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AUDIT OF THE CLEARANCE OF  
ACCOUNTS PROCEDURE



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# AUDIT OF THE CLEARANCE OF ACCOUNTS PROCEDURE

(pursuant to Article 287(4), second subparagraph, TFEU)

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# EXECUTIVE SUMMARY

## I.

The Member States' paying agencies, on behalf of the Commission, pay out some 54 billion euro of agricultural expenditure annually. The final recognition of this expenditure by the Commission is determined through a procedure called the clearance of accounts. This procedure has evolved, after its reform in 1996, from an original single clearance decision relating to a particular financial year to the current two-stage procedure. Firstly the accounts of paying agencies are checked for accuracy by certification bodies in the Member States and are then subject to an annual financial clearance decision by the Commission. Secondly the Commission itself then carries out the conformity clearance procedure through audits designed to identify and exclude (in later years) payments not complying with the rules.

## II.

The Court's audit examined both stages of the procedure to determine whether they met the objectives set and allowed the Commission and other stakeholders to gain the necessary information as to the accuracy of the accounts and the legality and regularity of the agricultural payments.

## III.

The financial clearance procedure, which is based on audits carried out by independent certification bodies in the Member States, covers primarily the reliability of the accounts of the paying agencies. On the basis of this work, the Commission makes its annual financial clearance decision and decides whether to accept the accounts of a financial year or postpone their acceptance until further work is done. The Court found that, overall, the procedure provided the Commission with sufficient information to take its annual financial decision. However, recent changes have expanded the scope of the work of the certification bodies beyond an audit of reliability to include elements of legality and regularity of payments. The use of such elements for assurance purposes has, as yet, proved to be limited. Certification bodies and directors of the paying agencies were not always clear what was expected of them, this against a background of annual changes of the guidelines and requirements.

## EXECUTIVE SUMMARY

### IV.

As regards the conformity clearance procedure, which covers the legality and regularity of the underlying payments, the Court found that it had contributed to the protection of the financial interests of the EU, by excluding over 5 billion euro of expenditure in the past 10 years. Analysis of recent conformity decisions, has shown that, where the amount of financial correction could have been calculated either on the basis of a specific correction, an extrapolation of control results or a flat-rate correction, in the vast majority of cases (by value), the amounts excluded were determined on the basis of flat-rate corrections. The difficulty with this type of correction is that they do not provide an adequate basis to determine accurately the total amount of irregular payments that are due to weaknesses found in the systems. They are therefore perceived as more of a sanction on Member States' authorities than an accounting correction. The extensive use of flat-rate corrections is a consequence of the Commission's limited audit resources and of its audit approach adapted to this situation. A more accurate accounting correction, based on a precise estimation of the damage to the Community, requires the Commission to consider the use of other methods and sources of information for its calculation, notably in cases when the financial consequences of system weaknesses are quantifiable and significant.

### V.

The complete clearance procedure, and in particular the conformity clearance, still takes too long and has become divorced from a particular budgetary exercise. Furthermore, at the end of the procedure, the Commission does not formally recognise, at a given point in time, the expenditure chargeable to a particular budgetary year, as stipulated by the financial regulation.

### VI.

The more recent changes have blurred the distinction between what is to be achieved in terms of reliability and legality and regularity. In order to better comply with the overall objective of the procedure and more fully meet the needs and expectations of the various stakeholders, the Court recommends a comprehensive review and subsequent reform of the clearance of accounts procedure.

# INTRODUCTION

## WHAT IS CLEARANCE OF AGRICULTURAL EXPENDITURE?

1. Agricultural expenditure in financial year 2008 amounted to some 54 billion euro, representing close to 50 % of the EU's payments in that year. The management of this expenditure is, in the main, shared between Member States and the Commission: aid is paid by the designated national authorities, the so-called paying agencies ('PA'), who are then reimbursed by the Commission. The final recognition of expenditure by the Commission is determined through a procedure called the clearance of accounts.
2. The purpose of this procedure is set out in the Financial Regulation applicable to the general budget of the European Communities<sup>1</sup> and its Implementing Rules<sup>2</sup>. Article 53b(4) of the Financial Regulation states that the objective of the procedure is to 'ensure that the funds are used in accordance with the applicable rules' and to 'enable the Commission to assume final responsibility for the implementation of the budget'. Article 42(2)(c) of the Implementing Rules dealing with the implementation of Article 53b further clarifies that 'the clearance of accounts procedure shall consist in [the] establishment by the Commission of the amount of expenditure recognised as chargeable to the budget ...'<sup>3</sup>.

## IMPORTANT CHANGES OVER THE LAST 25 YEARS

3. Prior to 1996 the Commission took an annual single clearance of accounts decision that covered both the reliability of the PAs' accounts and the legality and regularity of the underlying expenditure.

<sup>1</sup> Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1).

<sup>2</sup> Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 357, 31.12.2002, p. 1).

<sup>3</sup> Similarly, Council Regulation (EC) No 1290/2005 recalls, in recital 24 of its preamble, that 'the Commission which is responsible for the proper application of Community law under Article 211 of the Treaty, should decide whether the expenditure incurred by the Member States complies with Community legislation' (OJ L 209, 11.8.2005, p. 1).



4. This decision was based on specific audits carried out by the Commission, which resulted in long delays for the final clearance of the accounts in spite of the time limit provided for in the legislation (14½ months after the closure of the financial year). The Court, in its Special Report published in 1982, pointed out the fact that the delay in completing the work was such that the clearance decision had lost most of its relevance. It concluded that none of the financial years on which a decision had been made could be considered as finally cleared because such decisions were not final, incomplete or disputed<sup>4</sup>.
  
5. The Commission, in 1991, set up a working group in order to address the increasing difficulties encountered in the clearance of accounts procedure and reported by the different parties concerned. The working group considered that the single annual clearance of accounts decision created difficulties in that it had to fulfil, simultaneously, an accounting objective and recognition that expenditure has been effected in accordance with Community rules. Based on the reform suggested, it was therefore decided to split the procedure into two separate decisions:
  - (a) An annual decision covering the completeness, accuracy and veracity (hereinafter referred to as the 'reliability') of the annual accounts submitted by the accredited PAs (hereinafter called 'the financial decision'); for the purpose of this decision, the Commission requires a certification of those accounts, to be conducted by independent audit bodies (certification bodies, hereinafter 'CBs').
  - (b) Decisions on expenditure to be excluded from Community financing because it has not been effected in compliance with Community rules. Such decisions (hereinafter called 'conformity decisions') are made at the initiative of the Commission and are no longer linked to expenditure incurred in a specific financial year, rather they cover in most cases expenditure of several financial years.

<sup>4</sup> Special Report No 25/82 concerning clearance of the accounts of the EAGGF Guarantee section (OJ C 313, 29.11.1982).

6. In its 1994 opinion on this reform, the Court maintained its preference for a single annual decision and, whilst recognising the problems associated with the extant system (long delays, in particular), considered that the new split-decision system was a compromise rather than a solution to the clearance problems. In the intervening period, the Court has consistently noted in its annual reports that the timescale for clearing overall expenditure for a given year had not been accelerated.

## BOX 1

## DESCRIPTION OF THE CURRENT CLEARANCE OF ACCOUNTS PROCEDURE

The process of the current clearance of accounts procedure is as follows:

- (a) farmers present claims to an accredited PA in their Member States;
- (b) the PA checks these claims and pays the claimant. It then reports expenditure made to the Commission, which reimburses the PA;
- (c) the accounts and payments of the PA are examined by an independent body (the CB) which reports to the Commission in February of the following year;
- (d) by 30 April of that year, the Commission must decide on whether to accept the accounts (financial clearance decision) or to ask for more work to be performed or for additional information;
- (e) the Commission can then still examine the payments made by the PA. For this purpose, a specific directorate within the Commission's Directorate-General for Agriculture and Rural Development carries out audits selected on the basis of an annual risk analysis which aim to verify that Member States have strictly applied Community rules for checking the legality and regularity of the expenditure (conformity audits);
- (f) where these conformity audits reveal that expenditure has not been effected in compliance with Community rules or that Member States have not satisfactorily checked the expenditure in question and that this has resulted in a financial loss to the EU budget, the Commission can impose a correction, which in effect is a refusal to reimburse the Member State for payments it has made. Any such correction proposed by the Commission must be notified to the Member States, who have the right to invoke a conciliation procedure. Only when this procedure has run its course is the Commission in a position to include a correction in a conformity decision.

7. The most recent changes affecting the clearance of accounts procedure came into effect in 2007 by means of the introduction of revised regulations<sup>5</sup>. These changes refer to legality and regularity issues and the Commission receives the additional elements in the context of the financial clearance. In particular, the CBs must now certify not only the accounts but also the functioning of the internal control system of the PA and include in their certification report an opinion on the newly introduced statement of assurance ('SoA') issued by the director of the PA. In addition, CBs must verify and validate control statistics communicated to the Commission by Member States and assess a number of on-the-spot checks of beneficiaries carried out by PAs.

<sup>5</sup> Regulation (EC) No 1290/2005 on the financing of the common agricultural policy and the implementing Commission Regulation (EC) No 885/2006 (OJ L 171, 23.6.2006, p. 90) laying down detailed rules as regards the accreditation of paying agencies and other bodies and the clearance of the accounts of the EAGF and of the EAFRD.

# SCOPE AND OBJECTIVES

8. The fact that the current clearance of accounts procedure consists of two distinct stages determined the Court's audit approach. Its scope and objectives have been established taking into account the specifics of each of the two stages and the procedure as a whole. This report is thus divided into three parts.

## THE FINANCIAL CLEARANCE OF ACCOUNTS

9. The audit assessed the role of the CBs and the quality of the various assurance elements (see **Box 2**) provided by national entities as well as the use made of them. The questions addressed in this context were:
- (a) Does the Commission have sufficient information to take its annual financial clearance decision, which it must do by 30 April each year?
  - (b) Does the financial clearance procedure with its various components provide elements of assurance in respect of legality and regularity of underlying transactions?
10. The field audit work was carried out at the level of the Commission and in selected paying agencies in 10 Member States: Denmark, Germany, Greece, Spain, France, Italy, the Netherlands, Poland, Portugal and the United Kingdom<sup>6</sup>. Visits to these Member States took place between November 2008 and May 2009.
11. The scope of each of these audits covered the planning, testing and reporting by the CB, together with the relevant underlying documentation. The audit work included interviews with officials, an examination of the audit methodology as well as of the working papers of the CB, and tests of selected operations. Also, the audit covered the basis for the preparation of the SoA signed by the director of the PA.
12. The period under examination included the financial years 2007 and 2008, and took into account the implementation of the revisions that the Commission had introduced in its guidelines during the course of 2008. Changes made from 2009 were not included in the audit.

<sup>6</sup> In those Member States where more than one paying agency is accredited, only one was covered by the audit, together with the corresponding certification body. This was the case for Germany (Sachsen-Anhalt), Spain (Extremadura), France (AUP), Italy (AGEA), Poland (ARiMR) and the United Kingdom (RPA).

## THE CONFORMITY CLEARANCE OF ACCOUNTS

- 13.** This part of the audit was planned with a view to determining how the Commission takes its conformity decisions and the extent to which they exclude irregular payments from Community financing. Accordingly, the questions the audit was designed to answer were:
- (a) Does the conformity procedure allow for a sufficient coverage of expenditure?
  - (b) Is the financial damage caused to the budget by the impact of irregular payments adequately compensated by conformity corrections?
  - (c) Are conformity decisions taken in a timely manner?
- 14.** The audit covered in general the conformity decisions 1 to 29 which were taken from 1999 until the end of 2008. However, where considered necessary, the Court focused on the latest conformity decisions. Evidence was obtained through file review and interviews at the Commission.

## THE CLEARANCE OF ACCOUNTS PROCEDURE AS A WHOLE

- 15.** Having reviewed in detail each of the stages of the clearance of accounts procedure, the audit then sought to evaluate the coverage and results of the procedure as a whole, to determine whether it fulfils its role, as defined in the Financial Regulation. Accordingly the following questions were addressed:
- (a) Does the current clearance of accounts procedure allow for the recognition of expenditure chargeable to the budget and thus allow for the clearance of the accounts submitted to the budgetary authorities?
  - (b) Does the current clearance of accounts procedure contribute to the protection of the financial interests of the Community budget?

# PART I — THE FINANCIAL CLEARANCE OF ACCOUNTS

## INTRODUCTION

16. Article 30 of Regulation (EC) No 1290/2005 states that the Commission's financial 'clearance decision shall cover the completeness, accuracy and veracity of the annual accounts submitted'. This decision is based to a great extent on the audit certificates and reports issued by CBs and on the statements of assurance ('SoA') issued by directors of PAs. To this end, the Commission issued guidelines that both CBs and the directors of PAs must take into account.

### BOX 2

## CHRONOLOGY OF THE LATEST CHANGES TO THE FINANCIAL CLEARANCE OF THE ACCOUNTS

The detailed implementation rules applicable from financial year 2007 onwards:

- require the CBs to include in their certificates not only that the accounts of the PAs are true, complete and accurate, but also that 'the internal control procedures have operated satisfactorily';
- revise the model report to be followed by the CBs and include specific sections on (i) the verification and validation of the IACS, rural development and *ex post*<sup>7</sup> control statistics; (ii) the respect of the financial ceilings in measures subject to quantitative limits; and (iii) the single payment scheme;
- require the annual accounts, both in respect of EAGF and EAFRD, to be accompanied by an SoA, signed by the person in charge of the accredited PA (normally the director of the PA), on the reliability of the PA's accounts and on the system in place to provide reasonable assurance on the legality and regularity of underlying transactions. CBs are also required to issue an opinion on this SoA.

Furthermore, important additions were to be applied from financial year 2008.

These additions:

- specify the minimum amount of testing expected from CBs in the area of debtors;
- further develop the requirement for CBs to verify and validate the control statistics communicated by PAs and to assess the quality of the underlying on-the-spot controls;
- require the SoA to be accompanied by a paper listing concisely the documents and work performed which formed the basis of the SoA, as well as by an analysis of the control statistics. It also requires CBs to 'assess whether the supporting information used in the establishment of the SoA provides a sufficient basis and justification for the SoA, and that it is consistent with the information it has obtained during the course of its audit'.

<sup>7</sup> Council Regulation (EC) No 485/2008 of 26 May 2008 on scrutiny by Member States of transactions forming part of the system of financing by the European Agricultural Guarantee Fund (OJ L 143, 3.6.2008, p. 1).

- 17.** The accounts, together with the accompanying statements and audit certificates, are to be submitted by Member States by 1 February following the end of the financial year<sup>8</sup>. By 30 April, the Commission must issue a formal decision in which it accepts ('clears') the annual accounts of the PAs or postpones ('disjoins') such acceptance to a later date. The decision is taken after a review of the set of documents submitted by Member States and, if deemed necessary, additional bilateral queries.
- 18.** The following observations concerning the financial clearance of accounts are presented under two sections that cover, respectively, the certification of the reliability of the accounts (paragraphs 19 to 24) and the additional work required from CBs since 2007 in respect of the legality and regularity of transactions (paragraphs 25 to 52).

<sup>8</sup> The financial year as regards the EAGF and the EAFRD runs from 16 October to 15 October of the following year.

