall estimated level of error (*ineligible costs included in cost claims*: 42 % of the overall estimated level of error). Two other major contributors to the estimated level of error were *incorrect declarations of area by farmers* (19 %) and *ineligible projects/activities or beneficiaries* (16 %). *Serious errors in public procurement* (11 %) contributed considerably less when compared with 2014 (see ***Diagram 7***).

Diagram 7

Comparison of types of errors and their contribution to the overall estimated level of error (2014 and 2015)



% Portion of the overall estimated level of error, expressed in percentage points.

* Due to a change in the legal framework of the common agricultural policy in 2015, we no longer include cross-compliance in our transaction testing.

Reimbursement spending was most affected by error

The correct calculation of payments to recipients of funding often depends on information provided by the recipients themselves. This is especially significant in the area of reimbursement activities.

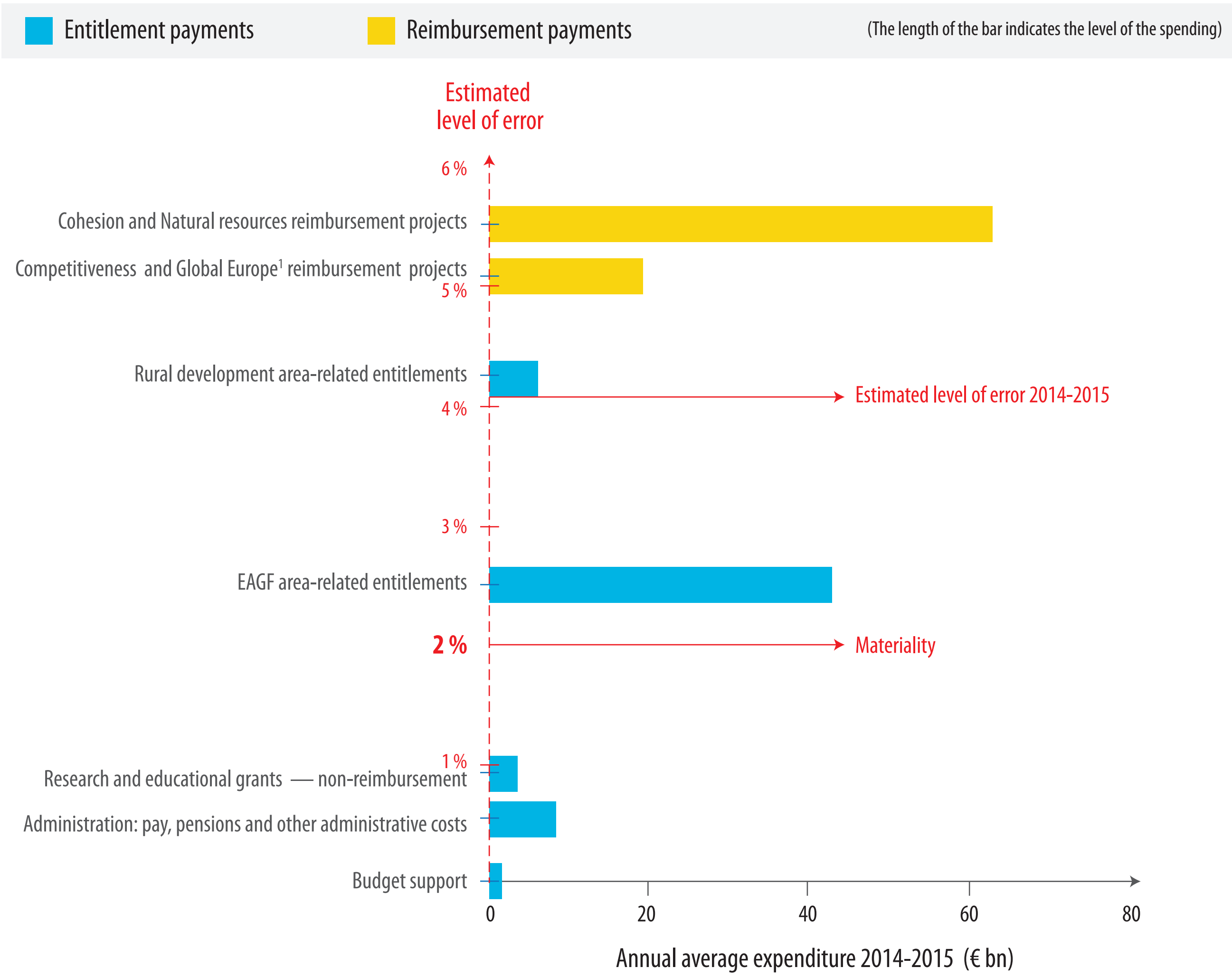
EU spending by programme expenditure type includes the following errors:

- *For reimbursement expenditure*, the estimated level of error is 5.2 % (2014: 5.5 %). Typical errors in this area include ineligible costs contained in the cost claims, ineligible projects, activities and beneficiaries, and serious infringement of public procurement rules.
- *For entitlement programmes*, the estimated level of error is 1.9 % (2014: 2.7 %), with typical errors including small over-declarations by farmers of agricultural areas.

Diagram 8, based on our audit testing of EU spending over the last two years, clearly shows that the more complex information required from beneficiaries is, the higher is the risk of error.

Diagram 8

The relationship between basis for payment and estimated level of error in EU transactions (2014-2015)



1 Reimbursement for 'Global Europe' includes multi-donor projects which in practice have many of the attributes of entitlement spending and are affected by lower levels of error.

Management mode has a limited impact on level of error

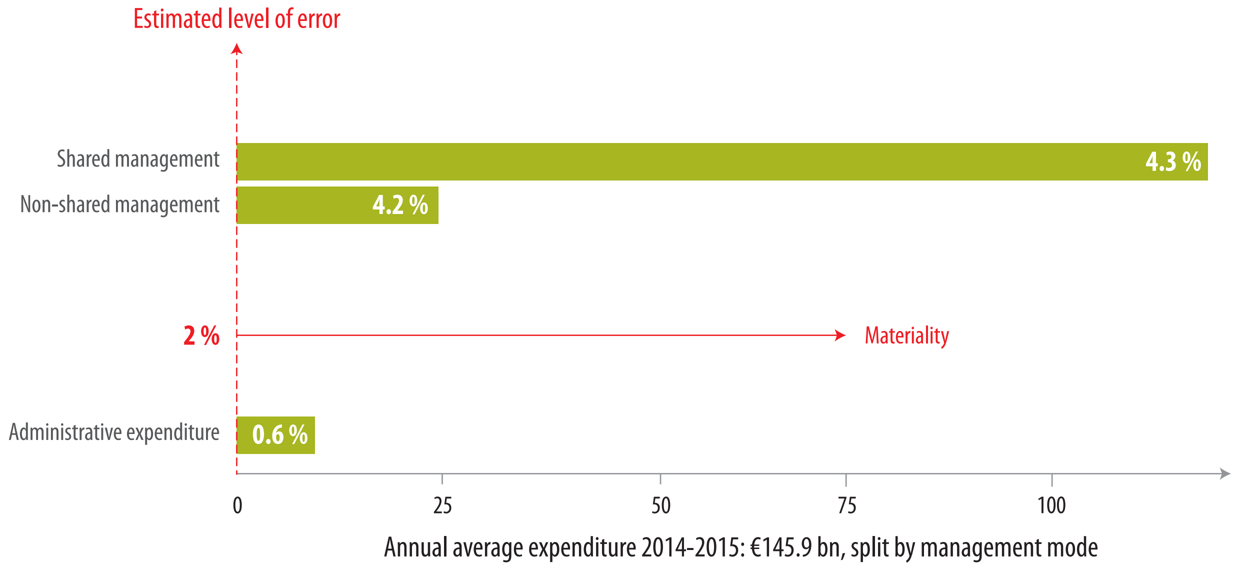
In 2015, as in the previous year, we continue to find nearly the same estimated level of error under shared management with the Member States (4.0 % in 2015 and 4.6 % in 2014) and for expenditure managed directly by the Commission (3.9 % in 2015 and 4.6 % in 2014).

