

IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS AND BODIES

COURT OF AUDITORS



In accordance with the provisions of Article 248(1) and (4) of the EC Treaty and Articles 129 and 143 of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, as amended by Council Regulation (EC, Euratom) No 1995/2006 of 13 December 2006,

the Court of Auditors of the European Communities, at its meeting of 27 September 2007, adopted its

Annual Report on the implementation of the budget concerning the financial year 2006.

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

(2007/C 273/01)

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GENERAL INTRODUCTION

0.1. This document, covering the 2006 financial year, comprises the Court's 30th annual report on the implementation of the general budget of the European Union. The annual report in relation to the European Development Funds is presented in a separate volume.

0.2. The structure of the annual report on the implementation of the general budget is as follows: Chapter 1 — the Statement of Assurance; Chapter 2 — the Commission's internal control system; Chapter 3 — key observations on budgetary management; Chapters 4 to 10 — revenue and activities financed from different parts of the budget, reflecting the headings of the financial perspective; and Chapter 11 — financial instruments and banking activities. The replies of the Commission — or other EU Institutions where appropriate — are presented with the report.

0.3. The chapters covering revenue and the major areas of expenditure have the following main elements:

- detailed analyses of the results of the audit work carried out in the context of the Statement of Assurance in the form of specific assessments;
- results of follow-up reviews of progress made on implementing recommendations of the Court and the Budgetary Authorities arising from previous audits;
- a list of the special reports published by the Court since the last annual report.

0.4. The specific assessments are based on an evaluation of the operation of the principal supervisory and control systems governing revenue and each expenditure area and the results of the Court's testing of underlying transactions. The Court's overall appraisal of all these elements forms the basis for the Statement of Assurance set out in Chapter 1, which now includes a table summarising the Court's assessment of the functioning of supervisory and control systems, and the error range for each budgetary area. In addition, the Annexes to Chapters 4 to 9 set out the elements used for monitoring and evaluating the financial management of the EU budget.

0.5. As the Court has repeatedly stated, the key to adequate management of the EU budget is through sufficient, appropriate internal control systems operated by the Commission and Member States. Over the past few years the Court has recognised in its annual reports the efforts of the Commission in promoting and applying improved control and management procedures. The 2006 annual report continues this trend by identifying areas of improvement — some significant — as well as setting out the large areas of expenditure where the situation continues to remain unsatisfactory.

0.6. The most apparent area of improvement is agriculture where the Court found a marked reduction on the estimated overall level of error in underlying transactions, although it still remains just above the materiality threshold. This reflects the fact that the integrated administrative and control system continues to be effective (where properly applied) and is also the effect of the introduction of the single payment scheme.

0.7. Despite the advances noted, the Court's audit of other areas of CAP expenditure, structural measures and internal policies show that complicated rules or unclear eligibility criteria or complex legal requirements have a considerable impact on the legality and regularity of the underlying transactions. In these areas, which cover a significant part of the budget, checks on expenditure claims, which are mainly based on the information supplied by the beneficiary are, in many cases, insufficient in number and coverage and often of inadequate quality.

0.8. 2006 saw the adoption of a substantially revised financial regulation. In addition, strengthened sectoral regulations partly related to the 2007 to 2013 period were approved. These elements aim to simplify systems and procedures while strengthening controls. They have thus the potential to achieve better implementation of the budget in the coming years. The Court provided input to these processes in the form of opinions and will closely monitor their application. In addition, the Court also assessed the implementation of the Commission's action plan to an integrated control framework adopted in early 2006 and found that its impact is only likely to be evident in the medium to long term.

0.9. As set out in Chapter 1, the Court found continuing progress in the Commission's important and complex task — started in 2005 — of introducing accruals-based accounting. However, certain weaknesses persist, notably at the level of the recording and processing of information concerning prefinancing and open invoices.

0.10. Significant recent developments are the new requirement for Member States to provide annual summaries of the available audits and declarations, the voluntary initiatives by some of them to issue national declarations and the decisions by some national audit bodies to issue audit reports on the management of EU funds. The national declarations are used essentially for accountability to national parliaments. They may prove of relevance to the Commission within its overall responsibilities for managing the budget notably through its supervisory role. In its opinion No 6/2007 of July 2007, the Court considers that all these elements, if properly implemented, could stimulate improved management and control of EU funds in Member States. The opinion also sets out the conditions by which such elements could give added value and be used by the Court — following the requirements of international auditing standards.

CHAPTER 1

The Statement of Assurance and supporting information

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THE COURT'S STATEMENT OF ASSURANCE PROVIDED TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

I. Pursuant to the provisions of Article 248 of the Treaty the Court has audited

- (a) the 'Final annual accounts of the European Communities' ⁽¹⁾ which comprise the 'Consolidated financial statements' ⁽²⁾ and the 'Consolidated reports on implementation of the budget' ⁽³⁾ for the financial year ended 31 December 2006; and
- (b) the legality and regularity of the underlying transactions within the legal framework of the European Communities.

Management's responsibility

II. In accordance with Articles 268 to 280 of the Treaty and the Financial Regulation, management ⁽⁴⁾ is responsible for the preparation and fair presentation of the 'Final annual accounts of the European Communities' and the legality and regularity of the underlying transactions:

- (a) The management's responsibility concerning the 'Final annual accounts of the European Communities' includes designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, on the basis of the accounting rules adopted by the Commission's accounting officer ⁽⁵⁾, and making accounting estimates that are reasonable in the circumstances. According to Article 129 of the Financial Regulation, the Commission approves the 'Final annual accounts of the European Communities' after the Commission's accounting officer has consolidated them on the basis of the information presented by the other institutions ⁽⁶⁾ and bodies ⁽⁷⁾ and established a note, accompanying the final consolidated accounts, declaring, inter alia, that he has a reasonable assurance that these accounts present a true and fair view of the financial position of the European Communities in all material aspects.

(1) The 'Final annual accounts of the European Communities' make up volume I of the annual accounts of the European Communities financial year 2006.

(2) The 'Consolidated financial statements' comprise the balance sheet, the economic outturn account (including segment reporting), the cash flow table, the statement of changes in net assets and a summary of significant accounting policies and other explanatory notes.

(3) The 'Consolidated reports on implementation of the budget' comprise the consolidated reports on implementation of the budget and a summary of budgetary principles and other explanatory notes.

(4) At the level of the European Institutions and bodies management includes the Members of the Institutions, Directors of the Agencies, Authorising Officers by delegation and sub-delegation, Accounting Officers and the leading staff of financial, audit or control units. At the level of Member and Beneficiary States, management includes Authorising Officers, Accounting Officers and the leading staff of paying authorities, certifying bodies and implementing agencies.

(5) The accounting rules adopted by the Commission's accounting officer are derived from International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants or, in their absence, International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. In accordance with the Financial Regulation, the 'Consolidated financial statements' for the financial year 2006 are prepared for the second time on the basis of these accounting rules adopted by the Commission's accounting officer, which adapt accruals based accounting principles to the specific environment of the Communities, while the 'Consolidated reports on implementation of the budget' continue to be primarily based on movements of cash.

(6) Before the adoption of the final annual accounts by the institutions, the different accounting officers sign them off, thereby certifying that they have a reasonable assurance that the accounts present a true and fair view of the financial situation of the institution (Article 61 of the Financial Regulation).

(7) The final annual accounts are drawn up by the respective directors and sent to the Commission's accounting officer together with the opinion of the management board concerned. In addition, the respective accounting officers sign them off, thereby certifying that they have a reasonable assurance that the accounts present a true and fair view of the financial situation of the bodies (Article 61 of the Financial Regulation).

- (b) The way in which management exercises its responsibility for legality and regularity of underlying transactions depends on the method of implementation of the budget. In the case of direct centralised management, implementation tasks are performed by the Commission's departments. Under shared management, implementation tasks are delegated to Member States, under decentralised management to third countries and under indirect centralised management to other bodies. In the case of joint management, implementation tasks are shared between the Commission and international organisations (Article 53 to 57 of the Financial Regulation). Implementation tasks have to comply with the principle of sound financial management, requiring designing, implementing and maintaining effective and efficient internal control including adequate supervision and appropriate measures to prevent irregularities and fraud and, if necessary, legal proceedings to recover funds wrongly paid or used. Regardless of the method of implementation applied, the Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the European Communities (Article 274 of the Treaty).

Auditor's responsibility

III. The Court's responsibility is to provide, on the basis of its audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. Except as described in paragraph IV, the Court conducted its audit in accordance with the IFAC and INTOSAI International Auditing Standards and Codes of Ethics, in so far as these are applicable in the European Community context. These standards require that the Court plans and performs the audit to obtain reasonable assurance whether the 'Final annual accounts of the European Communities' are free from material misstatement and the underlying transactions, taken as a whole, are legal and regular.

IV. In the case of revenue the scope of the Court's audit work was limited. Firstly, VAT and GNI own resources are based on macroeconomic statistics for which the underlying data cannot be audited directly by the Court, and secondly, the audits of traditional own resources cannot cover imports that have not been subject to custom supervision.

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

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

Opinion on the reliability of the accounts

VII. In the Court's opinion, except for the effects of the matters described in paragraph VIII, the 'Final annual accounts of the European Communities' present fairly, in all material respects, the financial position of the Communities as of 31 December 2006, and the results of their operations and cash flows for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the Commission's accounting officer.

VIII. The Court's audit has identified errors in amounts registered in the accounting system as invoices/cost statements and pre-financing which have the effect of overstating the accounts payable by some 201 million euro and the total amount of long and short term pre-financing by some 656 million euro.

IX. Without calling into question the opinion expressed in paragraph VII, the Court notes that, due in part to the complex system of financial management and despite improvements made, weaknesses in the accounting systems of certain institutions and Directorates-General of the Commission still put at risk the quality of financial information (in particular for cut-off and employee benefits). This led to a number of corrections after the presentation of the provisional accounts.

Opinion on the legality and regularity of the underlying transactions

X. In the Court's opinion, revenue, commitments and payments for Administrative expenditure, Pre-accession strategy, with the exception of the Sapard Programme, and External actions, for those payments managed and controlled directly by Commission delegations, are free from material error. In these areas the supervisory and control systems are implemented in a manner which provides for an adequate risk management. Moreover, for common agriculture policy (CAP) expenditure the Court's audit shows that, where properly applied, the integrated administration and control system (IACS), in particular in respect of the Single Payment System, is an effective system to limit the risk of irregular expenditure.

XI. Without calling into question the opinion expressed in paragraph X, the Court emphasises that, in the area of pre-accession strategy, significant risks still exist at the level of the implementing organisations in the newly acceded and candidate countries for all programmes and instruments.

XII. In the Court's opinion, in the other areas of expenditure payments are still materially affected by errors, although to different levels, and the Commission and the Member and other beneficiary states need to make further efforts to implement adequate supervisory and control systems, so as to improve the handling of the attendant risks. These areas are listed below, namely: common agricultural policy, structural measures, internal policies and external actions.

- (a) In CAP expenditure, the Court found a marked reduction in the estimated overall level of error in underlying transactions. However, it still remains just above the materiality threshold. Clearance systems and post payment checks for CAP subsidies not covered by IACS provide limited assurance as to compliance with Community legislation. Furthermore, claims for EU aid are not usually checked on the spot by the independent bodies in charge of the certification of the accounts of paying agencies.
- (b) In Structural measures, the Court found that control systems in the Member States are generally ineffective or moderately effective, and that the Commission maintains only a moderately effective supervision to mitigate the risk that the control systems in the Member States fail to prevent overstated or ineligible expenditure. Therefore, the reimbursement of expenditure to structural policies projects is subject to material error.
- (c) In Internal policies the Court's audit revealed that the supervisory and control systems do not sufficiently mitigate the inherent risk of the reimbursement of overstated costs, resulting in a material level of error in payments to beneficiaries.
- (d) In External actions, despite the improvements of the Commission's supervisory and control systems, a material level of error was detected at the level of implementing organisations, due to continued weaknesses in the systems designed to ensure the legality and regularity of transactions at this level.

XIII. The Court emphasises that its audits in the area of CAP expenditure, structural measures and internal policies show that complicated or unclear eligibility criteria or complex legal requirements have a considerable impact on the legality and regularity of underlying transactions. For example, because of the often complex eligibility conditions, the agri-environmental measures in Rural Development are prone to a significantly higher incidence of error than the non-rural development part of CAP expenditure.

XIV. The Court notes the improvements introduced by the Commission as regards its internal control framework and the positive impact they have on the assessment of the operation of supervisory and control systems and of the impact of relevant reservations on the assurance provided by the Commission's Directors-General declarations. However, the Court continues to find weaknesses in those assessments, namely as regards their impact on the assurance concerning the legality and regularity of underlying transactions.

27 September 2007.

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THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

INFORMATION IN SUPPORT OF THE STATEMENT OF ASSURANCE

Introduction

1.1. Pursuant to Article 248 of the EC Treaty, the Court of Auditors provides the European Parliament and the Council with a Statement of Assurance concerning the reliability of the accounts and the legality and regularity of the underlying transactions (the DAS). The Treaty also authorises the Court to supplement this statement with specific assessments of each major area of Community activity.

1.2. The aim of the work on the reliability of the accounts of the European Communities is to obtain sufficient evidence to conclude on the extent to which revenue, expenditure, assets and liabilities have been properly registered and that the annual accounts present fairly, in all material respects, the financial position as of 31 December 2006, and the results of their operations and cash flows for the year then ended (see paragraphs 1.6 to 1.37).

1.3. The aim of the work on the legality and regularity of the underlying transactions is to gather sufficient evidence, of a direct or indirect nature, to give an opinion on whether they are in accordance with the applicable regulations or contractual provisions, and have been correctly calculated (see paragraphs 1.38 to 1.42 of this chapter for horizontal issues and chapters 2 and 4 to 10 for details).

1.4. Once again, the Court paid particular attention to the efforts made by the Commission to strengthen its internal control system and to the follow-up given to the action plans adopted within the context of the Roadmap towards an integrated internal control framework or annexed to the annual activity reports and their Synthesis for the financial year 2006 and before (see chapter 2).

1.5. In addition, in the absence of indicators presented by the Commission over a series of years ⁽⁸⁾, the Court provides certain indicators to monitor progress in improving internal controls both overall, and for each income and expenditure area (see annexes to this chapter and to chapters 2 and 4 to 10).

1.5. *In addition to assessments of compliance with internal control standards, for the first time in 2006 the Commission encouraged the Annual Activity Reports for 2006 to include a section on 'key indicators supporting reasonable assurance' (Section 2.4), and for the Structural Funds they contain, as well as assessments of Member States' systems, information on the inputs, outputs, results and impact of Commission actions to obtain assurance on legality and regularity of transactions.*

Three quarters of the Directorates-General presented legality and regularity indicators in 2006, including all major spending departments.

From the 2007 annual activity reports onwards, the use of indicators will be mandatory.

⁽⁸⁾ See paragraphs 1.51 and 1.52 of the Annual Report concerning the financial year 2004 and chapter 2 of the present Annual Report.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

*Reliability of the accounts***General background**

1.6. The Court's observations concern the final annual accounts for the financial year 2006, drawn up by the Commission's Accounting Officer and approved by the Commission in compliance with Article 129 of the Financial Regulation of 25 June 2002 and sent to the Court by 31 July 2007. The accounts comprise the 'consolidated financial statements' — covering, in particular, the balance sheet setting out the assets and liabilities at the end of the year — and the 'consolidated reports on the implementation of the budget' — covering the revenue and expenditure for the year.

1.7. The 2006 annual accounts are the second set of accounts prepared under the accruals based accounting rules which were introduced by the European Communities in 2005 on the basis of provisions of the Financial Regulation (in particular Articles 123 to 138)⁽⁹⁾. In comparison to the 2005 annual accounts, the following major changes occurred:

- the accounts of 24 agencies were consolidated, as compared with 16 in 2005;
- more detailed information is given on the different forms of recovery of Commission expenditure;
- the Accounting Officer of each institution and body consolidated in the final consolidated accounts signed off its individual accounts and the Accounting Officer of the Commission stated that he had obtained reasonable assurance that the consolidated accounts present a true and fair view of the financial position of the European Communities in all material aspects.

1.8. The Commission's Accounting Officer, at the request of the Court, provided the latter with a representation letter confirming that subject to certain limitations the final accounts are complete and reliable (see paragraphs 1.30 and 2.23 to 2.25).

⁽⁹⁾ Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1), last amended by Regulation (EC, Euratom) No 1995/2006, (OJ L 390, 30.12.2006, p. 1).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Audit scope and approach

1.9. The Court continued its audit of the modernisation of the Communities accounting system ⁽¹⁰⁾. In the third phase of the audit ⁽¹¹⁾, the Court concentrated on the following elements:

- assessment of whether measures taken within the Commission, to remedy weaknesses in the new financial reporting framework and accounting systems of certain Directorates-General ⁽¹²⁾, contribute to providing reasonable assurance that the accounts are true and fair (see paragraphs 1.13 to 1.21);
- verification of the reliability of the 2006 accounts, concentrating on elements captured for the first time in the 2005 accounts and for which qualifications were presented ⁽¹³⁾ (pre-financing and related guarantees, invoices/cost statements and cut-off) (see paragraphs 1.22 to 1.37).

Strengthening the transition to accruals based accounts*General achievements*

1.10. The Commission's Accounting Officer introduced a series of measures in order to consolidate the transition to accruals based accounts, including checks on a monthly basis in order to detect inconsistencies in the recording of pre-financings.

1.11. These measures have contributed to a strengthening of the financial reporting framework and accounting systems. However, certain weaknesses still exist which put at risk the quality of accounting data (see paragraphs 1.13 to 1.21). **Table 1.1** contains a follow-up of the Court's qualifications concerning the reliability of the accounts which were expressed in the Statement of Assurance for the 2005 financial year, as well as the other points raised by the Court, which were settled or which still need to be addressed in the context of the measures taken by the Commission to consolidate the transition to accruals based accounts.

1.9. *The Commission published on 21 June 2007 a Progress Report as at 31 March 2007 on the modernisation of the accounting system (COM(2007) 343 final) reporting, inter alia, that the project was implemented largely in accordance with the project plan 2006-2007 and updating and extending the IT systems improvement plan to 2008. Progress was made in improving the control environment and quality of accounting data in all Directorates-General. Significant progress was reported in developing the ABAC IT system, and two Institutions and six Agencies also migrated to the ABAC system during the year. The migration of the European Development Funds (EDF) accounts to ABAC has been prepared and the Commission services are working to 'go live' in 2008.*

1.10. *These measures will be continually improved as part of ongoing projects aimed at improving the quality of accounting information.*

1.11. *The Commission continues to improve its accounting framework and systems. It considers that the remaining risks are adequately addressed and have no material impact on the reliability of the 2006 accounts.*

See replies to paragraphs 1.15 to 1.21, and also to paragraphs 1.28, 1.31, 1.33 and 1.37.

⁽¹⁰⁾ See communication from the Commission — Modernisation of the Accounting System of the European Communities (COM(2002) 755 final of 17.12.2002).

⁽¹¹⁾ The Court's preliminary findings of the first phase of its audit were presented in the Annual Report concerning the financial year 2004 (see paragraphs 1.21 to 1.45) and for the second phase in the Annual Report concerning the financial year 2005 (see paragraphs 1.5 to 1.58). Results of subsequent stages will be included in future Annual Reports.

⁽¹²⁾ See paragraphs VI, VII and VIII of the Court's Statement of Assurance concerning the financial year 2005.

⁽¹³⁾ See paragraphs VI, VII a) and b) of the Court's Statement of Assurance concerning the financial year 2005.

Table 1.1 — Follow-up of the reservations expressed in the Court's Statement of Assurance concerning the financial year 2005 as to the reliability of the accounts and certain other observations made in the Annual Report concerning the financial year 2005

| Reservations in the 2005 Statement of Assurance | Replies in the 2005 Annual report | Developments | Commission's reply |
|--|---|--|--|
| In the context of a complex exercise, the existing financial reporting framework has not been consistently applied, in particular for cut-off, and, | For the 2006 closure, concerning cut-off, more in-depth testing and controls will be made in the light of the experience of the first year of application of accruals accounting. Furthermore, the Commission will strengthen its control over the application of the cut-off methodology. | In order to strengthen the cut-off procedures, the Commission's Accounting Officer's services provided the Directorates-General with reports and with a procedure for <i>ex-post</i> cut-off testing. However, not all Directorates-General carried out this testing. Furthermore, several deficiencies concerning the cut-off procedures were again noted which had a negative impact on the provisional accounts. However, after corrections made, the final accounts were not affected. | See reply to paragraph 1.18. |
| accounting systems in certain Directorates-General of the Commission were not able to ensure the quality of financial information. | The validation of local systems is a rather new activity. As the situation is constantly evolving, the accounting services' validation team needs to keep track of this evolution and has also introduced since June 2006 a procedure for changes in local systems. The accounting services are committed to making a follow-up concerning the issues and matters for further consideration mentioned in the 2005 validation reports. | For several local systems the Accounting Officer's validation has been conditional or suspended. The Court's audit confirmed that the Commission's Accounting Officer's decisions were well founded: the issues and matters outstanding were important. The Court considers that in the light of these continuing problems, the Director-General for Budget should have made a specific reservation on these issues. | See reply to paragraph 1.17. <i>In view of the progress made, a reservation in the 2006 annual activity report was not necessary.</i> |
| Errors have been identified in amounts registered in the accounting system as pre-financing and invoices/cost statements in both the opening and closing balance sheets leading to an overstatement of the net assets in the opening balance sheet by some 132 million euro and in the closing balance sheet by some 314 million euro. | The Commission will examine the transactions containing errors. | Errors identified for pre-financings and invoices/cost statements are still at a material level in terms of frequency and financial impact as regards the balance sheet items concerned. However, it is not material overall. | See replies to paragraphs 1.28 and 1.31. |
| The audit confirmed the general reservation of the Director-General of Education and Culture covering the lack of assurance as regards the correctness of its share of the total amounts included in both the consolidated opening and closing balance sheets. | Inconsistent treatment of accrual accounting requirements in the local accounting system had led to differences in the opening and closing balances. Modifications to the local system are underway and will ensure correct treatment of transactions in the future. Corrections of past errors are ongoing and should be completed by the end of 2006. | The Court's audit found that measures taken improved the quality of the accounting data. However, certain weaknesses still exist (in particular inadequate documentation). | See replies to paragraphs 1.19 to 1.21. |
| Certain other observations made in the context of the 2005 Annual Report | Replies in the 2005 Annual report | Evolution of the situation | |
| The Commission's Accounting Officer did not fully comply with accounting rules Nos 1, 2 and 12 with regard to the scope of consolidation, the new structure and presentation of the balance sheet and the revised treatment of the Communities' pension liabilities. As the comprehension of these issues evolved since the adoption of the accounting rules, the necessary amendments should be introduced. | The accounting rules Nos 1, 2 and 12 will be adapted. | The modifications to these accounting rules have been adopted by the Commission's Accounting Officer in October 2006. | |
| The different character of the liabilities to be covered by the amounts to be called from Member states should be disclosed further, in particular the short-term and long-term nature of those amounts. | The different character is disclosed in a note to the balance sheet. | The Court still considers that the different character of the liabilities to be covered by the amounts to be called from Member States should be disclosed further, in particular the years when they fall due. | See reply to paragraph 1.33. |
| Although the explanatory notes to the consolidated accounts contain more information about possible corrections, they do not identify the amount of expenditure which may be subject to verification and clearance of accounts procedures. | The corrections to be decided in future conformity decisions (EAGGF Guarantee) is disclosed as a contingent asset in the Commission's accounts. | Compared to 2005, the explanatory notes to the annual accounts contain supplementary information about the fact that some transactions are likely to be corrected later. However, as for the past, the amounts (and areas) of expenditure which may be subject to verification and clearance of accounts procedures is not disclosed. | See reply to paragraph 1.34. |

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Modification of the Accounting rules

1.12. Taking into consideration the results of the Court's audit of the 2005 accounts, the Commission's Accounting Officer, after having consulted the Advisory Committee on Accounting Rules, amended Accounting Rules Nos 1, 2 and 12 with regard to the scope of consolidation, the structure and presentation of the balance sheet and the treatment of the Communities' pension liabilities⁽¹⁴⁾. The 2006 accounts were prepared applying these accounting rules.

Validation of local subsidiary accounting systems

1.13. At present, 19 Directorates-General use their own IT-systems for financial management purposes and for the creation of transactions which are sent to the central accounting system (ABAC) via an interface.

1.14. For the financial year 2006, the Commission's Accounting Officer's services carried out a follow up of the previous year findings⁽¹⁵⁾. In addition nine further services⁽¹⁶⁾ were subject to in-depth reviews as part of a cyclical approach aiming at full coverage of Commission's services on a medium term.

1.15. The Commission's Accounting Officer was not able to provide validation to the local systems of the EuropeAid Co-operation Office⁽¹⁷⁾, Directorate-General for Education and Culture⁽¹⁸⁾ and

1.15. *The lead time for new applications and for rectifying problems in local systems can be considerable, especially where changes in IT systems are involved. Furthermore, staff have to be trained in their use in order to ensure that the intended benefits are forthcoming.*

Significant progress was made in 2006 in relation to the three services mentioned by the Court. In the case of the Europe Aid Cooperation Office, substantial work was carried out on the local IT System, CRIS, and by the year end, most of the developments had been put into production and were working satisfactorily.

With regard to the Directorate-General for Education and Culture, efforts in 2006 were concentrated on putting in place appropriate intermediary solutions pending the replacement of the Directorate-General's local IT system.

The new ABAC Delegation module was launched at the beginning of 2007.

All three services' systems will be examined by the Commission's Accounting Officer in 2007 and he will decide at the year end whether the improvements are sufficient to warrant their validation.

While the number of matters for follow up and further consideration has not decreased in absolute terms, the number of Directorates-General covered by these remarks has almost doubled (from 13 Directorates General and Services in 2005 to 22 in 2006). This implies a substantial decrease in the average number of matters outstanding per Directorate-General. This figure should continue to decrease in 2007, as a result of further progress made by all the Directorates-General/Services concerned.

⁽¹⁴⁾ See paragraphs 1.24, 1.25 and 1.49 of the Annual Report concerning the financial year 2005.

⁽¹⁵⁾ The Accounting Officer did not validate three local subsidiary accounting systems and highlighted a number of other issues for consideration. For further details see paragraphs 1.20 and 1.21 of the Annual Report concerning the financial year 2005.

⁽¹⁶⁾ Directorates-General Personnel and Administration, Competition, Information Society and Media, Joint Research Centre, Internal Market and Services, Taxation and Customs Union, Energy and Transport. As well as the Office Infrastructure and Logistics — Brussels and the Office Infrastructure and Logistics — Luxembourg.

⁽¹⁷⁾ EuropeAid Co-operation Office's revamped local system CRIS went into production on 22 January 2007 and further verifications will take place before the system can be validated.

⁽¹⁸⁾ Directorate-General for Education and Culture's new system Symmetry was delayed until 2008 and a new version of the existing system APPFIN was put in production in October 2006. Despite the fact that the quality of data improved from November 2006 on, certain weaknesses still exist (in particular weak documentation). Further validation procedures will take place in 2007.

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the Directorate-General for External Relations ⁽¹⁹⁾ regarding the financial year 2006. Furthermore, the number and importance of issues and matters for further consideration remains much the same as for the final validation report of the financial year 2005 ⁽²⁰⁾.

1.16. Three ⁽²¹⁾ of the nine services that were subject to in-depth reviews by the services of the Commission's Accounting Officer presented significant risks as regards their cut-off procedures. This matter led to the conditional validation of the local systems in the final validation report for the financial year 2006. However, after checking the cut-off procedures and finalising the validation reports for the three Directorates-General (Information Society and Media, Energy and Transport and the Joint Research Centre), the Accounting Officer issued clean validations with one non-accounting reservation for the Joint Research Centre.

1.17. The Court's audit confirmed that the Commission's Accounting Officer's decisions were well founded: the issues and matters outstanding were important. The Court considers that in the light of these continuing problems, the Director-General for Budget should have made a specific reservation on these issues.

Strengthening of cut-off procedures

1.18. Given that 2005 was the first year of a cut-off exercise, no benchmark methods are available to check the adequacy of methods. In view of this difficulty, the Commission's Accounting Officer's services have provided to the Directorates-General a procedure for *ex-post* testing of cut-off data and a first report combining data from budgetary sources and from general accounting. This aimed, in particular, at ensuring the consistency of the cut-off methods and procedures. However, some Directorates-General did not

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1.17. *A general reservation was included in the 2005 Annual Activity Report at a time when the Commission had not yet completed its first set of provisional accounts based on accrual accounting principles. It also took account of the considerable challenges faced by the Commission services in applying new accounting rules and the difficulties encountered in the validation process of local systems.*

The first definitive results from the new system were tested and documented when the Commission's accounting officer prepared the 2005 annual accounts. Since then further significant progress has been made in clarifying the application of the new accounting rules for establishing the annual accounts and also improving the local systems.

In view of the progress made, a reservation in the 2006 Annual Activity Report was not necessary.

1.18. *The Commission made a significant effort during 2006 to improve the estimation of cut-off amounts as detailed in paragraph 1.32. However, for transactions still in progress for which the lifecycle may be up to 7 years, in the absence of information from the beneficiaries of EC funds on work-in-progress and the lack of coercive legal means to obtain it, some services found it very difficult to proceed with testing cut-off methodologies.*

⁽¹⁹⁾ ABAC Delegation IT system for imprest accounts managed by Directorate-General for External Relations went into production on 8 January 2007 (except for the module dealing with Assets which was not completed yet). Additional validation procedures will take place in 2007.

⁽²⁰⁾ Notably some general issues regarding the clearing of pre-financings, timeliness of transactions' posting, use of ABAC Contracts, treatment of pre-financing in some domains, data consistency between local systems and ABAC, widespread lack of knowledge/understanding about accrual accounting principles across the services.

⁽²¹⁾ Directorates-General Information Society and Media, Energy and Transport and the Joint Research Centre.

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carry out *ex-post* testing of cut-off methodologies ⁽²²⁾. This had a negative impact on the reliability of the accounting data included in the provisional accounts. However, after corrections made, the final accounts were not affected (see paragraph 1.32).

Measures concerning Directorate-General Education and Culture

1.19. The Court's 2005 audit confirmed the general reservation of the Director-General for Education and Culture regarding the completeness and correctness of the accounts of that Directorate-General. Given the incidence of omissions and double or wrong postings, it was not possible to quantify the over — or understatement in its share of the assets and liabilities ⁽²³⁾.

1.20. With a view to remedying weaknesses identified concerning the 2005 accounts, the Commission's Accounting Officer's services enhanced their supervision as regards Directorate-General for Education and Culture and the newly created Education, Audiovisual and Culture Executive Agency. Furthermore, a task force, including an accounting group, were created in order to perform a detailed review of all invoices/cost claims open in 2006 and to ensure the correctness of the transactions initiated in the operational units. In addition, an external consultant has been contracted with a view to provide assistance for the identification of errors disclosed in the 2005 final accounts and the closing of the 2006 accounts.

1.21. These measures led to an improvement of the quality of the accounting data. However, an audit ⁽²⁴⁾ revealed that various financial data were not adequately allocated between the Directorate-General for Education and Culture and the Executive Agency. Furthermore, checks performed and corrections made should be better documented, in the context of the 2006 closing of the accounts.

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1.19. In 2006, the Directorate-General for Education and Culture substantially improved the quality of its financial information. The expenditure of this Directorate-General and the Education, Audiovisual and Culture Executive Agency amounts in total to some 1,5 % of the EC budget.

1.20. The Directorate-General for Education and Culture and the Education, Audiovisual and Culture Executive Agency have taken action in several areas, including:

- the local system has been improved to prevent the booking of the same invoice more than once in ABAC,
- in 2006 a task force performed a detailed review of all historical invoices in order to identify and correct any duplicate entries,
- the cut-off methodology has been refined,
- the risk associated with the partial absence of reconciliation between the local and central systems was mitigated by the use of data from the central accounting system as a basis for cut-off calculations and for reporting pre-financing and outstanding commitments (RAL).

1.21. As this is not an issue that affects the true and fair view of the Commission's accounts, the Accounting Services advised the Directorate-General for Education and Culture and the Education, Audiovisual and Culture Executive Agency not to focus this year on splitting the transactions but to concentrate their efforts on improving the quality of their global accounting data.

As a result of the measures undertaken, the overall framework (procedures, IT systems and accounting controls) designed and implemented by the Directorate-General for Education and Culture and its executive agency provides reasonable assurance on the completeness, accuracy and reliability of the accounting data for the 2006 accounting exercise.

⁽²²⁾ EuropeAid Co-operation Office, Directorate-General for Enlargement, Directorate-General for Research, Directorate-General for Energy and Transport, Directorate-General for Education and Culture and also the Education, Audiovisual and Culture Executive Agency did not carry out *ex-post* testing of its cut-off methodologies.

⁽²³⁾ See paragraph VIII in the Court's Statement of Assurance concerning the financial year 2005.

⁽²⁴⁾ The audit of the Directorate-General for Education and Culture and the Executive Agency was conducted by the Commission's Internal Audit Service under the supervision of the Court.

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Consolidated financial statements as at 31 December 2006*General remarks*

1.22. During 2006, the Commission services made significant efforts to ensure the completeness and accuracy of the registration of new pre-financing payments as well as of new open invoices/cost statements, and the cut-off.

1.23. The Court's audit of intangible and tangible fixed assets, stocks, financial and other liabilities, provisions for risks and charges and reserves did not discover any significant misstatements. However, the Court identified a number of errors elsewhere, which are presented below.

1.24. The Court's audit led it to conclude that the year-end procedures should be strengthened in some of the consolidated entities (e.g. European Parliament, Committee of the Regions) and the Commission in order to avoid necessary corrections after the presentation of the provisional accounts.

1.25. Furthermore, the Court has noted differences in the treatment of some issues between the consolidated entities and between the Commission's Directorates-General (e.g. accrued charges for leave not taken which are accounted for by some Agencies and Institutions but not by the Commission and the European Parliament; multi-annual contracts other than operating leases which are presented for the first time under contingent liabilities by the Council but not by the other consolidated entities; no systematic separation of the value for land and buildings and no contingent liability for the possible need to regrade upwards a significant number of staff appointed at a lower grade than the one of the competition they passed pending the outcome of an ongoing case in front of the European Court of First Instance).

1.24. *While the issues concerned by this remark do not affect the true and fair view of the consolidated accounts, the Commission will nonetheless endeavour to continue improving its year-end accounting procedures.*

1.25. *The issues mentioned by the Court do not affect the true and fair view of the consolidated accounts. The Commission will however investigate the issues of untaken leave and multi-annual contracts. The remaining differences noted by the Court represent the fact that the different consolidated entities have different materiality levels to consider when making accounting decisions. Furthermore the limited cases where it is not possible to split land and buildings values (in certain Commission delegations and a few other consolidated bodies) is clearly a case of lack of information at the level of the individual entity rather than an inconsistent accounting treatment between consolidated entities.*

The Court of First Instance rejected on 11 July 2007 the request made in case T-58/05 regarding recruitment of officials after 1 May 2004. This means that currently — subject to the outcome of a possible appeal to the Court of Justice — there are no budgetary implications. Because of the remoteness of the risk no contingent liability was considered necessary.

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Consolidated balance sheet as at 31 December 2006

Risk capital operations

1.26. In the consolidated financial statements of the European Communities, risk capital operations (211 million euro as at 31 December 2006) are classified in the balance sheet under the heading 'Investments' (investments available for sale). These are held at historic costs less any provisions for impairment, as their fair value cannot currently be reliably measured. While such a valuation method is acceptable in the circumstances, it is not applied consistently. The Court found some cases where provisional estimates for impairments available to the manager of the operations (European Investment Bank), for a total amount of 21 million euro, had not been communicated to the Commission (see paragraphs 11.10 and 11.11).

Pre-financing

1.27. The audit of a representative sample of 150 pre-financings from the population of pre-financings registered in the accounting system identified a material level of error in terms of frequency and financial impact as regards this item of the balance sheet. However, it is not material overall. The most common types of errors are:

- Pre-financing entries were recorded for the wrong amount.

- Pre-financing amounts were recorded although they were cleared before the year-end.

1.28. Furthermore, additional audit work on the identification and validation of pre-financings revealed problems of completeness/accuracy for the closing balance sheet:

- Instructions on the accounting treatment of unpaid final invoices and the related clearing of pre-financing should be reviewed in order to guarantee a harmonised approach amongst Commission services.

1.26. Reporting and accounting standards have evolved significantly over the period of the MEDA mandates (which cover these risk capital operations). The European Investment Bank (EIB) and the Commission have been following developments and are currently reviewing the situation together, looking for the most cost-effective solution and also taking into account information available according to the contracts signed with final beneficiaries many years ago (hence not including current reporting standards).

New reporting requirements will also be agreed as regards the content of the annual executive reports, enabling the Commission to monitor more thoroughly the application of the relevant legal base and mandate.

1.28.

- *These instructions have been carefully reviewed during July 2007. For the limited number of invoices concerned, the conclusion is that the accounting treatment used by all Commission services for the 2006 closure is the most suitable available. The same treatment will apply for the next closure at the end of 2007.*

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- Recovery orders are not systematically issued when clearing of pre-financing reveals that money should be recovered from the beneficiary. This results in pre-financing being overstated and the receivables being understated by an amount that cannot be precisely quantified.
- Insufficient impairment tests were carried out to adjust the value of pre-financing to their recoverable amount, resulting in a possible overstatement of pre-financing and a corresponding understatement of expenses on write-down of pre-financing ⁽²⁵⁾.

Receivables

1.29. For European Agricultural Guidance and Guarantee Fund expenditure, the Commission has introduced a new recovery procedure ⁽²⁶⁾ which includes tables for the presentation of the debtors' accounts. The Court's work in relation to these debtors' accounts questions the completeness of these tables ⁽²⁷⁾ (see paragraphs 5.61 and 5.62).

Employee benefits

1.30. For Members of the European Parliament from countries whose national authorities do not provide a pension scheme, the Bureau of the European Parliament adopted a provisional pension scheme pending the establishment of a definitive Community pension scheme for all Members ⁽²⁸⁾. However, the liability in respect of these pension rights is not recognised in the consolidated balance sheet. In the absence of an actuarial evaluation for these pension rights, the financial impact on the (provision for) 'Employee benefits' and on the economic outturn account cannot be quantified.

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- *Pre-financing amounts are not intended to be recovered but to be used by beneficiaries in accomplishing their contracts. Recoveries occur in rare cases where beneficiaries fail in their obligations or where there are marginal differences between the amounts paid and the final eligible costs.*
- *Impairment tests were not considered as a priority as most of the Directorates-General concerned deal with public entities, because of the existence of bank guarantees and because of the rather low rate of recovery orders issued in the past. Further attention will be given to this question in the future to confirm the assumption.*

1.29. *There is a clear link between these tables and the paying agencies' debtors' ledger, and the Commission's new guidelines applicable from 2007 require the certification bodies to reconcile the debtor's ledger with the tables and to provide explanations to any discrepancies found.*

The tables form part of the paying agencies' annual accounts and, as such, are certified by the certification bodies. Moreover, the Commission devoted a considerable amount of work into gaining reasonable assurance.

A detailed follow-up will be carried out by the Commission in the course of 2007 with a view to ensuring that the debts are properly reported in the tables of Annex III.

See replies to paragraphs 5.61 and 5.62.

1.30. *The future of this provisional pension scheme is currently being reconsidered. In view of the uncertainty regarding its future, and of the absence of an actuarial valuation, no meaningful provision can be made in the accounts.*

⁽²⁵⁾ EuropeAid Co-operation Office, Directorate-General for the Information Society and Media, Directorate-General for Energy and Transport, Directorate-General for Education and Culture.

⁽²⁶⁾ Council Regulation (EC) No 1290/2005 (OJ L 209, 11.8.2005, p. 1) and Commission Regulation (EC) No 885/2006 (OJ L 171, 23.6.2006, p. 90).

⁽²⁷⁾ Limitations of the opinions of the certificates and major findings in the reports of the certifying bodies, limited work done by some of them and insufficient information in some of their reports.

⁽²⁸⁾ Enlarged Bureau decision of 4 November 1981; Bureau decision of 24 and 25 May 1982, as amended on 13 September 1995 (PE 113.116/BUR./rev. XVII/02-2004/Ann.III).

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Accounts payable

1.31. The audit of a representative sample of 150 invoices/cost statements from the population of accounts payable registered in the accounting system identified a material level of error in terms of frequency and financial impact as regards this balance sheet item. However, it is not material overall. Most of the errors concern invoices or cost statements recorded for the wrong amounts.

Cut-off procedure

1.32. Weaknesses concerning cut-off procedures (see paragraph 1.18) led to deficiencies in the provisional accounts which have been corrected in the final accounts,

1.31. *The level of errors found by the Court was limited.*

1.32. *In 2006, the Commission improved the estimation of its cut-off amounts by taking the following actions:*

- *a new cut-off report was developed,*
- *cut-off techniques were further refined,*
- *a new procedure and checklist were provided to the services,*
- *an overview document on cut-off methodology by Directorates-General was drafted and workshops by families of Directorates-General organised,*
- *the Directorate-General for Budget performed on the spot controls in selected Directorates-General,*
- *several Internal Audit Capability Services played a role in assessing the cut-off exercise.*

Amounts to be called from Member States

1.33. Total assets increased from 58,7 billion euro in 2005 to 67 billion euro, with total liabilities increasing from 120,9 billion euro to 131,8 billion euro. The difference will be financed from budgetary amounts already voted or has to be covered in future budgets. As already indicated previously ⁽²⁹⁾, the different character of the liabilities to be covered by the amounts to be called from Member States should be disclosed further, in particular the years when they fall due.

1.33. *The current split of amounts to be called from Member States between long-term and short-term amounts is sufficient, especially when combined with the long-term/short-term split of assets and liabilities given on the balance sheet.*

⁽²⁹⁾ See paragraph 1.49 of the Annual Report concerning the financial year 2005.

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Off-balance sheet items and notes to the accounts

1.34. Compared to 2005, the explanatory notes to the annual accounts contain supplementary 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. However, as for the past, the notes still do not identify, for each calendar year, the amounts (and areas) of expenditure which are accepted by the Commission and the amounts (and areas) of expenditure which may be subject to further verification and clearance of accounts ⁽³⁰⁾.

Consolidated economic outturn account (including segment reporting)

1.35. Following a specific request of the Court, in particular the explanatory notes concerning the 2006 economic outturn account ⁽³¹⁾ contain more information regarding the amounts recovered in response to illegal or irregular operations, in particular at the level of final beneficiaries/recipients, where more than 90 % of the errors are identified. However, further measures are necessary in order to ensure completeness and reliability of the accounting data and information presented in the explanatory notes (see paragraphs 2.23 to 2.25).

1.36. A detailed reconciliation between budgetary outturn and economic outturn is indispensable for obtaining reasonable assurance concerning the reliability of the accounts. However, the reconciliation made available to the Court in July 2007 still presents unexplained minor differences. Furthermore, the intelligibility of the accounts would be improved if a table presenting such a reconciliation was included in the annual accounts.

Consolidated reports on implementation of the budget

1.37. The amount of 'Outstanding' recovery orders in the budgetary tables for the financial year 2005 (6 175 million euro) ⁽³²⁾ does not agree with the corresponding amount of 'Entitlements established' and carried forward from the previous year in the 2006 annual accounts (6 180 million euro) ⁽³³⁾. As this represents an infringement of the principle of continuity, this should have been clarified before the establishment of the accounts.

1.34. *The Financial Regulation, and the sector regulations regarding agriculture and the structural funds, give the Commission the right to make checks on all expenditure for many years after it was 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.*

1.35. *The ABAC accounting system is being adapted to increase the quantity of information recorded regarding recoveries. These improvements are planned to be effective for the 2008 accounts.*

1.36. *The Commission accepts that the reconciliation procedure needs to be improved. Action will be taken in order to address the deficiencies identified. Furthermore, the Commission will consider including a full reconciliation in the annual accounts.*

1.37. *The difference of 5 million euro concerns a prior year adjustment in the budgetary accounts of a consolidated entity.*

⁽³⁰⁾ See paragraphs 1.10 and 1.11 of the Annual Report concerning the financial year 2002, paragraph 1.11 of the Annual Report concerning the financial year 2003, paragraphs 1.12 and 1.13 of the Annual Report concerning the financial year 2004 and paragraph 1.57 of the Annual Report for the financial year 2005.

⁽³¹⁾ Further information can also be found under contingent assets (frauds and irregularities and forecasts of revenue) and in the explanatory notes to the consolidated reports on implementation of the budget.

⁽³²⁾ See reports on the implementation of the budget, table 2 'Consolidated summary of the implementation of budget revenue 2005'.

⁽³³⁾ See reports on the implementation of the budget, table 2 'Consolidated summary of the implementation of budget revenue 2006'.

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*Legality and regularity of underlying transactions***The Court's approach**

1.38. Faced with a rapidly changing audit environment and based on the experience gained over twelve years, it was necessary to further develop and adapt the methodology underlying the DAS. The core element of the revised DAS approach is an assurance model which is based on two principal sources of evidence:

- (a) An examination of the operation of the supervisory and control systems applied in the collection and disbursement of European funds by Community Institutions, Member States and Third Countries; aiming to provide representative information on the implementation and functioning of key controls in respect of their ability to prevent or detect and correct errors.
- (b) Checks based on representative samples of transactions relating to revenue and relating to expenditure, down to the level of the final beneficiary, aiming to provide direct evidence on the legality and regularity of payments.

Under the assurance model a judgement is made on the level of confidence that can be derived from the operation of supervisory and control systems as well as from direct testing of transactions in order to arrive at a high level of assurance considered necessary concerning the legality and regularity of transactions.

1.39. These principal sources can be complemented by two other sources:

- (a) An analysis of the Annual Activity Reports and the declarations of the Commission's Directors-General and their synthesis stating whether the Commission has reasonable assurance that the systems in place ensure the legality/regularity of the underlying transactions.
- (b) An examination of the work of other auditors, defined as those that are independent of the Community's management and control process (e.g. Supreme Audit Institutions in the Member States or Third Countries) ⁽³⁴⁾.

1.38-1.39. *The Court's annual statement of assurance and other audit work and the recommendations are an invaluable source of information for the Commission and it endeavours to diligently follow up the recommendations made.*

With the encouragement of the discharge authority and the Court, the Commission continues to take part in an extensive informal and most useful dialogue with the Court on the impact of errors found in the annual audits.

It has already taken measures to improve quality control through the action plan towards an integrated internal control framework, which proposes actions to fill identified gaps in supervisory and control systems, and to strengthen the systems further.

This requires the full cooperation of all Member States, given their shared management responsibilities for three quarters of the Union's budget.

The Commission's reporting system and modernised accounting system provide considerable details each year on management of the Community resources and explain the reasons for the assurances each Director General makes each year, their reservations or other observations, and the actions being undertaken as a result of audit and control work.

The Court's audit concerns the legality and regularity of the transactions recorded in a given year. The Directors-General provide assurance on the operation of the multiannual control systems during that year. The Commission does not underestimate the system weaknesses that can lead to spending failing to meet the required conditions, but it builds up its assurance over time and takes into account the remedial measures being taken to correct such weaknesses and the capacity of the multi-annual system to correct errors some time after the disbursement of funds.

⁽³⁴⁾ More detailed information can be found on the Court's internet site www.eca.europa.eu.

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Audit results 2006

1.40. As in previous years, the conclusions of the various specific assessments show that in those areas where the supervisory and control systems, taken as a whole, are properly and correctly applied the Court's substantive testing revealed that the risk of material errors in the legality and regularity of the underlying transactions was limited (see paragraphs 4.28, 5.65 regarding IACS, 8.31 concerning delegations, 9.23 except for Sapard and 10.6). For these areas, the Court estimates that the errors have a financial impact of less than 2 % of the respective population by value (see **Table 1.2**). Furthermore, the Court's assessment of the declarations by Directors-General and authorising officers by delegation confirmed that no, or only minor reservations had to be presented (see paragraphs 2.11 to 2.12).

1.40. *The Commission considers that progress has been made in the application of the supervisory and control systems in 2006, but acknowledges that further actions need to be taken. The implementation of the action plan towards an integrated internal control framework and the positive impact that it is likely to have in future years on the assurance gained from the systems are further signals of the Commission's willingness to improve even further.*

Table 1.2 — Specific assessments concerning legality and regularity of underlying transactions

| Specific assessments of the 2006 Annual Report | | Functioning of supervisory and control systems | Error range | |
|--|------------|--|------------------------------|----------|
| Own resources ⁽¹⁾ | | | | |
| Common agricultural policy | IACS | | Overall for CAP | IACS |
| | non-IACS | | | non-IACS |
| Structural operations | | | | |
| Internal policies | | | | |
| External actions | | | Headquarters and Delegations | |
| | | | Implementing organisations | |
| Pre-accession strategy | Phare/ISPA | | | |
| | SAPARD | | | |
| Administrative expenditure ⁽²⁾ | | | | |




The above table summarises the overall assessment of supervisory and control systems, as outlined in the relevant chapters, and gives the broad results of the Court's substantive testing. The table highlights the key elements but cannot present all of the relevant detail for which it is necessary to refer to the body of the report, within the context of the methodology underlying the Court's audit approach (see paragraphs 1.38 and 1.39).

Legend

Functioning of supervisory and control systems

| | |
|---|---------------------------------------|
|  | Satisfactory |
|  | Partially satisfactory ⁽³⁾ |
|  | Unsatisfactory |

Error range

| | |
|---|---|
|  | Less than 2 % (below materiality threshold) |
|  | Between 2 % and 5 % |
|  | Greater than 5 % |

⁽¹⁾ See scope limitations in paragraphs 4.3, 4.4 and 4.7.

⁽²⁾ For 'Functioning of supervisory and control systems', paragraphs 10.6 and 10.25 draw attention to some weaknesses

⁽³⁾ Systems are classified as 'partially satisfactory' where some control arrangements have been judged to work adequately whilst others have not. Consequently, taken as a whole, they might not succeed in restricting errors in the underlying transactions to an acceptable level.

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1.41. In areas where the Court's audit indicated that supervisory and control systems are at best only partially satisfactory, the Court's substantive testing continues to identify material levels of error (see paragraphs 5.65 to 5.78 for non-IACS, 6.37 to 6.39, 7.30 and 7.31, 8.31 and 8.32 concerning implementing organisations and 9.23 for Sapard). The Court estimates that for these areas the errors have a financial impact of more than 2 % of the population by value (see **Table 1.2**). Furthermore, the Court's assessment of the declarations by Directors-General confirmed that major reservations were either presented or, in the Court's view, should have been presented for the areas in question (see paragraphs 2.11 to 2.12 and 2.13 to 2.17).

1.42. The specific assessments for expenditure under the common agricultural policy, structural policies and internal policies, show that complicated or unclear eligibility criteria or complex legal requirements can have a considerable impact on the legality and regularity of transactions (see paragraphs 5.44 for Rural Development Expenditure, 6.29 for Structural Operations and 7.11 for Internal Policies). For example, the Court's systems' audit indicates that Rural Development measures are prone to a high incidence of errors because of the often complex eligibility conditions⁽³⁵⁾. On the other hand, the design and implementation of the single payment scheme limits the risk of irregular payments. Nevertheless, the overall error rate of agricultural expenditure as a whole is still above materiality.

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1.41. Community-funded expenditure in these budget areas is subject to a series of control processes, some of which take place before the certification of expenditure to the Commission and some afterwards. For example, in internal policies, the inherent risk of the reimbursement of overstated costs has been mitigated by a substantial increase in the number of ex-post audits, while for external aid implementing organisations the Commission ensures that controls on payment claims by the beneficiaries are effected at key stages of project implementation, thus allowing errors on advance payments to be detected and remedied. The findings presented by the Court show the situation at a particular point in the execution of these control processes. A large proportion of the errors are likely to be corrected through the operation of the multi-annual corrective system.

As regards agriculture, the Commission notes that the level of error overall has decreased markedly and is close to the materiality level. For the non-rural development part of EAGGF Guarantee expenditure, which accounts for more than 85 % of total expenditure, the level of error is below the materiality level.

Concerning the other policy areas, the Commission will take the potential risks into account in its audits. Annual activity reports generally set out clearly the Directorates-General assessments of the effectiveness of management and control system in the Member States and the corrective measures underway to bring about the required improvements. Directors General enter reservations where there appear to be significant deficiencies posing a material risk to the Community budget that could not be adequately managed through the normal corrective mechanisms of the control system.

See also replies to paragraphs 2.8 to 2.17, 2.36, 5.65, 6.38 to 6.40, 7.30, 7.31, 8.31, 8.32 and 9.23.

1.42. While sometimes the achievement of policy goals requires detailed regulation, the Commission is sensitive to the need to simplify rules as far as the achievement of the policy goals permits. Where legal requirements remain complex, the Commission provides guidance to simplify and clarify their application. Avoidance of errors also depends in large measure on the guidance Member States' authorities provide to implementing bodies and beneficiaries, on the effectiveness of controls, and on beneficiaries' awareness that non-compliance can lead to loss of the grant. The Commission is encouraging Member States to step up their activities in these areas as part of the Action Plan towards an Integrated Internal Control Framework.

Agri-environmental measures, that concern a small part of CAP expenditure, are prone to weaknesses (see reply to paragraph 5.72). The deficiencies may be adequately managed through the corrective measures of the control systems. Furthermore, legislative changes for the coming period were introduced.

The Commission considers that their control is rather complex, but the objective of these measures to integrate environmental concerns in agriculture and their added value is widely recognized.

⁽³⁵⁾ The Court's substantive testing reveals that the error rate calculated on the basis of a sub-sample, covering only the non-rural development part of agricultural expenditure, is below materiality.

CHAPTER 2

Commission internal control framework

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INTRODUCTION AND AUDIT SCOPE

2.1. This chapter reports on the Commission's efforts in 2006 to improve the effectiveness of supervisory and control systems in its Directorates-General in order to ensure the legality and regularity of transactions resulting from the EU budget. In particular, it analyses:

- the extent to which the management representations contained in the annual activity reports and declarations by the Directors-General, and in the Commission's synthesis, are confirmed by the Court's audit findings (paragraphs 2.3 to 2.18),
- information on recoveries and financial corrections (paragraphs 2.23 to 2.30).

2.2. The chapter also comments on the Commission's action plan towards an integrated control framework (paragraphs 2.19 to 2.22) and reviews the functioning of the Commission's supervisory and control systems (paragraphs 2.31 to 2.34).

THE COMMISSION'S MANAGEMENT REPRESENTATIONS

The Commission's Synthesis Report

2.3. In addition to the report on policy achievements ⁽¹⁾, the Commission adopted the 2006 Synthesis Report ⁽²⁾ on its management achievements considering that 'the internal control systems in place, with the limitations described in the annual activity reports, provide reasonable assurance as to the legality and regularity of operations for which the Commission takes overall responsibility pursuant to Article 274 of the EC Treaty. However, it acknowledges that further efforts are needed to resolve a number of weaknesses, in particular those highlighted in the reservations of the delegated authorising officers.'

2.1. *Actions taken in 2006 included the launch of the action plan towards an integrated internal control framework, where the first progress report in March 2007 set out progress made. Improvements were made in the guidelines for the Annual Activity Reports including the presentation of services' control strategies and their results and — non-mandatory for 2006 — of legality and regularity indicators.*

The broad spectrum of actions being taken to improve the supervisory and control systems responds to recommendations of the Court and the Commission's own internal auditors and those made by the Parliament and the Council during the annual discharge procedure.

⁽¹⁾ COM(2007) 67 of 28.2.2007.

⁽²⁾ COM(2007) 274 of 30.5.2007.

THE COURT'S OBSERVATIONS

2.4. The Commission's assessment of certain cross-cutting issues is in line with the analysis of the Court, concerning the conclusions on the direct centralised management in the area of research (see paragraph 2.12), the need for simplification (see paragraph 1.42), continued efforts in the development of legality and regularity indicators (see paragraph 2.18) and further improvements of the quality of annual activity reports (see paragraphs 2.7 and 2.9). However, for certain parts of the common agricultural policy, structural measures, and also certain parts of external actions the Court's audit reveals significant weaknesses in the supervisory and control systems which go beyond those set out by the Directors-General as reservations in their declarations accompanying the annual activity reports (see paragraphs 2.13 to 2.17). Furthermore, the Commission's analysis of the remaining problems concerning the reliability of the accounts, in particular at the level of local subsidiary systems, was not complete (see paragraphs 1.13 to 1.17).

2.5. The Commission states in its Synthesis Report that 'in some cases' the difference between the Court's assessment of the assurance to be drawn from internal control systems and the assurance given by the responsible Directors-General derives primarily from diverging interpretations on the typology and impact of errors and/or on the evaluation of systems deficiencies. In the Court's view, the divergence reflects mainly the fact that the Commission's assessment of management achievements does not adequately take into consideration the impact of ongoing control weaknesses, although they are mostly recognised in the different action plans and annual activity reports (see paragraphs 2.11 and 2.19 to 2.22).

2.6. For example, as already stated in the Annual Report concerning the financial year 2005 ⁽³⁾, the Court's audits show that, in a number of areas, the existing supervisory and control systems do not ensure the prevention or timely identification and correction of errors (see paragraphs 5.76, 6.39, 7.30, 8.31 ⁽⁴⁾ and 9.23).

⁽³⁾ See the Annual Report concerning the financial year 2005, paragraph 1.64.

⁽⁴⁾ In external actions, errors found were mostly at the level of the project implementing organisations.

THE COMMISSION'S REPLIES

2.4. *Directors General enter reservations in their declarations where the information they have built up from their own and the Member States' audit work on the functioning of systems indicate significant deficiencies posing a material risk to the Community budget that could not be adequately managed through the normal corrective mechanisms of the control system. In addition to these cases Directors General might choose a reservation when a high reputational risk for the Community institutions exists. The Directors General mentioned by the Court therefore did not issue reservations when they considered that the risk was adequately managed and they explained the reasons of their assessment in their Annual Activity Reports.*

Agri-environmental measures, which concern a small part of CAP expenditure, are prone to weaknesses (see paragraph 5.72). The deficiencies may be adequately managed through the corrective measures of the control systems. Furthermore, legislative changes for the coming period were introduced.

See also the replies to paragraphs 1.15, 1.17, 1.42, 2.13 and 2.18.

2.5. *The Commission indicated in the Synthesis Report that the assessment of the assurance to be drawn from the internal control framework also takes account of its multi-annual character, which enables corrections to be made some time after the disbursement of funds, and of the corrective measures to remedy the identified control weaknesses.*

The Directors General concerned are discussing their differences of perception with the Court, and will explain the reasons in their annual activity reports for 2007 onwards.

The Synthesis Report also indicated that Directors General take due consideration of the results of audits of the Court as a major source for their assurance.

2.6. *In the area of agricultural expenditure the results of the controls at the level of the final beneficiaries, as communicated by the Member States to the Commission and published in the relevant annual activity report provide an indication of the extent of irregular payments for agricultural expenditure. To further improve the assurance which can be*

THE COURT'S OBSERVATIONS

that its services apply a multi-annual system under which errors in one year may be detected and corrected in subsequent years. Independently of these arguments, the Commission does not have at its disposal adequate and reliable information concerning corrections made at the level of final beneficiaries (see paragraphs 2.23 to 2.30).

THE COMMISSION'S REPLIES

gained from this information, as from 2007, the Commission has implemented the Court's recommendation that the certification bodies should do more work to verify and validate the inspection statistics and post-payment checks.

In the structural actions area, the Commission broadly shares the Court's view that improvements are necessary in national systems. However, there is evidence that between 20 and 35 % of systems are satisfactory, around 60 % are in need of improvements to correct material deficiencies in key controls, and around 10 % are seriously deficient (see reply to paragraph 6.35). In the latter cases, payments are suspended or financial corrections are imposed where Member States do not themselves make the required corrections.

The Commission maintains that a large proportion of the errors found are likely to be corrected through the multi-annual corrective mechanisms in the system. The guidelines for the 2007 annual activity reports will require more detailed information on recoveries. In particular the Commission has taken steps to obtain better information regarding corrections made by Member States. See the replies to paragraphs 5.76, 6.39, 7.30, 8.31 and 9.23.

Annual activity reports and declarations by Directors-General

Process of preparation

2.7. The guidance ⁽⁵⁾ for the 2006 annual activity reports, as well as the peer review exercise ⁽⁶⁾, indicate the continued efforts made by the central services of the Commission in order to clarify the link between the effectiveness of internal control systems and the basis on which the declarations are built ⁽⁷⁾, and provide general information on how to present key indicators on legality and regularity ⁽⁸⁾.

⁽⁵⁾ Note from the Commission's central services (SEC GEN, DG BUDG and DG ADMIN) to Directors-General and Heads of Service — Standing instructions for the preparation of the annual activity reports for year 2006, SEC(2006) 1789 of 19.12.2006.

⁽⁶⁾ This is a process, organised by families of Directorates-General under the coordination of the central services, to improve consistency and coherence between reservations included in the declarations.

⁽⁷⁾ In particular, under part 2 'Management and internal control systems', an 'Internal Control Template' (ICT) should be used for the description of the inherent nature and characteristics of the management, risk and control environment. The elaboration of the ICT is foreseen by action 3 of the action plan towards an integrated internal control framework.

⁽⁸⁾ In the framework of the 2005 Synthesis Report multiannual objective no 4 (COM(2006) 277 of 7.6.2006), specific common templates of legality and regularity indicators should be further developed by the families of Directorates-General. By the end of 2006, only the 'Cooperation for Growth and Employment' family had finalised its overview on objectives and indicators.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Declarations by Directors-General

2.8. In their declarations attached to the annual activity reports, the Directors-General have to state whether the resources assigned to the activities have been used in accordance with principles of sound financial management and internal controls implemented in their departments provide reasonable assurance that the underlying transactions are legal and regular. In the event of material internal control weaknesses or irregularities, they have to qualify the declarations issuing reservations ⁽⁹⁾ and to draw up remedial action plans.

2.9. The Court's analysis of the annual activity reports and declarations of the Directors-General for the financial year 2006 reveals that the materiality criteria, as well as the definition of the reservations and their impact on the assurance were, in general ⁽¹⁰⁾, clear. The Court's audit also reveals that the annual activity reports generally present an improved assessment of the strengths and weaknesses of supervisory and control systems ⁽¹¹⁾.

2.10. All the Directors-General stated that they had obtained reasonable assurance that the resources allocated to them had been used for the specified purposes, and that the internal controls which they had introduced ensured the legality and regularity of the underlying transactions.

2.11. The Court notes that 15 of the 40 declarations contain one or more reservations. The total number of reservations fell from 2005 (31) to 2006 (20) ⁽¹²⁾. The majority refers to weaknesses already identified in previous years ⁽¹³⁾ and concerns mainly the legality and regularity of the underlying transactions. The most important reservations in the context of the DAS are shown in **Table 2.1**.

⁽⁹⁾ The Directors-General are required to provide an overall summary on the combined impact of reservations on the declarations as a whole and to reach a clear conclusion as to whether, in the light of those reservations, the assurance to be provided in the declarations can be maintained.

⁽¹⁰⁾ As regards the materiality criteria and/or reservations (definition and/or impact) in the context of the DAS, there is still a scope for improvement for the following DGs: EAC, ECFIN, ENV, EPSO/EAS, ESTAT and FISH.

⁽¹¹⁾ Despite the fact that the Directorates-General did not use the Internal Control Template in a harmonised manner (see paragraph 2.7).

⁽¹²⁾ The detailed analysis of the Court reveals that 2006 reservations include 6 new and 14 carry-over reservations. However, for example, the number of Member States/regions covered in the reservation concerning the European Social Fund (ESF) increased from 1 to 8.

⁽¹³⁾ See Annual Reports concerning the financial year 2003 and 2004, paragraphs 1.67, and concerning the financial year 2005, paragraph 2.17.

2.8. *The combination of these two principles (reasonable assurance on sound financial management and legality and regularity) leads to a certain 'balance' of risks and controls being considered as acceptable by management, even though 'full assurance' and 'full legality/regularity' cannot be reached.*

2.9. *The Commission expects further improvements for 2007, thanks notably to the generalisation of the use of the Internal Control Template in the annual activity reports which establishes a clearer link between control systems and assurance. The Commission will also pursue its efforts to improving materiality criteria and strengthening the basis of the assurance where needed.*

Table 2.1 — Evolution of the evidence given by Commission Directorates-General's annual activity reports for the Court's Statement of Assurance

| Sector | Most important reservations of Directors-General (included in the declarations) | 2004 | 2005 | 2006 | Impact of these most important reservations on the Director-General's assurance in the Court's view ⁽¹⁾ | | | Other significant weaknesses revealed by the Court's audit and/or the Commission (not included in the declarations) | 2004 | 2005 | 2006 | Evidence given by the annual activity report for the Court's audit conclusions ⁽²⁾ | | |
|----------------------------|---|-------------|-------------------------------|---|--|------|------|--|------|------|------|---|--------------------------------------|--------------------------------------|
| | | | | | 2004 | 2005 | 2006 | | | | | 2004 | 2005 | 2006 |
| Own Resources | — 'Hilton' beef | x | x | | } A | A | A | / | | | | } A | A | A |
| Common Agricultural Policy | — IACS in Greece | x | x | x | } B | B | B | — Limited scope of the Commission's monitoring action and backlog of incomplete checks as regards Regulation (EEC) No 4045/89 — Management and control systems in the Member States concerning rural development (paragraph 5.66) | x | | x | } C | B ⁽⁴⁾ C ⁽⁵⁾ | B ⁽⁴⁾ C ⁽⁵⁾ |
| Structural measures | — EAGGF-Guidance: management and control systems in the Member States (2000/2006) | x | | | } | B | B | B | x | x | x | } | C | C |
| | — ESF: management and control systems in the Member States (2000/2006) | x | x United Kingdom | x Spain, Scotland (United Kingdom), Sweden, Slovakia, Slovenia, Latvia, Calabria and Lazio (Italy) | | | | | | | | | | |
| | — IFOP: management and control systems in the Member States (2000/2006) | x Italy | | | | | | | | | | | | |
| | — ERDF: management and control systems (2000/2006) | x Greece | x United Kingdom and Spain | x England and Scotland (United Kingdom) | | | | | | | | | | |
| | — INTERREG: management and control systems (2000/2006) | | | x All programmes (except IIIB North West Europe and Azores, Canaries and Madeira) | | | | | | | | | | |
| | — Cohesion Funds: management and control systems (2000/2006) | x Greece | x Spain | | | | | | | | | | | |

| Sector | Most important reservations of Directors-General (included in the declarations) | 2004 | 2005 | 2006 | Impact of these most important reservations on the Director-General's assurance in the Court's view ⁽¹⁾ | | | Other significant weaknesses revealed by the Court's audit and/or the Commission (not included in the declarations) | 2004 | 2005 | 2006 | Evidence given by the annual activity report for the Court's audit conclusions ⁽²⁾ | | | | | | | |
|---------------------------------------|---|----------------|-------|------|--|------|------|---|------|------|------|---|------|------|---|---|---|---|---|
| | | | | | 2004 | 2005 | 2006 | | | | | 2004 | 2005 | 2006 | | | | | |
| | | | | | | | | | | | | | | | | | | | |
| Internal policies, including research | — Insufficient assurance/weaknesses on management through National Agencies | | x | x | } | | | | | | | | | | | | | | |
| | — (On-the-spot audits for internal policies contracts) — absence of sufficient evidence to determine the residual level of persisting errors with the regard to the accuracy of cost claims | x | x | x | | B | B | B | } | | | | | | | | | | |
| | — Error frequency (eligibility) in the cost claims for research contracts | x | x | x | | | | | | | x | | | B | B | B | | | |
| | — Weaknesses in the European Fund for Refugee's management and control systems | x | x | x | | | | | | | | | | | | | | | |
| | United Kingdom and Luxembourg | United Kingdom | Italy | | | | | | | | | | | | | | | | |
| External actions | — Non respect of contract procurement procedures by a Humanitarian Organisation | x | | | } | A | A | A | } | | | x | } | C | B | B | | | |
| | — Legal status and liability of contractual partner in the framework of the implementation of EU contribution to UNMIK Pillar IV in Kosovo | | x | | | | | | | | | | | | | | | | |
| Pre-accession strategy | — ISPA: management and control systems | x | | | } | | | | } | | | | } | | | | | | |
| | — PHARE: Risks inherent in the decentralised systems, omissions in the audit of systems and transactions | Romania | | | | B | A | A | | | | | | | | B | A | A | |
| Administrative expenditure | — Implementation of internal control standards in the EU's delegations | x | x | | } | A | A | A | } | | | | } | x | | | A | A | A |

Key:

⁽¹⁾ Impact of these most important reservations on the Director-General's declaration in the Court's view:
A: reasonable assurance that the internal control systems ensure the legality and regularity of the underlying transactions with no or insignificant qualifications.
B: reasonable assurance with qualifications that the internal control systems ensure the legality and regularity of the underlying transactions (errors < 2 % or system weaknesses whose financial impact < 10 % of the budget concerned).
C: no assurance (errors > 2 % or system weaknesses whose financial impact > 10 % of the budget concerned).