## OBSERVATIONS

### ASSURANCE IN RESPECT OF RELIABILITY OF THE ACCOUNTS OF PAYING AGENCIES

- 19.** As presented above, the annual financial clearance decision taken by the Commission covers the reliability of the accounts, i.e. their completeness, accuracy and veracity, and is largely based on certificates and reports issued by CBs on those accounts.
- 20.** The Court's audit of a sample of CBs examined the extent to which their work provides sufficient assurance for the Commission to take its decision and whether weaknesses found were correctly reflected in that decision. The following paragraphs summarise the main shortcomings detected by the Court.

## RELIANCE ON THE WORK OF THE INTERNAL AUDIT UNIT

- 21.** The audit found that certain CBs relied extensively on the work of the internal audit units of the PAs without sufficient verification of this work as required by International Auditing Standards. They either relied partly on work previously done by the internal audit unit of the PA (DE, ES), or requested the internal audit unit to carry out part of the testing on their behalf (DK, PT, UK)<sup>9</sup>.

## INSUFFICIENT SUBSTANTIVE TESTING OF EXPENDITURE (I.E. CHECKING OF INDIVIDUAL PAYMENTS)

- 22.** Instances of non-compliance with the Commission's requirements<sup>10</sup> for substantive testing — a key feature of the audit procedures — included inadequate documentation to demonstrate that the minimum number of individual payments had been recalculated by the CBs (ES, IT), insufficient verification of single payment scheme ('SPS') entitlements<sup>11</sup> and the resulting payments (DK, DE, ES, IT, UK) and weaknesses in the working papers prepared by CBs to support their audit conclusions (DE, EL, ES, IT, PL, PT, UK).

## INSUFFICIENT TESTING OF DEBTORS' TABLES

- 23.** The accounts to be presented by PAs include tables listing cases of undue payments, resulting from irregularities or cross-compliance issues, which are pending recovery and subsequent recrediting to the Community budget ('debtors' tables'). The reliability of these figures is important since they have a direct financial impact on the amounts to be recovered in application of the recovery mechanism foreseen under the clearance of accounts procedure<sup>12</sup>. CBs are therefore required to test the tables for accuracy and completeness.

<sup>9</sup> In the particular case of Denmark, the use of the internal audit unit was substantial: the CB only worked directly on the substantive testing of expenditure and the verification of the information system security. For all other areas, including the assessment of the internal control system, the testing of debtors' accounts and the validation of control statistics, the CB relied on the work and conclusions of the internal audit unit. In addition, the internal audit unit was involved in the selection process of the CB, which was finally contracted directly by the PA after proposal by the internal audit unit.

<sup>10</sup> Commission's guideline No 3 ('Audit strategy') provides the main requirements of the work of the CBs, including details on sampling methodology and key items to be covered by testing.

<sup>11</sup> As per Article 43 of Regulation (EC) No 1782/2003, 'a farmer shall receive a payment entitlement per hectare which is calculated by dividing the reference amount by the three-year average number of all hectares which in the reference period gave right to direct payments' (OJ L 270, 21.10.2003, p. 1).

<sup>12</sup> The so-called '50-50 rule', by which the Commission establishes a mechanism for sharing the loss resulting from non-recovery of debts within reasonable deadlines, is foreseen by Articles 32 and 33 of Regulation (EC) No 1290/2005 (OJ L 209, 11.8.2005, p. 1).



24. Such testing was found to be insufficient both in respect of completeness and accuracy in most Member States visited. The main findings related to the fact that CBs had not verified the timely entry into the tables of cases of detected irregularities and the existence of sufficient support for corrections and write-offs booked by PAs respectively.

#### **INSUFFICIENT WORK TO SUPPORT ASSURANCE IN RESPECT OF LEGALITY AND REGULARITY OF UNDERLYING TRANSACTIONS**

25. As indicated earlier, the Commission has significantly extended the work required from CBs, beyond the limits of the reliability of the accounts, to cover certain aspects related to legality and regularity. CBs now have to certify the satisfactory functioning of the internal control procedures, to verify and validate control statistics and to assess the quality of on-the-spot checks.
26. The current procedure, however, does not require CBs to verify at the level of the final beneficiary that transactions are eligible and therefore CBs do not include such verification in their substantive testing.

#### **LACK OF IDENTIFICATION OF KEY AND ANCILLARY CONTROLS AND LIMITED TESTING OF SYSTEMS AS TO THEIR RELIABILITY**

27. One of the key new elements introduced by the revised regulatory framework is the requirement for CBs to state whether they have obtained reasonable assurance that '[...] the internal control procedures have operated satisfactorily'<sup>13</sup>.

<sup>13</sup> Article 5 of Commission Regulation (EC) No 885/2006 of 21 June 2006 laying down detailed rules for the application of Council Regulation (EC) No 1290/2005 as regards the accreditation of paying agencies and other bodies and the clearance of the accounts of the EAGF and of the EAFRD (OJ L 171, 23.6.2006, p. 90).

- 28.** One CB failed to identify the main key and ancillary controls that should be in place at the PAs audited (ES), despite the Commission having provided a list for guidance for some schemes<sup>14</sup>. In others (DK, EL, IT, PT), this identification was not complete.
- 29.** In those cases where key and ancillary controls were identified by the CBs, the audit found that their testing was, to a large extent, limited to a verification of the existence of such controls rather than a verification of their actual operation and effectiveness, i.e. that they were functioning effectively and that their results reflected reality (DK, DE, EL, ES, IT, PL, PT, UK).
- 30.** In addition, in most of the cases where the PA has legitimately delegated specific functions to outside bodies ('delegated bodies'), the audit found that the CBs limited their audit scope to the documentation available at the central PA (DK, EL, IT, NL, PT) or failed to identify and subsequently test some of those bodies (DE, FR).

#### LIMITATIONS OF THE VALIDATION OF CONTROL STATISTICS

- 31.** A significant extension of the CB's role as regards legality and regularity is that, since financial year 2007, they are required to verify and validate the control statistics which are to be annually communicated by Member States to the Commission. These statistics present, in a table format, the results of administrative and on-the-spot checks carried out by PAs. In September 2008, the Commission published revised guidelines on the validation work to be carried out by CBs.

<sup>14</sup> Key controls are those physical and administrative checks required to verify substantive elements, in particular the existence of the subject of the claim, the quantity, and the qualitative conditions including the respect of time limits, harvesting requirements, retention periods, etc. They are performed on the spot and by cross-checks to independent data such as land registers. Ancillary controls are those administrative operations required to correctly process claims, such as verification of the respect of time limits for their submission, identification of duplicate claims for the same subject, risk analysis, application of sanctions and appropriate supervision of the procedures.

- 32.** The revised guidelines still did not fully specify the scope of the audit task; in particular, which elements of the statistics need to be verified and sampled by the CBs. This lack of precision contributed to the great variability in the scope and depth of the work done by CBs found by the Court's audit, as some CBs opted to limit their testing to only a part of the statistics included in the tables.
- 33.** The depth of testing stipulated by the Commission was not reached in the majority of the CBs visited. In particular:
- (a) a complete reconciliation between the control statistics communicated to the Commission and the underlying databases was not accomplished (DE, EL, ES (2007), FR, and IT);
  - (b) some PAs did not have complete databases to support their control statistics in respect of some IACS and rural development schemes (DE, EL, FR); moreover in some cases (DK, DE, FR) the reconciliation between the statistics communicated and the underlying databases revealed discrepancies which were not properly analysed by the CBs;
  - (c) in addition, some CBs failed to meet the target for the minimum number of inspection reports to sample in order to test the databases underlying the control statistics (DE, NL) or tested only parts of those databases (DE, EL, FR, IT).
- 34.** The shortcomings mentioned above together with the adverse opinions given by some CBs (DK, UK) on the reliability of, at least a part of, those statistics, place significant limitations on their use for assurance purposes by the Commission. A further inherent limitation to the use of control statistics arises from the sampling methodologies used by PAs in selecting claims for on-the-spot checks. These methodologies do not allow for a statistical extrapolation with a specified confidence level, which, in turn, impacts on the use that can be made of any error rates based thereon.

### INSUFFICIENT VERIFICATION OF ON-THE-SPOT CHECKS

- 35.** As part of the requirement to test the effective functioning of the internal control system and to verify and validate control statistics, CBs are required to check a sample of on-the-spot checks. The guidelines require the CBs to check a minimum of 10 controls per population audited, either by re-performing or by accompanying the inspectors, with the objective of assessing the adequacy of such controls. Only one of the CBs audited (PL) accomplished the Commission's requirement. All other CBs visited were below that target and in some cases their work was inadequate (EL, FR, IT). CBs justified these shortcomings by referring to the late introduction of the corresponding Commission guideline, and highlighted the difficulties inherent to such audit task, namely its cost, timing and the technical expertise required.
- 36.** Furthermore, the CBs visited focused on 'classical' field inspections and did not cover on-the-spot checks conducted by 'remote sensing', although these comprise a significant proportion of the total checks (DE, EL, FR, PL, UK).
- 37.** The large majority of the CBs visited, with the exception of DK and IT, chose to accompany ongoing field inspections, rather than selecting a specific sample of previously carried out inspections and re-performing them. This approach complies with the Commission's guidelines, but presents the drawback of eliminating the 'surprise effect', since the field inspectors know they are to be evaluated and therefore such inspections may not be representative of the population being assessed. Re-performance<sup>15</sup> of a previous check provides a better assessment of the on-the-spot checks carried out during the period being verified.
- 38.** These findings concerning the CBs' assessments of on-the-spot checks also impact on the use that can be made of the control statistics transmitted to the Commission by PAs, which are essentially built upon the results of such checks. This is recognised in its new proposals set out to the Member States (see the Commission's reply to paragraph 67), whereby the Commission set out new conditions under which it is prepared to limit the amount of financial corrections to the error rate found by the Member State and reported in its control statistics.

<sup>15</sup> A re-performance of a check does not imply that the CB would have carry out such task on its own. The relevant PA departments and equipment would have to be also involved in the repetition of a on-the-spot check previously carried out.

**THE PAYING AGENCY DIRECTOR'S STATEMENT OF ASSURANCE —  
A POSITIVE STEP, BUT AS YET WITHOUT SUFFICIENT BASIS**

- 39.** As from financial year 2007, the director of each PA is required to submit to the Commission an SoA<sup>16</sup>, stating whether the accounts presented give a true, complete and accurate view of the expenditure and receipts for the financial year and whether a system which provides reasonable assurance on the legality and regularity of the underlying transactions is in place.
- 40.** In addition, since financial year 2008, the directors of PAs are required to disclose the basis on which the SoA has been established by means of a list of documents used and a summary of the work carried out. An analysis of the control statistics must form part of the basis of the SoA.
- 41.** The Court views the introduction of the SoA as a positive step in increasing the accountability and ownership for the proper management of agricultural expenditure. However, its use by the Commission for assurance purposes is dependent on the methodology used for preparing that statement.
- 42.** In financial year 2008, the weaknesses found by the Court regarding the preparation of the SoAs limit the assurance the Commission can take from them. These limitations are detailed in the following paragraphs.
- 43.** Whilst the 2008 revision of guideline No 4<sup>17</sup> was first discussed at the meeting of the Committee of Agricultural Funds held in July 2008, it was only presented to PA directors at the meeting in December of that year, after the financial year end and less than two months before the deadline for the submission of the accounts. It was therefore made available too late for it to be properly taken into account in respect of financial year 2008. More significantly, the guideline also suffered from a lack of detail in respect of which control statistics were considered most relevant and what type of analysis was to be made.

<sup>16</sup> The statement of assurance is required by Article 8(1)(c)(iii) of Regulation (EC) No 1290/2005.

<sup>17</sup> Guideline No 4 on the SoA to be provided by the director of a PA pursuant to Article 8(1)(c)(iii) of Regulation (EC) No 1290/2005.

- 44.** From a formal point of view, the Court notes that most SoAs examined were not accompanied by a summary of the work performed to support the statement (EL, PT) nor by a quantitative analysis of control statistics (DK, DE, EL, FR, NL, PT).
- 45.** In substance, the Court found that the preparation of most SoAs, although making use of several elements of the internal control system, was not supported by an assurance model ensuring the coverage of all key controls and accreditation criteria in a systematic way. Such a model, if applied by PA directors, would strengthen the support for their statements.
- 46.** An example of the consequences arising from the absence of such assurance model is the case where the SoA is partly based on 'sub-SoAs' issued by heads of different departments within the PA and these sub-SoAs are in turn found to be essentially based on the judgment of the relevant head of department and not supported by any evidence (e.g. a checklist) that would demonstrate the basis on which they were prepared (EL, ES). In one Member State (ES), no sub-SoA was issued for key functions such as the execution of payments.
- 47.** Despite being systematically mentioned by the PA directors in the list of documents accompanying the SoA, the analysis of control statistics, and in particular of error rates, was found to be non-existent (EL, ES, NL, PL), inadequate (DE, FR, IT) or incomplete (PT, UK) during the Court's visits to Member States.
- 48.** In addition, a limited recalculation of error rates was performed by the Court and revealed that in certain cases they exceeded 2 %, which is defined by the Commission as the threshold above which a reservation needed to be considered for inclusion in the SoA (EL, ES Extremadura, IT, PT). No such analysis by the directors of the PAs concerned was found.
- 49.** Finally, checks carried out by the Court or by the CBs themselves on the control statistics revealed shortcomings in the corresponding tables of three PAs that call into question the reliability of those statistics (DK, EL, UK).

**LIMITED ADDED VALUE FROM THE CERTIFICATION BODIES' OPINION  
ON THE STATEMENT OF ASSURANCE**

- 50.** Since financial year 2007, the CBs are also required to issue a separate opinion on whether the SoA complies with the requirements set out by the regulatory framework. Guidance on this work has been provided by the Commission in its guideline No 7, which requires among others that CBs verify whether the supporting information accompanying the SoA is adequate.
- 51.** Even if some CBs developed specific work programmes to assess the SoA, in substance no additional audit work was carried out to support that opinion, beyond that which was undertaken in the context of the certification of the accounts. As such, the value added by the CB's opinion on the SoA is limited, since it comprises little more than a comparison between the audit certificate and the SoA (DK, DE, EL, ES, IT, UK). In one case (FR), the CB's opinion did not follow the model required by guideline No 7 and in particular did not refer to any assessment of the basis of preparation of the SoA.
- 52.** The Court further notes that the limitations affecting the use of control statistics, highlighted earlier in this report (see paragraphs 47 to 49), were not mentioned by the respective CBs in their opinions on the SoA.