The different risk patterns of reimbursement and entitlement schemes, rather than management modes, influence the level of error in different areas of spending (see ***Diagram 9***). The estimated level of error shows a much stronger relationship with the basis for payment than with the management mode. The highest levels of error over the last 2 years were in 'Competitiveness for growth and jobs' (managed directly by the Commission and indirectly through entrusted entities) and 'Economic, social and territorial cohesion' (under shared management). Reimbursement schemes dominate spending in both of these areas.

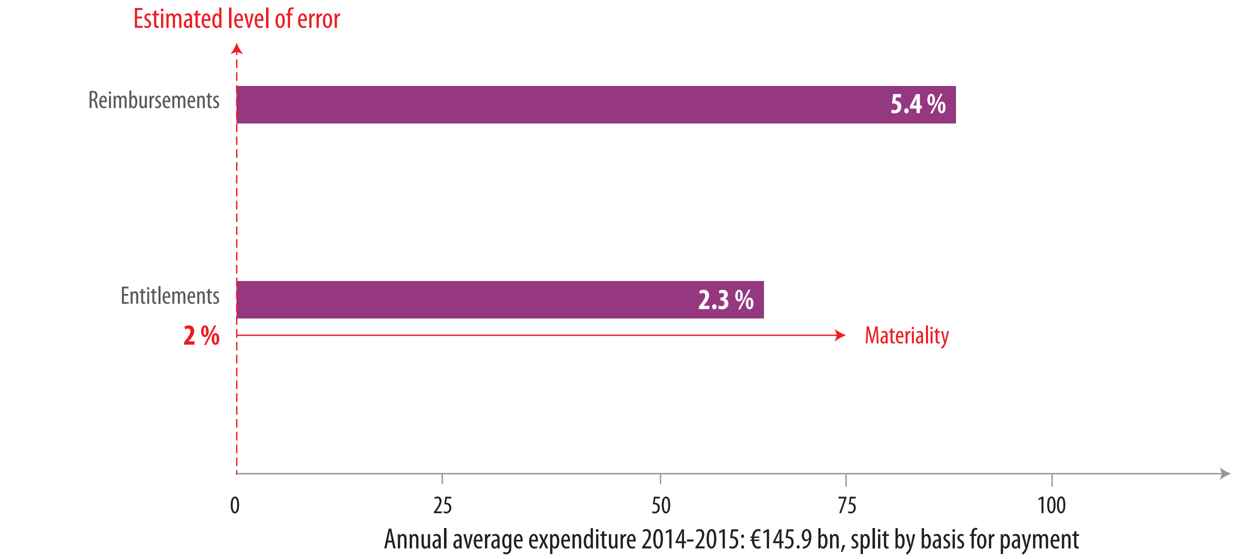
Diagram 9

Average estimated level of error by management mode and by basis for payment (2014-2015)

Management mode (The length of the bar indicates the level of the spending)



Basis for payment (The length of the bar indicates the level of the spending)



Explanation:
The graphs present the same amount of expenditure.

- In the top graph, spending is split on the basis of management mode, showing that the great majority of operational spending is under shared management.
- The bottom graph presents spending split by the basis for payment and shows that reimbursement spending is significantly greater than entitlement spending.
- The position of the bars indicate the estimated level of error for each. This shows the limited impact of management mode and the significant impact of basis for payment.

Corrective action had an impact on the estimated level of error

The Member States and the Commission apply corrective measures in cases of irregular expenditure and when errors in payments had not been detected earlier in the process. The mechanisms applied to make and record corrective action are complex. We seek to take account of these measures in the results of our audits when they are made prior to payment or before our examination. We check the application of the corrections (for example, recoveries from beneficiaries and corrections at project level) and adjust the quantification of error whenever this is appropriate. While we take note of corrections made after notification of our audits, we do not assume that a corrective action stimulated by our work is representative of the population as a whole.

In 2015, if such corrective measures had not been applied to the payments audited by us, our overall estimated level of error would have been 4.3 % rather than 3.8 %.

However, we also found that for some transactions affected by error, if the Commission, authorities in the Member States or independent auditors had made use of all information available to them, they could have prevented, or detected and corrected the errors before the related errors were made. Based on transactions within our samples, this had the potential to reduce estimated levels of error both for shared management spending and for spending directly managed by the Commission.

For example, using all information available might have reduced the level of error by a total of 3.2 percentage points for spending under rural development, environment, climate action and fisheries (5.3 %), 3.0 percentage points for expenditure under ‘Economic, social and territorial cohesion’ (5.2 %); and by 0.9 percentage points for spending under agriculture — EAGF (2.2 %). For the European Development Funds (EDFs), mostly directly managed by the Commission, the estimated level of error (3.8 %) might have been reduced by 1.7 percentage points.

Scope for further improvement in the Commission’s assessment of risk and impact of corrective actions

Each Commission directorate-general produces an annual activity report. They provide an account of the achievement of the key policy objectives (discussed below) and a management report of the director-general to the Commissioners. In 2015 the Commission simplified the structure of the annual activity reports and gave directors-general more flexibility on how to report.

Our analysis of the Commission’s estimate of the level of error (‘amount at risk’) has indicated that further steps have been taken to improve its quantification of amounts at risk and corrective capacity. However, there is still scope for improvement in the Commission’s assessment of both these issues.

Want to know more? Full information on the main findings can be found in Chapter 1 of the 2015 annual report on the EU budget. The full text of our annual report can be found on our website (http://www.eca.europa.eu/en/Pages/AR2015.aspx).

Amounts to be paid in the current and future years are at a high level

The budget for payments in 2015 was the second highest ever. Moreover, for the third successive year, the final level of payments (€145.2 billion) was higher than the level set in the original budget (€141.3 billion). This was realised through eight amending budgets during the year.

More than three-quarters of operational spending went to schemes operating under the rules of the previous MFF. These include subsidies to farmers for 2014, reimbursement of claims for cohesion projects for the period 2007-2013 operational programmes, and payments for research projects under the Seventh Framework Programme which began in 2007.

What are commitments and payments?

The EU budget has two components: commitments (representing amounts to be paid in the current or future years) and payments (covering payments of funds in the current year). Payments can only be made against a valid commitment. The annual ceilings for commitments and payments are laid down in the multiannual financial frameworks agreed by the Parliament and Council.

The level of commitments in 2015 was higher than in any previous year and just within the overall limit (97.7 % of the amount available). Continuing lengthy delays between initial commitments and final clearings of expenditure means that patterns of spending are slow to respond to changing budgetary priorities and increases the risk that documentation is unavailable at closure. We recommend that the Commission takes measures to reduce the outstanding commitments, including a quicker decommitment procedure; faster closure of the 2007-2013 programmes; wider use of net correction in spending on cohesion; reducing cash held by fiduciaries; and the compilation of payment plans and forecasts in those areas where outstanding commitments and other obligations are significant.

Backlogs in the use of 2007-2013 European Structural and Investment Funds (ESIFs) are significant. By the end of 2015, 10 % of the total €446.2 billion allocated to all approved operational programmes was still outstanding. We observe that five Member States (Czech Republic, Spain, Italy, Poland and Romania) account for more than half of the unused commitments of ESIFs that have not led to payment.

These backlogs may pose a significant challenge to some Member States. In order to use all the funds available for this period, authorities need to submit valid claims equalling the total of all outstanding commitments together with the required national co-financing and the amount of pre-financing already provided from the budget. In some Member States the unclaimed EU contribution, together with required co-financing, exceeds 15 % of the total general government expenditure. We recommend that the Commission considers, in its budgetary and financial management, the capacity constraints in certain Member States, in order to ensure that funds are used effectively.

As we reported in previous years, the Commission does not prepare and annually update a cash flow forecast spanning a 7- to 10-year horizon, covering key elements such as budgetary ceilings, payment needs, capacity constraints and potential cancellation of commitments. Such a forecast would enable stakeholders to anticipate future payment requirements and budgetary priorities.

Increasing use of financial instruments poses higher risks

Several financial mechanisms supporting EU policies are not directly financed by the EU budget or recorded in the EU balance sheet. These include the European Financial Stability Facility, the European Stability Mechanism, the Single Resolution Mechanism and the European Investment Bank and the linked European Investment Fund. For some of these, we are not the auditors. The increasing use of such financial instruments, poses higher risks for accountability and the coordination of EU policies and operations.

