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COMMISSION OF THE EUROPEAN COMMUNITIES

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**REPORT FROM THE COMMISSION**

**Member States' replies to the Court of Auditors' 2007 Annual Report**

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## **1. SCOPE OF THE REPORT**

The European Court of Auditors (ECA), the European Union's external auditor, provides a statement of assurance (the DAS) in the annual report on the reliability of the accounts and the legality and regularity of the underlying transactions. The main aim of the DAS is to provide an audit opinion as to whether EU income and expenditure is accurately recorded in the accounts and has been raised and spent in accordance with all contractual and legal obligations.<sup>1</sup>

The Commission is required to inform Member States of the details of the ECA annual report that relate to the management of funds for which they are responsible as soon as the report has been transmitted and the Member States have an obligation to reply within sixty days.<sup>2</sup> On 11 November 2008, the Commission duly transmitted these findings and invited the Member States to fill in a three part questionnaire. The Member States had already received the Court's findings for their respective countries and had discussed them with the Court and the Commission prior to the adoption of the Court's report. The summary of Member States replies is presented in a Commission report (accompanied by the Commission Staff Working Document) to the ECA, the Council, and the European Parliament before 28 February 2009.

## **2 EXECUTIVE SUMMARY**

The 2007 ECA annual report is significant for two reasons. Firstly the Court has modified the structure of the report and it now closely reflects the new financial framework. Secondly, this is the final DAS to be presented under this Commission's and this Parliament's mandate.

The results of the Commission's efforts to further improve the control framework are becoming visible in the ECA results. The Court has, for the first time, given an unqualified (clean) opinion on the reliability of the accounts. The Court has also given unqualified opinions on the legality and regularity of transactions in Revenue, commitments and payments for Economic and Financial affairs, and Administrative expenditure. The Court notes that the supervisory and control systems in those areas taken as a whole function effectively. By contrast, shared management is dominated by the Court's adverse opinions on the legality and regularity of transactions. In addition, the supervisory and control systems in these areas are reportedly partially effective. For Agriculture and Natural Resources the Court has concluded that the transactions underlying the expenditure for the policy area as a whole were affected by a material level of error, but for EAGF- which represents 85% of agricultural expenditure- the error rate is slightly below the materiality threshold. The Cohesion policy area was identified by the Court as the area most affected by error with an estimated 11% of the total amount that should not have been reimbursed. The main weaknesses were identified in day to day checks by managing and paying authorities as well as in the work of audit bodies. It is worth noting that the vast majority of transactions audited by the ECA relate to the 2000-2006 programming period.

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<sup>1</sup> European Court of Auditors- Annual Report 2007 EU Budget-Information note pg7  
<sup>2</sup> Financial Regulation Article 143.6

In November 2008, one day after the presentation of the annual report, the Commission duly provided each Member State with details of errors following the ECA audits carried out in each particular country. The majority of Member States replied to the Commission within an acceptable deadline and with sufficient detail.

The Court classifies errors as either "quantifiable" or "non quantifiable". Member States are responsible for more than 90% of the total number of quantifiable errors in shared management. In their replies to the actions taken in the light of the quantifiable error findings, 15 out of the 17 Member States concerned provided some information on the actions taken and the likely outcome. The Commission will monitor these actions in its follow-up of the Court's error findings.

Member States were also requested to respond to six specific questions on Agriculture and Cohesion. For Agriculture, the Court expressed concerns about the reliability of payments made under the Single Payments Scheme – SPS. Almost all Member States replied to this question and indicated that some improvements had been made. The questions on Cohesion were based on the levels of staffing and training for staff in managing and paying authorities. Several Member States indicated in their replies that new staff members had joined the managing and paying authorities in the last 12 months. Over 70% of Member States replied that staff in both managing and paying authorities was trained in financial management and control in the last 12 months.

Member States were also requested to reply to two general questions. The first question related to the tripartite discussions which were held between the Commission, certain Member States and the ECA on the individual error findings in May-June 2008. Six Member States stated that they had taken part in these tripartite discussions. The replies showed satisfaction with this initiative.

The second question asked how the Commission could improve its supervisory role in shared management. The main improvements suggested were: simplification of rules and regulations, improvements in monitoring and guidance in public procurement matters.

### **3. GENERAL 2007 DAS FINDINGS AND DAS FINDINGS IN SHARED MANAGEMENT**

The results of the Commission's efforts to further improve the control framework are becoming visible in the ECA results. Although this trend has been noted by some Member States, others underline the fact that for the 14<sup>th</sup> consecutive year, the Commission has failed to obtain a positive DAS. In this context, a reconsideration of the current DAS approach has been suggested and the Court's recommendation to set a level of tolerable risk of error, striking a balance between the cost and benefits of controls has been welcomed.