## PART II — THE CONFORMITY CLEARANCE OF ACCOUNTS

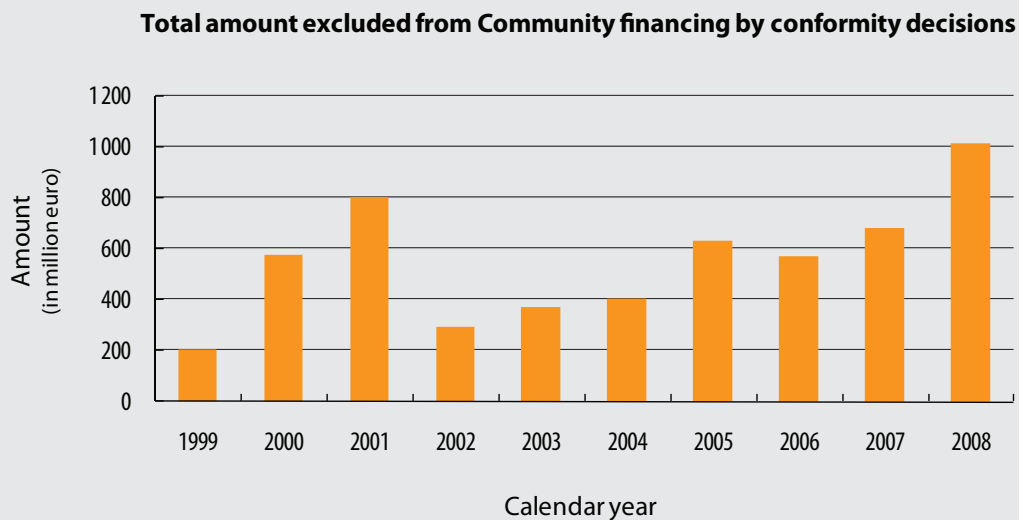
### INTRODUCTION

53. Conformity clearance in its present form was introduced as a part of the reform that took effect in 1996. Article 31(1) of Regulation (EC) No 1290/2005 stipulates for this stage of the procedure that 'if the Commission finds that expenditure ... has been incurred in a way that has infringed Community rules, it shall decide what amounts are to be excluded from Community financing ...'.
54. From 1999 to the end of 2008, the Commission took 29 conformity decisions and by means of them excluded a total amount of 5 582 million euro from community financing. **Graph 1** presents the amounts excluded per calendar year in this period<sup>18</sup>.

<sup>18</sup> These amounts pertain, however, to different preceding financial years.

GRAPH 1

### AMOUNTS EXCLUDED PER CALENDAR YEAR





## OBSERVATIONS

### THE COMMISSION'S CONFORMITY AUDITS DO NOT ADEQUATELY COVER EXPENDITURE AND RISKS

- 55.** The Commission determines each year the measures and the Member States that will be audited for conformity on the basis of an annual risk analysis carried out across the range of agricultural expenditure.
- 56.** To carry out its risk analysis for a specific year ( $n$ ), the Commission segments agricultural expenditure of the year ( $n - 2$ ) into separate 'audit fields'<sup>19</sup>. In the central risk analysis (CRA) 2008 the Commission distinguished 83 audit fields which are defined as being subject to a similar management and control system. As the expenditure under these audit fields was effected by different PAs, these audit fields are assigned to the PAs concerned and form a so-called audit field/PA pair (hereinafter 'audit area'). For the purpose of its 2008 central risk analysis, the Commission identified 1 807 audit areas which are characterised by different risk factors. The risk factors taken into consideration are the importance in financial terms and a number of other risk factors such as the quality of the control systems applying to that audit area or the characteristics of the PA. By combining these risk factors the Commission determines the exposure to risk of each audit area and quantifies it by means of an individual figure (called the 'composite risk'). The individual audit areas are ranked in decreasing order of the value of their composite risk. The Commission then determines its audit priorities on the basis of this list. The fact that the financial importance plays a major role in the quantification of the exposure to risk implies that an audit area with high expenditure is more likely to be highly ranked and audited.

<sup>19</sup> The central risk analysis for the year 2008 ( $n$ ) is based on the expenditure made in financial year 2006 ( $n - 2$ ).

57. This procedure results in a limited number of measures and PAs, which the Commission has identified as priorities, being subject to its conformity audits. The extent of the coverage of the Commission's conformity audits carried out in 2006, 2007 and 2008 is presented in **Table 1**.
58. The table shows that conformity audits covered only part of the agricultural expenditure: 44 % in 2006, 25 % in 2007 and 47 % in 2008. The fact that over the three years the sum of the percentages are above 100 % does not mean that all audit areas had been covered in this period. This is because some audit areas have been covered more than once in the period examined.

TABLE 1

### COVERAGE OF EXPENDITURE BY CONFORMITY AUDITS

Policy areas <sup>1</sup>	Main schemes	% of expenditure covered		
		2006	2007	2008
Intervention on the agricultural markets	Export refunds, fruit and vegetables, milk, public storage, wine	48 %	32 %	47 % <sup>2</sup>
Direct aid	Single payment scheme, SAPS, coupled premiums	50 %	24 %	47 %
Rural development	Agri-environment, mountain areas, farm modernisation, diversification	16 %	20 %	45 %
	<b>Average</b>	<b>44 %</b>	<b>25 %</b>	<b>47 %</b>

<sup>1</sup> The policy areas correspond to the different levels of the Directorate-General for Agriculture and Rural Development's activity based budgeting ('ABB').

<sup>2</sup> The percentage shown differs from the one published in the Commission's Directorate-General for Agriculture and Rural Development 'Annual Activity Report 2008' (54 %). This is because the Court compared gross values for both amounts audited and paid whilst the Commission compared the gross amounts audited to the net amounts paid.

Source: Table underlying the information published on page 92 of the Commission's Directorate-General for Agriculture and Rural Development 'Annual Activity Report 2008'.

59. The Commission's ability to exclude expenditure not made in conformity with Community rules through its conformity audits is further limited by the so-called '24-month rule' that is embodied in the regulation<sup>20</sup>. The rule states that 'financing may not be refused for expenditure which is incurred more than 24 months before the Commission notifies the Member State in writing of its inspection findings'. The purpose of this rule is to provide a degree of legal certainty to the Member States. In practice, this means that audit findings notified on 15 October 2005 would allow the Commission to exclude payments made as from 15 October 2003 only. If the same type of irregular payments, revealed in the course of the same audit, had been made before 15 October 2003, then the '24-month rule' would not allow to exclude them.
60. Whilst legal certainty is a legitimate objective, and while complete audit coverage within a given period is not feasible, the combined effect of the Commission's current audit coverage and the 24 month rule result in a situation where for some expenditure areas, if ultimately audited, there is no possibility to impose corrections. This can be best illustrated by the example in **Box 3**.

<sup>20</sup> Article 31(4)(a) of Regulation (EC) No 1290/2005.

### BOX 3

## IRREGULAR PAYMENTS NOT COVERED BY CONFORMITY CLEARANCE

The Court assessed a correction included in conformity decision No 22 of 27 July 2006 (2006/554/EC). This correction amounted to some 77,1 million euro and addressed, inter alia, the risk that aid was paid for parcels of French wetlands which were not eligible for direct aid. The amount of the correction was established on expenditure incurred during the 24 months prior to the notification to France in October 2001. Even though, the Commission considered payments for the same type of parcels made before October 1999 to also be irregular, such payments could not be included in the correction as a result of the application of the '24-month rule'. In this case, which is a further illustration of the long delays inherent in the system, the Court estimated the payments that could not be corrected to amount to some 100 million euro.

61. The accurate determination of the total amount that the Commission may be unable to exclude due to the application of this rule implies specific and exhaustive information that is not available in the Commission. The Court's analysis shows that the audit areas affected by this limitation are individually relatively small in financial terms, but due to their number, the total amount is not insignificant. In this context the Court further points out that the large number of audit areas included in the Commission's central risk analysis (1 807 in 2008) does not allow their full coverage in a reasonable period of time.

#### THE COMMISSION'S CORRECTIONS ARE NOT BASED ON A PRECISE ESTIMATION OF THE FINANCIAL DAMAGE CAUSED TO THE COMMUNITY

62. Regulation (EC) No 1290/2005 sets out the general principles to be followed to determine the amount of conformity corrections and stipulates that 'the Commission shall assess the amounts to be excluded on the basis of the gravity of the non-conformity recorded. It shall take due account of the nature and gravity of the infringement and of the financial damage caused to the Community'<sup>21</sup>. Under these rules the Commission has the discretion to determine the methods it uses to establish the amount of the financial corrections. The Commission has detailed these methods for the calculation of conformity corrections in a working document<sup>22</sup>.
63. The Commission's working document provides that flat-rates are to be used when it is not possible to use one of the other two methods (see **Box 4**). The Court therefore analysed the nature of corrections applied where the Commission's working document allowed to use flat-rate or specific cases (other methods) to establish the corrections<sup>23</sup>. The analysis covered the six conformity decisions taken in the period covered by the audit (2007 and 2008)<sup>24</sup>.

<sup>21</sup> Article 31(2) of Regulation (EC) No 1290/2005.

<sup>22</sup> Guidelines for the calculation of financial consequences when preparing the decision regarding the clearance of the accounts of EAGGF Guarantee (Document VI/5330/97 of 23.12.1997).

<sup>23</sup> The analysis is based on corrections that fall under Annex II to Document VI/5330/97, which allows to calculate the correction on the basis of a flat-rate or other methods.

<sup>24</sup> Commission Decisions of 18 April 2007 (2007/243/EC), of 3 October 2007 (2007/647/EC), of 20 December 2007 (2008/68/EC), of 19 April 2008 (2008/321/EC), of 8 July 2008 (2008/582/EC) and of 8 December 2008 (2008/960/EC).

## BOX 4

## COMMISSION'S METHODS FOR THE CALCULATION OF FINANCIAL CORRECTIONS

The Commission details three calculation methods:

- (a) When the error revealed by the audit is based on a specific case (or a few cases), the correction is equal to the value of the erroneous transactions.
- (b) When the errors are revealed by the examination of a representative sample of transactions, the correction is then based on the extrapolation of these results.
- (c) When it is not possible to use one of the two methods mentioned above, flat-rate corrections are applied to the amount of expenditure placed at risk.

The level of the flat-rate correction applied (2 %, 5 %, 10 %, 25 % or higher) depends on the seriousness of the weaknesses found, whether they are related to key or ancillary controls and whether they are recurrent or not<sup>25</sup>.

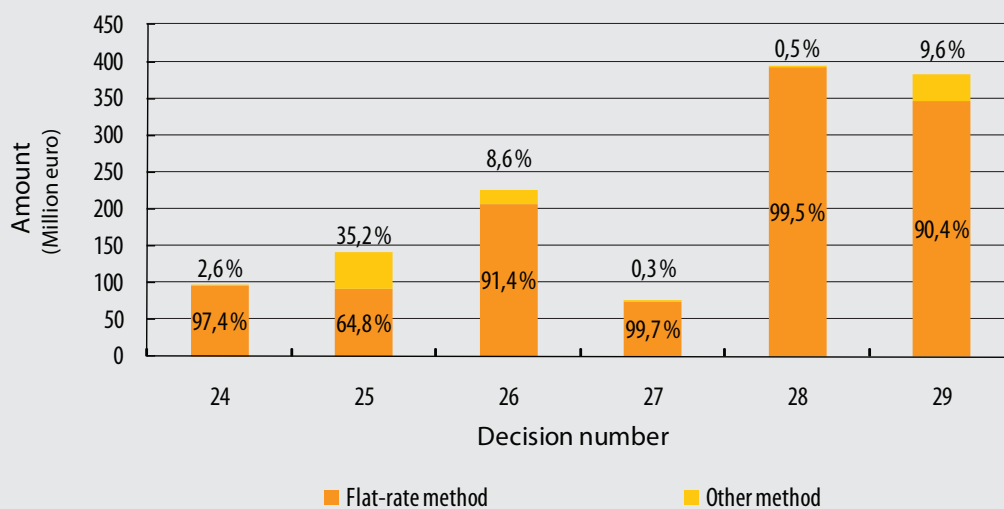
Use of a 2 % flat-rate	Key controls are satisfactory but one or more ancillary controls failed to operate.
Use of a 5 % flat-rate	Not all the key controls are executed in the number, frequency or depth required by the regulations. Therefore, the risk of loss for the fund is significant.
Use of a 10 % flat-rate	One or more key controls are not applied or applied so poorly or so infrequently that they are completely ineffective in determining the eligibility of the claim or preventing irregularity. Therefore there is a high risk of widespread loss to the fund.
Use of a 25 % flat-rate	When a control system is absent or gravely deficient and there is evidence of widespread irregularity and negligence in countering irregular or fraudulent practices. There is a risk of exceptionally high losses to the fund.
Use of higher flat-rates	Deficiencies are so serious as to constitute a complete failure to comply with Community rules, so rendering all payments irregular.

<sup>25</sup> A definition of key and ancillary controls is provided under footnote 14.

64. **Graph 2** shows that, for each of the conformity decisions analysed (2007 and 2008), the vast majority of corrections (by value) are flat-rate corrections and that they cannot therefore be considered the exception. Overall, considering the six conformity decisions, 92 % of the corrections (by value) are flat-rate corrections.

GRAPH 2

### FLAT-RATE CORRECTIONS AS COMPARED TO OTHER METHODS



- 65.** The overriding reason for this method mostly being used is that the key element of the Commission's conformity audits is the evaluation of systems operated by the Member States. This approach, however, does not give sufficient consideration to the need to determine with greater precision the financial consequences of the weaknesses detected in the systems. In cases where such consequences are quantifiable and significant, so that the potential corrections are large, there is a need to undertake sufficient so-called substantive testing, i.e. detailed testing of an aid payment including a check of its eligibility at beneficiary level (on the spot), which would allow an accurate quantification of the amount to be corrected (e.g. by way of extrapolation of a statistically valid sample). The Commission in its operational handbook recognises this limitation and explains it by stating that 'in the clearance of accounts process, the auditor is required to assess not only the weakness in the system (which would imply the test of controls), but also take account of the financial effect of the weakness (which would imply substantive testing)', but that, in practice, this is not possible because 'substantive testing to a reasonable level would require more resources than are available'.

66. The difficulty with the flat-rate method is that weaknesses in systems are indicative of a risk of irregular payments but do not provide evidence that irregular payments were actually made, still less that their total amount was equal to the flat-rate correction imposed. Therefore, flat-rate corrections do not provide an adequate basis to accurately determine the irregular payments due to the system's weaknesses found<sup>26</sup>. Indeed, the Commission in its 'Operational handbook for conformity audits' recognises that the systems-based approach will usually make it impossible to estimate accurately the amount of non-complying payments since there is generally no observable relationship between the weaknesses identified in systems and errors in payment<sup>27</sup>. This situation is illustrated by the following example in **Box 5**.

<sup>26</sup> The fact that this method has been accepted by the Court of Justice as being in conformity with the underlying legal provisions does not put this observation into question. In fact the Court of Justice has not so far questioned the flat-rate method as such, but only whether its use is in compliance with legal provisions.

<sup>27</sup> See paragraph 28.2.1 of the Commission's 'Operational handbook for conformity audits.'

## BOX 5

### THE COMMISSION'S SCOPE OF TESTING

In its conformity decision No 28, the Commission excluded an amount of 55 million GBP (68 million euro) from Community financing which concerned payments made by the United Kingdom PA in financial years 2004 and 2005. This amount resulted from a flat-rate correction of 5 % due to system weaknesses identified by the Commission auditors and concerned the inadequate quality of on-the-spot checks using remote sensing (the inappropriate timing of the follow-up field visits and the inaccurate determination of the area eligible for payment).

The Commission checked a number of parcels for their size and eligibility, but it did not test a representative sample of individual payments, which would have allowed it to calculate the precise amount of the damage to the EU budget.

In the absence of such an approach, it is not possible to establish whether the flat-rate correction was adequate, insufficient or excessive.



67. The Court's observation was underlined by the European Parliament in its discharge resolution for financial year 2007, whereby it deplored, among other shortcomings in the clearance system, the fact that no valid link can be made between the amounts recovered and the real amount of irregular payments<sup>28</sup>. Already in 2003, the European Parliament, in its resolution on the reform of the procedure of the clearance of accounts, had noted 'that some 90 % of all corrections by value are flat-rate corrections and not exact corrections' and asked 'the Commission to propose measures in order to reduce its reliance on flat-rate corrections by the end of 2004'<sup>29</sup>. To date, no such measures have been proposed.