Other mechanisms are partially recorded in the EU balance sheet such as the blending facilities and the European Fund for Strategic Investments (EFSI). One mechanism that we audit separately is the European Development Funds (see our observations on pages 49 to 51).

Furthermore, we have noticed an increasing use of financial instruments under indirect management for the 2014-2020 period. These instruments are principally composed of loans, equity instruments, guarantees and risk sharing instruments. The European Investment Bank (EIB) Group managed almost all of the financial instruments under indirect management. Increasing amounts are held in these instruments.

Under shared management, unused amounts of financial instruments remain relatively high, 80 % of which were concentrated in five Member States (of which Italy constituted 45 % of the total).

The launch of EFSI has affected the delay in the launch of the Connecting Europe Facility. EFSI will also impact the use made of some other financial instruments. We recommend that the Commission assesses these factors.

Want to know more? Full information on the main findings on budgetary and financial management can be found in Chapter 2 of the 2015 annual report on the EU budget.

Focus on performance to be increased

EU money should be spent in line with the principles of sound financial management: economy, efficiency and effectiveness. Achieving good performance involves 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).

We regularly assess these attributes through our performance audits. We also include a chapter in our annual report assessing different systems put in place by the Commission to ensure that EU funds are spent well, and not just in line with the relevant legislation. This chapter also considers how well the recommendations of the ECA are followed up, and looks at some key messages of our performance audits during the year in question. For this annual report, the chapter takes a special look at the performance management systems for Horizon 2020, building on last year's review of Europe 2020.

Horizon 2020 has a budget of around €75 billion for the 2014-2020 period. It supports the Europe 2020 strategy and the EU objective of creating a European Research Area. It brings together for the first time previously separate spending programmes for research and innovation. Funding is mainly provided in form of grants, although access to other forms of finance, such as financial instruments, is also available.

Difficulty in tracking Horizon 2020 contribution to Europe 2020

Horizon 2020 is an ambitious, wide-ranging programme. Its general objective is based on three priorities: excellent science, industrial leadership, and societal challenges. There are high-level links between Europe 2020 and Horizon 2020. Two of the three main indicators for Horizon 2020 also measure progress against Europe 2020. These indicators, however, are of limited use in tracking the contribution of Horizon 2020 to Europe 2020.

Two sets of overlapping, but different, political priorities for Horizon 2020

The European Commission has adopted 10 political priorities for 2014-2019. These priorities are not exactly the same as the Europe 2020 priorities. This is not a problem, since it is normal that strategic priorities change as circumstances alter, and that the priorities of the Commission would not be exactly the same as the EU as a whole. However, as noted by the Commission's internal audit service and now also by the ECA, the Commission has not so far mapped out the relationship between the two sets of priorities, and these links should now be clarified — the Commission accepts our recommendation on this point.

Partial complementarity between national and European research programmes

A key success factor for Horizon 2020 is effective synergy and complementarity between national and European research and innovation programmes. The supreme audit institutions of Bulgaria and Portugal have found that while there were areas of complementarity in their countries, there were also some limitations at national level.

The mechanics of Horizon 2020 do not consistently drive a focus on performance

The legal framework of Horizon 2020 introduces several important elements for performance management, such as objectives and key performance indicators. Overall, the objectives and indicators which have been agreed do represent a real improvement on the previous framework programmes. However, there remain a number of weaknesses in the performance indicators used in Horizon 2020, such as in relation to the balance of indicators which measure only inputs or outputs as opposed to results and impact, the absence of baselines or a lack of ambition in targets.

The Horizon 2020 legislation requires that the work programmes set out the objectives being pursued and the expected results. In this way, high-level objectives defined in the legislation can be translated into lower-level objectives useful for managing performance. We, however, found that the Commission is not using its Horizon 2020 work programmes and associated calls to increase the required targeted focus on performance.

For the proposals and grant agreements that we examined, we found sufficient emphasis on performance in the objectives, when this is required by the Commission. The same applies for the evaluation process of these proposals. Grant agreements require beneficiaries to report information for the aggregation of the Horizon 2020 key performance indicators. However, the use of the wider concept of 'expected impact' rather than 'expected result' increases the risk that information provided for this part is too broad and the performance assessment of Horizon 2020 will be difficult to aggregate.

The Commission does not always use key performance concepts (for example, 'output', 'results' and 'impact') consistently. Even though the institution has defined how such terms should be commonly used, it does not always abide by these definitions.

Commission is limited in its ability to monitor and report on the performance of Horizon 2020

We found that that the current setup does not enable the Commission to monitor and report separately the spending and performance of research and development (R&D) and innovation within Horizon 2020. In addition, while the financial contribution of Horizon 2020 within Europe 2020 is well established in the budgetary process through the published programme statements, the Commission has not yet reported on the implementation of Horizon 2020 and its contribution to Europe 2020 in a meaningful way.

Objectives not fit for management purposes also noted at the level of directorates-general

As a separate theme of our chapter, we reviewed the management plans and the annual activity reports of four directorates-general responsible for expenditure under 'Natural resources'. We noted that many of the objectives used in management plans and annual activity reports were taken directly from policy or legislative documents and lacked the level of detail necessary for management and monitoring purposes.

We make three recommendations on performance-related issues, which the Commission has accepted

We recommend that the Commission:

- assesses the performance of work programmes and calls, by translating high-level objectives set out in the Horizon 2020 legislation into operational objectives at work programme level;
- further clarifies the links between the Europe 2020 strategy (2010-2020), the multiannual financial framework (2014-2020) and the Commission priorities (2015-2019). The strategic planning process (2016-2020) could provide this opportunity;
- ensures consistent use of the terms 'input', 'output', 'result', and 'impact', in line with its better regulation guidelines.

Issues affecting best value for money and results in the EU

In 2015, we published 25 special reports covering a wide range of performance audit subjects which assess whether the EU's intervention was managed in accordance with the principles of sound financial management (economy, efficiency and effectiveness). A complete list of these reports is presented on pages 55 and 56.

Follow-up of special report recommendations

This year, we investigated the extent to which Member State authorities are aware of and can follow up on our special report recommendations, because even though the Commission is our principal auditee, some of our recommendations do affect them. In a survey that we carried out, we found that there is a reasonable level of awareness of our performance audit recommendations at Member State level and our messages do indeed get through to Member States through one or more of our targeted communication channels. However, there is a wide variation in the level of formal follow-up and only moderate evidence of changes in national policy and practice as a result. It is clear that there is scope for improvement and this is something we will consider further in the coming months, in conjunction with relevant authorities and stakeholders.

Want to know more? Full information on our assessment on performance can be found in Chapter 3 of the 2015 annual report on the EU budget.
Our special reports —- which are mainly performance audits — are available in all EU languages on our website (http://www.eca.europa.eu/en/Pages/AuditReportsOpinions.aspx).

A closer look at revenue and spending areas

28

Note on the naming of Member States in examples

Due to our sampling approach we do not audit transactions in every Member State, beneficiary state and/or region each year. The examples of errors given in this document are provided in order to illustrate the most frequent error types. They do not form a basis for drawing conclusions on the individual Member States, beneficiary states and/or regions concerned.

Revenue
€153.8 billion

What we audited

Our audit covered the EU's revenue, through which it finances its budget. In 2015, revenue contributions calculated on the basis of Member States' gross national income (GNI) and the value added tax (VAT) collected by them, provided 64 % and 13 % of the total respectively. Traditional own resources, mainly customs duties collected on imports and the sugar production charge collected by Member State administrations on behalf of the EU, provided a further 13 % of the revenue, with the remaining 10 % being from other sources.

What we found

Affected by material error?
No

Estimated level of error:
0.0 % (2014: 0.0 %)

Our audit of EU revenue

GNI- and VAT-based EU revenue is calculated on the basis of macroeconomic statistics and estimates provided by Member States. Our audit of the regularity of the underlying transactions covers the Commission's systems for the processing of the data it receives, but not the initial generation by the authorities in the Member States. As a consequence, our audit conclusion addresses the impact of any errors by the Commission on overall revenue.

For customs duties and sugar levies, we examine the Commission's treatment of the statements submitted by the Member States and the controls in selected Member States, the receipts of the amounts by the Commission and their recording in the accounts.