⁽²⁾ Evidence given by the annual activity report for the Court's audit conclusions:
A: sufficient evidence for the Court's DAS conclusions (clear and unambiguous).
B: sufficient evidence for the Court's DAS conclusions after corrections (with immaterial inaccuracies or missing information of minor importance).
C: insufficient evidence for the Court's DAS conclusions (with material inaccuracies or missing information of major importance, for example: negligence of the problems of shared management, cover of the previous financial year, lack of quantification, unusable information).

⁽³⁾ Although included in the annual activity reports.
⁽⁴⁾ For CAP expenditure, where IACS is properly applied.
^(?) For CAP expenditure, which is not subject to IACS or where IACS is not properly applied.

Source: Court of Auditors.

THE COURT'S OBSERVATIONS

2.12. For own resources, internal policies (including research), pre-accession strategy⁽¹⁴⁾ and administrative expenditure (see **Table 2.1** and paragraphs 4.28, 7.30, 9.23, 10.15, 10.16 and 10.25) the annual activity reports are generally in line with the conclusions of the relevant DAS specific assessments.

2.13. On the other hand, in significant parts of the EU budget, the Directors-General give a more positive account of the legality and regularity of EU spending than is consistent with the Court's audit.

2.14. As regards the common agricultural policy, the assurance provided by the declaration of the Director-General for Agriculture and Rural Development (see **Table 2.1**), in some significant respects, is not compatible with the Court's findings. The Directorate-General for Agriculture and Rural Development is using an assurance model in support of the declaration. The elements of this model are specified in the annual activity report⁽¹⁵⁾. The Court's audit findings show weaknesses which impact on each of these elements and which limit the assurance it can draw from the declaration. In particular, taking assurance from elements not related to 2006 expenditure⁽¹⁶⁾, using forecasts of future corrections (contingent assets) in respect of the current year and including the impact of financial corrections falling to Member States rather than to the irregularly paid beneficiaries (see paragraphs 5.63-5.64).

⁽¹⁴⁾ Except for SAPARD.

⁽¹⁵⁾ For example, for EAGGF guarantee: 1. compulsory administrative structure at the level of the Member States, 2. detailed systems for controls and dissuasive sanctions, 3. ex-post controls, 4. clearance of accounts procedures.

⁽¹⁶⁾ For example, clearance of accounts procedures (see paragraphs 5.56-5.64) and ex-post scrutinies of payments (see paragraphs 5.48-5.53).

THE COMMISSION'S REPLIES

2.13. *The Court's audit concerns the legality and regularity of the transactions recorded in a given year. The Directors-General provide assurance on the operation of the multiannual control systems during that year. The Commission does not underestimate the system weaknesses that can lead to spending failing to meet the required conditions, but it builds up its assurance over time and takes into account the remedial measures being taken to correct such weaknesses and the capacity of the multi-annual system to correct errors some time after the disbursement of funds.*

See also replies to paragraphs 2.5 and 2.6.

2.14. *The Commission notes that the total level of error has decreased markedly and that, for the non-rural development part of EAGGF Guarantee expenditure, which accounts for more than 85 % of total expenditure, it is below the materiality level. As regards Rural Development, the agri-environmental measures are prone to a high incidence of material error.*

The assurance gained by the Director-General for Agriculture and Rural Development is based on a comprehensive system for the management and control of agricultural expenditure which ensures that irregular payments to final beneficiaries are prevented or detected and recovered. This system relies on four complementary levels, each of which works satisfactorily. In particular, as regards the conformity procedure, its multi-annual nature does not affect the assurance which can be derived from this procedure for the financial year 2006. While it is true that the financial consequences are only determined at the end of the procedures, the preliminary findings of the audits carried out in 2006 are already known. Furthermore, since the Commission's audits cover the Member States' management and control systems, they do not only provide information on the expenditure audited, but indirectly also on future expenditure covered by the systems in question.

Furthermore, 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 COURT'S OBSERVATIONS

2.15. In structural policies, the declarations of the Directors-General of Regional Policies and of Employment, Social Affairs and Equal Opportunities understate the significant weaknesses of management and control systems in the Member States (see paragraph 6.38) and material level of errors at project level (see paragraph 6.39) singled out by the Court's audits (see **Table 2.1**).

2.16. The Court also questions whether the overall assessment of the Director-General for Regional Policy in respect of the European Regional Development Fund (ERDF) and the Cohesion Fund is compatible with the qualifications which he makes on the functioning of management and control systems in 10 and 9 Member States respectively⁽¹⁷⁾. The same situation exists for the Directorate-General for Employment, Social Affairs and Equal Opportunities⁽¹⁸⁾. Furthermore, the Court notes that the annual activity report of the latter states that an 'audit opinion' was not formulated on 17,5 % of the expenditure concerning the programming period 2000-2006 for the European Social Fund (ESF); the Director-General based his assurance on management representations.

THE COMMISSION'S REPLIES

2.15. *The annual activity reports of the responsible Directors General set out the basis for their assessment of the effectiveness of management and control system in the Member States and the corrective measures underway to bring about the required improvements and indicate the levels of risk for Community funds. The assessments are based on extensive audit work and are broadly in line with those of the Court. They indicate, as set out in the reply to paragraph 2.6, that some 10 % of control systems are seriously deficient, and therefore present a high risk. In these cases, payments to Member States may be suspended and financial corrections imposed where the Member State does not itself make the required corrections. The Commission maintains that a large proportion of the errors found are likely to be corrected through the multi-annual corrective mechanisms in the system.*

2.16. *While the management and audit services of the Directorate General for Regional Policy gave qualified opinions on systems in a number of Member States on account of material deficiencies affecting key elements of their systems, it was concluded, on the basis of the corrective measures being taken and having regard to the multi-annual operation of the control arrangements, that the deficiencies were not so significant as to warrant a formal reservation on the Director General's declaration. As regards the European Social Fund, the Commission considers that the overall assessment by the Director-General of Directorate General for Employment, Social Affairs and equal Opportunities on systems is compatible with the reservations on programmes in 7 Member States. Management representations are there to close the gap on non-audited operations because it is simply not possible to have 100 % audit coverage every year.*

⁽¹⁷⁾ For ERDF, the analysis of the annual activity report of Directorate-General for Regional Policy reveals that 'the opinion was qualified in relation to material deficiencies affecting key elements of the system' for Czech Republic, Greece, Ireland, Latvia, Lithuania, Luxembourg, Netherlands, Slovakia and Spain. Moreover for Slovenia it was qualified because of a scope limitation. As regards the Cohesion Fund, 'the opinion was qualified in relation to material deficiencies affecting key elements of the system' in Czech Republic, Hungary, Ireland, Latvia, Lithuania, Poland, Portugal, Slovakia and Spain. Furthermore, concerning the closure of programming period 1994 to 1999 no precise information is given on the level of irregularities identified and the financial correction procedures launched.

⁽¹⁸⁾ For the European Social Fund (ESF), the analysis of the annual activity report of Directorate-General for Employment, Social Affairs and Equal Opportunities reveals that, in the DG's view, national/regional systems covering 73,39 % of 2006 payments provided reasonable assurance with limitations.

THE COURT'S OBSERVATIONS

2.17. The material incidence of error and the weaknesses in the supervisory and control systems designed to ensure the legality and regularity of the transactions at the level of project implementing organisations in the area of external actions (see paragraphs 8.31 and 8.32) found by the Court are not sufficiently reflected in the annual activity report and declaration of Europe Aid Co-operation Office (see **Table 2.1**).

Legality and regularity indicators

2.18. Three quarters ⁽¹⁹⁾ of the Directorates-General present legality and regularity indicators in their 2006 annual activity reports. The Court notes that not all of these indicators comply with the general types (of result and/or impact indicators) indicated in the guidelines prepared by the Commission's central services. The Court considers that additional efforts are still necessary at the level of the Directorates-General in order to measure the effectiveness of the supervisory and control systems as well as the legality and regularity of the underlying transactions (see paragraphs 2.31 to 2.34).

ACTION PLANS

General assessment

2.19. On 7 March 2007, the Commission presented a report ⁽²⁰⁾ on the state of play of the action plan ⁽²¹⁾ towards an integrated internal control framework, whose conclusion is broadly positive. It stated that it has made concrete progress on the implementation of the action plan, but that the remaining challenges should be addressed. Although there have been some delays, the Commission considers that by the end of 2007 it will 'have the foundations in place' for properly managing the risk of errors and providing increased assurance that transactions are legal and regular.

2.20. In the detailed analysis accompanying its progress report (see **Table 2.2**), the Commission assessed that, out of the 35 sub-actions, 10 were completed, 5 were almost completed, 13 were in progress, 4 were not yet started and 3 were withdrawn. It also introduced 6 new sub-actions to be implemented by the end of 2007.

THE COMMISSION'S REPLIES

2.17. *The Commission internal control system seeks a balance between the costs and benefits of checks, and is shaped to take into account the multiannual character of external aid expenditure, ensuring that controls on payment claims by the beneficiaries are effected at key stages of project implementation, thus allowing errors on advance payments to be detected and remedied.*

Measures were taken in 2006 to further strengthen the control systems, including distribution of an improved practical guide for contractual procedures, the guide for programme estimates, more detailed reporting guidelines for Delegations and more rigorous ex post controls.

2.18. *While it was not yet mandatory for Directors General to provide legality and regularity indicators in their Annual Activity reports for 2006 according to the general types recommended in the standing instructions (D(2006) 12058), the 2006 Synthesis report announces continued efforts to develop these legality and regularity indicators while ensuring a coherent approach by policy family of services. From the 2007 annual activity reports onwards, the use of indicators will be mandatory.*

⁽¹⁹⁾ The only exceptions are represented by DGs BEPA, BUDG, DIGIT, EPSO/EAS, ESTAT, MARKT, OIL, PMO and SG, which exclude all major spending services.

⁽²⁰⁾ COM(2007) 86 of 7.3.2007.

⁽²¹⁾ COM(2006) 9 of 17.1.2006.

Table 2.2 — Overview of the implementation of the Commission’s action plan towards an integrated internal control framework

| Reference | Domain/(sub-)actions/deadline set in the action plan | Assessment of the completion by the Commission | Court's assessment of the stage of implementation as at 31.12.2006 | Court's preliminary assessment of the impact achieved as at 31.12.2006 |
|---|---|--|--|--|
| Simplification and common control principles | | | | |
| 1 | Keep under consideration simplification of the rules for the 2007 to 2013 period concerning in particular the eligibility of expenditure in the structural funds and in the research programmes (31.12.2006). | Almost completed | Almost implemented | Further action needed ⁽¹⁾ |
| 2 | Propose internal control as budgetary principle in the revised Financial Regulation on the basis of the results of the inter-institutional consultation (1.6.2006). | Withdrawn | Not implemented | Objective not entirely achieved (follow-up required) |
| 3a | Establish Internal Control Templates which outline the range of control components which would be expected in a given control environment (31.5.2006). | Completed | Implemented | Impact not yet realised (follow-up required) |
| 3b | Demonstrate how Directorates-General will gain assurance on the internal control structures for shared management and internal policies, taking the developed templates and control strategies at Commission-level into account (30.9.2006). | Completed | Implemented | Impact not yet realised (follow-up required) |
| 3c | Organise peer review to enhance coherence and consistency of control strategies per family (31.3.2007). | In progress | In progress of implementation | — |
| 3d | Demonstrate how Directorates-General will gain assurance on the internal control structures for external policy, administrative expenditure, pre-accession aid, EDF and own resources, taking the developed templates and control strategies at Commission-level into account (31.12.2007). | In progress | In progress of implementation | — |
| 3e | Organise peer review to enhance coherence and consistency of control strategies per family (31.12.2007). | Not yet started | | |
| 3N | As from Synthesis Report 2006, the Commission will clearly set out and communicate to the budgetary authority reservations to the global assurance, including where relevant by sector or Member State, together with the corresponding financial corrections or suspensions of payments (31.12.2007). | New measure introduced on 7.3.2007 | | |
| 4 | Launch inter-institutional initiative on the basic principles to be considered regarding the risks to be tolerated in the underlying transactions and the definition of common benchmarks for the management of this risk (31.3.2006). | Withdrawn | Not implemented | Objective not entirely achieved (follow-up required) |
| Management declarations and audit assurance | | | | |
| 5 | Promote the use of management declarations at operational level in the negotiations on the 2007-2013 legislation for indirect centralised management and the establishment of national coordinating bodies able to provide an overview of the assurance available for example by a synthesis of operational declarations per policy area (30.6.2006). | Completed | Implemented | Impact not yet realised (follow-up required) |
| 6a | Develop guidelines on making management declarations more effective in research and other internal policies (30.9.2006). | Withdrawn | Not implemented | Objective not entirely achieved (follow-up required) |

| Reference | Domain/(sub-)actions/deadline set in the action plan | Assessment of the completion by the Commission | Court's assessment of the stage of implementation as at 31.12.2006 | Court's preliminary assessment of the impact achieved as at 31.12.2006 |
|--|---|--|--|--|
| 6b | Extend guidelines on making management declarations more effective for external policies (31.12.2007). | Not yet started | | |
| 7a | Establish criteria for certification audits in research and internal policies, focusing on the use of 'agreed-upon procedures' (31.12.2006). | Completed | Implemented | Impact not yet realised (follow-up required) |
| 7b | Examine criteria, where these are not already in place, for certification audits in shared management 2007 to 2013, considering also the use of 'agreed-upon procedures' (31.3.2007). | In progress | In progress of implementation | — |
| 7c | Extend criteria for certification audits, focusing on the use of 'agreed-upon procedures', to other management modes, where appropriate (31.12.2007). | Not yet started | | |
| 8 | Analysis of potential additional assurance from SAIs on existing practice related to EU funds (31.12.2006). | Completed | See Action 8N | |
| 8N | To build on the momentum created by this action, the Commission will pursue contact with the SAIs with a view to determining how their work can be used to provide assurance on the execution of its programmes in the Member States. It will also launch a case study on the key issues faced by SAIs in examining Community expenditure (31.12.2007). | New measure introduced on 7.3.2007 | | |
| Single audit approach: sharing of results and prioritising cost-benefit | | | | |
| 9a.1 | Assess potential actions necessary for enhancing the sharing of audit and control results and recording of their follow-up in the area of internal policies, including research (31.12.2006). | Completed | Implemented | Impact not yet realised (follow-up required) |
| 9a.1N | To oversee the initial stages of data-sharing in ABAC, the Commission will, for the Sixth Framework Programme, monitor the use of data sharing and management reporting with a view to identifying key factors for success in better integrating the sharing of data in the overall control process (31.12.2007). | New measure introduced on 7.3.2007 | | |
| 9a.2 | Assess potential actions necessary for enhancing the sharing of audit and control results and recording of their follow-up in the area of structural funds 2007 to 2013 (31.5.2007). | Almost completed | In progress of implementation | — |
| 9a.3 | Assess potential actions necessary for enhancing the sharing of audit and control results and recording of their follow-up in the area of other policies (31.12.2007). | In progress | In progress of implementation | — |
| 9b | For expenditure under direct management, implement a tool linked to ABAC for a Commission-wide exchange of information on control and audit missions on all legal entities (31.12.2007). | In progress | In progress of implementation | — |
| 9c | Award tender for a Commission-wide contractual framework to assist Directorates-General on methodological issues, implementation of control work and tracking control performance (30.4.2007). | Almost completed | Almost implemented | Impact not yet realised (follow-up required) |

| Reference | Domain/(sub-)actions/deadline set in the action plan | Assessment of the completion by the Commission | Court's assessment of the stage of implementation as at 31.12.2006 | Court's preliminary assessment of the impact achieved as at 31.12.2006 |
|-----------------------------|--|--|--|--|
| 10a.1 | Assess costs of controls in shared management: define a common methodology (31.5.2006). | Completed | Implemented | Impact not yet realised (follow-up required) |
| 10a.2 | Assess costs of controls in shared management: launch initiative for data to be provided by Member States (30.9.2006). | Completed | In progress of implementation | — |
| 10a.3 | Assess costs of controls in shared management: provision of data by Member States (28.2.2007). | In progress | In progress of implementation | — |
| 10a.4 | Assess costs of controls in shared management: analysis of received information (30.9.2007). | Not yet started | | |
| 10b | Make a first estimation on the costs of control incurred in direct management expenditure (30.6.2007). | In progress | In progress of implementation | — |
| 10N | To further explore the cost-benefit ratio of control, the Commission will examine the effect of programme design and eligibility requirements on costs of control to develop a detailed analysis of tolerable risk on a practical basis (31.12.2007). | New measure introduced on 7.3.2007 | | |
| 11 | Run a pilot-exercise for evaluating benefits in the context of control of internal policies (30.6.2007). | In progress | In progress of implementation | — |
| 11N | To determine whether recovery and offsetting systems are working effectively, by identifying amounts recovered in 2005 and 2006 and their coherence with errors identified during controls the Commission will, in direct management, develop a typology of error and the relationship with recoveries, financial corrections and adjustments to payments and for shared management it will examine the reliability of national monitoring and reporting systems (31.12.2007). | New measure introduced on 7.3.2007 | | |
| Sector specific gaps | | | | |
| 12 | Put in place steps to close these gaps via the annual management plans, with follow-up reporting on progress in the annual activity reports (15.6.2007). | Almost completed | Almost implemented | Impact not yet realised (follow-up required) |
| 12N | To ensure effective delivery of added assurance, the Commission will perform 300 audits for FP6 in 2007, compared with the 45 carried out in 2006. In addition, having developed a systematic approach to analysing and sampling the FP6 beneficiary population as part of action 16b, the Commission will proceed with the identification and correction of errors in beneficiaries receiving the most significant proportion of the budget. This will also provide, by the end of 2007, a representative picture of the level and nature of irregularities in the research budget as a whole (31.12.2007). | New measure introduced on 7.3.2007 | | |
| 13.1 | Finalise, as requested by Ecofin, the analysis for structural funds on the present controls at sector and regional level and the value of existing statements and declarations, taking the article 13 annual reports due by June 2006 and the results of Commission audits into account (31.3.2007). | Almost completed | Almost implemented | Impact not yet realised (follow-up required) |

| Reference | Domain/(sub-)actions/deadline set in the action plan | Assessment of the completion by the Commission | Court's assessment of the stage of implementation as at 31.12.2006 | Court's preliminary assessment of the impact achieved as at 31.12.2006 |
|-----------|--|--|--|--|
| 13.2 | Update, in the context of the annual activity reports, how Directorates-General gain assurance from the internal control structures for structural funds and agriculture for the 2007 to 2013 period (31.12.2007). | Completed | In progress of implementation | — |
| 14a | Disseminate good practices for primary level checks to manage the risk of error in underlying transactions and recommend Member States to step up their information activities directed at beneficiaries, including information on controls and risk of cancellation of funds (30.6.2006). | Completed | Implemented | Impact not yet realised (follow-up required) |
| 14b | Provide in the context of the structural funds and indirect centralised management 2007 to 2013 guidelines for beneficiaries and/or intermediate levels on controls and responsibilities in the control chain (31.12.2007). | In progress | In progress of implementation | — |
| 15 | Conclude for structural funds 'contracts of confidence' with 8 Member States, if sufficient volunteers, as a sound basis to prepare for implementation of the new legislation and to improve assurance on expenditure under the existing legislation (31.12.2007). | In progress | In progress of implementation | — |
| 16a | Establish guidelines, based on existing experience, on accreditation, training and monitoring of external auditors in the domain of research and other internal policies (30.6.2007). | In progress | In progress of implementation | — |
| 16b | Develop common approaches to using risk and representative sampling in research and other internal policies, and external policies (31.12.2007). | In progress | In progress of implementation | — |
| 16c | Coordinate audit standards, error rate reporting, etc. for structural funds (31.12.2007). | In progress | In progress of implementation | — |

(¹) The implementation/interpretation of the legal framework still should bear in mind the objective of simplification.

Source: Court of Auditors.

THE COURT'S OBSERVATIONS

2.21. As stated in its annual report 2005 ⁽²²⁾, the Court will evaluate the results of the action plan when it is possible to assess its impact. The Court however notes that the Commission's timetable for its action plan (see paragraph 2.19) appears to be optimistic and points out that most of the actions concerned are likely to have a real impact on the functioning of the supervisory and control systems of the Commission only in the medium/long term.

2.22. **Table 2.2** provides an overview of the Court's preliminary assessment on the implementation of the measures included in the action plan towards an integrated internal control framework. At the end of 2006, this analysis indicates that 4 actions were not yet started, 16 were still in progress (of implementation), 15 ⁽²³⁾ required follow-up (the objective was not entirely achieved or the impact was not yet realised) and 6 were newly introduced actions. The Court considers that some of these actions are a follow-up of (or linked to) previous actions established by the Synthesis Report for 2005 and/or before (see paragraph 2.29) ⁽²⁴⁾.

THE COMMISSION'S REPLIES

2.21. *The Commission itself pointed out in the progress report on the Commission Action Plan towards an Integrated Internal Control Framework ⁽¹⁾ that the new sub-actions will be completed within the original timetable for the action plan (end of 2007) and will, together with the ongoing actions, ensure that the framework will be in place by that date for the Integrated Internal Control Framework to begin to have the planned impact on assurance.*

2.22. *The implementation of the action plan is largely respecting the timetable set by the Commission, which extends over the years 2006 and 2007. The Commission will provide a final report on the implementation of the action plan in spring 2008. The impact will be seen over a longer period. The Commission will monitor this impact on assurance and the 2008 report will take a first look at the impact of the different actions and will draw conclusions for the future consolidation of the integrated internal control framework (see COM(2007) 86).*

⁽²²⁾ See the Annual Report concerning the financial year 2005, paragraphs 2.3 and 2.24.

⁽²³⁾ 11 of them have been almost or fully implemented.

⁽²⁴⁾ In particular, multi-annual objectives presented in annex 1 of the 2005 Synthesis Report (COM(2006) 277 of 7.6.2006), which also include actions of previous synthesis reports still in progress. E.g. objectives no 1 'achieving an effective internal control system and ownership of internal control concepts and processes at all levels in each Directorate-General and service', 2 'promoting the Commission's accountability through annual activity reports and their synthesis solidly based on assurances from managers', 3 'establishing effective and comprehensive risk management ...', 4 'making objectives and indicators a policy and management tool ...', 5 'ensuring a smooth implementation of accepted internal audit recommendations', 8 'ensuring strong follow-up of action plans related to the expressed reservations, notably for the progress to be made in 2006', 9 'enhancing accountability by establishing a comprehensive integrated internal control framework ...', 10 'improving efficiency and strengthening accountability by ensuring proportionality and a sound balance between *ex-ante* and *ex-post* controls and by further harmonisation and better focusing of *ex-post* controls' and 12 'making financial management more efficient by applying simplification measures'. See also the Annual Report concerning the financial year 2002, paragraph 1 104, and concerning the financial year 2003, paragraph 1.76.

⁽¹⁾ See COM(2006) 9 final of 17.1.2006.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Correction of errors

2.23. The primary objective of supervisory and control systems is to prevent or to detect and correct errors in transactions from the EU budget. As in previous years, the Court's audit has found evidence of material error in substantial areas of EU spending and that most errors occur at the level of final beneficiaries; correction of errors in spending from the EU budget would therefore require primarily action at this level ⁽²⁵⁾.

2.24. There is however insufficient evidence concerning corrections made. The information on recoveries and financial corrections presented in the 2006 annual activity reports and different sections of the 2006 final consolidated annual accounts does not contain sufficient explanations in order to disclose the risk of overlapping of the different elements. Furthermore, it does not make it possible to distinguish between the recoveries of illegal/irregular expenditure at the level of the final beneficiaries/recipients and the corrections borne by Member States for systems weaknesses.

2.23. *Where the supervisory and control systems have been assessed as ineffective and where the weaknesses identified constitute a risk for the EC budget, the Commission applies the mechanisms laid down for the exercise of its supervisory role to recover the respective amounts from the Member State responsible. Member States thus have an incentive to ensure adequate controls in order to avoid possible financial corrections.*

Errors in the Structural Funds identified by the Court also occur at the level of implementing bodies, not the individual claimants, for example in the determination of co-financing rates. Flat rate financial corrections borne by Member States are in these cases an indication of the extent of the effectiveness of the Commission's supervisory control to safeguard the Community budget.

2.24. *Whereas the information on recoveries and financial corrections in the agricultural sector is generally adequate, it needs to be improved in other sectors. Action 11N of the action plan is aimed inter alia at determining 'whether recovery and offsetting systems are working effectively', by identifying amounts recovered in 2005 and 2006 and their coherence with errors identified during controls and for shared management it will examine the reliability of national monitoring and reporting systems.*

The Commission will endeavour to analyse the various systems used in recovering amounts in order to provide better information about such recoveries in the annual accounts.

⁽²⁵⁾ Therefore, recoveries such as flat rate or lump sum corrections supported by the Member States for weaknesses in the supervisory and control systems or spontaneous reimbursements by the final beneficiaries/recipients are not directly relevant for indicating effectiveness of supervisory and control systems at the level of final beneficiaries/recipients.

THE COURT'S OBSERVATIONS

2.25. Moreover, the information given is incomplete because it does not show the full extent of corrections made on EC expenditure nor to which extent the amounts relate to expenditure made in 2006 (see paragraphs 5.61 and 5.62). In particular, this is the case for the area of structural actions, despite the fact that specific mechanisms are in place, both at the level of the Commission and the Member States, to ensure the return of ineligible grants (e.g. by exchanging ineligible against eligible expenditure and by offsetting of recoveries with expenditure or by reduction of future cost claims).

Information available in the Commission on correction of errors

2.26. In view of the need to ensure the availability, completeness and reliability of the information on correction of errors, the Commission launched in 2006 a number of initiatives.

2.27. In addition to an action taken for EAGGF Guarantee (see paragraphs 5.52 and 5.61), the Commission modified Regulation (EC) No 448/2001 in December 2006 ⁽²⁶⁾ and issued a guidance note on information that is required regarding the corrections made and amounts to be recovered by Member States in the area of structural actions.

2.28. In March 2007, a 'new measure (11N)' was introduced in the action plan towards an integrated internal control framework (see paragraph 2.20 and **Table 2.2**). On this basis, the Commission aims at determining whether recovery and offsetting systems are working effectively, by identifying amounts recovered in 2005 and 2006 and their coherence with errors identified during controls. In this context, it will, in the case of expenditure under direct management, develop a typology of errors and seek to identify the relationship with recoveries, financial corrections and adjustments to payments. For expenditure under shared management, it will examine the reliability of national monitoring systems.

THE COMMISSION'S REPLIES

2.25. *The decisions on financial corrections in agriculture taken in 2006 are listed in the Directorate General for Agriculture and Rural Development annual activity report with, for each decision, the total of the sums excluded from Community financing.*

The Commission accepts that it needs to furnish more complete evidence of financial corrections and recoveries regarding structural actions, and has therefore taken steps to improve the quality of the information available within the Commission and to obtain the information from Member States which despite regulatory requirements has not been consistently supplied.

2.27. *In January 2007 the Commission also wrote to all Member States requesting information for 2006 and cumulatively for the whole 2000-2006 period on recoveries and withdrawals and the situation of pending recoveries at the end of 2006.*

⁽²⁶⁾ Regulation (EC) No 1978/2006 (OJ L 368, 23.12.2006, p. 89).

THE COURT'S OBSERVATIONS

2.29. However, this action 11N is in reality a follow-up of (or otherwise linked to) previous Commission horizontal action plans ⁽²⁷⁾ (see paragraph 2.22) which the Commission had considered as having been completed.

2.30. In a number of previous annual reports ⁽²⁸⁾, the Court has drawn the attention of the Commission to the deficiencies in obtaining reliable information on the correction of errors. Due to the complexity of the issues, there is no indication that these deficiencies have yet been solved or are likely to be solved in the short term.

THE COMMISSION'S REPLIES

2.29. *Action 11N is wider than the previous actions cited by the Court, as it makes the link with the findings of controls.*

2.30. *As indicated in reply to paragraph 2.6, the Commission will make sure that future annual activity reports include more information about corrections that were envisaged, launched or imposed during the given year. The Commission pays particular attention to developing preventive measures, based on an analysis of the reasons which lead to the imposition of corrections. These may be general measures such as defining the legislative framework or more specific, such as individual financial checks.*

⁽²⁷⁾ (a) Action 96 'More effective management of recovery of unduly paid funds' (COM(2000) 200 of 1.3.2000) of the White Paper;

(b) Action No 5.3.2A 'The recovery of amounts due (...) is to be addressed in the annual management plan (...) accompanied by appropriate performance indicators (...)' and B 'Directorate-General for Budget will lead the monitoring process on clearance of the backlog of recoveries (...) that would provide for management purposes regular and reliable statistics/indicators (...) and that would allow a Commission wide overview of overall performance and effectiveness' of the synthesis 2002 (COM(2003) 391 of 9.7.2003); and

(c) followed-up by objectives No 5 of synthesis 2004 (COM(2005) 256 of 15.6.2006) and No 4 of synthesis 2005 (COM(2006) 277 of 7.6.2006) 'Making objectives and indicators a policy and management tool (...)'.

⁽²⁸⁾ See e.g. the financial reservation on Sundry debtors in the Court's Statement of Assurance concerning the financial years 2004, 2003, 2002 and paragraph 6.41 of the Annual Report concerning the financial year 2005.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONTROL STANDARDS

2.31. The Court examined the application of the internal control standards ⁽²⁹⁾ by a number ⁽³⁰⁾ of the Commission's services, with the view to assessing not only the degree of implementation of the minimum requirements (baselines), but also to evaluate the effectiveness of the systems ensuring the legality and regularity of the underlying transactions ⁽³¹⁾.

Compliance with baseline requirements

2.32. The overview on the state of internal control in the Commission's services in 2006, presented by the Directorate-General for the Budget, shows that, for the 2006 financial year, the Directorates-General comply on average with 95 % of the baseline requirements. Given that the baseline requirements remained essentially unchanged ⁽³²⁾, the Court notes that compliance with the internal control standards is stable, compared with 2005. The Court's assessment of the implementation of internal control standards (generally consistent with the Commission's analysis) is presented in **Table 2.3**.

2.32. *Even if the average of 95 % seems to be stable and unchanged in 2006 Directorates-General were faced with new requirements in the area of ICS 11 (in particular preparation of IT Security Plans based upon a risk analysis of IT systems) and ICS 15 (two new requirements in the area of business continuity planning).*

⁽²⁹⁾ Standards no 11 'Risk analysis and management', 12 'Adequate management information', 14 'Reporting improprieties', 17 'Supervision', 18 'Recording exceptions', 20 'Recording and correction of internal control weaknesses', 21 'Audit reports' and 22 'Internal audit capability'.

⁽³⁰⁾ DGs AGRI, AIDCO, BUDG, ECFIN, ECHO, ELARG, EMPL, FISH, INFOS, PMO, OIB, OIL, OPOCE, REGIO, RELEX, RTD and TREN.

⁽³¹⁾ The immediate direct impact of the internal control standards varies, depending on the management mode for the budget implementation. For example, for agriculture and structural funds, where day-to-day management is carried out by national or regional authorities, the Commission's internal controls extend to supervision of management and control systems in Member States.

⁽³²⁾ The number of baseline requirements increased from 75 to 79. For 9 of the baseline requirements selected for 2006, minor modifications were made in comparison with 2005.

Table 2.3 — The Court's analysis of the implementation of internal control standards (with a direct link to the legality and regularity of underlying transactions) for the main Directorates-General (situation as at 31 December 2006)

| Directorates-General or services | Execution of payment appropriations in 2006 (million euro) | Compliance | | | | | | | | | | | | | | | | | | | | | | | |
|--|--|--|------|------|---|------|------|---|------|------|---------------------------------|------|------|--|------|------|---|------|------|-----------------------------------|------|------|---|------|------|
| | | Standard no 11 'Risk analysis and management' | | | Standard no 12 'Adequate management information' | | | Standard no 14 'Reporting improprieties' | | | Standard no 17 'Supervision' | | | Standard no 18 'Recording exceptions' | | | Standard no 20 'Recording and correction of internal control weaknesses' | | | Standard no 21 'Audit reports' | | | Standard no 22 'Internal audit capability' | | |
| | | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 |
| Agriculture and Rural Development | 53 465 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Budget | 1 086 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Economic and Financial Affairs | 283 | B | A | B | B | A | B | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Enlargement | 2 063 | A | A | A | A | A | A | A | A | A | B | B | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Energy and Transport | 1 161 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Employment, Social Affairs and Equal Opportunities | 9 478 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| External relations | 523 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| EuropeAid | 3 572 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Fisheries and Maritime Affairs | 725 | B | A | B | B | A | A | A | A | A | B | A | A | A | A | A | B | A | A | A | A | A | B | A | A |
| Humanitarian Aid | 607 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Information Society and Media | 1 268 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Office for Administration and Payment of Individual Entitlements | 2 611 | A | A | B | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Office Infrastructure and Logistics Brussels | 332 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Office Infrastructure and Logistics Luxembourg | 70 | A | A | B | B | B | A | A | A | A | B | A | B | A | A | A | A | A | A | A | A | A | A | A | A |
| Publications Office | 154 | B | A | A | B | B | A | A | A | A | B | B | B | B | A | A | A | A | A | A | A | A | B | B | A |
| Regional Policy | 19 766 | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A | A |
| Research | 3 325 | A | A | B | B | B | B | A | A | A | A | A | B | A | A | A | A | A | A | A | A | A | A | A | A |

Assessment:

Compliance

A: Compliance with baseline requirements.

B: Partial compliance with baseline requirements.

Source: Court of Auditors.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Effectiveness

2.33. Despite the high level of compliance with the baseline requirements, supervisory and control systems at the level of the Commission do not sufficiently mitigate the risk of error, in particular, in certain areas of agriculture, structural policies, internal policies, external actions and pre-accession aid (see paragraphs 5.77, 6.38, 7.30, 8.32, 9.23 and **Table 2.4**). This analysis is in line with one of the conclusions ⁽³³⁾ of the 2006 annual report of the Commission's Internal Audit Service (IAS) ⁽³⁴⁾.

2.33. This is to be expected as the Internal Control Standards mainly concern operations within the Commission, whereas the bulk of the errors occur in expenditure managed by the Member States or by implementing organisations.

As regards the area of agriculture replies are given in paragraphs 5.63, 5.64 and 5.77.

As regards pre-accession aid, see reply to paragraph 9.23.

Table 2.4 — Assessment of effectiveness of supervisory and control systems ⁽¹⁾

| Policy area | Overall assessment |
|--|--------------------|
| <i>Own Resources ⁽²⁾</i> | |
| <i>Agriculture</i> | |
| — Commission level | |
| IACS | |
| non-IACS | |
| — Member State level | |
| IACS | |
| non-IACS | |
| <i>Structural policies</i> | |
| — Commission level | |
| — Member State level | |
| <i>Internal policies including research</i> | |
| <i>External actions</i> | |
| — Commission Headquarters and Delegation | |
| <i>Pre-accession aid</i> | |
| — Commission level | |
| Phare/Turkey and ISPA | |
| SAPARD | |
| — National level | |
| <i>Administrative expenditure ⁽³⁾</i> | |

The above table summarises the overall assessment of supervisory and control systems, as outlined in the relevant chapters. It highlights the key elements but cannot present all of the relevant detail for which it is necessary to refer to the body of the report, within the context of the methodology underlying the Court's audit approach (see paragraphs 1.38 and 1.39).

Legend

| | |
|---|------------------------|
|  | Satisfactory |
|  | Partially satisfactory |
|  | Unsatisfactory |

⁽¹⁾ Distinction between Commission and other levels is provided when information is relevant.

⁽²⁾ See scope limitations in paragraphs 4.3, 4.4 and 4.7.

⁽³⁾ The assessment is limited to the 'Functioning of supervisory and control systems' of the Commission.

Source: Court of Auditors.

⁽³³⁾ The IAS audit work found clear improvements in the internal control systems in many areas. However, there are also still major weaknesses and further efforts are needed. Areas for improvement include e.g. *ex-post* controls and contract management.

⁽³⁴⁾ COM(2007) 280 of 30.5.2007.

THE COURT'S OBSERVATIONS

2.34. The quality review performed by the Commission's Internal Audit Service (IAS) on the Internal Audit Capabilities (IACs) of Directorates-General concluded that the majority of IACs ⁽³⁵⁾ partly or generally complied with (professional) standards but efforts to improve the internal audit work should continue ⁽³⁶⁾. The Court takes note of the findings included in this review and welcomes the relevant proposals for improvement, in particular the one recommending that, on the one hand, IACs should provide an overall assessment on the internal control systems of Directorates-General at the end of the 3 year period ending 2009 and, on the other hand, the same would also apply to the IAS at the Commission level ⁽³⁷⁾.

OVERALL CONCLUSION AND RECOMMENDATIONS

2.35. In the financial year 2006, the Court finds further improvements in the Commission's supervisory and control systems, in particular, the improvement of the process of preparation of the annual activity reports and declarations (paragraph 2.7) and the assessment of the functioning of supervisory and control systems and of the impact of the relevant reservations on the assurance given in the Directors-General declarations (paragraphs 2.9 and 2.12).

2.36. The Court's audits however identified continuing weaknesses in the assessments provided by the annual activity reports and declarations of some Directors-General (paragraphs 2.13 to 2.18) and the functioning of the supervisory and control systems (paragraphs 2.33 and 2.34).

THE COMMISSION'S REPLIES

2.34. *The role of the Internal Audit Capability (IAC) is not to provide an annual opinion on the Annual Activity Reports (AAR) of the Directors General, but to give advice regarding the AAR process and in accordance with the nature and scope of its work during the year in question, the IAC should express an opinion on the state of control as a contribution to the preparation of the AAR (see SEC(2003) 0059).*

The Commission has no current plans to change its control structure as regards the role of the Internal Audit Capabilities.

The issue could be re-examined in the future when the Commission will have gained more experience with the present architecture of internal control, also taking into account the resources required.

2.36. *Annual activity reports generally set out clearly their assessment of the effectiveness of management and control system in the Member States and the corrective measures underway to bring about the required improvements. The Director Generals' assessments differ from the Court's, for example with regard to the need for reservations on the assurance expressed, largely because of the multi-annual perspective of the control systems put into place in each policy area.*

⁽³⁵⁾ The requirements underlying the IAC are foreseen by the internal control standard No 22.

⁽³⁶⁾ Increasing professionalism and coordination of audit planning process.

⁽³⁷⁾ See also the Annual Report concerning the financial year 2004, paragraph 1.76.

THE COURT'S OBSERVATIONS

2.37. The Court recommends that the Commission continues its efforts to reinforce the supervisory and control systems of its Directorates-General focusing on the following areas:

- (a) ensuring that annual activity reports and declarations present a consistent and rigorous assessment of supervisory and control systems, including appropriate legality and regularity indicators which is compatible with the reservations (paragraphs 2.13 to 2.18);
- (b) completing an appropriate follow-up of the relevant measures of the action plan towards an integrated internal control framework in view to ensure a real impact on the supervisory and control systems, in particular the elaboration of adequate and reliable information on correction of errors at the level of final beneficiaries (paragraphs 2.19 to 2.30);
- (c) improving the effectiveness of the supervisory and control systems with a view to sufficiently mitigate the risk of error (paragraphs 2.33 and 2.34).

THE COMMISSION'S REPLIES

2.37.

- (a) *The Commission committed itself in the 2006 Synthesis Report to monitoring the implementation of remedial actions launched by the delegated authorising officers to resolve underlying control weaknesses.*
- (b) *The Commission will provide a final report on the implementation of the action plan in spring 2008. This report will take a first look at the impact of the different actions on assurance and will draw conclusions for the future consolidation of the Integrated Internal Control Framework.*
- (c) *The Commission agrees with the recommendation and aims to ensure that the control resources are used cost effectively and that the cost of control is justified in terms of the observed error rate, the dissuasive effects, and other qualitative benefits.*

The Commission will continue its efforts to enhance the supervisory and control systems with a particular view to further mitigate the risk of errors in the programmes implemented by Member States in shared management. The Commission's action plan towards an integrated internal control framework is intended to optimise the cooperation with the Member States and the effectiveness of the overall control framework. The new elements introduced in the regulatory framework for the 2007-2013 period will also increase effectiveness.

CHAPTER 3

Budgetary Management

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THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

INTRODUCTION

3.1. This chapter analyses issues arising from the implementation of the EU general budget in 2006, the last year of the 2000 to 2006 financial perspective. In particular, it covers the high rate of budgetary implementation, the amending budgets, the increasing level of outstanding budgetary commitments and the effect of lower than forecast spending in the Cohesion Fund.

3.2. For more detailed information on the structure and operation of the budget — particularly the meaning of, and relationship between, payments and commitments — see **Annex I** of this Annual Report.

OBSERVATIONS

Amending budgets have the effect of reversing increase in payments budget

3.3. Total appropriations in 2006 for commitments (122,8 billion euro) and payments (111,2 billion euro) were respectively 4,1 % and 1,6 % higher than in 2005. Overall, the appropriations for commitments and payments remained below the financial perspective ceilings by 0,7 billion euro and 7,9 billion euro respectively.

3.4. The six amending budgets voted during the year resulted in an overall 0,6 billion euro decrease in appropriations for commitments and a 4,6 billion euro decrease in appropriations for payments. The latter is mostly a reaction to lower than expected payments in agriculture (0,9 billion euro) and structural operations (3,3 billion euro). Reducing appropriations for payments in this way reflects good budgetary management as it reduces the budgetary surplus⁽¹⁾ by the same amount (allowing own resources to be returned to Member States).

3.5. The budgetary outturn for 2006 is given in **Diagrams III and IV** of **Annex I**, and shows the following:

— utilisation rates for both commitments and payments — at 99 % and 96 % respectively — were identical to 2005;

⁽¹⁾ The budgetary surplus shows the extent to which the budget has not been used. It is not a reserve and it cannot be accumulated and used in future years to finance expenditure. The unused revenue that the surplus represents is offset against the own resources to be collected for the following year.

3.4. *The Commission is taking steps to reduce underimplementation to a minimum through active budget management. The Budget Forecast Alert system helps detect potential problems at an early stage. Unforeseeable events are dealt with by amending budgets, as recommended by the Court. As a result of this approach, the rate of implementation of final payments has steadily risen to close to 100 %.*

3.5.

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- for structural operations the 3,3 billion euro reduction in payment appropriations (which exceeded the budgetary increase in this area for the year) resulted in a final utilisation rate of 99 %. This would have been 90 % without the amending budget. This reduction was mainly due to the holding back of payment claims in Spain and payments to the United Kingdom as a result of weaknesses in their management and control system-;
- 2,7 billion euro of unused payment appropriations were not cancelled but carried over from 2006 to 2007, the same level as was carried over from 2005 to 2006;
- the budgetary surplus for the year was 1,9 billion euro, less than in 2005 (2,4 billion euro).

3.6. Detailed information on budgetary implementation for 2006 can be obtained from the Commission document 'Report on budgetary and financial management — Financial year 2006' ⁽²⁾ (see paragraph 3.15).

Outstanding budgetary commitments show a further increase

3.7. Outstanding budgetary commitments — unused commitments carried forward to be used in future years, mainly on multiannual programmes — increased by 12,6 billion euro (10,6 %) to 131,6 billion euro (see **Table 3.1**). Around 90 % of the increase (and 71 % of the total) related to structural operations, 23 % of which (2,9 billion euro) related to the Cohesion Fund (see paragraph 3.12).

3.8. 2006 was the last year of the 2000 to 2006 programming period: by the end of the year all commitments for that period had been made. The outstanding budgetary commitments at the end of 2006 therefore represent the full extent of the remaining payments to be made over the next few years ⁽³⁾. They correspond to 28 % of the total amounts of the related financial perspective headings for the whole period.

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- *But for this, and lower than expected payments in EU-10, the initially available payment appropriations would have been fully used, according to Commission estimates.*

3.7. *As the Court notes at paragraph 3.10, a build-up of outstanding commitments over a given Financial Perspective period is a natural consequence of differentiated expenditure, whereby commitments are made within the period but payments can continue beyond the end of the period.*

⁽²⁾ http://ec.europa.eu/budget/library/publications/fin_manag_account/rep_budg_fin_manag_2006_en.pdf.

⁽³⁾ At the same time as payments related to the start of the 2007 to 2013 period.

Table 3.1 — Change in balance of outstanding commitments 2006

| | By type | | Total | Agriculture | Structural operations | Internal policies | External actions | Administration | Reserves | Pre-accession strategy | Compensation | Rounding |
|--|-----------------------------------|-------------------------------|-----------------|--------------|-----------------------|-------------------|------------------|----------------|----------|------------------------|--------------|------------|
| | Non-Differentiated appropriations | Differentiated appropriations | | | | | | | | | | |
| Commitments brought forward | | | | | | | | | | | | |
| Balance brought forward | 1 254 | 117 826 | 119 080 | 1 863 | 81 704 | 14 597 | 12 387 | 820 | | 7 710 | | - 1 |
| Payments | - 1 006 | - 43 576 | - 44 582 | - 1 797 | - 31 567 | - 4 804 | - 3 561 | - 703 | | - 2 150 | | |
| Decommitments | - 56 | - 1 674 | - 1 730 | - 18 | - 707 | - 430 | - 311 | - 13 | | - 250 | | - 1 |
| Cancellations | - 163 | | - 163 | - 42 | - 5 | - 23 | - 21 | - 70 | | - 4 | | 2 |
| Commitments made in 2006 | | | | | | | | | | | | |
| Commitments made | 56 465 | 64 595 | 121 060 | 49 865 | 44 579 | 10 195 | 5 867 | 6 675 | 128 | 2 678 | 1 074 | - 1 |
| Payments | - 55 334 | - 6 660 | - 61 994 | - 48 001 | - 832 | - 4 210 | - 1 626 | - 5 997 | - 128 | - 126 | - 1 074 | |
| Cancellations | - 15 | | - 15 | | - 2 | - 7 | - 2 | - 4 | | - 1 | | 1 |
| Rounding | - 1 | | - 1 | | 1 | | 1 | - 1 | | | | - 2 |
| Commitments outstanding at end 2006 | 1 144 | 130 511 | 131 655 | 1 870 | 93 171 | 15 318 | 12 734 | 707 | 0 | 7 857 | 0 | - 2 |

Source: 2006 annual accounts.

THE COURT'S OBSERVATIONS

3.9. At the end of 2006 the balance of outstanding budgetary commitments represented 2,6 years' worth of payments and 2,0 years' worth of commitments at the 2006 rates. These measures are respectively 30 % and 38 % more than at the corresponding point in the previous cycle (i.e. 1999, which was the last year of the 1994 to 1999 period), indicating a higher relative level of outstanding budgetary commitments.

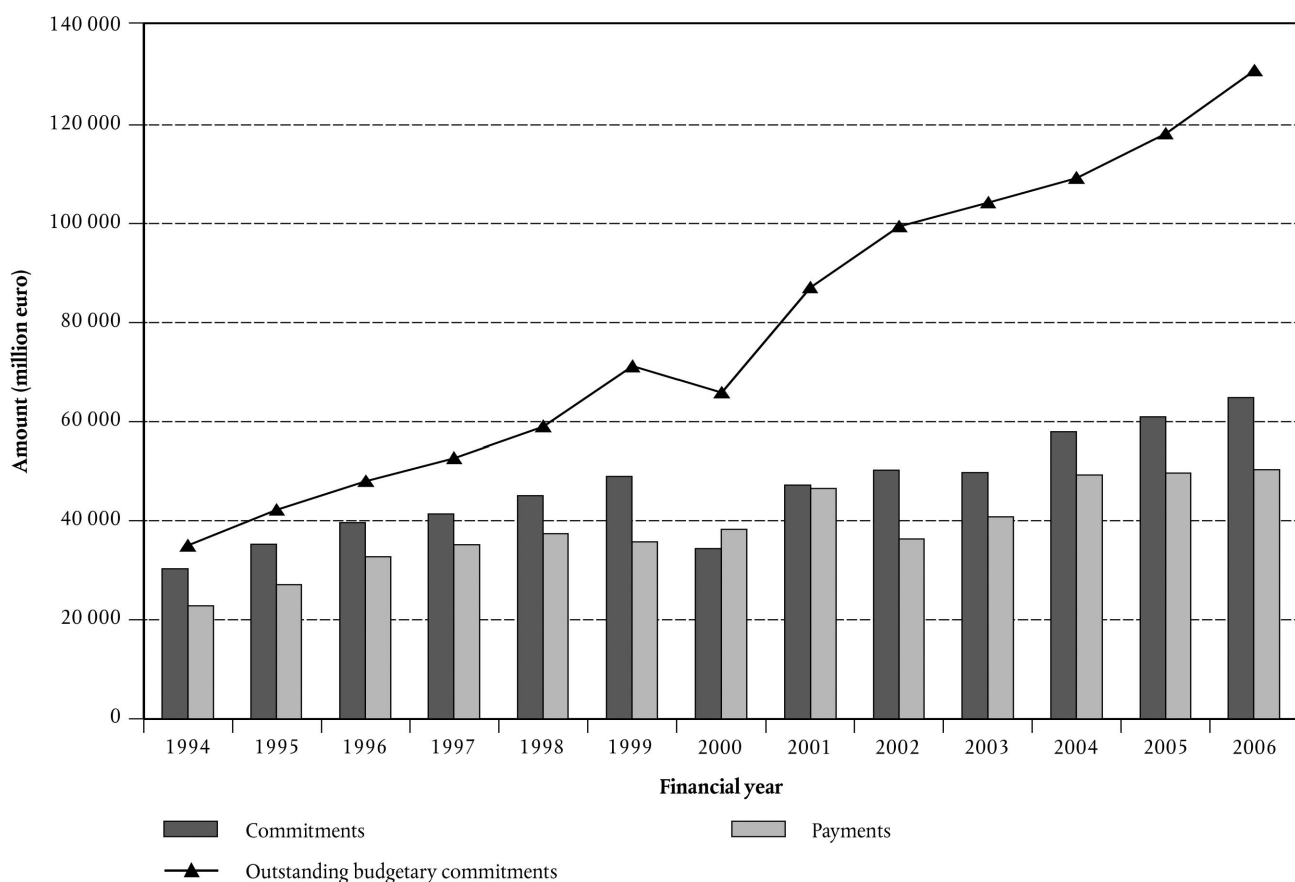
3.10. Outstanding budgetary commitments arise as a natural consequence of differentiated expenditure, where expenditure programmes take a number of years to complete and commitments are made sometimes years before the corresponding payments. In the event of underspending — such as happened to a significant extent between 1999 and 2003 ⁽⁴⁾ and is currently the case for structural operations spending in the enlargement countries (see paragraph 3.12) — the unused payment appropriations are cancelled, but unused commitments made are carried forward for a certain period before being decommitted (see paragraph 3.13). Since 1994, commitments have exceeded payments by an average of 21 % (see **Graph 3.1**). The effect is a greater than expected build up of outstanding commitments, with the situation being rolled forward each year.

THE COMMISSION'S REPLIES

3.9-3.10. The Commission also uses the ratio of outstanding commitments to average annual commitments, which is less influenced by advance payments and one-off events. This ratio has been around 2 years of commitments (2,1 in 2006), which is normal given the $n + 2$ rule.

The year 1999 was four years after enlargement of the Union from 12 to 15 Member States, whereas 2006 was two years after the accession of ten new Member States. Secondly, the changeover in the commitments and payments system (commitments made automatically every year in 2000-2006 instead of depending on progress in execution as in 1994-1999, and payments as reimbursements instead of advances) has also tended to increase outstanding commitments relative to the previous period. The build-up of commitments over the period is normal in these circumstances.

Graph 3.1 — Differentiated appropriations 1994 to 2006



⁽⁴⁾ See paragraph 2.12 of the Annual Report concerning the financial year 2003.

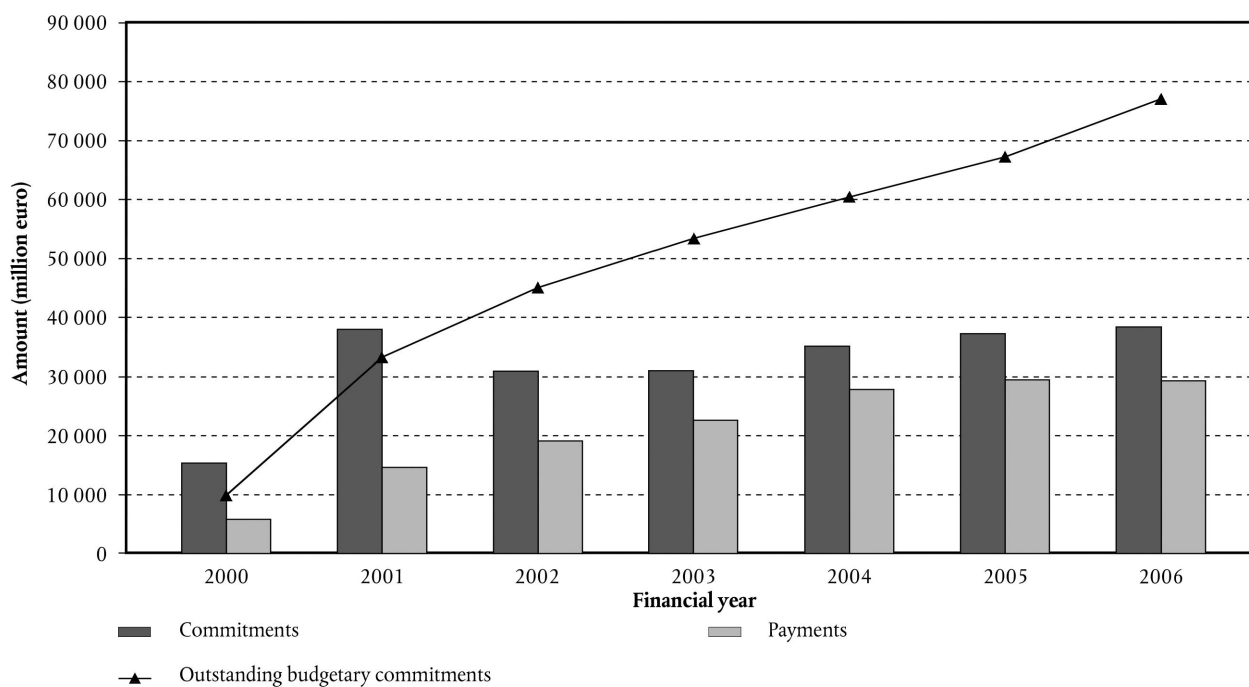
THE COURT'S OBSERVATIONS

3.11. As mentioned in paragraph 3.7, structural operations — the Structural Funds and the Cohesion Fund — represent the majority share of the outstanding commitments. For the Structural Funds the 2000-2006 programmes outstanding commitments were 76,9 billion euro, representing 2,6 years of payments at the 2006 spending rate (see **Graph 3.2**). This represents a pro rata fall from 3,6 years of payments at the end of 2005. Beneficiaries of the funds have until the end of 2008 to make payments⁽⁵⁾. However, experience shows that spending naturally tails off towards closure. This indicates that expenditure risks being decommitted under the year $n + 2$ rule (see paragraph 3.13). Indeed, spending in 2006 was slightly less than for 2005 despite the increased budget⁽⁶⁾.

THE COMMISSION'S REPLIES

3.11. *The slight fall in 2006 payments compared to 2005 was not related to the end of programme period. Available evidence on execution trends of the programmes of the 2000-2006 programme period does not suggest any underlying significant deceleration.*

Graph 3.2 — Structural Funds 2000-2006 programming period



⁽⁵⁾ The Commission can make payments to Member States up to the closure of the operational programmes, the claims for which have to be made to the Commission by March 2010. However, these are to be based on payments made by final beneficiaries up to the end of 2008.

⁽⁶⁾ In more general terms 'The cumulative backlog of payments from years 2000 to 2006 is 29,6 billion euro'. Source: Commission Analysis of the budgetary implementation of the Structural Funds in 2006, May 2007, page 15.

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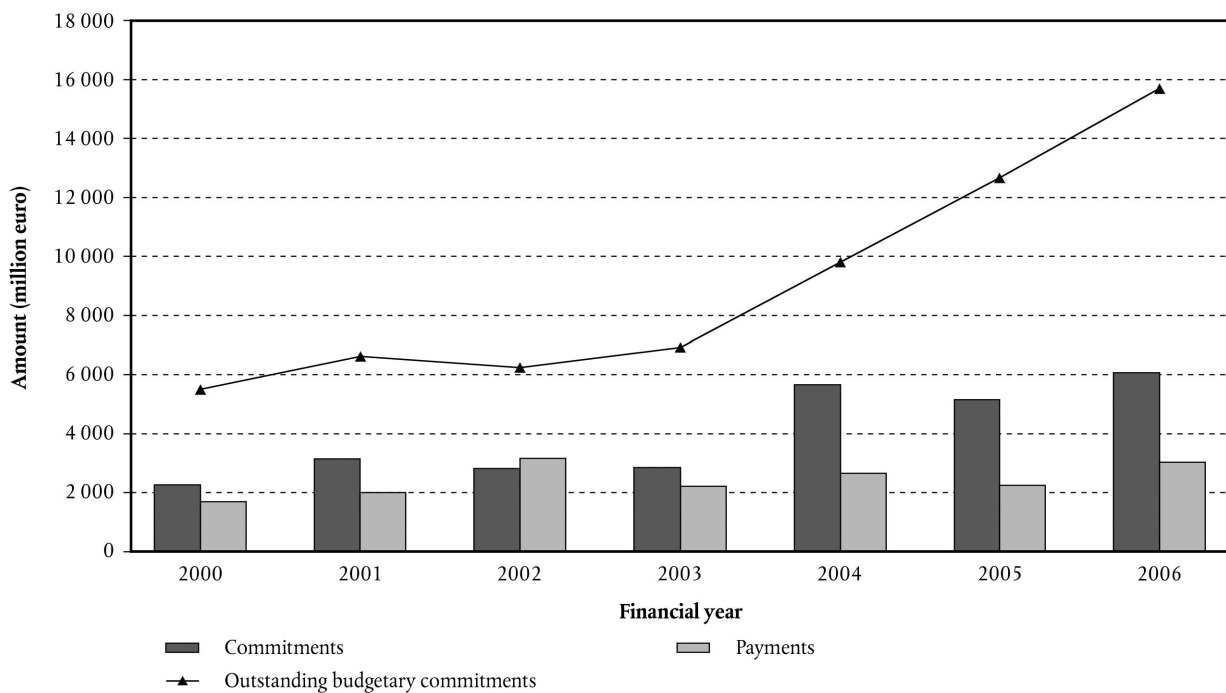
Cohesion Fund spending below estimates

3.12. The spending rate for the Cohesion Fund was less than expected in the new Member States, linked to their difficulties in absorbing expenditure. An amending budget reduced payment appropriations by 0,5 billion euro and outstanding budgetary commitments increased from 12,5 billion euro in 2005 to 15,4 billion euro at the end of 2006 (see **Graph 3.3**). This represents 5,1 years of payments at the 2006 spending rate. The corresponding spending is therefore likely to reach far into the 2007 to 2013 period, when the Member States will have new programmes to establish and the additional related expenditure to absorb.

3.12. *The Commission refers to its comments at paragraph 3.9 on the ratio between the level of outstanding commitments and the average annual commitments. For the Cohesion Fund this ratio was 3,9 at the end of 2006.*

The profile for Cohesion Fund spending in EU-10 was based on the decisions of the Copenhagen European Council in 2002. Cohesion Fund spending in EU-10 has been constrained not only by start-up absorption difficulties, but also by the relatively long lead times for implementing infrastructure projects. However, the level of this spending in EU-10 is forecast to increase in the next few years. Most projects have a final date of implementation of end 2010, with the bulk of closures expected for 2011 and 2012. In the 2007-2013 period Cohesion Fund projects will have shorter implementation times as the $n + 2/n + 3$ rule will be applied to them (see also the Court's observation at paragraph 3.14).

Graph 3.3 — Cohesion Fund



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THE COMMISSION'S REPLIES

Year n + 2 rule resulted in a low level of decommitment

3.13. Outstanding commitments for the Structural Funds (but not the Cohesion Fund) are subject to the year n + 2 rule, which requires commitments to be cancelled if no corresponding payments have been made by the end of the second year following the year the commitment was made. Member States are warned of the risk of cancellation, so helping them focus attention where implementation is falling behind. The total amount decommitted under the year n + 2 rule in 2006 was 217 million euro (286 million euro in 2005). De-commitments remain small in comparison with average annual commitments (around 0,7 %).

3.14. The Court notes that the new 2007 to 2013 programming period is subject to a change, by which some Member States ⁽⁷⁾ will be granted one extra year (n + 3) to make claims on the related commitments. At the same time, the Cohesion Fund will be subject to the n + 2/n + 3 rule. The first change will potentially result in a further increase in outstanding budgetary commitments, but this effect is likely to be mitigated by the effect of the second change.

Commission report on budgetary and financial management improved, but provides an inconsistent level of information

3.15. The Commission's report on budgetary and financial management provides improved information on detailed budget implementation, outstanding budgetary commitments — including indicators — and reasons for lower than forecast spending. However, in contrast to 2005, no information is given on the cumulative implementation of the larger multiannual Community programmes, and no distinction is made between EU-15 and EU-10 expenditure. Furthermore, the report does not always present a consistent level of analysis. For example, more detailed explanation is given for lower than forecast spending in agriculture than for the other areas. The lower than forecast spending on structural operations which triggered the amending budget is not analysed in detail ⁽⁸⁾.

3.13. *The objective of the n + 2 rule is to boost implementation. A low rate of cancellation indicates that the rule is working as intended.*

The rule has proved effective in improving financial management of the funds and minimising losses (amounts de-committed) by comparison with the previous system of de-commitment only at closure.

3.15. *The Commission takes note of the comments. The timing of the report which is required by the Financial Regulation (end March) makes it difficult to provide more analysis of structural operations expenditure, which is why this information is presented in the separate report on the Structural Funds published in May.*

The report contains an implementation overview chapter of each Financial Perspective heading as well as a separate chapter 'Analysis by policy area of main cases of under-implementation' intended to provide a comprehensive picture of budgetary adjustments and the implementation outcome. This is usually done by quoting the reasons given to the Budgetary Authority.

⁽⁷⁾ The year n + 3 rule applies to spending on the 2007 to 2013 period in 2007 to 2010 for the Member States acceding in 2004 and 2007, as well as Portugal and Greece (Article 93 of Council Regulation (EC) No 1083/2006).

⁽⁸⁾ Additional information is however provided on the Structural Funds in the annual report on the budgetary execution of the Structural Funds.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONCLUSIONS AND RECOMMENDATIONS

3.16. The 2006 budget increased compared to 2005 and the spending rates remain at a high level. Nevertheless, for structural operations initial payments appropriations turned out to be significantly higher than required and the final budget had to be reduced by 3,3 billion euro by an amending budget, effectively cancelling the increase received.

3.17. Outstanding budgetary commitments on differentiated expenditure increased by 10,7 % to 130,5 billion euro. At 2,6 years' worth of payments this is 30 % more than at the comparable point in the previous period (1999). The change from the year $n + 2$ rule to the year $n + 3$ rule for certain Member States for the new programming period risks further increasing the level of outstanding budgetary commitments, although this effect is likely to be mitigated by the application of the $n + 2/n + 3$ rule to the Cohesion Fund.

3.18. As highlighted in 2005 ⁽⁹⁾, the already high rate of spending in the Structural Funds (which represents the major proportion of differentiated expenditure and the outstanding commitments) needs to be further increased in 2007 and 2008 to ensure that the deadline for beneficiaries in Member States to make payments (end of 2008) is met for the 2000 to 2006 programmes. This will be difficult as spending tends to reduce at the end of the programming period. The risk that subsequent closure of the current programmes will be delayed and impact on the start and implementation of the 2007 to 2013 programmes — as was the case for the start of the current programming period ⁽¹⁰⁾ — should be addressed by the Commission and the Member States.

3.16. *The final budget had to be reduced due to a reduction in payments to Spain and the United Kingdom as a result of weaknesses in their management and control systems and to lower than expected spending in the EU-10.*

3.17. *The ratio of outstanding commitments to average annual commitments is around 2, which is normal given the $n + 2$ rule.*

The situation in 1999 is not readily comparable with that of 2006, given the change in the regulatory framework and enlargement (see paragraph 3.9).

3.18. *The deadline for expenditure (end 2008) is to be distinguished from the closing date for the submission of final payment claims by the Member States (March 2010). Payment of the balances due will be made for most programmes in 2010/2011. To prepare for the closure, the Commission issued closure guidelines in 2006 and is organising closure seminars for Member States. If the closing date for expenditure is not met, the unspent funds will be decommitted by the Commission at closure. Available evidence on execution trends of the 2000-2006 programmes does not suggest any significant underlying deceleration. The Commission is working closely with Member States to facilitate a smooth start-up of the 2007-2013 programmes*

⁽⁹⁾ See paragraphs 3.10 and 3.16 of the Annual Report concerning the financial year 2005.

⁽¹⁰⁾ As indicated by the Commission in COM(2002) 528 final, p. 4 — 'The administrative and financial constraints connected with the completion of the 1994 to 1999 programmes contributed largely to the delays in starting up programmes for the 2000 to 2006 period'.

THE COURT'S OBSERVATIONS

3.19. Specific attention is required for the Cohesion Fund where underspending has caused a large increase in outstanding budgetary commitments. The situation is likely to be exacerbated by the start of the new programming period.

3.20. As previously recommended ⁽¹⁾, when proposing future payment budgets the Commission needs to take better account of the absorption capacities of Member States and the expenditure profile within the programming period. In this context, the Commission should also pay due attention to the risks to sound financial management.

3.21. The Report on budgetary and financial management prepared by DG Budget provides an improved but inconsistent information level of detail. The Court recommends that consistent level of analysis on lower than forecast spending is provided for all principal budgetary areas.

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3.19. *The Commission is monitoring the Cohesion Fund situation carefully. The lower than expected spending rate of Cohesion Fund in EU-10 is partly due to the relatively long lead times for infrastructure projects and partly to start-up problems (see paragraph 3.12). The application of the $n + 2/n + 3$ rule in 2007-2013 will work against the accumulation of outstanding commitments.*

3.20. *The Commission's budget planning, anchored in the principle of sound financial management, takes account to the extent possible of the absorption capacities of Member States, paying particular attention to previous years' budgetary execution, forecasts, and the level of programme implementation. Unforeseeable events are dealt with by amending budgets. The rate of implementation of final payments has steadily risen to close to 100 %.*

3.21. *The Commission takes note of these comments (see also reply to paragraph 3.15).*

⁽¹⁾ See paragraph 3.21 of the Annual Report concerning the financial year 2005.

CHAPTER 4

Revenue

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INTRODUCTION

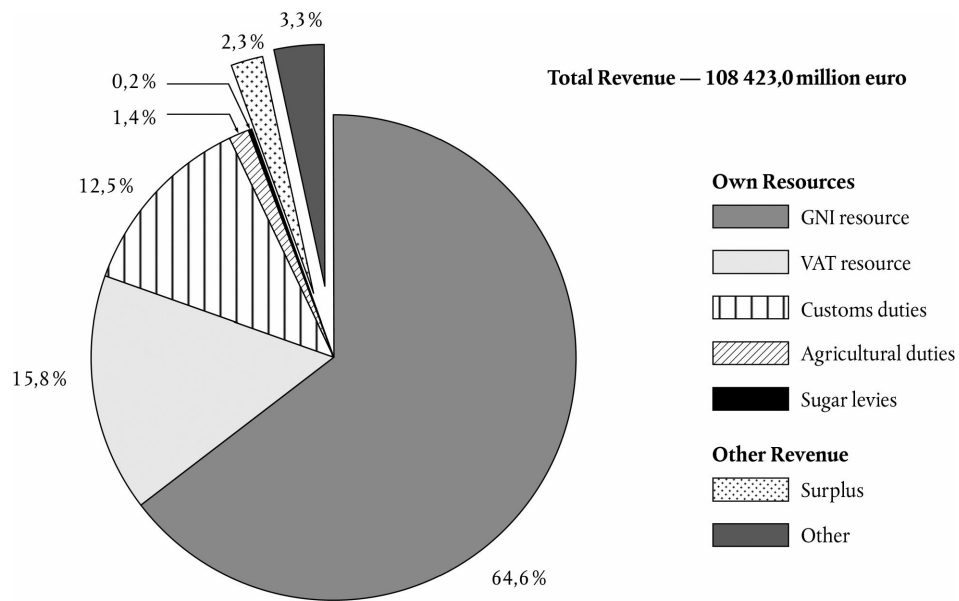
4.1. The revenue in the budget of the European Union consists of own resources and other revenue. As shown in **Table 4.1**, **Graph 4.1** and **Graph 4.2** own resources are by far the main source of financing for budgetary expenditure (94,4 %).