#### CONFORMITY DECISIONS ARE TAKEN TOO LATE

68. The Court has pointed on several occasions to the long delays in the clearance of accounts procedure prior to its reform in 1996. Consequently, the Court, in its Opinion No 5/94 concerning the reform of Council Regulation (EEC) No 729/70 on the financing of the common agricultural policy, indicated that it was necessary to set precise time limits at all stages of the clearance procedure in order to avoid unacceptable delays. This proposal was not finally adopted in the amended version of the regulation.
69. However, the Commission has set an indicative internal target by which it aims to complete the conformity clearance procedure. It provides for the entire procedure to be finalized within 450 days after the audit took place (without conciliation) and 645 days in the case that the Member State requests conciliation. The various stages in the procedure foreseen are presented in **Box 6**.

<sup>28</sup> See paragraphs 82 and 83 of the European Parliament resolution of 23 April 2009 on the discharge for implementation of the European Union general budget for the financial year 2007, Section III — Commission (P6\_TA(2009)0289): '82. Deplores the fact that the same shortcomings inherent in the clearance system were again found by the ECA in 2007, such as the retroactive and multiannual nature of conformity clearance and the fact that no valid link can be made between the amounts recovered and the real amount of irregular payments (paragraph 5.47 of the Annual Report for 2007);

83. Considers that, after a number of years of the same serious criticisms of the same problem by the ECA, the Commission must propose measures to reform the system to make it possible to establish clear and valid links between amounts recovered and the amount of irregular payments and ensure, as far as possible, that the cost of financial corrections is met by the final beneficiaries and not by the taxpayer and that flat-rate corrections are applied to those Member States which fail to meet their obligations.'

<sup>29</sup> See paragraph 19 of the European Parliament resolution on reform of the procedure of the clearance of accounts (OJ C 39 E, 13.2.2004, p. 51).

## BOX 6

## INDICATIVE INTERNAL TARGET OF THE CONFORMITY CLEARANCE PROCEDURE

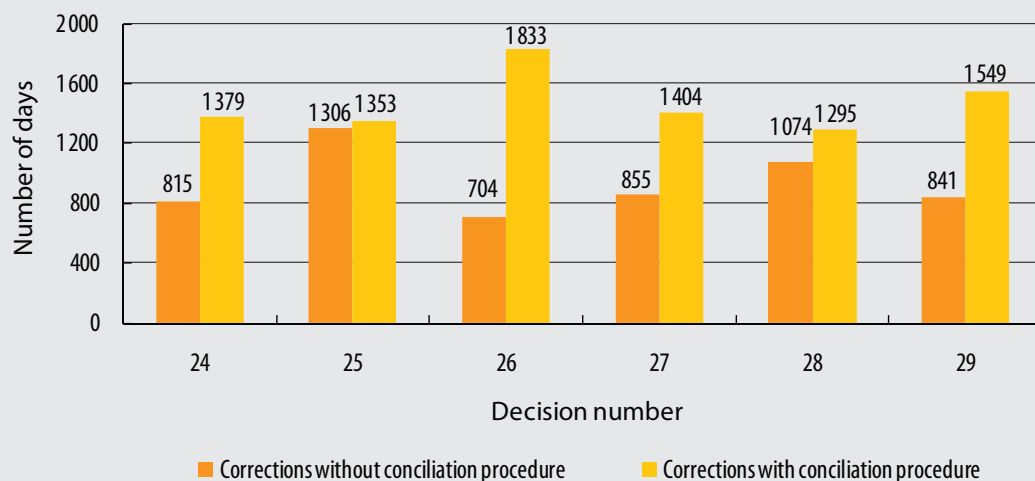
Stage A	Audit in the Member State	
Stage B	Reporting on audit findings	A + 60 days
Stage C	Letter to Member States on findings	B + 30 days
Stage D	Reply of the Member States	C + 60 days
Stage E	Translation and examination of the reply	D + 90 days
Stage F	Bilateral meeting on issues disagreed	E + 45 days
Stage G	Conclusion letter of bilateral meeting	F + 15 days
Stage H	Member State's reply to the conclusions, its translation and examination on part of the Commission	G + 105 days
Stage I	Draft final conclusion	H + 45 days
<b>Days since the audit took place (without conciliation)</b>		<b>450 days</b>
Stage J	Member States' request for conciliation	I + 30 days
Stage K	Conciliation Body report	J + 120 days
Stage L	Draft final Commission position	K + 45 days
<b>Days since the audit took place (with conciliation)</b>		<b>645 days</b>
<b>Proposed frequency of conformity decisions</b>		<b>two to three times/year</b>

Source: Commission's Directorate-General for Agriculture: 'Fact sheet – The clearance of accounts procedure' ([http://ec.europa.eu/agriculture/publi/fact/clear/clear\\_en.pdf](http://ec.europa.eu/agriculture/publi/fact/clear/clear_en.pdf)).

70. On the basis of the six conformity decisions taken in 2007 and 2008, the Court assessed the actual time needed for arriving at a draft final conclusion (stage I — procedure without conciliation) or a draft final position (stage L — procedure with conciliation). The results are shown in **Graph 3**.
71. This analysis shows that, in general, the time needed for corrections, both with and without a conciliation procedure, was significantly in excess of the Commission's indicative internal target. In many instances, this was due to the fact that the Commission was obliged to carry out further audits in a Member State in order to better establish the magnitude and severity of their control systems' deficiencies.

GRAPH 3

## TIME NEEDED FOR THE CONFORMITY PROCEDURE



- 72.** The procedure is obviously lengthened when Member States request conciliation. In 2003, the European Parliament, in its resolution on the reform of the procedure, noted that it: 'regrets that the conciliation procedure does not result in a decline in the number of cases brought before the Court of Justice. It considers that the conciliation procedure does not in practice aim to reconcile positions, but rather serves as an extra opportunity for Member States to appeal, as a check on the Commission's work and as an incentive for the Commission to perform well. It doubts whether this provides sufficient basis to justify the continuation of the conciliation procedure in the long term. It asks the Commission, together with the Conciliation Body, to explore ways to filter and thereby reduce the number of cases referred to the Conciliation Body'<sup>30</sup>.
- 73.** Overall, the Court observed that the conformity clearance procedure is too long (taking two to five years). At the end of 2008, the clearance of accounts was not complete for any year later than 2001.

<sup>30</sup> See paragraphs 10 to 12 of the European Parliament resolution of 30 January 2003 on reform of the procedure of the clearance of accounts.

# PART III — THE CLEARANCE OF ACCOUNTS PROCEDURE AS A WHOLE

## INTRODUCTION

74. In Parts I and II of this report, the two stages of the current clearance of accounts procedure have been examined separately. In this part, consideration is given as to whether these procedures, taken as a whole, fulfil the role of the clearance of accounts.

## OBSERVATIONS

### COMPLIANCE OF THE CURRENT CLEARANCE OF ACCOUNTS PROCEDURE WITH THE FINANCIAL REGULATION

75. As was recalled in the introduction to this report, the overall objective of the clearance of accounts is to enable the Commission to assume final responsibility for the implementation of the budget in a situation where agricultural expenditure is executed by Member States under 'shared management'. For this purpose it is incumbent upon the Commission to recognise that part of expenditure that has been made in accordance with the applicable rules and is chargeable to the EU budget and to exclude from Community financing that part which does not comply with the rules. This is detailed in Article 53b of the Financial Regulation and Article 42 of the Implementing Rules of the Financial Regulation.
76. The clearance of accounts procedure shall consist, therefore, in the establishment of the amount of expenditure recognised as chargeable to the budget. This implies a positive, final act of recognition, on the part of the Commission, of the expenditure chargeable to a particular budgetary exercise, in order to inform the budgetary authorities and assume its final responsibility.

- 77.** The current two stages of the clearance procedure provide only for an annual financial decision on the reliability of the accounts (the financial decision). In the subsequent conformity decisions, specified amounts are excluded. However, there is no formal final decision establishing for a given exercise the amount of expenditure recognised as chargeable to the budget. In the absence of such a decision on legality and regularity, the expenditure of the year in question cannot be considered as being fully cleared.
- 78.** The conformity decisions can not be considered to fully compensate for the limitation of the annual financial decision for the following reasons:
- (a) the Commission makes conformity decisions (normally three per year) on an ad hoc basis when it has completed an audit or a group of audits. These decisions are not related to a specific financial year, but concern various financial years. Conformity decision No 29 for instance, taken in 2008, included corrections which were related to financial years going from 2001 to 2007;
  - (b) the conformity decisions may be taken up until a point in time where they are time barred. In practical terms, this means that conformity audits ongoing at the end of 2008 allowed for corrections relating as far back as financial year 2002. This implies that by the end of 2008, financial year 2001 can be considered as being closed. This status is, however, (i) not formally notified to any of the stakeholders in a Commission decision, nor even as a note to the financial statements and (ii) achieved only long after the corresponding financial decision had been taken.
- 79.** The Court has repeatedly pointed to these issues in its annual reports where it identified as inherent limitations in the clearance system the retroactive and multiannual nature of the conformity clearance<sup>31</sup>. In 2007, the Court reported that 'conformity decisions did not relate to payments made to final beneficiaries in the year in which the decisions were taken — they usually related to several years of expenditure and were taken several years in arrears. By the end of 2006 clearance was not complete for any year later than 1998<sup>32</sup>; by the end of 2008 not for any year later than 2001.

<sup>31</sup> See paragraph 5.58 of the Court's Annual Report concerning the financial year 2008 (OJ C 269, 10.11.2009) and paragraph 5.47 of the Court's Annual Report concerning the financial year 2007 (OJ C 286, 10.11.2008).

<sup>32</sup> See paragraph 5.63(a) of the Court's Annual Report concerning the financial year 2006 (OJ C 273, 15.11.2007).

- 80.** The European Parliament has raised the subject in its resolution on the procedure of the clearance of accounts for the 2003 exercise where it 'invites the Commission to inform the discharge authority when a specific financial year has been finalised and to present the financial corrections per Member State and per sector for that year in the following annual Financial Report on the EAGGF'<sup>33</sup>. No progress in responding to that request had been made at the time of the audit. However, the Commission has undertaken to provide additional information in the annual accounts 2009 to be published in 2010.
- 81.** The Court considers that the current clearance of accounts procedure does not provide for a formal, final recognition of the expenditure chargeable to a particular budgetary exercise, either in the form of a specific decision stating the amount finally accepted or in the form of specific information disclosed in the financial statements, a position that the Court repeatedly stated in its annual reports addressed to the discharge authority. Accordingly the procedure does not provide the necessary clarity regarding the amount recognised as chargeable to the budget for a given financial year as stipulated by the Financial Regulation (see paragraph 2).
- 82.** In this regard, the Court recalls that in its 1994 opinion on the reform, 'the Court reiterates its adherence to the principle of a single, annual EAGGF-Guarantee clearance decision, as postulated by Regulation (EEC) No 729/70 in its first version' and considered that 'in this context, the Commission's proposal looks like a compromise solution, taking account of the weaknesses observed in the clearance procedure but not remedying them completely'.

<sup>33</sup> See paragraph 8 of the European Parliament resolution on reform of the procedure of the clearance of accounts.

## THE CONSEQUENCES OF THE CURRENT SITUATION

### THE CONSEQUENCES ON THE FINANCIAL STATEMENTS

- 83.** The financial statements are presented to the European Parliament and Council following the annual financial clearance decision but prior to the conformity decisions being taken. Therefore, these financial statements do not yet reflect the exclusion of the expenditure not made in compliance with the rules.

**84.** The Court, in this context, has repeatedly stated in its annual reports that ‘although the explanatory notes to the annual accounts contain information about the fact that some transactions are likely to be corrected at a later date by the Commission’s departments or the Member States, the amounts and areas of expenditure which may be subject to further verification and clearance of accounts procedures are still not identified in the notes’<sup>34</sup>. Taking 2008 as an example, the notes to the financial statements indicate that the Commission decided to recover 859 million euro<sup>35</sup> from Member States (through conformity decisions). This amount relates to expenditure booked in earlier years, but no information is provided as to which years, which Member States or which measures are concerned.

**85.** The Commission has sought to mitigate this lack of certainty by including, in the notes to the accounts, an estimate of amounts it considers may be excluded in future years, based on averaging the total of exclusions in previous years. Whilst the inclusion of such estimates gives supplementary information to the user of the financial statements, they cannot be considered to be a reliable indicator of the future corrections in terms of value nor of which area of expenditure any future correction will affect. Again, taking 2008 as an example, the financial statements include a note disclosing that the Commission expects to recover, by means of future conformity decisions, some 1,7 billion euro relating to expenditure incurred during the period 2001–08<sup>36</sup>.

#### CONSEQUENCES FOR THE DISCHARGE PROCEDURE

**86.** The discharge is the decision taken by the authority empowered, the European Parliament, which releases the executive, the Commission, from any further liability in respect of its management of the budget, thus marking final closure of the budget.

<sup>34</sup> See paragraph 1.28 of the Court’s Annual Report concerning the financial year 2007.

<sup>35</sup> See note 6.4.1.1 to the financial statements in the annual accounts of the European Communities for financial year 2008.

<sup>36</sup> See note 5.3 to the financial statements in the annual accounts of the European Communities for financial year 2008.



- 87.** The discharge decision is the culmination of a procedure that starts in the year following the execution of the budget in question and is normally completed by 15 May of the year after that. After the Council has drawn up a recommendation, Parliament examines the financial statements referred to in Article 275 EC (Article 318 TFEU), the annual report and relevant special reports by the Court of Auditors and the Court's statement of assurance referred to in Article 248 EC (Article 287 TFEU).
- 88.** The current clearance of accounts procedure impacts on the main actors in the discharge procedure, European Parliament and Council, in the following ways: The European Parliament and the Council are asked to examine financial statements which present incomplete information and to discharge the Commission from its responsibility for management of the budget whilst the expenditure concerned is not definitive and will be amended, or corrected, later by the Commission's conformity decisions. The European Parliament has commented on this situation in the past (see paragraph 80). Reference to this question was also made by the Council which in its recommendation on the discharge to be given to the Commission for the financial year 2004 'calls on the Commission to indicate separately in the Director-General's declaration verified expenditure and expenditure subject to further checks'<sup>37</sup>.

### **THE ROLE OF THE CLEARANCE OF ACCOUNTS IN THE PROTECTION OF THE COMMUNITY FINANCIAL INTERESTS**

- 89.** Even though the exclusion of irregular payments shields the EU budget from expenditure that should not be charged to it, the Commission itself points out that conformity clearance is not a mechanism to make 'recoveries' of irregular payments from beneficiaries, but it highlights that the corrections 'are a strong incentive for the Member States to improve their management and control'<sup>38</sup>. However, the 2008 financial statements of the European Commission include the amount of 859 million euro for conformity clearance under the heading 'Recovery of undue payments'.

<sup>37</sup> See paragraph 4 of chapter 4 of the Council recommendation on the discharge to be given to the Commission in respect of the implementation of the general budget of the European Communities for the financial year 2004.

<sup>38</sup> See note 6.2.1 to the financial statements in the annual accounts of the European Communities for financial year 2008.