Our audit evidence indicates that these systems were effective overall and we found no errors in the transactions we tested.

On 26 May 2014, a new own resources legislative package was formally approved by the Council. When ratified by the Member States, it will be applied with retroactive effect from 1 January 2014. We will duly follow up on these developments and on the calculation of the retroactive impact.

A reservation is a means by which a doubtful element in GNI data submitted by a Member State is kept open for possible correction. The verification cycles of the Commission for GNI cover long periods. The resulting corrections can have a significant impact on some Member States' contributions.

In 2015 the Commission lifted most of the reservations after significant corrections in 2014. We did not identify serious problems in the lifted reservations that we reviewed.

We also draw attention to the only outstanding general reservations at the end of 2015, which were for the Greek GNI data covering 2008 and 2009. Although progress has been made to improve the reliability of the Greek GNI data, these reservations have not been lifted.

Regarding customs duties, the Member States' authorities perform checks to verify whether tariff and import regulations are respected by importers. We found, as in previous years, that the methodology used for these checks (which include 'post-clearance' audits), the quality and the results they produced varied across the Member States we audited. We also highlight the interruption of the 3-year time-barring in France for debt notifications, a practice which differs from those in other Member States and leads to different treatment of economic operators within the EU.

At the end of 2015, the Commission also had a list of 325 open points concerning non-compliance with EU customs rules that they had identified through inspections in Member States. These pending issues require Member States to take measures to rectify their position and can have a financial impact. We found inefficiencies in the management of the amounts receivable (known as the B accounts) in the Member States. The Commission identified similar shortcomings in 17 of the 22 Member States they visited.

We identified risks related to customs debt recovery from companies registered outside the EU or from citizens of non-EU countries. We found a number of cases from different Member States that were unable to collect debts from citizens or companies based, for example, in Belarus, the British Virgin Islands, Russia, Switzerland, Turkey and Ukraine.

What we recommend

We recommend that the Commission:

- takes the necessary steps to harmonise the time limits of debt notifications to economic operators across Member States;
- ensures that Member States provide correct declarations of the amounts collected from customs duties in the quarterly statements, and provides guidance on what should be recorded;
- facilitates to the extent possible the recovery of customs debts by the Member States, where the debtors are not based in an EU Member State; and
- improves checks on the calculations of the contributions from the European Economic Area and the European Free Trade Association and the calculation of correction mechanisms.

Want to know more? Full information on our audit of EU revenue can be found in Chapter 4 of the 2015 annual report on the EU budget.

Competitiveness for growth and jobs
€14.5 billion

What we audited

The objectives of this spending include improving research and innovation, enhancing education systems and promoting employment, ensuring a digital single market, promoting renewable energy and energy efficiency, modernising the transport sector and improving the business environment, especially for small and medium-sized enterprises (SMEs).

Research and innovation, which accounts for 62 % of spending, is made through the Seventh Framework Programme for Research and Development 2007-2013 (FP7) and Horizon 2020, the new framework programme covering the 2014-2020 period. Other major spending instruments, support education, training, youth and sport (the Lifelong Learning Programme and Erasmus+); the development of transport infrastructure (the Trans-European Networks Transport Programme and Connecting Europe Facility); the energy sector (the European Energy Programme for Recovery); and space programmes (satellite navigation programmes such as Galileo and the European Geostationary Navigation Overlay Service, and Copernicus which is an earth observation programme).

Almost 90 % of expenditure is in the form of grants to private and public beneficiaries, with the Commission reimbursing costs declared by the beneficiaries in project cost statements.

What we found

Affected by material error?
Yes

Estimated level of error:
4.4 % (2014: 5.6 %)

For research and innovation, we found a similar type and range of errors to those we have detected throughout the course of FP7.

In contrast, we found fewer errors in payments for other spending instruments in comparison to previous years. Most of the errors are related to the reimbursement of ineligible personnel and indirect costs declared by beneficiaries.

For personnel costs, beneficiaries often incorrectly calculated the hourly rates for their staff assigned to the project, or were unable to provide adequate supporting evidence of the actual time spent on the project. In the case of indirect costs, errors were linked to incorrect overhead rates or the inclusion of costs not linked to the project. When beneficiaries declared a flat rate for indirect costs, which is based on a percentage of direct costs, the errors in direct costs also led to a proportionate error in the declared indirect costs. We also detected errors of non-compliance with the rules on public procurement, although we found a general improvement in the level of compliance in this area.

Examples: Reimbursement of ineligible personnel and indirect costs under FP7 and other programmes

We found that some of the personnel and indirect costs of a beneficiary working with 11 partners in an FP7 project for the development of enhanced geographical management information systems were ineligible. Part of the personnel costs declared by the beneficiary had actually been deployed on a different project. The beneficiary also included ineligible items in the calculation of indirect costs (such as staff costs not linked to administrative support, marketing costs, and office and travel costs not linked to the research activities).

In another case, involving a project for the development of cloud computing services financed through the 2007-2013 Competitiveness and Innovation Programme, we found that the beneficiary overcharged personnel costs, calculating costs using a standard number of working hours which was higher than the actual number of hours. The beneficiary also claimed ineligible bonus payments and expenses that were not incurred within the reporting period of the cost declaration.

Almost all of the errors that we found in cost statements were due to the beneficiaries misinterpreting the complex eligibility rules or incorrectly calculating their costs. We identified two cases of suspected fraud where the beneficiaries appeared to have intentionally overstated their eligible project costs.

Horizon 2020 has simpler funding rules than FP7 and the Commission has made considerable efforts to reduce administrative complexity. However, we noted in our 2014 annual report that some eligibility criteria in the new framework programme actually bring an increased risk of error and recommended that the Commission updates its control strategy to address, for example, cases when researchers receive additional remuneration, or participants make use of a large research infrastructure. In the limited testing we performed in 2015 for Horizon 2020, we found that the risk of errors related to cases of additional remuneration was occurring.

The Commission has established a Common Support Centre with the aim of achieving efficient and harmonised management of Horizon 2020 by the various implementing bodies. This is a positive step towards streamlining IT system and operations, harmonising grant management, coordinating audit activities, and ensuring that the implementing bodies apply Horizon 2020 rules consistently. However, the European Institute of Innovation and Technology, which is expected to manage 3 % of the Horizon 2020 budget, does not participate in this management and control framework.

What we recommend

We recommend that the Commission:

- along with national authorities and independent auditors, use all the relevant information available to prevent, or detect and correct errors before reimbursement;
- issues guidance to beneficiaries on the specific differences between Horizon 2020, FP7 and similar programmes;
- issues common guidelines to the implementing bodies for research and innovation spending, in order to ensure consistent treatment of beneficiaries when applying audit recommendations for the recovery of ineligible costs under FP7; and
- closely monitors the implementation of extrapolated corrections based on its ex post audits of reimbursed costs under FP7.

Want to know more? Full information on our audit of EU expenditure on 'Competitiveness for growth and jobs' can be found in Chapter 5 of the 2015 annual report on the EU budget.

Economic, social and territorial cohesion
€53.9 billion

What we audited

This spending area aims to reduce development disparities between regions, restructure declining industrial areas and encourage cross-border, transnational and interregional cooperation. It comprises two main parts: regional and urban policy, and employment and social affairs.

- The EU's regional and urban policy is mostly implemented through the European Regional Development Fund (ERDF) and the Cohesion Fund (CF). It accounts for nearly 80 % of the spending in 2015. The ERDF finances infrastructure projects, the creation or preservation of jobs, regional economic development initiatives and activities supporting SMEs. The CF finances investments in infrastructure in the fields of environment and transport.

- Employment and social affairs policy is mainly financed by the European Social Fund (ESF). The expenditure in this area covers around 20 % of the spending and comprises investments in human capital and support actions aimed at improving the adaptability of workers and enterprises to the changes in working patterns, increasing access to employment, reinforcing the social inclusion of disadvantaged persons and strengthening the capacity and efficiency of administrations and public services.

The ERDF, CF and ESF are governed by common rules, subject to exceptions in the specific regulation of each fund. The management of expenditure is shared with Member States and involves the co-financing of projects within approved spending programmes. Eligibility rules for the reimbursement of costs are set out at national or regional level, and may vary from one Member State to another.