The Court's audit opinion on the underlying transactions was very similar to that presented in 2006. Although the estimated error rates have fallen in two policy areas formerly covered under Internal policies and External actions, this has not affected the overall picture. However, the Court gave an unqualified (clean) opinion on the reliability of the accounts. In addition, the Court has given unqualified opinions on the legality and regularity of transactions in certain areas-namely Revenue,

commitments, and payments for Economic and Financial affairs, and Administrative and other expenditure. The supervisory and control systems in those areas taken as a whole function effectively and the sample of transactions selected have been declared free of any material error.

The overall picture in shared management is dominated by the Court's adverse opinions on the legality and regularity of transactions. The Court concludes that these areas are to varying degrees still affected by a material level of error.

Table 1.1 below provides a summary of the DAS results per chapter on the legality and regularity of underlying transactions.

**Table 1.1 - Summary of 2007 DAS results on the legality and regularity of underlying transactions<sup>3</sup> as interpreted by the Commission**

	<i>Estimated error rate</i>
Revenue	Below 2%
Agriculture and Natural Resources – EAGF*	Below 2 %
Agriculture and Natural Resources -non EAGF*	Above 5%
Cohesion	Above 5 %
Research, transport & energy	Between 2% and 5%
External actions	Between 2 % and 5 %
Education & citizenship	Between 2 % and 5 %
Economic & financial affairs	Below 2 %
Administration	Below 2 %
EDF	Between 2% and 5%

\*This is a breakdown of Chapter 5 in the Court's annual report.

The higher error rates estimated by the Court are to be found in the areas of Cohesion and Rural development. In the biggest spending area, Agriculture and Natural Resources, the Court concluded that the transactions underlying the expenditure for the policy area as a whole were affected by a material level of error. The Court also

<sup>3</sup> Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2007, together with the institutions' replies OJC 286 of 10.11.2008 p29

stated that the supervisory and control systems were partially effective. While the EAGF expenditure representing around 85% of all expenditure for Agriculture had an error rate which was slightly below 2%, Rural development accounted for a large part of the overall error rate. In addition, as in the previous year 2006, the Court noted that the Integrated Administration and Control System (IACS) was effective in decreasing the risk of irregular spending, where properly implemented and conditional on the accuracy and reliability of data entered into the system. The Court therefore recommended improvements in the identification, registration and management of entitlements.

The Cohesion policy area was identified by the Court as the area most affected by error. The Court estimated that at least 11% of the total amount reimbursed to Cohesion policy projects should not have been reimbursed. The Court rated the supervisory and control systems (Commission and Member States) in Cohesion policy as partially effective for the first time in 2007. The transactions audited by the ECA in the Cohesion policy area all related to the 2000-2006 programming period. In 2007 the Court again identified the main weaknesses in first level controls as well as within audit bodies. They were as follows<sup>4</sup>:

**Managing authorities**-insufficient day to day checks of the reliability of expenditure, failure to identify expenditure declarations not supported by appropriate evidence and failure to identify weaknesses in tender procedures

**Paying authorities**-failure to identify when managing authorities had not carried out adequate day to day checks

**Audit bodies**-failure to carry out sufficient checks to obtain assurance on the effective functioning of the control systems.

The Court cited complex or imprecise legal requirements as having a serious impact on the legality and regularity of transactions in Rural development and Cohesion.

Spending in the area of Education and Citizenship is partly managed through shared management. The Court concluded that the payments underlying this policy area were affected by a material level of error. The supervisory and control systems were also judged to be partially effective.

#### **4. FOLLOW UP OF ERRORS**

In its letter, the Commission duly provided each Member State with details of errors following the ECA audits carried out in each particular country. The Member State was then asked to provide details of actions taken to rectify the errors as well as the timing, content and expected outcome. The majority of Member States provided the information requested within an acceptable deadline. Moreover, the quality of the replies in general was good with certain countries providing very detailed information on actions taken for audit findings. The Commission will monitor the actions taken as part of its routine follow-up of all Court reports.

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<sup>4</sup> Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2007, together with the institutions' replies OJC 286 of 10.11.2008 p150

## **Definition and treatment of errors**

According to the ECA "errors may relate to a condition of payment" or to an "other compliance issue". The Court now classifies errors as either "quantifiable" or "non quantifiable".<sup>5</sup> Only quantifiable errors are taken into consideration when determining the financial impact of errors for the whole audit population and the overall error rate to be published.