- 90.** The Court in this respect further points out that conformity decisions taken can undoubtedly go some way to protecting the financial interests of the EU. However, the fact that the financial corrections are excluded from the amounts subsequently reimbursed to the Member States has the following consequences:
- (a) financial corrections are not charged to the farmers and traders who obtained irregular payments, but rather in the main to the national taxpayers;
  - (b) they do not, in the vast majority of cases, have a direct preventive or dissuasive effect on beneficiaries who have received payments made not in accordance with the rules as the exclusions made cannot be related to individual cases and subsequently recovered.
- 91.** The Court observes that the bulk of corrections (by value) are flat-rate based (see paragraph 64) and, therefore, do not exclude identified items of expenditure (that did not comply with the rules) but rather sanction weaknesses in the checks and procedures introduced by Member States. The mechanism by which the amounts decided upon are excluded provides that the amounts are deducted from future payments made to the Member States by the Commission. For these reasons the clearance decisions have come to be regarded as sanctions on the Member State's administration rather than corrections for non-compliant payments.

# CONCLUSIONS AND RECOMMENDATIONS

## CONCLUSIONS

### THE FINANCIAL CLEARANCE OF ACCOUNTS

92. The annual financial clearance procedure initially covered the reliability of the accounts but, recently, has been extended to cover certain aspects of the legality and regularity of transactions.
93. Regarding the [reliability of the accounts](#), the Court found that there was a high variability in the standard of the CBs' testing which, in some cases, adversely affected the basis of their certification as outlined in paragraphs 21 to 24 above. Notwithstanding the weaknesses detected, the Court concluded that their impact would not have changed the Commission's decision on the accounts of the PAs concerned (i.e. to clear or disjoin them). Accordingly, the Court concludes that the clearance of accounts procedure, as regards the reliability of the accounts, provides reasonable assurance and sufficient information for the Commission to take its annual financial clearance decision.
94. Regarding the [new elements of assurance](#) relating to the legality and regularity of underlying transactions that are now required from CBs and PA directors, the Court concluded, for the reasons outlined in paragraphs 25 to 52 above, that the use that could be made of such new elements for assurance purposes was as yet limited. In particular, the testing of the internal control procedures varied significantly between the CBs visited and , in general, the work done is not sufficient to support their statement that the internal control procedures of the PAs have operated satisfactorily. Also, the SoAs of the directors of PAs cannot provide assurance as to the legality and regularity of the underlying transactions unless there is reasonable assurance that the control statistics are reliable, which is not yet the case. The value added by the opinion issued by CBs on the SoA is not as yet clear.

## THE CONFORMITY CLEARANCE OF ACCOUNTS

- 95.** Between 1999 and the end of 2008, the Commission has recovered, from Member States, 5 582 million euro through its conformity decisions. However, significant shortcomings still affect the implementation of the conformity clearance procedure and adversely impact on the achievement of its objective to exclude irregular payments from Community financing.
- 96.** The resources available to the Commission for its conformity audits result in limited audit coverage of agricultural expenditure which, when combined with the application of the '24-month rule', results in a situation whereby irregular payments may be identified but cannot then be excluded from Community financing.
- 97.** As the Court has previously observed, the audit of systems by the Commission does not preclude the use of an appropriate sampling method to determine the financial impact of irregular expenditure. Any appropriate method should include an examination of the legality and regularity of the payments at the level of the final beneficiaries. The fact that the Commission has adapted its audit approach to its available resources results in a lack of sufficient such substantive testing and, consequently, in the generalisation of flat-rate corrections. These corrections do not allow for the establishment of a valid link between the amounts recovered from Member States through conformity decisions and the amounts of irregular payments that the recoveries are supposed to compensate for.
- 98.** The European Parliament in its resolution on the reform of the procedure of the clearance of accounts pointed out that 'the clearance of accounts was reformed in 1996 to overcome the problem of long delays in the clearance decisions'. However, the time needed to take the conformity decisions and complete the procedure is still considered to be too long. As a result of the length of the conformity procedure, at the end of 2008, the clearance of accounts procedure was not complete for any year later than 2001.

## THE CLEARANCE OF ACCOUNTS PROCEDURE AS A WHOLE

- 99.** The 1996 reform of the clearance of accounts procedure introduced a two-stage procedure which implies that there is now only an annual Commission financial decision and that the conformity decisions cover several years and are no longer linked to a particular financial year.
- 100.** Through the clearance of accounts procedure, the Commission does not take a formal final decision establishing, for a given exercise, the amount of expenditure recognised as chargeable to the budget as stipulated by the Financial Regulation. In the absence of such a decision on legality and regularity, the expenditure of the year in question cannot be considered as being fully cleared at the time of the discharge.
- 101.** The financial statements are presented to the Parliament and Council following the financial clearance decision but before the exclusion of irregular expenditure. The Parliament, by granting discharge to the Commission, exonerates it from its responsibility for implementation. By doing so, it issues an opinion on information covering operations for which the Commission has not yet assumed responsibility and which is therefore likely to be amended at a later stage.
- 102.** The Commission's imposition of corrections through its conformity decisions which are, in the main (by value), flat-rate corrections, runs the risk that the amounts excluded are not considered by the Member States as being clear and undisputable. Consequently, although the 1996 reform advocated a preventive and corrective mechanism philosophy rather than a means of imposing penalties, financial corrections can be perceived as sanctions<sup>39</sup> which are negotiable rather than recoveries of irregular payments.

<sup>39</sup> The fact that 'recurrent' weaknesses identified by the Commission entail the application of a higher rate of flat-rate correction reinforces this perception.

- 103.** The conformity decisions are not related directly to irregular payments made to beneficiaries and do not therefore directly exclude this irregular expenditure from Community financing. In fact, the cost of the financial corrections included in these decisions is borne by the Member States rather than by the beneficiaries of the aid irregularly paid.

### RECOMMENDATIONS

- 104.** The Court recommends that the clearance of accounts procedure, as a whole, be reviewed with a view to addressing, in particular, the following points:
- (a) The objectives set for the various phases of the clearance of accounts procedure and for the procedure as a whole, as well as the respective roles and responsibilities of the different parties involved should be more clearly defined in the relevant regulations rather than being frequently modified over time by means of guidelines. This should help in stabilising the role of the CBs.
  - (b) An important element of the revision recommended in (a) above should be to establish time limits for all stages of the procedure and, in particular, a time limit for the Commission to take its final decision on a specific financial year.
  - (c) The Commission should, at the end of the conformity clearance procedure, recognise the amount of expenditure chargeable to the accounts of a given financial year and inform the discharge authorities accordingly.
  - (d) In order to improve the current disclosure provided to users of the financial statements, the statements should identify, for each Member State, the amounts by budget area and by budget year which may be subject to further verification.

- (e) Longstanding criticisms that are still relevant in spite of previous reforms should be addressed: they include the excessively long delays necessary to complete the procedure, the fact that the procedure is divorced from the annual financial statements (see (c) and (d), above) and the excessive reliance on forfeitary corrections. As to the latter, the Commission should consider a more extensive use of statistically valid samples in cases where significant system weaknesses are found. Such an approach would constitute an undisputed means of establishing a well-founded and proportionate relationship between the financial impact of errors on the accounts and the correction the Commission imposes. The Commission should therefore explore the various ways which would allow it to achieve this objective, bearing in mind the cost–benefit of such controls.
- (f) The power for the Commission to sanction Member States for control weaknesses, currently exercised through the conformity decisions, should be separated from the clearance of accounts procedure which is of a different nature.
- (g) Finally, the Court considers that the clearance of accounts procedure, as regards the reliability of the accounts, would be further enhanced by the continued supervision of the work of certification bodies by the Commission, in particular through specific audit visits.

This Report was adopted by Chamber I, headed by Mr Michel CRETIN, Member of the Court of Auditors, in Luxembourg at its meeting of 21 July 2010.

*For the Court of Auditors*



Vitor Manuel da SILVA CALDEIRA  
*President*

# REPLY OF THE COMMISSION

## EXECUTIVE SUMMARY

### III.

The Commission considers that within the overall framework for the management and control of agricultural expenditure, the new work required from the certification bodies is an important and useful element for the purpose of gaining reasonable assurance on the legality and regularity of the underlying transactions. These new requirements were first introduced for financial year 2007 and while modified and expanded for financial year 2008 have, since then, in substance remained unchanged. The new requirements were also discussed with the certification bodies in an annual conference.

As a result the situation in financial year 2009 (after the end of the audited period) has improved substantially for all the new elements of assurance mentioned (i.e. those concerning legality and regularity of payments).

### IV.

The conformity clearance procedure is designed to exclude expenditure from EU financing which has been incurred in a way that has infringed EU law. In contrast, it is not a mechanism by which irregular payments to beneficiaries are recovered which, according to the principle of shared management and the rules of Article 9(1)(a)(iii) of Council Regulation (EC) No 1290/2005 and Article 53b(2)(c) of the Financial Regulation, is the sole responsibility of Member States. Where irregular payments to individual beneficiaries are or can be identified as a result of the conformity clearance procedures, Member States are required to follow them up by recovery actions against these beneficiaries.



## REPLY OF THE COMMISSION

Article 31(2) of Regulation (EC) No 1290/2005 provides that financial corrections shall be determined on the basis of the nature and gravity of the infringement and of the financial damage caused to the EU. Where possible, the amount is calculated on the basis of the loss actually caused or on the basis of an extrapolation. Where this is not possible, flat rates are used which, in accordance with the legal requirements, take account of the severity of the deficiencies in the national control system in order to reflect the financial risk for the EU. The Commission's system thereby establishes a clear hierarchy of methods to be used and, therefore, the Commission does not agree that in a given case there are 'options' open to it as to the type of financial correction to be applied. The Commission considers that there is a valid link between the amount of the correction and the amount of irregular payments made as a result of the deficiencies in the system. Conformity clearance includes cases where the deficiencies found are limited to the control system in place and cannot be linked to individual irregular payments to beneficiaries but, because of the flat-rate approach taken for control deficiencies, the risk to the EU budget is covered, e.g. when a Member State does not accomplish the minimum number of controls.

Moreover, as agricultural expenditure is implemented under shared management, the Member States are better placed than the Commission to assess and provide evidence of the real financial loss or risk for the EU budget. The operational handbook explicitly recognises this and requires the Commission to take such evidence, if reliable, into account. A more precise calculation of the financial loss for the EU budget therefore requires the active cooperation of the Member State concerned at all levels of the conformity clearance procedure because only the Member State has all the necessary information to make such a calculation. Unfortunately, however, despite the Commission's requests, Member States often do not avail themselves of this possibility. Since the reform of the system in 1996, flat-rate corrections account for slightly less than 70 % of the amount of total corrections by value. However, the Commission considers it to be more appropriate to look at the number of cases with a financial correction where a flat rate was used. Here, only 45 % of all cases are based on a flat-rate approach and, if the last 10 conformity decisions are taken, this percentage drops further to 37 %. This demonstrates the Commission's continuous effort to limit the use of flat rates as much as possible.

Since the methodology used by the Commission to calculate financial corrections is based on its best estimate of the risk to the EU budget, it cannot by definition amount to a sanction.

## REPLY OF THE COMMISSION

As part of this effort, the Commission recently set out to Member States the conditions under which it is prepared to limit the amount of any financial correction to the error rate found by the Member State in the transactions at final beneficiary level and reported in its control statistics for the aid scheme concerned.

Financial corrections are an accounting correction and not a sanction on Member States' authorities. The flat-rate methodology has been upheld by the Court of Justice as being in conformity with the legal rules governing the conformity work. In particular, the Court of Justice has confirmed that it is not up to the Commission to undertake the checks necessary to put a precise figure to the losses incurred, but rather it is for the Member State to show that the Commission's estimate was excessive.

The use of flat-rate corrections was also endorsed by the European Parliament in its 2007 discharge resolution (§ 83) for cases where Member States do not comply with their legal obligations.

Alternative methods for the calculation of financial corrections referred to by the Court would require a substantial increase in audit resources which would not be in line with any cost-benefit analysis.

### V.

The financial clearance decision is taken around six months after the end of the financial year in question. Through this decision, the Commission establishes the amount of expenditure recognised as chargeable to the EU budget for that year. The fact that the decision is without prejudice to subsequent conformity decisions imposing financial corrections on Member States is explicitly provided for in Article 30 of Regulation (EC) No 1290/2005, which has the same legal status as the Financial Regulation. Moreover, in substance, it is fully compatible with the Financial Regulation, which for any other expenditure provides that the Commission can make *ex post* checks up to five years after the discharge decision on the year in which the final payment was made. Otherwise, all budgetary expenditure would be considered provisional until an *ex post* check is made or the five-year period has lapsed.

The amount of expenditure which is likely to be excluded from financing by future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and in a note to the financial statements. Together with the financial clearance decision, this disclosure provides the European Parliament and the Council with the information they require for the discharge procedure.

# REPLY OF THE COMMISSION

## INTRODUCTION

The observation of the Court relates to a fundamental principle of the clearance of accounts systems as provided for in its current legal basis, which the Commission is bound to apply (since 1996). It was not objected to by any of the parties intervening in the adoption of the legislation. As such the observation could be best considered in the context of a possible review of the legislation.

### VI.

The Commission considers the current system to function well and to achieve its overall objectives. It will, however, continue to improve its operations in practice and, where necessary, submit appropriate proposals for further improvements to the European Parliament and the Council for the post-2013 period.

### 2.

Article 42(1) of the Implementing Rules dealing with the implementation of Articles 53b and 53c of the Financial Regulation defines that the purpose of the clearance of accounts shall be to ensure that expenditure by the Member States in the context of shared management [...] and which may be chargeable to the EU budget is in order and consistent with the applicable EU rules.

### 5.

The Belle working group set up by the Commission in 1991 was mandated to study the operations involved in the clearance of accounts procedure in order both to assess their effectiveness and efficiency in achieving the general aims of the CAP and the Financial Regulation and, if necessary, to propose legislative and/or administrative means of enforcing those operations.

### 5. (b)

Each financial correction included in a conformity decision is linked to a specific financial year which is identified in the annex to this decision.

### Box 1 (b)

The checks undertaken by the PAs are based on management and control systems for which the minimum requirements are laid down by the Commission.

### 6.

Under the reformed system, the financial clearance decision is adopted by 30 April of the year following the financial year concerned. Thus the reformed clearance of accounts procedure has significantly accelerated the timescale for clearing the PAs' accounts.

# REPLY OF THE COMMISSION

## PART I — THE FINANCIAL CLEARANCE OF ACCOUNTS

### 21.

Reliance on the work of other auditors, where judged appropriate, is foreseen in International Auditing Standards and the Commission's guidelines. The CBs may rely on the work of the internal audit units (IAU) if they have sufficiently verified such work.

An audit mission in November 2009 to the Danish CB, covering primarily financial year 2009, did not reveal any major deficiencies in either body with regard to working documents and checklists.

With regard to the Court's observation in footnote 9 that in Denmark the IAU was involved in the selection process of the CB, which was finally contracted directly by the PA after proposal by the IAU, it should be noted that the CB's contract was renewed for financial years 2009 and 2010 with the signatory being the competent authority.

### 22.

In the majority of cases the Court's findings relate to weaknesses in the CBs' documentation of their audit work, rather than the work itself.

CBs should compile sufficient audit evidence in support of their findings. The Commission considers this issue as part of its risk analysis, although it can only assess this directly during its visits to the CBs selected for audit. Although the exact layout and content of working papers and checklists should be left to the professional judgment of CBs, the Commission has made (and will continue to make) recommendations in this key area where it finds weaknesses.

Beyond the general requirements for substantive testing of expenditure according to guideline No 3, CBs are required for SPS to check that the payments can be derived from the underlying entitlements. However, there is no requirement to verify within the substantive testing the entitlements as such.