In addition, there are specific instruments and funds, such as the European Neighbourhood Instrument (ENI) which targets neighbouring countries and the Fund for European Aid to the most Deprived (FEAD). Together they account for less than 1 % of the overall spending.

What we found

Affected by material error?
Yes

Estimated level of error:
5.2 % (2014: 5.7 %)

The principal sources of error for the spending on 'Economic, social and territorial cohesion' as a whole are the inclusion of ineligible expenditure in the beneficiaries' cost declarations and the selection of ineligible projects, activities or beneficiaries, followed by the infringement of public procurement rules and state aid rules.

Most errors are due to ineligible costs being declared by the beneficiaries. In addition, some of the projects that we examined did not meet eligibility conditions set out in the regulations and/or the national eligibility rules.

Serious failure to comply with EU and national public procurement rules — such as additional works or services procured improperly and unjustified direct award of contracts — remains a significant source of error for ERDF and CF spending. Our Special Report No 10/2015 on actions taken by Member States and the Commission to address the problem of public procurement errors in this spending area provides additional analysis and insight on these issues.

Example: Ineligible costs declared

In the United Kingdom, for an ERDF project which provided financial support to SMEs, part of the funding was retained by the beneficiary and not given as a grant to SMEs. The amounts retained were ineligible for co-financing as they did not meet the eligibility conditions.

Example: Ineligible project

For an ERDF project in the Czech Republic, the call for proposals specified that only SMEs were eligible. The managing authority provided funding to a beneficiary on this basis, which however had not been confirmed at the time the project was selected. Other ineligible projects were found in Italy and Poland.

Example: Serious failure to comply with public procurement rules

In Germany, additional works in a road construction project financed through ERDF — in excess of 50 % of the initial value of the contract — were directly awarded to the same contractor in breach of the EU's public procurement directive. Similar cases were found in other ERDF projects in Italy and the United Kingdom.

We also verify whether EU state aid rules have been respected. Unlawful state aid represents an unfair advantage for the beneficiary entities and thereby distorts the internal market. There can be some exceptions to the rule but these need to be notified and accepted by the Commission. Our Special Report No 24/2016 provides further information on the need for additional efforts by the Commission and Member States to prevent, detect and correct infringements of state aid rules in the area of cohesion.

For a significant proportion of transactions affected by quantifiable errors, authorities in the Member States had sufficient information available to prevent, or detect and correct the errors before claiming reimbursement from the Commission. If all this information had been used to correct errors before declaring the expenditure to the Commission, the estimated level of error for expenditure for the overall spending on 'Economic, social and territorial cohesion' would have been 2.4 percentage points lower. In addition, we found that for a number of cases, the error that we detected was made by national authorities. These contributed 0.6 percentage points to the estimated level of error.

Financial instruments in ERDF and ESF

By the end of 2014, the average disbursement rate to final recipients of financial instruments was 57 %, an improvement in comparison to the previous year (47 %). These funds provide assistance to enterprises or urban projects by way of equity investments, loans or guarantees. In total, 1 025 financial instruments have been set up with an endowment of around €16.0 billion. Several Member States face difficulties to use the endowments in full, with Greece, Spain, Italy, the Netherlands, Austria and Slovakia having the lowest disbursement rates as at the end of 2014.

Our Special Report No 19/2016 provides further information on the lessons to be learnt from the implementation of the EU budget through financial instruments in the 2007-2013 programming period.

Commission's assessment of error rates

In general, the Commission's assessment of error rates reported by audit authorities is largely coherent with the evidence provided by these audit authorities. However, the Commission's scope for validating (and, where necessary, adjusting) the reported error rates is limited when the audit authorities are not requested to provide the Commission with more specific information on their audits of operations for its verification of the annual control reports (for example, details on the audit scope, coverage, sub-sampling and classification of errors). Our analysis showed that in 2015 such information has been requested more often than in previous years.

Overall, the Commission's calculation of the amounts at risk in the 2015 annual activity reports is accurate and consistent with the available information reported and/or provided by the audit authorities. We also found that the reservations made by the Commission in the 2015 annual activity reports were in line with the Commission's instructions and the information made available to the two directorates-general.

Assessment of project performance

In our assessment for 2015, we examined 149 completed projects from 15 Member States. For two of the projects, we could not carry out our assessment since no indicators had been specified by the managing authorities.

We also found that almost all projects examined had fully or partially achieved their objectives for outputs. However, some Member States need to further improve the setting of results indicators at project level. For 38 % of the projects assessed, the Member State authorities implemented a performance measurement system to allow the monitoring of project outputs but did not define any result indicators or targets in the project approval documents. Finally, only four projects failed to reach any of their objectives.

Looking forward: 2014-2020 programming period

By the end of 2015, fewer than 20 % of the national authorities responsible for European Structural and Investment Funds (ESIFs) had been designated. This is a necessary step for Member State authorities to submit statements of expenditure to the Commission. As a consequence, there is a risk that delays in budgetary execution for the 2014-2020 programming period will be greater than those experienced for the 2007-2013 period.

In 2015, the Commission set up a high-level group of experts to assess and encourage the implementation of simplification measures by Member States for beneficiaries of (ESIFs) and to contribute to the preparation of the post-2020 programming period.

What we recommend

We recommend that the Commission:

- fundamentally reconsiders the design and delivery mechanism for the ESIFs when making its legislative proposal for the next programming period, also taking into account the suggestions of the high level simplification group;
- makes use of the experience acquired in the 2007-2013 programming period and reports on a focused analysis of the national eligibility rules for the 2014-2020 programming period, and uses it to provide guidance to Member States on how to simplify and avoid unnecessary complex and/or burdensome rules;
- submits a legislative proposal to amend the applicable regulation concerning the extension of the eligibility period for financial instruments under shared management;
- clarifies to Member States the notion of recoverable VAT, in particular for public beneficiaries, to avoid different interpretation of the term 'non-recoverable' VAT and avoid a suboptimal use of EU funds; and
- ensures that all the expenditure related to ERDF and ESF financial instruments for the 2007-2013 programming period is included sufficiently early in the closure declarations to enable Member States to carry out their checks, and to also encourage Member States to audit financial instruments in preparation for the closure of the programmes.

Want to know more? Full information on our audit of EU expenditure for 'Economic, social and territorial cohesion' can be found in Chapter 6 of the 2015 annual report on the EU budget.

Natural resources
€58.6 billion

What we audited

This spending area covers the common agricultural policy (CAP), common fisheries policy (CFP) and environmental measures.

The CAP is the basis for EU spending on agriculture. It aims to increase agricultural productivity, ensure a fair standard of living for the agricultural community, stabilise markets, assure the availability of supplies and ensure that supplies reach the consumers at reasonable prices.

The CAP is implemented through two funds: the European Agricultural Guarantee Fund (EAGF) which fully finances EU direct aid and market measures, and the European Agricultural Fund for Rural Development (EAFRD) which co-finances rural development programmes together with the Member States. Management of the CAP spending is shared with Member States. Expenditure under both funds is channelled through some 80 paying agencies, which are responsible for checking the eligibility of aid applications and making payments to beneficiaries.

The CFP is mainly implemented through the European Maritime and Fisheries Fund (EMFF), which is managed by the Commission and the Member States under shared management. The EU's policy on the environment is managed centrally by the Commission and the LIFE programme is most important fund for expenditure in this area.

What we found

Affected by material error?

Agriculture — market and direct support:

Yes

Rural development, environment, climate action and fisheries:

Yes

Estimated level of error[1]:

Natural resources overall:

2.9 %

(2014: 3.6 % / without cross-compliance errors: 3.0 %)

Comprising

Agriculture – market and direct support:

2.2 %

(2014: 2.9 % / without cross-compliance errors: 2.2 %)

Rural development, environment, climate action and fisheries:

5.3 %

(2014: 6.2 % / without cross-compliance errors: 6.0 %)

1 The figures for 2015 exclude the quantification of cross-compliance errors following changes in the CAP legal framework. This was not the case for 2014.

The nature and pattern of errors varies significantly between EAGF and the other spending areas under 'Natural resources'.

Agriculture — market and direct support (EAGF)

Many of the errors identified in our audits are the result of inaccurate or ineligible claims by beneficiaries, with the most frequent being the over-declaration of agricultural land surface area. We found errors of this type in 12 of the 18 Member States visited.