Table 4.1 — Revenue for the financial years 2005 and 2006

| <i>(million euro)</i> | | | | | |
|---|------------------------|--------------------------------|------------------|------------------------|-------------------------|
| Type of revenue and corresponding budget heading | Actual revenue in 2005 | Development of the 2006 budget | | Actual revenue in 2006 | % change (2005 to 2006) |
| | | Initial budget | Final budget | | |
| | (a) | (b) | (c) | (d) | $e = [(d) - (a)]/(a)$ |
| 1 <i>Traditional own resources (net of 25 % collection costs)</i> | 14 063,1 | 14 225,1 | 14 888,9 | 15 028,3 | 6,9 |
| — Agricultural duties (Chapter 10) | 1 350,8 | 763,5 | 863,4 | 1 291,8 | - 4,4 |
| — Sugar and isoglucose levies (Chapter 11) | 695,1 | 556,2 | 150,6 | 151,6 | - 78,2 |
| — Customs duties (Chapter 12) | 12 017,2 | 12 905,4 | 13 874,9 | 13 584,9 | 13,0 |
| 2 <i>VAT resource</i> | 16 018,0 | 15 884,3 | 17 186,1 | 17 206,2 | 7,4 |
| — VAT resource from the current financial year (Chapter 13) | 15 618,9 | 15 884,3 | 17 200,3 | 17 219,8 | 10,2 |
| — Balances from previous years (Chapter 31) | 399,1 | 0,0 | - 14,2 | - 13,6 | - 103,4 |
| 3 <i>GNI resource</i> | 70 860,6 | 80 562,5 | 70 451,4 | 70 132,1 | - 1,0 |
| — GNI resource from the current financial year (Chapter 14) | 68 811,6 | 80 562,5 | 68 921,2 | 68 602,1 | - 0,3 |
| — Balances from previous years (Chapter 32) | 2 049,0 | 0,0 | 1 530,2 | 1 530,0 | - 25,3 |
| 4 <i>Balances and adjustments</i> | - 130,6 | 0,0 | 0,0 | - 15,3 | - 88,3 |
| — UK correction (Chapter 15) | - 120,3 | 0,0 | 0,0 | - 6,0 | - 95,0 |
| — Final calculation of UK correction (Chapter 35) | - 10,3 | 0,0 | 0,0 | - 4,0 | - 61,2 |
| — Intermediate calculation of UK correction (Chapter 36) | 0,0 | 0,0 | 0,0 | - 5,3 | NA |
| 5 <i>Other revenue</i> | 6 279,6 | 1 297,7 | 4 852,0 | 6 071,7 | - 3,3 |
| — Surplus from previous financial year (Chapter 30) | 3 262,7 | 0,0 | 2 502,8 | 2 502,8 | - 23,3 |
| — Miscellaneous revenues (Titles 4 to 9) | 3 016,9 | 1 297,7 | 2 349,2 | 3 568,9 | 18,3 |
| Grand Total | 107 090,7 | 111 969,6 | 107 378,4 | 108 423,0 | 1,2 |

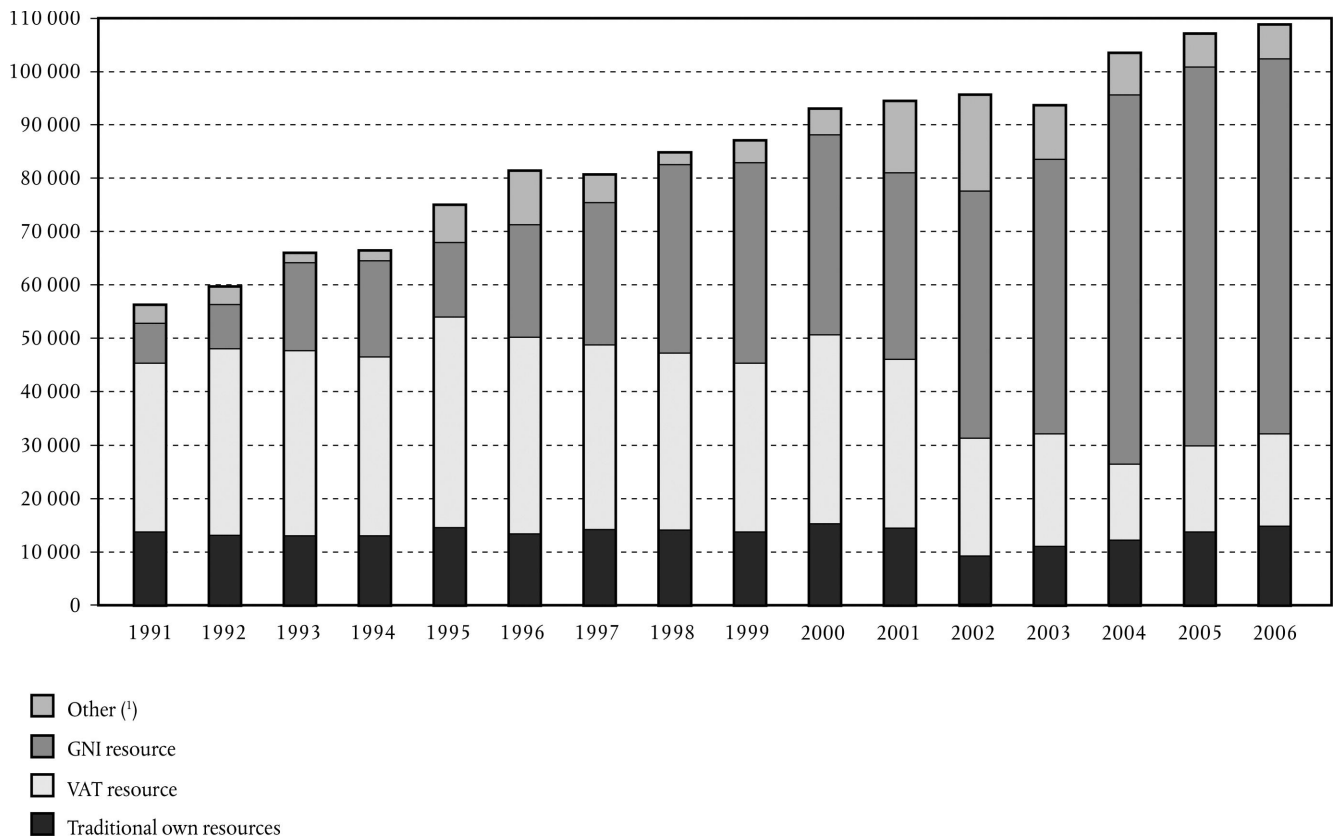
Source: Budgets and amending budgets for 2006; Annual Accounts of the European Communities, 2006.

Graph 4.1 — Breakdown of actual revenue in 2006



Source: Annual Accounts of the European Communities, 2006.

Graph 4.2 — Evolution of sources of actual revenue 1991 to 2006



(1) Contains surplus from previous financial year and miscellaneous revenue.

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4.2. There are three categories of own resources: traditional own resources ⁽¹⁾ (customs duties, agricultural duties and sugar levies) (14,0 %), own resources calculated on the basis of value added tax (VAT) collected by Member States (15,8 %) and own resources based on the Member States' gross national income (GNI) ⁽²⁾ (64,6 %).

SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

*Audit scope***Traditional own resources**

4.3. The main risks to the receipt of traditional own resources are evasion of duty by the taxpayer, whether by misrepresentation or simply by smuggling; miscalculation or failure to establish duty because of undetected errors or weaknesses in customs authorities' systems; and errors or omissions in Member States' accounting for the duty established. The Court's audit of the transactions underlying the accounts cannot cover undeclared imports or those that have escaped customs surveillance.

4.4. The Court audited a sample of underlying transactions made up of Member States' declarations to the Commission and carried out an evaluation of supervisory and control systems, both in the Commission and in Member States.

4.5. This included a review of the organisation of customs supervision and of the national systems for accounting for traditional own resources in six Member States ⁽³⁾ and evaluation of the supervisory role of the joint committees (ACOR ⁽⁴⁾, Customs Code Committee ⁽⁵⁾).

⁽¹⁾ Traditional own resources are collected by Member States on behalf of the European Union, retaining 25 % to cover collection costs.

⁽²⁾ The VAT and GNI own resources are contributions resulting from the application of uniform rates to Member States' harmonised VAT assessment bases or to the Member States' GNI, calculated according to Community rules.

⁽³⁾ Belgium, France, Italy, Hungary, Slovakia, United Kingdom; in addition the traditional own resources accounting system of Finland was reviewed.

⁽⁴⁾ Advisory Committee on Own Resources, referred to in Article 20 of Council Regulation (EC, Euratom) No 1150/2000 (OJ L 130, 31.5.2000, p. 1), as amended by Regulation (EC, Euratom) No 2028/2004 (OJ L 352, 27.11.2004, p. 1). The Committee consists of representatives of the Member States and of the Commission, and provides the liaison between the Commission and the Member States on own resources matters. It examines questions concerning the implementation of the own resources system, as well as the estimates of own resources.

⁽⁵⁾ Articles 247 to 249 of Council Regulation (EEC) No 2913/92 (OJ L 302, 19.10.1992, p. 1).

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VAT and GNI own resources

4.6. The main risks for these two resources lie at the level of the compilation of data used for the National accounts, the use of estimates where statistical data are not available, and the complexity of the legislative framework.

4.7. The VAT and GNI own resources reflect macroeconomic statistics, for which the underlying data cannot be audited directly. For this reason, the VAT/GNI audit took as its starting point the receipt by the Commission of the macroeconomic aggregates prepared by the Member States (either as forecasts or as final figures) and assessed the Commission's systems for handling the data until they are ultimately included in the final accounts. The audit thus covered the establishment of the annual budget and its implementation in respect of the contributions by Member States. The audit also covered the Commission supervisory and control systems which are intended to provide assurance that EU revenue is correctly established and collected, as well as the supervisory role of the ACOR ⁽⁶⁾ and GNI ⁽⁷⁾ Committees.

Temporary budget compensation and cash-flow facility for new Member States

4.8. In addition the Court's audit covered the implementation of those arrangements intended to compensate new Member States for budgetary imbalances ⁽⁸⁾ in accordance with Articles 29 and 30 of the Act concerning the conditions of accession of EU-10 Member States ⁽⁹⁾. These arrangements had the form of a

⁽⁶⁾ See footnote 4.

⁽⁷⁾ The GNI Committee is referred to in Article 4 of Council Regulation (EC, Euratom) No 1287/2003 (OJ L 181, 19.7.2003, p. 1). The Committee consists of representatives of the Commission and Member States. Each year, the Committee examines the GNI data forwarded by the Member States and issues an opinion on the appropriateness of these data for own resource purposes with respect to reliability, comparability and exhaustiveness. The Committee is consulted by the Commission with regard to the latter's proposals for improving GNI calculations, and it also deals with questions relating to the GNI compilation practices, revision of GNI data and the problem of exhaustiveness of GNI.

⁽⁸⁾ The European Council of Fontainebleau of 25 and 26 June 1984 recognised that 'any Member State sustaining a budgetary burden which is excessive in relation to its relative prosperity may benefit from a correction at the appropriate time'. It also pointed out that the 'expenditure policy is ultimately the essential means of resolving the question of budgetary imbalances'.

⁽⁹⁾ Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded (OJ L 236, 23.9.2003, p. 33).

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temporary budget compensation for the Czech Republic, Cyprus, Malta and Slovenia, as well as a cash flow facility for all 10 acceding States, totalling 3 386 million euro at 1999 prices and to be paid over the years 2004 to 2006 as an item of expenditure under the general budget of the European Communities.

*Legality and regularity of underlying transactions***Traditional own resources**

4.9. Traditional own resources are collected by the Member States who enter them in the accounting system kept by the national Treasury ('the A accounts') and thereby make the resources available to the Communities. Where duties or levies remain unpaid and no security has been provided, or they are covered by securities but have been challenged, it is possible for Member States to suspend making these resources available by entering them in a separate account ('the B account' ⁽¹⁰⁾).

4.10. The Court found that overall the underlying transactions audited were legal and regular. However some errors and weaknesses were found.

4.11. As in previous years the Court's audit and the Commission's inspection visits detected recurrent bookkeeping problems affecting B accounts. Late or inaccurate entries, omissions and erroneous cancellations were found in a number of Member States ⁽¹¹⁾. In two of these ⁽¹²⁾, unchallenged customs debts covered by securities had systematically been recorded in the B accounts, even though the parts covered by the security should have been made available. Furthermore the payment of a balance of 22,7 million euro by Germany is still under discussion with the Commission ⁽¹³⁾.

4.11. *The Commission has taken action to resolve these issues. Belgium is amending its national procedures to exclude guaranteed amounts as a result of a European Court of Justice judgment in an infringement brought by the Commission ⁽¹⁾; and the Commission is pursuing the incorrect treatment of guaranteed amounts in the UK as a result of the Commission's own inspection findings. Germany has provided further information to the Commission during a recent inspection which satisfactorily explains nearly all of the accounting corrections Germany had made in its B account. The Commission expects that the remaining points will be closed shortly.*

⁽¹⁰⁾ Council Regulation (EC, Euratom) No 2028/2004 of 16 November 2004 amending Regulation (EC, Euratom) No 1150/2000 implementing Decision 94/728/EC, Euratom on the system of the Communities' own resources.

⁽¹¹⁾ Belgium, France, Italy, Hungary, Slovakia, Finland and United Kingdom.

⁽¹²⁾ Belgium and United Kingdom.

⁽¹³⁾ See Annex 4.1 — Follow-up of recent Court's observations.

⁽¹⁾ Judgment dated 5 October 2006 in case C-377/03

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4.12. Member States must also forward to the Commission annually estimates of the totals for entitlements that are unlikely to be recovered ⁽¹⁴⁾. In four of the Member States visited ⁽¹⁵⁾ there are no written instructions for producing these estimates, which might affect their quality, as well as the consistency of the methods followed year on year.

4.13. At present, the securities lodged with a view to imports or exports of agricultural products under the Tariff Quota System managed by an import or export licence and subsequently forfeited become a resource of the Member State concerned. The Court considers that such a security should ⁽¹⁶⁾ form part of the Communities' own resources and the amounts involved should be made available to the Commission. The Commission is invited to clarify this issue. Furthermore, the Court has asked, on several occasions since December 2006, to be informed on the amounts involved; the Commission has not been able to provide reliable data ⁽¹⁷⁾.

VAT and GNI own resources

4.14. The Court's audit found the calculation of Member States' contributions and their settlement by Member States to be legal and regular. However the Court draws attention to the comments made in paragraphs 4.24 to 4.26.

Temporary budget compensation and cash-flow facility for new Member States

4.15. In respect of the compensations referred to in paragraph 4.8, the audit did not reveal any errors in the calculation and payment of the amounts concerned.

*Supervisory and control systems***Traditional own resources**

4.16. The Court has reviewed the inspections carried out by the Commission ⁽¹⁸⁾ and has taken the results into account. As in previous years, the Commission's methodology was found to be soundly-based and the documentation to be good. The inspections confirmed that the own resources collection systems were generally satisfactory, but certain weaknesses in respect of transit procedure and management of B accounts were identified.

⁽¹⁴⁾ Article 6(4)(b) of Regulation (EC, Euratom) No 2028/2004.

⁽¹⁵⁾ Belgium, Slovakia, Finland and United Kingdom.

⁽¹⁶⁾ On the basis of Article 2(1)(a) of the current own resources Decision 2000/597/EC, Euratom (OJ L 253, 7.10.2000, p. 42).

⁽¹⁷⁾ According to Article 31 of Regulation (EEC) No 2220/85 as amended (OJ L 205, 3.8.1985, p. 5), 'Member States shall keep available for the Commission, for each year, the total number and sum of the securities forfeited'.

⁽¹⁸⁾ Article 18 of Regulation (EC, Euratom) No 1150/2000, as amended by Regulation (EC, Euratom) No 2028/2004.

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4.12. *The Commission will pass on the Court's findings to the Member States concerned.*

4.13. *The Commission will raise the Court's consideration in the appropriate forum in order to clarify the question.*

On the basis of a request made to the Member States the provisional partial amount of securities forfeited for import licenses within tariff quotas is 1,05 million euro for the budget year 2005-2006. This figure is still subject to review by the Member States. The Court will be informed as soon as an up-dated figure is available.

THE COURT'S OBSERVATIONS

4.17. On-the-spot audits by the Court confirmed that overall the audited supervisory and control systems for customs and for traditional own resources accounting were functioning satisfactorily in the six Member States ⁽¹⁹⁾ that were visited. Nevertheless some weaknesses were found.

4.18. Community regulations do not usually prescribe any particular methods, and they do not set the level of customs control to be exercised. Nevertheless, Member States must implement checks that provide adequate protection for the Communities' financial interests ⁽²⁰⁾. However, the audits detected some weaknesses in the area of checks carried out by Member States. In one Member State ⁽²¹⁾, for example, the frequency with which the IT system triggered physical checks on imported goods was very low compared to other Member States ⁽²²⁾, of the order of 1 in 7 000 (0,014 %). In another Member State ⁽²³⁾, *ex post* checks on traders applying simplified procedures ⁽²⁴⁾ were carried out with intervals of more than three years, even though the period of limitation for traditional own resources that have been evaded is three years.

VAT own resource

4.19. The Commission maintained the satisfactory frequency and quality of its on-the-spot inspections during 2006.

4.20. Reservations are a device for the Commission to keep doubtful elements in the VAT statements submitted by Member States open for correction after the statutory time-limit of four years. The number of reservations is still significant and one case goes back as far as 1989 (see **Table 4.2**). 82 % of all active reservations as at the end of 2006 have been issued since 2002 with an average age of a reservation being 3,4 years. The changes to EU-25 VAT base following the work on reservations performed in 2006 resulted in a negative adjustment to the aggregate VAT resource of around 14 million euro.

⁽¹⁹⁾ Belgium, France, Italy, Hungary, Slovakia, United Kingdom.

⁽²⁰⁾ Article 2(1) of Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities' financial interests (OJ L 312, 23.12.1995, p. 1) and Articles 17 and 18 of Regulation (EC, Euratom) No 2028/2004.

⁽²¹⁾ United Kingdom.

⁽²²⁾ The Court's audit revealed rates of physical checks in other Member States of at least 0,3 %.

⁽²³⁾ France.

⁽²⁴⁾ Provided for by Article 76 of Regulation (EEC) No 2913/92 — because formalities and procedures are reduced, these procedures are high-risk.

THE COMMISSION'S REPLIES

4.18. *Member States use different balances of pre-release and later audit-based checks in their framework of customs controls. Therefore comparisons of the frequency with which individual components of that framework are applied do not show the full picture. The requirement for a common risk management framework for customs control ⁽²⁾, although primarily aimed at enhancing security and safety, is expected to have a positive effect on the protection of the community's financial interests. The Commission will take up the Court's findings with the Member States concerned.*

4.20. *The Commission hopes to lift the two oldest reservations, from 1989 and 1993, in the near future. A further three reservations date from 1995. Most reservations are lifted following the next control mission after the one in which they were created.*

⁽²⁾ Regulation (EC) No 648/2005 of the European Parliament and of the Council of 13 April 2005 amending Council Regulation (EEC) No 2913/92 establishing the Community Customs Code (OJ L 117, 4.5.2005, p. 13), in particular its implementing provisions.

Table 4.2 — VAT reservations as at 31 December 2006

| Member States | Number of reservations outstanding at 31.12.2005 | Reservations set in 2006 | Reservations lifted in 2006 | Number of reservations outstanding at 31.12.2006 | Oldest year to which reservations apply |
|----------------|--|--------------------------|-----------------------------|--|---|
| Belgium | 6 | 2 | 0 | 8 | 1989 |
| Denmark | 1 | 1 | 1 | 1 | 1991 |
| Germany | 17 | 6 | 6 | 17 | 1999 |
| Ireland | 10 | 4 | 2 | 12 | 1998 |
| Greece | 13 | 4 | 1 | 16 | 1997 |
| Spain | 6 | 0 | 1 | 5 | 1999 |
| France | 7 | 0 | 4 | 3 | 1993 |
| Italy | 11 | 3 | 1 | 13 | 1995 |
| Luxembourg | 1 | 0 | 0 | 1 | 1997 |
| Netherlands | 1 | 1 | 1 | 1 | 2002 |
| Austria | 8 | 0 | 0 | 8 | 1995 |
| Portugal | 5 | 8 | 3 | 10 | 1996 |
| Slovakia | 0 | 3 | 0 | 3 | 2004 |
| Finland | 7 | 2 | 3 | 6 | 1995 |
| Sweden | 11 | 1 | 1 | 11 | 1998 |
| United Kingdom | 7 | 2 | 5 | 4 | 1995 |
| Total | 111 | 37 | 29 | 119 | |

GNI own resource

4.21. At the beginning of 2006, there were 63 open specific GNI reservations ⁽²⁵⁾ relating to the period 1995 to 2001. During the year, 20 reservations were lifted, leaving a balance of 43 open reservations as at the year end (See **table 4.3**). In 2006 general reservations were issued in respect of the years 2002, 2003 and 2004 of all EU-15 Member States pending the analysis of the updated inventories ⁽²⁶⁾. The Commission expects to replace the general reservations by specific reservations in 2007 or 2008 depending on progress made in analysis of inventories, which is due to start in 2007. The changes to GNP/GNI of EU-15 Member States (Greece excluded) following the work on specific reservations for the period 1995 to 2001 resulted in a negative adjustment to the aggregate GNI resource of around 500 million euro over the whole period. This has been taken into account in Member States VAT/GNI balances payments in 2004, 2005 and 2006.

⁽²⁵⁾ Reservations in respect of GNI resource relate to sources and methods used by Member States for the compilation of national accounts aggregates and make it possible to adjust GNI aggregates after the four year time limit set in Community legislation. A general reservation covers the totality of a Member State's data, whereas a specific reservation covers discrete sources and methods.

⁽²⁶⁾ No reservations for EU-10 Member States have been set so far as their GNI data in respect of 2004 will remain open for own resource purposes until September 2008.

Table 4.3 — GNI specific reservations as at 31 December 2006

| Member States | Number of reservations outstanding at 31.12.2005 | Reservations set in 2006 | Reservations lifted in 2006 | Number of reservations outstanding at 31.12.2006 |
|----------------|--|--------------------------|-----------------------------|--|
| Belgium | 3 | 0 | 3 | 0 |
| Denmark | 5 | 0 | 2 | 3 |
| Germany | 3 | 0 | 3 | 0 |
| Ireland | 4 | 0 | 0 | 4 |
| Greece | 7 | 0 | 0 | 7 |
| Spain | 5 | 0 | 0 | 5 |
| France | 8 | 0 | 5 | 3 |
| Italy | 4 | 0 | 0 | 4 |
| Luxembourg | 8 | 0 | 0 | 8 |
| Netherlands | 2 | 0 | 2 | 0 |
| Austria | 1 | 0 | 1 | 0 |
| Portugal | 4 | 0 | 4 | 0 |
| Finland | 3 | 0 | 0 | 3 |
| Sweden | 0 | 0 | 0 | 0 |
| United Kingdom | 6 | 0 | 0 | 6 |
| Total | 63 | 0 | 20 | 43 |

4.22. Before 22 September of each year, Member States have to provide the Commission (Eurostat) with figures for aggregate GNI and its components (the GNI questionnaire) covering the preceding year and any revisions made to the figures for previous years. Together with these figures, Member States have to transmit a report on the quality of GNI data (the GNI quality report) supplying the information necessary to show how the aggregates are reached, and in particular describing any significant changes in the procedures and basic statistics used and explaining the revisions made to earlier GNI data supplied ⁽²⁷⁾.

4.23. On the basis of the GNI data received, the GNI Committee ⁽²⁸⁾ gives an opinion on the appropriateness of Member States' GNI data for own resources purposes ⁽²⁹⁾. The GNI data supplied by the Member States can give rise to adjustments to the GNI balances established for previous years.

4.24. On 22 September 2006 Greece transmitted to the Commission the GNI questionnaire covering financial years from 1995 to 2005. The revised Greek GNP/GNI ⁽³⁰⁾ data included in the questionnaire showed increases of between 13 % and 26 %. As there is no legal obligation to do so, neither the Commission nor the GNI Committee had received any advance notice of such increases.

⁽²⁷⁾ Article 2(2) and (3) of Regulation (EC, Euratom) No 1287/2003.

⁽²⁸⁾ See footnote 7.

⁽²⁹⁾ Article 5 of Regulation (EC, Euratom) No 1287/2003.

⁽³⁰⁾ GNP was used up until 2001. GNI has been used since 2002.

THE COURT'S OBSERVATIONS

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4.25. Following the specific reservations set by the Commission for the years 1995 to 2001, Greece adopted year 2000 as the new benchmark year for its revised GNI figures, the previous benchmark year being 1988. The usual practice is that National Statistical Institutes perform major revisions to national accounts data in about five-year intervals reflecting improvements in source data and methodology, and these include an update of benchmark estimates.

4.26. At its meeting on 25 and 26 October 2006, faced with such a major revision, and due to insufficient information on the revised figures in the Greek 2006 quality report, the GNI Committee considered that the unrevised Greek GNP/GNI data should be used for own resources purposes until the Commission had checked the new data on the basis of the updated GNI inventory⁽³¹⁾. Any understatement of GNI for a particular Member State — while not affecting the overall GNI own resource — has the effect of increasing the contributions from the other Member States, until the problem is identified and corrected. Furthermore, an understatement might have the additional effect of an unwarranted cap⁽³²⁾ being placed on the VAT base, causing further overpayments from the other Member States. This situation will not be rectified until the Greek GNI figures are adopted by the GNI Committee and the Commission then must calculate the balances and adjustments to balances based on these figures.

4.27. Member States were supposed to submit their updated or new GNI inventories to the Commission by 31 December 2006. Following initial analysis, on-the-spot control missions would be undertaken by the Commission starting in 2007. Six Member States⁽³³⁾ had not transmitted their complete, new or updated GNI inventories by the end of June 2007.

4.27. The Commission continuously reminded Member States of the need to meet the deadline throughout 2006 and issued a further reminder just after 31 December 2006, as well as on the occasions of the meetings with Member States' Directors of National Accounts on 31 January and of the GNI Committee on 26 April 2007. At this GNI Committee meeting, the delegates from Member States which have not yet sent their GNI inventories indicated that these inventories were to be sent by the end of June 2007 at the latest. Further actions by the Commission are being considered.

Given the amount of work required for the analysis of the inventories and the GNI control missions to 25 Member States, these missions will be conducted over a three-year period 2007-2009.

⁽³¹⁾ This is a document which Member States have to provide to the Commission describing the procedures and basic statistics used to calculate GNI and its components according to ESA 95.

⁽³²⁾ According to Article 2(1)(c) of Decision 2000/597/EC, Euratom the VAT bases to be taken into account for calculating the Member States VAT contributions shall not exceed 50 % of GNI/GNP for each Member State.

⁽³³⁾ Spain, France, Italy, Cyprus, Luxembourg and United Kingdom.

THE COURT'S OBSERVATIONS

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Conclusions and recommendations

4.28. With due consideration to its scope (see paragraphs 4.3, 4.4 and 4.7), the Court's audit as regards own resources revealed that overall the underlying transactions audited were free from material error and that the overall functioning of the supervisory and control systems audited was satisfactory, except for the low rates of checks described in paragraph 4.18 and the problems mentioned in paragraph 4.11 as affecting the B accounts.

4.29. The Court recommends that the Commission verifies that the level of customs checks carried out by Member States adequately protects the Communities' financial interests (see paragraph 4.18).

4.30. The Court considers that forfeited securities described in paragraph 4.13 should be made available to the Commission and invites the Commission to clarify this issue.

4.31. Since the Commission has no effective means of ensuring that Member States provide adequate and timely information which would permit it to lift outstanding reservations about the calculation of VAT own resources, it should examine what other steps are open to it to bring pressure to bear on those Member States concerned in long-outstanding reservations to resolve the matter (see paragraph 4.20).

4.32. In respect of the Commission's controls of the GNI data and the underlying systems, the Court recommends that the Commission:

(a) sets rules on communication of GNI revisions, so that the Commission and the GNI Committee are forewarned of major revisions (see paragraph 4.24);

4.28. *The Commission will pursue the findings the Court did not consider satisfactory with the Member States concerned.*

4.29. *The Commission makes regular inspections of the adequacy of Member States' frameworks of customs control to provide assurance to the budgetary authority that they comply with Community legislative requirements and protect the Communities' financial interest.*

4.30. *The Commission will raise the Court's consideration in the appropriate forum in order to clarify the question.*

4.31. *Although the Commission already presses individual Member States to provide the necessary information without delay, it has now begun collective discussions with the Member States, in the Advisory Committee on Own Resources, concerning possible mechanisms to achieve this objective. The Commission welcomes the Court's continued insistence on this matter.*

4.32.

(a) *Proper communication and close coordination of the national accounts revision policies of Member States are of major importance and have been discussed with Member States on many occasions⁽³⁾. The Commission has taken several actions on this question and will continue to work closely with Member States to achieve better communication and coordination.*

⁽³⁾ For example the Committee on Monetary, Financial and Balance of Payments Statistics has proposed guidelines for better communication of major revisions of national accounts. These guidelines include advance notice of revisions indicating, where possible, their potential impact as well as a proper documentation of the reasons and impact on major aggregates and the timetable for further revisions. The proposed guidelines also cover coordination and communication on major revisions due to changes in concepts, definitions or classifications in the European Union. These guidelines were further discussed by the Statistical Programme Committee on 24 May 2007.

THE COURT'S OBSERVATIONS

- (b) implements a co-ordinated policy for national accounts data revisions, including the requirement for a regular benchmarking (see paragraph 4.25);
- (c) ensures that the conclusions from control of the Greek inventory are available early enough, so as to allow the inclusion of corrected data in accounts for the financial year 2007 (see paragraph 4.26).

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- (b) *The Commission again discussed national accounts revisions with the GNI Committee on 26 April 2007. Most Member States supported the principle of better communication and coordination of all major revisions, including common regular benchmarking, e.g. every five years. Many Member States pointed to major practical difficulties relating to differences in statistical systems, and in data sources and surveys as well as their periodicity in the various countries. The Commission will continue discussions on these issues with Member States.*
- (c) *The Commission finalised its desk examination of the updated Greek GNI inventory sent to Eurostat in February 2007 and carried out a GNI control mission to Greece on 20-26 June 2007. Further to this control mission, Eurostat will pursue discussions with the Greek statistical authorities. The Commission expects to reach conclusions on the appropriate levels of the Greek GNI figures in time for the official GNI notification of 22 September 2007, which is used in the 2007 budgetary procedures.*

FOLLOW UP OF PREVIOUS OBSERVATIONS

4.33. The results of the Court's follow-up of previous observations in recent annual reports can be found in **Annex 4.1**.

SPECIAL REPORTS ISSUED SINCE THE LAST ANNUAL REPORT

4.34. Special Report No 11/2006 on the Community transit system (OJ C 44, 27.2.2007, p. 1).

ANNEX 4.1

Follow-up of recent Court's observations

| Court's observations | Situation in 2006 | Further action needed | Commission reply |
|--|---|--|--|
| <i>Traditional own resources: Agricultural tariff quotas</i> | | | |
| Paragraph 3.16 of the Annual Report concerning the financial year 2003 identified that certain quotas allow large numbers of importers, all linked to a main operator, to introduce their own requests for a licence to ensure a maximum quota allocation. | The Court's audit revealed that in 2006 several importers, all linked to a main operator, were able to submit their own licence requests. This distorts competition and puts a heavy burden on the managing services in both the Commission and the Member State. | Even though the Commission has taken action to improve the procedural framework through Commission Regulation (EC) No 1301/2006 (to come into effect from 1 January 2007), this does not fully address the problem. The Court considers that the Commission should implement additional measures that preclude several importers all linked to a main operator from lodging more than one application in respect of the same period. | <i>Commission Regulation (EC) No 1301/2006 laying down common rules for the administration of import tariff quotas for agricultural products has reinforced and harmonised the provisions concerning applications for licences, inter alia, aiming at preventing applications lodged by operators not involved in external trade in the sector concerned. According to Article 5 of the Regulation, an operator must furnish proof of such involvement in trade with third countries in the sector concerned. These provisions also apply to subsidiaries in so far as they fulfil the abovementioned requirements.</i> <i>In parallel, Commission services have been pursuing an action to streamline and harmonise the provisions laid down in the regulations opening import tariff quotas in the different market organisations. The effects will be assessed in the forthcoming months. If necessary, further measures will be considered in this context.</i> |
| <i>Potential duties under discussion between the Commission and Germany</i> | | | |
| In paragraph 3.23 of the Annual Report concerning the financial year 2004, the Court noted that in 2003 Germany removed entries totalling 40,1 million euro from its B account, without providing a full explanation of this reduction. In 2005, the Court indicated that 22,7 million euro of potential duties remain under discussion between the Commission and Germany. | The balance of 22,7 million euro was still under discussion in 2006. | Germany should provide the evidence required so that the Commission can conclude the case. | <i>The Commission has obtained further explanations and demonstrations from Germany which satisfactorily resolves nearly all of the corrections made. The remainder are undergoing further scrutiny.</i> |
| <i>VAT own resource: financial impact of outstanding reservations</i> | | | |
| In paragraph 4.14 of the Annual Report concerning the financial year 2005 the Court noted that the financial impact of outstanding reservations was not quantified and further recommended that the Commission should attempt to estimate, where possible, the impact of these reservations. | As the financial impact of the reservations is seldom easy to estimate, during the 2006 audit the Court recommended that a note explaining the reservations mechanism be included in the financial statements, so as to make the reader aware of the uncertainty relating to the VAT resource figure. This recommendation was accepted by the Commission and a relevant note has been included in the 2006 Annual Accounts. | None. | <i>With a view to reducing the number of reservations with apparently minor financial impact, the Commission will remind Member States that they may seek authorisation either not to take certain transactions into account or to use approximations where precise calculation would be likely to involve unjustified administrative burdens relative to the effect on the VAT base.</i> |
| <i>GNI own resource: quality reports</i> | | | |
| In paragraph 4.17 of the Annual Report concerning the financial year 2005 the Court noted that in the 2005 quality reports Member States were still not reporting on the results of their investigations of the quality of GNI and its components. | The analysis of quality reports submitted in 2006 showed that, following the discussion at the GNI Committee of 3 July 2006, with 2 exceptions, Member States addressed this point. | The Commission should ensure that all Member States with no exceptions provide the information requested. | <i>The Commission will continue its efforts to ensure that all Member States meet the requirements of this provision of the GNI quality reports.</i> |

| Court's observations | Situation in 2006 | Further action needed | Commission reply |
|---|--|--|--|
| <i>GNI own resource: direct verification</i> | | | |
| <p>In paragraph 3.35 of its Annual Report concerning the financial year 2004, as well as in paragraph 4.16 of its Annual Report concerning the financial year 2005, the Court pointed out that there is still insufficient verification by the Commission of the GNI data ⁽¹⁾.</p> | <p>The issue was discussed by the GNI Committee in July 2006 and the Commission concluded that it would reflect on identifying domains that could lend themselves to more direct verification of the underlying national accounts which form the basis for the figures forwarded in GNI questionnaires ⁽²⁾. However, no such approach was implemented in 2006 and the Commission's reply to paragraph 4.16 stated that it would only resume control missions to Member States after the new inventories are available and analysed in 2008.</p> | <p>The Commission should perform more direct verification in the context of checking the GNI inventories and questionnaires in 2007.</p> | <p><i>After a complete round of missions based on the inventories of 2001, Member States were asked to provide, by the end of 2006, new inventories taking into account the recent major revisions of their national accounts. Most inventories were transmitted in December 2006. Some will arrive in 2007. Therefore, no missions on these inventories could be carried out in 2006.</i></p> <p><i>The Commission will resume, in 2007, its control missions to Member States following analysis of the new inventories and will perform direct verification in the sense indicated by the Court on selected domains, taking into account resource constraints both in the Commission and in Member States. The Commission will continue, as in the past, to keep the Court informed of its activities in this area.</i></p> |
| <i>GNI own resource: financial impact of outstanding reservations</i> | | | |
| <p>In paragraph 91 of the Special Report No 17/2000, the Court pointed out that it is essential for the Commission to quantify the impact of its reservations on GNP.</p> | <p>As the financial impact of the reservations is seldom easy to estimate, during the 2006 audit the Court recommended that a note explaining the reservations mechanism be included in the financial statements, so as to make the reader aware of the uncertainty relating to the GNI resource figure. This recommendation was accepted by the Commission and a relevant note has been included in the 2006 Annual Accounts.</p> | <p>None.</p> | |
| <p>⁽¹⁾ Article 5 of Regulation (EC, Euratom) No 1287/2003 requires that the Commission verifies the sources and methods used by Member States to calculate GNI, notably in respect of the comparability, reliability and exhaustiveness.</p> <p>⁽²⁾ A GNI questionnaire is provided by each Member State and contains figures for aggregate GNI and its components.</p> | | | |

CHAPTER 5

The common agricultural policy

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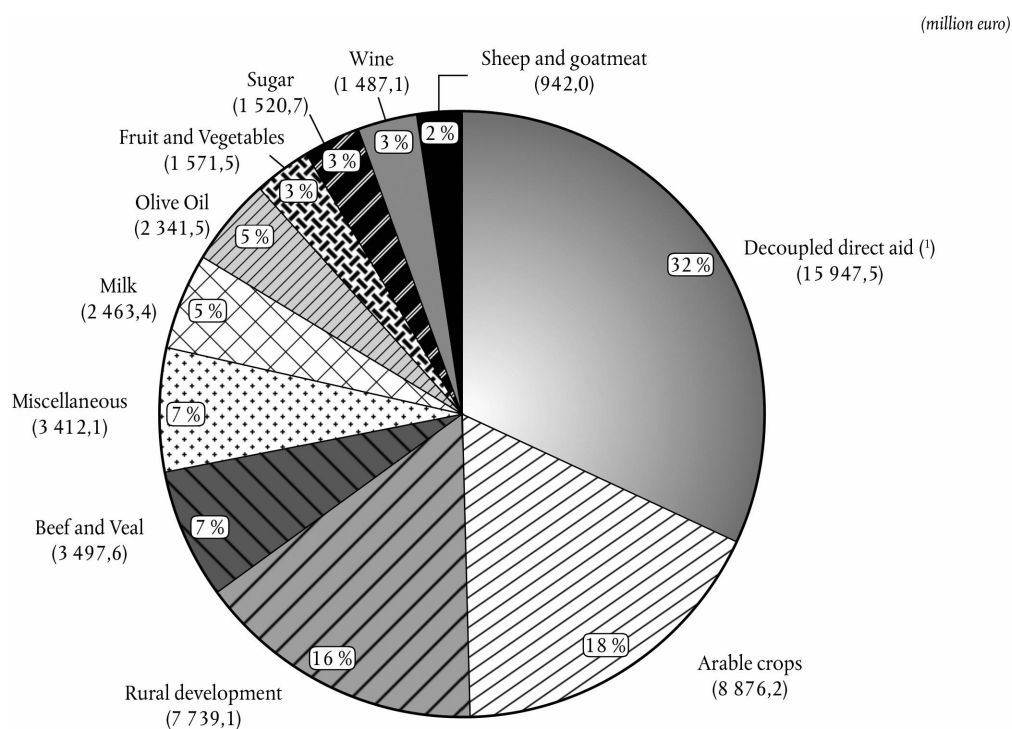
THE COURT'S OBSERVATIONS

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INTRODUCTION

5.1. This chapter deals with the Court's audit of Agriculture and Rural Development under the Guarantee Fund expenditure which totalled 49 799 million euro in 2006 (2005: 48 466 million euro ⁽¹⁾) (for details see **Graph 5.1**). Under the Treaty, the European Commission has overall responsibility for implementing the EU budget. Virtually all agricultural expenditure is carried out under shared management. This means that payments to final beneficiaries (farmers, private companies, traders, associations or public entities) are made by Paying Agencies approved by the Member States. Less than 1 % of expenditure is managed directly by the Commission.

Graph 5.1 — Breakdown of EAGGF-Guarantee expenditure by sector — financial year 2006



⁽¹⁾ SPS and SAPS.

Source: The Commission's Annual accounts for 2006 — Volume II.

⁽¹⁾ Net payments.

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5.2. The expenditure declared by the Member States is subject to several control systems:

- (a) check of the correctness of the farmer's claims under the Integrated Administration and Control System (IACS) ⁽²⁾;
- (b) sector-specific controls, e.g. for olive oil and rural development;
- (c) physical checks on subsidised exports of agricultural goods ⁽³⁾;
- (d) post-payment scrutiny of commercial documents on the premises of traders and processors of agricultural goods ⁽⁴⁾;
- (e) the clearance procedure, which covers all of the expenditure declared as far as the completeness and accuracy of the annual accounts are concerned (the financial decision) and, on a multi-annual basis, the legality and regularity of the expenditure (conformity decisions).

5.3. In order to obtain assurance as to the legality and regularity of the transactions underlying the Community's accounts, the Court audited these supervisory and control systems and tested a random sample of payments drawn from the expenditure of 30 paying agencies (which were collectively responsible for 68 % of CAP expenditure) (see **Table 5.1**).

⁽²⁾ Council Regulations (EEC) No 3508/92 (OJ L 355, 5.12.1992, p. 1) and (EC) No 1782/2003 (OJ L 270, 21.10.2003, p. 1) covering animal premiums and area aid.

⁽³⁾ Council Regulation (EEC) No 386/90 (OJ L 42, 16.2.1990, p. 6).

⁽⁴⁾ Council Regulation (EEC) No 4045/89 (OJ L 388, 30.12.1989, p. 18) covering payments above a specified threshold of export refunds, processing and transformation subsidies, cotton, olive oil, tobacco and some rural development measures.

Table 5.1 — Paying agencies by expenditure declared in 2006

| No | Member State | Paying agency | Amounts declared in million euro ⁽¹⁾ | % of total | Modified certificates ⁽²⁾ | Disjoined accounts ⁽³⁾ |
|--------------------------------|----------------|-------------------------|---|-------------|--------------------------------------|-----------------------------------|
| 1 | France | ONIC | 4 263,0 | 8,5 | × | |
| 2 | Italy | AGEA | 3 307,3 | 6,6 | × | × |
| 3 | Greece | OPEKEPE | 3 083,2 | 6,2 | | |
| 4 | United Kingdom | RPA | 2 925,2 | 5,8 | | |
| 5 | Poland | ARiMR | 1 964,8 | 3,9 | × | |
| 6 | Spain | Andalucía | 1 806,0 | 3,6 | | |
| 7 | Ireland | DAF | 1 723,3 | 3,4 | | |
| 8 | France | OFIVAL | 1 646,2 | 3,3 | | |
| 9 | Germany | Bayern, Landwirtschaft | 1 260,4 | 2,5 | | |
| 10 | Denmark | DFFE | 1 163,3 | 2,3 | | |
| 11 | France | CNASEA | 1 025,3 | 2,0 | | |
| 12 | Spain | Castilla — La Mancha | 912,9 | 1,8 | | |
| 13 | Germany | Niedersachsen | 905,8 | 1,8 | | |
| 14 | Hungary | MVH | 890,2 | 1,8 | | |
| 15 | Portugal | INGA | 879,8 | 1,8 | × | |
| 16 | Finland | MMM | 824,4 | 1,6 | | |
| 17 | United Kingdom | SERAD | 679,5 | 1,4 | | |
| 18 | Spain | Aragón | 560,2 | 1,1 | | |
| 19 | Germany | Nordrhein-Westfalen LWK | 527,7 | 1,1 | | |
| 20 | Italy | AVEPA | 498,4 | 1,0 | × | |
| 21 | Italy | AGREA | 426,8 | 0,9 | × | |
| 22 | Spain | Cataluña | 396,8 | 0,8 | | |
| 23 | Belgium | BIRB | 393,5 | 0,8 | | |
| 24 | Germany | Schleswig-Holstein | 371,3 | 0,7 | | |
| 25 | Germany | Hamburg-Jonas | 313,5 | 0,6 | | |
| 26 | Lithuania | NMA | 308,0 | 0,6 | × | × |
| 27 | Germany | Thüringen | 293,8 | 0,6 | × | |
| 28 | Belgium | Région Wallonne | 272,7 | 0,5 | × | |
| 29 | Germany | Rheinland-Pfalz | 215,1 | 0,4 | | |
| 30 | Spain | Galicia | 175,4 | 0,4 | | |
| PAs covered by DAS 2006 | | | 34 013,8 | 68,0 | | |
| 31 | Austria | AMA | 1 234,6 | 2,5 | | |
| 32 | France | ONIEP | 1 077,2 | 2,2 | | |
| 33 | Spain | Castilla — León | 966,4 | 1,9 | | |
| 34 | France | ONIOL | 930,7 | 1,9 | × | |
| 35 | Sweden | SJV | 918,3 | 1,8 | | |
| 36 | Spain | Extremadura | 686,9 | 1,4 | | |
| 37 | Italy | Region Lombardie | 543,4 | 1,1 | × | |
| 38 | Germany | Baden-Württemberg | 514,5 | 1,0 | | × |
| 39 | Czech Republic | SAIF | 497,5 | 1,0 | | |
| 40 | Germany | Mecklenburg-Vorpommern | 447,8 | 0,9 | × | |
| 41 | Netherlands | PZ | 447,4 | 0,9 | | |
| 42 | France | VINIFLOR | 446,6 | 0,9 | × | |
| 43 | Germany | Brandenburg | 443,7 | 0,9 | | |
| 44 | Germany | Sachsen-Anhalt | 411,2 | 0,8 | | |
| 45 | Italy | FINPIEMONTE | 381,5 | 0,8 | × | |
| 46 | Netherlands | Dienst Regelingen | 365,3 | 0,7 | | |
| 47 | Germany | Sachsen | 355,3 | 0,7 | × | |
| 48 | United Kingdom | DARD | 350,3 | 0,7 | | |
| 49 | Spain | FEGA | 333,8 | 0,7 | | |
| 50 | United Kingdom | NAW | 333,5 | 0,7 | | |
| 51 | Belgium | ALV | 277,2 | 0,6 | | |
| 52 | Slovakia | APA | 266,1 | 0,5 | × | × |
| 53 | Germany | Hessen | 249,7 | 0,5 | | |

| No | Member State | Paying agency | Amounts declared in million euro ⁽¹⁾ | % of total | Modified certificates ⁽²⁾ | Disjoined accounts ⁽³⁾ |
|----|----------------|--------------------------|---|--------------|--------------------------------------|-----------------------------------|
| 54 | Netherlands | HPA | 233,5 | 0,5 | | |
| 55 | Italy | ARTEA | 232,8 | 0,5 | × | |
| 56 | France | AUP | 208,1 | 0,4 | × | |
| 57 | Germany | BLE | 178,0 | 0,4 | | |
| 58 | Poland | ARR | 175,3 | 0,4 | | |
| 59 | Spain | Valencia | 174,6 | 0,3 | | |
| 60 | Slovenia | AAMRD | 159,1 | 0,3 | | |
| 61 | France | FIRS | 153,9 | 0,3 | | |
| 62 | Spain | Navarra | 137,1 | 0,3 | | |
| 63 | Latvia | RSS | 136,6 | 0,3 | | |
| 64 | Spain | Murcia | 125,5 | 0,3 | | |
| 65 | Italy | ARBEA | 124,3 | 0,2 | × | × |
| 66 | France | ONIGC | 113,6 | 0,2 | × | |
| 67 | France | ONIVINS | 108,6 | 0,2 | | |
| 68 | Spain | Canarias | 99,0 | 0,2 | | |
| 69 | Italy | SAISA | 91,4 | 0,2 | | |
| 70 | Spain | Asturias | 85,2 | 0,2 | × | |
| 71 | Spain | País Vasco | 75,9 | 0,2 | | |
| 72 | Estonia | PRIA | 75,3 | 0,2 | | |
| 73 | France | ODEADOM | 74,8 | 0,1 | | |
| 74 | Netherlands | PT | 72,4 | 0,1 | | |
| 75 | France | ONIFLHOR | 68,6 | 0,1 | × | |
| 76 | Portugal | IFADAP | 68,4 | 0,1 | × | × |
| 77 | Spain | Madrid | 58,4 | 0,1 | | |
| 78 | Netherlands | PVE | 54,3 | 0,1 | | |
| 79 | France | ONILAIT | 52,1 | 0,1 | | |
| 80 | Cyprus | CAPO | 48,5 | 0,1 | | |
| 81 | Luxembourg | Min. Agric. | 46,9 | 0,1 | | |
| 82 | Spain | La Rioja | 45,9 | 0,1 | | |
| 83 | Spain | Cantabria | 44,2 | 0,1 | | |
| 84 | Netherlands | DLG | 44,0 | 0,1 | | |
| 85 | Austria | ZA Salzburg | 37,6 | 0,1 | | |
| 86 | Spain | Baleares | 34,4 | 0,1 | | |
| 87 | Germany | Saarland | 23,1 | 0,0 | | |
| 88 | United Kingdom | FC | 18,5 | 0,0 | | |
| 89 | Germany | Bayern, Umwelt | 16,6 | 0,0 | × | × |
| 90 | Italy | ENR | 15,6 | 0,0 | | |
| 91 | Malta | MRAE | 9,3 | 0,0 | | |
| 92 | France | OFIMER | 8,9 | 0,0 | | |
| 93 | Germany | Hamburg | 7,2 | 0,0 | | |
| 94 | United Kingdom | CCW | 5,3 | 0,0 | | |
| 95 | Germany | Nordrhein-Westfalen LfEJ | 5,1 | 0,0 | | |
| 96 | Germany | Bremen | 3,6 | 0,0 | | |
| 97 | Spain | FROM | 2,4 | 0,0 | | |
| 98 | Ireland | DCMNR | 0,6 | 0,0 | | |
| | | Subtotal | 16 033,4 | 32,0 | | |
| | | Total | 50 047,2 | 100,0 | | |

⁽¹⁾ Conformity corrections declared and amounting to – 64,8 million euro (Spain), – 152,1 million euro (Italy) and – 0,3 (Netherlands) are not included because they cannot be allocated to individual paying agencies.

⁽²⁾ This includes a qualified opinion, scope limitation or an emphasis of matter.

⁽³⁾ Accounts disjoined from the financial decisions where further work or information was requested from the certifying bodies.

⁽⁴⁾ Only accounts concerning expenditure in the field of rural development measures disjoined.

Source: Summary report of the Commission on the financial clearance of the EAGGF Guarantee Section accounts for 2006.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

5.4. In addition the Court has examined the systems put in place to implement the Single Payment Scheme (see paragraph 5.15) under which some 14 200 million euro was paid to beneficiaries in 2006 ⁽⁵⁾. It did not carry out any systems audit on the Single Area Payment Scheme (SAPS) (see paragraph 5.40) as it was too early to see improvements in the Member States previously audited. Nevertheless, the Court included these Member States in its direct testing of transactions.

5.5. Given concerns about the legality and regularity of payments in connection with schemes not directly covered by the IACS, the Court has carried out specific audits of olive oil production aid (including the reliability of the GIS) (see paragraph 5.82) and dried grapes (see paragraph 5.12).

SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

The Integrated Administration and Control System (IACS)

5.6. The IACS is the key management and control tool for the Single Payment Scheme (SPS) (see paragraph 5.15), the Single Area Payment Scheme (SAPS) (see paragraph 5.39) and all area aid and animal premium schemes. It covers almost 70 % of the Guarantee Fund budget.

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

⁽⁵⁾ Regulation (EC) No 1782/2003.

THE COURT'S OBSERVATIONS

5.8. The IACS inspection results reported to the Commission by paying agencies address the legality and regularity of payments to farmers but the Court considers that they should be verified and validated by an independent body. Errors that have occurred in the calculation of entitlements are not included in the IACS inspection results although they affect the legality and regularity of the payments made. However, the errors found as a result of inspections by the paying agencies are corrected before payment.

5.9. According to these statistics (see **Table 5.2** and **Graph 5.2**), for all Member States together, 28,9 % (40 % in previous year) of the area applications checked in 2005 and giving rise to payment in the financial year 2006 contained errors. These errors represent 1,4 % of the area verified by the paying agencies. For EU-15 this latter percentage decreased from 2,0 % in 2004 to 1,2 % in 2005. The decrease in the error rate is linked to the introduction of the SPS in 10 Member States of EU-15 ⁽⁶⁾, where the error rate has dropped to 0,7 %; in the other five the error rate is still 1,8 % and is the same in the new Member States.

5.10. In the 10 Member States that decoupled all or part of animal premiums the number of animals still subject to checking has gone down by between 35 % and 67 % depending on the aid scheme and the error rate has noticeably decreased. For the largest scheme, the suckler cow premium (see **Table 5.3** and **Graph 5.3**), Member States found 0,7 % of animals claimed to be missing or ineligible (1,56 % in 2004); for the special beef premium it was 1,23 % (2,53 % in 2004) and for the sheep and goat premiums it has fallen to 3,6 % from 6,3 % in 2004.

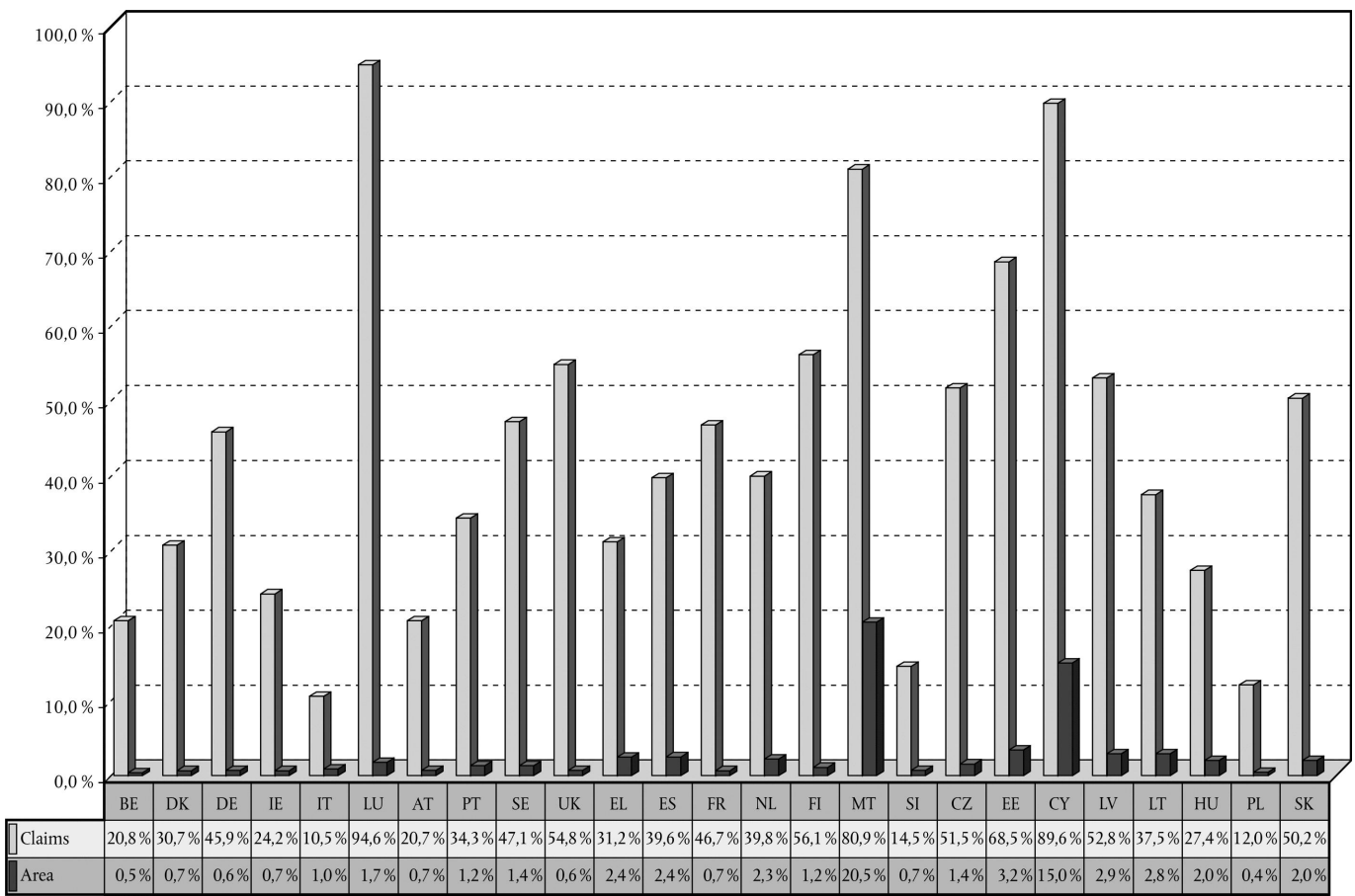
THE COMMISSION'S REPLIES

5.8. *In order to further improve the assurance that can be gained from the IACS inspection results with regard to the effectiveness of the control systems, the Commission has implemented the Court's recommendations that the certification bodies should do more work to verify and validate the inspection statistics and post-payment checks. From financial year 2007 onwards, the certification bodies will be required by the Commission's guidelines to analyse and report on the results of on-the-spot controls and the control statistics.*

5.9-5.10. *The Commission would like to emphasise this positive trend towards lower error rates in applications and over-declarations of areas and animals and considers this to be a very positive impact of the recent CAP reforms.*

⁽⁶⁾ Austria, Belgium, Denmark, Germany, Ireland, Italy, Luxembourg, Portugal, Sweden and the United Kingdom.

Graph 5.2 — Area aid — Results of field inspections: percentage of applications inspected which were overstated

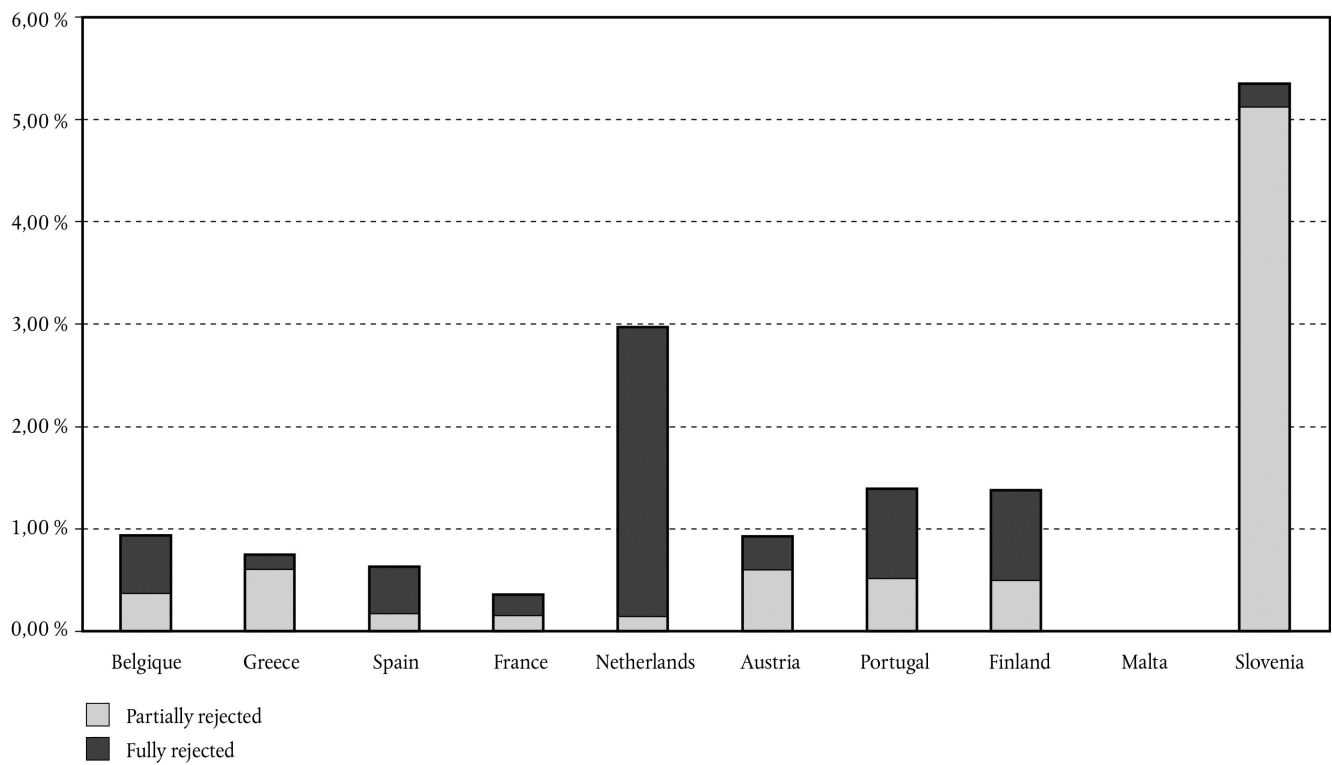


Source: IACS statistics submitted by Member States to DG AGRI and annual activity report 2006 DG AGRI.

Table 5.3 — IACS inspections for suckler cow premium — Results of on-the-spot checks in 2005 (payment year 2006)

| Member States | Total number of animals | | | Inspected animals partially rejected | | Inspected animals rejected | | Animals inspected (random selection) | | | | | | |
|---------------|-------------------------|------------------|-------------|--------------------------------------|--------------------|----------------------------|--------------------|--------------------------------------|----------------------|--------------------|--------------------|----------------------|------------|------------|
| | Claimed | Inspected | % | Number | % of total claimed | Number | % of total claimed | Number | % of total inspected | % of total claimed | Partially rejected | % partially rejected | Rejected | % rejected |
| Belgique | 397 513 | 35 506 | 8,9 | 126 | 0,4 | 317 | 0,9 | 5 071 | 14,3 | 1,3 | 35 | 0,7 | 36 | 0,7 |
| Greece | 210 982 | 92 332 | 43,8 | 557 | 0,6 | 688 | 0,7 | 4 080 | 4,4 | 1,9 | 27 | 0,7 | 29 | 0,7 |
| Spain | 1 775 937 | 302 457 | 17,0 | 471 | 0,2 | 1 825 | 0,6 | 45 712 | 15,1 | 2,6 | 70 | 0,2 | 90 | 0,2 |
| France | 4 232 508 | 445 155 | 10,5 | 665 | 0,1 | 1 565 | 0,4 | 73 247 | 16,5 | 1,7 | 84 | 0,1 | 280 | 0,4 |
| Netherlands | 72 344 | 12 047 | 16,7 | 17 | 0,1 | 358 | 3,0 | 2 310 | 19,2 | 3,2 | 3 | 0,1 | 43 | 1,9 |
| Austria | 550 638 | 56 238 | 10,2 | 336 | 0,6 | 517 | 0,9 | 8 462 | 15,0 | 1,5 | 32 | 0,4 | 35 | 0,4 |
| Portugal | 422 430 | 86 825 | 20,6 | 442 | 0,5 | 1 201 | 1,4 | 11 003 | 12,7 | 2,6 | 83 | 0,8 | 83 | 0,8 |
| Finland | 46 311 | 7 072 | 36,0 | 36 | 0,5 | 97 | 1,4 | 1 454 | 20,6 | 3,1 | 6 | 0,4 | 6 | 0,4 |
| Malta | 0 | 0 | 0,0 | 0 | 0,0 | 0 | 0,0 | 0 | 0,0 | 0,0 | 0 | 0,0 | 0 | 0,0 |
| Slovenia | 88 781 | 13 009 | 14,7 | 662 | 5,1 | 692 | 5,3 | 2 337 | 18,0 | 2,6 | 121 | 5,2 | 121 | 5,2 |
| EU-10 | 7 797 444 | 1 050 641 | 13,5 | 3 312 | 0,3 | 7 260 | 0,7 | 153 676 | 14,6 | 2,0 | 461 | 0,3 | 723 | 0,5 |

Sources: IACS statistics submitted by Member States to DG AGRI.
Annual Activity Report — DG AGRI.

Graph 5.3 — IACS inspections for suckler cow premium: percentage of controlled animals with errors

Source: IACS statistics submitted by Member States and Annual Activity Report 2006 DG AGRI.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The situation in Greece

5.11. For the fifth consecutive year the Director General's declaration contains a reservation concerning insufficient implementation of the IACS in Greece. For 2006 the Court has confirmed continuing failure to implement key controls, namely: claims handling, inspection procedures, animal database integrity and the Land Parcel Identification System. Some 850 million euro per year is paid to farmers under these unsatisfactory control conditions. For the period 1996-2005 the Commission has imposed corrections totalling 479 million euro, equivalent to some 6 % of the expenditure declared. Corrections have also been made for dried grapes.

5.12. The dried grapes aid scheme requires growers to produce a minimum quantity of dried grapes per hectare (i.e. they have to achieve a minimum yield). Nearly all the aid (about 115 million euro p.a.) is paid in Greece.

5.13. The Court's DAS audits in recent years as well as a specific audit in 2006 have established that since 1999 the Greek national authorities have incorrectly applied reductions in the minimum yield requirements for both sultanas and currants covering the great majority of the dried grapes area. Only in 2002/03, a year in which severe weather affected much of Greece, were these based on insurance agency assessments of the damage and were in accordance with the rules. In other years most of the reductions were decided by the national authorities, for reasons not linked to natural disasters (7). This has resulted in payments being made to growers who did not meet the minimum yield requirements (in particular for sultanas — some 50 % of total production) and who were not affected by a natural disaster.

5.11. *As regards financial year 2006 (claim year 2005), audits confirm the persistence of important deficiencies in the functioning of the key elements of the IACS in Greece such as the claims procedure, the quality of on-the-spot-controls, the quality of animal data bases and in particular the Land Parcel Identification System.*

In order to protect the financial interests of the Community, the Commission continues with an intensive audit programme and as long as necessary will impose financial corrections on Greece.

Moreover, the Commission closely monitors and supervises the Greek action plan that has been drawn up by the Greek authorities on the explicit request of and in close cooperation with the Commission in order to remedy the above deficiencies. The action plan contains strict deadlines for the implementation of the different actions which should produce their first results as of financial year 2007 (claim year 2006).

5.13. *The Commission conducted several missions on the dried grapes scheme in recent years in Greece and is aware of the developments described. For the most recent years the Greek authorities granted generalised derogations in the form of uniform reductions of mandatory production quantities for the whole of Greece, justifying them by referring to national disasters and, to a lesser degree, to other reasons.*

The Commission considers that this is not in compliance with Community legislation and as a result of its on-the-spot missions conformity procedures are underway.

(7) Reasons for refunds given in Ministerial decisions: 'poor soil conditions', 'the altitude of the parcels', 'the cultivation mode and mode for drying', 'the plant health status of the vineyards', 'the age of the vineyards leading to easy affection by viruses and soil fatigue', 'replantation were not done with the appropriate plants for the soil and weather conditions of the region', 'sultanas grown on plants affected by viruses due to the utilisation of non-certified plants during replantation'.

THE COURT'S OBSERVATIONS

5.14. The Commission has made flat-rate financial corrections for failures in key controls for the period 1997-2002 (40 million euro). Corrections have not yet been proposed for subsequent years and the Commission has not established the extent of ineligible payments, which for sultanas, may be significant.

The Single Payment Scheme (SPS)

What is it and how does it work?

5.15. Under the SPS farmers are not paid on the basis of what they produce or the number of animals they keep ⁽⁸⁾. Instead the following steps have to be taken to receive the aid in full:

- (a) application for entitlements for the first year (and in the same year application for payment (single application) accompanied by the declaration of eligible hectares);
- (b) once the entitlements are established, single application (every year) declaring all hectares and notably the SPS eligible hectares;
- (c) the farmer must keep his land in good agricultural and environmental condition (GAEC) and meet a number of specific environmental requirements (Cross Compliance).

5.16. In order to qualify under the SPS farmers must first obtain 'entitlements' ⁽⁹⁾. National authorities opt for one of the models provided for under EU legislation (see **Table 5.4**) and calculate the number and value of each farmer's entitlements. Under the historical model each farmer is granted entitlements based on the average amount of aid received and area farmed during the reference period 2000-2002. Under the regional model all entitlements of a region have the same flat-rate value and the farmer is allocated an entitlement for every eligible hectare declared in the first year of application. The hybrid model combines the historical element with a flat rate amount and, if it is dynamic, the historical component decreases each year until it becomes a predominantly flat rate-system.

⁽⁸⁾ The following aid schemes are included in the SPS: arable crops, beef and veal, sheepmeat and goatmeat, milk and milk products, grain legumes, dried fodder, rice, seeds, potato starch, cotton, olive oil, tobacco, hops and sugar beet.

⁽⁹⁾ Every entitlement, together with one hectare of land declared by the farmer and kept in good agricultural and environmental condition (GAEC), gives raise to an SPS payment.