### 24.

The guidelines have been revised for financial year 2009 to further clarify how the test of completeness and accuracy of the debtors' ledger and Annex III/IIIA to Regulation (EC) No 885/2006 should be carried out and reported upon. An analysis of the certification reports with regard to financial year 2009 shows that, since the Court's audit, improvements have been made in this respect.

In addition to the work carried out by the CBs, the Commission has over the past three years audited 14 PAs in 11 Member States as regards their follow-up of irregularity cases and their reporting under Annex III to Regulation (EC) No 885/2006. In general, the PAs have adequate procedures in place to protect the financial interests of the European Union. Deficiencies found during these audits are being followed in the context of conformity clearance procedures.

## REPLY OF THE COMMISSION

### 26.

The Commission has recently put forward a system<sup>1</sup> by which Member States can, from 2010, reinforce the overall framework for gaining reasonable assurance on legality and regularity of transactions at the level of final beneficiaries. To this end, CBs should extend their work beyond the present requirements by fully reperforming, for a given expenditure population, a representative sample of transactions which the PA in question has checked on the spot. The work would cover the entire handling of the file, from receipt of the aid application to the calculation and execution of the final payment.

### 28.

The Commission agrees that further improvements can and should be made and it is regularly raising the issue with the Member States. However, there is no requirement to test and assess each key and ancillary control that should be in place at the PA.

### 29.

In the view of the Commission, an opinion on the internal control procedures would not require specific testing and assessment of the reliability of each key and ancillary control. Regulation (EC) No 885/2006 does not require the CB to conclude on whether all possible controls are operational, but only requires the CB to review the paying agency's compliance with the accreditation criteria (Annex I to Regulation (EC) No 885/2006).

<sup>1</sup> Document D/413722/2009.

However, CBs would be required to assess these aspects under the new system described in the Commission's reply to paragraph 26.

### 30.

Where necessary the Commission has pointed out in formal communications to Member States that delegated bodies shall also be identified and tested. There is, however, no requirement to visit and test every delegated body every year.

### 31.

The modification aimed at clarifying obligations which already existed before and at improving the reporting from the CBs.

### 32.

The Commission considers that the revised guidelines adequately specify the full scope of the audit task. PAs are expected to reconcile all information in their submitted annual questionnaires to the underlying database information. CBs are to check that this has been done and to indicate whether discrepancies have been found. They should also check the existence and adequacy of the audit trail.

To test the accuracy of the database, CBs must take a sample of at least 20 field inspection reports per set of statistics and check that the data they contain has been correctly entered into the database.

CBs are required to clearly conclude on the above elements. Notwithstanding the improvements in this area in financial year 2009, the Commission will consider whether further clarification in the guidelines is needed.

## REPLY OF THE COMMISSION

### 33. (a)

PAs are expected to perform this reconciliation. CBs are expected to check that it has been done properly. This was made very clear to Member States in the summary report for financial year 2008<sup>2</sup> and recommendations have been made in this respect to Member States (PAs and CBs) where appropriate. As a result, the Commission considers that the situation improved for financial year 2009. According to the reports of the CBs for financial year 2009, a complete reconciliation was accomplished for the majority of paying agencies.

### 33. (b)–(c)

The Commission acknowledges the deficiencies identified by the Court concerning financial year 2007 and 2008 and has raised these issues with the Member States concerned. As a result, the Commission considers that the situation has improved significantly for financial year 2009. An analysis of certification reports shows that in around 90 % of cases, the CBs carried out the work at the levels required by the Commission's guidelines, with a few exceptions.

<sup>2</sup> AGR/2009/80073-00-03/EN of 3 April 2009.

### 34.

For the reasons set out below, the Commission takes the view that the shortcomings identified do not place significant limitations on their use for assurance purposes by the Commission:

- The error rates established by the Commission on the basis of the control statistics provided by the Member States are consistent over several years.
- An analysis of the certification reports with regard to financial year 2009 shows that clear improvements have been made by CBs.
- The statistical information is the result of a very large sample of applications checked<sup>3</sup> and even if a safety margin of a 25 % increase in the error rates were applied, the residual error rates would still be below 2 %.
- The error rates established by the Court in its DAS 2008 exercise are consistent with the residual error rates established by the Commission on the basis of the control statistics provided by the Member States.

<sup>3</sup> SPS/SAPS: 600 315 applications checked; animals: 798 119 animals checked (suckler cow premium and special beef premium); export refunds: 13 023 declarations checked; 275 491 checks carried out on beneficiaries for area-related rural development measures (cf. Annual Activity Report 2009 of the Agriculture and Rural Development DG, footnote 33, page 61).

## REPLY OF THE COMMISSION

With regard to the sampling methodologies used by the PAs in selecting claims for on-the-spot checks, random-based samples are normally required. Although the random-based samples do not follow a statistical methodology such as monetary unit sampling (MUS), the samples are normally large enough to provide reasonable assurance as to their representativeness.

### 35.

The Commission acknowledges the deficiencies identified by the Court concerning financial years 2007 and 2008 and it has already disclosed the information in the AAR of those years. It has raised these issues with the Member States concerned and considers that, as a result, the situation has improved significantly for financial year 2009. An analysis of the CBs' reports shows that they carried out the work at the levels required by the guidelines, with a few exceptions, in over 90 % of the IACS cases (both funds), concluding in 92 % (EAGF) and 87 % (EAFRD) of these cases that the quality of the on-the-spot checks was at least adequate. For the non-IACS populations, CBs met the work requirements, with a few exceptions, in over 80 % of cases, and concluded similarly in 90 % (EAGF) and 87 % (EAFRD) of all cases.

The Commission considers that these modifications have been introduced (the English version of the revised guidelines was introduced already in July 2008) sufficiently in advance to enable CBs to comply with the new guidelines.

### 36.

The Commission agrees that further improvements can and should be made and it is regularly pursuing the issue with the Member States.

### 37.

Even though the Commission agrees that, in general, a re-performance of a previous check provides a better assessment of the quality of the on-the-spot checks, it is still possible to evaluate the control environment through inspections accompanied by the CB. In certain cases it may also not be possible to re-perform a check. These problems are inherent in many *ex posts* controls performed by external auditors.

Moreover, accompanied field inspections would reduce the administrative burden on the farmer.

### 38.

For the reasons set out in its reply to paragraph 34, the Commission considers that the Court's findings do not place significant limitations on the use that can be made of the control statistics for assurance purposes.

The new system for the reinforcement of assurance referred to is not a reaction to weaknesses in the work of the CBs but, rather, an attempt to reinforce the assurance already given by the current system.

## REPLY OF THE COMMISSION

### 41.

By issuing guideline No 4 on the statement of assurance, a common methodology is provided on how to draw up the SoA. It sets out the applicable legal provisions and provides recommendations from the Commission with a view to ensuring that the SoAs are drawn up on the basis of comparable criteria.

### 43.

The revised guideline on the SoA was presented to the Member States for the first time in June 2008 and finalised in July 2008. This was sufficiently in time for the directors of the PAs to prepare their SoA to be signed by January 2009. An earlier revision was not possible because the results of the previous year's exercise first needed to be evaluated.

The Commission considers that the guidelines are adequately detailed. Further to analysing the SoAs received for financial year 2008, the guideline was further revised. The 2009 revision treats in separate annexes how to carry out the analysis of the control statistics explicitly requesting detailed information where the error rate in a population is above 2 %, where the comparison with the situation in the previous financial year shows a significant deterioration or where the error rate in a population is implausibly low, and how to deal with the requirement to disclose the basis on which the statement of assurance is drawn. Templates for transmission of control statistics were provided by the Commission in order to ensure uniformity of the data supplied by the Member States to the Commission.

### 44.

The requirement that each statement of assurance should be accompanied by a list of the documents examined and the work performed by the director of the paying agency before signing his statement was fulfilled in 75 out of 82 cases for financial year 2008. The analysis of the control statistics was provided in 32 cases and the comparison with the situation in the previous year in 24 cases.

The Commission analysis shows that, for the financial year 2009, the situation improved: all 88 PAs provided a list of the documents examined and a summary of the work performed and 83 PAs provided the required analysis of the control statistics.

### 45–46.

The assurance model underlying the SoAs follows from the Commission's guidelines and was discussed at the first meeting with the directors of the PAs in December 2007. At that occasion, the Commission also explicitly stated that the so-called cascade model based on 'sub-SoAs' was insufficient and even discouraged its use, in particular for the execution of payments.

### 47.

For financial year 2008, the analysis of the control statistics was provided in 32 cases and the comparison with the situation in the previous year in 24 cases. For financial year 2009, guideline No 4 has been revised with a view to improving this situation. In consequence, for this financial year, the required analysis of the control statistics was carried out by 84 out of 88 PAs.



## REPLY OF THE COMMISSION

### 48.

The analysis of the control statistics is required to be carried out at aid scheme level, the threshold above 2 % (at the level of a population) giving an indication for consideration of a reservation. However a reservation is only required if the following factors are cumulatively fulfilled:

- the examination of the qualitative aspects leads to a finding of significant deficiencies in a national control system as defined in point 4.2 (Qualitative aspects) of guideline No 4; and
- the amount of undue payments is estimated to exceed 2 % of the total payments made in the financial year in question under any of the populations referred to in point 4.3 (Quantitative aspects) of guideline No 4; and
- it has not been possible to counter the impact of the deficiencies by corrective measures.

The director of the PA is expected to make a reservation only if all these three conditions are fulfilled.

### 49.

For the reasons set out in its reply to paragraph 34, the Commission does not question the reliability of the control statistics.

### 51.

It is correct that the work performed in the context of the certification would to a large extent provide an adequate basis also for the opinion on the SoA.

However, the CB should in addition check: whether the supporting information accompanying the statement of assurance is adequate and it should provide an opinion:

- (if applicable) whether the paying agency director's reservations have been correctly disclosed;
- (if applicable) which audit population(s) should, in its opinion, have received a reservation, but did not;
- (if applicable) which audit population(s) did receive a reservation that was not required (i.e. the underlying issue(s) was/were not material);
- whether, in its opinion, the SoA complies in all material respects with Article 3 of Regulation (EC) No 885/2006 (Commission guideline No 4) for the financial year 16.10.xx to 15.10.xx + 1.

Thus, the Commission is of the view that the opinion provides added value.

In financial year 2009, the French CB did follow the model required by guideline No 7.

### 52.

From financial year 2009 onwards, the CBs have been better placed to assess this information because the revised guideline No 4 includes templates to be completed by the PA.

## REPLY OF THE COMMISSION

### PART II — THE CONFORMITY CLEARANCE OF ACCOUNTS

#### 54.

The Court's Graph 1 shows when the various conformity clearance decisions were adopted rather than the amounts excluded in respect of each financial year. The financial corrections on expenditure for each financial year, including estimates of future corrections, are shown in Commission Graph 1.

#### 56.

The Central Risk Analysis serves as a planning tool. In fact agricultural expenditure of the year  $n - 2$  was allocated to 76 different audit fields; each audit field is subject to a similar management and control system. As the expenditure under these audit fields was effected by different paying agencies, for planning purposes, 1807 audit field/paying agency pairs were identified. For these audit field/paying agency pairs the following risk factors are taken into account: materiality (amounts of declared expenditure), last audit year (period elapsed since the last audit of the measure in question), inherent risk of the measure in question, control system risks (risk associated with the control system), paying agency risk (risk related to the paying agency) and finally taking into account the OLAF risk (related with OLAF denunciations and irregularities) and the Court of Auditors risk (related with the findings from the ECA). The composite risk is calculated by audit field/paying agency pair by multiplying materiality and the 'weighed risk' which is a weighted average of the various risk indicators mentioned above. Based on the composite risk, the ranking of the audit field/paying agency pairs is established for the whole directorate.

#### 57–58.

For financial year 2009, the part of the expenditure covered by the Commission's conformity audits increased to 61 %<sup>4</sup>. The Commission considers this to be an impressive and sufficient coverage and, therefore, does not consider that, as a result of the risk analysis, only a limited number of measures and PAs identified as priorities are subject to conformity audits. Moreover, for direct aids, which in financial year 2009 accounted for 72 % of total agricultural expenditure and are covered by the IACS, all Member States with the exception of Luxembourg were audited over the past three years.

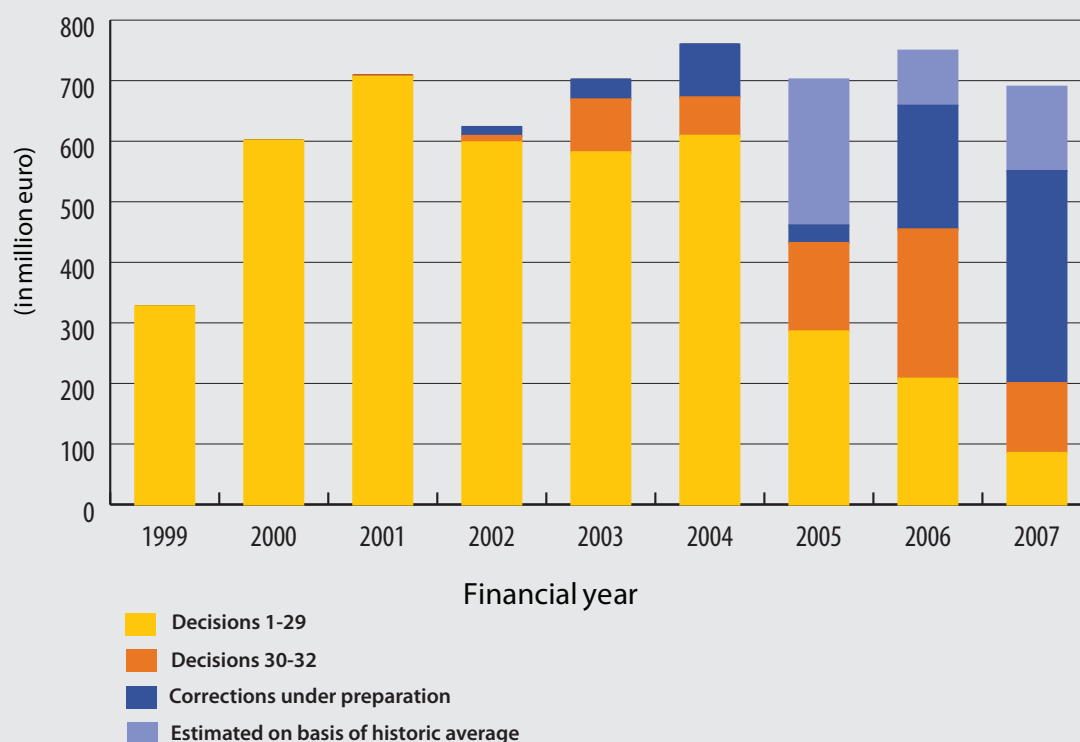
## REPLY OF THE COMMISSION

### 59.

The 24 month rule is a deliberate choice of the EU legislator with a view to ensuring legal certainty for Member States. It is inherent in the application of this rule that certain expenditure cannot be subject to financial corrections although it may be affected by deficiencies. The Commission has repeatedly proposed an extension of this time limit, but these proposals were turned down by both the Council and the European Parliament.

<sup>4</sup> 26,5 % for 'Intervention on agricultural markets', 70,9 % for 'Direct aid' and 43,6 % for 'Rural development'.