The reliability of the data in the Land Parcel Identification System (LPIS) database has improved over recent years, but we still detect errors in declared land area. We acknowledge that inaccuracies below 2 % are difficult to detect and correct. However, larger disparities between the data on eligibility recorded in the LPIS and the actual eligible land area that is visible on ortho-images (aerial photographs) kept in the LPIS database should have been detected and corrected (for example, errors we identified in Greece, Spain, Italy and the United Kingdom).

Another source of errors linked to agricultural land surface area is due to national definitions of eligible permanent pasture not being compliant with EU legislation.

Example: National eligibility criteria not complying with EU legislation

In France, authorities grant aid for grazing heathland also for areas that include a mixture of eligible herbaceous flora and ineligible vegetation, such as bushes and dense wood. We had already reported this issue in our 2013 annual report and we continue to find such cases (six in 2015).

In several cases of quantifiable errors made by final beneficiaries in agriculture, national authorities had sufficient information to prevent, or detect and correct the errors before declaring the expenditure to the Commission. If all the information had been used to correct errors, the estimated level of error would have been 0.3 percentage points lower. In addition, we detected four cases of errors made by the national authorities. These contributed 0.6 percentage points to the estimated level of error. We also identified shortcomings in the adjustments made in the Commission's assessment of the estimate level of error under the EAGF.

Rural development, environment, climate action and fisheries

The main reasons for errors in this spending category were the ineligibility of the beneficiary, activity, project or expenditure, and non-compliance with public procurement rules. In addition, we found errors related to non-compliance with agri-environment commitments and over-declarations of eligible hectares.

Example: Ineligible expenditure or activity

In Romania, we found that national authorities were not taking into appropriate account the number of production cycles when calculating expenditure using the simplified cost option. As a result, payments to all beneficiaries were systematically overstated. After further checks, we concluded that between 2012 (when the aid was introduced) and October 2015, up to €152 million out of a total €450 million could be ineligible. Simplified cost options may reduce the administrative burden for Member States and beneficiaries, but these should be based on a sound methodology, in particular an accurate calculation of the simplified cost.

Example: Non-compliance with public procurement rules

We found cases of non-compliance with public procurement rules in Germany, Greece, Italy and Romania. For example, in Italy, authorities assessed the procurement of a monorail infrastructure (financed by an EU grant) to help farmers transport olives, mainly on the basis of additional unrelated works (new roads, sewage and an aqueduct). This is irregular under Italian public procurement rules.

In a number of cases of quantifiable errors made by final beneficiaries for this spending area, national authorities had sufficient information to prevent, or detect and correct the errors before declaring the expenditure to the Commission. If all information had been used to correct errors, the estimated level of error would have been 1.7 percentage points lower. In addition, we detected some cases of errors made by the national authorities. These contributed 1.5 percentage points to the estimated level of error.

Other elements of internal control and performance

Our assessment of compliance of the Commission's conformity audits in agriculture with international audit standards and the main regulatory provisions indicated that these were overall compliant. We also found that the backlog of open files related to conformity procedures has been significantly reduced by the Commission. However, the Commission's audit manual does not include any detailed audit procedures and documentation requirements for the verification of data provided by Member States in relation to financial corrections, and in some cases we did not find sufficient and appropriate evidence of these checks having taken place.

Our visits to six paying agencies related to EAGF and EAFRD expenditure, revealed key control weaknesses related to the LPIS, the administrative controls, the quality of on-the-spot inspections and recovery procedures for incorrect payments. We also found weaknesses in the administrative checks carried out by five of the six paying agencies to verify eligibility for rural development payments. Action plans aimed at addressing the root cause of frequent errors are being updated but further improvement is needed in the area of public procurement.

In the case of fisheries, we found that in all the five audits that we examined there were weaknesses in the audit supervision and documentation. Our re-performance of an audit carried out by the Commission in Romania revealed deficiencies in the managing authority's administrative checks, particularly in relation to procurement.

In our 2015 assessment of performance-related issues for rural development investment projects, we found that most of the reviewed projects matched the needs of beneficiaries, both in terms of scale and the quality of the delivered works and products. There were, however, some cases of projects being larger than necessary. In addition, the targeting of support and the selection of projects was not as rigorous as could be expected, and there was insufficient evidence that costs were reasonable in several projects (see example below). Overall, there has been no improvement on these issues.

Example: Unreasonable costs

In Slovakia, we concluded that the paying agency had not carried out adequate checks on whether the costs claimed by a beneficiary for the construction of a storage facility were reasonable. We found that the price of the purchased concrete was six times higher than the normal market price and that the cost of the project should have been more than 50 % lower.

What we recommend

We recommend that:

- for the EAGF, the Commission should continue to follow up on cases where national legislation is not compliant with EU legislation, and also check that Member States with negative LPIS quality assessments take the necessary remedial action;
- for rural development, the Commission ensures that Member States' action plans include concrete actions to reduce errors on public procurement;
- for both the EAGF and rural development, the Commission takes measures to improve the work done by certification bodies in Member States and to ensure that the data provided by Member States and used for the calculation of financial corrections is properly verified; and
- in the area of fisheries, the Commission takes action to ensure that conformity audits are carried out in line with international auditing standards.

Want to know more? Full information on our audit of EU expenditure on 'Natural resources' can be found in Chapter 7 of the 2015 annual report on the EU budget.

Global Europe
€6.9 billion

What we audited

This spending area covers expenditure in the fields of foreign policy, support for EU candidate and potential candidate countries and development assistance and humanitarian aid for developing and neighbouring countries (with the exception of the European Development Funds — see pages 49 to 51).

Expenditure is dispersed across more than 150 countries, using a broad range of cooperation instruments and delivery methods. Spending is implemented directly by a number of directorates-general of the Commission, either from their headquarters in Brussels, by EU delegations in recipient countries, or indirectly by beneficiary countries or international organisations.

What we found

Affected by material error?
Yes

Estimated level of error:
2.8 % (2014: 2.7 %)

The most frequent type of error identified by our audit work was ineligible expenditure claimed by final beneficiaries. This involves spending on activities not covered by contracts or incurred outside the eligibility period. We also found cases of non-compliance with legal and contractual obligations, including procurement rules, the rule of origin, indirect costs wrongly being charged as direct costs or the inclusion of ineligible taxes.

Other errors we found related to the acceptance and clearance of payment by the Commission for services, works or supplies that had not yet been incurred by the beneficiary, or for which the beneficiary could not provide us with supporting documentation to justify the expenditure. We also identified delays in the Commission's validation of expenses and the authorisation of the resulting payments.

Example: Expenditure not incurred

We found that as part of a grant supporting ballistic missile non-proliferation paid through the Foreign Policy Instruments programme, the Commission had accepted expenditure claimed by a European-based research foundation that was based on estimated staff costs which were higher than the actually incurred costs.

Example: Expenditure not covered by the contract

For a project in Myanmar run by an international organisation campaigning against drug use, we found that the Commission had accepted costs related to staff training which were not covered in the related contract.

Example: Costs funded by another donor

We examined the payment of the Commission to a humanitarian organisation responding to the Syrian crisis, and found that costs they claimed for the transportation of food supplies had been funded by another donor.

We found no errors in payments made directly by the Commission to the general budgets of states, given that the Commission has considerable flexibility in deciding whether eligibility conditions have been met. There is also a lower risk of error in payments made to support activities that involve several international donors, as costs that are ineligible under EU rules can be covered through contributions by other donors.

Our transactions testing also revealed that indirect costs in twinning projects financed under the European Neighbourhood and Partnership Instrument are significantly higher than what is acceptable for grants. There is no maximum limit for lump-sum or flat-rate costs under this instrument, and this creates a risk that an implementing Member State partner may end up with a profit.

What we recommend

We recommend that the Commission:

- strengthens its checks on the quality of the expenditure verifications commissioned by beneficiaries, and improves the terms of reference provided to external auditors;
- revises the methodology applied by the Directorate-General for Neighbourhood and Enlargement Negotiations to calculate its estimated level of error in order to improve the statistical accuracy of the information being provided; and
- takes action to ensure that funding through twinning instruments complies with the non-profit rule and adheres to the principle of sound financial management.