THE COMMISSION'S REPLIES

5.14. *The conformity procedures are on-going in respect of the remaining years and, given its integration into the single payment scheme from 2008, the Commission intends to propose financial corrections in two 'packages' — one for the years not yet corrected (i.e. 2003 to 2005) and, as necessary, a second for the remaining period which will take especially into account that the derogations from the minimum yield requirement have apparently not been granted in conformity with Community law in the most recent years.*

5.16. *Under the SPS rules Member States have a significant discretionary margin to set up the system according to their specific needs and intentions. This goes for the basic choice of the model, whereby the regional model was conceived as an option to derogate from the historical model, and for the establishment of specific rules regarding the implementation of the model chosen.*

Table 5.4 — SPS models adopted by Member State audited

| Member State | Model applied | Beneficiaries of EU-direct payments claim year 2004 ⁽¹⁾ | | SPS Applications submitted 2005 ⁽²⁾ | | 2005 in % of 2004 (rounded) | |
|-----------------|----------------|--|------------------|--|--------------------------------|-----------------------------|---------------|
| | | Number | Area (1 000 ha) | Number ⁽³⁾ | Area (1 000 ha) ⁽⁴⁾ | Number (%) | Area (%) |
| Denmark | Hybrid dynamic | 52 420 | 2 329,00 | 69 474 | 2 734,00 | 132,53 | 117,00 |
| Germany | Hybrid dynamic | 330 640 | 14 050,00 | 386 237 | 16 825,00 | 116,81 | 119,00 |
| Luxembourg | Hybrid static | 1 970 | 122,00 | 2 006 | 123,00 | 101,83 | 101,00 |
| Sweden | Hybrid static | 59 440 | 2 763,00 | 84 454 | 3 171,00 | 142,08 | 115,00 |
| United Kingdom | | | | | | | |
| UK — England | Hybrid dynamic | 70 031 | 7 425,00 | 116 500 | 8 248,00 | 166,00 | 111,00 |
| UK — Scotland | Historic | 19 596 | 4 358,00 | 21 669 | 4 606,00 | 111,00 | 106,00 |
| UK — Wales | Historic | 16 821 | 1 301,00 | 18 364 | 1 439,00 | 109,00 | 111,00 |
| UK — N. Ireland | Hybrid static | 24 962 | 1 017,00 | 41 545 | 1 007,00 | 166,00 | 99,00 |
| | Total | 575 880 | 33 365,00 | 740 249 | 38 153,00 | 129,00 | 114,00 |

Source:

- (1) Figures for Denmark, Luxembourg, Germany and Sweden are figures submitted by the Member States under Commission Regulation (EC) No 296/96. The sector is currently analysing the United Kingdom figures in order to sort them by paying agency. Provisionally the figures for England, Scotland, Wales and Northern Ireland are taken from the IACS control statistics provided for in article 76 of Regulation (EC) No 796/2004.
- (2) Figures taken from the statistics transmitted under article 76 of Regulation (EC) No 796/2004.
- (3) A certain increase of the number of SPS claims compared to the number of beneficiaries of direct aid payments under the previous aid schemes is explained by the fact that certain categories of SPS beneficiaries (e. g. fruit-, vegetable- and warepatatoes producers, horskeepers) had exercised an agricultural activity before introduction of SPS but did not receive any EU direct aid.
- (4) A certain increase of the area covered SPS claims compared to the area declared under the previous direct aid schemes is explained by the fact that the areas used for agricultural production outside previous aid schemes are declared now under SPS and by the fact that under SPS the farmer is obliged to declare all the land at his disposal.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

5.17. Member States are to establish a national reserve ⁽¹⁰⁾ from which they allocate entitlements to new farmers, those in special situations or those affected by restructuring or development programmes.

The audit objectives

5.18. The Court has audited the systems for establishing entitlements in the 10 Member States ⁽¹¹⁾ which introduced the SPS in 2005 (payments in 2006, budgetary ceiling 15 088 million euro ⁽¹²⁾, 27 % of total agricultural expenditure) ⁽¹³⁾.

The objectives of the audit were to assess whether:

- (a) the national provisions adopted by the Member States comply with EU legislation and whether the entitlements have been correctly calculated;
- (b) the Member States have set up adequate administrative procedures and a reliable internal control for the correct, complete and accurate establishment and management of payment entitlements;
- (c) the Member States have implemented a reliable management and control system for processing SPS claims ⁽¹⁴⁾.

Calculating and allocating entitlements

5.19. Correct calculation and allocation of entitlements is a prerequisite for correct SPS payments. Incorrectly established entitlements will result in an over or under-payment in the first year and all subsequent years if not detected.

⁽¹⁰⁾ See article 42 of Regulation (EC) No 1782/2003.

⁽¹¹⁾ The calculation and allocation of entitlements was audited in: Austria, Belgium (Flanders), Denmark, Germany (Bavaria), Ireland, Italy (AGEA), Luxembourg, Portugal, Sweden, United Kingdom (England, Scotland and Northern Ireland).

⁽¹²⁾ See Annex V of Commission Regulation (EC) No 118/2005 (OJ L 24, 27.1.2005, p. 15).

⁽¹³⁾ The Court has not audited Cross Compliance — the farmer's respect of the various standards covering environmental, public, plant and animal health, etc.

⁽¹⁴⁾ This aspect was audited in Austria, Belgium (Wallonia), Denmark, Germany (Brandenburg), Ireland, Italy and the United Kingdom (Wales).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Non compliance with the rules

The ten months rule

5.20. Community legislation requires that land declared for SPS must be at the claimants' disposal for a minimum period of 10 months each year. Contrary to this, in the United Kingdom entitlements were allocated under SPS and aid was paid to landlords, not engaged in farming, who let out their land for most of the year and who do not therefore meet the requirement. In Northern Ireland, for example, more than 176 000 entitlements (worth 13,8 million euro) were allocated to such landlords ⁽¹⁵⁾.

5.21. The United Kingdom authorities consider that, depending on the terms of the letting agreement, landlords may qualify for SPS and/or rural development aid for land let to and farmed by the lessee. According to EU law however, only the farmer, i.e. the person disposing of the land and exercising an agricultural activity on the land is entitled to SPS payments and rural development aid.

5.20. *The general concept of de-coupling should be taken into account.*

Article 33 of Regulation (EC) No 1782/2003 establishes that only farmers as defined in Article 2 a of that regulation may have access to the Single Payment Scheme.

Under the regional model, adopted as a derogation to the historical model at the request of several Member States, it is allowed to pay on the basis of the whole agricultural area declared the first year of application; this extension concerned mainly grassland and fruits and vegetables. Indeed this model implies that new beneficiaries, which beforehand did not receive direct support, became eligible, if inter alia the area is at their disposal, if the GAEC is applied and if they exert on it an agricultural activity pursuant to the definition of Article 2 of Regulation (EC) No 1782/2003. This can include landlords but only if they are engaged in agricultural activity.

Indeed the claimant needs to have the land declared for a minimum of 10 months at his disposal. If in the cases the Court describes, land is less than 10 months at the landlord's disposal, it is not eligible. The Commission will take action through conformity procedures.

5.21. *The Commission shares the Court's interpretation of the relevant EU law.*

One eligibility condition is to exercise an agricultural activity.

The Member States have to identify who is considered as active farmers (having the right for entitlements). If the landlord bears the economic risk of the farming activity, it is not excluded to consider him 'exercising an agricultural activity'.

⁽¹⁵⁾ The value of entitlements allocated to landlords will substantially increase over time (see paragraph 5.28).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Consolidation of entitlements

5.22. EU legislation provides for the establishment of reference amounts for farmers in areas subject to restructuring and/or development programmes relating to public intervention in order to avoid the abandonment of land and/or to compensate for specific disadvantages for farmers in those areas. Where a farmer has lost land in this way and is no longer able to activate all of his entitlements, they may be consolidated, i.e. exchanged for a smaller number with a higher value.

5.23. Some Member States/countries (Austria, Ireland, Wales and Scotland) did not comply with EU legislation. They extended this provision to all cases ⁽¹⁶⁾ where a farmer in 2005 had fewer hectares than entitlements. Consolidation was granted in order to have the farmer's reference amount concentrated on a number of entitlements equal to the number of hectares held, and consequently to allow the farmer to activate all his entitlements. Wales and Scotland applied this irregular type of consolidation only in the first year of SPS whereas it continues in Austria and Ireland. In 2005, more than 200 000 hectares were consolidated in this way. The impact is estimated at 60 million euro per year ⁽¹⁷⁾.

5.24. In Northern Ireland and England, which apply the hybrid model, a consolidation effect arose when contrary to Community provisions ⁽¹⁸⁾ farmers were allowed to restrict allocation of entitlements to part of the eligible area declared in their 2005 claim. This enabled farmers to have their historical reference amount spread over fewer hectares, i.e. they were allocated fewer entitlements with higher values, and allowed landlords to claim entitlements in their own name for land let to farmers.

5.23. *The practice described by the Court has already been identified by the Commission and is being followed up through conformity procedures.*

5.24. *This issue will be followed up through conformity procedures.*

⁽¹⁶⁾ Especially cases where rental agreements were not renewed.

⁽¹⁷⁾ The Court estimated the financial impact using the average value of entitlements in the Member States concerned.

⁽¹⁸⁾ Article 59(4) of Regulation (EC) No 1782/2003 provides that under the regional model the number of entitlements per farmer shall be equal to the number of hectares he declares [...] the first year of application of the single payment scheme.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

New beneficiaries

5.25. EU legislation ⁽¹⁹⁾ gives access to the SPS to a farmer, defined as a natural or legal person, whose holding is located within the Community and who exercises an agricultural activity — the production, rearing of animals or growing of agricultural products or maintaining the land in good agricultural and environmental condition (GAEC).

5.26. Although claimants may qualify for the SPS merely by maintaining their land in GAEC, the admission conditions were not applied uniformly throughout the Community. For example, Luxembourg restricted the allocation of entitlements to applicants who actually operate an agricultural holding with all the machinery and equipment necessary for independent management. All other Member States applying the regional or hybrid model accepted claims from landowners who undertook to keep their land, or have it kept, in GAEC, even if they did not have any agricultural machinery or equipment.

5.27. **Table 5.4** shows that the number of direct aid beneficiaries has increased significantly. Especially under the regional model, where all grassland and land used for fruit and vegetables became eligible, the SPS has led to a substantial increase in the number of hectares in respect of which direct aid is paid and beneficiaries. The Court has also noted among them railway companies (England), horse riding/breeding clubs (Germany and Sweden) and golf/leisure clubs and city councils (Denmark and England).

Side-effects of the SPS

5.28. Entitlements allocated to landlords, not engaged in farming, are, under the hybrid model, solely based on the flat-rate regional element of SPS. Under the dynamic version of the model, whilst the value of such entitlements starts low, by the end of the dynamic phase these entitlements will have a much higher value: all entitlements will end up with the same value. There will be a significant redistribution effect on EU direct aid away from those actually farming and towards landowners, who will see the value of their entitlements multiplied by four in Denmark and Germany and tenfold in England. In England, the flat-rate element of entitlements was worth 28,20 euro per hectare in 2005, whereas all entitlements will have a face value of some 280 euro per hectare in 2012 ⁽²⁰⁾.

⁽¹⁹⁾ See Article 33(1) and Article 2(a) and (c) of Regulation (EC) No 1782/2003.

⁽²⁰⁾ For severely disadvantaged areas land the figures are 25,59 euro and some 230 euro; for moorland they are 3,36 euro and some 30 euro.

5.26. *Applying the principle of subsidiarity, the concrete implementation of GAEC is Member States' competence. Hence, no uniform implementation exists across the EU. Luxembourg has chosen stricter rules that it deemed suitable but those are not compulsory for the other Member States. The Commission does not oppose such a solution.*

5.27. *The criteria for allocating entitlements had to be met by the beneficiary. To activate subsequently an entitlement he must have eligible agricultural land at his disposal and exert thereon an agricultural activity. If a natural or legal person meets all eligibility conditions for the land at its disposal and declared, it is eligible. Golf courses as such are not eligible. Similarly, it is clear that e.g. the area used to play golf or for other leisure activities is excluded, and that only areas used for agricultural activity are eligible. The Commission is following up the cases identified by the Court.*

5.28. *See also the Commission's reply to paragraph 5.20 as to the concept of the regional model and its importance for conservation purposes.*

First of all, the choice of the model is up to the Member State. The model described here entails also a redistribution effect since, with a view to a flat rate payment for all eligible agricultural area, 1. the coverage is extended to those area that previously did not receive aid, 2. some of the individual historical rights (varying among beneficiaries and per hectare) are added and equally distributed on the (extended) area.

A legal or natural person who met the eligibility condition was entitled to receive the single payment.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Redistribution effect

5.29. Member States may apply the so-called windfall profit clause ⁽²¹⁾ whereby a farmer who had sold or leased for six years or more all or part of his holding after the reference period has the number of entitlements due to him on the basis of his aid during the reference period ⁽²²⁾ reduced by up to 90 %. These deductions are credited to the national reserve. Only Belgium, Denmark, Italy, Luxembourg and Sweden chose to apply this clause ⁽²³⁾. In the other Member States, farmers are allowed to keep all of their windfall entitlements. Windfall profits have not only increased the contribution rate borne by all farmers to the national reserve but also led to unequal treatment of farmers in the EU.

5.30. The Court has found that the allocations made under the new farmer and investment schemes created substantial abnormal profits which fall within and outside the scope of the windfall profit clause.

5.31. EU legislation ⁽²⁴⁾ allows Member States to allocate reference amounts from the national reserve to new farmers ⁽²⁵⁾ who started their agricultural activity after the reference period. In Scotland several new farmers were given entitlements where the applicant did not meet the criteria of the new farmer scheme ⁽²⁶⁾. In one case farmer A took over a holding in May 2004 for which the former farmer B had been allocated 602 entitlements worth 287 000 euro in 2005. Farmer A successfully applied

5.29. *Member States have indeed the choice to revert under certain conditions entitlements to the national reserve. Four Member States made use of this option, while others did not.*

Where this option has been selected, certain conditions need to be applied (see Article 42(9) of Regulation (EC) No 1782/2003 and Article 10 of Regulation (EC) No 795/2004). The windfall profit clause is optional for Member States. Windfall profit situations have often been substantially reduced by private contract clauses, because it is impossible for the sellers to activate an entitlement without land.

5.31. *As it is described, farmer A did not qualify as a new farmer and therefore the allocation from the national reserve needs to be verified.*

The described practice is being followed up through conformity procedures.

⁽²¹⁾ Article 42(9) of Council Regulation (EC) No 1782/2003 and Article 10 of Commission Regulation (EC) No 795/2004 (OJ L 141, 30.4.2004, p. 1).

⁽²²⁾ The windfall profit clause only applies to transfers prior to 15 May 2004. Transfers after that date and transfers free of charge fall outside its scope.

⁽²³⁾ Spain and France applied this clause in 2006.

⁽²⁴⁾ Article 42(3) of Regulation (EC) No 1782/2003.

⁽²⁵⁾ See the farmer definition in paragraph 5.26.

⁽²⁶⁾ See article 2(k) of Regulation (EC) No 795/2004 which provides that a new farmer may not have exercised any agricultural activity in his own name and at his own risk or must not have had the control of a legal person exercising an agricultural activity in the five years preceding the start of the new agricultural activity.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

under the new farmer scheme of the national reserve and received his entitlements worth 111 000 euro for which he was fully paid in 2005. Farmer B declared 410 ⁽²⁷⁾ of his 602 entitlements with 410 hectares of rough grazing land rented more than 300 kilometers away in the Scottish Highlands ⁽²⁸⁾ and on which he kept 85 sheep. For this new agricultural activity he was paid 182 000 euro in 2005. Farmers A and B were both legal entities that had jointly operated the holding in question until March 2004.

5.32. A simple transfer of a holding between family members during or after the reference period was sufficient to increase the number and values of entitlements allocated for the holding. In Ireland a farmer who stopped farming in 2002 leased his holding to his son. The father was allocated entitlements worth 38 000 euro on the basis of premia paid in 2000 and 2001. His son was approved as a new farmer and allocated entitlements worth 87 000 euro on the basis of premiums paid in 2002. In 2005 the father transferred his land and his entitlements free of charge to his son who ended up owning entitlements worth 125 000 euro. If the transfer had not occurred the holding would have been allocated entitlements worth 67 800 euro.

Increased entitlements due to investments

5.33. Entitlements from the national reserve may be allocated to farmers who made investments in production capacity or purchased land. In Scotland, the allocation for investment was disproportionate to the investment made. For example, one farmer had invested in 1 802 hectares of land located in a severely disadvantaged area, but the investment allocation was calculated on the basis of the much higher regional average value for the other land. He received entitlements worth 417 966 euro. In Northern Ireland, a farmer was allocated entitlements worth 109 000 euro. After the reference period he transferred more than 600 cattle to the holding of a family member who was allocated 140 000 euro for the same animals under the investment scheme.

5.32. *If a transfer occurred within the reference period the same piece of land will generate two entitlements. The situation results from the incompleteness of the reference period (2000-2002) for father and son, during which both could constitute rights for entitlements on the same area.*

The described practice is being followed up through conformity procedures.

5.33. *Member States have a margin of appreciation when implementing the investment clause for the allocation of entitlements. However, the allocation of payment entitlement has to be based on objective criteria and should ensure equal treatment among farmers.*

The described practice is being followed up through conformity procedures.

⁽²⁷⁾ 192 entitlements worth 115 000 euro have been transferred under the provisions of article 17 of Regulation (EC) No 795/2004 to farmer A's daughter and two other farmers in respect of land sold to them in 2003. These entitlements were transferred without applying the windfall profit clause.

⁽²⁸⁾ The lessor of the land was a sheep keeper who owned more than 11 700 hectares of rough grazing land for which he was allocated comparatively low value entitlements of 20 euro each. In total he had leased more than 3 000 hectares to farmers in similar situations as farmer B.

THE COURT'S OBSERVATIONS

5.34. By mid 2003, the features of the reform, including the existence of a scheme providing for allocations for investors, had become public knowledge. In the United Kingdom a 10 % increase in income was considered sufficient evidence of an investment. Paradoxically by increasing the number of cattle slaughtered during 2002 (i.e. destocking) farmers could meet this investment criterion. Consequently there was a general run on cattle premiums. For example, in Northern Ireland the number of animals claimed under the beef special premium and the slaughter premium schemes was more than 20 % higher in 2004 than the average for 2000-2002. As a consequence more than 82 % (10,5 million euro) of the allocations from the national reserve were made to investors. The same phenomenon was observed in Scotland and England (85 % (34,4 million euro) and 78 % (94 million euro) respectively). This run on premiums and the non-application of the windfall profit clause explain why the contribution rate to the national reserve was in excess of 3 %.

The activation of entitlements and payments

Reasonable overall quality of the management and control system

5.35. In 2005 the management and control systems applied by the Member States for processing farmers' claims were affected by three major changes: the introduction of a compulsory Geographical Information System (GIS), a new system for the identification and registration of payment entitlements, and the introduction of obligatory Cross Compliance checks. The Court's audit covered the first two elements. For detailed observations and the overall evaluation, see **Annex 5.2**.

5.36. In Scotland the system for identification and registration of payment entitlements is incomplete since it does not correctly record transfers of entitlements or monitor minimum activation obligations ⁽²⁹⁾. In several Member States the payment calculation was incorrect in cases where the area established after control was not enough to activate all entitlements declared by the farmer.

THE COMMISSION'S REPLIES

5.34. *Member States have a margin of appreciation how to implement the investment clause. However, the described interpretation of 'investment' is not covered by the corresponding Community legislation.*

Indeed, the EU legislation refers to increasing production capacity and purchasing land, an increase in income, in some cases (as described) may not necessarily reflect an increase of the production capacity.

See also the Commission's reply to paragraph 5.29 on the non-application of the windfall profit clause.

The case is followed up through conformity procedures.

5.36. *The Commission will follow up these alleged shortcomings through conformity procedures.*

⁽²⁹⁾ A standard entitlement must be activated at least once every three years and National Reserve entitlements must be activated every year for the first five years.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Long delays in establishing entitlements and making payments

5.37. In all Member States visited (except Portugal and Belgium) definitive entitlements were allocated wholly or partly after the legal deadline of 31 December 2005 (more than 8,3 billion euro in value terms). Some Member States were consequently unable to pay all farmers by the 30 June 2006 deadline. This was a particular problem in England.

5.37. Generally, the late establishment did not lead to a delay in SPS payments to the farmers. In case of non-respect the rules as set out in Regulation (EC) No 883/2006, in particular its Article 9, will be applied. Reductions due to late payments in 2006 will be applied only in England.

Overpayments

5.38. The Court's audit at final beneficiary level revealed 13 cases out of 54 (24 %) randomly selected payments tested where an incorrect area and/or ineligible areas had been taken into account for the calculation of the number of entitlements. The differences in area ranged from 0,35 % to 6,92 % but the total financial impact is limited. Nevertheless it should be noted that even very small errors can have a significant impact on future payments under the dynamic model (see paragraph 5.28).

5.38. The Court itself accepts that the design and implementation of the Single Payment Scheme limits the risk of irregular payments (see paragraph 5.66).

The Single Area Payments Scheme (SAPS)

5.39. The main difference between SAPS and SPS is that under the former 'entitlements' are not established. A uniform amount is paid for each hectare of eligible land. In due course the eight Member States that apply SAPS ⁽³⁰⁾ will be required to adopt SPS.

5.40. For 2006 the SAPS coverage was completed by visiting the remaining three New Member States that apply the scheme (Estonia, Cyprus and Latvia) ⁽³¹⁾ and three Member States for a second time (Lithuania, Hungary and Poland). In total 24 payments were tested at final beneficiary level.

⁽³⁰⁾ Cyprus, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia.

⁽³¹⁾ The other five Member States were audited the previous year. See the Annual Report concerning the financial year 2005, paragraphs 5.12 to 5.20.

THE COURT'S OBSERVATIONS

5.41. In Estonia the four beneficiaries audited had been paid for a larger area than was measured on the spot (average 4,6 %) and the Estonian authorities were unable to substantiate the figure for the calculation of the reduction coefficient they applied (3,51 %) ⁽³²⁾. In Cyprus, there are continuing weaknesses in the land registry system (it dates from 1926 and the changes to the natural borders of fields that have taken place since then are not reflected in it) which explains the two relatively large differences in area found (7,26 % and 18,7 %). In Hungary the reduction coefficient was wrongly calculated, leading to a systematic overpayment of 1,62 %.

Rural development

Guarantee expenditure

5.42. EAGGF-Guarantee expenditure for rural development amounted to 5 623 million euro in 2006 ⁽³³⁾. This covers spending on a large number of measures such as agri-environmental schemes, compensatory amounts for farming in less-favoured areas, investments in farms, and infrastructure in rural areas.

5.43. The Court's audit covered the administrative and control procedures and the audit of 25 payments at final beneficiary level in eight Member States.

5.44. The Court's audit found a high incidence of errors, by both nature and amount for the agri-environmental schemes. Payments under these schemes are dependent on respecting (often complex) conditions, such as observance of good farming practices. The Court found in seven out of eight cases audited that farmers had not met their commitments or that some conditions had not been effectively checked by the authorities.

⁽³²⁾ If the total aid payable exceeds the national SAPS envelope the aid must be reduced proportionally.

⁽³³⁾ A further 3 810 million euro was spent on rural development under the EAGGF-Guidance Fund (see chapter 6).

THE COMMISSION'S REPLIES

5.41. *As regards Estonia, the Commission has carried out an audit of the IACS in 2005 which did not reveal major deficiencies.*

The Court's findings are in line with the rate of error reported by Estonia to the Commission.

As regards Cyprus, the Commission shares the concerns of the Court. The deficiencies are being followed up through the conformity procedure. After the audit in 2005, an additional audit of the IACS in Cyprus is scheduled for the second half of 2007. Moreover, having regard to the nature of the deficiencies, the Commission requested the Cypriot authorities to take immediate action in order to remedy these deficiencies.

As regards Hungary, the Commission will examine the Court's findings in the light of the reply from Hungary and, if necessary, follow them up through conformity procedures.

5.44. *The Commission considers that the high incidence of errors in agri-environmental measures found by the Court is not representative for the total of rural development expenditure.*

As regards agri-environmental measures, the Commission considers that their control is rather complex, but the objective of these measures to integrate environmental concerns in agriculture and their added value is widely recognised.

With regard to the seven out of eight cases mentioned by the Court, the non-respect of the agri-environmental commitments was in many cases either partial or it had a limited impact.

The Commission has established a comprehensive programme to audit the national management and control systems for agri-environmental measures.

THE COURT'S OBSERVATIONS

5.45. The Court could not express an opinion in two cases because there was insufficient evidence to support the payment to the beneficiaries. It was not possible in one case to verify the reality of the investment and in the other to establish the link between the expenditure declared (interest rate subsidy on loans) and the financial benefit for the farmers.

Transitional Rural Development Instrument (TRDI)

5.46. Support for rural development in the EU-10 for the period 2004-2006 is made available under the 'transitional rural development instrument', against which an amount of 2 116 million euro was paid in 2006. The Court carried out system audits in two Member States: Latvia and Hungary. No problems were found in Latvia.

5.47. In Hungary for the financially most important measure, agri-environment (72,6 million euro), the audit found shortcomings in the control and management system. For example: on-the-spot checks were not performed throughout the year in 2005, but after the main harvest, (as a consequence many conditions were not verified at all); parcels could not always be reliably and individually identified; the condition of maximum livestocking density was not checked as part of IACS cross-checks (with animal databases).

Ex post scrutiny of payments to traders and processors

5.48. Member States are required to carry out annual programmes of post-payment checks of commercial documentation for export refunds, processing and transformation subsidies and some rural development expenditure. Member States must satisfy themselves that transactions have taken place and been executed correctly, and must take steps to recover sums lost as a result of irregularity or negligence. These checks are carried out under Regulation (EEC) No 4045/89.

5.49. The Commission plays a supervisory and coordination role by ensuring that Member States' risk analysis and control programmes are appropriate. This includes an analysis of the relevant reports and other documents provided by Member States and may entail visits to Member States in order to check the implementation of the regulations.

THE COMMISSION'S REPLIES

5.45. The Commission will follow up these cases through conformity procedures.

5.47. The Commission has identified similar weaknesses in the course of its audits in Hungary. The impact of the detected weaknesses has been analyzed during the conformity procedure, and in cases where a risk for the Fund has been established, financial corrections are being applied.

THE COURT'S OBSERVATIONS

5.50. In 2006, the Commission carried out specific missions to eight Member States. 35 conformity audits ⁽³⁴⁾ included a review of at least one post-payment check as part of the work carried out. The Commission also introduced at the end of December 2006 for certain measures, new, harmonised methods for examining aspects of the regulation in the context of conformity audits ⁽³⁵⁾. This should be extended to all measures involved in order to ensure standardisation of approach and coverage. In 2006, no audits covering aspects of the regulation were carried out by the unit responsible for rural development conformity audits although it represents 16 % of potential irregularities reported by Member States. In the other areas, both horizontal and conformity audits were carried out.

5.51. Despite the fact that the Regulation (EC) No 40/2006 introduced the obligation to report on expenditure actually checked, not all Member States were in a position to provide this information in 2006. The position in respect of checks on secondary purchasers of milk, public storage and multi-annual rural development projects and what constitutes a finished check is still differently interpreted and applied in the Member States.

5.52. In its Annual Report concerning the financial year 2005 the Court criticised the Commission for not being in a position to measure the success of checks in terms of detecting and recovering irregular payments. At the end of November 2006 the Commission sought information from Member States on recovery but with limited success — six Member States have responded to date. The Commission therefore still does not know how many of the potential irregularities initially reported under Regulation (EEC) No 4045/89 resulted in recovery or why they did not.

THE COMMISSION'S REPLIES

5.50. *In 2006 the rural development unit mainly carried out audits of measures not covered by the regulation such as agri-environment. However, the horizontally responsible unit examined 21 rural development controls representing 19 % of all the controls reviewed by the unit. Rural development represents 8 % of expenditure under the regulation.*

5.51. *The Commission is aware of these differences in the control practice of the Member States but these differences are not in violation of their obligations under the regulation.*

5.52. *The success of Regulation (EEC) No 4045/89 depends on and is measured by the number and value of potential irregularities found by the ex-post controllers. The Commission has provided the Court with exact data in this respect.*

The Commission expects to know by the end of the year for all the Member States concerned how many irregular payments have been recovered.

The follow-up given to the irregularities detected is systematically reviewed during the Commission's missions to the Member States. For the cases forming part of the sample of controls selected in 2006 the actions taken and justifications given were found generally to be acceptable.

Moreover, under the Commission's new guidelines, certification bodies are required from financial year 2007 onwards to verify that paying agencies follow-up properly all potential irregularities revealed in the course of application of Regulation (EEC) No 4045/89.

⁽³⁴⁾ To: Austria, Denmark, France, Germany, Ireland, Italy, the Netherlands and the United Kingdom.

⁽³⁵⁾ See paragraph 5.38(b) of the Annual Report concerning the financial year 2005.

THE COURT'S OBSERVATIONS

5.53. Backlogs in the completion of post-payment checks for 2004/2005 and earlier persist in Germany (Niedersachsen), Italy (Ministero Politiche Agricole) and Spain (Andalucia) at the time of submission of annual reports by Member States as per 1 January 2007.

Export refunds

5.54. Export refunds paid to exporters of EU agricultural products cover the difference between EU internal and world market prices, and allow surplus production to be disposed of on world markets. In 2006 refunds amounted to 2 493 million euro. Member States are required to physically check 5 % of exports to ensure that they are correctly described and entitled to the export refund claimed. They also have to carry out checks at the point of exit from the EU where this is different from the place at which the goods were presented for a physical check (substitution checks) ⁽³⁶⁾. The Commission monitors the quality and number of these checks.

5.55. Member States are obliged to provide the Commission with data regarding expenditure and information on the EAGGF-Guarantee Section for the purpose of the clearance of accounts as well for monitoring and forecasting ⁽³⁷⁾. An analysis carried out by the Court on this data for 2004/05 shows that the information provided in respect of physical and substitution checks is not reliable. It was further noted that Greece has not submitted any data in this respect. In relation to the Netherlands, it was found that the definition of 'physical checks' applied by one paying agency included documentary checks, leading to a significant overstatement of the number of checks recorded.

THE COMMISSION'S REPLIES

5.53. *The backlog of Ministero Politiche Agricole and of Niedersachsen is limited in financial importance. Moreover, it is regularly reduced. The Commission is closely monitoring the progress made.*

The Commission's mission to Spain from 11 to 15 June 2007 showed that the 2004/2005 and earlier backlog in Andalucia has been fully resolved.

5.54. *The Commission's monitoring of the checks includes on-the-spot audit and systematic collation and review of annual statistics supplied by Member States, which show a low level of irregularity.*

5.55. *Regulation (EC) No 2390/1999 concerns accounting data whose primary purpose is to provide details of individual transactions underlying Member State expenditure, but also captures other information known about a transaction at the time of entry in the accounts. The Commission is aware that, for this reason, the information is sometimes incomplete. Nonetheless, the data is useful for analytical and audit purposes but it is not used for monitoring physical control levels.*

Of much greater importance for this purpose are the detailed statistics which the Commission receives annually, which are checked systematically in-office and during on-the-spot audits and which are considered to be a very reliable monitoring tool.

The question of missing cells in the payment data was already raised with Greece by letter of 19 October 2005 and Greece did include this information in the 2005/2006 data.

Regarding the Netherlands, the Commission awaits the Member State's reply.

⁽³⁶⁾ Regulation (EEC) No 386/90.

⁽³⁷⁾ Commission Regulation (EC) No 2390/1999 (OJ L 295, 16.11.1999, p. 1).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The Commission's clearance of accounts

5.56. Management of expenditure on agriculture is, in the main, shared between Member States and the Commission. Aid is paid by the Member States, who are then reimbursed by the Commission. These reimbursements are considered as advances until the Commission 'clears' the accounts. The current two-stage clearance system used for this purpose includes an annual financial decision and multi-annual conformity decisions taken by the Commission.

Financial clearance

5.57. In the financial decisions for 2006 ⁽³⁸⁾ the Commission 'cleared' the accounts of 91 of the 98 paying agencies (see **Table 5.1**). The decisions are based on certificates of independent auditors (certifying bodies), which are limited to completeness, accuracy and the veracity of the paying agencies accounts. Checks on the legality and regularity of underlying payments ('conformity issues') are not explicitly stated in the Regulations and the Commission does not require the certifying bodies to perform them. Hence their certificates cannot be relied upon to provide such assurance.

5.58. Certifying bodies had to audit the single payment scheme for the first time in 2006. The Commission did not specify the scope and depth of the work for this task. The Italian certifying bodies, for example, excluded verification of entitlements from their work and mentioned this in their certificates. The Commission accepted this without comment.

5.57. According to the relevant legislation, the certificate drawn up by the certification body states whether it has gained reasonable assurance that the accounts transmitted to the Commission are true, complete and accurate. The certificate is based, *inter alia*, on an examination of procedures covering the paying agency's administrative structure as regards the question whether the structure is capable of ensuring that compliance with Community rules is checked before payments are made. The certificate forms part of the comprehensive system for the management and control of CAP expenditure and as such contributes to the assurance on the legality and regularity of the underlying transactions. Moreover, from financial year 2007 onwards, the certification bodies are also expected to provide an opinion on the effectiveness of internal control systems, *i.e.* whether the control system put in place by the paying agency provides reasonable assurance as to the legality and regularity of underlying transactions.

5.58. Certification bodies are requested to satisfy themselves that the paying agency's procedures for the verification of entitlements operate effectively. In contrast, they are not required to directly verify the accuracy of each beneficiary's entitlements in the sense of checking the legality and regularity of the underlying payment for each beneficiary in the sample. In 2006, all the certification bodies complied with this requirement by auditing the paying agencies' procedures for the verification of the SPS entitlements.

The scope and the depth of the work on the Single Payment Scheme has been specified in the Commission's new guideline on the model report which is applicable from financial year 2007 onwards.

⁽³⁸⁾ The Commission made a separate decision for rural development expenditure in the new Member States. This is to better reflect the financial management in this field.

THE COURT'S OBSERVATIONS

5.59. The Commission mainly places reliance on a desk review of the certifying bodies' certificates and reports. The Court found that the short time available and the number of languages involved limit the scope and depth of the Commission's review⁽³⁹⁾. For 7 of the 30 certificates and reports reviewed by the Court⁽⁴⁰⁾, the information available did not allow the Court to draw a conclusion as to the existence, or not, of material errors in the paying agencies' accounts.

5.60. The Court visited seven certifying bodies to review their work⁽⁴¹⁾. The main weaknesses found related to the scope and depth of the detailed testing, the work of delegated bodies, including on the spot controls and the check of completeness of debtors' accounts. These weaknesses should be resolved in order to provide a greater level of assurance which can be gained from the work of the certification bodies. In 2006 the Commission services made visits to the certifying bodies of four other paying agencies⁽⁴²⁾. Its overall conclusion was limited to the statement that 'the audit methodology of the certifying body appears to provide sufficient assurance for the clearance decision'.

5.61. The Commission has introduced a new recovery procedure⁽⁴³⁾ which includes tables for the presentation of the debtors' accounts but final guidelines on the completion of these tables were only provided in November 2006. The Court's work in relation to the reliability of the debtors' accounts questions the completeness of these tables: limitations of the opinions in the certificates and major findings in the reports, limited work done by some of the certifying bodies and insufficient information in some of their reports. Furthermore, the Commission's reconciliation of these tables resulted in some changes to tables that had already been certified as correct.

⁽³⁹⁾ Reports and certificates have to be transmitted to the Commission by 10 February and the decision is to be taken by 30 April.

⁽⁴⁰⁾ 30 paying agencies were included in the DAS population. For a further 15 paying agencies, where the certificate had been modified, the grounds for this were examined.

⁽⁴¹⁾ DAF-Ireland, AGEA and AGREA-Italy, BIRB-Belgium, FAGA-Spain, ONIC-France and OPEKEPE-Greece.

⁽⁴²⁾ ARBEA-Italy, IFADAP-Portugal, Ministère de l'Agriculture-Luxembourg and MVH-Hungary.

⁽⁴³⁾ Council Regulation (EC) No 1290/2005 (OJ L 209, 11.8.2005, p. 1) and Commission Regulation (EC) No 885/2006 (OJ L 171, 23.6.2006, p. 90).

THE COMMISSION'S REPLIES

5.59. *The Commission carries out the audit work necessary to gain reasonable assurance whether (based on the information presented) the paying agencies' accounts are true, complete and accurate, i.e. that they are free from material misstatement. Disjunctions arise when it is unable to conclude positively. This is a distinct and separate mechanism from conformity exercises, which aim to exclude expenditure from Community financing which has not been incurred in accordance with Community rules.*

The Commission was able to satisfy itself that there was not a material error in the total expenditure of the accounts it cleared. This includes the 7 accounts referred to by the Court.

5.60. *As to the scope and depth of the certification bodies' work, the applicable legislation requires these bodies to examine the paying agency's administrative structure only as regards the question whether that structure is capable of ensuring that compliance with Community rules is checked before payments are made. This is sufficient for the purpose of the financial clearance and should not be considered as a weakness.*

The Commission's audit missions carried out in 2006 confirm (via an assessment of the methodology used and the testing performed) that the certification bodies' reports and certificates are fundamentally reliable, although there is scope for improvement in some areas. The issues cited are all given due prominence in the Commission's new guideline on the model report. The certification bodies will be expected to cover these issues in greater depth and present their findings more clearly.

5.61. *The tables⁽¹⁾ referred to by the Court are designed to provide the Commission with the necessary information for applying the new clearance mechanism for irregularity cases provided for in Articles 32 and 33 of Council Regulation (EC) No 1290/2005. There is a clear link between these tables and the paying agencies' debtors' ledger, and the Commission's new guideline on the model report for the certification bodies applicable from 2007 requires the latter to reconcile the debtor's ledger with the tables and to provide explanations to any discrepancies found.*

The tables form part of the paying agencies' annual accounts and, as such, are certified by the certification bodies. Moreover, the Commission devoted a considerable amount of work into gaining reasonable assurance that reported debt was fairly categorised and stated. The balances at 15 October 2006 were assessed and the closing balances of the old table 105 were reconciled with the opening balances of the new tables of Annex III as of mid-October 2005. Where the reconciliation could not be carried out successfully and the amounts were significant, thus, no reasonable assurance could be gained, such as in the case of AGEA in Italy, the accounts were disjoined.

A detailed follow-up will be carried out by the Commission in the course of 2007 with a view to ensuring that the debts are properly reported in the tables of Annex III.

⁽¹⁾ See Annex III to Commission Regulation (EC) No 885/2006.

THE COURT'S OBSERVATIONS

5.62. The decision on the amounts of outstanding irregularities, which are charged in equal parts to the Community and the Member States ('50:50 rule')⁽⁴⁴⁾ was included for the first time in the financial clearance decisions for 2006 and an amount of some EUR 130 million each was charged to the Community and the Member States⁽⁴⁵⁾. An additional amount of 147 million euro was charged 100 % to the Community for irregularities that the Member States considered to be irrecoverable⁽⁴⁶⁾. The new procedure provides that significant amounts are charged to the Community on the basis of Member States' information. This implies that a detailed follow-up must now be carried out by the Commission to ensure that the debts should properly be charged to the Community.

Conformity clearance

5.63. Conformity decisions have the objective of excluding expenditure from Community financing where the Commission has found non-compliance with Community rules. Conformity clearance is also used by the Director General for Agriculture to support his declaration of assurance on the legality and regularity of EAGGF expenditure. Analysis of the system revealed the following weaknesses:

- (a) 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;

THE COMMISSION'S REPLIES

5.62. *The results referred to by the Court are the consequence of the new clearance mechanism for irregularity cases introduced by Article 32 of Regulation (EC) No 1290/2005.*

According to Article 49 of Regulation (EC) No 1290/2005, the new 50/50-rule was applied in 2007 to all outstanding cases for which full recovery had not taken place by 16 October 2006. Some of these cases date back to the 1980s. This explains the relatively high amount cleared. It is expected that in subsequent years, when only the cases which in that year reach the maturity of 4 or 8 years are concerned, the amounts to be cleared will be significantly lower.

The sums charged to either side are certified by the certification bodies, which means that they have been reviewed in detail by these bodies. Moreover, the Member States' correct application of this new clearance mechanism is being followed-up by the Commission in the framework of its audits on the paying agencies.

5.63.

- (a) *At the end of 2006, only 12 audits carried out in the years 2002 and before, allowing financial corrections for the period prior to 2001, have not yet been closed. This means that the conformity work on expenditure from the years 2000 and before has largely been completed.*

The multi-annual nature of the conformity procedures referred to by the Court does not affect the assurance which can be derived from these procedures for the financial year 2006. While it is true that the financial consequences are only determined at the end of the procedures, the preliminary findings of the audits carried out in 2006 are already known. Moreover, since the Commission's audits cover the Member States' management and control systems, they do not only provide information on the expenditure audited, but indirectly also on future expenditure covered by the systems in question.

⁽⁴⁴⁾ Article 32(5) of Regulation (EC) No 1290/2005.

⁽⁴⁵⁾ Additional amounts might be charged to the Community when the remaining accounts have been cleared.

⁽⁴⁶⁾ Article 32(6) of Regulation (EC) No 1290/2005.

THE COURT'S OBSERVATIONS

(b) DG AGRI's Annual Activity Report 2006 referred, in the chapter on assurance, to the contingent assets recorded in its accounts for 2006. These amounted to 1 472 million euro ⁽⁴⁷⁾ and are intended to predict the impact of future financial corrections. This accounting treatment improves the information available to the user of the accounts, but cannot provide the Court or the Commission with assurance as to the legality and regularity of the underlying transactions;

(c) the cost of financial corrections is borne by the Member States, usually by the general taxpayer, rather than by the beneficiaries of the aid irregularly paid;

(d) there was a lack of evidence that the number of audits carried out by the Commission covered in a sufficient manner the risks identified in the Commission's risk analysis. The testing at the level of the beneficiary is determined by the time available rather than on the basis of a laid down instruction to the auditor. The audits carried out do not systematically include a verification of the existence and accuracy of the information in the declarations at the final beneficiary level;

THE COMMISSION'S REPLIES

(b) *As stated in DG AGRI's Annual Activity Report 2006, it can be concluded from the results of the audits carried out in 2006 that the overall situation with respect to deficiencies in the national control systems is comparable to the situation in previous years and that, therefore, it is entirely justified to estimate the amount of financial corrections necessary to cover the risk for the 2006 expenditure on the basis of the average historical net correction rate for the period 1996-2001.*

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.

(c) *Where undue payments are or can be identified as a result of the conformity procedures, Member States are required to follow them up by recovery actions against the final beneficiaries. However, even where this is not possible, for example because the correction is based on deficiencies in the national control system and cannot be linked to any individual irregular payment, financial 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.*

(d) *In 2006, in total 354 audits including 184 with on-the-spot checks and 170 without such checks were carried out. The Commission considers that these audits cover in an appropriate manner the risks identified in the Commission's risk analysis.*

The Commission carries out compliance audits to evaluate the quality of the national management and control systems. Where appropriate, these audits may include tests of individual files at the level of the final beneficiaries, including on the spot checks. This approach is consistent with international audit standards as well as with the Commission's audit manual.

⁽⁴⁷⁾ In Table 9 of the balance sheet.

THE COURT'S OBSERVATIONS

- (e) the method used for calculating the expenditure to be excluded is in most cases a 'flat rate' where a percentage of total aid paid is recovered. Given that this method is based on the seriousness of the control system's weakness and not on the value of irregularities found, no valid link can be made between the amounts recovered by conformity decisions and the real amounts of irregular payments.

5.64. The Court carried out an audit of three financial corrections included in the three conformity decisions taken in 2006 which concerned the period 1999-2005 covering 25 % of the amount of the corrections made ⁽⁴⁸⁾. The following observations are made:

- (a) given the limited resources available the Commission's conformity audits are selected on the basis of a risk analysis. Due to the two-year limit there is thus a risk that expenditure is not checked in time in order to allow a correction to be made ⁽⁴⁹⁾. The Court found that corrections for irregular payments with an estimated maximum amount of 100 million euro could not be made as they were discovered after the time limit;

THE COMMISSION'S REPLIES

- (e) *The objective of the conformity clearance is to exclude expenditure from Community financing which has not been effected in compliance with Community rules. The Commission considers that this objective is achieved also in cases where financial corrections are applied on a flat rate basis because the amount of irregular payments to beneficiaries cannot be quantified. Flat-rate corrections are applied when the actual amount of irregular payments to beneficiaries cannot be determined by exact calculation or extrapolation. This principle has been regularly confirmed by the Court of Justice. Therefore, the Commission considers this method of flat rate corrections as fully appropriate*

5.64.

- (a) *The conformity audits to be carried out are determined on the basis of a central risk analysis. For the purpose of the conformity process, this selection is in line with international auditing standards. DG AGRI devotes more than 10 % of its total staff to this task.*

If deficiencies are discovered in the framework of conformity audits which represent a financial risk to the EAGGF, any financial corrections are limited to the expenditure effected 24 months prior to the transmission of the Article 11 letter notifying the Member State of the Commission's findings. This so-called 24 month rule was adopted by the Council to ensure legal certainty for the 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.

In the cases audited by the Court, the Commission has reacted on time to the information received.

⁽⁴⁸⁾ Commission Decision 2006/334/EC (OJ L 124, 11.5.2006, p. 21), Commission Decision 2006/554/EC (OJ L 218, 9.8.2006, p. 12) and Commission Decision 2006/932/EC (OJ L 355, 15.12.2006, p. 96).

⁽⁴⁹⁾ Corrections may be made for a maximum of two years prior to the audit findings being communicated, Article 7(4) of Council Regulation (EC) No 1258/1999 (OJ L 160, 26.6.1999, p. 103).

THE COURT'S OBSERVATIONS

- (b) the time needed by the Commission, for these complex cases, from the initial audit to the clearance decision, for the corrections examined, was between four and seven years which delayed the 'finalisation' of the clearance procedures for the financial years in question.

Conclusions and recommendations

5.65. Agriculture and Rural Development expenditure under the Guarantee Fund is affected by errors which, although decreasing, remain material. IACS, where properly applied, is an effective control system for limiting the risk of error or irregular expenditure. However, this is not the case in Greece.

5.66. The design and implementation of the SPS limits the risk of irregular payments to farmers. Nevertheless some Member States have failed to correctly apply certain key elements of the SPS: Austria, Ireland and the United Kingdom extended consolidation of entitlements beyond the provisions of the regulation (see paragraphs 5.22 to 5.24).

5.67. The United Kingdom did not comply with Community legislation when allocating entitlements and paying SPS and rural development aid to landlords for land let to and farmed by the lessee farmers (see paragraphs 5.20 and 5.21).

THE COMMISSION'S REPLIES

- (b) *The time needed for completing the conformity procedures depends on a number of factors. 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, the full respect of the Member State's right of defence is a fundamental principle of the conformity clearance procedure.*

The Court's statement ('(...) which delayed the "finalisation" of the clearance procedures for the financial years in question.') does not take into account the difference between the financial clearance of a given financial year and the conformity clearance. There is no conformity clearance per financial year.

5.65. *The Commission notes that the total level of error for all expenditure under the EAGGF Guarantee established by the Court has decreased markedly and is close to the materiality level. For the non-rural development part of EAGGF Guarantee expenditure, which accounts for more than 85 % of total expenditure, it is below this materiality level. Errors in rural development concentrate on agri-environmental measures.*

IACS is an effective control system to limit the risk of irregular expenditure.

The situation in Greece is addressed through ongoing audits and clearance of accounts procedures to protect the financial interest of the Union and through the monitoring and supervision of the implementation of the Greek action plan.

5.66. *The Commission is aware of these practices and shares the view of the Court. Any possible risk to the Fund will be taken into account through the conformity procedures.*

5.67. *The Member States have to identify who is considered as active farmers (having the right for entitlements). If the landlord bears the economic risk of the farming activity, it is not excluded to consider him 'exercising an agricultural activity'.*

THE COURT'S OBSERVATIONS

5.68. Even if the overall national ceilings were not breached, one quarter of the payments tested at final beneficiary level revealed overpayments although the total financial impact is limited (see paragraph 5.38).

5.69. Among the new beneficiaries, the Court noted railway companies, horse riding/breeding clubs, golf/leisure clubs and city councils in the United Kingdom, Germany, Sweden and Denmark (see paragraphs 5.25 to 5.27). Allocation of entitlements to landowners that never exercised any agricultural activity and who only keep land in GAEC has led to substantial redistributive effects of EU aid away from farmers to landlords, particularly in the dynamic hybrid model (see paragraph 5.28). The United Kingdom authorities set inappropriate criteria for allocations of entitlements for investments from the national reserve (see paragraphs 5.33 and 5.34).

5.70. The SPS regulations gave Member States discretion to choose how to allocate entitlements from the national reserve and whether or not to eliminate windfall profits (see paragraphs 5.29 to 5.34). The same issues have been dealt with very differently in, and even within, the Member States, consequently there can be no equal treatment of beneficiaries under the scheme.

5.71. The Commission should take these consequences into account when performing the 'Health Check' ⁽⁵⁰⁾ due in March 2008.

5.72. In rural development, the agri-environmental measures are prone to a high incidence of errors, because farmers do not meet the (often complex) eligibility conditions. The Commission should give due consideration to the pertinence of eligibility conditions for such measures.

THE COMMISSION'S REPLIES

5.69. *Regional models do, indeed, open up support to those who may not have received it in the past. This was a clear and conscious choice of the Member States concerned to redistribute support in the new circumstances of decoupling. The new beneficiaries are those who farmed actively in the relevant reference period (i.e. in the first year of application). They may or may not have been the owners of the land, but this is irrelevant to the question of who received the premia rights.*

5.70. *Member States have indeed the choice to revert under certain conditions entitlements to the national reserve. Where this option has been selected, certain conditions need to be applied.*

Similarly, the responsibility for the implementation of the SPS lies with the Member States.

5.71. *The 'Health Check' will scrutinise the functioning of the support schemes introduced with the CAP-reform 2003.*

5.72. *The Commission considers that the high incidence of errors in agri-environmental measures found by the Court is not representative for the total of rural development expenditure.*

As regards agri-environmental measures, the Commission considers that their control is rather complex, but the objective of these measures to integrate environmental concerns in agriculture and their added value is widely recognised.

Concerning the programming period 2007-2013 the newly introduced legislation ⁽²⁾ requires the Member States to ensure ex-ante that all the rural development measures and the related commitments and eligibility conditions they intend to implement are properly verifiable and controllable.

⁽⁵⁰⁾ Declaration No 3 on the review of the financial framework annexed to be Interinstitutional Agreement of 17 May 2006.

⁽²⁾ Article 48 of Commission Regulation (EC) No 1974/2006.

THE COURT'S OBSERVATIONS

5.73. The nature of post-payment checks⁽⁵¹⁾ and remaining weaknesses in their application limit the assurance that can be gained as to the legality and regularity of payments made in previous years.

5.74. Improvements are required in respect of the shortcomings detected by the Court and the Commission's clearance unit before the system of physical and substitution checks on export refund consignments can be considered as operating satisfactorily.

5.75. The Commission's financial clearance decisions concern the reliability of the accounts. The certificates issued by the Certifying bodies do not cover legality and regularity. Claims for EU aid are not usually checked by them on the spot. In order to improve the assurance that can be gained from this element of clearance, the Commission services should make frequent audit visits to a sufficient number of certifying bodies and ensure that conditions for its desk review of certifying bodies' certificates and reports provide for adequate scope and depth.

THE COMMISSION'S REPLIES

5.73. *The Commission considers that the system of post-payment checks works adequately. Its own audits confirm that assurance can be gained from these checks.*

Although there might not be a direct link between the expenditure incurred in 2006 and that controlled by the post-payment checks, these checks contribute to the overall assurance regarding the legality and regularity of the underlying transactions in 2006 since the system as such is functioning properly. In fact they are an extra level of controls in addition to the pre-payment checks and must therefore be regarded in the context of the overall system for the management and control of agricultural expenditure (see also the Commission's reply to paragraph 5.77).

5.74. *The physical and substitution checks under Regulation (EEC) No 386/90 form part of the whole chain of controls, which also include ex-ante administrative checks of refund payment claims, ex-post controls under Regulation (EEC) No 4045/89 and the Commission's own audits. The Commission considers this system as operating satisfactorily. As a proportion of expenditure, the irregularities reported by the Member States for both physical and other controls in export refunds have been decreasing in recent years and are now at a low level. Nevertheless, in response to the Court's main concerns identified in the Special Report No 4/2007 legislative changes are under consideration.*

5.75. *The Commission visits certification bodies (and paying agencies) on the basis of a risk analysis, which takes the magnitude of the issues confronting both bodies into account. This practice will be continued for the financial year 2007.*

The scope and depth of the Commission's review of certification bodies' certificates is considered to be adequate. The Commission carries out the audit work necessary to gain reasonable assurance whether (based on the information presented) the paying agencies' accounts are true, complete and accurate. Disjunctions arise when it is unable to conclude positively.

⁽⁵¹⁾ Post-payment checks on 2006 transactions will be carried out in the period July 2007 to July 2008. These checks can cover more than the transactions for the year 2006. The results will be reported to the Commission by 1 January 2009 at the latest. The Commission will then review them and may decide to exclude expenditure. For this reason the Court cannot derive assurance as to the EAGGF transactions for the year 2006.

THE COURT'S OBSERVATIONS

5.76. Although clearance systems (as well as post-payment checks) have the objective of excluding expenditure which does not comply with Community rules, at present they fail to do so at the level of payments to final beneficiaries ⁽⁵²⁾. The level of irregular payments financed by the CAP is not yet known or estimated by the Commission in a way considered appropriate by the Court ⁽⁵³⁾.

5.77. The Commission should ensure that supervisory and control systems provide assurance as to the legality and regularity of the transactions at the level of the final beneficiary and should seek to ensure that irregular payments are recovered. The Court has proposed different options to achieve this. The impact of the Commission's choice that the certifying bodies do more work to verify and validate IACS statistics and post-payment checks can only be evaluated later. Nevertheless where the Commission uses the work of others as a source of assurance it should perform sufficient work to ensure that it is reliable.

⁽⁵²⁾ Annual Report concerning the financial year 2005, paragraph 5.56.

⁽⁵³⁾ In order to estimate the level of irregularities, an appropriate sampling method should be clearly defined (Opinion of the Court No 2/2004 on the single audit model, paragraph 48) and the legality and regularity of expenditure should be verified at the level of the final beneficiary (Opinion of the Court No 1/2005 on the financing of the CAP, paragraph 24).

THE COMMISSION'S REPLIES

5.76. *The conformity procedure is designed to exclude expenditure from Community financing which has not been effected in compliance with Community rules, thus shielding the Community 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.*

The results of the controls at the level of the final beneficiaries as communicated to the Commission by the Member States and published in DG AGRI's Annual Activity Reports for a significant part of the CAP-expenditure provide for a reasonable indication of the extent of irregular payments. To further improve the assurance which can be gained from this information, as from 2007, the Commission has implemented the Court's recommendation that the certification bodies should do more work to verify and validate the inspections statistics and post payment checks.

5.77. *A comprehensive system for the management and control of agricultural expenditure ensures that irregular payments to final beneficiaries are prevented or detected and recovered. This system relies on four complementary levels:*

- (1)** *compulsory administrative structure at the level of Member States, centred around the establishment of paying agencies and an authority at high level which is competent for issuing and withdrawing the agency's accreditation. The decision for issuing the accreditation is based on a detailed review by an external audit body;*
- (2)** *detailed systems for controls and dissuasive sanctions to be applied by those paying agencies, with common basis features and special rules tailored to the specificities of each aid regime;*
- (3)** *ex-post controls through independent certification bodies and special departments performing checks under Regulation (EEC) No 4045/89;*
- (4)** *clearance of accounts through the Commission (both annual financial clearance and multi-annual conformity procedures).*

Taken together, the four levels are therefore the basis for the Commission to gain reasonable assurance as to the effective management of the risk of error in the legality and regularity of the underlying transactions in agriculture.

THE COURT'S OBSERVATIONS

5.78. The Commission's conformity decisions are not complete for any year later than 1998. Since these decisions in respect of 2006 expenditure will be taken in the future, the expenditure is provisional and assurance as to the legality and regularity of the transactions underlying the Community accounts can only be provided once a full clearance procedure is in place and applied.

THE COMMISSION'S REPLIES

5.78. *By the end of 2006, only 12 audits carried out in the years 2002 and before, allowing financial corrections for the period prior to 2001, have not yet been closed. This means that the conformity work on expenditure from the years 2000 and before has largely been completed.*

The Commission does not consider that the 2006 expenditure is provisional and that assurance as to the legality and regularity of the underlying transactions can only be provided once a full clearance procedure is in place and applied. Such an appreciation of the conformity procedure does not take into account that this procedure is but one, albeit important, part of the comprehensive system for the management and control of agricultural expenditure.

This system, which is described in detail in the Commission's reply to paragraph 5.77, is the basis for the Commission to gain reasonable assurance as to the effective management of the risk of error in the legality and regularity of the underlying transactions in agriculture.

As regards specifically financial year 2006, the preliminary findings of the audits carried out in 2006 are already known. Generally speaking, it can be concluded from these findings that the overall situation with respect to deficiencies in the national control systems is comparable to the situation in previous years.

FOLLOW-UP OF PREVIOUS OBSERVATIONS

Recoveries of irregular payments

5.79. In its Special Report No 3/2004 on the recovery of irregular payments the Court identified a number of serious weaknesses in the system of recording, recovering and writing off irregular payments.

5.80. The Council and Commission have responded positively to many of these by:

- (a) setting up a joint Task Force Recovery (TFR) to resolve/clear the backlog of irregularity cases over 0,5 million each ⁽⁵⁴⁾. The outcome was a Commission Decision ⁽⁵⁵⁾, charging 317 million euro ⁽⁵⁶⁾ to the Member States and 176 million to the Community Budget;

5.80.

⁽⁵⁴⁾ Notified to the Commission before 1999.

⁽⁵⁵⁾ Commission Decision 2006/678/EC (OJ L 278, 10.10.2006, p. 24).

⁽⁵⁶⁾ 165 cases, of which 157 relating to Italy.

THE COURT'S OBSERVATIONS

- (b) introducing new requirements for reporting and dealing with irregularities ⁽⁵⁷⁾, and taking steps to clarify the responsibilities of DG AGRI and OLAF in respect of the financial follow up of irregularities (although a draft memorandum of understanding between the parties has yet to be signed);
- (c) putting some 2 600 cases, communicated before 1999 and under the '500 000 threshold', of a total amount of 168,7 million euro ⁽⁵⁸⁾ under the '50/50' approach ⁽⁵⁹⁾ applicable from 16 October 2006.

5.81. However there are still some important issues which have to be resolved:

- (a) the Commission is not yet in a position to finalise the 'Jordan/Iraq' case relating to false proofs of arrivals of exports of meat and poultry involving 35 million euro of alleged irregular payments, since legal proceedings, including a preliminary ruling procedure before the European Court of Justice are still pending in June 2007;
- (b) the placing of the 2 600 lower value task-force cases under the new 50:50 clearance procedure implies that a follow-up is made by the Commission to ensure that the amounts charged to the Community under this procedure are correct;
- (c) the discussion of the 2nd Report from the Commission on the implementation of Council Regulation No 1469/95 (referred to as the 'blacklist') has not yet reached an operational conclusion since the European Parliament has not issued any opinion on the subject.

⁽⁵⁷⁾ Under Commission Regulation (EC) No 1848/2006 (OJ L 355, 15.12.2006, p. 56).

⁽⁵⁸⁾ Situation as per 14 November 2005.

⁽⁵⁹⁾ 50 % of the financial consequences of non-recovery shall be borne by the Member States and 50 % by the Community budget if recovery has not taken place within four/eight years of the primary administrative or judicial finding/or not decided by national Courts. In the clearance decision taken in April 2007 most of the cases referred to are not yet decided upon as the accounts of AGEA in Italy are disjoined.

THE COMMISSION'S REPLIES

- (b) *The new regulation dealing with irregularities ⁽³⁾ has been successfully implemented by all 27 Member States from 1 January 2007 onwards and a Working Party of Cocolaf ⁽⁴⁾ was held on 23 May 2007 to present detailed practical guidelines to Member States.*

The instrument clarifying the responsibilities of all services concerned is subject to an Inter Service Consultation during June/July 2007 and is expected to be applicable shortly thereafter.

5.81.

- (b) *As far as the charging of sums is concerned, the Commission observes that this is subject to the certification by the certifying bodies and that the sum of 147 million euro is therefore reviewed in detail by these bodies.*

Furthermore, the Commission is in the process of following up on the cases where amounts have been charged to it in the context of the audits of the paying agencies.

- (c) *The Special Committee on Agriculture ⁽⁵⁾ had a last debate and adopted its conclusions on 6 June 2006 ⁽⁶⁾.*

The Commission report ⁽⁷⁾ was transmitted to the European Parliament (Cocobu ⁽⁸⁾) on 24 October 2005, however, it has not been debated by the European Parliament yet.

⁽³⁾ Commission Regulation (EC) No 1848/2006.

⁽⁴⁾ Cocolaf: Advisory Committee for the Coordination of Fraud Prevention.

⁽⁵⁾ The Special Committee on Agriculture (SCA) comprises permanent representatives of the Member States; the SCA prepares Council decisions on common agricultural policy matters.

⁽⁶⁾ Last document reference 7763/06.

⁽⁷⁾ Second Report from the Commission on the application of Council Regulation (EC) No 1469/95.

⁽⁸⁾ Cocobu: Committee on Budgetary Control.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Olive oil

5.82. In its previous Annual Report ⁽⁶⁰⁾ the Court raised concerns about the reliability of the olive cultivation Geographical Information System. For the 2004/2005 marketing year the Court carried out a specific audit of the olive oil production aid scheme in the main producer Member States (Italy, Spain and Greece).

5.83. As part of the audit, 50 payments files were tested, 33 of which were checked on the spot. Eight farmers (24 %) had declared at least 5 % more olive trees than were counted. Two of these led to significant overpayments.

5.84. The audit confirmed that the weaknesses previously identified persist and that the GIS in all three Member States is neither complete nor reliable. Since the GIS data is used to calculate entitlements under the SPS ⁽⁶¹⁾ the Court will pay particular attention to this aspect during its audit of 2007 expenditure.

5.83-5.84. *The aid was paid on the basis of the quantity of olive oil produced. The number of trees was an element of the system of control of the scheme, among many other elements (control of the mills, control of the yield, etc.).*

A sanction on the amount of aid is foreseen in the regulation when the discrepancy between the trees declared and the trees counted is higher than 5 %. In the cases where those sanctions have not been applied or have been badly applied by the Member States, or in the cases where the olive GIS was not updated, the procedure of clearance of accounts is ongoing or has already led to financial corrections.

Some 180 million euro of financial corrections have already been applied by the Commission since financial year 2000 and more significant corrections are in the pipeline.

As of 1 January 2006, the olive oil production aid has been fully decoupled and integrated in the single payment scheme (only Spain kept a small element of coupled aid).

Now, the olive parcel is to be considered as a 'classical' agricultural parcel which is controlled within the framework of the IACS. This should significantly reduce any risk of error.

SPECIAL REPORTS

5.85. The Court has published one Special Report relevant to agriculture in the last 12 months: Physical and substitution checks on export refund consignments (Special Report No 4/2007). It can be found on the Court's website (www.eca.europa.eu).

⁽⁶⁰⁾ See paragraphs 5.25 to 5.27.

⁽⁶¹⁾ The number of hectares to be taken into account for determining the number of payment entitlements is based on an algorithm which derives the olive area from the position of olive trees using GIS-based automatic processing.

Evolution of key observations — Agriculture




| | 2005 | | 2006 | |
|-----------|---|--|--|-----------------|
| | Observations | Replies of the Commission | Observations | Recommendations |
| IACS | <p><i>Area aid schemes</i></p> <p>As in previous years, in certain Member States risk-based transactions proved to have a lower rate of error than randomly selected transactions (5.8).</p> <p><i>Animal Premium Schemes</i></p> <p>In general, the national statistics for animal premiums are still less reliable than the equivalent statistics for area aid applications (5.24).</p> <p>The DAS findings concerning IACS in Greece indicate that there has been no significant improvement since last year (5.10).</p> | <p>The Commission's audits have shown that some Member States recorded remote sensing controls as random controls, although the farmers have been selected on a risk basis within the zone.</p> <p>no reply</p> <p>In 2005, the Commission continued with its enhanced audit programme. Deficiencies are followed up under clearance of accounts procedures. The Greek authorities have set up an action plan targeting the deficiencies, in order to ensure that the main IACS components are enhanced and used effectively. The Greek authorities have included in their action plan for 2006 the implementation of a new claim procedure changing the role of farmers unions.</p> | <p>For the fifth consecutive year the Director General's declaration contains a reservation concerning insufficient implementation of the IACS in Greece. For 2006 the Commission and the Court have confirmed continuing failure to implement key controls (5.11).</p> | |
| SPS | N/A | N/A | <p>The United Kingdom allocated entitlements to landlords who let out their land for most of the year (5.20).</p> <p>Contrary to the rules some Member States have extended the provision concerning consolidation of entitlements to all cases where a farmer in 2005 had fewer hectares than entitlements (5.23).</p> <p>The SPS has had a number of side-effects: aid has been paid to landlords and new beneficiaries (5.28); in many Member States 'farmers' have been allowed to keep their windfall profits (5.29); inappropriate investment criteria have led to questionable allocation of extra entitlements (5.34).</p> | |
| Olive oil | The Court has found that in all Member States the failure to update the GIS data (the alphanumerical database, the real number of olive trees, new plantings and the production potential) clearly demonstrates that the GIS can still not be considered fully operational (5.25-5.26). | The deficiencies in the olive GIS are also known to the Commission, which shares the concerns of the Court about the implementation of the reform. | The on-the-spot visits in the main producer Member States revealed general problems which affect the reliability and accuracy of GIS and consequently the correct calculation of entitlements under the SPS (5.84). | |

| | 2005 | | 2006 | |
|-------------------|---|--|--|-----------------|
| | Observations | Replies of the Commission | Observations | Recommendations |
| Ex-post scrutiny | <p>The Commission still cannot provide full and comparable information on the transactions checked (4045/89) and the value of irregularities detected and recovered. It has made regulatory changes to improve the reporting, but the effects are not yet known (5.38).</p> <p>As a follow-up to its work in 2003 (examining the Commission's monitoring of 4045/89 checks) the Court re-visited seven Member States to assess the progress made. Whilst the Court's follow — up found that improvements had been made in the overall quality of checks examined, weaknesses persisted in the recovery of irregularities detected by the checks, there was a failure to complete the planned post-payment checks on time and in two Member States a persistent failure to complete the minimum number (5.39).</p> <p>The Commission has started an exercise to assess the extent of the failure to complete the planned checks in certain Member States (highlighted in previous Court reports). Initial results have confirmed the failure of four Member States to complete the minimum number of post-payment checks required but as yet no remedial action has been taken (5.38).</p> | <p>The Commission considers that it already receives sufficient information regarding transactions tested and irregularities detected.</p> <p>The reporting has been further improved by the introduction of Regulation (EC) No 40/2006, permitting the potential level of irregularities to be estimated for all categories of expenditure.</p> <p>Recovery of irregular payments is not the responsibility of those carrying out post-payment checks but of the paying agencies</p> <p>The Commission has, in fact, already assessed the extent of the backlog. Remedial action has been initiated through missions to two Member States where the backlog is most serious. The two Member States in question have been requested to develop action plans to resolve the backlog.</p> <p>Such action plans including a clear calculation of the number of outstanding scrutinies versus available resources and including clear deadlines are to be communicated to the Commission and their implementation will be closely followed up.</p> | <p>The conformity unit responsible for rural development did not carry out any audits covering Regulation (EEC) No 4045/89 issues (5.50).</p> <p>The Commission still does not know how many of the potential irregularities initially reported under regulation (EEC) No 4045/89 resulted in recovery or why they did not (5.52).</p> <p>Backlogs persist in Germany, Italy and Spain (5.53).</p> | |
| Export refunds | <p><i>Checks on export refunds:</i></p> <p>The weaknesses found by the Commission during audits in Member States in 2004 have not yet been the subject of a final decision on whether or not a financial correction should be imposed (5.34).</p> | <p>Two enquiries have been closed without a financial correction (Poland, Lithuania). For the remaining enquiries, where deficiencies have been identified, clearance of accounts procedures are under way.</p> | <p>The Court's own audit of physical and substitution checks led to Special Report No 4/2007 of 21 June 2007.</p> <p>An analysis carried out by the Court shows that the information in respect of physical and substitution checks is not reliable (5.55).</p> | |
| Rural development | <p>The Court continues to find high incidence of errors because farmers did not meet their commitments or the key eligibility conditions were not checked by the authorities (5.29).</p> | <p>The Commission will examine in detail the problems identified by the Court when the replies from the Member States have been received.</p> | <p>For agri-environmental measures the Court continues to find a high incidence of errors because farmers do not meet their commitments or the key eligibility conditions are not checked by the authorities (5.44).</p> | |

ANNEX 5.2

Assessment of supervisory and control systems — single payment scheme (SPS) — managed under IACS ⁽¹⁾

| Member State | Key internal control | | | |
|-----------------------|--|--|---|--|
| | Administrative procedures and controls to ensure correct payment | Risk analysis and selection procedures for inspections | Inspection methodology, quality control and reporting of individual results | Preparation and reliability of statistics on inspections and results |
| Austria | 3/4/5 | | | |
| Belgium (Wallonia) | 3/4/14 | | | |
| Germany (Brandenburg) | 1/2/3 | | | |
| Italy | 3/12 | | 9/13 | 6 |
| Ireland | 1/3/5 | 8 | 9/10 | 7 |
| Wales | 1/3/5/11 | | | |

| | |
|---|------------------------|
|  | Satisfactory |
|  | Partially satisfactory |
|  | Unsatisfactory |

- 1 Claim registration procedures do not provide sufficient proof of the actual date of receipt and/or are not adequately controlled.
- 2 The database used for administrative cross-checks and payment calculation is fed with reference parcel data only at the beginning of the claim year. Modifications made to the reference parcels during the claim year are not carried over to the database before payments are made.
- 3 Incorrect calculation of payments where area determined is not sufficient for all entitlements declared.
- 4 No or insufficient administrative cross-checks whether area declared for set-aside meets the legal conditions.
- 5 Consolidation was systematically granted in cases other than provided in EU legislation and led to irregular payments (in Austria 5 570 entitlements, in Wales 4 552 entitlements and in Ireland more than 150 000 entitlements were affected by irregular consolidation).
- 6 Minor differences between the statistics reported to the Commission and the underlying data transmitted to the auditors and substantial delays in transmitting statistics to the Commission.
- 7 Significant differences between statistics reported to the Commission and the underlying data transmitted to the auditors and substantial delays in transmitting statistics to the Commission.
- 8 The selection of inspections (campaign year 2005/06) was based on outdated application data (campaign year 2004/05).
- 9 Weaknesses detected concerning the quality control and/or the training system.
- 10 Deductions made for ineligible areas are systematically reduced by a 5 % measurement tolerance.
- 11 The same parcel can be claimed by different farmers under different EU aid schemes.
- 12 The land parcel identification system in certain cases does not allow to identify the location of the agricultural parcel within the reference parcel. The national instructions allow to exceed the eligible area of the reference parcel by a tolerance of up to 5 % or 0,5 ha.
- 13 Where an agricultural parcel comprises two or more cadastral parcels measurements are carried out and tolerances applied separately for each cadastral parcel and not for the agricultural parcel as a whole. This leads to incorrect tolerance margins being applied.
- 14 The Land Parcel Identification System is not updated by information held by cadastral authorities nor by information's on parcels afforested.