**Graph 1 - Amounts excluded in respect of each financial year**  
(incl. estimates of future corrections)



## REPLY OF THE COMMISSION

### 60.

The Commission considers that a complete coverage of all audit areas over, say, a three-year period would not be possible even with significantly increased resources, and would go against the single audit concept<sup>5</sup>. It would be inefficient to devote human and financial resources to the audit of audit field/paying agency pairs with limited expenditure and a low risk. Therefore, the Commission carries out its conformity audit work on the basis of a central risk analysis, which incorporates all the necessary risk factors and is in line with internationally accepted auditing standards.

### Box 3

In the case referred to by the Court, the Commission has reacted on time to the information received and the risk has been correctly covered. Therefore, the Commission does not consider that the EUR 100 million referred to by the Court should have been subject to a financial correction.

The 24-month rule is a deliberate choice of the EU legislator with a view to ensuring legal certainty for Member States. It is inherent in the application of this rule that certain expenditure cannot be subject to financial corrections although it may be affected by deficiencies. The Commission has repeatedly proposed an extension of this time limit, but these proposals were turned down by both the Council and the European Parliament.

<sup>5</sup> This would require the audit of some 1 800 audit areas over this time span in order to avoid that certain parts thereof can no longer be corrected due to the 24-month rule.

### 61.

For direct aids, which in financial year 2009 accounted for 72% of total agricultural expenditure and are subject to the IACS, all Member States with the exception of Luxembourg were audited over the past three years 2007–09 and, thus, within a time span which prevents the exclusionary effect of the 24-month rule.

The number of audit field/paying agency pairs is the consequence of the large number of different control systems for the various agricultural aid schemes and the number of PAs established by the Member States. Direct aids, however, only represented 12 audit fields in the 2008 risk analysis.

### 63.

The Commission considers that the use of flat rates is fully in line with the objective of the conformity clearance and the most effective and efficient way of achieving this objective, notably if the deficiencies found concern only the Member State's management and control system. It takes account of the fact that it is not possible to take a statistically valid sample in the context of each of the around 150 conformity missions carried out by the Agricultural and Rural Development DG each year. The Commission estimates that such substantive testing would, in fact, require on average some 100 individual files to be audited in each case, thus amounting to more than 15 000 files per year.

The use of flat-rate corrections has been upheld by the Court of Justice as being in conformity with the legal rules governing the conformity work.

## REPLY OF THE COMMISSION

### 64.

For all the 32 conformity decisions adopted from 1996 to the end of 2009, slightly less than 70 % of the total amount of financial corrections were determined by using flat rates. However, the Commission considers it to be pertinent to look at the number of cases rather than the amounts involved because each conformity audit is equally important within the overall annual audit programme. Here, flat rates were used in only 45 % of all cases and, if the past 10 decisions are taken, this percentage decreases further to 37%. This demonstrates the Commission's continuous efforts to calculate or extrapolate the financial loss for the EU budget whenever this is possible.

As part of this effort, the Commission recently set out to Member States the conditions under which it is prepared to limit the amount of any financial correction to the error rate found by the Member State in the transactions at final beneficiary level and reported in its control statistics for the aid scheme concerned.

### 65.

The Commission considers that by focusing on the functioning of Member States' management and control systems, the system-based audit approach is the most effective and efficient way of achieving this objective. To supplement this work by a substantive testing of a representative sample of individual payments in the context of each of the around 150 on-the-spot conformity audits carried out by the Agricultural and Rural Development DG each year would require a substantial (more than twofold) increase in the current audit resources, which would not be in line with any cost-benefit analysis. The increase would be even higher (fivefold) if the Commission had to carry out such substantive testing on all audit fields over, say, a three-year period.

Nor would it take account of the fact that independent audit bodies are certifying the PAs' accounts and the functioning of their internal control procedures and are verifying and validating their control statistics, an element covering the legality and regularity of the underlying transactions which is currently being further reinforced.

Nor would it be possible to limit such substantive testing to cases where the 'consequences are quantifiable and significant' as those conclusions cannot be drawn at the time of the audit and, if it were implemented towards the end of the procedure such substantive testing may well be irrelevant and/or impossible.

## REPLY OF THE COMMISSION

### 66.

Flat-rate corrections reflect the degree of financial risk for the EU budget which results from the deficiencies in the Member States' management and control systems. Therefore, the Commission considers that there is a correlation between the flat rate used and the level of irregular payments to final beneficiaries. The guidelines in working document VI/5330/97 have established a clear, objective and stable system for the application of the flat-rate corrections, avoiding subjectivity as well as unequal treatment.

The Commission's operational handbook explicitly states that the system of flat-rate corrections is used to link the weaknesses identified to the risk for the EU budget and that this risk is the overriding element in the assessment of the level of financial corrections. Therefore, the auditors are required to assess whether there are any factors which would mitigate or amplify the risk. The conformity decisions provide ample examples that this assessment is taking place and, where justified, leads to a reduction or increase of the level of financial corrections.

Moreover, as agricultural expenditure is implemented under shared management, the Member States are better placed than the Commission to assess and provide evidence of the real financial loss or risk for the EU budget. The operational handbook explicitly recognises this and requires the Commission to take such evidence, if reliable, into account. A more precise calculation of the financial loss for the EU budget therefore requires the active cooperation of the Member State concerned at all levels of the conformity clearance procedure because only the Member State has all the necessary information to make such a calculation. Unfortunately, however, despite the Commission's requests, Member States often do not avail themselves of this possibility. The Court of Justice has confirmed that it is not up to the Commission to undertake the checks necessary to put a precise figure to the losses incurred, but rather it is for the Member State to show that the Commission's estimate was excessive.

In this context, the Commission has recently set out to Member States the conditions under which it is prepared to limit the amount of any financial correction to the error rate found by the Member States in the transactions at final beneficiary level and reported in its control statistics for the aid scheme concerned.

## REPLY OF THE COMMISSION

### Box 5

In the case in hand, the testing of representative sample of files suggested by the Court would have potentially treated the UK differently to other Member States. In order to treat Member States equally, such substantive testing would have to be carried out systematically, at least in all cases where there is a potential financial correction. Such an approach would require a significant increase in audit resources and is not in line with a cost-benefit analysis. This is why the Commission has decided on a system-based audit approach with a hierarchy of corrections of which the flat-rate approach is but one and which has been upheld by the Court of Justice. Furthermore, Member States are in all cases invited to calculate more precisely the financial loss for the EU budget but they do not always avail themselves of this possibility. Nevertheless, the Commission developed an alternative method in order to better determine the real residual risk and has set this out to Member States (see paragraph 104(e), final subparagraph).

See also the replies to paragraphs 65 and 66.

### 67.

In its 2007 discharge resolution, the Parliament explicitly requested that 'flat-rate corrections are applied to those Member States which fail to meet their obligations'<sup>6</sup>.

<sup>6</sup> See paragraph 83 of the European Parliament resolution of 23 April 2009 on the discharge for implementation of the European Union general budget for the financial year 2007, Section III — Commission (P6\_TA(2009)0289).

To date the percentage of financial correction (by value) determined on the basis of flat rates amounts to slightly less than 70 %.

Moreover, in December 2009, the Commission set out to Member States the conditions under which it is prepared to limit the amount of any financial correction to the error rate found by the Member State, in the transactions at final beneficiary level and reported in its control statistics for the aid scheme concerned.

### 68.

The 1996 reform introduced an annual financial clearance to be completed by 30 April of the year  $n + 1$  and the 24-month rule for conformity clearance. By doing so, a major contribution was made to the discharge procedure (and now the AAR) taking into account their timing. To conclude the conformity clearance work within such a timetable would impair the conformity clearance process.

## REPLY OF THE COMMISSION

### 69.

The time needed for completing the conformity procedure depends on a number of factors, some of which are outside the Commission's responsibility and control. Such factors include, for example, the complexity of the case, requiring additional work or even additional missions, the respect of deadlines by the Member States, translation requirements and the follow-up of the recommendations of the Conciliation Body. Furthermore, quite often the target is exceeded in order to fully respect the Member State's right of defence, which is a fundamental principle of the conformity clearance procedure and explicitly required by Article 42(2)(c) of the Implementing Rules to the Financial Regulation.

### 71.

Member States are aware of any deficiencies found shortly after the mission and can immediately take corrective action. The audit results are known and taken into account for the AAR for the year concerned. The length of time to determine the amount of the financial correction is a secondary issue if the deficiencies have already been notified and corrected.

Shortening the deadlines for the conformity clearance procedure would impact negatively on the Commission's ability to carry out the necessary audit work, which would be neither in the interests of the EU nor of the Member States. The Commission will nevertheless continue to work at reducing the time needed to complete conformity clearance procedures.

### 72.

None of the parties involved in the legislative procedure proposed any changes to the conciliation procedure in their opinions on the Commission's proposal for a Council regulation on financing of the common agricultural policy, which was subsequently adopted as Regulation (EC) No 1290/2005.

In 2006, the Commission adopted measures to reduce the number of cases going to conciliation by doubling the threshold above which cases are considered admissible. The Conciliation Body has not seen the increase in cases which would be commensurate with the increase in size of the EU.

The Commission considers the conciliation procedure to be a useful element in the conformity procedure. This is demonstrated by the Conciliation Body's impact on the financial corrections proposed. In 28 % of cases a reduction of more than 10 % in the amount of financial correction resulted from the procedure; in 13 % of cases, there was a reduction of less than 10 % while in 3,5 % of cases the Commission decided to withdraw its correction.



## REPLY OF THE COMMISSION

### PART III — THE CLEARANCE OF ACCOUNTS PROCEDURE AS A WHOLE

#### 73.

Whether the time target can be met in a given case depends on a number of factors, some of which are outside the Commission's responsibility and control. Such factors include, for example, the complexity of the case, requiring additional work or even additional missions, the respect of deadlines by the Member States and the follow-up of the recommendations of the Conciliation Body. Quite often, the target is exceeded in order to fully respect the Member State's right of defence, which is a fundamental principle of the conformity clearance procedure.

At the end of 2009, only 10 audits carried out in the years 2004 and before, allowing financial corrections of expenditure from the period prior to 2003, had not been closed. The financial corrections related to these audits as regards expenditure from the period prior to 2003 are estimated to be around EUR 15 million. This means that the conformity work on expenditure incurred in the years prior to 2003 had largely been completed.

#### 76-77.

The financial clearance decision is taken around six months after the end of the financial year in question. Through this decision, the Commission establishes the amount of expenditure recognised as chargeable to the EU budget for that year. The fact that the decision is without prejudice to subsequent conformity decisions imposing financial corrections on Member States is explicitly provided for in Article 30 of Regulation (EC) No 1290/2005, which has the same legal status as the Financial Regulation. Moreover, in substance, it is fully compatible with the Financial Regulation, which for any other expenditure provides that the Commission can make *ex post* checks up to five years after the discharge decision on the year in which the final payment was made. Otherwise, all budgetary expenditure would be considered provisional until an *ex post* check is made or the five-year period has lapsed.

The amount of expenditure which is likely to be excluded from financing by future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and in a note to the financial statements. Together with the financial clearance decision, this disclosure provides the European Parliament and the Council with the information they require for the discharge procedure.

## REPLY OF THE COMMISSION

This role of the financial clearance decision was already set out explicitly in the memorandum of March 1993 by which the Commission approved the guidelines for the reform of the clearance of accounts system which became applicable in 1996 (SEC(93) 306) and was not called into question by any of the parties involved in the adoption of the subsequent legislation.

### **78. (a)**

Each financial correction included in a conformity decision is linked to a specific financial year which is identified in the annex to this decision.

### **78. (b)**

As already indicated in the reply to paragraph 73, by the end of 2009, the conformity work on expenditure incurred prior to 2003 had largely been completed.

The financial statements include the pertinent information concerning the financial corrections of the year.

See also the reply to paragraphs 76–77.

### **79.**

What the Court describes as limitations are, rather, positive features inherent to a system which has proven its value in safeguarding the financial interests of the EU.

### **80.**

Conformity clearance decisions disclose the amounts excluded from EU financing per year of expenditure and per Member State. The amounts per Member State are disclosed in note 6 to the financial statements 2009 of the Commission.

Annex 36 to the Commission staff working document accompanying the financial report on the EAGF 2008 financial year provides information on the financial corrections made on expenditure from each financial year. Information on the distribution of these corrections between Member States and between sectors is provided in the Commission's fact sheet 'Managing the agricultural budget wisely', which is published at the following Internet address:  
[http://ec.europa.eu/agriculture/publi/fact/index\\_en.htm](http://ec.europa.eu/agriculture/publi/fact/index_en.htm).

## REPLY OF THE COMMISSION

### 81.

The financial clearance decision is taken around six months after the end of the financial year in question. Through this decision, the Commission establishes the amount of expenditure recognised as chargeable to the EU budget for that year. The fact that the decision is without prejudice to subsequent conformity decisions imposing financial corrections on Member States is explicitly provided for in Article 30 of Regulation (EC) No 1290/2005, which has the same legal status as the Financial Regulation. Moreover, in substance, it is fully compatible with the Financial Regulation, which for any other expenditure provides that the Commission can make *ex post* checks up to five years after the discharge decision on the year in which the final payment was made. Otherwise, all budgetary expenditure would be considered provisional until an *ex post* check is made or the five-year period has lapsed. The amount of expenditure which is likely to be excluded from financing by future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and in a note to the financial statements. Together with the financial clearance decision, this disclosure provides the European Parliament and the Council with the information they require for the discharge procedure.

The financial statements already include all the information required by the Financial regulation and the accounting rules. See also the reply to paragraphs 76–77.

### 82.

Under the reformed system, the financial clearance decision is adopted by 30 April of the year following the financial year concerned. Thus the reformed clearance of accounts procedure has significantly accelerated the timescale for clearing the PAs' accounts.

### 83.

With the adoption of the annual financial clearance decision, the Commission accepts the accounts of the accredited paying agencies and the corresponding expenditure therefore becomes definitive. This acceptance is not called into question by the possibility of subsequent financial corrections under the conformity clearance process. The amount of expenditure which is likely to be excluded from EU financing by such future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and disclosed in a note to the financial statements of the Commission.

The financial statements give all the information required by the Financial Regulation and the accounting rules. In particular they include as a contingent asset an estimate of future financial corrections.

## REPLY OF THE COMMISSION

### 84.

The Financial Regulation and the sectoral regulations regarding agriculture give the Commission the right to make checks on all expenditure for some years after it is incurred. The accounts should not imply that, because of this right, all the expenditure concerned remains to be accepted. Where the amounts of potential recoveries are quantifiable, they are disclosed in notes 5.3 and 5.4 to the consolidated accounts.

These conformity clearance decisions disclose the amounts excluded from EU financing per year of expenditure and per Member State. The amounts per Member State are disclosed in note 6 to the financial statements 2009 of the Commission.

### 85.

The purpose of recording the contingent assets in the Commission's accounts is to disclose the (potential) receivables, based on the results of its audits, and has not been intended to provide any assurance as to the legality and regularity of the underlying transactions.

The amount included in the contingent asset corresponds to the best estimation of the expenditure which is likely to be excluded from EU financing by future conformity decisions. This amount is disclosed in a note to the financial statements of the Commission, divided into EAGF and EAFRD.

### 88.

The annual accounts present all information required by the accounting rules and financial regulation. In particular, the amount of expenditure which is likely to be excluded from EU financing by future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and in a note to the financial statements of the Commission. The accounts are not amended by subsequent conformity decisions. The financial effect of a conformity decision falls in the financial year in which the decision is executed and does, thus, not amend the accounts of previous financial years.