Want to know more? Full information on our audit of EU expenditure for 'Global Europe' can be found in Chapter 8 of the 2015 annual report on the EU budget.

Security and citizenship
€2.1 billion

What we audited

This spending area groups various policies whose common objective is to strengthen the concept of 'EU citizenship' by creating an area of freedom, justice and security without internal frontiers. Expenditure covers border protection, immigration and asylum policy, justice and home affairs, public health, consumer protection, culture, youth, information and dialogue with citizens. It is a relatively small but increasing part of the EU budget (approximately 1.4 %).

Nearly a third of the spending is done through 12 decentralised agencies which we report on separately in our specific annual reports for agencies. We have focused our audit on 'Migration and security', which accounts for the largest share (40 %).

'Migration and security' spending is largely implemented through shared management between the Member States and the Commission. However, a significant quarter of the spending in 2015 was managed directly by the Commission. We, therefore, examined the main systems under the responsibility of the Commission's Directorate-General for Migration and Home Affairs, reviewing both grants and procurement procedures under direct management, as well as the assessments done by the Commission of Member State systems for managing funds under shared management.

What we found

For the grants and procurement procedures under the direct management of the Commission, we concluded that the controls required by the financial regulation had been implemented and that there were no major weaknesses.

On the other hand, we identified limitations in the Commission's assessments of Member States' management and control systems for the 2007-2013 SOLID programme ('Solidarity and Management of Migration Flows'). We found that the Commission's assessments did not include any testing of the effectiveness of key internal controls but rather focused on gaining an understanding of the control procedures and documenting them. This could have resulted in the Commission giving incorrectly low risk assessments in some cases. Furthermore, the Commission performed relatively few ex post audits in Member States on programmes it considered to be low risk. We consider that this reduces the reliability of Member States expenditure for the SOLID programme.

Want to know more? Full information on our audit of EU expenditure for 'Security and citizenship' can be found in Chapter 8 of the 2015 annual report on the EU budget.

Administration
€9.0 billion

What we audited

Administration covers the expenditure of EU institutions and other bodies. These are the Commission, Parliament, European External Action Service (EEAS), European Council and Council, European Court of Justice, European Court of Auditors (ECA), European Economic and Social Committee, Committee of Regions, European Ombudsman and European Data Protection Supervisor.

Spending on human resources (salaries, pensions and allowances) accounts for about 60 % of the total. The remainder is expenditure on buildings, equipment, energy, communications and information technology.

The results of our audits of the European Union agencies, other decentralised bodies, and the European Schools, are reported in specific annual reports which are published separately, together with a summary of the results. The ECA's own spending is audited by an external firm and the auditors' report is published in the *Official Journal of the European Union* and on our website.

What we found

Affected by material error?
No

Estimated level of error:
0.6 % (2014: 0.5 %)

Our examination of systems did not reveal any significant weaknesses overall. However, we found some areas where there is scope for improvement in certain institutions and bodies. These are addressed by the following recommendations.

What we recommend

We recommend that:

- o the European Parliament reinforces its monitoring of the political parties' application of the rules and procedures for authorisation and settlement of expenditure, and for procurement;
- o the Commission improves its systems for ensuring timely updating of information on the personal situation of staff members which is used for calculating family allowances; and
- o the EEAS strengthens the procedures for the recruitment of local staff and for the procurement of contracts of less than €60 000 in delegations.

Want to know more? Full information on our audit of EU expenditure for 'Administration' can be found in Chapter 9 of the 2015 annual report on the EU budget.

European Development Funds (EDFs)
€3.1 billion

What we audited

The EDFs provide European Union assistance for development cooperation to the African, Caribbean and Pacific (ACP) states and overseas countries and territories (OCTs). EDF spending and cooperation instruments aim to overcome poverty, and to promote sustainable development and the integration of ACP countries and OCTs in the world economy.

The EDFs are funded by the EU's Member States and are implemented either through individual projects or by providing budget support (a contribution to a country's general budget for a specific policy or objective). Each EDF is governed by its own financial regulation.

External aid financed by the EDFs is implemented in a high risk environment, notably due to the geographically dispersed activities and weak institutional and administrative capacity in partner countries. They are managed outside the framework of the EU budget by the European Commission and, for some assistance, by the European Investment Bank.

What we found

Reliability of the EDFs' accounts:

The 2015 accounts present fairly the financial position of the EDFs, the results of their operations, their cash flows and the changes in net assets.

Is the revenue of EDFs affected by material error?

No

Are the payments of the EDFs affected by material error?

Yes

Estimated level of error:

3.8 % (2014: 3.8 %)

We found that EDF expenditure on budget support and in multi-donor actions carried out by international organisations is significantly less prone to error than other EDF payments. However, this is linked to the nature of funding and the considerable flexibility that the Commission can apply when deciding whether the general conditions have been met. For example, in multi-donor projects the Commission accepts that conditions for payment have been met as long as the amount contributed by other donors is sufficient to cover those costs which are considered ineligible under EDF rules.

For payments linked to budget support, our audit of regularity can only go as far as the stage when aid is paid to the partner country. This does not permit us to detect possible shortcomings in the use these funds once they have been incorporated into the national budget.

Overall, as in previous years, the level of error we found in EDF expenditure — including in some final claims which had been subject to expenditure verifications and external audits — point to weaknesses in the *ex ante* checks. Errors due to the absence of supporting documents to justify expenditure and non-compliance with procurement rules (see examples) were the cause of more than two-thirds of the estimated level of error.

Example: Failure to provide the necessary supporting documentation to justify expenditure

We examined the expenditure on laboratory, information technology and office equipment in Mozambique that was financed by an EDF project. For four of the ten sampled payments, we were not provided with sufficient supporting documentation for the procurement and delivery of these items.

Example: Failure by the beneficiary to comply with procurement rules

We audited the procurement of agricultural product testing laboratory equipment in Ethiopia and found that the contract was awarded directly to a company without following the required competitive tendering procedure. In addition, the selected company was acting only as an intermediary and was not the authorised distributor of the procured equipment.

Overall, if all the information had been used by the Commission to correct errors it committed itself or made by the beneficiaries for projects financed by the EDFs, the estimated level of error would have been 1.7 percentage points lower.

The Commission's Directorate-General for International Cooperation and Development, which manages almost all of the spending under the EDFs, adopted a new action plan in 2015 to address weaknesses in its control system. It is too early for us to assess progress on these actions. We also found that the previous action plan, adopted in 2013, has been mostly implemented, with 19 actions concluded and the remaining four being underway at the end of 2015.

What we recommend

We recommend that the Commission:

- strengthens the monitoring of the quality of the audits and expenditure verifications outsourced directly by beneficiaries;
- revises its estimates on corrections and improves its assessment of risk and level of error for expenditure involving indirect management with beneficiary countries; and
- applies appropriate sanctions to entities that do not comply with their obligation to provide our auditors with the necessary supporting documentation.

Want to know more? Full information on our audit of the EDFs can be found in the 2015 annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds (EDFs).

Audit approach at a glance

The ECA's statement of assurance opinions are based on objective evidence obtained from audit testing in accordance with international auditing standards. This is how we do our work.

Reliability of the accounts

Do the EU annual accounts provide complete and accurate information?

The EU budget is complex. Hundreds of thousands of accounting entries are initiated by Commission directorates-general each year, capturing information from many different sources (including Member States). We check that accounting processes work properly and the resulting accounting data are complete, correctly recorded and properly presented.

- Evaluation of the accounting system to ensure it provides a good basis for producing reliable data.
- Verification of key accounting procedures to ensure they function correctly.
- Analytical checks of accounting data to ensure they are presented consistently and appear reasonable.
- Direct checking of a sample of accounting entries to ensure the underlying transaction exists and is accurately recorded.
- Checking of financial statements to ensure they fairly present the financial situation.

Regularity of transactions

Do the EU income and expensed payment[1] transactions underlying the EU accounts comply with the rules governing them?

The EU budget involves millions of payments to beneficiaries both in the EU and in the rest of the world. The majority of this spending is managed by Member States. To obtain the evidence we need, we test income and expensed payments directly and assess the systems by which they are administered and checked.