⁽¹⁾ Aspects relevant to cross-compliance are not included.

CHAPTER 6

Structural Policies

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INTRODUCTION

6.1. The EU implements a number of Structural Policies. They are intended to reduce the developmental disparities between regions. In the programming period 2000-2006, they accounted for approximately one third of the total Community budget making them the second largest part of the budget. In the new programming period, running from 2007 to 2013, Structural Policies will continue to be major policies of the European Union.

SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

*Specific characteristics of Structural Policies***Aims and objectives of Structural Policies**

6.2. In the programming period 2000-2006, Structural Policies were directed to:

- structural adjustment of regions whose development was lagging behind (Objective 1),
- economic and social conversion of areas facing structural difficulties (Objective 2),
- modernisation of systems of education and employment (Objective 3),
- interregional cooperation throughout the European Union (the Community Initiative Interreg III),
- regeneration of cities and neighbourhoods in crisis (the Community Initiative URBAN II),
- combating discrimination in the labour market (the Community Initiative EQUAL),
- development of rural areas (the Community Initiative Leader+),
- improvement of environment and transport infrastructure in the least prosperous Member States, and
- experimental regional programmes (Innovative Actions).

THE COURT'S OBSERVATIONS

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Instruments for funding Structural Policies

6.3. Community funding of Structural Policies is a form of co-financing. It is matched by national funding. The European Community provides funding for Structural Policies through appropriations from its budget which are known as Structural Funds and Cohesion Fund. There are four Structural Funds:

- the European Regional Development Fund (ERDF),
- the European Social Fund (ESF),
- the European Agricultural Guidance and Guarantee Fund — Guidance section (EAGGF-Guidance), and
- the Financial Instrument for Fisheries Guidance (FIFG).

6.4. The ERDF supports Objectives 1 and 2 by co-financing investment in infrastructure, the creation or maintenance of jobs, local development initiatives and the activities of small and medium-sized enterprises. It also provides funding for the Community Initiatives Interreg III and URBAN II.

6.5. The ESF supports Objectives 1, 2 and 3 by granting financial assistance to combat unemployment, develop human resources and promote integration into the labour market. It also provides funding for the Community Initiative EQUAL.

6.6. The EAGGF-Guidance supports Objective 1 by co-financing rural development and modernisation of agricultural structures. It also provides funding for the Community Initiative Leader+.

6.7. The FIFG supports Objective 1 by co-financing measures for strengthening the competitiveness of the fisheries sector in order to foster the development of the areas dependent upon it.

6.8. The Cohesion Fund supports the improvement of environment and transport infrastructure in the Member States whose gross national product per capita is below 90 % of the European Union average.

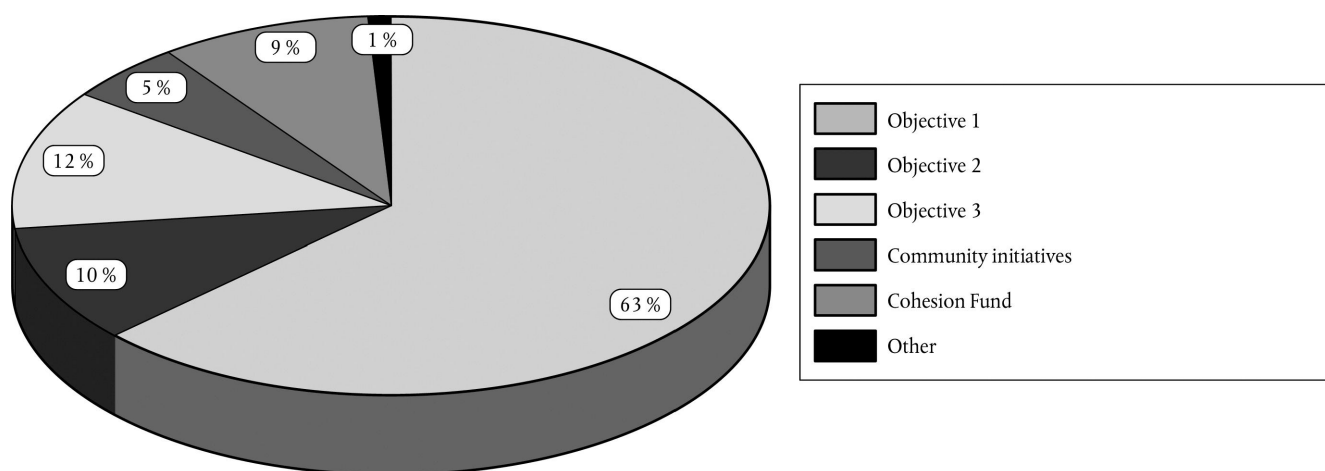
THE COURT'S OBSERVATIONS

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Size and form of Community funding of Structural Policies

6.9. In 2006, Community funding of Structural Policies totalled 32,4 billion euro. About 85 % of that amount was spent on Objectives 1, 2 and 3. See **Figure 6.1**.

Figure 6.1 — Breakdown of Community funding of Structural Policies in 2006



6.10. The unit of financing of Structural Policies is a *project*. Under the Structural Funds a project is financed within a framework known as an *operational programme*. For the funding period 2000-2006 there were 545 operational programmes. They varied in size from under 500 000 euro to over 8 billion euro. Project expenditure within these programmes varied from a few hundred euros of aid to an individual beneficiary up to hundreds of millions euros for a major infrastructure project. Under the Cohesion Fund there are no operational programmes, only projects. For the period 2000-2006 there were 1 094 Cohesion Fund projects. They ranged from 50 000 euro to over 1 billion euro.

6.11. The co-financing of a project by a Structural Fund or the Cohesion Fund generally takes the form of the *reimbursement* of costs to the project. The reimbursement of project costs is based on an *expenditure declaration* prepared by the project promoter ⁽¹⁾. A project promoter usually submits several interim expenditure declarations and a final one at the end of the project.

6.11. *The co-financing from Structural Funds by the Commission is at programme level and is done by way of reimbursement of aggregated statements of expenditure submitted generally three times per year.*

⁽¹⁾ Project promoters range from private individuals to associations, private or public companies to local, regional or national bodies.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Errors in co-financing of Structural Policies projects

6.12. There is a high risk that the costs of Structural Policies projects are incorrectly declared and, consequently, incorrectly reimbursed. In the context of this report, an incorrect reimbursement is an *over-reimbursement*. It may be a result of:

- an eligibility error,
- an occurrence error,
- an accuracy error, or
- a multiple error.

6.13. As its name suggests, an *eligibility error* means that reimbursement does not comply with an eligibility rule. Regulations define in detail which expenditure is eligible for reimbursement from a fund. An *occurrence error* is made when a reimbursement includes a cost which is not supported by an invoice or some other document of an equivalent probative value. An *accuracy error* is made when a cost is reimbursed at an improper amount. A *multiple error* is a combination of errors, for example a combination of an eligibility and accuracy error.

6.14. A project may also be affected by *compliance errors*. They are mainly errors in contracting and failures to meet publicity requirements. For most compliance errors the regulations do not define an impact on reimbursement of project costs.

6.15. The Court however considers that some compliance errors must be regarded as making expenditure ineligible for reimbursement. For example, where a project should have been awarded to a contractor by way of a tendering procedure but was not, the Court considers such a project as ineligible and counts the reimbursement of its expenditure as an eligibility error. The same applies if a tendering procedure was carried out in such a way that it was not valid. If only a part of tendering procedure was not valid, then, in estimating the eligibility error, the Court seeks to apply the rule of proportionality.

6.12. *There is a high inherent risk because, for example, of decentralisation of management to regional and local bodies in the Member States and the large number of beneficiaries. If the first level management checks and the certification function are working effectively, this risk can be adequately addressed.*

6.15. *The Commission also considers that failure to hold a tender where it is required under the Community rules on public procurement makes a project partly or wholly ineligible for funding. It applies financial corrections in these and other cases of breaches of the public procurement rules, based on guidelines setting out a scale which takes account of the seriousness of the infringement.*

THE COURT'S OBSERVATIONS

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Controls over Structural Policies projects

6.16. There are two levels of controls over Structural Policies projects. The first is the control system in the Member State. It is intended to prevent the incorrect reimbursements of project costs and other irregularities. The second level is the Commission's supervision. It is intended to mitigate the risk of control failures in the Member States.

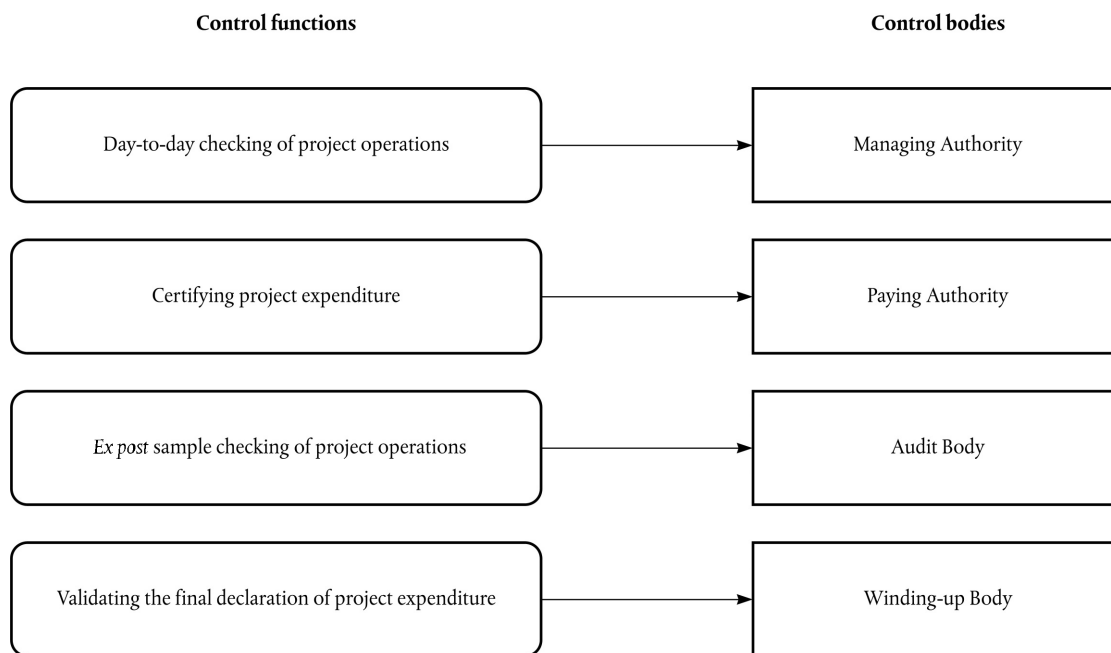
6.17. The control system in the Member State comprises four key control functions. They must be clearly defined and assigned to independent bodies (principle of segregation of duties). See **Figure 6.2**. The Member State's control system should ensure that records are kept which enable the expenditure declarations made to the Commission to be reconciled to the accounting records and supporting documents of individual projects (audit trail requirement).

6.16. Member State control systems operate on a multiannual basis. They should ensure the certification of regular expenditure to the Commission, but also provide for ongoing ex post audits and a winding up declaration at closure.

The Commission's supervision is based on management and audit activities which are also carried out on a multiannual basis.

6.17. In addition to the ex post sample checking indicated in Figure 6.2, the audit bodies are also required to carry out systems audits.

Figure 6.2 — Key controls in Member State



6.18. The control functions and the corresponding control bodies shown in the above figure are set up in many different ways in the Member States. The control bodies are usually located in government offices. In some Member States the control functions are performed at the national level (centralised controls). In other Member States the control functions are delegated through intermediate bodies to an entity at a regional or local level or to a sector specific entity (decentralised controls) ⁽²⁾.

⁽²⁾ The principle of segregation of duties does not strictly apply to the last two functions in Figure 6.2, i.e. the regulations do not require that the audit body and winding-up body be separate bodies.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

6.19. The Court assesses a key control by using the following rating scale:

- satisfactory,
- partially satisfactory, or
- unsatisfactory.

6.20. A pattern of ratings of key controls indicates a level of likelihood that the corresponding control system detects and prevents an error. Since the likelihood of detecting and preventing an error is a measure of the *effectiveness of control*, the Court uses the ratings of key controls to categorise a control system as:

- effective,
- moderately effective, or
- ineffective.

6.21. As stated earlier, the second level of control over Structural Policies projects is the Commission's supervision. It comprises mainly audit and financial corrections.

6.21. *The Commission's supervision comprises, as well as its audit work which may lead to financial corrections, coordination with national audit bodies, provision of guidance, annual meetings with managing authorities and audit bodies based on annual implementing and control reports, on-going monitoring of programmes (participation in monitoring committees, ad hoc meetings, etc.), and other actions required by internal control standards.*

6.22. A Commission audit can be an effective supervisory instrument:

- if it is based on an assessment of the risk of failures in a Member State's control system,
- if it provides an operationally useful result; that is, if it provides either a sound basis for corrective action or reasonable assurance that there is no need for such action, and
- if there is corrective action based on the audit result.

THE COURT'S OBSERVATIONS

6.23. Accordingly, the Court assesses Commission audits by using the following cumulative scale:

- there were major weaknesses in risk assessment,
- there was adequate risk assessment, but the audit result was of little operational use,
- there was adequate risk assessment and an operationally useful audit result, but no post-audit corrective action,
- there was adequate risk assessment, an operationally useful audit result and corresponding post-audit corrective action.

6.24. Responsibility for the regularity of spending on Structural Policies starts in a Member State, but the terminal point of the accountability chain is the Commission. In other words the Commission is ultimately responsible for the regularity of Community spending on Structural Policies. Therefore, it is essential that the Commission's audit activity — being its main supervisory activity — is effective.

The Court's audit

6.25. The Court audited 177 interim reimbursements made in the year 2006. They were made to 167 Structural Funds projects (77 ERDF projects, 60 ESF projects, 30 EAGGF projects) and 10 Cohesion Fund projects. The 167 Structural Funds projects were carried out within 17 operational programmes. For each operational programme the respective Member State set up at least one control system as illustrated in **Figure 6.2**. The Court examined those control systems and the control system which a Member State set up for its Cohesion Fund projects. The Court also examined part of the Commission's supervisory activity. This was done by way of analyses of 15 audits undertaken by the Commission.

THE COMMISSION'S REPLIES

6.24. *Under shared management, while the Commission is accountable to the budget authority under Article 274 of the EC Treaty and the Financial Regulation, the Member States are required to cooperate with the Commission at all stages in the control chain in order to ensure the legality and regularity of expenditure.*

6.25. *The Commission reimburses Member States on the basis of expenditure from projects aggregated in certified expenditure declarations sent to the Commission. The Member State pays the project promoters the contribution due for the expenditure they have declared, as included in the expenditure certified to the Commission.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Key findings on regularity of Community funding of Structural Policies

6.26. Key findings on the regularity of Community funding of Structural Policies projects in the budget year 2006 are presented in three tables below: in **Tables 6.1, 6.2 and 6.3**.

6.26. *Where errors have a financial impact, the multiannual nature of the control system helps to offset the inherent risks, as corrections can be made some time after the disbursement of funds. Where the Commission identifies failings it takes action: naming the Member States in the annual activity reports, suspending payments and recovering funds where appropriate.*

Moreover, the Commission may have a different assessment of the financial impact of the findings, based on its own calculation of the eligible costs as it results from its own audit work and the consideration of further supporting documents submitted.

Table 6.1 — Cross-tabulation of compliance by correctness of reimbursement ⁽¹⁾

| Projects where compliance errors were | Projects which were | | Total |
|---------------------------------------|-------------------------|--------------------------|---------------------------|
| | incorrectly reimbursed | correctly reimbursed | |
| present | 36 cases 20 % | 45 cases 25 % | 81 cases 45 % |
| not present | 41 cases 23 % | 55 cases 31 % | 96 cases 54 % |
| Total | 77 cases 44 % | 100 cases 56 % | 177 cases 100 % |

⁽¹⁾ This cross-tabulation is based on the Court's sample of projects. Since for each project in the sample one reimbursement was audited, the notion the sample of projects and the notion the sample of reimbursements can be used interchangeably.

Table 6.2 — Cross-tabulation of reimbursement correctness by fund ⁽¹⁾

| Correctness of Reimbursement | Fund | | | | Total |
|------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|---------------------------|
| | ERDF | ESF | EAGGF | Cohesion Fund | |
| Eligibility error | 15 cases 19 % | 9 cases 15 % | 3 cases 10 % | 2 cases 20 % | 29 cases 16 % |
| Occurrence error | 5 cases 6 % | 7 cases 12 % | 0 cases 0 % | 1 case 10 % | 13 cases 7 % |
| Accuracy error | 2 cases 3 % | 7 cases 12 % | 1 case 3 % | 0 cases 0 % | 10 cases 6 % |
| Multiple error | 13 cases 17 % | 12 cases 20 % | 0 cases 0 % | 0 cases 0 % | 25 cases 14 % |
| Correct reimbursement | 42 cases 55 % | 25 cases 42 % | 26 cases 87 % | 7 cases 70 % | 100 cases 56 % |
| Total | 77 cases 100 % | 60 cases 100 % | 30 cases 100 % | 10 cases 100 % | 177 cases 100 % |

⁽¹⁾ This cross-tabulation is based on the Court's sample of projects.

THE COURT'S OBSERVATIONS

6.27. **Table 6.1** shows that only 31 % of projects in the Court's audit sample were found to be free from error, i.e. were correctly reimbursed and were not affected by compliance errors.

6.28. **Table 6.2** shows that incorrect cost reimbursement occurred in all funds rather frequently. However, there appears to be an association between fund and risk of incorrect reimbursement. The distribution of errors in the Court's audit sample suggests that the reimbursements from the ERDF and the ESF were more error prone than the reimbursements from the other two funds.

6.29. The underlying cause of over-reimbursements varied between the four funds. See **Table 6.2**. In the Court's audit sample the most frequent causes of incorrect reimbursements from the ERDF were multiple and eligibility errors. Multiple errors were usually a combination of an eligibility and accuracy error. Thus, eligibility error was the most frequent single error underlying incorrect reimbursements from the ERDF. The ERDF eligibility errors mainly relate to:

- the application of incorrect grant rates (the split between Community co-financing and the National matched funding),
- inclusion of costs which are not reimbursable (such as recoverable VAT), and
- lack of tendering.

6.30. In comparison with other Structural Funds and the Cohesion Fund, ESF had a greater proportion of occurrence errors. They usually reflected a lack of evidence to support the calculation of overheads or the apportionment of staff costs which are often the main costs in an ESF expenditure declaration. In some cases project promoters sought to use a flat rate amount for the staff costs or overheads which is a simplification allowed in certain circumstances. However, in the cases examined, where a flat rate was used it was found that it was generally not applied correctly by the project promoter. There were also a number of ESF cases where the errors in declaring overheads or staff costs are, by their nature, accuracy errors. That is to say, they were failures to calculate correctly the values for staff costs or overheads costs.

THE COMMISSION'S REPLIES

6.27. *Table 6.1 shows that 56 % of projects were correctly reimbursed, taking account of cases of compliance errors with no financial impact.*

6.28. *The Commission will follow up the findings and take appropriate measures. It notes that in a small number of cases the Court's classification of the findings as errors is based on a strict interpretation of the complex legal provisions applicable.*

6.29. *In their own audit work Commission auditors have identified eligibility as a major source of risk and have therefore focused their audit activity on the effectiveness of day-to-day checks by management.*

6.30. *The Commission considers that improvements in the way the Member States implement the Article 4 checks could reduce the quantity of such errors. Consequently, recommendations to improve the Article 4 checks have been addressed to the Member States concerned and general guidelines on management verifications have been issued.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

6.31. An estimate of the impact of errors on Community funding of Structural Policies projects in budget year 2006 is given in **Table 6.3**. In addition, there are also basic parameters of the estimation of the impact of errors.

Table 6.3 — Summary of results of testing the regularity of reimbursements

| | |
|--|--|
| Sample size | 180 (177 reimbursements considered as 180 sample units) |
| Proportion of reimbursements in the sample affected by error | 44 % |
| Estimated impact of errors | At least 12 % of the total amount reimbursed should not have been reimbursed |

Key findings on Control Systems in Member States

6.32. Key findings on Control Systems in the Member States are presented in **Annex 6.1** where 19 control systems from the Court's audit sample are categorised as effective, moderately effective or ineffective.

6.32. *The Court did not find significant deficiencies in the systems for three Cohesion Fund projects it audited in Poland, the Czech Republic and Latvia.*

Concerning the systems in Spain for ERDF and the Cohesion Fund, including those referred to by the Court, the result of the extensive audit work carried out by the Commission at the end of 2006 to monitor the implementation of the agreed action plan was that significant improvements had been made at the level of the national managing authority and some of the intermediate bodies (ministries and regions), which would lead to a categorisation of Spain overall as 'moderately effective'.

The Commission considers that the Court's classification as unsatisfactory of the systems operating for EAGGF in Poland and Spain is too severe.

In Poland, for example, the Court's assessment of the audit body is based on the finding that ex post controls had not yet started. This body had started systems audit already and the delayed start of the ex post controls was justified by late certification of expenditure.

Both in Spain and Poland, the classification of the managing authority is based mainly on formal aspects such as poor documentation on controls.

THE COURT'S OBSERVATIONS

6.33. As explained earlier the categorisation of control systems with regard to their effectiveness is based on the Court's assessment of the functioning of the control bodies. Those assessments identified a number of weaknesses. The main weaknesses in the functioning of the Managing Authority were the insufficient on-the-spot checks of the reality of expenditure and the failure to identify that cost statements were not supported by appropriate evidence. The main weakness in the functioning of the Paying Authority was the failure to identify that the Managing Authority had not carried out adequate day to day checks. The main weakness in the functioning of the Audit Body was the failure to carry out sufficient checks of appropriate quality on the expenditure of the programmes.

6.34. To illustrate the nature of the weaknesses that lead to the overall assessment of a control system as ineffective, we can examine one of the cases audited. In that example the Managing Authority appeared to be operating well; they were examining all of the cost declarations on the spot. However, the Audit Body identified some serious errors in projects that had been checked by an Intermediate Body on behalf of the Managing Authority. The Audit Body informed the Managing Authority and the Paying Authority of the errors which were of such seriousness that they recommended that all subsequent payments be stopped. Initially payments were stopped. However, after about five weeks the Managing Authority commenced payments again and the Paying Authority continued certifying to the Commission payment claims containing significant irregularities for almost two years. Hence, the functioning of the Managing and Paying Authority was unsatisfactory and therefore the control system failed to prevent reimbursement errors.

6.35. The categorisation of the 19 control systems is summarised in **Table 6.4**. The numbers in **Table 6.4** represent sample counts of the three categories of control system. Even though the audit sample which they refer to is rather small, the numbers in **Table 6.4** give a general picture of the effectiveness of the control systems in the Member States. They allow the Court to claim, with reasonable confidence, that the control systems in the Member States are generally ineffective or only moderately effective. This is broadly similar to the Court's findings in previous years.

THE COMMISSION'S REPLIES

6.33. *The Commission in its own audits has found similar weaknesses in some national systems, for which it has taken the required measures.*

6.34. *The Commission agrees that the functioning of these authorities was unsatisfactory. Nevertheless, it notes that in the affected region, the managing authority had begun to carry out more thorough checks and to correct the irregular expenditure found before the announcement of the Court's audit. It had also re-imposed the payments suspension, albeit after an interval of 22 months.*

6.35. *The Directorates General responsible for Structural Policies have set out the results of their assessments of the effective functioning of national systems in their respective annual activity reports (see http://ec.europa.eu/atwork/synthesis/aar/index_en.htm). The assessments based principally on the results of the Commission's extensive audit work in all Member States indicate the following broad categorisation of systems (percentages in relation to volume of Community funds): between 20 and 35 % satisfactory, around 60 % in need of improvements to correct material deficiencies in key controls, and around 10 % seriously deficient. Thus, the majority of systems still require improvement, although there are a significant number for which there is evidence that they work satisfactorily. The annual activity reports also set out the corrective measures underway to bring about the required improvements, which include follow-up audits, monitoring of action plans and the use of powers to suspend payments and apply financial corrections.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Table 6.4 — Effectiveness of control systems in the Court's audit sample

| Control system | Fund | | | | Total |
|----------------------|----------|----------|----------|---------------|-----------|
| | ERDF | ESF | EAGGF | Cohesion Fund | |
| Ineffective | 5 | 5 | 2 | 1 | 13 |
| Moderately effective | 2 | 3 | 1 | 0 | 6 |
| Effective | 0 | 0 | 0 | 0 | 0 |
| Total | 7 | 8 | 3 | 1 | 19 |

Key findings on the Commission's audit activity

6.36. The key findings on the Commission's audit activity come from analyses of 15 audits carried out by DG REGIO and DG EMPL. The 15 audits were rated on the cumulative scale defined in Paragraph 6.23. The results are summarised in **Table 6.5**. As can be seen in that table, just over half of the Commission's audits examined by the Court appear to have had all qualities of an effective supervisory instrument: there was an adequate risk assessment, an operationally useful audit result and corresponding post-audit corrective action.

6.36. For some of the audits the Commission accepts that there were shortcomings in documentation making review difficult, but not that this might indicate a lack of an operationally useful audit result, as stated in footnote 7 to table 6.5.

Table 6.5 — Evaluation of a sample of the Commission's audits

| Rating of audit | Number of audits | |
|--|------------------|----------|
| | DG REGIO | DG EMPL |
| There were major weaknesses in risk assessment. | 0 | 0 |
| There was adequate risk assessment, but the audit result was of little operational use. | 1 | 0 |
| There was adequate risk assessment and an operationally useful audit result, but no post-audit corrective action. | 0 | 0 |
| There was adequate risk assessment, an operationally useful audit result and corresponding post-audit corrective action ⁽¹⁾ . | 7 | 1 |
| There were weaknesses in audit documentation making assessment of the audit result difficult ⁽²⁾ . | 2 | 4 |
| Total | 10 | 5 |

⁽¹⁾ The follow-up associated with audit result is occasionally late.

⁽²⁾ This is not a rating within the scale presented in Paragraph 6.23. The cases are included for completeness and also because incomplete documentation might be interpreted as an indication of a lack of an operationally useful audit result.

THE COURT'S OBSERVATIONS

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CONCLUSIONS AND RECOMMENDATIONS

Conclusions

6.37. There is high risk that declared costs of Structural Policies projects are misstated or ineligible for reimbursement. Mitigation of that risk requires effective control systems in the Member States as well as effective supervision by the Commission.

6.38. However:

- the control systems in the Member States are generally ineffective or moderately effective, and
- the Commission maintains only moderately effective supervision to mitigate the risk that the control systems in the Member States fail to prevent reimbursement of overstated or ineligible expenditure.

6.39. Therefore, the reimbursement of expenditure to Structural Policies projects is subject to material error. The Court is reasonably confident that in the budget year 2006 at least 12 % of the total amount reimbursed to Structural Policies projects should not have been reimbursed. In addition, a significant percentage of Structural Policies projects were subject to compliance errors which the Court did not regard as making expenditure ineligible for reimbursement.

6.37. *Effective shared management also requires cooperation between the Member States and the Commission at all stages in the control chain. The Commission's action plan towards an integrated internal control framework is intended to optimise this cooperation and the effectiveness of the overall control framework. However, given that the intensity of on-the-spot checks should reflect the costs and benefits of these controls, some errors will still be found in interim payments even in an effective control framework.*

6.38.

- *The Commission refers to its reply at point 6.35 indicating its assessment that some 10 % of control systems are seriously deficient, and the corrective measures which it takes in these cases.*
- *The Commission considers that it has put in place effective systems to carry out its supervisory role. The Commission's audit work is only one aspect of its supervisory activity but is extensive. To arrive at the assessments of systems referred to in the reply to paragraph 6.35 it has audited systems representing 53 % and 82 % of the planned ERDF and ESF allocations respectively to EU-15 programmes and 65 % and 92 % of those to EU-10 programmes. For EAGGF Guidance and FIFG respectively 85 % and 91 % of systems in terms of the total planned contribution had been audited. Necessarily the results of the Commission's actions in a given year are not apparent in the same year in relation to expenditure declared and reimbursed.*

6.39. *Structural Fund expenditure declared by a beneficiary is subject to a series of control processes some of which take place before the certification of expenditure to the Commission and some afterwards. The findings presented by the Court of Auditors show the situation at a particular point in the execution of these control processes. The Commission maintains that a large proportion of these errors are likely to be corrected through the operation of the multiannual corrective system, in particular the continuing audit work of national and Community audit bodies. The Commission accepts that it is necessary to provide better evidence of financial corrections by Member States resulting from the Commission's and their own audit work.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

6.40. The following recommendations are intended to reinforce the prevention of errors in the early stages of a project through working with the project promoters and ensuring that the first level controls are functioning effectively.

6.41. The Member State should seek to prevent errors from occurring by working with the project promoters at the start of each project. The Managing Authority should provide the project promoters with training and guidance when setting up the project systems to meet Community regulation requirements and when drawing up the first expenditure declarations. Specific attention should be given to ensuring that the project promoter is aware of which costs are eligible for reimbursement and the need to keep records to demonstrate how cost items are calculated and allocated. A rigorous review of checklists used for their accuracy and completeness is of paramount importance in this respect.

6.42. The Member State authorities should provide their staff with training and guidance on the tasks required for reviewing and assessing the projects. In particular, the Managing Authority staff need to have the skills to review contracting procedures and costing systems to be able to assess whether a project contract is being awarded correctly and cost declarations are being prepared in line with regulations.

6.43. The Commission should focus its audit and supervisory efforts on the operations of the Managing Authorities in the Member States, as this has been identified as one of the most important functions in the effective implementation of the Structural Funds. Specifically the Commission should have a regularly updated assessment of the effectiveness of all of the Managing Authorities — either made by themselves or obtained from other sources — to enable them to target their audit effort at the least effective or highest risk Managing Authorities.

6.41. *The Commission has already recommended Member States to step up their information activities directed at beneficiaries and will take further appropriate action.*

Under the Commission implementing regulation for the 2007-2013 period (Regulation (EC) No 1828/2006), the managing authority is required to ensure that beneficiaries are informed of the conditions of funding and the information to be kept and communicated and to satisfy itself that the beneficiary has the capacity to fulfil the conditions.

6.42. *The Commission has issued guidance on best practices in day-to-day management checks and the checks to be made by the paying authority before certification of expenditure. In addition, the Commission contributes to training activities for managing authorities on the requirements under the Regulations. It will continue with these and similar actions.*

6.43. *The Commission is already devoting a large proportion of its supervisory activity to managing authorities. It issued guidance notes in 2006 on the first level management checks and the certification function, as mentioned above. Furthermore, the Commission is asking managing authorities in certain Member States to assess their performance on compliance with regulatory requirements through self assessment questionnaires.*

THE COURT'S OBSERVATIONS

6.44. The Commission should reinforce the feedback mechanisms in the control system in Structural Funds. For instance, if the Audit Body identifies that there is an error in an expenditure declaration this information should not only be reported but also action taken by the Managing Authority to rectify the problem and consider how to prevent it happening again in the future. This involves all of the control bodies working together to take action when problems or issues are identified. The Commission could reinforce the importance of the feedback mechanism by informing the control bodies of the need to take action whenever a weakness or error is identified whether it be from within their own audit or reported from another control body. In addition, when the Commission carries out an audit, it should review the reporting of weaknesses and errors and identify whether the action taken was sufficient to address the immediate and future consequences of the issue.

6.45. The Commission should actively encourage and facilitate the use of the simplifications provided for in the new Structural Funds regulations. For example, the use of flat-rate amounts for indirect costs in the European Social Fund ⁽³⁾. Such simplifications will reduce the likelihood of errors and reduce the administrative burden on the project promoters.

SPECIAL REPORT ISSUED SINCE THE LAST ANNUAL REPORT

6.46. The Court has issued one Special Report on Structural Policies since its last Annual Report:

Special Report No 1/2007 concerning the implementation of the mid-term processes on the Structural Funds 2000-2006.

THE COMMISSION'S REPLIES

6.44. *Feedback mechanisms are built into the control system through requirements for the exchange of the results of checks done by the managing authority, paying authority and audit body and via the annual control reports to the Commission. The follow-up of audit results is a permanent point on the agenda for discussion between the Member States and the Commission at the annual bilateral audit coordination meetings. It is also a regular component of systems audits. The Commission will continue to carry out reviews of national systems audit reports and to check that requisite follow-up action has been taken.*

6.45. *The Commission is already acting on this recommendation. An important element of simplification is the provision of guidance so as to simplify the application of the regulations in practice. For example, for the 2007-2013 period the Commission is issuing guidance on financial engineering operations and cost-benefit analysis in revenue generating projects.*

⁽³⁾ Article 11(3)(b) of Regulation (EC) No 1081/2006 of the European Parliament and of the Council of 5 July 2006 on the European Social Fund and repealing Regulation (EC) No 1784/1999 (OJ L 210, 31.7.2006, p. 12).

ANNEX 6.1

Categorisation of control systems

| Programme | Assessments of the functioning of: | | | | Control system is: |
|--|------------------------------------|------------------|------------|-----------------|----------------------|
| | Managing Authority | Paying Authority | Audit Body | Winding-up Body | |
| EAGGF — Sachsen-Anhalt | | | | | Moderately effective |
| EAGGF — Poland | | | | | Ineffective |
| EAGGF — Spain | | | | | Ineffective |
| ESF — Objective 3 — Germany — North Rhine-Westphalia | | | | | Moderately effective |
| ESF — Objective 3 — Germany — Lower Saxony | | | | | Ineffective |
| ESF — Objective 3 — France — Midi Pyrénées | | | | | Ineffective |
| ESF — Objective 3 — France — Nord-Pas de Calais | | | | | Moderately effective |
| ESF — Objective 1 — Education measures — Slovenia | | | | | Ineffective |
| ESF — Objective 1 — Germany — Thüringen | | | | | Moderately effective |
| ESF — Objective 1 — Fomento del empleo — Spain | | | | | Ineffective |
| ESF — Objective 3 — UK — Scotland | | | | | Ineffective |
| ERDF — Italy — Campania | | | | | Ineffective |
| ERDF — Spain — Pais Vasco | | | | | Ineffective |
| ERDF — Greece — Peloponnesus | | | | | Moderately effective |
| ERDF — Portugal — Accessibility and transport | | | | | Moderately effective |
| ERDF — Interreg — Austria/Hungary | | | | | Ineffective |
| ERDF — Spain — Valencia | | | | | Ineffective |
| ERDF — UK — Merseyside | | | | | Ineffective |
| CF — Spain — 7 projects | | | | | Ineffective |

Legend:

| | |
|--|------------------------|
|  | Satisfactory |
|  | Partially satisfactory |
|  | Unsatisfactory |

CHAPTER 7

Internal Policies, including Research

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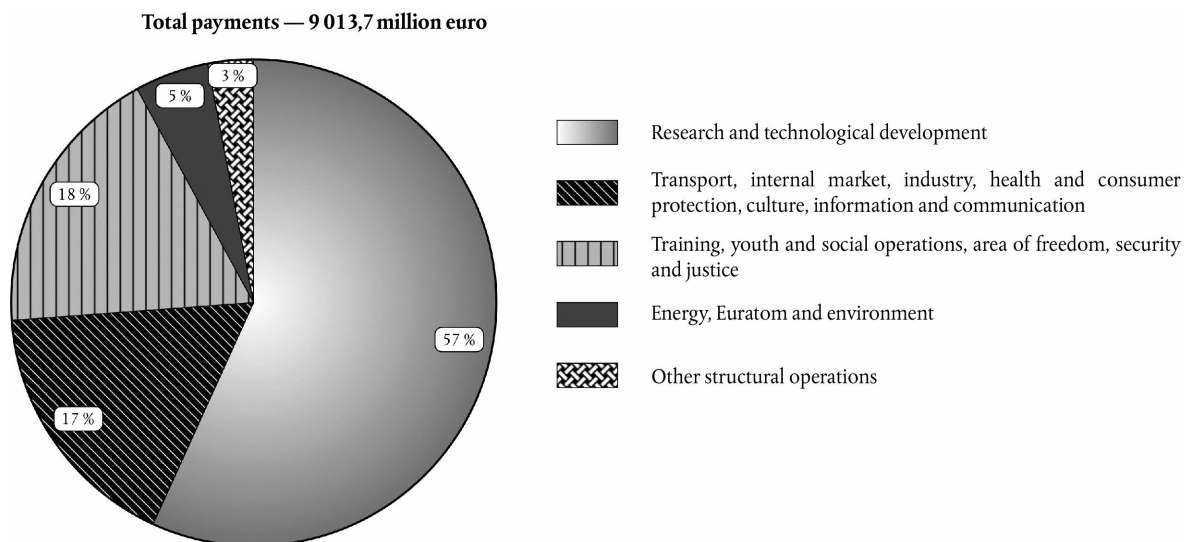
THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

INTRODUCTION

7.1. Internal Policies cover a wide range of European Union (EU) actions contributing to the development of the internal market. Payments in 2006 were 9 014 million euro (**Figure 7.1**). The principal area of activity is Research and Technological Development, which accounts for more than half of the expenditure.

Figure 7.1 — Breakdown of payments by budgetary area in 2006



Source: 2006 annual accounts.

7.2. The Commission directly manages most of the expenditure ⁽¹⁾. The majority of the actions are implemented through multi-annual programmes, allocating grants to projects or measures carried out by private and public beneficiaries. The grants are usually paid in instalments: an advance upon signature of the grant agreement or contract, followed by interim and final payments which reimburse eligible expenditure reported by the beneficiaries in periodic cost statements.

⁽¹⁾ Management of some programmes such as the European Refugee Fund and the Schengen Facility is, however, shared with Member States. The Commission delegates the management of parts of the Socrates, Leonardo and Youth programmes to National Agencies (covering around 70 % of the budget of the Directorate-General for Education and Culture).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Audit scope

7.3. The audit covered the legality and regularity of the underlying transactions related to payments made in 2006 from all sections of the EU budget falling within Internal Policies. The specific assessment is based on:

- (a) substantive testing of a random sample of nine commitments and 150 payments made by the Commission in 2006;
- (b) a review of the operation of selected supervisory and control systems:
 - audit certification of project cost statements,
 - desk reviews of cost statements before reimbursement of expenditure,
 - *ex-post* audits of projects.
- (c) a follow-up to the principal observations by the Court in recent Statements of Assurance.

7.4. The Court's sample of payments for substantive testing included 58 advances ⁽²⁾, which are subject to less stringent payment conditions than interim and final payments. Testing of the advances was therefore limited to a review at the Commission of the project selection procedure, the financing decision and the payment authorisation. Of the 92 interim and final payments ⁽³⁾, 62 were tested on documentation at the Commission and 30 were audited at the premises of the beneficiary.

⁽²⁾ 32 for the Sixth Framework Programme for Research and Technological Development, five Galileo Joint Undertaking, four Trans-European Network (Transport), four Socrates and 13 other.

⁽³⁾ 17 Fifth Framework Programme for Research and Technological Development, 28 Sixth Framework Programme for Research and Technological Development, 2 TEN-Transport, one eTEN, four LIFE, two Leonardo, two Socrates, one MEDIA and 35 other (e. g. payments to staff and to experts).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Specific characteristics of Internal Policies

7.5. EU support for research and technological development covers a wide range of research activities and is characterised by a multiplicity of funding schemes supporting various thematic areas and types of projects. The projects are carried out by research institutes and universities, but also by individuals, commercial firms or public administrations. They usually involve multiple research partners working as a consortium across a number of EU Member States, although a single 'project coordinator' is nominated to maintain contact with the Commission and to take charge of the financial and administrative aspects of the contract. EU grants to partners in individual projects range from a few hundred euros to tens of millions. Of the more than 15 000 final beneficiaries, approximately 2 % account for more than 40 % of the total EU funding.

7.6. Other measures cover the spectrum of Internal Policies, such as grants to actions supporting citizenship or for mobility in the education and training sector. These grants range from 2 000 euro up to 20 000 euro. At the other end of the scale, support to a major road or rail infrastructure project for the Trans-European Transport Network may be up to 10 million euro.

7.7. The principal risk to the legality and regularity of the underlying transactions is that beneficiaries overstate costs in their cost statements, and this is not subsequently detected and corrected by the Commission.

7.7. *The Commission largely concurs with the analysis of the Court of Auditors on the nature of the main risks. The risk that beneficiaries overstate costs in their cost statements largely stems from the applicable regulatory framework, which is based on the reimbursement of actual costs. Despite the significant improvements introduced in the regulatory framework, these factors remain for the most part unchanged and they will continue to affect the management of the Research Framework Programmes in the coming years. Furthermore, many of the resulting errors can only be detected by carrying out on-the-spot audits. Therefore the Commission has devised a common audit strategy to increase assurance on the legality and regularity of the expenditure on a multiannual basis (see the Commission's reply to paragraph 7.12).*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Legality and regularity of underlying transactions

7.8. Overstatement of expenditure by beneficiaries may be the result of errors of:

- eligibility: reimbursement of costs which are ineligible under the rules,
- occurrence: reimbursement of costs for which there is inadequate supporting evidence, or
- accuracy: reimbursement of incorrectly calculated costs.

7.9. A project may also be affected by errors with no impact on cost reimbursement. A frequently encountered example is the failure of the Commission to reimburse beneficiaries within the stipulated deadlines (detailed observations on late payments by the Commission may be found in **Annex 7.1**).

7.9. *The Commission has taken measures to improve the payment times, see Annex 7.1.*

Material level of error in costs declared by the beneficiaries

7.10. The Court detected errors affecting the claims for reimbursement submitted by the beneficiaries in 26 out of the 150 transactions audited (see **Table 7.1**). Most of the errors were found in the 30 transactions audited at the beneficiary. The most frequently occurring errors were:

- inadequate supporting evidence to justify the costs claimed, in particular for personnel costs, which is usually the largest single cost category,
- use of budgeted figures which does not comply with the requirement to use actual costs,
- unjustified allocation of indirect costs to the project,
- claims for costs incurred outside the eligibility period,
- inclusion of various ineligible costs.

7.10. *The audit of the Court found that most errors occurred in the payments audited at the beneficiary. Such errors or ineligible expenditure can indeed only be detected by on site checks or, to a limited extent, by desk controls.*

In a few cases the Commission may have a different assessment of the financial impact of the findings, based on its own calculation of the eligible costs as it results from its own audits and the consideration of further supporting documents submitted by the beneficiary.

Table 7.1 — Presentation of the results of transaction testing

| | |
|---|-----------|
| Sample size | 150 |
| Proportion of transactions affected by an error | 17 % |
| Estimated impact of errors on the population | 2 % — 5 % |

THE COURT'S OBSERVATIONS

7.11. The errors occur in the context of a complex legal framework with numerous (not always clear) eligibility criteria. Similarly to previous years, the Court found that beneficiaries are often unable to substantiate personnel costs claimed in their cost statements.

Supervisory and control systems

7.12. The Commission has to manage thousands of beneficiaries and the projects they undertake. Many errors of legality and regularity can only be detected (and thereby corrected) by performing on-the-spot checks. However, to undertake such checks on each project each year would be prohibitive in terms of cost. Therefore, the Commission needs a coherent control strategy — defining type and intensity of checking — for keeping the incidence of error to an acceptable level, balanced against the cost of the checks involved ⁽⁴⁾.

7.13. A summary of the results of the Court's review of selected supervisory and control systems may be found in **Annex 7.2**.

THE COMMISSION'S REPLIES

7.11. *The Commission acknowledges that the substantiation of the personnel costs to be charged to research projects are a frequent source of discrepancies and errors. It has taken significant steps to address this issue, see the replies to paragraphs 7.7 and 7.12.*

For the Seventh Framework Programme (FP7), the use of average personnel costs will require the beneficiary to have their methodology confirmed by an independent auditor and accepted by the Commission. This confirmation by the auditor includes checking that a reliable time recording system is in place.

As part of its efforts to clarify the rules for the FP7, since April 2007 the Commission has published four of the six chapters of the Guide for beneficiaries, including the Guide on financial issues. The Commission plans to make available the remaining chapters in September 2007. At the beginning of FP7, the Commission organised information days and workshops for the beneficiaries, in order to explain the process and clarify the beneficiaries' rights and obligations.

7.12-7.13. *The Commission has devised a common ex post audit strategy for the Sixth Framework Programme (FP6), designed to increase assurance on the legality and regularity of the expenditure on a multi-annual basis. This strategy calls for a substantial increase in the number of ex post audits, including the audit of contracts with the most significant beneficiaries, i.e. those receiving the highest financial contributions.*

The results of these audits will be thoroughly followed-up; recovering from the beneficiary any amounts unduly paid and extrapolating any systemic errors detected to all other, non-audited contracts with the same beneficiary. The Commission will apply liquidated damages if the auditee fails to implement audit results on systemic errors.

This strategy is expected to ensure that the level of 'residual' (non-detected) error is significantly reduced.

The audited contracts will include: (1) the approximately 200 contractors representing the largest share of the budget (collectively the contracts concerned represent over 40 % of the budget); (2) a representative, value-based random sample from the remaining population; and (3) a risk-based sample focusing on potentially riskier contractors.

The implementation of this audit strategy implies a substantial reinforcement of the Commission's audit staff, an increased number of audits and reinforced implementation procedures regarding audit results.

The modalities for subsequently extending this control framework to FP7 are currently being considered. For FP7 steps have already been taken to strengthen the quality of the audit certification of cost statements (see paragraph 7.17).

⁽⁴⁾ Opinion No 2/2004, paragraphs 50 to 53.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Audit certification of cost statements

7.14. EU financial rules require that requests for payment of grants above a certain threshold have to be accompanied by an audit report or certificate ⁽⁵⁾. This requirement has, for cost claims meeting certain criteria, been generalised for the Sixth Framework Programme and some other Internal Policies programmes. Therefore, cost statements are to be certified by an independent auditor or by a competent public officer in the case of certain public bodies.

7.15. In 2005 the Court examined the use of audit certificates for cost statements for the Sixth Framework Programme ⁽⁶⁾. For 2006, the Court analysed the use of audit certificates in all areas of Internal Policies. The Court tested the operation of this control for the 15 transactions in its sample audited on the spot where a certificate had been provided. The Court compared the results of its own testing with the certificate. The Court also reviewed the Commission's own reports on the functioning of the control.

Audit certificates do not yet function as a reliable control

7.16. In nine out of the 15 cases examined by the Court, the certifying auditor had issued an unqualified opinion whereas the Court identified errors with significant financial impact on the cost statements or systems not in line with requirements. In four of the nine cases, the personnel cost accounting systems of the beneficiaries did not comply with contractual provisions. In one of these cases, personnel costs were overstated by more than 50 %. In another two of these cases, the beneficiary used a cost calculation method which was not in line with the contractual provisions.

7.17. The Court's findings are similar to the results of the Commission's own assessment of the audit certificates which finds that the work performed by the certifying auditors is sometimes too superficial without the appropriate amount of substantive testing, that improved guidelines are needed to address the uncertainty on eligibility issues and on the independence of the auditors, and that the lack of a mandatory model audit certificate and of standard terms of reference encourages incoherent approaches.

7.16. *The research family DGs are in general agreement with the Court's conclusion. Nevertheless, the Commission considers that the audit certificates have contributed to a reduction in error rates for FP6 in comparison with FP5.*

7.17. *Concerning the observed weaknesses in the reliability of audit certificates for FP6, the Commission has responded by improving support to certifying entities, beneficiaries and operational departments within the Commission. DG INFSO has set up 'Clinics on audit certificates', involving central and line departments, with the aim of ensuring a consistent handling of audit certificates in the DG, in line with the contractual provisions. The results are accessible on the DG's intranet.*

As described in its reply to paragraph 7.12, the Commission has also devised a common ex post audit strategy for FP6 to increase assurance of the legality and regularity of the expenditure on a multiannual basis.

⁽⁵⁾ Article 180 of the Implementing Rules of the Financial Regulation applicable to the general budget of the European Communities.

⁽⁶⁾ Annual Report concerning the financial year 2005, paragraphs 7.15 to 7.17.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

For FP7, the Commission has introduced three further measures to improve the quality of audit certificates: (1) 'agreed upon procedures', which consist of a compulsory set of procedures and a mandatory report to be provided by certifying auditors; (2) compulsory certification of the cost calculation methodology for average personnel costs, and (3) optional certification of both the personnel cost and indirect cost methodologies. These measures are designed to ensure, before payments are authorised, that beneficiaries' costing methodologies comply with the contractual provisions.

Outside the research area, in 2004, DG Environment developed, for the LIFE programme, a template for an independent external audit report together with clear instructions specifying the scope and objective of the certification audit, the audit methodology, the auditor's competence and the expected audit results.

Ex-ante desk reviews of cost statements

7.18. For interim and final payments to projects, the Commission performs desk reviews of the cost statements submitted by beneficiaries before reimbursing the declared expenditure.

7.19. The audit examined the guidelines and procedures, the reporting and monitoring arrangements, and the sharing of the results of the desk reviews in the Directorates-General for Research (DG RTD), Information Society and Media (DG INFSO) and Energy and Transport (DG TREN). The Court tested the operation of these checks for 30 payments included in its substantive testing sample (paragraph 7.3).

Comprehensive procedures but limited monitoring and sharing of results

7.20. All the Directorates-General audited have detailed written guidelines and procedures for performing the desk reviews and make use of standard checklists.

7.21. DG RTD and DG TREN use monitoring tools (scoreboards) to provide aggregate information on the costs accepted or rejected on the basis of the checks but there is no analysis of the types and rates of errors which could contribute to developing a risk-based control strategy.

7.21. *The Commission is aware that the main problems are with the personnel costs and the indirect costs and, on this basis, is seeking to develop and apply a risk based control strategy.*

THE COURT'S OBSERVATIONS

7.22. Sharing of the results of the checks by the DGs can contribute to increased efficiency and effectiveness, for example by identifying common problems and fostering a coordinated approach. The Court found that the three Directorates-General have made only slight efforts to share information on the results of their checks, both within and between the Directorates-General. In the absence of detailed monitoring of the results of the checks, the exchange of experience is limited to discussions of methodology and general issues.

7.23. In three out of the 30 cases reviewed, the Court identified problems in the cost statements which should have been detected by the Commission's *ex-ante* checks. In one case, the beneficiary had used an inappropriate allocation method for indirect costs. In another case the Commission applied an incorrect reimbursement rate. In a further case, the Commission had requested the necessary supporting documentation from the beneficiary but the payment was made before receiving it.

The Commission's *ex-post* financial audits

7.24. The Commission performs *ex-post* audits of projects at the final beneficiaries after interim or final payments have been made. The audits are carried out by units in the Directorates-General or, more usually, by external audit firms on behalf of the Commission.

7.25. The Court analysed data on *ex-post* audits provided by the Commission and reviewed arrangements for the sharing of audit results by the Internal Policies Directorates-General.

Insufficient coverage of ex-post audits

7.26. In 2005 the Court criticised the marked reduction in the number of *ex-post* audits of Internal Policies projects by the Commission compared to the previous year ⁽⁷⁾. During 2006, the number of audits has recovered to pre-2005 levels (**Table 7.2**). However, the proportion of audited contracts (2,3 %) remains insufficient to compensate for the shortcomings in the other elements of the supervisory and control systems.

THE COMMISSION'S REPLIES

7.22. Desk controls of cost statements essentially focus on formal aspects. This is why the Commission has privileged the use of standard procedures and checklists to ensure the efficiency and effectiveness of these controls. The Commission agrees that, subject to cost/benefit considerations, the sharing of the results of these checks may be useful, in particular for DGs within the research area dealing with the same or similar beneficiaries.

7.23. Guidelines, including checklists, have been prepared and are regularly updated. Staff is also trained in order to improve the efficiency of the controls.

7.24. The number of *ex post* audits has now increased. The number of audits planned for FP6 will take account of residual error and cost-benefit considerations.

7.26. As indicated by the Commission in the Court's Annual Report concerning the financial year 2005, the reduction of the number of *ex post* audits in 2005 was due to delays encountered with the newly appointed external audit firm. 2005 must therefore be considered as an atypical year. In 2006, 564 *ex post* audits were closed, more than in 2004 (see Table 7.2).

In order to further increase the assurance gained from *ex post* audits, the Commission has devised a common *ex post* audit strategy for FP6 as described in its reply to paragraph 7.12.

⁽⁷⁾ Annual Report concerning the financial year 2005, paragraphs 7.19 to 7.20.

Table 7.2 — Ex-post financial audits completed 2004 to 2006

| Directorate General | Number of completed audits | | | | | | Number of audited contracts | | | Number of open contracts | | | Value of audited contracts (million euro) | | | Value of open contracts (million euro) | | | Adjustments of ineligible costs in favour of the Commission as a result of the audits | | | | | | % audited contracts/open contracts | | |
|--------------------------------------|----------------------------|------------|------------|---------------------|-----------|------------|-----------------------------|------------|------------|--------------------------|---------------|---------------|---|---------------|---------------|--|-----------------|------------------|---|---------------------------|------------------|---------------------------|------------------|---------------------------|------------------------------------|------------|------------|
| | All programmes | | | Research programmes | | | | | | | | | | | | | | | 2004 | | 2005 | | 2006 | | | | |
| | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | 2004 | 2005 | 2006 | Value (mio euro) | % value-audited contracts | Value (mio euro) | % value-audited contracts | Value (mio euro) | % value-audited contracts | 2004 | 2005 | 2006 |
| Agriculture | 5 | 7 | 5 | | | | 6 | 20 | 7 | 245 | 153 | 158 | 16,18 | 22,67 | 13,96 | 42,54 | 35,48 | 36,56 | 0,00 | 0,0 | 1,68 | 7,4 | 1,26 | 9,1 | 2,4 | 13,1 | 4,4 |
| Education and Culture ⁽¹⁾ | 75 | 77 | 104 | | | | 80 | 77 | 104 | 15 884 | 11 748 | 13 222 | 24,10 | 48,28 | 15,56 | 740,30 | 570,46 | 670,97 | 7,80 | 32,4 | 3,66 | 7,6 | 1,92 | 12,3 | 0,5 | 0,7 | 0,8 |
| Employment and Social Affairs | 25 | 33 | 31 | | | | 27 | 37 | 35 | 1 639 | 1 553 | 1 485 | 11,53 | 14,47 | 14,93 | 139,56 | 131,11 | 186,67 | 0,19 | 1,7 | 0,37 | 2,6 | 0,37 | 2,5 | 1,6 | 2,4 | 2,4 |
| Environment | 42 | 44 | 25 | | | | 73 | 49 | 25 | 1 748 | 1 774 | 1 761 | 35,07 | 68,60 | 33,45 | 385,87 | 431,30 | 478,20 | 1,18 | 3,4 | 0,47 | 0,7 | 1,41 | 4,2 | 4,2 | 2,8 | 1,4 |
| Justice, Freedom and Security | 8 | 11 | 11 | | | | 47 | 46 | 54 | 901 | 1 055 | 426 | 28,60 | 17,90 | 7,43 | 117,00 | 177,00 | 35,25 | 2,53 | 8,8 | 1,10 | 6,1 | 0,08 | 1,1 | 5,2 | 4,4 | 12,7 |
| Health and Consumer Protection | 8 | 7 | 6 | | | | 12 | 7 | 6 | 522 | 476 | 478 | 6,29 | 5,34 | 17,14 | 153,90 | 165,58 | 183,73 | 0,36 | 5,8 | 0,27 | 5,1 | 0,04 | 0,2 | 2,3 | 1,5 | 1,3 |
| Energy and Transport ⁽²⁾ | 54 | 16 | 69 | 53 | 7 | 59 | 81 | 20 | 100 | 1 077 | 1 099 | 1 166 | 87,09 | 21,49 | 66,48 | 689,41 | 899,46 | 929,55 | 9,95 | 1,8 | 0,85 | 0,0 | 5,47 | 8,2 | 7,5 | 1,8 | 8,6 |
| Enterprise and Industry | 43 | 8 | 52 | 34 | 1 | 44 | 64 | 8 | 69 | 1 684 | 1 672 | 2 369 | 38,12 | 22,28 | 28,66 | 221,96 | 305,75 | 1 179,00 | 1,00 | 2,6 | 1,38 | 6,2 | 0,64 | 2,2 | 3,8 | 0,5 | 2,9 |
| Fisheries and Maritime Affairs | 18 | 11 | 4 | 15 | 7 | | 41 | 29 | 27 | 238 | 239 | 215 | 12,23 | 50,25 | 97,51 | 270,01 | 174,51 | 203,30 | 1,16 | 9,5 | 1,39 | 2,8 | 0,10 | 0,1 | 17,2 | 12,1 | 12,6 |
| Information Society and Media | 95 | 30 | 84 | 93 | 30 | 80 | 230 | 72 | 196 | 2 320 | 5 727 | 1 810 | 115,37 | 32,61 | 79,45 | 1 745,00 | 2 030,00 | 2 004,00 | 8,20 | 7,1 | 4,71 | 14,4 | 6,42 | 8,1 | 9,9 | 1,3 | 10,8 |
| Research | 118 | 23 | 173 | 118 | 23 | 151 | 167 | 35 | 198 | 7 696 | 8 906 | 12 070 | 263,40 | 38,25 | 58,68 | 3 451,39 | 5 032,43 | 6 663,85 | 2,79 | 1,1 | 0,72 | 1,9 | 3,47 | 5,9 | 2,2 | 0,4 | 1,6 |
| Total | 491 | 267 | 564 | 313 | 68 | 334 | 828 | 400 | 821 | 33 954 | 34 402 | 35 160 | 637,99 | 342,15 | 433,24 | 7 956,94 | 9 953,07 | 12 571,08 | 35,16 | 5,5 | 16,59 | 4,8 | 21,19 | 4,9 | 2,4 | 1,2 | 2,3 |

⁽¹⁾ Including the Education, Audiovisual and Culture Executive Agency.⁽²⁾ Excluding Trans-European Network (Transport) projects.

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7.27. Research projects managed by DG RTD account for more than half of the value of open contracts in 2006. The Court has previously noted the insufficient coverage of the Fifth Framework Programme (1998 to 2002) by DG RTD *ex-post* audits ⁽⁸⁾. The Commission's own Internal Audit Service (IAS) has also observed that, for the Sixth Framework Programme (2002 to 2006), only two audits were conducted in 2005 and that in 2006 the audit coverage remained insufficient in relation to the underlying risks associated with research projects.

7.28. As with the *ex-ante* desk reviews, sharing results of the *ex-post* checks can increase their efficiency and effectiveness. The Court found that the Directorates-General managing research expenditure ⁽⁹⁾ share audit results, although they do not have written procedures. The other Internal Policies Directorates-General audited ⁽¹⁰⁾ do not systematically disseminate results to other DGs and have not established any procedures. In November 2006, the Commission introduced an audit tracking system to enable results of audits performed by all Commission departments to be registered in a central database accessible to all Directorates-General. The Court examined the use of the tool by the research DGs and found that it is used only by DG ENTR.

Follow-up to previous observations

7.29. The results of the Court's follow-up of key observations in recent Statements of Assurance may be found in **Annex 7.1**. The observations concern the insufficient coverage of the Commission's *ex-post* audits, delays by the Commission in making payments to beneficiaries and insufficient checks by the Commission of the management and control systems of the national managing authorities for education and culture projects.

THE COMMISSION'S REPLIES

7.27. *These problems have been reported in the DGs' annual activity reports and in the Commission's synthesis report. Actions have already been taken to correct this situation and to avoid similar difficulties in the future.*

See also the Commission's reply to paragraph 7.12.

7.28. *Audit results are shared among the research DGs on a systematic basis. The principles of audit result sharing are laid out in the common audit strategy for FP6. These principles are currently under further development by a dedicated working group.*

An increase of the audit coverage as targeted by the audit strategy requires the implementation of the audit results on systemic errors to non-audited projects across DGs. In that sense the systematic and consistent sharing of audit results is important. The research DGs have given priority to this.

The Commission's new audit tracking system allows information on audits to be linked to the Legal Entity File of the relevant beneficiary in the Commission's accounting system. Following its introduction late in 2006, data on audits will be progressively entered into the system, including via interface from the existing DG-specific audit databases.

7.29. *See the Commission's replies in Annex 7.1.*

⁽⁸⁾ Annual Report concerning the financial year 2004, paragraph 6.20 and Annual Report concerning the financial year 2005, paragraph 7.20.

⁽⁹⁾ Research; Energy and Transport; Information Society and Media; Enterprise and Industry.

⁽¹⁰⁾ Justice, Freedom and Security; Environment; Education and Culture; Health and Consumer Protection.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Conclusion

7.30. The Court's audit revealed a material level of error in payments to beneficiaries. The Commission's supervisory and control systems do not sufficiently mitigate the inherent risk of the reimbursement of overstated costs.

7.31. Improving the financial management of Internal Policies poses a considerable challenge. On the one hand, the system needs arrangements which satisfactorily protect the Community's financial interests and ensure that funds have been used for the purposes intended; on the other hand, financial control arrangements need to be proportionate and realistically designed. The system as it now operates is not yet 'transparent, robust and simple to administer' ⁽¹⁾.

Recommendations

7.32. At present, most Internal Policies expenditure is used to reimburse beneficiaries' cost claims, including justification of time spent on projects or measures. If such a system is to operate effectively, the Commission needs to take the following measures:

- simplify and clarify the rules for the calculation and reporting of costs by beneficiaries (paragraphs 7.8 to 7.11),

7.30. *The Commission continues to improve its control systems in the context of the action plan towards an integrated control framework. A multi-annual approach to mitigating the inherent risk of the reimbursement of overstated costs has been introduced, including a substantial increase in the number of ex post audits (see reply to paragraph 7.12).*

7.31. *The Commission agrees with the Court's assessment that further improvements are needed in the financial management of Internal Policies. The Commission's common ex post audit strategy in the research area is designed to ensure that the level of 'residual' (non-detected) error is reduced to an acceptable level.*

7.32.

- *The FP7 rules for participation and the model grant agreement adopted by the Commission on 10 April 2007 are an important simplification compared with previous Framework Programmes. The 'Guide for beneficiaries', including in particular the 'Guide to financial issues', as well as reporting guidelines are intended to contribute to a better understanding of the rules by the beneficiaries.*

The mechanism introduced for beneficiaries participating in multiple projects for an ex-ante certification of their methodology for the calculation of average personnel costs and overheads is intended to increase the reliability and accuracy of their cost claims and it constitutes an important step towards simplification. Furthermore, it increases the legal certainty both for beneficiaries and the Commission, and reduces the risks associated with this significant source of errors.

⁽¹⁾ Opinion No 1/2006, paragraph 94.

THE COURT'S OBSERVATIONS

- provide guidance to the certifying auditors on eligibility criteria and the accounting requirements linked to EU grant funding, proposing a model mandatory audit certificate and clarifying the terms of reference (paragraphs 7.14 to 7.17),
- enhance its desk reviews of cost statements by better monitoring of errors and increased sharing of the results of the checks (paragraphs 7.18 to 7.23),
- perform an appropriate amount of *ex-post* audits in order to address the risks to the legality and regularity of expenditure, and ensure better internal dissemination of audit results (paragraphs 7.24 to 7.28),
- respect the time limits for making payments set out in the Financial Regulation (paragraph 7.29 and **Annex 7.1**);
- follow up its audits of the management and control systems of the National Agencies managing education and culture projects and ensure that sufficient on-the-spot checks are performed (paragraph 7.29 and **Annex 7.1**).

7.33. The Court, however, repeats its recommendation that efforts should be continued to simplify the rules covering these programmes, where possible making more extensive use of lump sum financing and move to a results-based financing system ⁽¹²⁾.

SPECIAL REPORTS ISSUED SINCE THE LAST ANNUAL REPORT

7.34. Special Report No 3/2007 concerning the management of the European Refugee Fund (2000-2004).

THE COMMISSION'S REPLIES

- *The Commission is creating a web-site dedicated to ex post audits, in order to provide easily accessible information and guidance on cost eligibility and certification issues.*

For FP7, the Commission has developed audit certification on the basis of 'agreed-upon procedures'. This requires certifying auditors to perform a compulsory set of procedures and report in a mandatory format.

- *The Commission is constantly reviewing and updating its checklists to improve the quality of ex- ante desk reviews. Further steps to increase sharing the results of checks will be taken, subject to cost/benefit considerations.*
- *The Commission is increasing the number of ex post audits, including through the implementation of a common audit strategy for FP6, as described in the reply to paragraph 7.12. A new integrated IT system is also being implemented, which should help ensure better dissemination of audit results.*
- *The Commission is continuing its efforts to reduce the problem of late payments, see Annex 7.1.*
- *DG EAC is implementing an improved system following the adoption of a new generation of programmes in education, training, and youth. The programmes provide for a comprehensive set of checks and controls of the respect of procedures and internal control mechanisms in order to ensure and verify the regularity and legality of transactions and the eligibility of activities.*

7.33. *Further simplification within the existing legal framework is among the priorities of the Commission.*

Concerning the simplification of the rules for the reimbursement of costs and in particular the use of lump sums, on 4 June 2007 the Commission adopted the use of lump sums for International Cooperation Partner Countries within grant agreements for indirect actions concluded under FP7.

⁽¹²⁾ See Annual Report concerning the financial year 2005, paragraphs 7.8 and 7.29 and Opinion No 1/2006, paragraphs 58 to 61.