Member States are responsible for more than 90% of the total number of quantifiable errors in shared management (100% in the Cohesion Policy area). All Member States provided at least a partial reply with regard to all quantifiable errors with 100% error rate. In each case they stated whether the error had been accepted or rejected and what actions had been taken. Several Member States (Czech Republic, Germany, Ireland, Spain, Greece and UK) accepted most of the errors indicated by the Court. In their replies to the actions taken in the light of the quantifiable error findings, 15 out of the 17 Member States concerned provided some information on the actions taken and the likely outcome. Some Member States highlighted the fact that recoveries were either initiated or had already taken place and amounts recovered were mentioned. In the case of one Member State -Greece- in each case of accepted error the Community contribution was reduced to zero.

### **5. ACTIONS TAKEN BY MEMBER STATES TO ADDRESS SHORTCOMINGS IN COHESION AND AGRICULTURE/NATURAL RESOURCES**

The questionnaire sent to Member States included one question on the Agriculture and Natural Resources chapter based on improvements to the SPS. The Court had expressed concerns in the 2007 report about the reliability of payments made under the SPS. According to the Court, the most urgent issues to be addressed were entitlements, information on land parcels and clarification and simplification of rules underpinning the measures, in particular the use of the national reserve. Almost all Member States replied to this question and indicated that some improvements had been made. Several new Member States stated that they were currently not applying the SPS. However, those who did have such a system in place indicated that it had recently been audited and approved by the competent national authority. All the issues mentioned by the Court had been taken into account. Several of the Member States already applying the system mentioned that improvements were continually being made, particularly in the field of ortho-photography and entitlements. In addition, data bases were being updated and restructured in several cases.

The four questions on Cohesion were based on the levels of staffing and training for staff in managing and paying authorities. The majority of Member States replied to the question on the number of new staff members joining the managing and paying authorities in the last 12 months. New staff was taken on in a context of restructuring and in certain cases for the closure of the 2000-2006 programming period as well as to cover the programmes for the new 2007-2013 period. New Member

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<sup>5</sup> Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2007, together with the institutions' replies OJC 286 of 10.11.2008 pg 28

States in particular displayed overall a pattern of high staff increases – in the case of Bulgaria up to 88%.

Over 70% of Member States replied positively that staff in both managing and paying authorities was trained in financial management and control in the last 12 months. Most countries had some statistical record of staff trained and several countries highlighted the fact that ongoing training in financial management and control, programme and contractual management in the form of seminars, information sessions and conferences were standard features of their training programmes. Induction courses, (in one case lasting up to three days) and starter packs were an integral part of most Member States' training package. In addition, starter packs for new staff members were available in 80% of Member States. These packs were made up of several basic documents including checklists, guidance notes and procedure manuals. Several Member States stated that managing and paying authorities had websites and that use of the intranet for disseminating information was standard practice. In a few cases public procurement documentation was not readily available and Lithuania stated that more Commission support was necessary in this area. Difficulties with public procurement and the resulting problems with tender procedures lead to one of the most frequent errors as observed by the ECA.

Question 6 was based on the Court's observation on audit bodies<sup>6</sup>. It was intended to identify the reasons for the failure on the part of the audit bodies to carry out sufficient checks. Nearly all Member States interpreted the term "audit body" as the National Supreme Audit Body and stated that this institution was independent and that the work carried out by it was of a very high quality. However, the Court was referring to the other audit entities carrying out audit functions in the context of project management and control as indicated in point 6.29 of the ECA annual report. It is therefore not possible to exploit the replies provided by Member States.

Finally, question 7 focused on the overall reduction of errors identified in each country in the last year. Most Member States were unable to make the comparison as audits were not carried out by the ECA in the same country in two consecutive years. However, four countries- Hungary, UK (Scotland), Poland and Spain noted that there had been an overall decline in errors compared to past audit years.

Table 1.2 below provides a summary of the total number of replies to the questionnaire, with details of staff increases, staff training and starter pack documentation available in Member States.