- Samples of transactions are drawn from across the EU budget using statistical techniques to provide a basis for detailed testing by our auditors.
- The sampled transactions are audited in detail, usually at the premises of final recipients (for example, a farmer, a research institute, a company providing publicly procured works or services) to obtain direct evidence that the underlying event 'exists', is properly recorded and complies with the rules under which the payments concerned are made.
- Errors are analysed and classified as either quantifiable or not.
- The impact of errors is calculated through the extrapolation of quantifiable errors in the form of an estimated level of error.
- The estimated level of error is compared against a materiality threshold of 2 % to determine our opinion.
- The systems for revenue are assessed to determine their effectiveness in making sure the transactions they manage are legal and regular.
- Other relevant information is taken into account, such as annual activity reports and reports of other external auditors.
- All findings are discussed with both the authorities in the Member States and the Commission to ensure the facts are correct.
- We adopt our opinions based on the work done and results achieved.

1 Expensed payments: interim payments, final payments and clearing of advances.

More information on the audit process for the statement of assurance can be found in Annex 1.1 to the 2015 annual report on the EU budget.

The European Court of Auditors and its work

The European Court of Auditors — ECA — is the independent audit institution of the European Union. We are based in Luxembourg and employ around 900 professional and support staff of all EU nationalities. Since our creation in 1977 we have focused attention on the importance of EU financial management and contributed to its improvement.

The ECA's audit reports and opinions are an essential element of the EU accountability chain. Our output is used to hold to account — notably within the annual discharge procedure — those responsible for managing the EU budget. This is mainly the Commission, but also concerns the other EU institutions and bodies. Member States also play a major role in shared management.

Our principal tasks are:

- financial and compliance audits, principally in the form of the statement of assurance;
- performance audits of topics selected to maximise the impact of our work; and
- opinions on regulations related to budgetary management and other issues of importance.

We aim to manage our resources in a way that ensures an appropriate balance between our various activities, helping achieve robust results and a good coverage across the different areas of the EU budget.

Our output

We produce:

- **annual reports** on the EU budget and European Development Funds. The annual reports mainly comprise the statement of assurance opinions and results, and are published each year between October and November;
- **specific annual reports** setting out the ECA's financial audit opinions on each of the EU's various agencies and bodies. 52 were published in 2015;
- **special reports** on selected audit topics, published throughout the year. They are mainly performance audits. 25 were published in 2015;
- **opinions** used by the European Parliament and the Council when approving EU laws and other decisions with significant financial management implications, and other review-based outputs. Eight opinions and two summary reports on EU agencies and joint undertakings were published in 2015;
- **annual activity reports** providing information and insight on our activities for the year.

Our work contributes to raising awareness and increasing transparency about EU financial management, providing assurance on the state of that management and making recommendations for further improvement. We do so in the interests of the citizens of the European Union.

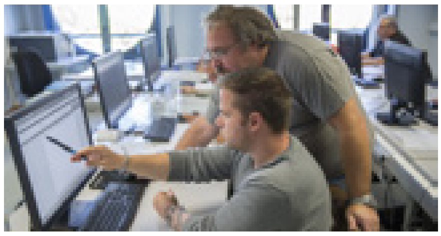
Information on our audits of the European Union agencies and other decentralised bodies can be found in the respective 2015 specific annual reports available on our website (http://www.eca.europa.eu/en/Pages/AuditReportsOpinions.aspx).

2015
Special reports

Our special reports — which are mainly performance audits — are available on our website eca.europa.eu in all EU languages

Inland Waterway Transport in Europe: No significant improvements in modal share and navigability condition since 2001 (No 1/2015)

EU funding of urban waste water treatment plants in the Danube river basin: further efforts needed in helping Member States to achieve EU waste water policy objectives (No 2/2015)

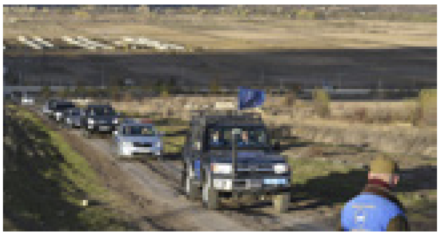


EU Youth Guarantee: first steps taken but implementation risk ahead (No 3/2015)

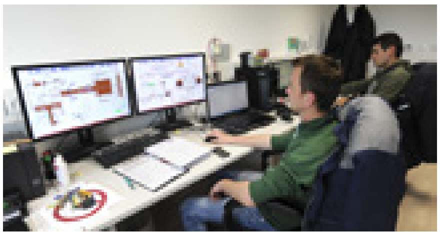
Technical assistance: what contribution has it made to agriculture and rural development? (No 4/2015)

Are financial instruments a successful and promising tool in the rural development area? (No 5/2015)

The integrity and implementation of the EU ETS (No 6/2015)

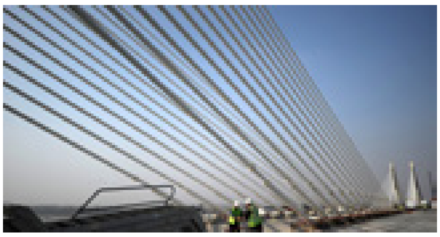


The EU police mission in Afghanistan: mixed results (No 7/2015)



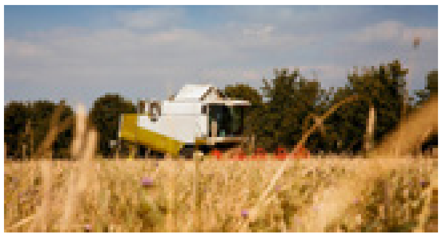
Is EU financial support adequately addressing the needs of micro-entrepreneurs? (No 8/2015)

EU support for the fight against torture and the abolition of the death penalty (No 9/2015)



Efforts to address problems with public procurement in EU cohesion expenditure should be intensified (No 10/2015)

Are the Fisheries Partnership Agreements well managed by the Commission? (No 11/2015)



The EU priority of promoting a knowledge-based rural economy has been affected by poor management of knowledge-transfer and advisory measures (No 12/2015)

2015
Special reports

EU support to timber-producing countries under the FLEGT action plan (No 13/2015)

The ACP Investment Facility: does it provide added value? (No 14/2015)

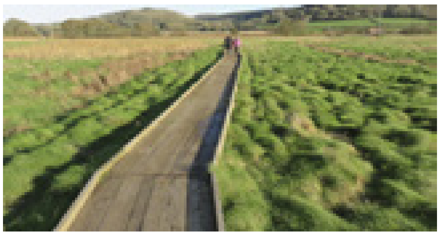
ACP-EU Energy Facility support for renewable energy in East Africa (No 15/2015)

Improving the security of energy supply by developing the internal energy market: more efforts needed (No 16/2015)

Commission’s support of youth action teams: redirection of ESF funding achieved, but insufficient focus on results (No 17/2015)

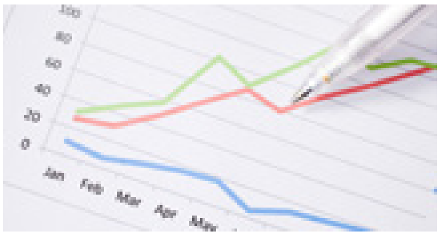
Financial assistance provided to countries in difficulties (No 18/2015)

More attention to results needed to improve the delivery of technical assistance to Greece (No 19/2015)



The cost-effectiveness of EU Rural Development support for non-productive investments in agriculture (No 20/2015)

Review of the risks related to a results-oriented approach for EU development and cooperation action (No 21/2015)



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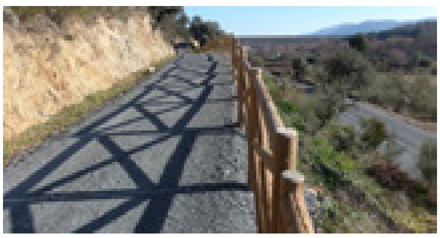

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Introducing and explaining the EU auditor's 2015 annual reports

The European Court of Auditors is the EU's independent audit institution — guardians of the EU's finances. This publication provides a summary of the main findings and conclusions of the ECA's 2015 annual reports on the EU budget and the European Development Funds. It covers the reliability of the accounts, the regularity of income and spending and getting results from the budget. The full texts of the reports are available on www.eca.europa.eu and in the *Official Journal of the European Union*.

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