Follow-up of key Statement of Assurance observations

| Court observation | Action taken | Court analysis | Commission reply |
|---|---|--|--|
| 1. Insufficient coverage of the Commission's ex-post audits | | | |
| <p>The Commission has persistently fallen short of its target of auditing 10 % of the contractors (beneficiaries) for the Fifth Framework Programme for Research and Technological Development. The Court found undue delays in the completion of the audits, in the subsequent reporting of findings to the Commission and in the launching of related recovery procedures by the Commission.</p> <p>The Commission has not yet set a concrete audit target for the Sixth Framework Programme.</p> <p>(Annual Report concerning the financial year 2003, paragraphs 6.27 to 6.33 and Annex 6.1; Annual Report concerning the financial year 2004, paragraphs 6.18 to 6.24 and Annex 6.1; Annual Report concerning the financial year 2005, paragraphs 7.18 to 7.23).</p> | <p>The Commission has developed a specific audit strategy for the Sixth Framework Programme based on a detailed analysis of the population of beneficiaries. The Commission will extend systemic findings to all contracts of the most significant beneficiaries.</p> | <p>The Commission should ensure appropriate coverage of the checks, based on a coherent strategy which includes the largest beneficiaries and a risk-based sample of others.</p> <p>The common audit strategy for FP6 which is being implemented by the Commission represents a sound basis for addressing the problems identified by the Court.</p> | <p><i>The Commission notes that the Court considers the common audit strategy for FP6 to be a sound basis for addressing the problems identified.</i></p> <p><i>The Commission has also decided to substantially reinforce the ex post audit functions. The measures will lead to an increased level of audit coverage.</i></p> <p><i>DG EAC is revising its audit strategy thereby taking due account of the Court's recommendations.</i></p> |
| 2. Persistent late payments by the Commission | | | |
| <p>In a significant proportion of cases, the Directorates-General responsible for Internal Policies audited by the Court (DGs RTD, INFISO, TREN and ENTR) have incurred undue delays in making payments to beneficiaries, thus failing to comply with the time limits for expenditure operations set out in the Financial Regulation. The Court found that DG EAC has no reliable management information on its late payments.</p> <p>In 2005, 11 out of 69 Internal Policies payments audited by the Court were made late (i.e. 16 %). For 2006, the Court identified late payments in 21 out of 113 cases (i.e. 18,6 %).</p> <p>(Annual Report concerning the financial year 2003, paragraph 6.22; Annual Report concerning the financial year 2004, paragraph 6.27; Annual Report concerning the financial year 2005, paragraph 7.10).</p> | <p>DG RTD has harmonised the registration method for the time to pay and revised its reporting scheme. For the difficult area of payments to experts, the DG has adopted a specific action plan.</p> <p>DG INFISO has improved its management information on late payments and introduced regular training sessions to reduce payment times.</p> <p>DG TREN has introduced systematic review of payment deadlines, improved monitoring of delays and increased internal communication on late payments.</p> <p>DG ENTR now closely monitors the time needed for payments and has introduced awareness-raising actions led by its financial units.</p> <p>DG EAC is awaiting the introduction of its new accounting system in order to begin monitoring late payments.</p> | <p>The Directorates-General should continue to develop the initiatives undertaken in 2006 in order to tackle the problem of late payments. Exchange of experience by the Directorates-General could help to identify common issues and to develop more efficient and effective controls.</p> | <p><i>The Commission is continuing its efforts to reduce the problem of late payments. The DGs are gradually putting in place pro-active management reports to enhance the monitoring of payment times. Performance indicators are being developed and implemented.</i></p> |

| Court observation | Action taken | Court analysis | Commission reply |
|--|--|---|--|
| 3. Insufficient checks by the Commission of the management and control systems of national managing authorities (National Agencies) for education and culture projects | | | |
| <p>The Commission has not complied with the requirement of the Financial Regulation to carry out checks on the management and control systems of the National Agencies before entrusting them with the implementation of Community actions.</p> <p>Systems audits performed by the Commission did not include on-the-spot checks of projects, limiting the assurance provided on the legality and regularity of the underlying transactions. The audit reports contained several shortcomings, such as inappropriate or inconsistent classification of the importance of findings as well as insufficient action to correct the identified weaknesses.</p> <p>(Annual Report concerning the financial year 2005, paragraphs 7.24 to 7.27).</p> | <p>DG EAC has continued its programme of systems audits in 2006, for which 96 of the 99 planned audits were completed by the end of March 2007.</p> <p>The task list of the externally contracted auditor has been extended to include on-the-spot checks. A pilot action for such checks has been initiated for the Leonardo da Vinci vocational training programme, but at the end of 2006 only limited progress had been made.</p> <p>The content of audit reports has been discussed with the auditor to arrive at a common understanding.</p> | <p>DG EAC should introduce systematic follow-up to the audit reports and develop an overview of the results of the audits, including clear identification of the rates of error affecting the projects.</p> | <p><i>DG EAC has completed all but one of its system audits by June 2007; only the final acceptance of one report is outstanding. Conclusions have been drawn and taken into account before contracting National Agencies (NAs) for the new programmes. A series of follow-up audits are under preparation and will be conducted in the course of 2007.</i></p> <p><i>As concerns the implementation of the new programmes, the requirements of the Financial Regulation are respected through the Commission's analysis and approval of ex-ante declarations of assurance issued by National Authorities before the Commission enters into a contractual relation with the National Agencies. Where relevant, the analysis takes account of the audit findings. National Authorities will also issue annual ex post declarations of assurance concerning the use of funds during the previous year.</i></p> |

ANNEX 7.2

Assessment of supervisory and control systems

| System concerned | Key internal control | | | | Overall assessment |
|---|----------------------|--------------------|-----------------------|--------------------|--------------------|
| | Adequate guidelines | Adequacy of checks | Monitoring of results | Sharing of results | |
| Audit certification of cost statements | | | | | |
| Ex ante desk reviews of cost statements | | | | | |
| Commission's ex-post financial audits | | | | | |

Legend:



Satisfactory

Partially satisfactory

Unsatisfactory

N/A

Not applicable: does not apply or not assessed

CHAPTER 8

External actions

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INTRODUCTION

8.1. This chapter deals with the external aid financed from the general budget ⁽¹⁾. The main areas are food aid/food security, humanitarian aid, NGO co-financing and relations with Asia, Latin America, the Commonwealth of Independent States, the Western Balkans, the Middle East and the Southern Mediterranean. The Directorates-General for External Relations and for Development are responsible for formulating development cooperation policies, country/regional strategies and multi-annual programming, and the EuropeAid Cooperation Office (EuropeAid) is responsible for their implementation. The Directorates-General for Humanitarian Aid (DG ECHO) and Enlargement (DG ELARG) are responsible for the formulation of both policy and strategy as well as for implementation. DG ECHO for humanitarian aid and DG ELARG is responsible for CARDS ⁽²⁾.

8.2. **Diagrams III** and **IV** of **Annex I** show the funds spent in 2006 for financial perspective Heading 4 'External actions' (commitments: 5 867 million euro; payments: 5 186 million euro).

SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Audit scope

8.3. The objective of the audit was to provide a conclusion as to the legality and regularity of the underlying transactions in external actions. The audit comprised an evaluation of the Commission's supervisory and control systems which are designed to ensure the legality and regularity of transactions, supported by tests of transactions at the Delegations and implementing organisations. Transactions processed by the Commission headquarters, mainly relating to direct budget support and multi-regional projects, were not included in the Court's audit sample. The audit included an assessment of the system of external audits carried out by private firms on behalf of the Commission — an important component of the Commission's assurance as regards expenditure at project level.

⁽¹⁾ Aid provided through the European Development Funds is reported separately as it is not financed from the general budget.

⁽²⁾ Community Assistance for Reconstruction, Development and Stabilisation.

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Specific characteristics of external actions spending

8.4. The majority (approximately 80 %) of external actions expenditure is managed by the Commission's Delegations in the third countries concerned. Most of their payments are advances made to the organisations implementing development projects (e.g. international organisations, government institutions or NGOs).

8.5. The projects supported are dispersed through more than 150 countries, and the implementing organisations vary greatly both in size and administrative capacity. Within the projects there are a large number of individual payments, which are subject to complex rules, in particular concerning tendering and the origin of supplies.

8.6. The main risk to legality and regularity is that project claims may include ineligible expenditure, and this may go undetected.

*Legality and regularity of underlying transactions***EuropeAid***Transactions audited at Delegation level*

8.7. The Court visited three Commission Delegations (China, Jordan and Guatemala) to assess their supervisory and control systems and to audit a number of transactions for which the EuropeAid Cooperation Office was the Authorising Officer by delegation.

8.8. The Court audited a sample of 20 payments (for a total of 17 million euro) and seven tenders (for a total of 11 million euro) at the three Delegations focusing on the payments and reimbursements made to the projects visited on-the-spot (see paragraph 8.9) and high-value amounts. This work revealed a low level of errors.

8.4. *Final payments, including a clearing of the advances, are usually made upon completion of the projects and approval by the Commission of their final reports.*

THE COURT'S OBSERVATIONS

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Transactions audited at implementing organisation level

8.9. The Court visited 11 projects managed by implementing organisations, where a sample of 132 payments (for a total of 6,9 million euro) and 20 tenders (for a total of 9,4 million euro) was audited. The selection of transactions ensured coverage of all main cost categories.

8.10. As in previous years, the Court found that compliance with the prescribed contracting procedures and the eligibility of expenditure at project level were the highest risk areas and a material incidence of error was found in the sample of transactions of interim and final payments examined:

- (a) in nine out of the 11 projects audited on the spot, the Court found that contracting procedures were not applied properly. An example of non-compliance with the prescribed procedures was the splitting of contracts in order to avoid stricter tendering procedures;
- (b) the Court detected ineligible expenditure in three out of the 11 projects audited, such as the inclusion of ineligible cost categories, the overspending of budget lines and expenditure outside the specified implementation period of the projects;
- (c) in four out of the 11 projects the supporting evidence (e.g. invoices, receipts and bank statements) necessary to validate the payments checked was missing.

DG ECHO

8.11. As regards DG ECHO (DG for Humanitarian Aid), it was found that the rules on eligibility of expenditure and on tendering procedures give ambiguous definitions of certain points, which should be clarified. Audits at two implementing partners showed that rates of exchange, depreciation on equipment such as vehicles, and interest received on advances were handled differently by the implementing partners, resulting in variations in the amounts of eligible expenditure in otherwise similar situations.

8.10. *Certain comments made by the Court concerning current contracts for which the final payments have not yet been made, in relation to which corrective action should therefore be taken at the time of closure under the Commission's control system.*

For example, the Commission carries out mandatory audits and/or audits based on risk analysis in order to detect and correct any errors made by the implementing organisations before or even after the final payments. These audits usually accompany clearances of accounts.

8.11. *With the mobility between staff of partners and the variety of types of operations, the Commission accepts that the implementing partners can have varied the interpretation on eligibility or tendering rules. Recognising this, the Commission made a major effort to clarify the interpretation of various financial and contractual rules by the issue of Fact Sheets and, in the spirit of partnership, has undertaken regular training of partners and increased the vigilance so that partners are better guided.*

Different techniques for depreciation for vehicles are possible and the concept of interest on prefinancing payments has been clarified in the implementing rules of the Financial Regulation, and will be reflected in the revised Framework Partnership Agreement between DG ECHO and humanitarian organisations.

THE COURT'S OBSERVATIONS

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*Supervisory and control systems***Components of the control strategy**

8.12. In view of the specific characteristics of external aid expenditure (see paragraphs 8.4 and 8.5), the Commission faces a considerable challenge in implementing systems to control this spending effectively and efficiently. Besides the *ex ante* checks made on all payments the key supervisory and control systems include:

- audits which include systems reviews and certification of projects' financial statements, usually carried out by professional external audit firms. When required routinely under the terms of project financing agreements these audits are usually commissioned by the beneficiary,
- additional project audits carried out for the Commission. These are selected annually on the basis of risk analysis,
- *ex post* documentary checks on payments made by Commission services,
- verification missions to Delegations carried out by Commission headquarters' staff.

Audits of Implementing Bodies

8.13. EuropeAid operates a two-stage audit strategy in order to verify the legality and regularity of expenditure at project level. A first layer of assurance is provided by the certification audits required in most project financing agreements and a second layer consists of additional audits of projects selected on the basis of a risk analysis.

8.14. Financial and audit reports are required in most cases before payments are made to project implementing organisations. It is essential that these reports can be relied on as they are such an important component of the control structure for payments. The quality of the reports and particularly of the audit reports is therefore of major importance in the approval process for most payments processed through the Delegations.

8.12. *The primary assurance mechanism is represented by the ex ante checks made by the Commission's services during the authorisation process, in line with the applicable Financial Regulation. Such controls may also rely, in relation to the type of action financed, on audit reports.*

The elements mentioned by the Court should be considered as part of the wider management and control system put in place by the Commission, ranging from the ex ante assessment of the actions to be financed and the selection of the operators to implement them to the various controls carried out at different steps of the management cycle including monitoring of the programme implementation and on the spot checks.

THE COURT'S OBSERVATIONS

8.15. The Court made a desk review of 22 project audits as well as examining project audits at the Delegations visited. For four of the audits covered by the desk review, the terms of reference used did not require testing of all key aspects.

8.16. In all 10 audit reports reviewed at the Delegations, the scope of the audit was insufficient. Some risk areas such as compliance with the prescribed contracting procedures were not covered and for two out of the 10 audits the contracted auditors were not provided with complete terms of reference.

8.17. The Court detected internal control weaknesses in eight out of the 11 implementing organisations visited on the spot. The main weaknesses detected were inadequate financial procedures, insufficient documentation for the allocation of expenditure to projects and budget lines, the entering of advances as actual expenditure in the accounting system and the inconsistent use of exchange rates.

8.18. DG ECHO commissions audits at its implementing partners' headquarters offices and of projects on the spot. In both cases a review of internal controls is made and a sample of project expenditure is tested. The majority of audits are done at the partners' headquarters. As the reality of project expenditure can be more effectively checked at field level, there should be more emphasis on on-the-spot audits.

Ex post controls

8.19. EuropeAid has a programme of *ex post* controls which are carried out at headquarters, and cover payments made by Commission services on a sample basis to assess whether the Authorising Officers carried out the required checks. The Commission reviewed the usefulness of *ex post* controls in 2006 and re-oriented them. However, as they do not cover transactions at the level of project implementing organisations, they can only make a limited contribution to the overall assurance on systems and procedures and the legality and regularity of the underlying transactions.

THE COMMISSION'S REPLIES

8.15-8.16. *The objective of financial audits is to certify the eligibility of expenditure incurred by the beneficiary in the light of the contractual provisions, including tendering procedures, if the action so requires of the beneficiary.*

The tendering procedures were mentioned in the terms of reference of the selected audits, and the auditors did test such aspects during the audit work. These elements are reflected in the corresponding work programs of the auditors in the audit report.

New standard contracts and terms of reference for expenditure verifications to be launched by beneficiaries are applicable to contracts signed after 1 February 2006. These further reinforce the verification of the contractual aspects mentioned by the Court.

8.17. *Implementing organisations are not part of the Commission Internal Control System, they are linked to the Commission by a contractual relation for the implementation of a specific action. The Commission monitoring and control system aims at ensuring the compliance of contract partners with the contractual requirements and covers, where necessary, relevant aspects of their internal control systems.*

The fact that a weakness is identified at implementing organisation level neither implies a weakness of the Commission control system nor that this weakness will go undetected by the Commission.

8.18. *The balance between headquarter and field audits has to be seen in the context of an overall risk-based control strategy, where the Commission puts important emphasis on monitoring operations during implementation of the project through close follow-up performed by both experts in the field and geographical desks at headquarters. Furthermore, the Commission analyses in detail the information provided by partners in the various reports.*

A new Framework Contract concluded in August 2006, has rebalanced the audits in favour of field audits to better link them with headquarter audits.

8.19. *Setting up a transactional ex-post control system, and defining its characteristics, are both based on an appreciation of residual risk and of the interaction with the other components of the control system. Ex-post transactional controls provide an additional layer of assurance for the appreciation of the elements which are subject to such control.*

This covers payments, recoveries and clearance of pre-financing transactions carried out by the Commission. However, the control of, for instance, a clearance of pre-financing transaction necessarily covers the reporting made by the beneficiary on their own transactions. Transactions at implementing organisation level fall within the scope of other controls, notably audits.

THE COURT'S OBSERVATIONS

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Verification missions to Delegations

8.20. The finance units of the EuropeAid geographic directorates ⁽³⁾ carry out a programme of verification missions to Delegations, which consist of a review of their financial systems for processing transactions, their contracting system and their supervisory and control systems, completed by tests of transactions processed by the Delegations and some project implementing organisations. EuropeAid intends to introduce a standardised methodology for these verification missions in 2007. However, only one of the finance units carried out a programme of verification missions to its Delegations in 2006, including implementing organisations. One of the other two units did not carry out any verification missions in 2006, and the other only visited two Delegations and no implementing organisations.

Using the results*Collecting and collating the control information in EuropeAid*

8.21. The value of the external audit reports as a source of assurance, regarding the legality and regularity of expenditure for which EuropeAid is responsible, depends on their coverage and on the follow-up that they receive. It is therefore important that both are completely and coherently documented and reported to EuropeAid headquarters.

8.22. External assistance management reports from Delegations should provide headquarters with important financial and technical information on a six-monthly basis. The Court's review of a sample of 16 such reports concluded that the same situation as applied in previous years also existed in 2006, namely that the information provided on external audits was incomplete (only two reports gave any information on results) and inconsistent in terms of the categories of audits included (planned and/or in progress, managed by the Delegation or also by project implementing organisations).

8.20. All delegations were subject to a systematic verification exercise before devolution was held to be operational (2001 to 2004).

All geographic Directorates carry out a monitoring of their delegations' management of devolved operations, using a varying combination of checks, inspections and audits.

Besides verification missions, this monitoring relies on regular reporting from delegations (External assistance management reports — EAMRs), the use of the information systems, the projects monitoring system by external experts, regular contacts with the delegations and is complemented by the activities of the IAC, IAS and Inspection Service. Verification missions are to be considered in a multiannual perspective and their number may vary from year to year in accordance with the Directorates' needs and priorities. The first of the two services mentioned by the Court for instance has planned 4 missions in 2007, 2 of which have already been carried out. The second one, which has consistently carried out a programme of missions to its delegations since 2003, has planned 4 such missions in 2007.

8.21. The majority of project audits are mandatory and/or ex ante audits, i.e. they take place during the implementation of the action and are provided for in the Financial Regulations, the specific programme legal basis (complemented by EuropeAid financial and contractual procedures) and reflected in conventional (e.g. financing agreements with third countries) and contractual documents.

8.22. Delegations report on the implementation of their audit plans in the EAMRs, also highlighting aspects of general interest, where appropriate. As regards the use of audit results, relations between EuropeAid and the Delegations ensure proper, more regular and more detailed exchanges of information.

The recently modified reporting format used by Delegations on the implementation of the Annual Audit Plan for 2007 is now more detailed and will allow a clearer distinction between the different phases of the audit process and the origin of the audit. By including in the EAMRs audits managed by project implementing organisations some delegations went beyond reporting requirements.

⁽³⁾ The geographic directorates are: (1) Asia and Central Asia; (2) Europe, the Southern Mediterranean, Middle East and Neighbourhood Policy; (3) Latin America.

THE COURT'S OBSERVATIONS

8.23. The Court has in previous years ⁽⁴⁾ drawn attention to the lack of complete information at EuropeAid headquarters on these audits, including their results and the corrective action needed and taken. The availability of such information in an up-to-date database would not only provide a comprehensive view of the audit effort and its total contribution to assurance, key information for the following year's risk analysis, but could also allow all the interested parties to have access to this important information. This would be particularly valuable because of the varying degrees of involvement of different Directorates-General. However, again in 2006, details of the majority of external audits were not yet being input to the audit module of the Common Relex Information System (CRIS Audit).

8.24. Although a sample of audits is reviewed annually by EuropeAid headquarters in order to draw general conclusions, there is not yet a systematic centralisation of results, errors discovered and follow-up carried out. As a result, the value of these audits to the Commission's assurance on expenditure at project level is not yet being fully used.

Sharing audit information between Commission services

8.25. The three organisations selected for review by the Court received funding from more than one Directorate-General. Better coordination of audits and more extensive sharing of audit information between the Commission services (for example, by using CRIS Audit — see paragraph 8.23) would be valuable both to avoid duplication of audit work, and to ensure that there is no inadvertent under-coverage of an organisation in the light of its total receipts from the Commission as a whole.

THE COMMISSION'S REPLIES

8.23. *The current system for the planning and centralised monitoring of external audits provides the information necessary for EuropeAid's risk analysis and audit strategy. The planning and follow-up of audit results are both ensured by the authorising departments concerned at Headquarters or in Delegations. No payment subject to an audit is authorised before receiving and taking into account the results of such audits. EuropeAid intends to further improve the operation of CRIS-Audit building on the experience gathered, as a tool complementary to the current system. Meanwhile, the Commission has made the Annual Audit Plan (AAP) 2007 reporting format more detailed.*

On the need to share audit information with other Commission services see the Commission reply to paragraph 8.25.

8.24. *EuropeAid has developed appropriate tools to conduct audits while several mechanisms contribute to their quality control as well as to the consolidation and use of the systemic audit findings.*

EuropeAid follows at central level the implementation of the AAP and has been performing, since 2005, a review of audit reports issued during the year. The objective of this review is to contribute to the monitoring of audit activity at Headquarters and in the Delegations as well as learn lessons and propose appropriate measures to further improve the audit system based, inter alia, on an analysis of the typology of audit findings (see also reply to paragraph 8.23).

8.25. *The Court correctly highlights the need for sharing information of audit results, which should take place when it is expected to provide clear added value.*

The Commission services regularly exchange information resulting from audits, assessments and evaluations. At present, this needs based exchange and co-ordination seems to be adequate. The Commission is willing to deepen this co-ordination if the need arises.

⁽⁴⁾ See the Annual Report concerning the financial year 2005, paragraph 8.9.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Coordination of the control strategy

8.26. As noted in the Court's Opinion No 2/2004 ⁽⁵⁾, any control system is a trade-off between the cost of operating the defined intensity of checks on the one hand and the benefit these procedures bring on the other. It is necessary to establish a strategy that defines the contribution to overall assurance to be made by each of the various control procedures in force, both to avoid unnecessary duplication and to ensure that techniques to be applied selectively (such as project audits) are well targeted. In addition, efficient reporting systems are needed to provide a reliable picture of control activities undertaken and of the main results so that the maximum benefit can be obtained and informed decisions made about the necessary types and intensity of control.

8.27. The Common Relex Information System (CRIS) provides data for the day-to-day management of projects. Largely as a result of data definition limitations some desirable analyses of financial information are not available from the system. For example, there is insufficient or inconsistent financial information available by type of implementing organisation or funding method on which to base the more detailed risk analysis mentioned in paragraph 8.28. EuropeAid recognises the need to enhance CRIS.

8.28. During 2006 EuropeAid brought into use a central risk register, to be updated quarterly. At the end of December 2006, critical risks had been identified for input to the 2007 Annual Management Plan. However, there is, as in previous years, no indication that the findings of project external auditors, and the particular risks associated with the different types of implementing organisations (NGO, international organisation, government institution, etc.) and funding methods (grant, budgetary support, trust fund, etc.) were taken into account in the analysis made. Neither is the identification of risks linked systematically to the findings of the Commission's internal audit services. These elements would have provided very useful input for a comprehensive risk analysis exercise, which would also help to focus the control activities.

8.26. *The Commission Services are fully aware of the need to have and apply a control strategy that is cost effective, integrating audits, evaluations, assessments, monitoring and supervisory activities. In line with the Court's Opinion, the Commission has set up an Action Plan 'Towards an Integrated Internal Control Framework' which aims to develop a common, coordinated approach and tools for all Commission's services. This includes the formalisation and harmonisation of the presentation of the internal control strategies the aim of which is to provide an overall view of the internal control flow and related accountability chain and to document how associated risks are addressed. Work is ongoing in line with and following the schedule of the Action Plan.*

8.27. *Information from the system allows relevant analyses to be performed in relation to the needs of EuropeAid, including by type of implementing organisation or management mode. The system is being constantly refined in line with evolving management needs.*

8.28. *The annual Risk Self-assessment is carried out in the context of the Annual Management Plan and is a high level risk assessment which complements other and more detailed risk analyses, carried out for instance in the context of the establishment of the AAP. It focuses on residual risk taking account of the mechanisms already in place. The fact that the elements mentioned by the Court are not directly reflected in the formulation of the risk (obviously synthetic) does not imply that these elements have not been taken into account during the exercise.*

⁽⁵⁾ Opinion No 2/2004 of the Court of Auditors on the 'single audit' model, paragraph 50.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Internal audit

8.29. In 2006 the Internal Audit Service (IAS) reported on the EC/UN Financial and Administrative Framework Agreement (FAFA) and on a follow-up of their 2003 audit of the EuropeAid internal control system as a whole. An action plan to implement those recommendations on FAFA that were accepted is being carried out by EuropeAid and DG ECHO. The Court has reported on FAFA ⁽⁶⁾, and will follow up this issue. As regards the internal control system, EuropeAid had implemented most of the IAS recommendations and was making good progress with the remainder.

8.30. The Internal Audit Capability (IAC) serving both EuropeAid and DG ECHO completed a number of assignments in 2006, including audits of the risk management systems and of procurement in EuropeAid. The IAC does not at present provide an annual overall assessment of the state of internal control in EuropeAid and DG ECHO. Such a periodic global assessment could be a valuable assurance to the respective Directors-General. Despite the creation during 2006 of two additional posts in the IAC, it does not seem feasible with the present staff complement to carry out, within the three-year cycle proposed, the full audit coverage identified in the EuropeAid Audit Needs Assessment. A similar audit needs assessment for the DG ECHO part of the work was completed in early 2007.

Conclusions and recommendations

8.31. The Court's audit revealed a low level of error affecting transactions checked at the level of the Delegations (see paragraph 8.8). However, a material incidence of error was detected in the sample tested at the level of the project implementing organisations (see paragraphs 8.9-8.10).

⁽⁶⁾ See the Annual Report concerning the financial year 2005, paragraphs 8.24-8.28, and the Annual Report concerning the financial year 2006 on the activities funded by the European Development Funds, paragraph 52.

8.30. *The role of the IAC is not to provide an annual opinion on the Annual Activity Reports (AAR) of the DGs, but to give advice regarding the AAR process and in accordance with the nature and scope of its work during the year in question, the IAC should express an opinion on the state of control as a contribution to the preparation of the AAR (see SEC(2003) 0059).*

In giving the assurance, the Directors General rely on various information resources (including amongst others the audits performed by the IAS or other controlling bodies, including the IAC) which all collectively contribute to the assurance.

In 2006 the IAC in EuropeAid was reinforced with 2 additional posts allowing it to widen the scope of its work. As can be seen from the activities of the IAC in 2006, its work programme for 2006 has been completed as originally planned.

8.31. *The Commission estimates that the overall financial impact of the errors on final payments for all external actions, based on the errors detected by the Court and the audits and controls that the Commission undertakes is acceptable, though could be improved further.*

Certain comments made by the Court concerning current contracts for which the final payments have not yet been made, in relation to which corrective action should therefore be taken at the time of closure under the Commission's control system.

THE COURT'S OBSERVATIONS

8.32. The Court's overall assessment of the Commission's supervisory and control systems in 2006 is shown in **Annex 8.2**. As explained in paragraphs 8.13 to 8.18, there continued to be weaknesses in the systems designed to ensure the legality and regularity of transactions at the level of project implementing organisations.

8.33. In order to mitigate these weaknesses, the Court recommends that:

- (a) external auditors of projects should carry out their work on the basis of terms of reference that cover all known risk areas, including compliance with the Commission's requirements regarding contracting procedures and the eligibility of expenditure, and clear reporting requirements should be set out (see paragraphs 8.15 and 8.16);
- (b) the data definitions and rules for input to CRIS should be developed so that it contains a reliable and useful analytical record of all audits of projects, whether carried out by external auditors or Commission staff, permitting the information to be:
 - better summarised,
 - linked to the corresponding project management information,
 - used to feed the risk assessment system,
 - and ultimately shared in the RELEX family (see paragraphs 8.23, 8.25 and 8.27);
- (c) the information provided by Delegations about audits should be better reviewed by EuropeAid headquarters to ensure it is complete and consistent. This should be supported by verification missions carried out by all directorates (see paragraphs 8.20, 8.22 and 8.24);

THE COMMISSION'S REPLIES

8.32. *The Commission internal control system is shaped to take into account the multiannual character of external aid expenditure, ensuring that controls on payment claims by the beneficiaries be effected at key stages of project implementation, thus allowing errors on advance payments to be detected and remedied.*

Measures were taken in 2006 to further strengthen the control systems, including distribution of the improved practical guide for contractual procedures covering both the budget and the EDF, the guide for programme estimates, more detailed reporting guidelines for Delegations and more rigorous ex-post controls.

The Commission is aware that there is room for improvement but considers the systems currently in place provide reasonable assurance concerning the legality and regularity of external action expenditure as a whole.

8.33.

- (a) *New standard contracts and terms of reference for expenditure verifications, which entered into force on 1 February 2006, specifically address the aspects mentioned by the Court.*
- (b) *The Commission intends to further improve the operation of CRIS-Audit building on the experience gathered, as a complement to the existing system.*
- (c) *The Commission has recently modified the delegations reporting format on the implementation of the Annual Audit Plan for 2007 so that it is now more detailed and will allow a clearer distinction between the different phases of the audit process, and the reason for the audit.*

THE COURT'S OBSERVATIONS

- (d) DG ECHO should clarify the rules on eligibility of expenditure to prevent varying interpretations (see paragraph 8.11);
- (e) the balance between DG ECHO's headquarters and field audits of implementing partners should be reviewed, in order to obtain a better view of the reality of project expenditure (see paragraph 8.18).

THE COMMISSION'S REPLIES

- (d)** *The Commission continued to work with contracting organisations on improving their understanding of the rules, to accommodate varying interpretations. Fact sheets have been sent to all partners in June 2007 to give a clear interpretation on existing rules.*
- (e)** *The balance between headquarter and field audits has been reviewed and should be seen in the context of an overall control strategy (see paragraph 8.18).*

ANNEX 8.1

Follow up of key Statement of Assurance observations

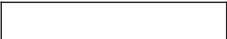


| Court observation | Action taken | Court analysis | Commission reply |
|---|---|---|--|
| <p><i>Errors in payments made by implementing organisations</i></p> <p>The Court found a material incidence of error in the sample of payments tested at implementing organisation level.</p> <p>(Annual Report concerning the financial year 2005, paragraph 8.20)</p> | <p>Terms of reference for financial audits to be launched by Beneficiaries have been revised.</p> | <p>The action taken had not yet delivered effective results for the payments audited in 2006.</p> | <p>See the Commission's replies to paragraphs 8.10, 8.15, 8.16 and 8.31.</p> |
| <p><i>External audits of projects</i></p> <p>External auditors were not provided with complete terms of reference, meaning that some risk areas were not covered by the audits, such as the need to test compliance with the prescribed contracting procedures.</p> <p>(Annual Report concerning the financial year 2005, paragraph 8.15)</p> | <p>New standard contracts and terms of reference for expenditure verifications, which entered into force on 1 February 2006, specifically address the contractual aspects mentioned by the Court.</p> | <p>The full effect will not be visible until 2007 (the majority of audit reports reviewed in the context of the DAS 2006 were contracted before February 2006).</p> | <p>See the Commission's replies to paragraphs 8.10, 8.15 and 8.16.</p> |
| <p><i>Information on audits and their results</i></p> <p>Neither External Assistance Management Reports (EAMRs) nor the computerised management information system CRIS (Common Relex Information System) contain complete and systematic information on audits of projects and their results.</p> <p>(Annual Report concerning the financial year 2005, paragraphs 8.9 and 8.10)</p> | <p>The entry of audit information in CRIS increased in 2006, but was not yet complete. EAMRs continued to report audits inconsistently.</p> | <p>Although the use of CRIS increased, the potential benefits of a complete central record of audits and their results are not yet being realised.</p> | <p>See the Commission's reply to paragraph 8.23.</p> |
| <p><i>Risk assessment</i></p> <p>EuropeAid's risk assessment should make reference to the findings of audits at project level and differentiate between the different types of implementing organisations and funding methods.</p> <p>(Annual Report concerning the financial year 2005, paragraph 8.23(a))</p> | <p>The risk assessment has been improved by introducing a central Risk Register, updated quarterly.</p> | <p>Despite the introduction of the Risk Register, there is still no link to audit findings or explicit analysis by organisation and funding method.</p> | <p>See the Commission's reply to paragraph 8.28.</p> |

ANNEX 8.2

Assessment of supervisory and control systems

| System concerned | Key internal control | | | | | | Overall assessment |
|-------------------------------|------------------------|----------------------------------|-----------------|--------------------------------------|-----------------|----------------------|--------------------|
| | Procedures and manuals | Management <i>ex ante</i> checks | Internal audits | Transactional <i>ex post</i> control | External audits | Management reporting | |
| EuropeAid Co-operation office | | | | | | | |
| DG Humanitarian Aid (ECHO) | | | | N/A | | | |
| Commission's Delegations | | | | N/A | | | |

Legend:

| | |
|---|--|
|  | Satisfactory |
|  | Partially satisfactory |
|  | Unsatisfactory |
| N/A | Not applicable: does not apply or not assessed |

CHAPTER 9

Pre-accession strategy

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THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

INTRODUCTION

9.1. This chapter of the annual report deals with Heading 7 of the Financial Perspectives covering expenditure under the pre-accession instruments (Phare, ISPA and Sapard) for Central and Eastern European countries ⁽¹⁾, and the pre-accession assistance programme for Turkey.

9.2. The Phare programme ⁽²⁾ and the pre-accession assistance programme for Turkey ⁽³⁾ are managed by the Directorate-General for Enlargement. These pre-accession programmes support institution-building and investments. ISPA ⁽⁴⁾ was set up to facilitate accession in the fields of environment and transport and is managed by the Directorate-General for Regional Policy. Sapard ⁽⁵⁾ is implemented under the responsibility of the Directorate-General for Agriculture and aims to help the beneficiary countries deal with problems arising from structural adjustment in their agricultural sectors and rural areas, as well as to contribute to the implementation of the common agricultural policy.

9.3. The Phare, Turkey and ISPA programmes and projects are mainly implemented through a Decentralised Implementation System (DIS), with *ex ante* control of procurement and contract award decisions carried out by the Commission Delegations, or through the Extended Decentralised Implementation System, in which the Commission's *ex ante* control of tendering and contracting is waived (EDIS) ⁽⁶⁾. Under decentralised management, payments to contractors and beneficiaries are made by the national authorities, with *ex post* control by the Commission.

⁽¹⁾ The eight countries that became Member States in 2004 (the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia and Slovakia), the two countries that became Member States on 1 January 2007 (Bulgaria and Romania) and the candidate country Croatia.

⁽²⁾ Poland, Hungary and Restructuring in the East, Council Regulation (EEC) No 3906/89 (OJ L 375, 23.12.1989, p. 11).

⁽³⁾ Council Regulation (EC) No 2500/2001 of 17 December 2001 concerning pre-accession financial assistance for Turkey (OJ L 342, 27.12.2001, p. 1).

⁽⁴⁾ Instrument for Structural Policies for Pre-Accession, Council Regulation (EC) No 1267/1999 (OJ L 161, 26.6.1999, p. 73).

⁽⁵⁾ Special Accession Programme for Agriculture and Rural Development, Council Regulation (EC) No 1268/1999 (OJ L 161, 26.6.1999, p. 87).

⁽⁶⁾ Under EDIS specific implementing agencies were accredited to implement the Phare and ISPA programme without the Commission's *ex ante* control of tendering and contracting.

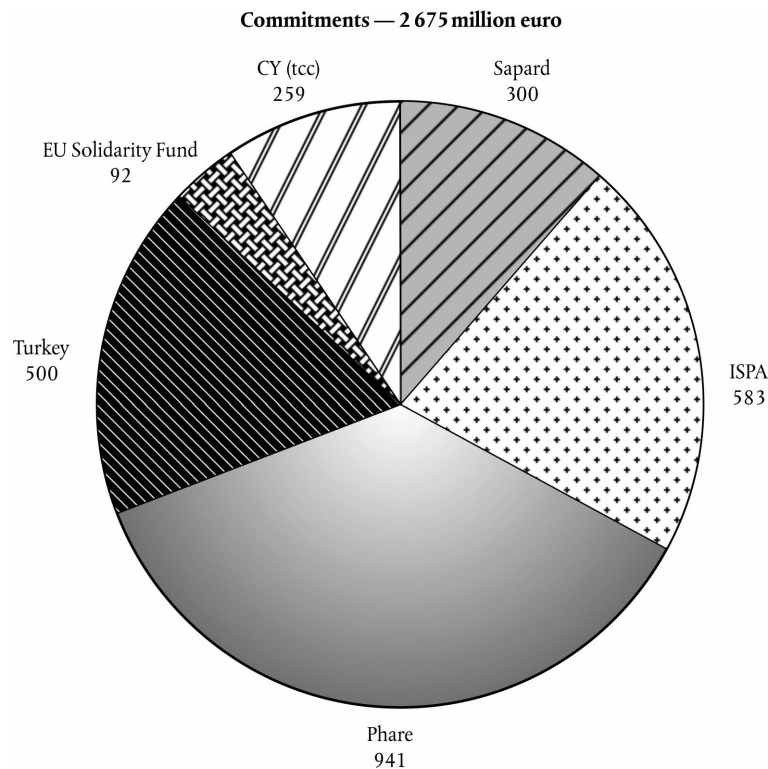
THE COURT'S OBSERVATIONS

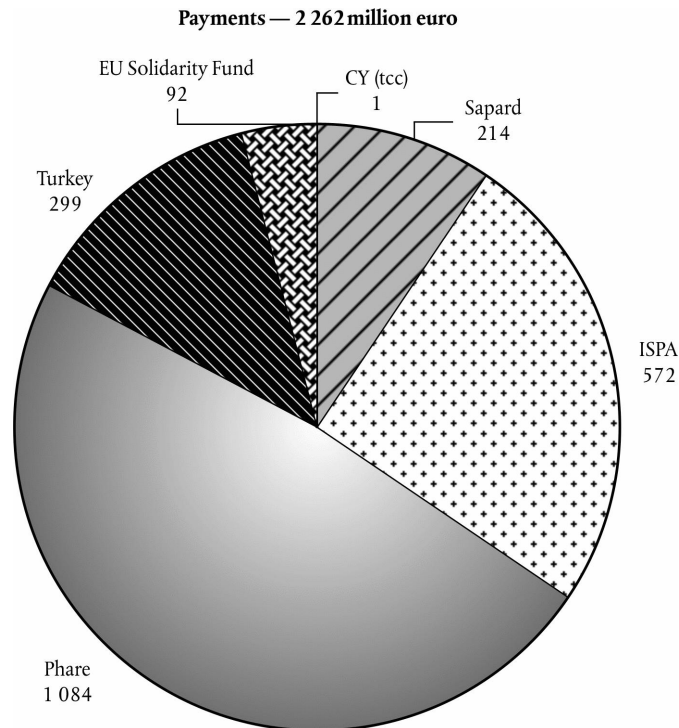
THE COMMISSION'S REPLIES

9.4. Sapard, on the other hand, is also implemented in a decentralised manner, but without *ex ante* approval by the Commission for project selection, tendering and contracting. Based on its own assessments, the Commission has conferred management of the programme on each beneficiary country. Implementation and payment functions are the responsibility of accredited paying agencies, which reimburse expenditure incurred by beneficiaries. Each paying agency is required to provide the Commission annually with a certificate on its accounts and an audit report by an independent certifying body. The Commission checks to ensure that systems are adequate and are operating as intended and carries out clearance of accounts procedures at the end of a financial year.

9.5. In 2006, payments under the pre-accession programmes totalled 2 277 million euros. **Graph 9.1** shows a breakdown of the funds committed and spent in 2006. For the eight Central and Eastern European countries that became Member States in 2004, no new expenditure was committed after accession (except for Sapard, where some commitments were made up to the end of 2004). For Bulgaria and Romania the last commitment year was 2006. Former ISPA projects in the newly acceded countries are treated as Cohesion Fund projects. Commission payments on these projects can continue until 2010/2011. For Phare, payments will continue at least until the end of 2009.

Graph 9.1 — Commitments and payments in 2006





9.6. A new single Instrument for Pre-accession Assistance, IPA, will replace Phare, Turkey, ISPA and Sapard programmes for the Financial Perspectives 2007-2013.

SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

Approach and scope of the audit

9.7. The audit is based on two main sources of information:

- (a) substantive testing of transactions: a sample of 80 transactions has been drawn from the pre-accession budget area;
- (b) an assessment of the functioning of the supervisory and control systems at the following levels: Commission headquarters, EC Delegations and national implementing and paying agencies.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Phare and Turkey programmes

9.8. For the Phare and Turkey programmes, the Court:

- (a) carried out substantive tests on a total of 67 transactions at the level of the Commission and at the beneficiary country level in Bulgaria, the Czech Republic, Hungary, Latvia (desk review), Lithuania, Poland, Romania, Slovakia and Turkey;
- (b) evaluated the supervisory and control systems (implementation of internal control standards, system for *ex post* control activities and closure of programmes at central level and various tests of controls on the transactions selected for substantive testing in the beneficiary countries).

ISPA

9.9. For ISPA, substantive testing was carried out on seven payments and public procurement procedures relating to five projects in Romania and two projects in Bulgaria (7). A review was made of the supervisory and control systems put in place by the Commission: in particular relating to the *ex ante* controls carried out by the EC Delegations (paragraph 9.3) and to Directorate General for Regional Policy audit activity. Finally, the progress of the countries in obtaining EDIS approval was analysed.

Sapard

9.10. For Sapard, at Commission level, the audit involved an appraisal of the supervisory and control systems including the Commission's review of the certifying bodies' reports and tests of transactions on a sample of payments (six Commission payments). Furthermore, the Court's audit comprised tests of controls and tests of transactions on five projects in Romania and an additional sample of five projects in Latvia, covering the main measures implemented at the time of the audit. These audits involved verifying the project documentation in the respective paying agencies and the legality and regularity of the project on-the-spot.

(7) Payments to the third country benefiting from ISPA assistance (Croatia) represented less than 1 % of total ISPA payments in 2006.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

*Audit findings***Legality and regularity of the underlying transactions**

9.11. The errors found by the audit of the underlying transactions were not significant regarding the Phare, Turkey and ISPA programmes. However in the case of Sapard, significant errors were found.

Phare and Turkey programmes

9.12. For the Phare Programme, the Court found one substantive error: in Slovakia, where an incorrect co-financing ratio was applied. In addition, some formal errors, such as non-compliance with tendering and contracting rules were found.

ISPA

9.13. The ISPA transactions tested were not affected by significant errors. Certain errors of a formal nature were identified which mainly relate to the non respect of some PRAG ⁽⁸⁾ requirements (such as no explanation provided regarding the absence of voting members in the meetings of the evaluation committee or lack of publication of forecast and award notices in the Official Journal).

Sapard

9.14. The Sapard transactions audited by the Court were affected by significant errors. The Court found projects where the beneficiaries of the community aid did not comply with their contractual obligations. In particular, a project audited in Romania was found to have been ineligible for EU financing for failure to adhere to the Commission's prescribed procurement rules and procedures. For certain projects, the checks actually carried out by the authorities during the on-the-spot visits were not clearly evidenced or they were not appropriate even leading to a payment for an investment that was not completely finalised.

9.11. *The Commission considers that in the case of Sapard, for the reasons set out under paragraph 9.14, the number of errors with financial impact is not significant.*

9.13. *The Commission is looking into the circumstances of these apparent breaches of requirements. Although forecast notices are generally required by the PRAG rules, there may be exceptions.*

9.14. *Most of the errors found concern one project in Romania. The error found in the procurement procedures concerned formal aspects of the tender.*

The Commission has examined the operation of public tendering and has given it an appropriate follow-up in the conformity procedure.

As regards the on-the-spot checks, the Romanian authorities have taken action to improve their procedures.

⁽⁸⁾ Practical Guide to Phare, ISPA and Sapard contract procedures.

THE COURT'S OBSERVATIONS

9.15. For the sample of payments audited at Commission level, the Court reiterates its last year's observation as to the legality and regularity of the expenditure incurred under the so called 'limited time procedure' ⁽⁹⁾ that consists in a change in the adopted (i.e. accredited) procedures, whereby not all checks are performed before projects are approved by the Sapard Agency. This procedure has neither been accredited by the competent Bulgarian authorities nor officially examined and approved by the Commission. The Commission recognized that this procedure does not respect the rules and should not be applied. It nevertheless decided that, based mainly on (unverified) information provided by the Bulgarian authorities, an amount of 19 580 843,66 euro was considered to be eligible and was subsequently paid in November 2006.

Supervisory and control systems

9.16. The assessment of the supervisory and control systems for the pre-accession budget area involves three different Directorates-General (paragraph 9.2). For all pre-accession instruments the audit still revealed weaknesses in the control systems of the national authorities involved in the implementation of the projects.

Phare and Turkey programmes

9.17. The *ex post* controls (closure audits) reviewed by the Court, relating to projects financed under the 2000 and 2001 Phare national programmes and carried out during the year by the contracted external auditors, showed a financially insignificant level of error. This was corroborated by the results of the Court's tests of transactions.

THE COMMISSION'S REPLIES

9.15. *The Commission regrets that the Bulgarian authorities failed to inform it in due time of the implementation of the 'Limited Time Procedure' (LTP) but reiterates that this breach of some provisions of the Multiannual Financing Agreement (MAFA) ⁽¹⁾ constitutes a formal error. The Commission is required to evaluate, inter alia, 'the gravity of the infringement and the financial loss to the Community' ⁽²⁾. The Commission carried out a mission to Bulgaria from 19 to 23 March 2007. Its review of certain projects approved under the LTP showed that each control stage of the accredited procedure was observed before the contract with the beneficiary was signed, thus not affecting the eligibility of the expenditure for projects processed under this procedure.*

⁽⁹⁾ Annual Report concerning the financial year 2005, paragraph 9.10.

⁽¹⁾ Article 5(4) of Section A.

⁽²⁾ See paragraphs 2 and 4 of Article 12 of Section A of the MAFA.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

9.18. The EC Delegations' *ex ante* control of the tendering and awarding of contracts under decentralised management has been an effective key control to ensure the legality and regularity of the underlying transactions. Regarding the Phare and Turkey programmes, the Court has observed in the tendering files a high frequency of corrective actions due to the Delegation's *ex ante* controls in Bulgaria, Romania and Turkey. This indicates that the national supervisory systems at the DIS institutions are still weak. Thanks to the maintaining of the *ex ante* control in the concerned delegations, these weaknesses had no serious negative financial consequences.

9.19. In Romania two out of three Phare Implementing Agencies received EDIS accreditation in December 2006. In Bulgaria however, EDIS accreditation for Phare has been further delayed confirming the Court's finding that the national administration supervisory systems at the DIS institutions are weak.

9.19. *The Commission regrets the delays in the EDIS accreditation in Bulgaria but confirms that delays in the accreditation could not be avoided as management and control structures were not adequate to waive ex ante control. To ensure the sound financial management of EC funds under EDIS, the Commission had to insist on further improvements of the administrative structures before granting it. In Romania, the third Implementing Agency received EDIS in April 2007.*

ISPA

9.20. The Commission has been, and still is, closely monitoring systems and projects under ISPA. The Court's audit resulted in some recommendations for further improvement of the audit tools and documentation (such as checklists).

9.20. *The Court's suggestions for checklists will be considered.*

9.21. In 2006 (June for Romania and November for Bulgaria) the systems put in place for ISPA management allowed the Commission to waive the *ex ante* approval requirement. However, for some implementing agencies, the approval could not yet be given or was given subject to particular safeguarding conditions. In its Decision, the Commission included a number of issues to be followed up by the different bodies involved. The implementation of these issues was still ongoing at the end of 2006.

9.21. *The issues are being followed up through monitoring activities, checks on payment claims and audits.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Sapard

9.22. The Court's audit in Latvia and Romania found that the Sapard administrative and control systems included the key concepts ⁽¹⁰⁾ but their functioning showed the following weaknesses:

- (a) changes in the accredited procedures in Romania (see also Bulgaria above in paragraph 9.15) and in the RDP (Rural Development Plan) in Latvia had not been given the necessary prior approval by the Commission;
- (b) the insufficient accuracy and quality of the checks in one project in Romania did not allow the detection of errors that consequently were not corrected (see paragraph 9.14);
- (c) a price database to check that purchases had been made at reasonable prices which affect the eligible amount of a project was not yet in place in Romania. This point was already raised in 2005 annual report (point 9.17(c)).

9.22.

- (a) *Both cases are being followed up in the conformity procedure.*
- (c) *A price database is one tool to evaluate the reasonableness of prices and, in the case of Sapard, it is not a regulatory requirement according to the Multiannual Financing Agreement. However, the Commission shares the Court's view, that the existence of such a database could provide even greater assurance of sound financial management in private purchasing.*

Conclusions and recommendations

9.23. The transactions audited by the Court were not affected by significant errors, except for the transactions financed by Sapard. This reflects the weaknesses detected in the functioning of certain key controls in the Sapard systems (see 9.22). For the Phare, Turkey and ISPA programmes, the EC Delegations' *ex ante* control of the tendering and awarding of contracts under decentralised management, continued to be an effective control to compensate the local lack of capacity to manage the procurement process in the context of the rapidly increasing funding.

9.23. *As stated in the Commission's replies to paragraphs 9.11, 9.14 and 9.22, the Commission is of the opinion that the errors identified by the Court in Sapard are not significant with the possible exception of public tendering in Romania. The Commission is of course aware of the potential risks related to Sapard, and will take these into account in its audits, but has so far found no evidence of an overall material financial risk.*

9.24. The Court's follow-up of key statement of assurance observations is shown in **Annex 9.1** and overall assessment of the Supervisory and control systems in 2006 is shown in **Annex 9.2**.

⁽¹⁰⁾ Adequate separation of duties, proper authorisation of transactions, adequate documents and records, on the spot control (Physical control), independent checks.

THE COURT'S OBSERVATIONS

9.25. The Court recommends that the Commission:

- (a) monitor closely the effective functioning of national supervisory and control systems, notably the preparation and management of tenders in Turkey, procurement under EDIS in Bulgaria and Romania and the timely delivery of national co-financing;
- (b) ensure that the Romanian and Bulgarian authorities bring the systems to a good standard of financial management of the Structural Funds providing adequate assurance of the correctness, regularity and eligibility of claims on Community assistance;
- (c) for Sapard, should follow-up the improvement of the quality of the Control Reports issued by the Romanian Authorities;
- (d) ensure, through close monitoring, that no changes to the accredited procedures are introduced by the Sapard paying agencies without its prior approval.

THE COMMISSION'S REPLIES

9.25.

- (a) *The issues are being followed up through monitoring activities, checks on payment claims and audits.*
- (b) *Monitoring and audit work are continuing to this end.*
- (c) *The Commission is aware that the reporting of the on-the-spot checks could be improved in some cases and is following this up in the clearance of accounts procedure.*
- (d) *The Commission has expressed its concerns to the Romanian and Bulgarian authorities, and has reminded them of the obligation, till the date of their accession, to submit any proposed changes of the procedures to the Commission before their implementation.*

FOLLOW-UP REVIEW OF PREVIOUS OBSERVATIONS IN
SPECIAL REPORT NO 6/2003 CONCERNING TWINNING AS
THE MAIN INSTRUMENT TO SUPPORT
INSTITUTION-BUILDING IN CANDIDATE COUNTRIES

Introduction

9.26. In July 2003, the European Court of Auditors published Special Report No 6/2003 (SR 6/2003) concerning Twinning as the main instrument to support institution-building in candidate countries ⁽¹¹⁾. The main conclusion was that Twinning is a positive instrument for institution building that acted as a catalyst in setting candidate countries' reform in motion. However, the actual results of the projects were limited compared to the over optimistic objectives. To increase the value for money and to improve the achievement of results, the Special Report recommended the Commission to (i) pay more attention to the formulation of realistic and achievable objectives, (ii) monitor the achievements more promptly, (iii) simplify the procedures, (iv) use Twinning more selectively, and (v) use the gained knowledge and experience to bolster the sustainability. European Parliament and the Council supported these recommendations ⁽¹²⁾.

⁽¹¹⁾ OJ C 167, 17.7.2003

⁽¹²⁾ European Parliament Report on the discharge for 2002 (A5-0200/2004), Council meeting 2569 (6970/04).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

9.27. The objective of this follow-up review, carried out in mid 2006, was to assess the overall progress of the Twinning instrument since the publication of the Court's Special Report, and to assess to what extent the recommendations made in the original report have been implemented.

9.28. The Commission (DG ELARG) acts as a facilitator and co-ordinator of the Twinning instrument and thereby sets out the rules and guidelines to be followed by the Twinning partners, amongst others by maintaining the Twinning Manual. Line DGs are part of the internal consultation structure and are involved in programming the assistance. The Twinning partners, i.e. beneficiary institutions and Member States, are exclusively responsible for the implementation.

The Court's Observations

9.29. The Commission has addressed many of the observations identified in SR 6/2003. Through the revisions of the Twinning Manual in 2004 and 2005 the Commission introduced remedial measures such as reimbursing the Twinning partners for the project preparatory costs only when deadlines are met, paying the Resident Twinning Adviser's (RTA) salary through the same body as the project expenditure, setting conditions for the use of mandated bodies (i.e. the bodies which act *in lieu* of public administration) in order to avoid unfair competition and preserve the public character of Twinning, and promoting the use of the special Twinning Light instrument for less complex projects. Since 2005 the Manual has covered, in addition to Phare, the CARDS, MEDA and TACIS programmes as well.

9.30. The commitment of the beneficiary country, both at the level of concrete project implementation and at the level of global political commitment, is an essential precondition for the success of any Twinning project. This is recognized in the Twinning Manual. However, even in 2006 the outputs of some of the projects were never used, because preconditions for successful project implementation had not been fully met or the beneficiary government had not committed itself to using the project outputs.

9.29. *The Commission welcomes the Court's acknowledgement of the Commission's commitment to maintain and develop twinning as an efficient, credible and sound European institution building Instrument. Such continuous adjustment is especially important since twinning is now available for use in the European Neighbourhood policy area.*

9.30. *The success of each twinning project depends on the active co-operation and full commitment of all stakeholders, including also the selected Member States administrations.*

THE COURT'S OBSERVATIONS

9.31. The project design has developed significantly since the first round of Twinning projects. The scope of the later projects is more focused and objectives are more precise and measurable. One of the factors contributing to the improvement is that the beneficiaries have gained more experience in the implementation of EU projects. However, the initial design of a project, i.e. drafting the project fiche, is still difficult for the beneficiaries who do not have previous experience in Twinning or technical assistance projects. This still leads to complex projects with over-ambitious objectives in the start up phase of Twinning. For Twinning projects with investment components the procurement procedures often delayed the Twinning implementation which necessitated substantial project re-design or transfer of some components to the follow-up projects.

9.32. The RTAs produce quarterly progress reports which are now closely monitored by the Commission. For the projects reviewed by the Court the Delegations had regularly analysed and commented on these reports, and proposed corrective actions when needed

9.33. The Commission has not sufficiently simplified the procedures. The Twinning contracts still contain excessively detailed budgets at activity level and CVs of all experts participating in the project. Consequently, fine-tuning of activities, which is a normal part of project management after the inception phase (e.g. adjusting the number of workshop days, number of documents to be translated), still necessitates a formal modification of the contract, which complicates project management unnecessarily.

9.34. The Commission has not followed the Court's recommendation to use Twinning more selectively. The choice between Twinning and technical assistance continues not to be based on any in-depth analysis.

9.35. All the projects reviewed in 2006 included measures supporting the sustainability of their outputs. Examples include training of trainers components and using results in the follow-up project.

THE COMMISSION'S REPLIES

9.31. *Twinning projects arise from a dialogue between the Commission and beneficiary countries. The Commission has launched several initiatives to assist potential beneficiary administrations with the programming of targeted twinning projects:*

- *a 2004 CD Rom contained all requests for twinning assistance (fiches) and was updated in 2006,*
- *a new template for twinning project requests (fiches) was developed in the 2005 Common twinning manual,*
- *training efforts have been stepped up, including for instance the launch of the bi-yearly in house training sessions for twinning co-ordinators and training sessions in loco.*

9.33. *In 2007 the Commission has further streamlined the twinning rules including those governing budgetary modifications so as to increase clarity and simplicity in the management of twinning projects. The Twinning manual foresees a flexible structure to amend approved twinning contracts. As in all contractual relationships, amendments have to be notified beforehand. This is a logical requirement as these amendments very often encompass an adjustment not only of the mandatory results but also of the expenditure pattern of Community funds.*

9.34. *The identification and design of twinning projects is the outcome of a process and dialogue between the Commission and the Beneficiary country under the final scrutiny and approval of the Phare or CARDS management committee.*

THE COURT'S OBSERVATIONS

9.36. In general, Twinning projects cover similar areas of intervention in all beneficiary countries. However, a systematic approach by the Commission to disseminating the best practice, including an open database of projects and their results, is still missing, and the RTA network, crucial for exchanging knowledge and experience, has not been established. Moreover, there is no systematic approach to *ex post* evaluation of project results. After the end of the project there is no procedure established to verify the use of the results achieved. Only thematic evaluations are carried out at the programme level. However, these do not deal with the individual projects but evaluate the whole instrument.

Recommendations

9.37. The Court recommends that the Commission should:

- (a) consider setting stricter conditions for beneficiary governments to use the project outputs;
- (b) consider more effective ways of supporting beneficiaries to design their first project, including the planning for procurement;
- (c) consider reducing the level of detail in Twinning contracts in order to allow more flexibility for the project management;
- (d) ensure well-founded choices between Twinning and technical assistance and raise the beneficiaries' awareness of the difference between the two;

THE COMMISSION'S REPLIES

9.36. *The Commission has made substantial efforts to disseminate best twinning practices through the periodical issue of twinning news, and publication of a new twinning brochure and a DVD.*

Following-up the Court's observations in its special report, the co-operation of the beneficiary countries was requested in 2003 to set up the RTA network, but in the absence of a positive feed-back, it has proved impossible to set it up.

Besides the thematic evaluations, the Commission undertakes random evaluations of individual projects.

9.37. *The Commission welcomes the Court's recommendations and endeavours to take them into due account in the further development of twinning.*

- (a) *The Commission will continue to ensure that beneficiary administrations ensure the sustainability of twinning project results. If that condition is not met, the Commission can interrupt the implementation of the project.*
- (b) *The Commission has already launched several initiatives to assist potential beneficiaries and takes into account the need of improved coordination to ensure timely procurement.*
- (c) *The Commission is committed to further streamline the rules governing budgetary modifications so as to increase clarity and simplicity in the management of twinning projects.*
- (d) *The Commission will continue to highlight the specificities of twinning and to ensure that the choice between twinning and technical assistance is specifically addressed.*

THE COURT'S OBSERVATIONS

- (e) establish (i) a systematic approach to *ex post* evaluation or monitoring of project results and verifying whether the results are used, (ii) a network of RTAs and (iii) a database of project results in order to disseminate best practice.

THE COMMISSION'S REPLIES

- (e)
- (i) *The Commission will continue undertaking regular impact assessments that are disseminated during the annual meeting of national contact points.*
- (ii) *The Commission regrets that by now, due to the lack of co-operation of other twinning stakeholders, it has unfortunately not been possible to set up the recommended network.*
- (iii) *The setting up of a data base raises several issues in relation with continued co-operation with the providers of twinning expertise and data protection.*

ANNEX 9.1(a)

Follow up of key Statement of Assurance observations — Pre-accession strategy — Phare and Turkey part

| Court observation | Action taken | Court analysis | Commission reply |
|---|---|---|---|
| <p>High frequency of corrective actions resulting from the Delegations' <i>ex-ante</i> controls.</p> <p>(Annual Report concerning the financial year 2005, paragraph 9.13)</p> | <p>Continuous support from the Delegations to improve the quality of the national authorities work.</p> | <p>Also in 2006 the Court found a high frequency of corrective actions due to the Delegations' <i>ex-ante</i> controls.</p> | <p><i>The Commission makes all efforts to support the national administrations in building and setting up the appropriate structures and procedures in order to enhance their management and control capability.</i></p> |
| <p>Insufficient procedure to remind the national authorities about submitting final declarations and lack of checklists for the review process.</p> <p>(Annual Report concerning the financial year 2005, paragraph 9.14)</p> | <p>Checklists have been developed. The period allowed for submitting the declarations has been lengthened.</p> | <p>There are still delays in submitting the final declarations.</p> | <p><i>The Commission issues regular written reminders for the need to submit final declarations in a timely manner. This issue has also been raised in the Joint Monitoring Committees. As a result of these efforts, most of the delayed final declarations have been received and dealt with.</i></p> |
| <p>EDIS accredited implementing agencies were not in all cases the actual contracting authority.</p> <p>(Annual Report concerning the financial year 2005, paragraph 9.15)</p> | <p>Due to national legislation (about ownership etc) the implementing agencies cannot in all cases be the formal contracting authority.</p> | <p>This observation is no longer an issue.</p> | |

ANNEX 9.1(b)

Follow up of key Statement of Assurance observations — Pre-accession strategy — Sapard part


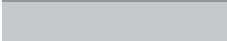

| Court observation | Action taken | Court analysis | Commission reply |
|--|---|---|---|
| <p>Changes in the implementing or paying arrangements of the Sapard Agency without prior approval by the Commission.</p> <p>(Annual Report concerning the financial year 2005, paragraph 9.10)</p> | <p>The Commission reminded the concerned national authorities of their obligation to submit any proposed changes to the procedures to the Commission before their implementation.</p> | <p>Also in 2006 the Court found that procedural changes were introduced without prior approval by the Commission.</p> | <p><i>The Commission has expressed its concerns to the Romanian and Bulgarian authorities, and reminded them of the obligation (till the date of their accession) to submit any proposed changes of the procedures to the Commission before their implementation.</i></p> |
| <p>Insufficient documentation underlying public tenders did not ensure that bids were received within the deadlines and were duly examined.</p> <p>(Annual Report concerning the financial year 2005, paragraph 9.17(a))</p> | <p>The Commission followed up the observations via the clearance of accounts process.</p> | <p>Also in 2006 the Court detected weaknesses in the application of the procurement procedures.</p> | <p><i>The Commission is following this up in the clearance of accounts procedure and financial corrections are being proposed as appropriate.</i></p> |
| <p>Inadequate systems to check the reasonableness of prices (such as a price database) affecting eligible amounts.</p> <p>(Annual Report concerning the financial year 2005, paragraph 9.17(c))</p> | <p>The Commission reminded the concerned national authorities to implement a database.</p> | <p>Cases of inadequacies in the database still existing.</p> | <p><i>Despite not being a regulatory requirement, a prices database could provide even greater assurance of sound financial management in private purchasing.</i></p> |

ANNEX 9.2(a)

Assessment of supervisory and control systems — Pre-accession strategy — Phare and Turkey part

| System concerned | Key internal control | | | | | Overall assessment |
|---------------------------------------|------------------------|-----------------|-----------------|----------------------------|----------------------|--------------------|
| | Procedures and manuals | Ex ante control | Internal audits | Ex post control activities | Management reporting | |
| DG Enlargement, central services | | | | | | |
| Commission's Delegation | | | | N/A | | |
| DIS implementing agencies | | | | N/A | | |
| EDIS accredited implementing agencies | | | | N/A | | |

Legend:


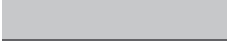

| | |
|--|--|
|  | Satisfactory |
|  | Partially satisfactory |
|  | Unsatisfactory |
| N/A | Not applicable: does not apply or not assessed |

ANNEX 9.2(b)

Assessment of supervisory and control systems — Pre-accession strategy — Sapard part

| System concerned | Key controls | | | | | | Overall assessment |
|--|-----------------------|----------------|-------------|-------------------|---|----------------------|--------------------|
| | Segregation of duties | Internal Audit | Audit trail | Management checks | Preliminary administrative & technical controls/assessments | On-the-spot controls | |
| DG Agriculture | N/A | N/A | | | N/A | | |
| Management and control agency in Latvia | | | | | | | |
| Management and control agency in Romania | | | | | | | |

Legend:

| | |
|--|--|
|  | Satisfactory |
|  | Partially satisfactory |
|  | Unsatisfactory |
| N/A | Not applicable: does not apply or not assessed |

CHAPTER 10

Administrative expenditure

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THE COURT'S OBSERVATIONS

INTRODUCTION

10.1. This chapter covers:

- the administrative expenditure of the Institutions and Community bodies ⁽¹⁾;
- the Agencies and other decentralised bodies and
- the European Schools.

ADMINISTRATIVE EXPENDITURE OF THE INSTITUTIONS AND COMMUNITY BODIES

10.2. The audit of administrative expenditure of the Institutions consists of two parts. The first part addresses the specific assessment in the context of the statement of assurance. The second part consists of specific observations for each Institution as required by Article 143(4) of the Financial Regulation. These observations are based on audits of areas selected on the basis of identified risks from previous audit findings.

10.3. The appropriations relating to this expenditure are managed directly by each Institution and are used to pay the salaries, allowances and pensions of persons working for the Institutions, as well as rent, purchases and miscellaneous expenses. In 2006 administrative expenditure by the European Union's institutions was 6 699 million euro, as further specified in **Table 10.1**.

Table 10.1 — Payments by Institution

| | <i>(million euro)</i> | |
|--|-----------------------|--------------|
| | 2005 | 2006 |
| European Parliament | 1 235 | 1 440 |
| Council | 533 | 585 |
| Commission | 3 952 | 4 150 |
| Court of Justice | 211 | 238 |
| Court of Auditors | 92 | 99 |
| European Economic and Social Committee | 96 | 108 |
| Committee of the Regions | 64 | 69 |
| European Ombudsman | 6 | 7 |
| European Data Protection Supervisor | 2 | 3 |
| Total | 6 191 | 6 699 |

10.4. Past audits by the Court had shown that the errors found were not material. A follow-up to observations from past Annual Reports is presented in **Table 10.2**.

⁽¹⁾ Commission, Parliament, Council, Court of Justice, Court of Auditors, European Economic and Social Committee, Committee of the Regions, European Ombudsman, European Data Protection Supervisor (Article 1 of the Financial Regulation).