**Table 1.2**

<b>Question</b>	<b>Total number of replies</b>	<b>Total number of replies not provided</b>
<b>1) Agriculture</b>	24	3
<b>2) Staff increase in Managing</b>	25	2

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<sup>6</sup> See footnote 4 above

<b>and Paying authorities</b>			
<i>% staff increase (when quantification was provided)</i>			
<b>5-24%</b>	4		
<b>25-49%</b>	8		
<b>50-100%</b>	5		
<b>3) Training in Managing authorities</b>	24	3	
<i>% staff trained (when quantification was provided)</i>			
<b>5-24%</b>	3		
<b>25-49%</b>	5		
<b>50-100%</b>	5		
<b>4) Training in Paying authorities</b>	24	3	
<i>% staff trained (when quantification was provided°)</i>			
<b>5-24%</b>	1		
<b>25-49%</b>	2		
<b>50-100%</b>	9		
<b>5) Content of starter pack</b>	22		5
	<b>yes</b>	<b>no</b>	<b>no reply</b>
<i>Checklists</i>	20	2	5
<i>Guidance notes on control strategies</i>	17	5	5
<i>Guidance notes on reporting control findings and error rates</i>	20	2	5
<i>Digest of eligibility rules for checking claims</i>	19	3	5
<i>Public procurement rules</i>	19	3	5

<i>Final payments-rules and checks to be made</i>	20	2	5
<i>Irregularities-the consequences</i>	19	3	5
<i>Any other procedure manuals</i>	19	3	5
<b>6) Audit bodies</b>	23	4	
<b>7) Reduction of errors</b>	23	4	
<b>8) Tripartite discussions</b>	24	3	

## 6. HELPING MEMBER STATES TO IMPROVE MANAGEMENT OF EU FUNDED PROJECTS

In order to discern how the Commission could further contribute to the improvement of Member States management of EU funded projects, two general questions were included in the questionnaire.

The first question was based on the tripartite discussions which were held between the ECA, certain Member States and the Commission prior to the contradictory meetings in July 2008. The meetings were held to discuss the Court's error findings on audited programmes and projects as a basis for the contradictory meetings and the question focused on how useful the Member States concerned considered these discussions. The second question asked how the Commission could improve its supervisory role in shared management.

### **Tripartite meetings**

Six Member States stated that they had taken part in the tripartite discussions. The replies indicated that although the outcomes of the meetings were not always entirely favourable for the Member State concerned, nonetheless, overall there was satisfaction with this initiative and it was regarded as very useful by Ireland, Greece, Slovakia and the Czech Republic. In particular, Ireland stated that "*This procedure and experience was extremely helpful for both the Managing Authority and the Member State*" for the following reasons:

*Understanding of ECA processes and procedures.*

*Incorporation of ECA checks into own member state checks and controls.*

*Face to face communication resulted in an agreement on many more points than written communication could have achieved.*

*The reasons for the points which remained in the report were fully explained by the ECA and understood and agreed by the Member State.*

*This enabled all outstanding issues to be resolved and the final report to be issued in a timely and efficient manner."*

### **Improving the Commission's supervisory role**

Member States generally indicated that they were satisfied with the way in which the Commission performed its supervisory role, and two countries cited the Contracts of Confidence which had been signed with the Commission in the Regional and Cohesion Funds. Moreover, Member States welcomed the fact that the Commission had strengthened its role by issuing guidelines in the 2007-2013 programming period. However, just over half the Member States and in particular the new Member States suggested that the Commission could improve its role. Some of the areas for improvement which were highlighted included:

- **Rules and regulations:** the provision of guidelines, **best practices** and training for managing and paying authorities; **simplification** of rules and regulations in order to promote more efficient project implementation.
- **Monitoring:** improvements in the monitoring role of the Commission with more information on the methodology used for the inspection missions undertaken by the Commission.
- **Public Procurement:** more supervision in the field of public procurement and training in Community law; Guidelines for public procurement.

## **7. CONCLUSION**

- The Commission is generally satisfied with the quality of the replies to the questionnaire received from the Member States, and the fact that the tight deadline was respected in almost all cases. In addition, some Member States also provided extensive documentation concerning the corrective measures employed.
- Member States remarked on the improvements in the DAS 2007, which for the first time provided an unqualified opinion on the reliability of the accounts. In the field of shared management Member States are continuing to make efforts to improve their systems and reduce errors. The replies to the questionnaire show an overall positive attitude, with improving staff levels, with high levels of staff increase and staff training in managing and paying authorities. The errors identified by the Court are often accepted by the Member States and in a large number of cases, actions have already been taken. They will be followed up by the Commission.
- Member States generally indicated that they were satisfied with the way in which the Commission performed its supervisory role. They pointed out the need for simplification, with regard to rules and regulations. In addition, there are requests for the Commission to strengthen and further develop the guidelines and assistance provided. Finally, Member States request clarification from the Commission and the Court of Auditors, with regard particularly to best practices.