### 89.

The conformity clearance is designed to exclude expenditure from EU financing which has not been executed in compliance with EU rules, thus shielding the EU budget from expenditure that should not be charged to it. In contrast, it is not a mechanism by which irregular payments to beneficiaries are recovered, which according to the principle of shared management is the sole responsibility of Member States, as referred to in Article 9(1)(a)(iii) of Council Regulation (EC) No 1290/2005 and Article 53b(2)(c) of the Financial Regulation.

The Commission considers that the conformity clearance has over the years proven to be a strong incentive for Member States to improve their management and control systems and, thus, to prevent or detect and recover irregular payments to final beneficiaries as reflected by the decreasing error rates at the final beneficiary level.

## REPLY OF THE COMMISSION

### **90. (a)**

The conformity clearance is not a mechanism by which irregular payments to beneficiaries are recovered, which according to the principle of shared management and the rules of Article 9(1)(a)(iii) of Council Regulation (EC) No 1290/2005 and Article 53b(2)(c) of the Financial Regulation is the sole responsibility of Member States. Where irregular payments to individual beneficiaries are or can be identified as a result of the conformity clearance procedures, Member States are required to follow them up by recovery actions against these beneficiaries.

### **90. (b)**

Even where financial corrections only relate to deficiencies in the Member States' management and control and not to irregular payments, these corrections are an important means to improve the Member States' management and control systems and, thus, to prevent or detect and recover irregular payments to final beneficiaries. The conformity clearance thereby contributes to the legality and regularity of the transactions at the level of the final beneficiaries. Moreover, agricultural legislation provides for effective, dissuasive and proportional sanctions to be imposed on beneficiaries who have received irregular payments.

### **91.**

Financial corrections are not sanctions on Member States as the Commission said already in the memorandum of March 1993 by which it approved the guidelines for the reform of the clearance of accounts system which became applicable in 1996 (SEC(93) 306). The current conformity clearance mechanism, including the use of flat-rate corrections, has been upheld by the Court of Justice, which implies that it is not a sanction mechanism as sanctions on Member States are the prerogative of the Court of Justice.

## REPLY OF THE COMMISSION

### CONCLUSIONS AND RECOMMENDATIONS

#### 93.

The Commission welcomes the Court's conclusion that the clearance of accounts procedure, as regards the reliability of the accounts, provides reasonable assurance and sufficient information for the Commission to take its annual financial clearance decision

#### 94.

The Commission acknowledges the shortcomings identified by the Court concerning financial years 2007 and 2008 and has raised these issues with Member States. As a result, for financial year 2009, the situation has improved for all the new elements of assurance mentioned.

In the view of the Commission, an opinion on the internal control procedures would not require specific testing and assessment of the reliability of each key and ancillary control (conformity aspects). The CB is only to check that the PA has an administrative organisation and a system of internal control complying with the criteria set out in Annex I to Regulation (EC) No 885/2006.

For the reasons set out in its reply to paragraph 34, the Commission considers that the control statistics are sufficiently reliable to be used for assurance purposes.

For the reasons set out under paragraph 51 above, the Commission is of the view that the CBs' opinions on the SoA do provide added value.

#### 95.

The Commission does not consider that significant shortcomings affect the implementation of the conformity clearance procedure. The Court's criticism essentially relates to the design of the procedure as such and not to its implementation which, as the Commission has set out in its replies to paragraphs 76–77, 78(b) and 81, is fully in line with the current rules, as acknowledged by the Court of Justice, and has over the past 15 years demonstrated its value in excluding non-conform expenditure from EU financing.

#### 96.

For financial year 2009, the part of the expenditure covered by the Commission's conformity audits increased to 61 %<sup>7</sup>. The Commission considers this to be a sufficient coverage and, therefore, that the risk analysis results in an adequate number of measures and PAs identified as priorities for conformity audits.

The Commission considers that a complete coverage of all audit areas over, say, a three-year period would not be possible even with significantly increased resources, and would go against the single audit concept. It would be disproportionate to devote human and financial resources to the audit of audit field/paying agency pairs with limited expenditure and a low risk. Therefore, the Commission carries out its conformity audit work on the basis of a central risk analysis, which incorporates all the necessary risk factors and is in line with internationally accepted auditing standards.

<sup>7</sup> 26,5 % for 'Intervention on agricultural markets', 70,9 % for 'Direct aid' and 43,6 % for 'Rural development'.

## REPLY OF THE COMMISSION

Moreover, for direct aids, which in financial year 2009 accounted for 72 % of total agricultural expenditure and are covered by the IACS, all Member States with the exception of Luxembourg were audited over the past three years.

The 24-month rule is a deliberate choice of the EU legislator with a view to ensuring legal certainty for Member States. It is inherent in the application of this rule that certain expenditure cannot be subject to financial corrections although it may be affected by deficiencies. The Commission has repeatedly proposed an extension of this time limit, but these proposals were turned down by both the Council and the European Parliament.

### 97.

The Commission considers that by focusing on the functioning of Member States' management and control systems, the system-based audit approach is the most effective and efficient way of achieving its objective of sound financial management. To supplement this work by a substantive testing of a representative sample of individual payments in the context of each of the around 150 on-the-spot conformity audits carried out by the Agriculture and Rural Development DG each year would require a substantial (more than twofold) increase in the current audit resources which would not be in line with any cost-benefit analysis. The increase would be even higher (fivefold) if the Commission had to carry out such substantive testing on all audit fields over, say, a three-year period.

Nor would it be possible to limit such substantive testing to cases where the consequences are quantifiable and significant as those conclusions cannot be drawn at the time of the audit and, if it were implemented towards the end of the procedure, such substantive testing may well be irrelevant and/or impossible. (See the reply to paragraph 65).

Flat-rate corrections reflect the degree of financial risk for the EU budget which results from the deficiencies in the Member States' management and control systems. Therefore, the Commission considers that there is a correlation between the flat rate used and the level of irregular payments to final beneficiaries. Conformity clearance includes cases where the deficiencies found are limited to the control system in place and cannot be linked to individual irregular payments to beneficiaries but, because of the flat-rate approach taken for control deficiencies, the risk to the EU budget is covered, e.g. when a Member State does not accomplish the minimum number of controls.

### 98.

The main objective of the 1996 reform of the clearance of accounts procedure was to enforce the effectiveness and efficiency in achieving the general aims of the CAP and the Financial Regulation.

At the end of 2009, the conformity work on expenditure incurred in the years prior to 2003 had largely been completed.

## REPLY OF THE COMMISSION

### 99.

Each financial correction included in a conformity decision is linked to a specific financial year which is identified in the annex to this decision.

### 100.

The financial clearance decision is taken around six months after the end of the financial year in question. Through this decision, the Commission establishes the amount of expenditure recognised as chargeable to the EU budget for that year. The fact that the decision is without prejudice to subsequent conformity decisions imposing financial corrections on Member States is explicitly provided for in Article 30 of Regulation (EC) No 1290/2005, which has the same legal status as the Financial Regulation. Moreover, in substance, it is fully compatible with the Financial Regulation, which for any other expenditure provides that the Commission can make *ex post* checks up to five years after the discharge decision on the year in which the final payment was made. Otherwise, all budgetary expenditure would be considered provisional until an *ex post* check is made or the five-year period has lapsed.

The amount of expenditure which is likely to be excluded from financing by future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and in a note to the financial statements. Together with the financial clearance decision, this disclosure provides the European Parliament and the Council with the information they require for the discharge procedure. See the reply to paragraphs 76–77.

### 101.

With the adoption of the annual financial clearance decision, the Commission accepts the accounts of the accredited paying agencies and the corresponding expenditure therefore becomes definitive. This acceptance is not called into question by the possibility of subsequent financial corrections under the conformity clearance process. The amount of expenditure which is likely to be excluded from EU financing by such future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and disclosed in a note to the financial statements of the Commission.

### 102.

Financial corrections are not sanctions but an exclusion from EU financing of expenditure which has not been effected in conformity with EU rules. These financial corrections are not 'negotiable', but are determined by the Commission on the basis of the principles set out in its working document VI/5330/97 and the information received in the course of the administrative procedure leading to the conformity decision. The Member State's participation in this procedure is part of the principle *audi et alteram partem*, allowing the Member State to give its opinion and to present its point of view, and the Commission is and should be willing to listen to the Member State's arguments and to take these into account. The number of financial corrections upheld by the Court of Justice demonstrate that the amounts are, in general, clear and indisputable.



## REPLY OF THE COMMISSION

### 103.

The conformity clearance is not a mechanism by which irregular payments to beneficiaries are recovered which, according to the principle of shared management and the rules of Article 9(1)(a)(iii) of Council Regulation (EC) No 1290/2005 and Article 53b(2)(c) of the Financial Regulation is the sole responsibility of Member States. However, where such irregular payments are, or can be, identified as a result of the conformity clearance procedure, Member States are required to follow them up by recovery actions against the beneficiaries.

### 104.

The Commission considers the current system to function well and to achieve its overall objectives. It will, however, continue to improve its operations in practice and, where necessary, submit appropriate proposals for further improvements to the European Parliament and the Council for the post-2013 period.

#### 104. (a)

The Commission considers that, in general, the rules and responsibilities of the different parties are sufficiently clearly defined in the existing regulations while taking account of the need to maintain the necessary flexibility. It will, however, consider whether to define in more detail the role of the CBs in the rules for the post-2013 period.

#### 104. (b)

The existing rules already provide for a time limit for the adoption of the annual financial clearance decision. Time limits for the conclusion of conformity clearance procedures would go against the objective of protecting the EU's financial interests as they would exclude financial correction after the deadline has elapsed. Therefore, the Commission does not intend to propose the introduction of such additional time limits.

#### 104. (c)

The financial clearance decision is taken around six months after the end of the financial year in question. Through this decision, the Commission establishes the amount of expenditure recognised as chargeable to the EU budget for that year. The fact that the decision is without prejudice to subsequent conformity decisions imposing financial corrections on Member States is explicitly provided for in Article 30 of Regulation (EC) No 1290/2005, which has the same legal status as the Financial Regulation. Moreover, in substance, it is fully compatible with the Financial Regulation, which for any other expenditure provides that the Commission can make *ex post* checks up to five years after the discharge decision on the year in which the final payment was made. Otherwise, all budgetary expenditure would be considered provisional until an *ex post* check is made or the five-year period has lapsed.

## REPLY OF THE COMMISSION

The amount of expenditure which is likely to be excluded from financing by future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and in a note to the financial statements. Together with the financial clearance decision, this disclosure provides the European Parliament and the Council with the information they require for the discharge procedure.

This role of the financial clearance decision was already set out explicitly in the memorandum of March 1993 by which the Commission approved the guidelines for the reform of the clearance of accounts system which became applicable in 1996 (SEC(93) 306) and was not called into question by any of the parties involved in the adoption of the subsequent legislation.

See also the reply to paragraph 97.

### **104. (d)**

The estimated amount of expenditure which is likely to be excluded from EU financing by future conformity decisions is disclosed as a contingent asset in the Commission's accounting system and disclosed in the note to the financial statements of the Commission. It would not be appropriate to make an assessment by Member State or by budget area of these amounts, which are at present a best estimate and may change when a final decision is taken, nor to include such detailed information in the financial statements.

The conformity clearance decisions identify the amounts excluded from EU financing per year of expenditure and per Member State. The amounts per Member State are disclosed in note 6 to the financial statements 2009 of the Commission.

### **104. (e)**

Under the reformed system, the financial clearance decision is adopted by 30 April of the year following the financial year concerned. Thus the reformed clearance of accounts procedure has significantly accelerated the timescale for clearing the PAs' accounts.

The time needed for completing the conformity procedure depends on a number of factors, some of which are outside the Commission's responsibility and control. Such factors include, for example, the complexity of the case, requiring additional work or even additional missions, the respect of deadlines by the Member States and the follow-up of the recommendations of the Conciliation Body. Furthermore, quite often the target is exceeded in order to fully respect the Member State's right of defence, which is a fundamental principle of the conformity clearance procedure and explicitly required by Article 42(2)(c) of the Implementing Rules to the Financial Regulation.

## REPLY OF THE COMMISSION

The use of flat rates is fully in line with the objective of the conformity clearance and the most effective and efficient way of achieving this objective. It takes account of the fact that it is not possible to take a statistically valid sample in the context of each of the around 150 conformity missions carried out by the Agriculture and Rural Development *DGeach* year. Nor would it be possible to limit such substantive testing to cases where the 'consequences are quantifiable and significant' as those conclusions cannot be drawn at the time of the audit and, if it were implemented towards the end of the procedure such substantive testing may well be irrelevant and/or impossible.

Furthermore, as agricultural expenditure is implemented under shared management, the Member States are better placed than the Commission to assess and provide evidence of the real financial loss or risk for the EU budget. The operational handbook explicitly recognises this and requires the Commission to take such evidence, if reliable, into account. A more precise calculation of the financial loss for the EU budget therefore requires the active cooperation of the Member State concerned at all levels of the conformity clearance procedure because only the Member State has all the necessary information to make such a calculation. Unfortunately, however, despite the Commission's requests, Member States often do not avail themselves of this possibility.

Moreover, the flat-rate methodology has been accepted by the Court of Justice as being in conformity with the legal rules governing the conformity work. In particular, the Court of Justice has confirmed that it is not up to the Commission to undertake the checks necessary to put a precise figure to the losses incurred, but rather it is for the Member State to show that the Commission's estimate was excessive.

The Commission has recently put forward a system by which Member States can, from 2010, reinforce the overall framework for gaining reasonable assurance on legality and regularity of transactions at the level of final beneficiaries. To this end, CBs should extend their work beyond the present requirements by fully re-performing, for a given expenditure population, a representative sample of transactions which the PA in question has checked on the spot. The work would cover the entire handling of the file, from receipt of the aid application to the calculation and execution of the final payment.

### **104. (f)**

Financial corrections imposed on Member States through conformity clearance decisions are not sanctions but an exclusion from EU financing of expenditure which has not been effected in conformity with EU rules. This is also confirmed by the jurisprudence of the Court of Justice.

### **104. (g)**

The Commission will continue to supervise the work of the certification bodies through specific audit visits.



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WHILST THE MANAGEMENT OF AGRICULTURAL EXPENDITURE IS, IN THE MAIN, SHARED BETWEEN THE MEMBER STATES AND THE COMMISSION, THE LATTER IS SUPPOSED TO FINALLY RECOGNISE THE EXPENDITURE CONCERNED TO ASSUME RESPONSIBILITY FOR THE IMPLEMENTATION OF THE BUDGET. THE PROCEDURE USED FOR THIS IS CALLED THE CLEARANCE OF ACCOUNTS AND CONSISTS OF TWO STAGES. THIS SPECIAL REPORT OUTLINES THE RESULTS OF THE COURT'S EXAMINATION OF BOTH STAGES OF THE CLEARANCE OF ACCOUNTS PROCEDURE, WHICH AIMED TO DETERMINE WHETHER THEY MET THE OBJECTIVES SET AND ALLOWED THE COMMISSION AND OTHER STAKEHOLDERS TO GAIN THE NECESSARY INFORMATION AS TO THE ACCURACY OF THE ACCOUNTS AND THE LEGALITY AND REGULARITY OF AGRICULTURAL EXPENDITURE.



EUROPEAN COURT OF AUDITORS



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