Table 10.2 — Follow-up to observations from past Annual Reports

| Observations | Action taken | Further action needed? | |
|--|---|---|--|
| <p><i>Reimbursement of accommodation costs incurred on mission.</i></p> <p>Annual Reports concerning the financial year 2004, paragraph 9.6, and 2005, paragraph 10.7:</p> <p>The amended Staff Regulations, which entered into force on 1 May 2004, state that accommodation costs incurred on mission are reimbursed up to a maximum fixed for each country, on production of supporting documents (Article 13 of Annex VII to the Staff Regulations). Contrary to this rule, all the Institutions, except the Court of Justice, the Court of Auditors and the Ombudsman, provided in their internal rules for the payment of a flat-rate sum, ranging from 30 to 60 % of the maximum allowable amount, to staff who do not produce any evidence of having incurred accommodation costs.</p> | <p>The European Economic and Social Committee and the Committee of the Regions amended their internal rules in December 2005 so as to ensure compliance with the Staff Regulations.</p> | <p>Parliament, Commission and Council should amend their internal rules in order to ensure that accommodation costs incurred on mission are reimbursed in compliance with the Staff Regulations.</p> | <p>The European Parliament's replies</p> <p><i>As Parliament indicated in its previous replies to the Court's Observations, it faces particular problems in regard to missions owing to the nature of its activities and their dispersal over three places of work. The application of a flat-rate system takes account of the legal advice tendered to Parliament's Bureau on this subject and is intended to strike a reasonable balance between the requirements of the regulatory framework and the exigencies of the institution's particular working environment. Moreover, the simplified provisions which have now been introduced will help to reduce the administrative costs generated by the management of a particularly high number of missions. See also Parliament's resolution of 24.4.2007⁽¹⁾, paragraph 12, granting discharge in respect of the 2005 accounts.</i></p> <p>The Council's replies</p> <p><i>The new internal mission rules of the GSC no longer provide for the 30 percent flat-rate payment. Before entering into force (foreseen for October 2007), these rules still have to be the subject of formal consultations with the staff representatives.</i></p> <p>The Commission's replies</p> <p><i>The Guide to missions — the internal rules adopted by the Commission governing missions of its staff — is currently under review to take due account of the remark of the Court. Adoption of the new rules is scheduled for the beginning of 2008.</i></p> |
| <p><i>Additional pension scheme for Members of the European Parliament</i></p> <p>Annual Reports concerning the financial year 2002, paragraphs 9.17 to 9.20, and 2005, Table 10.2:</p> <p>If the additional pension scheme for Members of the European Parliament is to continue, a sufficient legal basis has to be created as soon as possible. There should be clear rules established in the scheme to define the liabilities and responsibilities of the European Parliament and of the members of the scheme in case of a deficit.</p> | <p>The additional pension scheme is mentioned in Article 27 of the Statute for Members of the European Parliament adopted by the Parliament on 28 September 2005. The Statute will enter into force on the first day of the European Parliament parliamentary term beginning in 2009. No rules have been established defining the liabilities and responsibilities of the European Parliament and of the members of the scheme in case of a deficit</p> | <p>Until the first day of the European Parliament parliamentary term beginning in 2009 the Statute has no legal effect and cannot provide a legal basis for the parliamentary contribution to the ASBL pension fund. Appropriate rules should be established defining the liabilities and responsibilities of the European Parliament and of the members of the scheme in the event of a deficit.</p> | <p>The European Parliament's replies</p> <p><i>As Parliament indicated in its replies to the Court's observations concerning 2005, the fact that the Statute for Members states (Article 27) that the pension fund 'shall be maintained after the entry into force of this Statute for Members or former Members who have already acquired rights or future entitlements in that fund' is implicit recognition of a legal basis for the pension fund, including during the period prior to the Statute's entry into force.</i></p> <p><i>The working party with responsibility for the introduction of measures to implement the Statute for Members is continuing its work on, among other things, drafting rules governing the liabilities and responsibilities of Parliament and the members of the scheme in the event of a deficit.</i></p> <p><i>The outcome of the invitation to tender published in the Official Journal with a view to an independent actuarial study being carried out on the pension fund has been communicated to Parliament's Bureau. The study, which is to commence in the near future, will enable the Bureau subsequently to lay down measures seeking to guarantee the payment of additional pensions after the Statute's entry into force in 2009 and to draw up the agreement governing the relations between and respective responsibilities of the fund and Parliament.</i></p> |

| Observations | Action taken | Further action needed? | |
|---|---|---|--|
| <p><i>Payment by the Council of additional annual leave not taken</i></p> <p>Annual Reports concerning the financial years 2004, paragraph 9.18, and 2005, Table 10.2:</p> <p>At the Council additional annual leave granted before 31 December 1997 as a compensation for overtime is paid on retirement if the official has not taken the additional leave. As staff of the A and B categories are not entitled to compensation for overtime, such payments are not in accordance with Article 56 of the Staff Regulations.</p> | <p>Even though the General Secretariat has taken appropriate action in order to gradually eliminate the stock of compensatory leave for A and B staff granted before 31 December 1997, payments were still made in 2006 to compensate for additional leave not taken.</p> | <p>The payment of additional annual leave not taken should be discontinued.</p> | <p>The Council's replies</p> <p><i>The General Secretariat of the Council is aware of the position of the Court of Auditors concerning payment for old stock of days of compensatory leave not taken, and fully concurs with the Court's comments stressing the need to bring the current regularisation process to a close as soon as possible. As the Court noted, a compulsory instruction aiming at elimination of the remaining stocks by 2009 has been issued to this end. In addition, measures have been taken since 1997 to ensure that this situation will not recur in future.</i></p> <p><i>However, the General Secretariat considers that the Appointing Authority's obligation to respect the acquired rights of those concerned and the fundamental principles of European law relating to legitimate expectations and equal treatment means that it is necessary to retain a system of eliminating stocks of leave by granting time off work as well as by payment for a short transitional period. The General Secretariat is currently exploring all options for speeding up the process of eliminating stocks even further, including reducing the time at present allowed for using up such stocks.</i></p> |
| <p><i>Reimbursement of travel expenses of delegates of Council Members</i></p> <p>Annual Report concerning the financial year 2005, paragraph 10.11:</p> <p>The Council reformed its system for reimbursing the travel expenses of delegates of Council Members with Decision 190/2003, applicable from 1 January 2004. The reimbursement is paid within the limit of a fixed allocation per Member State. The Court found that the new system greatly reduced the administrative burden on the Council of paying delegates' expenses, but that there had been insufficient checks on the validity of Member States' statements before payment of the July 2005 instalment.</p> | <p>Internal Audit reports in February and November 2006 identified problems related to unclear eligibility rules and inadequate records of attendance at meetings. The situation did not change substantially in 2006 with respect to 2005.</p> <p>An improvement of the system for recording attendance at meetings is planned by the General Secretariat.</p> | <p>Further checks and controls should be introduced in order to ensure the validity of Member States' statements.</p> | <p>The Council's replies</p> <p><i>Since the introduction of the new system for reimbursing the travel expenses of delegates of Council Members, the Council Secretariat has gradually introduced rigorous checks on the statements supplied by Member States. Where anomalies or errors come to light, Member States are being invited to make the necessary corrections and to resubmit their statements.</i></p> <p>Currently the GSC is working on:</p> <ul style="list-style-type: none"> — revision of the decision, notably envisaging a clarification of the eligibility rules — the replacement of attendance forms by an electronic badge system. |
| <p><i>Follow up of family allowances by the Commission</i></p> <p>Annual Report concerning the financial year 2005, paragraph 10.12:</p> <p>Staff receiving the household allowance and having no dependent children are not regularly required to update the information. There was no evidence that 676 out of 1 605 Commission staff concerned based in Brussels had been requested to confirm or update their original declarations. Insufficient checks were also carried out concerning cases where national dependent child allowances might have been received and, if so, should have been deducted from the allowances paid according to the Staff Regulations.</p> | <p>The follow up of the different types of allowances is still mainly based on the voluntary transmission of information by the staff. Nevertheless, the Commission followed up 231 of the 676 cases in 2006 and plans to follow up the remainder of these cases within two years.</p> | <p>Further action needs to be taken by the Commission to verify family allowances on a regular basis.</p> | <p>The Commission's replies</p> <p><i>The Commission plans to complete the follow-up of the remainder of these cases by the beginning of 2008. The PMO is developing a new IT system, IRIS, which will fully computerise the documentation of procedures and monitor compliance with those procedures. The new system will be introduced in stages between mid 2007 and 2009.</i></p> |

| Observations | Action taken | Further action needed? | |
|---|---|---|--|
| <p><i>The internal audit service of the Court of Justice</i></p> <p>Annual Reports concerning the financial years 2004, paragraph 9.21, and 2005, paragraphs 10.13 and 10.14:</p> <p>The Court of Auditors observed that the head of the Internal Audit Service was responsible for ex-ante verification of the authorising officers' operations. The same situation was noted concerning the financial year 2005. Such an involvement in the carrying out of financial operations is not compatible with the total independence with which the internal auditor ought to perform his audit duties, in accordance with the principle stated in Article 86 of the Financial Regulation.</p> <p>In the second half of 2005 the internal auditor carried out some specific audits and addressed recommendations to the services concerned. However, at the time of the audit by the Court of Auditors no reports by the internal auditor were available.</p> | <p>In 2006 the head of the Internal Audit Service continued to be responsible for ex ante verification of the authorising officers' operations. The Internal Audit Service issued two audit reports and made several recommendations which resulted in significant savings.</p> | <p>The supervisory and control setup should be reorganized in order to ensure the total independence of the Internal Audit Service.</p> | |

(¹) P6_TA-PROV(2007)0133 — European Parliament decision of 24 April 2007 on the discharge for implementation of the European Union general budget for the financial year 2005, Section I — European Parliament (C6-0465/2006-2006/2071(DEC))

THE COURT'S OBSERVATIONS

Specific assessment in the context of the Statement of Assurance

10.5. The audit appraised the legality and regularity of the transactions underlying the accounts of the Institutions' administrative expenditure, in order to provide a specific assessment in the context of the statement of assurance. The Court assessed the supervisory and control systems and examined a random sample of 61 transactions drawn from the whole area of administrative expenditure.

Conclusions in the context of the Statement of Assurance

10.6. Subject to the issues mentioned in paragraphs 10.9 to 10.12, in 2006 all the Institutions had implemented a satisfactory framework of supervisory and control systems as required by the Financial Regulation and the sample tested showed no material level of error. However, the Court draws attention to the weaknesses in the Institutions supervisory and control systems which need to be rectified as indicated at paragraph 10.25.

*Specific observations on each Institution***Audit scope**

10.7. The audit of the specific risk areas referred to in paragraph 10.2 included an assessment of the relevant supervisory and control systems and a number of samples drawn concerning the following:

- (i) negotiated procurement procedures (Commission's OIB and OIL, Parliament, Council, Court of Justice, European Economic and Social Committee and Committee of the Regions),
- (ii) payment of expenses and allowances to Members of Institutions (Parliament, European Economic and Social Committee and Committee of the Regions),
- (iii) headquarters control over Commission Delegations (Commission's DG RELEX),
- (iv) procedures used to assure that the minimum internal control standards are implemented (Council),
- (v) Internal Audit function (Court of Justice).

THE COURT'S OBSERVATIONS

10.8. The weaknesses found are summarised in the subsequent text and concluded upon in paragraph 10.25. The errors and weaknesses cannot be extrapolated for the whole area of administrative expenditure because the specific audit areas for each Institution were selected based on known risks.

Parliament

10.9. Since 1998 the Court has, on several occasions ⁽²⁾, pointed out weaknesses in the regulatory framework established by the Bureau (a body consisting of the Parliament's President and 14 Vice-Presidents) for the payment of allowances for assistance to Members of the European Parliament (MEPs). In 2006 the expenditure for the MEPs assistance allowances amounted to around 132 million euro.

10.10. In 2004 the rules concerning the submission of supporting documentation by MEPs were amended and the resulting obligations were set out in a Quaestors' communication of July 2005. In that context, MEPs were required to present by 1 November 2005 documentary evidence of the use of their allowance, for the period July 2004-June 2005. This deadline was subsequently extended several times and, according to the data available to the Court, the supporting documents presented by the MEPs and regarded as adequate justifications by the responsible administrative department only cover 27,2 % (11,9 million euro) for 2004 (July-December) and 22,5 % (27,1 million euro) for 2005 (full year) of the relevant expenditure.

10.11. On 23 March 2007 a Quaestors' communication extended the deadline for submitting supporting documents, relating to the year 2006, to 30 April 2007, without mentioning that documents still had to be presented for 2004 and 2005. As of 1 May 2007, no measures had been taken by the Bureau to ensure that the obligation to supply adequate supporting documentation had been complied with.

10.10-10.11. THE REPLY OF THE EUROPEAN PARLIAMENT

Due to a lack of clarity of the initial text, and the impact of the enlargement of the Union in 2004, the Quaestors, after in-depth political and technical consultations, needed to draw up and adopt implementing measures. The Bureau agreed consequently to extend the deadline and instructed the Quaestors to examine ways to simplify the technical documentation to be submitted in relation to regularisation of expenses.

Considering the widely differing situations in the Member States and the time needed to comply with the new requirements, it was not deemed appropriate to impose a final deadline for obligations which derived from a rule which was under review.

Moreover, the Bureau adopted on 25 September 2006 a new set of rules, called the 'Codex' (rights and obligations of assistants and their Members) which had an impact on the rules governing the Parliamentary Assistance Allowance (new revision adopted by the Bureau on 13 December 2006).

Regarding that, the Quaestors informed all Members that the documentation had to be delivered before 30 April 2007. A huge number of documents has been received and is now under examination.

⁽²⁾ Special Report No 10/98, paragraph 1.37, and, in particular, paragraph 9.22 of its Annual Report concerning the financial year 2002 where the Court already noted that as new rules, issued in April 2000, were not applied strictly, the risk of inappropriate use of the allowance remained. Lately, Annual Report concerning the financial year 2005, paragraph 10.10.

THE COURT'S OBSERVATIONS

10.12. The Court notes, therefore, that the Bureau has not ensured that the rules requiring the submission of adequate supporting documentation have been implemented effectively. As the major part of the amounts paid for MEPs assistance allowance have not been subsequently justified by appropriate supporting documents of the expenses incurred on behalf of the MEPs, the Court considers that there is not sufficient documentation to demonstrate that the MEPs have actually employed or engaged the services of one or more assistants and that the duties or services mentioned in the contracts signed by the MEPs have been really carried out. The Bureau should take action in order to obtain the documents considered essential to prove that the expenditure was justified. Should these documents not be presented within reasonable time, appropriate measures, such as suspension of payments and/or issuing of recovery orders, should be initiated for the sums not justified.

10.13. The internal auditor finalised a comprehensive audit of the Parliament's procurement procedures in 2006. The audit identified numerous weaknesses in the operation of internal and management controls over the procurement procedures, in particular concerning planning, compliance with applicable regulations and rules, reliability of management information and sound financial management. A detailed action plan comprising 144 individual actions was drawn up and some concrete measures have already been taken in 2006 by the Secretary General, such as the establishment of an advisory body (the Procurement Forum) and the setting up of a central register of contracts. The Court's examination of a sample of negotiated procurement procedures and contracts at the Parliament confirmed the findings of the Parliament's internal auditor.

10.12. THE REPLY OF THE EUROPEAN PARLIAMENT

It must be recalled that before any payment is made under the parliamentary assistance allowance, basic mandatory documents have to be submitted, such as application forms and contracts between the Member and the assistant(s), service provider or paying agent.

Other documents such as, proof of social security coverage when the assistant is an employed worker, is also requested to be delivered within three months. All Members comply with these conditions.

The supplementary documentation requested since the rules changed in 2004 and, more recently on 13 December 2006, concerns mainly contracts with service providers (approximately half the assistants) and relates to the obligation for providing invoices or fee statements to the Members who must forward a copy of the 'statement of amounts invoiced [by the service provider], accompanied by a declaration, certifying that all tax and social security obligations resulting from the applicable national legislation are complied with' to the Parliament's services. The delivery of all those documents needed more time than foreseen. As mentioned above, a huge number of documents has been received and is now under examination.

Following the examination, Members who do not comply with the obligation to deliver the necessary evidence regarding payments will receive an individualised letter, explaining what is still missing. Should a Member not comply with the obligation to submit the missing documentation, the Authorising Officer by Delegation can suspend payments and the Secretary General can decide to recover unduly paid sums. Such decisions are taken in cooperation with the Quaestors.

10.13. THE REPLY OF THE EUROPEAN PARLIAMENT

It is important to note that the audit of procurement procedures carried out by the Internal Auditor and finalised in 2006 was conducted in 2003, which was the first year of implementation of the new Financial Regulation.

Measures were in fact implemented in 2003 and during the following years. Therefore, in connection with 2006 and the measures referred to by the Court, it should be pointed out that the new advisory body, the Procurement Forum, is the replacement for the Interservice Group on Procurement set up in 2003 to provide support for authorising officers and that the central register of contracts introduced in 2006 is the result of developments carried out over the preceding years.

THE COURT'S OBSERVATIONS

Council

10.14. The examination of a sample of negotiated procurement procedures and contracts at the Council found that a contract for the provision of telecommunication services for meetings of the European Council concluded for a maximum duration of four years was prolonged for a further year. The extension of the contract (for an estimated cost of 900 000 euro) was incorrectly justified by the Council administration with reference to Article 126(1)(e) of the Implementing Rules to the Financial Regulation (hereinafter: IR) ⁽³⁾ which concerns 'additional services and works not included in the initial contract but which, through unforeseen circumstances, have become necessary'. The Court considers that an open tendering procedure should have been carried out before the expiry of the contract.

10.14. REPLY BY THE COUNCIL

The contract in question covers the availability of telecommunications infrastructure (telephone lines and ISDN-lines) to be used by journalists during EU summits (on average 3 times per year). Several months before the end of the contract the department of the authorising officer identified the need to open a procurement procedure to cover this requirement. However, at that particular time all administrative departments of the Secretariat had to concentrate their efforts on the projects related to the occupation of the new LEX-building (for 1 300 persons) in early 2007. It was therefore decided to extend the existing contract by nine months.

The GSC is aware of the fact that, — as stated by the Court of Auditors in its report, it should have carried out a new tendering procedure before the expiry of the contract. Given the exceptional circumstances however, it saw no alternative but to extend the current contract, limiting the extension as much as possible.

It should be noted that the GSC recently launched a tendering procedure for the above mentioned requirement.

Commission ⁽⁴⁾

10.15. The Annual Activity Report of DG RELEX for 2006 stated that improvements in supervisory controls over Delegations were implemented in 2006, notably through the establishment of an *Ex post* Control Unit in the External Service Directorate. The Director General's reservation of earlier years was lifted. However, in spite of the improvements made in 2006, the Court's audit found that the risk of duplicate payments had not been adequately addressed.

10.15. REPLY OF THE COMMISSION

The Director General considered that the Ex post Control Unit effectively contributed to provide him with the appropriate level of assurance on the quality of the financial management in Delegations by undertaking a large number of ex post control activities. The External Service directorate is continuously developing its sampling methodologies and verification techniques and the detection of double payments will be addressed in that process.

⁽³⁾ 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).

⁽⁴⁾ The Commission departments responsible for most of the administrative expenditure are the following: Directorate-General (DG) Personnel and Administration (ADMIN), DG for Translation (DGT), DG for Interpretation (SCIC), DG Communication (COMM), DG for External Relations (RELEX), Office for Infrastructures and Logistics — Luxembourg (OIL), Office for Infrastructures and Logistics — Brussels (OIB), Office for the Administration and Settlement of Individual Entitlements (PMO), European Personnel Selection Office (EPSO) and Publications Office (OPOCE).

THE COURT'S OBSERVATIONS

10.16. In 2006 improvements were made in the OIB's contracts and procurement management system, and the reservation in the 2005 Director's declaration was removed. Although no reservations were made in 2005 and 2006 concerning the OIL, the Internal Audit Service in April 2007 reported weaknesses in OIL's procurement management and controls. The Court's examination of a sample of negotiated procurement procedures at OIB and OIL showed that in a number of cases poor procurement planning and insufficient analysis of market conditions had resulted in negotiating with only one supplier, instead of launching calls for tenders.

10.16. REPLY OF THE COMMISSION

Improvements in procurement management have been made already as of 2006 following the action plan set up in 2005.

For OIB these include: internal reorganisation, training of staff (compulsory), more efficient management of a four-year rolling plan via an IT application, reinforcement of internal procedures, self-assessment by the management of the main strengths and weaknesses in the procurement and establishment of a subsequent action plan, reinforcement of internal networks and dissemination of information and best practices.

Improvements continue in 2007 namely through the reinforcement of resources and their qualifications, the improvement of the planning process and the improvement of the market analysis for the most complex and important tenders.

Article 126(1)b of the Implementing Rules (IR), permits negotiated procedures due to the 'supplier captivity' in certain domains.

Table: Market's procedures of OIB and OIL > EUR 60 000

| 2006 Procedures (amounts in million euro) | OIB | OIL |
|--|-------|------|
| Total numbers | 34 | 12 |
| Negotiated | 4 | 1 |
| Total amount | 137,0 | 14,5 |
| Amount of negotiated procedures | 2,5 | 0,07 |

Although the IAS report identified weaknesses in OIL, none of its recommendations were classified as criticism, and this justifies the absence of reservations. Nevertheless, OIL drew up an action plan to address the weaknesses noted by both the Court of Auditors and the IAS.

The action plan has just been introduced following IAS recommendations, and its effects should soon become visible.

THE COURT'S OBSERVATIONS

Court of Justice

10.17. With the exception of the issue mentioned in **Table 10.2** concerning the Internal Audit Service the audit did not give rise to any observations.

Court of Auditors

10.18. The Court of Auditors is audited by an independent external audit firm which issued a 'certificate concerning the regularity and fairness of the financial statements at 31 December 2006', accompanied by a 'report on the administrative and accounting procedures, the soundness of the financial management and the internal control system'. The report states that, in the auditor's opinion, his work did not 'disclose any facts which might cast doubt on the adequacy of the administrative and accounting procedures or internal control or the compliance of financial management with the applicable regulations'. Certificate and report will be published in the Official Journal.

European Economic and Social Committee

10.19. The examination of a sample of negotiated procurement procedures and contracts managed by the 'Joint Services' of the European Economic and Social Committee and the Committee of the Regions revealed management and control weaknesses. In 2006 the expenditure relating to contracts resulting from a negotiated procedure, instead of a call for tenders, was a high percentage of the whole expenditure for procurement. For budget lines 2 0 1 0 (insurance), 2 0 2 0 (water, gas, electricity and heating), 2 0 3 0 (Cleaning and maintenance) and 2 2 0 0 (new purchases of technical equipment and installations) this percentage exceeded 50 % of the total of the appropriations committed, which amounted to 6,4 million euro. This practice does not comply with the general rule, set out in Article 89 of the Financial Regulation, that 'all procurement contracts shall be put to tender on the broadest possible base'. The negotiated procedure is an exception applicable only within the strict limits set in Articles 126, 127 and 129 IR.

10.17. REPLY OF THE COURT OF JUSTICE

The only observation made by the Court of Auditors concerns internal audit. On that head, the Court of Justice emphasises that, in order to act on the remarks previously made by the Court of Auditors in its annual reports, the administrative organisation of the verification and audit system has been altered. Two administrative units have been created, without any hierarchical or operational inter-connection: an internal audit unit, run by the internal auditor, and a unit responsible for verification operations. This new organisation will be in operation from 1 October 2007, the date on which the internal auditor and the head of the verification unit, newly appointed by the Administrative Committee of the Court of Justice, will take up their duties.

10.19. REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

The total amount does indeed correspond to +/- 50 %. However, electricity and gas account for nearly half of this amount. This market was opened up only recently to competition. An interinstitutional procedure was launched in 2004 but was unsuccessful. The EESC participates in a new interinstitutional procedure, which is ongoing. A contract for an interpretation equipment system extension for new meeting rooms was awarded to the supplier of the system that was already installed in all other meeting rooms for reasons of technical compatibility. For several contracts, previously awarded by negotiated procedure, calls for tender were launched in the meantime (buildings maintenance contract, building inspection, elevator inspection, elevator maintenance, hygienic supplies and waste disposal) and in several cases new contracts have been signed since. As for the insurance contracts, an initiative for an interinstitutional call for tender in 2003 was not successful. The EESC is preparing to either launch its own call for tender or to be associated with interinstitutional contracts, with an aim to establishing a new legal framework in 2008.

The EESC considers that, when there was no call for tender for a contract, the situation was justified by the circumstances (e.g. previous call not successful, technical compatibility, etc.) and this explains the volume of contracts awarded without call for tender.

THE COURT'S OBSERVATIONS

10.20. Article 123(2) IR requires that in negotiated procedures the number of candidates invited to negotiate or to tender may not be less than three, provided that a sufficient number of candidates satisfy the selection criteria, and that the number of candidates invited to tender must be sufficient to ensure genuine competition. For 70 % of the contracts examined during the audit, a tender was requested from only one potential supplier. The Court considers that for most of these contracts (with a total value of 1,8 million euro), it would have been possible to request tenders from more than one supplier.

10.21. The proportion of negotiated procedures in relation to the number of contracts awarded by the authorising officer by delegation responsible for Chapters 2 0 (investments in immovable property, rental of buildings and associated costs) and 2 2 (movable property and associated costs) of the budget had increased significantly in relation to earlier years. It was also distinctly higher than the average recorded for the Institution. As far as March 2007, the authorising officer had not reported to the Institution setting out any measures taken to reverse that trend, as required by Article 54 IR.

Committee of the Regions

10.22. The remarks in paragraphs 10.19 to 10.21 also apply to the Committee of the Regions, as they concern contracts managed by the Committees' 'Joint Services'.

10.20. REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

The Court sampled 10 cases, 7 of which were awarded after negotiated procedure with one potential supplier. For three cases (interpretation equipment system extension, buildings maintenance contract extension, insurance contracts), please refer to the comments on point 10.19. One case concerns an expenditure on the Committee of the Regions' own appropriations (not shared with the EESC) and does not involve the EESC's authorizing officer. In two cases, a call for tender could theoretically have been launched, but this was not considered economical (banners and posters: small amounts and a new framework contract signed in the meantime; security badges: ordered with the supplier, not via distributors). In one case (a contract to carry out a conformity study for the JDE 'Belliard I & II' building), the Committees had no other choice but to implement EP resolution P6_TA(2005)0410, adopted on 15.12.2005, requesting this audit to be done by SICABEL. Hence, this contract was awarded to SICABEL by negotiated procedure and the CoA was kept fully informed on this.

10.21. REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

The EESC does not believe that there is a negative trend regarding the number of negotiated procedures for chapters 20 and 22. Nevertheless, the measures to reduce the number of negotiated procedures have been incorporated in the final version of the annual report on financial year 2006 of the authorizing officer by delegation. Please also see comments on point 10.19 for further details.

10.22. THE REPLY OF THE COMMITTEE OF THE REGIONS

The Committee of the Regions has noted the comments of the Court in relation to contracts managed by the Joint Services with the EESC and is committed to improving financial management practices and methods in the Joint Services. In this regard, the Secretary General of the CoR has written to the Secretary General of the EESC proposing the implementation of a number of corrective measures, in particular in the area of financial circuits and tendering procedures. It is hoped that these measures can be implemented by agreement between the two Committees as soon as possible.

THE COURT'S OBSERVATIONS

10.23. According to the Committee's rules, its Members may be refunded travel expenses for the cost of the flight tickets actually paid. Administrative costs incurred for the purchase of such tickets are reimbursed on presentation of the travel agency invoice. In various cases, travel expenditure was refunded on the basis of hand-written travel agency invoices always showing the same amount. In the context of an ex post verification procedure the Committee's administration found that this amount was on average 83 % higher than the price charged by the airline for the ticket used. There was no evidence of the actual administrative cost invoiced for the purchase. The Committee's administration carried out a broad investigation into the matter, which was completed in July 2007. In the Court's opinion the results of this investigation do not demonstrate that the amounts paid for administrative costs were justified.

European Ombudsman and European Data-Protection Supervisor

10.24. The audit did not give rise to any material observations.

Conclusion on the audit of the specific risk areas

10.25. The audit of the specific risk areas in some Institutions showed weaknesses in the supervisory and control systems related to the payment of allowances to Members of some of the Institutions. Concerning the European Parliament, the Bureau should initiate appropriate measures when the documents considered essential are not presented within reasonable time limits (see paragraphs 10.9 to 10.12). As to the negotiated procurement procedure, the Court noted that in many cases the Commission and other Institutions did not respect the general principle of competitive tendering (see paragraphs 10.13, 10.14, 10.16 and 10.19 to 10.21). In particular the European Economic and Social Committee and the Committee of the Regions largely disregarded the limited extent to which the negotiated procedure can be used according to the Financial Regulation. This can result in an increased risk for the legality and regularity of the expenditure.

10.23. THE REPLY OF THE COMMITTEE OF THE REGIONS

According to the Committee's rules, its members may be refunded travel expenses corresponding to flight tickets and related administrative costs on presentation of a travel agency invoice accompanied by the original air ticket and original boarding pass. The CoR rules allow members to travel with full flexibility tickets. The Committee has ascertained that the members had effectively paid the amounts invoiced by the travel agency, although the actual cost of the tickets used was lower. The difference between the amounts invoiced by the travel agency and the actual cost of the tickets is due to the fact that, as the travel agency stated on 9 February 2007, the travel agency guaranteed full flexibility for the tickets, with the effect that the members travelled with full flexibility at a cost equivalent to airline costs for a fully flexible ticket.

In order to guarantee full transparency, the Committee has subjected further reimbursements to compliance with a number of conditions. It has also requested the members concerned to cease travelling under the previous arrangements and to ensure that their reimbursement claims reflect the actual price indicated on the flight ticket issued.

10.25. THE REPLY OF THE EUROPEAN PARLIAMENT

See the reply to paragraph 10.12.

10.25. REPLY OF THE COMMISSION

The Commission is pursuing its efforts to improve procurement through better market analysis and planning. The Financial Regulation ⁽¹⁾ permits negotiated procedures in a number of cases, of which supplier capacity is one (see paragraph 10.16.).

10.25. REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

Please see comments on points 10.19, 10.20 and 10.21.

⁽¹⁾ Council Regulation (EC) No 1995/2006 of 13 December 2006 amending Regulation (EC) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 390, 30.12.2006, p. 1).

THE COURT'S OBSERVATIONS

Special Reports issued since the last Annual Report

10.26. Special Report No 2/2007 concerning the Institutions' expenditure on buildings.

EUROPEAN UNION AGENCIES

10.27. Agencies are distinct bodies from the Commission having their own legal personalities. The Commission has a major supervisory role vis à vis the agencies through its participation in their management boards and its power to propose or appoint executive directors. The Commission's budget is also their main source of financing except for the two self-financed agencies ⁽⁵⁾. The Commission has to approve the measures taken by the agencies to implement the financial and the staff regulations. The information and the observations set out below concern the role of the Commission towards the Agencies.

10.28. Audits of the European Union's agencies and other satellite bodies ⁽⁶⁾ are the subject of Specific Annual Reports. In 2006, the European Court of Auditors audited 24 agencies, five more ⁽⁷⁾ than in 2005. Their budgets amounted to 1 080,5 million euro in 2006, as against 928,4 million euro in 2005. The number of authorised posts for all the agencies rose from 2 588 in 2005 to 3 212 in 2006. See **Table 10.3**.

⁽⁵⁾ Office for Harmonisation in the Internal Market and Community Plant Variety Office.

⁽⁶⁾ Hereinafter referred to as the 'agencies'.

⁽⁷⁾ The following agencies achieved financial autonomy in 2006: European Police College, European Railway Agency, Intelligent Energy Executive Agency, European Agency for the Management of Operational Cooperation at the External Borders and the Education, Audiovisual and Culture Executive Agency.

Table 10.3 — EU agencies — Principal data

| Agencies and other decentralised bodies of the European Union | Headquarters | First year of financial autonomy | Budget ⁽¹⁾ (million euro) | | Authorised posts | |
|--|-------------------------|----------------------------------|--------------------------------------|--------------|------------------|--------------|
| | | | 2006 | 2005 | 2006 | 2005 |
| <i>Agencies</i> | | | | | | |
| European Centre for the Development of Vocational Training | Thessalonica | 1977 | 16,8 | 16,6 | 95 | 91 |
| European Foundation for the Improvement of Living and Working Conditions | Dublin | 1977 | 19,8 | 18,8 | 94 | 94 |
| European Environment Agency | Copenhagen | 1994 | 37,1 | 32,1 | 115 | 115 |
| European Training Foundation | Turin | 1994 | 27 | 26,7 | 105 | 104 |
| European Monitoring Centre for Drugs and Drug Addiction | Lisbon | 1995 | 13 | 13 | 77 | 77 |
| European Medicines Agency | London | 1994 | 139 | 110,1 | 424 | 379 |
| Translation Centre for the Bodies of the European Union | Luxembourg | 1995 | 40,9 | 28,4 | 189 | 181 |
| Community Plant Variety Office | Angers | 1995 | 11,2 | 12,1 | 41 | 38 |
| Office for Harmonisation in the Internal Market | Alicante | 1995 | 211,7 | 218,4 | 675 | 675 |
| European Agency for Safety and Health at Work | Bilbao | 1996 | 14,1 | 13,4 | 40 | 40 |
| European Fundamental Rights Agency ⁽²⁾ | Vienna | 1998 | 9,4 | 8,2 | 37 | 37 |
| European Agency for Reconstruction | Thessalonica | 2000 | 271 | 276,5 | 108 | 114 |
| European Police College ⁽³⁾ | Bramshill | 2006 | 5 | — | 22 | — |
| Eurojust | The Hague | 2002 | 14,7 | 13 | 112 | 87 |
| European Aviation Safety Agency | Cologne | 2003 | 65,7 | 57,5 | 328 | 200 |
| European Maritime Safety Agency | Lisbon | 2003 | 44,6 | 35,3 | 132 | 95 |
| European Food Safety Authority | Parma | 2003 | 40,2 | 36,7 | 250 | 194 |
| European Network and Information Security Agency | Heraklion | 2005 | 6,8 | 6,8 | 44 | 38 |
| European Railway Agency ⁽³⁾ | Valenciennes | 2006 | 14,4 | — | 95 | — |
| European Centre for Disease Prevention and Control | Stockholm | 2005 | 17,1 | 4,8 | 50 | 29 |
| European Agency for the Management of Operational Cooperation at the External Borders ⁽³⁾ | Warsaw | 2006 | 19,2 | — | 28 | — |
| European GNSS Supervisory Authority ⁽³⁾ | Brussels ⁽⁴⁾ | 2006 | 7 | — | 30 | — |
| <i>Executive Agencies</i> | | | | | | |
| Intelligent energy Executive Agency ⁽³⁾ | Brussels | 2006 | 5,6 | — | 46 | — |
| Education, Audiovisual and Culture Executive Agency ⁽³⁾ | Brussels | 2006 | 29,2 | — | 75 | — |
| Total | | | 1 080,5 | 928,4 | 3 212 | 2 588 |

⁽¹⁾ Payment appropriations.⁽²⁾ Formerly the European Monitoring Centre on Racism and Xenophobia.⁽³⁾ Agency having required its financial independence in 2006.⁽⁴⁾ Provisional seat.

THE COURT'S OBSERVATIONS

10.29. The disbursement of subsidies paid by the Commission from the Community budget is not based on sufficiently justified estimates of the agencies cash requirements. This, combined with the size of carry-overs, leads them to hold sizeable cash balances⁽⁸⁾. The Court recommends that the level of subsidies paid to the agencies is in line with their real cash requirements.

10.30. The general Financial Regulation of June 2002 was modified in 2006⁽⁹⁾. The amendments made focus on the budgetary principles, the internal control systems and the presentation of the accounts. They have not yet been incorporated into the agencies' framework financial regulation and in their various specific financial regulations.

10.31. The introduction in the agencies of the new system, ABAC, will take several years⁽¹⁰⁾. During this period, the Commission needs to ensure that the current SI2 system is adequately maintained in the agencies until the new system is implemented.

10.29. REPLY OF THE COMMISSION

Agencies are expected to present to the Commission requests for payment of all or part of the Community subsidy, supported by a cash-flow forecast, under terms and at intervals agreed with the Commission. As a general rule, the Commission makes payments by tranches; sums that were not spent have to be recovered by the Commission. The Commission services are studying the introduction of provisions in the appropriate act⁽²⁾ in order to enable the Commission to take into account the real needs of the agency throughout the year. This should lead to a more rigorous planning and increase transparency.

10.30. REPLY OF THE COMMISSION

The revision of the two framework financial regulations for agencies⁽³⁾ will incorporate amendments adopted by the Council in the general FR and could therefore only start once the general FR and its IR were adopted. The draft regulation for regulatory agencies was adopted by the Commission in July 2007 and submitted to the other institutions for their opinion⁽⁴⁾.

10.31. REPLY OF THE COMMISSION

The SI2 module is being phased out gradually but will be maintained until 31 December 2008. Agencies have autonomy to choose between ABAC or any other system. A dedicated project team reporting directly to the Commission's Accountant plans, analyses, and co-ordinates all activities accompanying the roll out of ABAC within an Agency, both in timing and resources.

⁽⁸⁾ Amount of cash held by Agencies at the end of 2006 (excluding Office for Harmonisation in the Internal Market, Community Plant Variety Office and Translation Centre for the bodies of the European Union — and the European GNSS Supervisory Authority): 213 million euro to be compared to 810 million euro appropriations.

⁽⁹⁾ Council Regulation (EC, Euratom) No 1995/2006 of 13 December 2006, amending Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the General Budget of the European Communities (OJ L 390, 30.12.2006, p. 1).

⁽¹⁰⁾ At the end of 2006, 14 agencies had still to implement ABAC. The Commission plans to implement ABAC in four agencies each year at the most.

⁽²⁾ Commission Regulation (EC, Euratom) No 2343/2002 of 23 December 2002 on the framework Financial Regulation for the bodies referred to in Article 185 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).

⁽³⁾ Regulatory and executive.

⁽⁴⁾ The revision of the framework financial regulation for executive agencies was adopted in May 2007 and is already with the institutions.

THE COURT'S OBSERVATIONS

10.32. In 2006, two Agencies decided to bear all the school costs for their staff children without applying Article 3 of Annex VII of the Staff Regulation and thereby creating unjustified disparities with other Community staff. This shows the necessity for the Commission to improve its monitoring of the implementation of the Staff Regulations by the Agencies.

10.32. REPLY OF THE COMMISSION

The guidelines make two key recommendations: (i) to adopt rules designed to implement the Staff Regulations (SR) in line with the Commission Implementing Rules (IR) with limited changes justified by the specific characteristics of Agency staff; and (ii) to define a more consistent staff policy based on tasks and requirements of each agency. As Regulatory Agencies are independent Community bodies, it lies within their responsibilities to adopt such rules. The Commission agreement can be given to IR identical to the Commission rules or deviating from them, when justified by the special attributes of Agencies (size, staffing structure, mandate etc). The Commission is working closely together with the Agencies in order to have the Commission IR applied in Agencies to the fullest extent possible. The Commission has also in cooperation with Agencies drawn up models of IR based on the Commission IR aiming to obtain a common core of principles and rules to ensure equal treatment of staff subject to the SR.

As regards the matter of schooling for Agency staff children, the Commission has proposed two solutions in the Guidelines: (i) to set up, in cooperation with the European School system, European sections in local national or international schools (European schooling) or (ii) to sign service contracts between the Agency and the surrounding international schools.

As regards European Schooling, there is, already at this time, the possibility for national authorities to select and fully finance local schools to become 'accredited' to give European Schooling according to a harmonised curriculum based on mother tongue education. In the future and in the context of the reform of the European School System, this possibility will be broadened and further consolidated. The Member States would bear the overall cost of this type of schooling, and the Commission is drawing up, as part of the reform, an approach to an EU contribution proportional to the number of children of Agency staff enjoying this type of schooling.

As regards the service contracts, the Agency would pay the school fees directly to the school. The school would then be considered as non-fee-paying and the staff concerned would not receive education allowance under Article 3 of Annex VII of the Staff Regulations.

In full coherence with this position, the Commission has repeatedly reminded the two agencies in question of the fact that their approach is not foreseen in the Guidelines, nor compliant with the Staff Regulations. This was done most recently in its comments to Multiannual Staff Policy Plans of Agencies which were transmitted to the Budgetary Authority in the framework of the 2008 budgetary procedure.

THE COURT'S OBSERVATIONS

EUROPEAN SCHOOLS

10.33. The Court's Specific Annual Report on the European Schools (not published in the Official Journal) is submitted to the Board of Governors and to the Directors of the European Schools. The Schools' 2006 budget of 231,1 million euro was financed mainly by a Commission grant (127,1 million euro) and by contributions from the Member States (50,7 million euro) ⁽¹⁾. The principal data concerning the European Schools are set out in **Table 10.4**.

Table 10.4 — European Schools — Principal data

| European School | Country | Budget ⁽¹⁾ ⁽²⁾ (million euro) | | Grant received from the Commission ⁽³⁾ (million euro) | | School population ⁽⁴⁾ | |
|------------------------|----------------|--|--------------|--|--------------|----------------------------------|---------------|
| | | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| Office | Belgium | 8,8 | 8,5 | 7,5 | 6,6 | — | — |
| Luxembourg I | Luxembourg | 34,1 | 33,3 | 21,5 | 19,4 | 3 285 | 3 190 |
| Luxembourg II | Luxembourg | 6,9 | 6,6 | 3,7 | 3,7 | 922 | 891 |
| Brussels I Uccle | Belgium | 27,8 | 27,1 | 19,0 | 16,0 | 2 954 | 2 617 |
| Brussels II (Woluwe) | Belgium | 27,6 | 27,3 | 18,0 | 17,1 | 2 919 | 3 014 |
| Brussels III (Ixelles) | Belgium | 25,8 | 25,6 | 17,0 | 16,9 | 2 646 | 2 781 |
| Mol | Belgium | 10,9 | 10,7 | 6,1 | 6,0 | 654 | 622 |
| Varese | Italy | 16,5 | 16,4 | 8,4 | 8,4 | 1 317 | 1 318 |
| Karlsruhe | Germany | 11,7 | 11,8 | 3,4 | 4,3 | 964 | 1 044 |
| Munich | Germany | 18,5 | 18,7 | 1,0 | 0,9 | 1 599 | 1 557 |
| Frankfurt | Germany | 10,7 | 9,4 | 4,7 | 3,5 | 937 | 876 |
| Alicante | Spain | 11,1 | 10,4 | 6,0 | 3,2 | 990 | 987 |
| Bergen | Netherlands | 10,0 | 10,8 | 5,4 | 5,0 | 563 | 626 |
| Culham | United Kingdom | 10,8 | 11,2 | 5,4 | 5,4 | 832 | 856 |
| Total | | 231,1 | 227,8 | 127,1 | 116,4 | 20 582 | 20 379 |

⁽¹⁾ Total revenue and expenditure as foreseen in the budget of each European School and the Office including all modifications made to the budgets initially adopted.

⁽²⁾ Source: European Schools, clôture des comptes 2006.

⁽³⁾ Source: European Schools, clôture des comptes 2006.

⁽⁴⁾ Source: 2006 Annual report of the Secretary General to the Board of Governors of the European Schools.

NB: Variations in totals are due to the effects of rounding.

10.34. The Court found no material errors that might call into question the reliability of the accounts that it examined and the legality and regularity of the transactions underlying these accounts.

⁽¹⁾ Source: General introduction to the 2007 budget of the European Schools.

CHAPTER 11

Financial instruments and banking activities

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INTRODUCTION

11.1. The Communities' financial instruments relating to banking activities operate both in the Member States and, to a greater extent, outside the Union, in the context of external policies. Their main aims are to boost economic development, improve infrastructure and create jobs, notably in small and medium-sized enterprises (SMEs), through measures to enhance their access to finance. The European Coal and Steel Community in Liquidation is involved in similar transactions.

11.2. The Court's audit covered banking measures in the Mediterranean area, the operation of the Guarantee Fund for External Actions and the activities of the European Coal and Steel Community in Liquidation (ECSC i.L.).

BANKING MEASURES IN THE MEDITERRANEAN AREA

Background

11.3. Co-operation between the EU and Mediterranean non-member countries started some 30 years ago and has been gradually developed over the years⁽¹⁾. The 'Euro-Mediterranean Partnership'⁽²⁾ was established by Council Regulation (EC) No 1488/96 of 23 July 1996 (MEDA I). A new amended Regulation⁽³⁾ (MEDA II) came into force in December 2000⁽⁴⁾. Since October 2002, the European Investment Bank (EIB) has brought together its operations in the Mediterranean region under the 'Facility for Euro-Mediterranean Investment and Partnership (FEMIP)'.

(1) For example by 'Protocols' — separate bilateral, financial agreements between the EU and Mediterranean countries — and by Council Regulation (EC) No 1763/92 of 29 June 1992 setting rules for financial co-operation with Mediterranean non-member countries.

(2) The partner countries and territories in the MEDA Regulation are: Morocco, Algeria, Tunisia, Egypt, Israel, Jordan, Gaza and the West Bank, Lebanon, Syria, Turkey, Cyprus and Malta. Cyprus and Malta have become EU Member States, Turkey is receiving special pre-accession assistance.

(3) Council Regulation (EC) No 2698/2000 of 27 November 2000 (MEDA II)(OJ L 311, 12.12.2000, p. 1), amending the old Regulation (EC) No 1488/96 (MEDA I) (OJ L 189, 30.7.1996, p. 1).

(4) The European Neighbourhood and Partnership Instrument has been established with effect from 2007 (OJ L 310, 9.11.2006, p. 1).

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11.4. Banking measures under the MEDA Regulation are financed from the EU budget and operated by the EIB: risk capital operations (RCO), interest rebates for certain EIB loans ⁽⁵⁾ and financing of Technical Assistance (TA) through a FEMIP Support Fund ⁽⁶⁾.

11.5. The objective of the Court's audit was to assess whether the related banking measures have been executed, monitored and accounted for in line with the relevant regulations and procedures both at the level of the Commission and of the EIB. The audit covered operations financed under the MEDA Regulation and some ongoing operations financed under previous legal provisions with outstanding disbursements or significant amounts at stake. The findings are based on documentary checks of 90 operations — 30 operations sampled for each of the three banking measures involved, including evaluation of the monitoring and control system. For the key financial data, see **Table 11.1**.

Table 11.1 — Key financial data

(in million euro)

| | 31.12.2005 | 31.12.2006 |
|--|------------------------------|------------|
| Risk capital operations (RCO) | | |
| net value of all ongoing operations | 223,9 | 210,8 |
| Loans with interest rebates | | |
| Loan amounts (all Mediterranean) | 3 348,2 | 3 513,2 |
| Interest rebates (all Mediterranean) | not available ⁽¹⁾ | 479,5 |
| Technical assistance-FEMIP Support Fund | | |
| Budgetary appropriations (all) | 105,0 | 105,0 |
| Disbursements to trust accounts | 40,5 | 50,0 |

⁽¹⁾ The total as at 30 June 2005 amounted to 489 million euro.
Source: European Investment Bank.

⁽⁵⁾ EIB loans from its own resources to which interest rebates from the EU budget are allocated.

⁽⁶⁾ The FEMIP Support Fund should be distinguished from the FEMIP Trust Fund which is financed directly by the EU Member States through contributions totalling 32,5 million euro. In addition, the Commission contributed 1 million euro to the Trust Fund.

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Observations concerning the management of the individual measures by the Commission and the EIB

Risk capital operations (RCO)

11.6. The most important RCO are conditionally repayable individual and global loans as well as participations in investment funds. Because of their nature, however, having no fixed repayment terms nor a specified rate of interest, they may be considered as quasi-equity investments.

Provision of risk capital through conditional loans

11.7. The individual loan allocations made in the context of three global loans, out of the nine global loans audited, totalling 16,8 million euro exceeded the overall ceiling of 15 million euro set by the EIB and approved by the Commission for those loans.

Provision of risk capital through investment funds

11.8. The Court's audit revealed that the investment funds included in the RCO portfolio did not fully comply with the MEDA Regulation as:

- the portfolio includes seven investment funds which are located outside the EU (Jersey, Guernsey, the Isle of Man and the British Virgin Islands). In total 36,2 million euro are committed to these funds;
- investment funds made investments outside the list of eligible partner territories and countries (the United Arab Emirates and the Isle of Man). This was notably due to the fact that the investment rules of the funds did not include the necessary investment restriction.

11.9. There was no control procedure in respect of cross-investments between funds. It was difficult therefore to verify that the overall ceilings had been respected.

Weaknesses in the monitoring, accounting for and valuation of RCO

11.10. The monitoring of RCO has not been adequate in the past. Intermediaries' reporting obligations, such as the communication of financial statements, sub-loan contracts and evidence of disbursements, were not consistently followed up. This led to

11.6. *The Commission has classified these assets under investments 'available for sale' in the 2006 final accounts.*

11.7. *In the end, the allocated amount was not fully disbursed.*

11.8.

— *Following a specific request by the EIB in 2003, the Commission confirmed that the investment funds should be located either in the European Union or in one of the Mediterranean Partner Countries (MPCs).*

— *The Commission does not receive exhaustive lists of investments made through investment funds. In future, the Commission will ensure that adequate reporting requirements fill this gap.*

11.9. *The Commission is currently able to monitor their investments and would intervene if it believed that cross-investments between funds became a problem.*

THE COURT'S OBSERVATIONS

late recoveries and uncertainty about the valuation of RCO. Following an internal re-organisation of the relevant EIB service in 2005 the financial monitoring has improved, although certain deficiencies relating to past operations still have to be addressed.

11.11. In the provisional consolidated financial statements of the European Communities RCO were classified under 'loans granted from the EC budget and the ECSC i.L.'. Because of their nature as quasi-equity investments (see paragraph 11.6), they should, according to the Commission's accounting rule No.11 (Financial assets and liabilities), be classified under the heading 'investments available for sale' and valued using fair values. However, they are held at historic costs less any provisions for impairment, as their fair value cannot currently be reliably measured. The provisions for impairment are based on the provisional or definitive write-offs. While such a valuation method is acceptable in the circumstances, it is not consistently applied. The Court found some cases where provisional estimates for impairments available to the EIB had not been communicated to the Commission. This shows that the convention between the Commission and the EIB needs to be updated so that the Commission receives all relevant information in time to allow it to take it into account in the application of its accounting rules. Furthermore, the Commission should more actively monitor the application of the convention rather than as at present relying entirely on the information provided by the EIB.

Interest rebates

11.12. Interest rebates are paid from the Community budget for certain EIB loans in the field of the environment. Globally, the related operations were satisfactorily managed. However, a number of weaknesses were noted. In particular, recent loan contracts, amounting to 135 million euro and benefiting from interest rebates of 26,8 million euro, allowed for payment in currencies other than the euro, contrary to Article 6 of the MEDA II Regulation. Furthermore, one project benefiting from an interest rebate of 8,5 million euro was closed although the beneficiary had not submitted the required report confirming the successful execution of the project.

THE COMMISSION'S REPLIES

11.11. *The Commission has made the necessary reclassification of these assets under investments 'available for sale' in the 2006 final accounts. Reporting and accounting standards have evolved significantly over the period of the MEDA mandates. The European Bank of Investment (EIB) and the Commission have been following developments and are currently reviewing the situation together, looking for the best cost-benefit solution and also taking into account information available according to the contracts signed with final beneficiaries many years ago (hence not including current reporting standards). New reporting requirements will also be agreed as regards the content of the annual executive reports, enabling the Commission to monitor more thoroughly the application of the relevant legal base and mandate.*

11.12. *Under MEDA II, only one disbursement was made in one project in another currency. For subsequent disbursements under this loan, the EIB notified the borrower that it would not be able to disburse in other currencies than the euro. The Bank is preparing amendments to the finance contracts so as to comply with the euro denomination requirement.*

THE COURT'S OBSERVATIONS

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FEMIP Support Fund for Technical Assistance

11.13. TA projects are to support beneficiaries during different stages of the project cycle, that is project identification, preparation and implementation. Overall, TA projects are adequately managed. Out of the 30 operations examined eligibility problems were found in three cases despite the fact that the framework agreement does not foresee derogation possibilities:

- (a) for two projects examined environmental impact assessment studies were financed for a total of 1,15 million euro which should instead be financed by the promoters,
- (b) an external TA mid-term evaluation amounting to 0,2 million euro was also financed from the TA support fund, whereas this is not in line with the definition of eligible TA projects in the framework agreement.

Reporting obligation towards the Budgetary Authorities

11.14. Since the start of the MEDA programme in 1996 the Commission is required to submit to the European Parliament and the Council an annual report giving information on the measures financed during the year (Article 15 of the MEDA Regulation). While the Commission has published a general annual report on development cooperation, this report does not currently provide sufficient information on progress achieved through the financial instruments.

Classification of bank accounts in the Communities' financial statements

11.15. Budgetary resources are transferred to specific interest-bearing bank accounts ⁽⁷⁾ held at the EIB in the name of the Commission. The amounts in these accounts were recorded as pre-financings in the provisional consolidated financial statements of the Communities. This classification differed from that used in accounting for similarly conducted programmes mandated by the Commission to other financial institutions. In these other cases the bank accounts were classified under 'cash and cash equivalents'.

11.13. *The European Directives related to environmental impact assessments (EIAs) are demanding, especially concerning the public consultation process. The EIA is an integral part of the EIB investment project cycle. Locally financed and implemented EIAs often do not meet the requirements of EU directives. Moreover, the EIB is sometimes criticized by non-governmental organizations (NGOs) to be not strict enough with respect to these requirements. With regard to the EIB investment amounting to 0,2 million euro, an EIA was set as conditionality for loan disbursement.*

The Commission agreed to the financing of the Mid Term Evaluation from the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) support fund after having assessed compliance with the eligibility criteria. The mid-term evaluation exercise supports EIB investments through improved technical assistance operations. Hence, both the Commission and the EIB found it appropriate to finance the mid-term evaluation exercise from the FEMIP support fund.

11.14. *The Commission will consider providing more detailed information to the budgetary authority.*

11.15. *For the 2006 final accounts a reclassification has been applied in the sense indicated by the Court.*

⁽⁷⁾ As at 31 December 2006 a total of 233,1 million euro are kept on these specific bank accounts.

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THE COMMISSION'S REPLIES

Conclusions and recommendations

11.16. The management of banking measures under the MEDA Regulation, in respect of Technical Assistance and loans with Interest Rebates was overall satisfactory. However, in respect of Risk Capital Operations, the Court found weaknesses in the execution and monitoring procedures as well as in the communication of all relevant data by the EIB to the Commission in order to allow the latter to fully apply its accounting rules. For RCO and interest rebate operations it was also found that beneficiaries did not always fulfil their contractual and reporting obligations. Appropriate action should be taken to ensure that the financial intermediaries and borrowers meet their contractual obligations.

11.17. The management convention between the Commission and the EIB for RCO and interest rebates needs improvement and should be updated.

11.18. The Commission should establish stricter monitoring procedures to ensure the completeness and reliability of the financial data. The Commission should provide more complete information on progress achieved through the financial instruments and should also treat the various bank accounts opened for mandated actions consistently.

11.16. *The Commission will take appropriate action to ensure that the financial intermediaries and borrowers meet their contractual obligations.*

11.17. *The Commission is in discussion with the EIB on the new reporting requirements in line with the new accounting rules and is looking for the best cost-benefit solution.*

11.18. *The Commission has mandated the EIB to implement operations on its behalf and has assigned to it some management responsibilities which are clearly laid out in the Convention and must be respected. The Commission is ready to further strengthen its monitoring of EIB mandated actions, respecting the provisions of the Convention.*

The Commission will consider providing more detailed information to the budgetary authority.

For the 2006 final accounts a reclassification has been applied in the sense indicated by the Court.

GUARANTEE FUND FOR EXTERNAL ACTIONS

11.19. The purpose of the Guarantee Fund for External Actions ⁽⁸⁾ ('the Fund'), which guarantees loans to third countries, is to reimburse the Community's creditors ⁽⁹⁾ in the event of a beneficiary's defaulting and to avoid direct calls on the

⁽⁸⁾ Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 (OJ L 293, 12.11.1994, p. 1), as last amended by Regulation (EC, Euratom) No 89/2007 of 30 January 2007 (OJ L 22, 31.1.2007, p. 1).

⁽⁹⁾ Principally the EIB, but also Euratom external lending and EC macro-financial assistance (MFA) loans to third countries.

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Community budget. The administrative management of the Fund is carried out by DG ECFIN while the EIB is responsible for its treasury management ⁽¹⁰⁾. At 31 December 2006, the Fund's total resources were 1 379 million euro.

11.20. The Court found that the Guarantee Fund was managed during 2006 in a satisfactory manner. No guarantee calls were made to the Fund in 2006.

THE ECSC IN LIQUIDATION

11.21. After the expiry of the Treaty establishing the European Coal and Steel Community on 23 July 2002, the assets and liabilities of the ECSC were transferred to the European Community ⁽¹¹⁾. Their net worth, referred to as the European Coal and Steel Community in Liquidation (ECSC i.L.), is allocated to research in the coal and steel industry. As at 31 December 2006, the total assets of the ECSC i.L. were 2 174 million euro compared to 2 214 million euro as of the 31 December 2005.

11.22. The winding-up of the financial operation of the ECSC i.L. is proceeding in compliance with the relevant legislation, including the multiannual financial guidelines.

FOLLOW UP OF PREVIOUS OBSERVATIONS

11.23. See **Annex 11.1**.

⁽¹⁰⁾ Management agreement between the EIB and the European Community, as last amended on 28 April 2002 and 8 May 2002.

⁽¹¹⁾ Protocol on the financial consequences of the expiry of the ECSC Treaty and on the Research Fund for Coal and Steel (OJ C 80, 10.3.2001, p. 67).

Follow-up of the Court's previous observations

| Court's observations | Situation in 2006 | Further action needed | Commission reply |
|---|--|---|--|
| <p><i>Specific observations concerning the Financial Mechanism projects</i></p> <p>Public tendering</p> <p>Paragraph 10.33 of the Annual Report concerning the financial year 2002 identified preferences for installation of an electric transformer for the construction of a wind farm in Spain (Galicia) where the concession for the installation of a wind farm required 74 % local production in Galicia (80 % including civil engineering work). The beneficiary had to prove that the product could not be found on the domestic market in order to obtain specific permission from the regional authorities to buy the equipment in Sweden. The Commission was invited to examine the situation in order to ensure that there were no preferences for national products.</p> | <p>The Commission has examined the case without the EIB and found the alleged breach of the relevant Directive but considered that no further action is opportune.</p> | | <p><i>The Commission examined the case from both the angles of public procurement and free movement of goods. It found a potential but unproven breach of the public procurement rules in force at the time but no evidence of any infringement of the free movement of goods provisions. It considered that no further action on the public procurement issue was opportune as under the current legislation the operator would no longer fall under the rules.</i></p> |
| <p><i>Overview of assets held by Financial Institutions on behalf of the Commission</i></p> <p>Paragraph 10.16 of the Annual Report concerning the financial year 2004 indicated that:</p> <p>(10.16(b)) a contribution to a banking operation that the Kreditanstalt für Wiederaufbau is carrying out in Bosnia and Herzegovina for which 44,25 million euro were paid, was not registered as an asset by the Commission and therefore not recorded in the accounts;</p> <p>(10.16(c)) EU funding totalling 16 million euro has been provided to the European Agency for Reconstruction (EAR) for banking operations in Kosovo, Montenegro and Serbia, managed by KfW. Neither the Commission nor the EAR had included these amounts in its provisional 2004 accounts.</p> <p>A similar problem was outlined in paragraphs 10.17 and 10.18 of the Annual Report concerning the financial year 2004 with regard to existing assets held by financial institutions on behalf of the Commission. Such an overview should ensure that the assets are subject to regular and adequate monitoring.</p> | <p>In line with its reply to the findings of the Court the Commission included the amounts in its 2004 final financial statements. However, in 2005 the amounts no longer appeared in the financial statements without justification.</p> <p>In 2006 the Commission booked 46,1 million euro coming from those participations as assets and created a profit in the economic outturn account. The Commission decided ⁽¹⁾ to use these amounts for a financial participation by purchasing 922,5685 'C' shares of 50 000 euro each in the 'European Fund for South East Europe' ⁽²⁾ (a profit oriented private SICAV) ⁽³⁾ The shares were bought ⁽⁴⁾ on behalf of the Commission by the European Investment Fund in the context of a specific trust agreement. The financial participation was valued at 49,4 million euro at the end of 2006.</p> <p>With the introduction of the new accounting system in 2005 the Commission has obtained a partial overview of assets held on its accounts.</p> | <p>The Commission needs to implement valid monitoring and control procedures in respect of its assets kept in financial participations to ensure that such assets are always properly recorded.</p> | <p><i>Since 2006 the Commission ensures that the recording and monitoring of assets kept in financial participations is done properly, in time and in the correct classification. The loans of 44,250 million euro to the Kreditanstalt für Wiederaufbau were not included in the assets of 2005. However, by signature of a transfer agreement on 19 June 2006, the Commission (EC) and the European Agency for Reconstruction (EAR) authorised the transfer of outstanding loans under the 'European Funds' to the European Fund for Southeast Europe (EFSE). The amount is included in the assets of the 2006 balance sheet of the EC and will be further monitored.</i></p> <p><i>The Commission will examine actions to be taken to improve the situation and apply appropriate measures.</i></p> |

⁽¹⁾ Decision C(2006) 2307 of 8.6.2006.

⁽²⁾ The Fund has A (private investments), B (mezzanine participations) and C (donor shares) shares. Losses are allocated first to the C shares and if the C shares are completely used to the B shares. The price of the B shares with lower risk was set at 25 000 euro which is half the price of the high risk C shares (50 000 euro).

⁽³⁾ The Fund is established under Luxembourg law as a SICAV: 'Société d'Investissement à capital Variable — Fonds d'Investissement Spécialisé'.

⁽⁴⁾ It was not a cash transaction as the assets were brought in from existing revolving loans managed by the German Kreditanstalt für Wiederaufbau (KfW) which were subject to the Court's findings in the 2004 Annual report outlined above.

ANNEXES

ANNEX I

Financial information on the general budget

CONTENTS

BACKGROUND INFORMATION ON THE BUDGET

1. Origin of the budget
2. Legal basis
3. Budgetary principles laid down in the Treaties and the Financial Regulation
4. Content and structure of the budget
5. Financing of the budget (budgetary revenue)
6. Types of budget appropriation
7. Implementation of the budget
 - 7.1. Responsibility for implementation
 - 7.2. Implementation of revenue
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 - 7.4. The consolidated statements on budgetary implementation and determination of the balance of the financial year
8. Presentation of the accounts
9. External audit
10. Discharge and follow-up

EXPLANATORY NOTES

Sources of financial data

Monetary unit

Abbreviations and symbols

DIAGRAMS

BACKGROUND INFORMATION ON THE BUDGET

1. ORIGIN OF THE BUDGET

The budget comprises the expenditure of the European Community and the European Atomic Energy Community (Euratom). It also includes administrative expenditure on cooperation in the fields of 'justice and home affairs' and the common foreign and security policy, as well as all other expenditure that the Council considers should be borne by the budget for the purpose of implementing these policies.

2. LEGAL BASIS

The budget is governed by the financial provisions of the Rome Treaties ⁽¹⁾ ⁽²⁾ (Articles 268 to 280 EC and Articles 171 to 183 Euratom) and by the financial regulations ⁽³⁾.

3. BUDGETARY PRINCIPLES LAID DOWN IN THE TREATIES AND THE FINANCIAL REGULATION

All items of Community revenue and expenditure are to be included in a single budget (unity and accuracy). The budget is authorised for one financial year only (annuality). Budgetary revenue and expenditure must balance (equilibrium). The accounts are established, implemented and presented in euro (unit of account). Revenue is to be used without distinction to finance all expenditure and, like the expenditure, is to be entered in full in the budget and subsequently in the financial statements without any adjustment of one item against another (universality). The appropriations are earmarked for specific purposes by title and chapter; the chapters are further subdivided into articles and items (specification). The budgetary appropriations are to be used in accordance with the principles of economy, efficiency and effectiveness (sound financial management). The budget is established and implemented and the accounts are presented in observance of the principle of transparency (transparency). There are some minor exceptions to these general principles.

4. CONTENT AND STRUCTURE OF THE BUDGET

The budget consists of a 'Summary statement of revenue and expenditure' and sections divided into 'Statements of revenue and expenditure' for each institution. The eight sections are: (I) Parliament; (II) Council; (III) Commission; (IV) Court of Justice; (V) Court of Auditors; (VI) Economic and Social Committee; (VII) Committee of the Regions; (VIII) European Ombudsman and European Data-protection Supervisor.

Within each section, items of revenue and expenditure are classified under budget headings (titles, chapters, articles and, where applicable, items) according to their type or the use to which they are to be applied.

5. FINANCING OF THE BUDGET (BUDGETARY REVENUE)

The budget is mainly financed from the Communities' own resources: GNI-based own resources; own resources accruing from VAT; customs duties; agricultural duties and sugar and isoglucose levies ⁽⁴⁾.

Besides own resources, there are other, marginal items of revenue (see **Diagram I**).

6. TYPES OF BUDGET APPROPRIATION

To cover estimated expenditure, the following types of budget appropriation are distinguished in the budget:

- (a) differentiated appropriations (DA) are used to finance multiannual activities in certain budgetary areas. They comprise commitment appropriations (CA) and payment appropriations (PA):
 - commitment appropriations make it possible to enter into legal obligations during the financial year for activities whose implementation extends over several financial years;

⁽¹⁾ Treaty of Rome (25 March 1957): Treaty establishing the European Economic Community (EEC).

⁽²⁾ Treaty of Rome (25 March 1957): Treaty establishing the European Atomic Energy Community (Euratom).

⁽³⁾ Mainly the Financial Regulation (FINREG) of 25 June 2002 (OJ L 248, 16.9.2002).

⁽⁴⁾ Principal legal acts relating to own resources: Council Decision 2000/597/EC, Euratom of 29 September 2000 (OJ L 253, 7.10.2000); Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 (OJ L 130, 31.5.2000); Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 (OJ L 155, 7.6.1989); Sixth Council Directive of 17 May 1977, common system of VAT: uniform assessment basis (OJ L 145, 13.6.1977); Council Directive 89/130/EEC, Euratom of 13 February 1989 on the harmonisation of the compilation of GNI (OJ L 49, 21.2.1989); Council Regulation (EC, Euratom) No 1287/2003 of 15 July 2003 on the harmonisation of gross national income at market prices (OJ L 181, 19.7.2003).

— payment appropriations make it possible to cover expenditure arising from commitments entered into during current and preceding financial years;

(b) non-differentiated appropriations (NDA) make it possible to ensure the commitment and payment of expenditure relating to annual activities during each financial year.

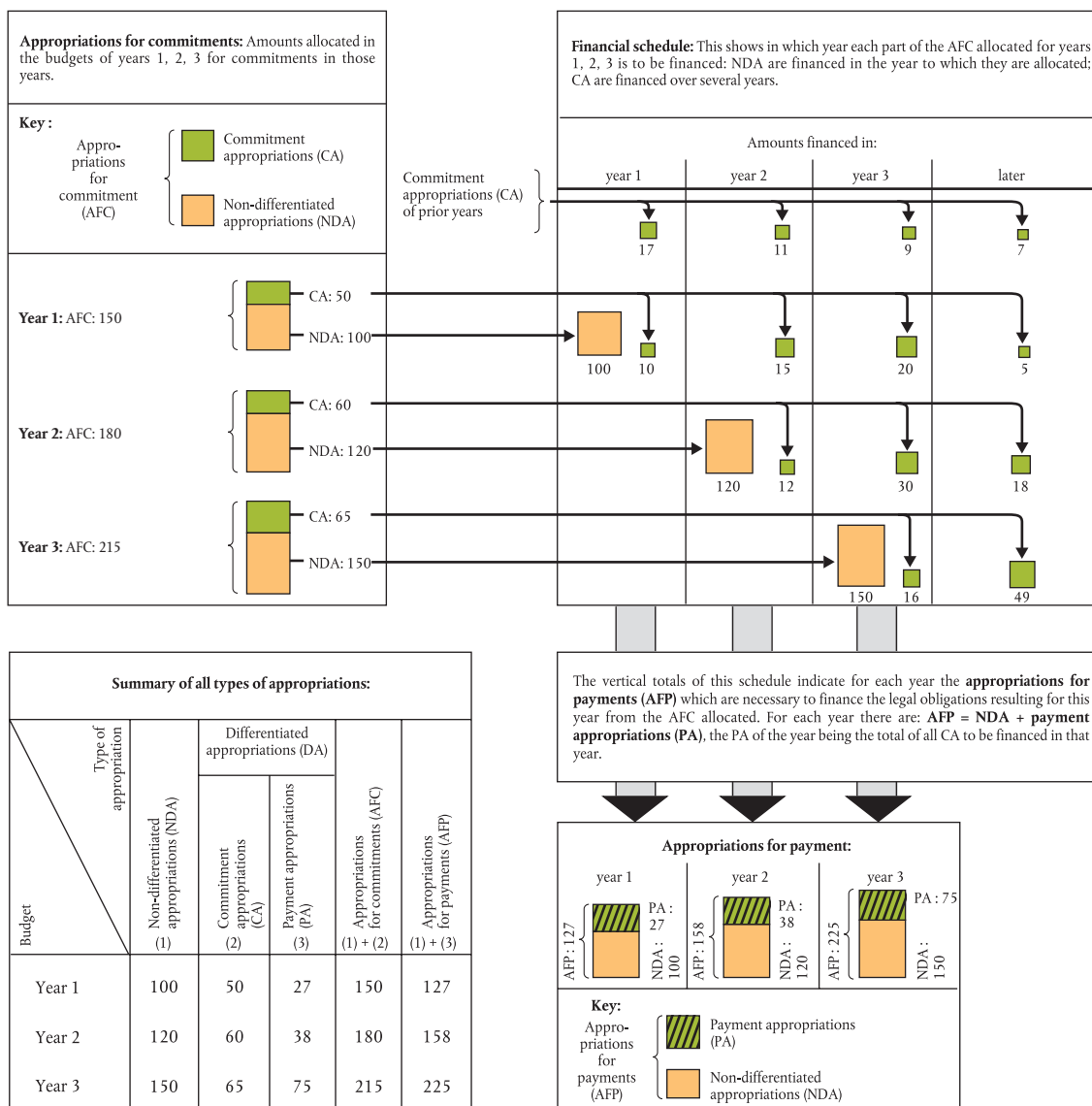
It is thus important to establish the following two totals for each financial year:

(a) the total of appropriations for commitments (AFC) ⁽⁵⁾ = non-differentiated appropriations (NDA) + commitment appropriations (CA) ⁽⁵⁾;

(b) the total of appropriations for payments (AFP) ⁽⁵⁾ = non-differentiated appropriations (NDA) + payment appropriations (PA) ⁽⁵⁾.

Revenue raised in the budget is intended to cover the total appropriations for payments. Commitment appropriations do not need to be covered by revenue.

The following simplified presentation (with illustrative amounts) shows the impact of these types of appropriations in each budget year.



⁽⁵⁾ It is important to note the differences between 'appropriations for commitments' and 'commitment appropriations' and between 'appropriations for payments' and 'payment appropriations'. The two terms 'commitment appropriations' and 'payment appropriations' are used exclusively in the context of differentiated appropriations.

7. IMPLEMENTATION OF THE BUDGET

7.1. Responsibility for implementation

The Commission implements the budget on its own responsibility in accordance with the Financial Regulation and within the limits of the allotted appropriations; it also confers upon the other institutions the requisite powers for the implementation of the sections of the budget relating to them ⁽⁶⁾. The Financial Regulation lays down the implementation procedures and, in particular, the responsibilities of the authorising officers, accounting officers, administrators of imprest accounts and internal auditors of the institutions. In the two largest areas of expenditure (EAGGF-Guarantee and Structural Funds) the management of Community funds is shared with the Member States.

7.2. Implementation of revenue

The estimated revenue is entered in the budget subject to changes deriving from amending budgets.

The budgetary implementation of revenue consists of establishing the entitlements and recovering the revenue due to the Communities (own resources and other revenue). It is governed by certain special provisions ⁽⁷⁾. The actual revenue of a financial year is defined as the total of sums collected against entitlements established during the current financial year and sums collected against entitlements still to be recovered from previous financial years.

7.3. Implementation of expenditure

The estimated expenditure is entered in the budget.

The budgetary implementation of expenditure, i.e. the evolution and utilisation of appropriations, may be summarised as follows:

(a) appropriations for commitments:

- (i) *evolution of appropriations*: the total appropriations for commitments available in a financial year are made up as follows: initial budget (NDA and CA) + amending budgets + assigned revenue + transfers + commitment appropriations carried over from the preceding financial year + non-automatic carry-overs from the preceding financial year not yet committed + released commitment appropriations from preceding financial years which have been made available again;
- (ii) *utilisation of appropriations*: the final appropriations for commitments are available in the financial year for use in the form of commitments entered into (appropriations for commitments utilised = amount of commitments entered into);
- (iii) *carry-overs of appropriations from one financial year to the next financial year*: appropriations belonging to the financial year which have not been utilised may be carried over to the next financial year following a decision by the institution concerned. Appropriations available as assigned revenue are automatically carried over;
- (iv) *cancellation of appropriations*: the balance is cancelled;

(b) appropriations for payments:

- (i) *evolution of appropriations*: the total appropriations for payments available in a financial year are made up as follows: initial budget (NDA and PA) + amending budgets + assigned revenue + transfers + appropriations carried over from the previous financial year in the form of automatic carry-overs or non-automatic carry-overs;

⁽⁶⁾ See Articles 274 of the EC Treaty, 179 of the Euratom Treaty and 50 of the FINREG.

⁽⁷⁾ See Articles 69 to 74 of the FINREG and Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 (OJ L 130, 31.5.2000).

- (ii) *utilisation of appropriations of the financial year*: the appropriations for payments of the financial year are available in the financial year for use as payments. They do not include appropriations carried over from the previous financial year (utilised appropriations for payments = amount of payments made against the appropriations of the financial year);
- (iii) *carry-overs of appropriations from one financial year to the next financial year*: unutilised appropriations of the financial year may be carried over to the next financial year following a decision by the institution concerned. Appropriations available as assigned revenue are automatically carried over;
- (iv) *cancellation of appropriations*: the balance is cancelled;
- (v) *total payments during the financial year*: payments against appropriations for payments of the financial year + payments against appropriations for payments carried over from the preceding financial year;
- (vi) *actual expenditure charged to a financial year*: expenditure in the consolidated statements on budgetary implementation (see paragraph 7.4) = payments against appropriations for payments of the financial year + appropriations for payments of the financial year carried over to the following financial year.

7.4. *The consolidated statements on budgetary implementation and determination of the balance of the financial year*

The consolidated statements on budgetary implementation are drawn up after the closure of each financial year. They determine the balance of the year, which is entered in the budget of the next financial year through an amending budget.

8. PRESENTATION OF THE ACCOUNTS

The accounts for a given financial year are forwarded not later than 31st of March of the following financial year to the Parliament, the Council and the Court of Auditors; these accounts comprise financial statements and statements on budgetary implementation, together with a report on the budgetary and financial management.

9. EXTERNAL AUDIT

Since 1977 the external audit of the budget has been carried out by the Court of Auditors of the European Communities ⁽⁸⁾. The Court of Auditors examines the accounts of all revenue and expenditure of the budget. It must provide the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. It also considers whether revenue has been received and expenditure incurred in a lawful and regular manner, and whether the financial management has been sound. The audits may be carried out before the closure of the financial year in question and are performed on the basis of records and, where necessary, on the spot in the institutions of the Communities, in the Member States and in third countries. The Court of Auditors draws up an annual report for each financial year and may also, at any time, submit its observations on specific questions and deliver opinions at the request of any of the institutions of the Communities.

10. DISCHARGE AND FOLLOW-UP

Since 1977 the following provisions have been applicable ⁽⁹⁾: Parliament, on the recommendation of the Council, gives, before 30 April of the second year following the financial year in question, discharge to the Commission in respect of its implementation of the budget. To this end, the Council and Parliament in turn examine the accounts presented by the Commission and the annual report and special reports of the Court of Auditors. The institutions must take appropriate action in response to the comments appearing in the decisions giving discharge and report on the measures taken.

⁽⁸⁾ See Articles 246, 247 and 248 of the EC Treaty, 160a, 160b and 160c of the Euratom Treaty and Articles 139 to 147 of the FINREG.

⁽⁹⁾ See Articles 276 of the EC Treaty and 180b of the Euratom Treaty.

EXPLANATORY NOTES

SOURCES OF FINANCIAL DATA

The financial data contained in this Annex have been drawn from the annual accounts of the European Communities and from other financial records provided by the Commission. The geographical distribution is in accordance with the country codes in the Commission's system of accounting information (ABAC). As the Commission points out, all the figures given by Member State — for both revenue and expenditure — are the result of arithmetic that gives an incomplete view of the benefits that each State derives from the Union. They must therefore be interpreted with circumspection.

MONETARY UNIT

All the financial data are presented in millions of euro. The totals are rounded from each exact value and will not therefore necessarily represent the sum of the rounded figures.

ABBREVIATIONS AND SYMBOLS

| | |
|-----------------|--|
| AFC | Appropriations for commitments |
| AFP | Appropriations for payments |
| AT | Austria |
| BE | Belgium |
| CA | Commitment appropriations |
| CY | Cyprus |
| CZ | Czech Republic |
| DA | Differentiated appropriations |
| DE | Germany |
| DIA | Diagram referred to within other diagrams (e.g. DIA III) |
| DK | Denmark |
| EAEC or Euratom | European Atomic Energy Community |
| EC | European Community(ies) |
| EE | Estonia |
| EEC | European Economic Community |
| EFTA | European Free Trade Association |
| EL | Greece |
| ES | Spain |
| EU | European Union |
| EU-25 | Total for the 25 Member States of the European Union |
| FI | Finland |
| FR | France |
| FINREG | Financial Regulation of 25 June 2002 |
| GNI | Gross National Income |
| HU | Hungary |

| | |
|-----|---|
| IE | Ireland |
| IT | Italy |
| LT | Lithuania |
| LU | Luxembourg |
| LV | Latvia |
| MT | Malta |
| NDA | Non-differentiated appropriations |
| NL | Netherlands |
| OJ | <i>Official Journal of the European Union</i> |
| PA | Payment appropriations |
| PL | Poland |
| PT | Portugal |
| S | Budgetary section |
| SE | Sweden |
| SI | Slovenia |
| SK | Slovakia |
| T | Budgetary title |
| UK | United Kingdom |
| VAT | Value-added tax |
| 0,0 | Data between zero and 0,05 |
| — | Lack of data |

*DIAGRAMS***BUDGET FOR THE FINANCIAL YEAR 2006 AND BUDGETARY IMPLEMENTATION DURING THE FINANCIAL YEAR 2006**

- DIA I Budget 2006 — Estimated revenue and final appropriations for payments
- DIA II Budget 2006 — Appropriations for commitments
- DIA III Appropriations for commitments available in 2006 and utilisation thereof
- DIA IV Appropriations for payments available in 2006 and utilisation thereof
- DIA V Own resources in 2006 — Actual revenue by Member State
- DIA VI Payments made in 2006, in each Member State

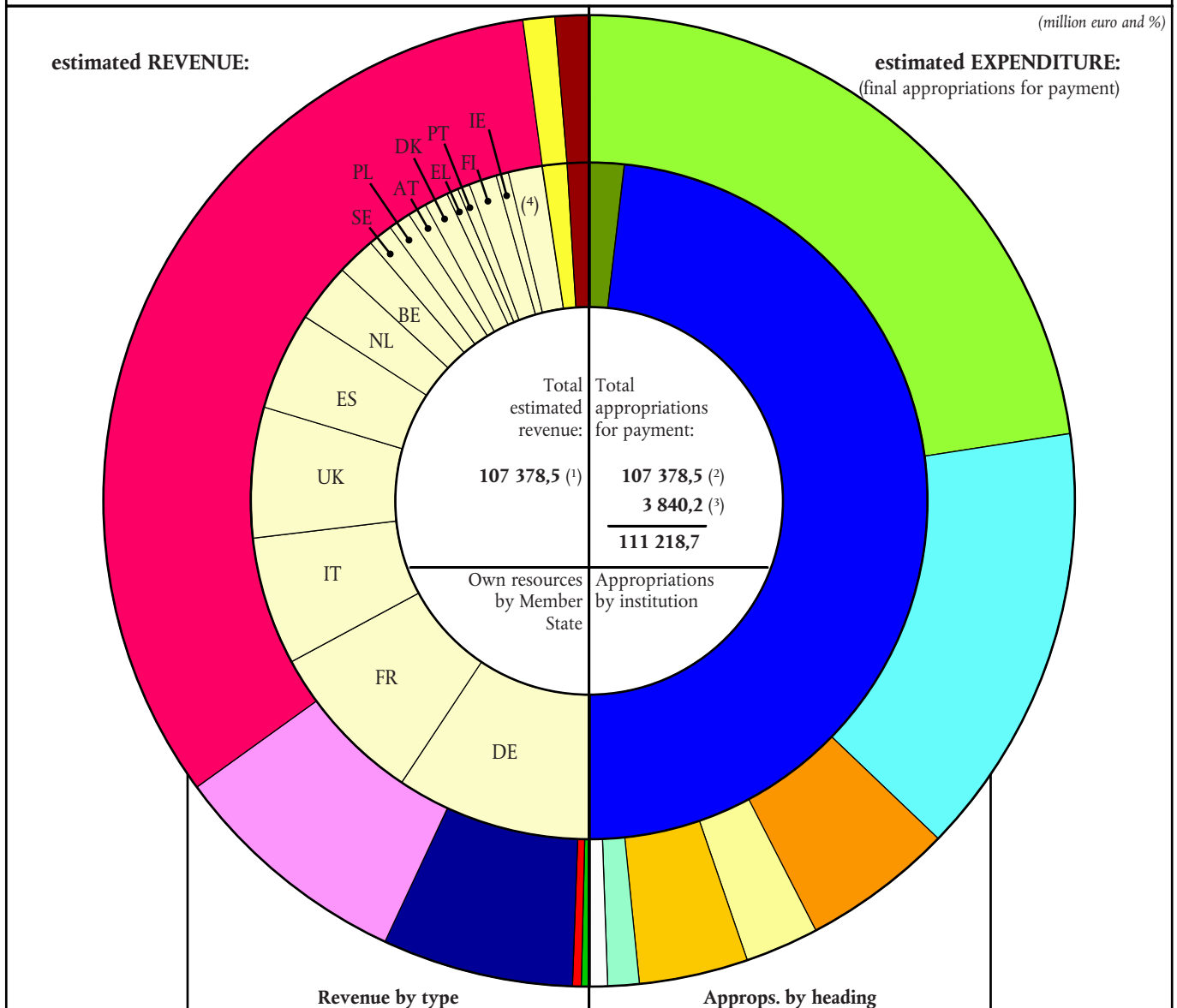
HISTORICAL DATA IN RESPECT OF THE IMPLEMENTATION OF THE BUDGET (2002-2006)

- DIA VII Evolution and utilisation of appropriations for payments for the period 2002-2006, by financial perspective heading

Diagram I

Budget 2006 — Estimated revenue and final appropriations for payments

[for revenue criteria, see 'Background information on the budget', paragraph 7.2; for expenditure criteria, see 'Background information on the general budget', paragraph 7.3 and for more detailed information, see Diagram IV, column (a)]



Revenue key:

| | | |
|--|----------|----------|
| Total own resources (by Member State) | | |
| Agricultural duties | 863,4 | (0,8 %) |
| 'Sugar' and 'isoglucose' levies | 150,6 | (0,1 %) |
| Customs duties | 13 874,9 | (12,9 %) |
| Own resources accruing from VAT | 17 186,1 | (16 %) |
| GNI-based own resources | 70 451,5 | (65,6 %) |
| Other revenue | 2 349,2 | (2,2 %) |
| Surplus available from the previous year | 2 502,8 | (2,3 %) |

Expenditure key

Financial perspective headings:

| | | |
|---|-----------|----------|
| 1. Agriculture | 50 498,5 | (45,4 %) |
| 2. Structural operations | 32 570,6 | (29,3 %) |
| 3. Internal policies | 10 807,8 | (9,7 %) |
| 4. External action | 5 731,3 | (5,2 %) |
| 5. Administration | 7 713,0 | (6,9 %) |
| 6. Reserves | 386,0 | (0,3 %) |
| 7. Pre-accession strategy | 2 438,0 | (2,2 %) |
| 8. Compensation | 1 073,5 | (1 %) |
| Appropriations available for other institutions | 3 043,0 | (2,7 %) |
| Appropriations available to the Commission | 108 175,7 | (97,3 %) |
| of which operating appropriations | 103 505,7 | (93,1 %) |

(¹) After amending budgets.

(⁴) Revenue contribution by CZ, HU, SK, SI, LU, LT, CY, LV, EE, MT was grouped together.

(²) After amending budgets and transfers between budget headings.

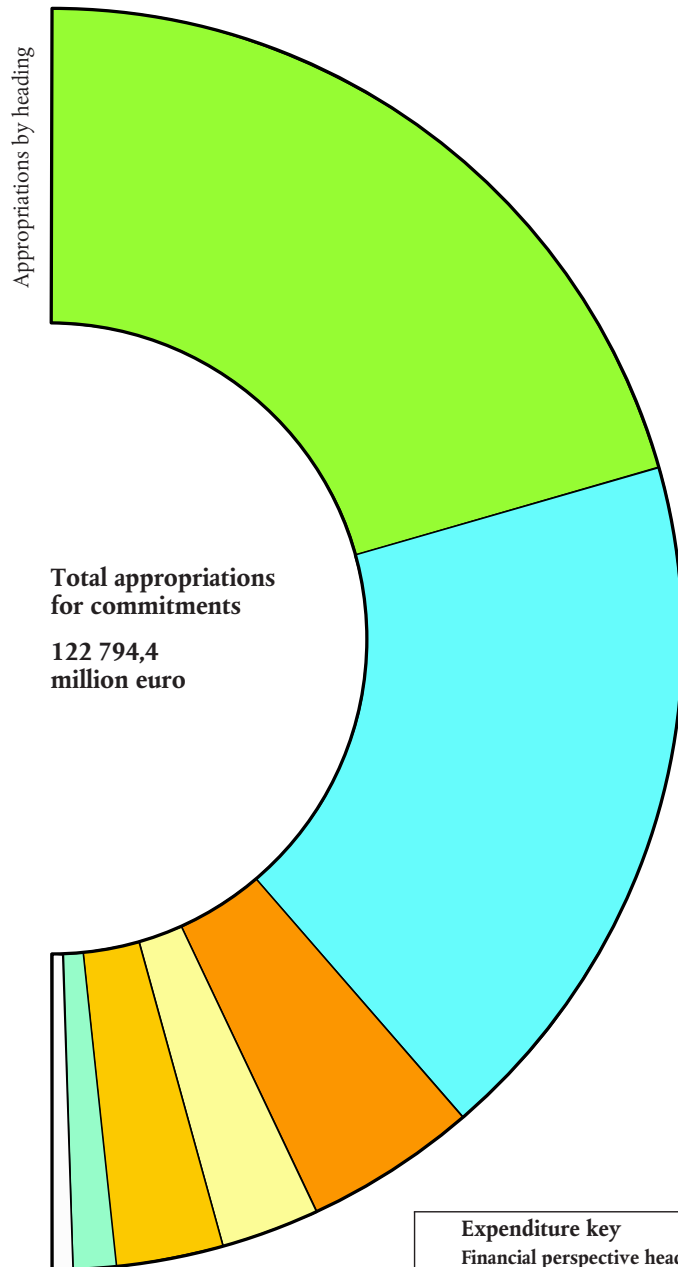
(³) Assigned revenue, appropriations made available again and carried over.

Diagram II

Budget 2006 — Appropriations for commitments

[after amending budgets; for more detailed information, see Diagram III, column (b)]

(million euro and %)



Note:

The total appropriations for commitment are not balanced by the budgetary revenue of 2006 as the commitment appropriations also include amounts to be financed by budgetary revenue from subsequent years.

Expenditure key

Financial perspective headings:

| | | |
|---------------------------|----------|----------|
| 1. Agriculture | 50 236,6 | (40,9 %) |
| 2. Structural operations | 44 659,6 | (36,4 %) |
| 3. Internal policies | 10 898,2 | (8,9 %) |
| 4. External action | 6 014,0 | (4,9 %) |
| 5. Administration | 6 913,6 | (5,6 %) |
| 6. Reserves | 278,0 | (0,2 %) |
| 7. Pre-accession strategy | 2 720,9 | (2,2 %) |
| 8. Compensation | 1 073,5 | (0,9 %) |

Diagram III

Appropriations for commitments available in 2006 and utilisation thereof

(million euro and %)

| Sections (S) and titles (T) corresponding to the 2006 budgetary nomenclature and financial perspective headings | Financial perspective | Final appropriations | | Utilisation of appropriations | | | | | |
|---|-----------------------|----------------------|-------------|-------------------------------|----------------------|-------------------------|------------|----------------|-----------------------|
| | | Amount (1) | Rate (%) | Commitments entered into | Utilisation rate (%) | Carry-overs to 2007 (2) | Rate (%) | Cancellations | Rate (%) |
| | | (a) | (b) | (b)/(a) | (c) | (c)/(b) | (d) | (d)/(b) | (e) = (b) - (c) - (d) |
| <i>Budgetary nomenclature</i> | | | | | | | | | |
| I Parliament (S. I) | | 1 368,5 | | 1 343,7 | 98,2 | 9,5 | 0,7 | 15,3 | 1,1 |
| II Council (S. II) | | 626,1 | | 574,7 | 91,8 | 17,8 | 2,8 | 33,6 | 5,4 |
| III Commission (S. III) (3) | | 120 235,3 | | 118 609,3 | 98,6 | 837,2 | 0,7 | 788,8 | 0,7 |
| III.1 Economic and financial affairs (T.01) | | 489,2 | | 385,0 | 78,7 | 1,5 | 0,3 | 102,7 | 21,0 |
| III.2 Enterprise (T.02) | | 467,4 | | 431,6 | 92,3 | 14,1 | 3,0 | 21,7 | 4,6 |
| III.3 Competition (T.03) | | 103,0 | | 100,0 | 97,1 | 2,5 | 2,4 | 0,5 | 0,5 |
| III.4 Employment and social affairs (T.04) | | 11 929,9 | | 11 910,4 | 99,8 | 10,2 | 0,1 | 9,3 | 0,1 |
| III.5 Agriculture and rural development (T.05) | | 54 664,8 | | 54 276,6 | 99,3 | 51,6 | 0,1 | 336,6 | 0,6 |
| III.6 Energy and transport (T.06) | | 1 539,2 | | 1 467,0 | 95,3 | 51,4 | 3,3 | 20,7 | 1,3 |
| III.7 Environment (T.07) | | 367,5 | | 349,2 | 95,0 | 8,1 | 2,2 | 10,2 | 2,8 |
| III.8 Research (T.08) | | 4 031,9 | | 3 932,5 | 97,5 | 88,7 | 2,2 | 10,8 | 0,3 |
| III.9 Information society (T.09) | | 1 601,6 | | 1 528,4 | 95,4 | 66,0 | 4,1 | 7,2 | 0,4 |
| III.10 Direct research (T.10) | | 644,9 | | 412,5 | 64,0 | 231,6 | 35,9 | 0,9 | 0,1 |
| III.11 Fisheries (T.11) | | 1 089,0 | | 1 055,7 | 96,9 | 3,6 | 0,3 | 29,7 | 2,7 |
| III.12 Internal market (T.12) | | 79,4 | | 74,9 | 94,3 | 1,8 | 2,2 | 2,7 | 3,4 |
| III.13 Regional policy (T.13) | | 28 930,7 | | 28 904,1 | 99,9 | 1,7 | 0,0 | 24,9 | 0,1 |
| III.14 Taxation and customs union (T.14) | | 136,1 | | 121,7 | 89,5 | 2,8 | 2,1 | 11,5 | 8,5 |
| III.15 Education and culture (T.15) | | 1 225,0 | | 1 146,8 | 93,6 | 70,5 | 5,8 | 7,7 | 0,6 |
| III.16 Press and communication (T.16) | | 214,8 | | 205,9 | 95,8 | 2,4 | 1,1 | 6,5 | 3,0 |
| III.17 Health and consumer protection (T.17) | | 587,9 | | 534,6 | 90,9 | 17,1 | 2,9 | 36,2 | 6,2 |
| III.18 Area of freedom, security and justice (T.18) | | 625,0 | | 590,5 | 94,5 | 12,0 | 1,9 | 22,5 | 3,6 |
| III.19 External relations (T.19) | | 3 652,3 | | 3 615,8 | 99,0 | 32,1 | 0,9 | 4,4 | 0,1 |
| III.20 Trade (T.20) | | 85,6 | | 83,1 | 97,1 | 1,6 | 1,8 | 1,0 | 1,1 |
| III.21 Development and relations with ACP States (T.21) | | 1 389,3 | | 1 292,0 | 93,0 | 91,1 | 6,6 | 6,2 | 0,4 |
| III.22 Enlargement (T.22) | | 2 410,6 | | 2 354,1 | 97,7 | 40,1 | 1,7 | 16,4 | 0,7 |
| III.23 Humanitarian aid (T.23) | | 663,4 | | 662,4 | 99,9 | 0,6 | 0,1 | 0,3 | 0,0 |
| III.24 Fight against fraud (T.24) | | 65,9 | | 61,6 | 93,5 | 0,1 | 0,1 | 4,2 | 6,3 |
| III.25 Commission's policy coordination and legal advice (T.25) | | 225,6 | | 218,5 | 96,9 | 5,5 | 2,4 | 1,6 | 0,7 |
| III.26 Commission's Administration (T.26) | | 713,5 | | 662,4 | 92,8 | 24,0 | 3,4 | 27,1 | 3,8 |
| III.27 Budget (T.27) | | 1 153,6 | | 1 146,9 | 99,4 | 1,6 | 0,1 | 5,1 | 0,4 |
| III.28 Audit (T.28) | | 11,8 | | 11,3 | 96,6 | 0,2 | 1,8 | 0,2 | 1,7 |
| III.29 Statistics (T.29) | | 139,6 | | 126,5 | 90,6 | 2,7 | 1,9 | 10,4 | 7,4 |
| III.30 Pensions (T.30) | | 947,7 | | 947,1 | 99,9 | 0,0 | 0,0 | 0,7 | 0,1 |
| III.31 Reserves (T.31) | | 49,0 | | — | — | — | — | 49,0 | 100,0 |
| IV Court of Justice (S. IV) | | 252,3 | | 238,6 | 94,6 | 1,6 | 0,7 | 12,0 | 4,8 |
| V Court of Auditors (S. V) | | 113,6 | | 101,2 | 89,1 | 0,1 | 0,1 | 12,2 | 10,8 |
| VI Economic and Social Committee (S. VI) | | 112,4 | | 109,0 | 97,0 | 0,2 | 0,2 | 3,2 | 2,8 |
| VII Committee of the Regions (S. VII) | | 74,4 | | 72,9 | 97,9 | 0,1 | 0,2 | 1,4 | 1,9 |
| VIII European Ombudsman and European Data-protection Supervisor (S. VIII) | | 11,8 | | 10,6 | 89,9 | — | — | 1,2 | 10,1 |
| Grand total appropriations for commitments | | 123 515,0 | | 122 794,4 | 99,4 | 866,6 | 0,7 | 867,7 | 0,7 |
| <i>Financial perspective</i> | | | | | | | | | |
| 1 Agriculture | 52 618,0 | 50 236,6 | 95,5 | 49 865,2 | 99,3 | 2,5 | 0,0 | 368,9 | 0,7 |
| 2 Structural operations | 44 617,0 | 44 659,6 | 100,1 | 44 578,8 | 99,8 | 46,4 | 0,1 | 34,4 | 0,1 |
| 3 Internal policies | 9 385,0 | 10 898,2 (1) | 116,1 | 10 195,0 | 93,5 | 548,8 | 5,0 | 154,4 | 1,4 |
| 4 External action | 5 269,0 | 6 014,0 (1) | 114,1 | 5 867,2 | 97,6 | 131,3 | 2,2 | 15,5 | 0,3 |
| 5 Administration | 6 528,0 (4) | 6 913,6 (1) | 105,9 | 6 674,6 | 96,5 | 112,0 | 1,6 | 127,0 | 1,8 |
| 6 Reserves | 458,0 | 278,0 | 60,7 | 127,6 | 45,9 | — | — | 150,4 | 54,1 |
| 7 Pre-accession strategy | 3 566,0 | 2 720,9 | 76,3 | 2 678,2 | 98,4 | 25,5 | 0,9 | 17,2 | 0,6 |
| 8 Compensation | 1 074,0 | 1 073,5 | 100,0 | 1 073,5 | 100,0 | — | — | — | — |
| Grand total appropriations for commitments | 123 515,0 | 122 794,4 | 99,4 | 121 060,1 | 98,6 | 866,6 | 0,7 | 867,7 | 0,7 |
| Grand total appropriations for payments | 119 112,0 | 111 218,7 | 93,4 | 106 575,5 | 95,8 | 2 660,9 | 2,4 | 1 982,4 | 1,8 |

(1) Final budget appropriations after taking account of transfers between budget headings, appropriations corresponding to assigned revenue or similar and appropriations carried over from the previous financial year. As a consequence the ceiling for some financial perspective headings is exceeded by the available appropriations.

(2) Including appropriations corresponding to assigned revenue or similar.

(3) For Section III (Commission) the titles (T) correspond to the activities/policy areas as defined by the institution for implementing activity based budgeting (ABB).

(4) The Interinstitutional Agreement of 1999 states in its annex that the ceiling for this heading is presented net of staff contributions to the pension scheme, up to a maximum of 1 100 million euro at 1999 prices for the period 2000-2006. In 2006 this reduction amounts to 180 million euro.

Diagram IV

Appropriations for payments available in 2006 and utilisation thereof

(million euro and %)

| Sections (S) and titles (T) corresponding to the 2006 budgetary nomenclature and financial perspective headings | Final appropriations (1) | Utilisation of appropriations | | | | | |
|---|--------------------------|-------------------------------|----------------------|---------------------|------------|-----------------------|------------|
| | | Payments made in 2006 | Utilisation rate (%) | Carry-overs to 2007 | Rate (%) | Cancellations | Rate (%) |
| | | (a) | (b)/(a) | (c) | (c)/(a) | (d) = (a) - (b) - (c) | (d)/(a) |
| <i>Budgetary nomenclature</i> | | | | | | | |
| I Parliament (S. I) | 1 701,3 | 1 440,3 | 84,7 | 224,1 | 13,2 | 36,9 | 2,2 |
| II Council (S. II) | 736,3 | 584,7 | 79,4 | 109,0 | 14,8 | 42,6 | 5,8 |
| III Commission (S. III) (2) | 108 175,7 | 104 026,7 | 96,2 | 2 282,7 | 2,1 | 1 866,3 | 1,7 |
| III.1 Economic and financial affairs (T.01) | 455,2 | 342,3 | 75,2 | 7,5 | 1,6 | 105,4 | 23,2 |
| III.2 Enterprise (T.02) | 478,0 | 330,3 | 69,1 | 58,1 | 12,2 | 89,6 | 18,8 |
| III.3 Competition (T.03) | 110,4 | 97,4 | 88,3 | 11,4 | 10,3 | 1,5 | 1,4 |
| III.4 Employment and social affairs (T.04) | 9 613,7 | 9 563,8 | 99,5 | 28,3 | 0,3 | 21,6 | 0,2 |
| III.5 Agriculture and rural development (T.05) | 54 002,8 | 53 581,8 | 99,2 | 78,3 | 0,1 | 342,7 | 0,6 |
| III.6 Energy and transport (T.06) | 1 481,7 | 1 301,1 | 87,8 | 102,2 | 6,9 | 78,4 | 5,3 |
| III.7 Environment (T.07) | 344,7 | 293,2 | 85,1 | 32,8 | 9,5 | 18,7 | 5,4 |
| III.8 Research (T.08) | 3 998,3 | 3 372,8 | 84,4 | 584,7 | 14,6 | 40,8 | 1,0 |
| III.9 Information society (T.09) | 1 660,0 | 1 426,5 | 85,9 | 207,8 | 12,5 | 25,7 | 1,5 |
| III.10 Direct research (T.10) | 625,5 | 392,7 | 62,8 | 223,2 | 35,7 | 9,6 | 1,5 |
| III.11 Fisheries (T.11) | 977,4 | 788,8 | 80,7 | 45,0 | 4,6 | 143,7 | 14,7 |
| III.12 Internal market (T.12) | 83,8 | 71,7 | 85,6 | 8,3 | 9,9 | 3,8 | 4,5 |
| III.13 Regional policy (T.13) | 19 992,6 | 19 835,6 | 99,2 | 16,7 | 0,1 | 140,3 | 0,7 |
| III.14 Taxation and customs union (T.14) | 126,1 | 106,1 | 84,2 | 9,4 | 7,5 | 10,5 | 8,3 |
| III.15 Education and culture (T.15) | 1 267,2 | 1 108,2 | 87,5 | 119,6 | 9,4 | 39,4 | 3,1 |
| III.16 Press and communication (T.16) | 236,4 | 188,7 | 79,8 | 30,5 | 12,9 | 17,3 | 7,3 |
| III.17 Health and consumer protection (T.17) | 822,5 | 424,4 | 51,6 | 287,1 | 34,9 | 111,0 | 13,5 |
| III.18 Area of freedom, security and justice (T.18) | 650,2 | 560,8 | 86,3 | 18,7 | 2,9 | 70,6 | 10,9 |
| III.19 External relations (T.19) | 3 530,3 | 3 318,0 | 94,0 | 96,5 | 2,7 | 115,8 | 3,3 |
| III.20 Trade (T.20) | 91,8 | 79,8 | 87,0 | 8,0 | 8,7 | 3,9 | 4,3 |
| III.21 Development and relations with ACP States (T.21) | 1 310,7 | 976,8 | 74,5 | 125,0 | 9,5 | 209,0 | 15,9 |
| III.22 Enlargement (T.22) | 2 166,1 | 2 113,1 | 97,6 | 23,9 | 1,1 | 29,1 | 1,3 |
| III.23 Humanitarian aid (T.23) | 635,0 | 625,1 | 98,4 | 5,6 | 0,9 | 4,3 | 0,7 |
| III.24 Fight against fraud (T.24) | 72,5 | 57,6 | 79,5 | 6,3 | 8,7 | 8,6 | 11,9 |
| III.25 Commission's policy coordination and legal advice (T.25) | 240,7 | 209,7 | 87,1 | 26,6 | 11,0 | 4,4 | 1,8 |
| III.26 Commission's Administration (T.26) | 789,1 | 646,1 | 81,9 | 97,6 | 12,4 | 45,4 | 5,8 |
| III.27 Budget (T.27) | 1 162,6 | 1 144,9 | 98,5 | 11,9 | 1,0 | 5,9 | 0,5 |
| III.28 Audit (T.28) | 12,5 | 10,9 | 87,3 | 1,3 | 10,2 | 0,3 | 2,5 |
| III.29 Statistics (T.29) | 133,2 | 111,3 | 83,5 | 10,5 | 7,9 | 11,4 | 8,6 |
| III.30 Pensions (T.30) | 947,7 | 947,0 | 99,9 | 0,1 | 0,0 | 0,7 | 0,1 |
| III.31 Reserves (T.31) | 157,0 | — | — | — | — | 157,0 | 100,0 |
| IV Court of Justice (S. IV) | 267,0 | 237,8 | 89,0 | 14,9 | 5,6 | 14,4 | 5,4 |
| V Court of Auditors (S. V) | 119,9 | 99,4 | 82,9 | 7,4 | 6,2 | 13,1 | 11,0 |
| VI Economic and Social Committee (S. VI) | 123,8 | 107,9 | 87,1 | 11,4 | 9,2 | 4,6 | 3,7 |
| VII Committee of the Regions (S. VII) | 82,0 | 69,3 | 84,5 | 9,6 | 11,7 | 3,2 | 3,9 |
| VIII European Ombudsman and European Data-protection Supervisor (S. VIII) | 12,7 | 9,6 | 75,3 | 1,8 | 14,2 | 1,3 | 10,5 |
| Grand total appropriations for payments | 111 218,7 | 106 575,5 | 95,8 | 2 660,9 | 2,4 | 1 982,4 | 1,8 |
| <i>Financial perspective</i> | | | | | | | |
| 1 Agriculture | 50 498,5 | 49 798,8 | 98,6 | 271,3 | 0,5 | 428,5 | 0,8 |
| 2 Structural operations | 32 570,6 | 32 399,3 | 99,5 | 58,4 | 0,2 | 112,9 | 0,3 |
| 3 Internal policies | 10 807,8 | 9 013,7 | 83,4 | 1 317,9 | 12,2 | 476,2 | 4,4 |
| 4 External action | 5 731,3 | 5 186,2 | 90,5 | 213,1 | 3,7 | 332,0 | 5,8 |
| 5 Administration | 7 713,0 | 6 699,7 | 86,9 | 785,1 | 10,2 | 228,2 | 3,0 |
| 6 Reserves | 386,0 | 127,6 | 33,1 | — | — | 258,4 | 66,9 |
| 7 Pre-accession strategy | 2 438,0 | 2 276,7 | 93,4 | 15,0 | 0,6 | 146,3 | 6,0 |
| 8 Compensation | 1 073,5 | 1 073,5 | 100,0 | — | — | — | — |
| Grand total appropriations for payments | 111 218,7 | 106 575,5 | 95,8 | 2 660,9 | 2,4 | 1 982,4 | 1,8 |

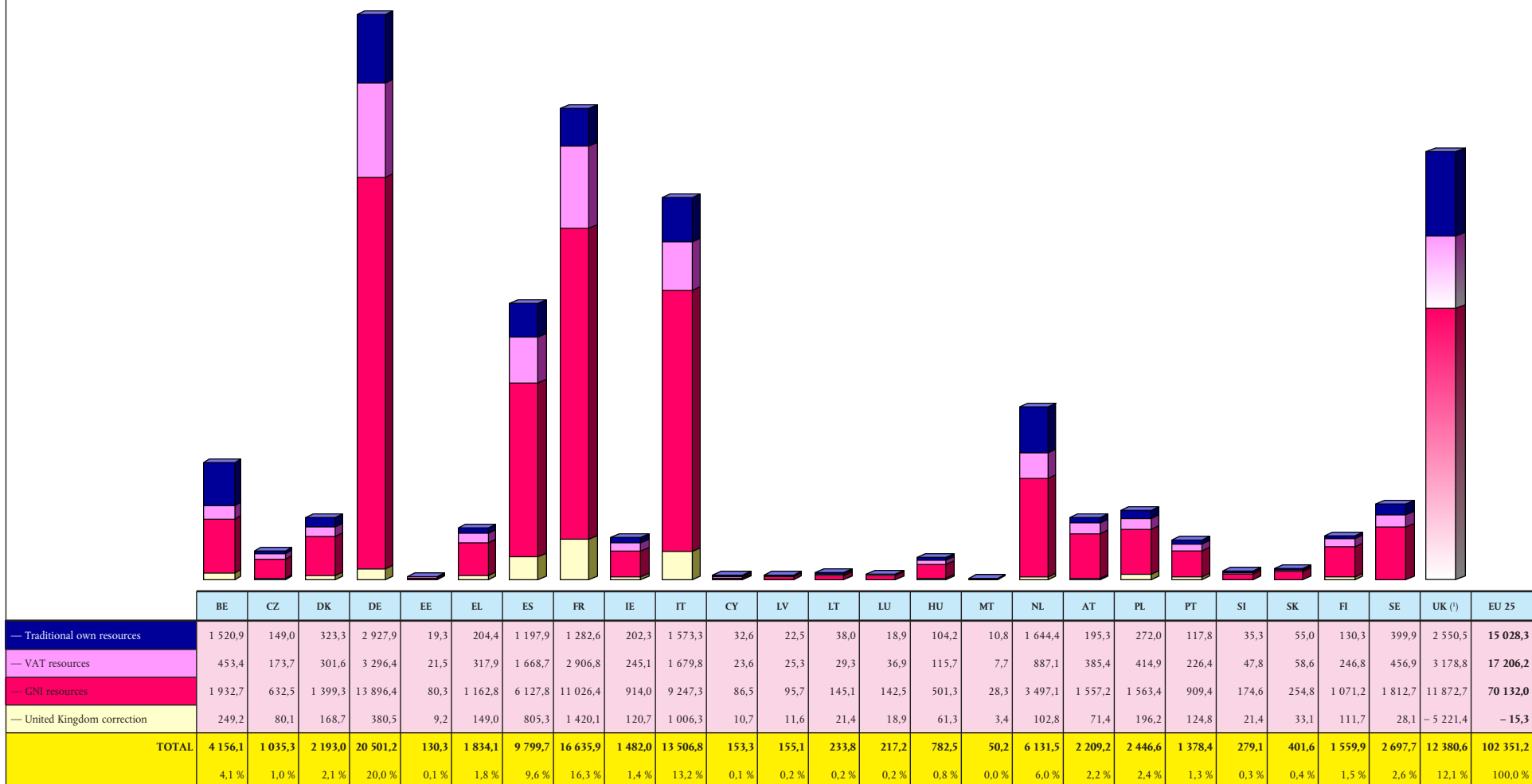
(1) Final budget appropriations after taking account of transfers between budget headings, appropriations relating to assigned revenue or similar and appropriations carried over from the previous financial year.

(2) For Section III (Commission) the titles (T) correspond to the activities/policy areas as defined by the institution for implementing activity based budgeting (ABB).

Diagram V
Own resources in 2006 — Actual revenue by Member State

Revenue Outturn

(million euro and %)



(1) For the United Kingdom a correction (5 221,4 million euro) is applied to the gross amount of own resources (17 602,0 million euro). The financing of this adjustment is borne by the other Member States. This correction was solely assigned to the VAT and GNI elements of gross own resources in accordance with their respective amounts.

Diagram VI

Payments made in 2006, in each Member State ⁽¹⁾

Note: Payments made in 2006 = payments against 2006 operating appropriations plus payments against carry-overs from 2005.

Financial perspective headings

(million euro and %)

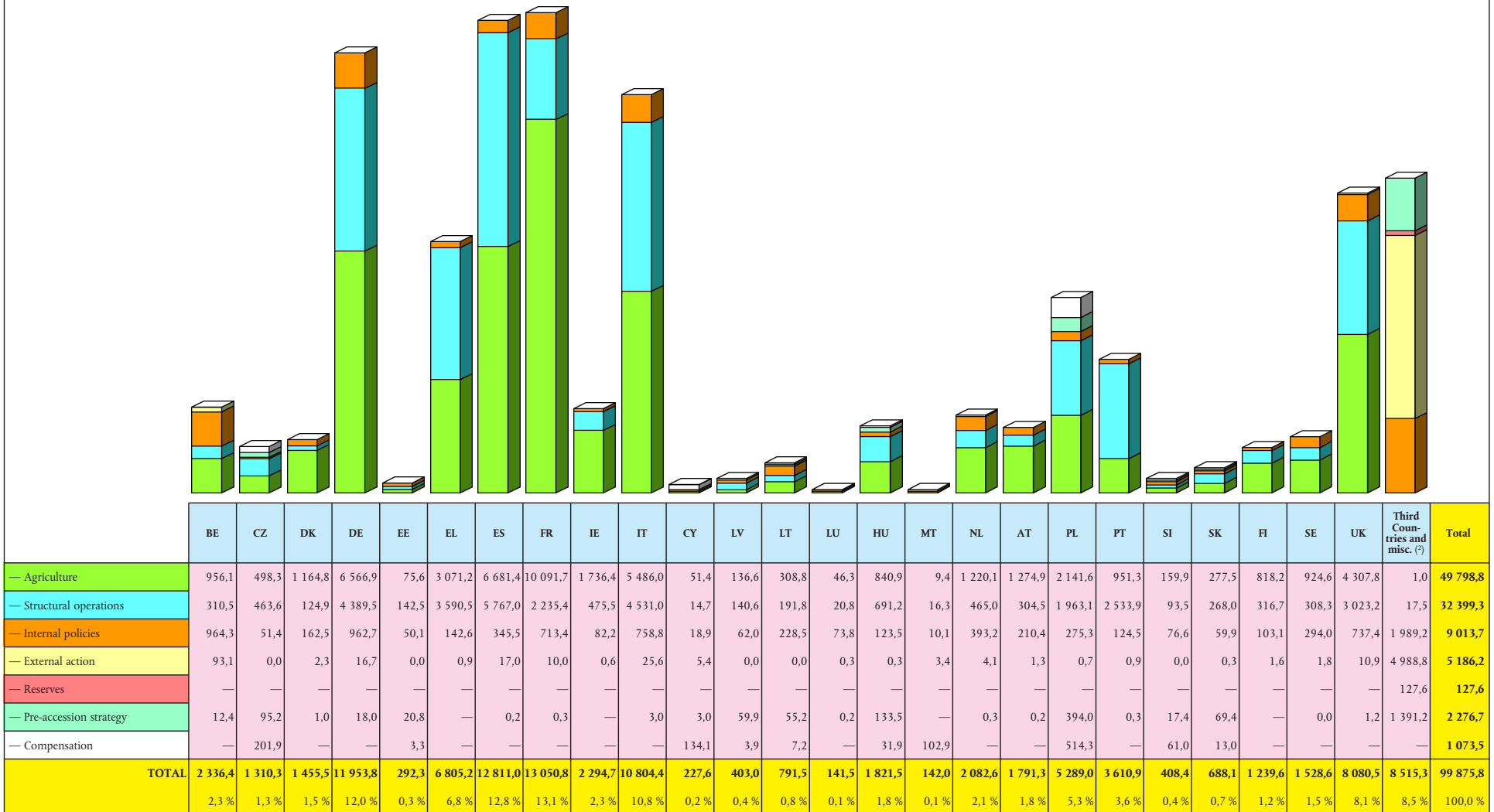
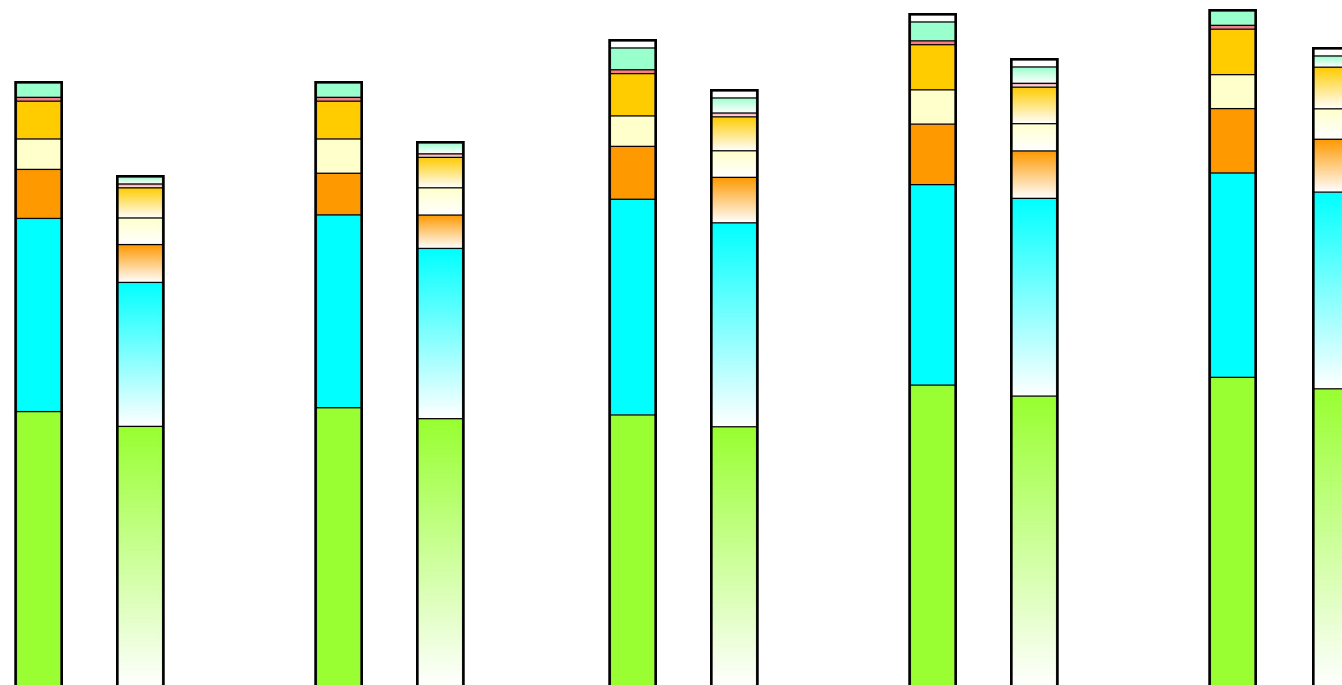
⁽¹⁾ The geographical breakdown is not by payments made to the Member States but by expenditure according to the data in the Commission's computerised accounting system ABAC.⁽²⁾ The amounts under 'Third Countries and miscellaneous' mainly include expenditure related to the projects implemented outside the Union and participation by third countries. Expenditure in respect of which the geographical distribution could not be made is also included.

Diagram VII

Evolution and utilisation of appropriations for payments for the period 2002-2006, by financial perspective heading

Financial perspective heading

(million euro)



| Headings | 2002 | | 2003 | | 2004 | | 2005 | | 2006 | |
|--------------------------|---|-----------------|---|-----------------|---|------------------|---|------------------|---|------------------|
| | Available appropriations ⁽¹⁾ | Payments made | Available appropriations ⁽¹⁾ | Payments made | Available appropriations ⁽¹⁾ | Payments made | Available appropriations ⁽¹⁾ | Payments made | Available appropriations ⁽¹⁾ | Payments made |
| — Agriculture | 44 940,0 | 43 520,6 | 45 095,7 | 44 379,2 | 44 308,3 | 43 579,4 | 48 908,0 | 48 465,8 | 50 498,5 | 49 798,8 |
| — Structural operations | 31 603,3 | 23 499,0 | 31 837,8 | 28 527,6 | 34 635,1 | 34 198,3 | 32 838,3 | 32 763,2 | 32 570,6 | 32 399,3 |
| — Internal policies | 7 956,8 | 6 566,7 | 7 256,8 | 5 671,8 | 8 992,1 | 7 255,2 | 9 753,6 | 7 972,1 | 10 807,8 | 9 013,7 |
| — External action | 4 969,8 | 4 423,7 | 4 898,9 | 4 285,8 | 5 098,0 | 4 605,8 | 5 435,4 | 5 013,1 | 5 731,3 | 5 186,2 |
| — Administration | 5 856,6 | 5 211,6 | 6 087,1 | 5 305,2 | 6 927,2 | 5 856,4 | 7 301,2 | 6 191,4 | 7 713,0 | 6 699,7 |
| — Reserves | 651,8 | 170,5 | 363,8 | 147,9 | 442,0 | 181,9 | 346,0 | 140,1 | 386,0 | 127,6 |
| — Pre-accession strategy | 2 600,9 | 1 752,4 | 2 798,5 | 2 239,8 | 3 219,9 | 3 052,9 | 3 546,5 | 2 984,6 | 2 438,0 | 2 276,7 |
| — Compensation | — | — | — | — | 1 409,5 | 1 409,5 | 1 305,0 | 1 305,0 | 1 073,5 | 1 073,5 |
| TOTAL | 98 579,3 | 85 144,5 | 98 338,7 | 90 557,5 | 105 032,1 | 100 139,4 | 109 434,0 | 104 835,2 | 111 218,7 | 106 575,5 |

⁽¹⁾ Available appropriations = Appropriations for payments of the financial year + appropriations carried over from the previous financial year.

ANNEX II

Reports and opinions adopted by the Court of Auditors since 2002

The Court of Auditors is required by the terms of the Treaties to produce an annual report. It is also required, by the Treaties and other legislation at present in force, to produce special annual reports on certain Community bodies and activities. The Treaties

also give the Court the power to submit observations on specific questions and to deliver opinions at the request of one of the institutions. The reports and opinions adopted by the Court since 2002 are listed below.

| Title | Publication |
|--|----------------------|
| Annual Reports and Statements of Assurance | |
| Twenty-fifth annual report concerning the financial year 2001: | OJ C 295, 28.11.2002 |
| — Report and Statement of Assurance on the activities financed from the general budget | |
| — Report and Statement of Assurance on the activities of the sixth, seventh and eighth EDFs | |
| Twenty-sixth annual report concerning the financial year 2002: | OJ C 286, 28.11.2003 |
| — Report and Statement of Assurance on the activities financed from the general budget | |
| — Report and Statement of Assurance on the activities of the sixth, seventh and eighth EDFs | |
| Twenty-seventh annual report concerning the financial year 2003: | OJ C 293, 30.11.2004 |
| — Report and Statement of Assurance on the activities financed from the general budget | |
| — Report and Statement of Assurance on the activities of the sixth, seventh, eighth and ninth EDFs | |
| Twenty-eighth annual report concerning the financial year 2004: | OJ C 301, 30.11.2005 |
| — Report and Statement of Assurance on the activities financed from the general budget | |
| — Report and Statement of Assurance on the activities of the sixth, seventh, eighth and ninth EDFs | |
| Twenty-ninth annual report concerning the financial year 2005: | OJ C 263, 31.10.2006 |
| — Report and Statement of Assurance on the implementation of the budget | |
| — Report and Statement of Assurance on the activities of the sixth, seventh, eighth and ninth EDFs | |
| Thirtieth annual report concerning the financial year 2006: | Published in this OJ |
| — Report and Statement of Assurance on the implementation of the budget | |
| — Report and Statement of Assurance on the activities of the sixth, seventh, eighth and ninth EDFs | |
| Special Reports | |
| <i>Revenue</i> | |
| — Special Report No 11/2006 on the Community transit system | OJ C 44, 27.2.2007 |
| <i>Common agricultural policy</i> | |
| — Special Report No 5/2002 on extensification premium and payment schemes in the common organisation of the market for beef and veal | OJ C 290, 25.11.2002 |

| Title | Publication |
|--|----------------------|
| — Special Report No 6/2002 on the audit of the Commission's management of the EU oilseeds support scheme | OJ C 254, 22.10.2002 |
| — Special Report No 7/2002 on the sound financial management of the common organisation of markets in the banana sector | OJ C 294, 28.11.2002 |
| — Special Report No 1/2003 concerning the prefinancing of export refunds | OJ C 98, 24.4.2003 |
| — Special Report No 4/2003 concerning rural development: support for less-favoured areas | OJ C 151, 27.6.2003 |
| — Special Report No 9/2003 concerning the system for setting the rates of subsidy on exports of agricultural products (export refunds) | OJ C 211, 5.9.2003 |
| — Special Report No 12/2003 on the sound financial management of the common organisation of the market in dried fodder | OJ C 298, 9.12.2003 |
| — Special Report No 13/2003 concerning production aid for cotton | OJ C 298, 9.12.2003 |
| — Special Report No 14/2003 on the measurement of farm incomes by the Commission [Article 33(1)(b) of the EC Treaty] | OJ C 45, 20.2.2004 |
| — Special Report No 3/2004 on recovery of irregular payments under the Common Agricultural Policy | OJ C 269, 4.11.2004 |
| — Special Report No 6/2004: The organisation of the system for the identification and registration of bovine animals in the European Union | OJ C 29, 4.2.2005 |
| — Special Report No 7/2004 on the common organisation of the market in raw tobacco | OJ C 41, 17.2.2005 |
| — Special Report No 8/2004 on the Commission's management and supervision of the measures to control foot-and-mouth disease and of the related expenditure | OJ C 54, 3.3.2005 |
| — Special Report No 9/2004 on Forestry Measures within Rural Development Policy | OJ C 67, 18.3.2005 |
| — Special Report No 3/2005 concerning rural development: the verification of agri-environment expenditure | OJ C 279, 11.11.2005 |
| — Special Report No 7/2006 — Rural Development Investments: Do they effectively address the problems of rural areas? | OJ C 282, 20.11.2006 |
| — Special Report No 8/2006 — Growing success? The effectiveness of the European Union support for fruit and vegetable producers' operational programmes | OJ C 282, 20.11.2006 |
| — Special Report No 4/2007 on physical and substitution checks on export refund consignments | Being published |
| <i>Structural policies</i> | |
| — Special Report No 3/2002 concerning the Community Initiative Employment — Integra | OJ C 263, 29.10.2002 |
| — Special Report No 4/2002 on local actions for employment | OJ C 263, 29.10.2002 |
| — Special Report No 7/2003 on the implementation of assistance programming for the period 2000 to 2006 within the framework of the Structural Funds | OJ C 174, 23.7.2003 |
| — Special Report No 4/2004 on the programming of the Community initiative concerning trans-European cooperation — Interreg III | OJ C 303, 7.12.2004 |
| — Special Report No 1/2006 on the contribution of the European Social Fund in combating early school leaving | OJ C 99, 26.4.2006 |

| Title | Publication |
|--|----------------------|
| — Special Report No 10/2006 on ex post evaluations of objectives 1 and 3 programmes 1994 to 1999 (Structural Funds) | OJ C 302, 12.12.2006 |
| — Special Report No 1/2007 concerning the implementation of the mid-term processes on the Structural Funds 2000 to 2006 | OJ C 124, 5.6.2007 |
| <i>Internal policies, including research</i> | |
| — Special Report No 2/2002 on the Socrates and Youth for Europe Community action programmes | OJ C 136, 7.6.2002 |
| — Special Report No 11/2003 concerning the Financial Instrument for the Environment (LIFE) | OJ C 292, 2.12.2003 |
| — Special Report No 1/2004 on the management of indirect RTD actions under the fifth framework programme (FP5) for research and technological development (1998 to 2002) | OJ C 99, 23.4.2004 |
| — Special Report No 6/2005 on the trans-European network for transport (TEN-T) | OJ C 94, 21.4.2006 |
| — Special Report No 3/2007 concerning the management of the European Refugee Fund (2000 to 2004) | OJ C 178, 31.7.2007 |
| <i>External action</i> | |
| — Special Report No 1/2002 concerning macrofinancial assistance (MFA) to third countries and structural adjustment facilities (SAF) in the Mediterranean countries | OJ C 121, 23.5.2002 |
| — Special Report No 2/2003 on the implementation of the food security policy in developing countries financed by the general budget of the European Union | OJ C 93, 17.4.2003 |
| — Special Report No 8/2003 concerning the execution of infrastructure work financed by the EDF | OJ C 181, 31.7.2003 |
| — Special Report No 10/2003 concerning the effectiveness of the Commission's management of development assistance to India in targeting the poor and ensuring sustainable benefits | OJ C 211, 5.9.2003 |
| — Special Report No 15/2003 concerning the audit of microproject programmes financed by the EDF | OJ C 63, 11.3.2004 |
| — Special Report No 10/2004 concerning the devolution of EC external aid management to the Commission delegations | OJ C 72, 22.3.2005 |
| — Special Report No 2/2005 concerning EDF budget aid to ACP countries: the Commission's management of the public finance reform aspect | OJ C 249, 7.10.2005 |
| — Special Report No 4/2005 concerning the Commission's management of economic cooperation in Asia | OJ C 260, 19.10.2005 |
| — Special Report No 2/2006 concerning the performance of projects financed under TACIS in the Russian Federation | OJ C 119, 19.5.2006 |
| — Special Report No 3/2006 concerning the European Commission Humanitarian Aid Response to the Tsunami | OJ C 170, 21.7.2006 |
| — Special Report No 5/2006 concerning the MEDA Programme | OJ C 200, 24.8.2006 |
| — Special Report No 6/2006 concerning the environmental aspects of the Commission's development cooperation | OJ C 235, 29.9.2006 |
| — Special Report No 5/2007 concerning the Commission's management of the CARDS Programme | Being published |

Pre-accession strategy

- Special Report No 5/2003 concerning PHARE and ISPA funding of environmental projects in the candidate countries OJ C 167, 17.7.2003

| Title | Publication |
|--|----------------------|
| — Special Report No 6/2003 concerning twinning as the main instrument to support institution-building in candidate countries | OJ C 167, 17.7.2003 |
| — Special Report No 2/2004 concerning pre-accession aid: 'Has Sapard been well managed?' | OJ C 295, 30.11.2004 |
| — Special Report No 5/2004 concerning PHARE support to prepare Candidate Countries for managing the Structural Funds | OJ C 15, 20.1.2005 |
| — Special Report No 4/2006 concerning PHARE investment projects in Bulgaria and Romania | OJ C 174, 26.7.2006 |

Administrative expenditure

| | |
|--|---|
| — Special Report No 3/2003 on the invalidity pensions scheme in the European institutions | OJ C 109, 7.5.2003 |
| — Special Report No 1/2005 concerning the management of the European Anti-fraud Office (OLAF) | OJ C 202, 18.8.2005 |
| — Special Report No 5/2005: Interpretation expenditure incurred by the Parliament, the Commission and the Council | OJ C 291, 23.11.2005 |
| — Special Report No 9/2006 concerning translation expenditure incurred by the Commission, the Parliament and the Council | OJ C 284, 21.11.2006 |
| — Special Report No 2/2007 concerning the Institutions' expenditure on buildings | OJ C 148, 2.7.2007 and OJ C 178, 31.7.2007 |

Financial instruments and banking activities

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Special Annual Reports

Financial statements of the ECSC

| | |
|--|---------------------|
| — Report on the financial statements of the ECSC at 31 December 2001 | OJ C 158, 3.7.2002 |
| — Report on the financial statements of the ECSC at 23 July 2002 | OJ C 127, 29.5.2003 |

ECSC annual report

| | |
|--|---------------------|
| — Annual Report and Statement of Assurance concerning the ECSC for the financial year 2001 | OJ C 302, 5.12.2002 |
| — Annual Report and Statement of Assurance concerning the ECSC for the financial year ended 23 July 2002 | OJ C 224, 19.9.2003 |

Euratom Supply Agency

| | |
|---|---------------------|
| — Report on the financial statements of the Euratom Supply Agency for the financial year 2001 | Not published in OJ |
| — Report on the financial statements of the Euratom Supply Agency for the financial year 2002 | Not published in OJ |
| — Report on the annual accounts of the Euratom Supply Agency for the financial year 2003 | Not published in OJ |
| — Report on the annual accounts of the Euratom Supply Agency for the financial year 2004 | Not published in OJ |
| — Report on the annual accounts of the Euratom Supply Agency for the financial year 2005 | Not published in OJ |
| — Report on the annual accounts of the Euratom Supply Agency for the financial year 2006 | Not published in OJ |

| Title | Publication |
|--|----------------------|
| <i>Joint European Torus (JET)</i> | |
| — Report on the 2001 accounts of the JET joint undertaking | Not published in OJ |
| <i>European Foundation for the Improvement of Living and Working Conditions (Eurofound, Dublin)</i> | |
| — Report on the financial statements of the European Foundation for the Improvement of Living and Working Conditions for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Foundation for the Improvement of Living and Working Conditions for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the financial statements of the European Foundation for the Improvement of Living and Working Conditions for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Foundation for the Improvement of Living and Working Conditions for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Foundation for the Improvement of Living and Working Conditions for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Foundation for the Improvement of Living and Working Conditions for the financial year 2006 | Being published |
| <i>European Centre for the Development of Vocational Training (Cedefop, Thessaloniki)</i> | |
| — Report on the financial statements of the European Centre for the Development of Vocational Training for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Centre for the Development of Vocational Training for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the European Centre for the Development of Vocational Training for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Centre for the Development of Vocational Training for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Centre for the Development of Vocational Training for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Centre for the Development of Vocational Training for the financial year 2006 | Being published |
| <i>European Schools</i> | |
| — Report on the financial statements of the European Schools for the financial year 2001 | Not published in OJ |
| — Report on the financial statements of the European Schools for the financial year 2002 | Not published in OJ |
| — Report on the annual accounts of the European Schools for the financial year 2003 | Not published in OJ |
| — Report on the annual accounts of the European Schools for the financial year 2004 | Not published in OJ |
| — Report on the annual accounts of the European Schools for the financial year 2005 | Not published in OJ |
| — Report on the annual accounts of the European Schools for the financial year 2006 | Not published in OJ |
| <i>European Central Bank (ECB, Frankfurt)</i> | |
| — Report on the audit of the operational efficiency of the management of the European Central Bank for the financial year 2001 | OJ C 259, 25.10.2002 |

| Title | Publication |
|---|----------------------|
| — Report on the audit of the operational efficiency of the management of the European Central Bank for the financial year 2002 | OJ C 45, 20.2.2004 |
| — Report on the audit of the operational efficiency of the management of the European Central Bank for the financial year 2003 | OJ C 286, 23.11.2004 |
| — Report on the audit of the operational efficiency of the management of the European Central Bank for the financial year 2004 | OJ C 119, 19.5.2006 |
| <i>Management of the 'Schengen contracts'</i> | |
| — Special Annual Report on the financial statements in respect of the management, by the Secretary-General/High Representative of the Council, of contracts concluded in his name on behalf of certain Member States, and relating to the installation and functioning of the Help Desk Server of the Management Unit and of the Sirene Network Phase II (Schengen contracts) for the financial year ended 31 December 2001 | Not published in OJ |
| — Special Annual Report on the 2002 financial statements relating to the 'Schengen contracts' | Not published in OJ |
| <i>Management of 'Sisnet contracts'</i> | |
| — Special Annual Report on the financial statements in respect of the management, by the Deputy Secretary-General of the Council, of contracts concluded in his name on behalf of certain Member States, relating to the installation and the functioning of the communication infrastructure for the Schengen environment, known as 'Sisnet', for the financial year ended 31 December 2001 | Not published in OJ |
| — Special Annual Report on the 2002 financial statements relating to 'Sisnet' | Not published in OJ |
| — Special Annual Report on the 2003 financial statements relating to 'Sisnet' | Not published in OJ |
| — Special Annual Report on the 2004 financial statements relating to 'Sisnet' | Not published in OJ |
| — Special Annual Report on the 2005 financial statements relating to 'Sisnet' | Not published in OJ |
| — Special Annual Report on the annual accounts for the final year 2006 relating to 'Sisnet' | Not published in OJ |
| <i>Community Plant Variety Office (CPVO, Angers)</i> | |
| — Report on the financial statements of the Community Plant Variety Office for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the Community Plant Variety Office for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the Community Plant Variety Office for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the Community Plant Variety Office for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the Community Plant Variety Office for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the Community Plant Variety Office for the financial year 2006 | Being published |
| <i>Office for Harmonisation in the Internal Market (OHIM, Alicante)</i> | |
| — Report on the financial statements of the Office for Harmonisation in the Internal Market for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the Office for Harmonisation in the Internal Market for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the Office for Harmonisation in the Internal Market for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the Office for Harmonisation in the Internal Market for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the Office for Harmonisation in the Internal Market for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the Office for Harmonisation in the Internal Market for the financial year 2006 | Being published |

| Title | Publication |
|---|----------------------|
| <i>European Agency for Safety and Health at Work (EASH, Bilbao)</i> | |
| — Report on the financial statements of the European Agency for Safety and Health at Work for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Agency for Safety and Health at Work for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the European Agency for Safety and Health at Work for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Agency for Safety and Health at Work for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Agency for Safety and Health at Work for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Agency for Safety and Health at Work for the financial year 2006 | Being published |
| <i>European Environment Agency (EEA, Copenhagen)</i> | |
| — Report on the financial statements of the European Environment Agency for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Environment Agency for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the European Environment Agency for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Environment Agency for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Environment Agency for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Environment Agency for the financial year 2006 | Being published |
| <i>European Monitoring Centre for Drugs and Drug Addiction (EMCDDA, Lisbon)</i> | |
| — Report on the financial statements of the European Monitoring Centre for Drugs and Drug Addiction for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Monitoring Centre for Drugs and Drug Addiction for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the European Monitoring Centre for Drugs and Drug Addiction for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Monitoring Centre for Drugs and Drug Addiction for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Monitoring Centre for Drugs and Drug Addiction for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Monitoring Centre for Drugs and Drug Addiction for the financial year 2006 | Being published |
| <i>European Medicines Agency (EMA, London)</i> | |
| — Report on the financial statements of the European Agency for the Evaluation of Medicinal Products concerning the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Agency for the Evaluation of Medicinal Products concerning the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the European Agency for the Evaluation of Medicinal Products concerning the 2003 financial year | OJ C 324, 30.12.2004 |

| Title | Publication |
|--|----------------------|
| — Report on the annual accounts of the European Medicines Agency for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Medicines Agency for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Medicines Agency for the financial year 2006 | Being published |

Translation Centre for the bodies of the European Union (TCBEU, Luxembourg)

| | |
|---|----------------------|
| — Report on the financial statements of the Translation Centre for Bodies of the European Union for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the Translation Centre for Bodies of the European Union for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the Translation Centre for the bodies of the European Union for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the Translation Centre for the bodies of the European Union for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the Translation Centre for the bodies of the European Union for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the Translation Centre for the bodies of the European Union for the financial year 2006 | Being published |

European Training Foundation (ETF, Turin)

| | |
|--|----------------------|
| — Report on the financial statements of the European Training Foundation for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Training Foundation for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the European Training Foundation for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Training Foundation for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Training Foundation for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Training Foundation for the financial year 2006 | Being published |

European Fundamental Rights Agency (FRA, Vienna) — European Monitoring Centre on Racism and Xenophobia

| | |
|---|----------------------|
| — Report on the financial statements of the European Monitoring Centre on Racism and Xenophobia for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Monitoring Centre on Racism and Xenophobia for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of the European Monitoring Centre on Racism and Xenophobia for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Monitoring Centre on Racism and Xenophobia for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Monitoring Centre on Racism and Xenophobia for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Fundamental Rights Agency for the financial year 2006 | Being published |

European Agency for Reconstruction (EAR, Thessaloniki)

| | |
|--|----------------------|
| — Report on the financial statements of the European Agency for Reconstruction for the financial year 2001 | OJ C 326, 27.12.2002 |
| — Report on the financial statements of the European Agency for Reconstruction for the financial year 2002 | OJ C 319, 30.12.2003 |

| Title | Publication |
|---|----------------------|
| — Report on the annual accounts of the European Agency for Reconstruction for the financial year 2003 | OJ C 41, 17.2.2005 |
| — Report on the annual accounts of the European Agency for Reconstruction for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Agency for Reconstruction for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Agency for Reconstruction for the financial year 2006 | Being published |
| <i>European Maritime Safety Agency (EMSA, Lisbon)</i> | |
| — Report on the annual accounts of the European Maritime Safety Agency for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Maritime Safety Agency for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Maritime Safety Agency for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Maritime Safety Agency for the financial year 2006 | Being published |
| <i>European Aviation Safety Agency (EASA, Cologne)</i> | |
| — Report on the annual accounts of the European Aviation Safety Agency for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Aviation Safety Agency for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Aviation Safety Agency for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Aviation Safety Agency for the financial year 2006 | Being published |
| <i>European Food Safety Authority (EFSA, Parma)</i> | |
| — Report on the annual accounts of the European Food Safety Authority for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of the European Food Safety Authority for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of the European Food Safety Authority for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Food Safety Authority for the financial year 2006 | Being published |
| <i>Eurojust</i> | |
| — Report on the financial statements of Eurojust for the financial year 2002 | OJ C 319, 30.12.2003 |
| — Report on the annual accounts of Eurojust for the 2003 financial year | OJ C 324, 30.12.2004 |
| — Report on the annual accounts of Eurojust for the financial year 2004 | OJ C 332, 28.12.2005 |
| — Report on the annual accounts of Eurojust for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of Eurojust for the financial year 2006 | Being published |
| <i>Convention</i> | |
| — Report on the accounts drawn up by the Secretary-General of the Convention on the future of the European Union for the financial year 2002 (started on 21 February and ended on 31 December 2002) | OJ C 122, 22.5.2003 |
| — Report on the accounts drawn up by the Secretary-General of the Convention on the future of the European Union for the financial year ended 31 December 2003 | OJ C 157, 14.6.2004 |

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| <i>Galileo Joint Undertaking (Brussels)</i> | |
| — Report on the accounts of the Galileo Joint Undertaking for the financial year ended 31 December 2003 | Not published in OJ |
| — Report on the accounts of the Galileo Joint Undertaking for the financial year ended 31 December 2004 | Not published in OJ |
| — Report on the annual accounts of the Galileo Joint Undertaking for the financial year ended 31 December 2005 | Not published in OJ |
| — Report on the annual accounts of the Galileo Joint Undertaking for the financial year ended 31 December 2006 | Not published in OJ |
| <i>European Network and Information Security Agency (ENISA, Heraklion)</i> | |
| — Report on the annual accounts of the European Network and Information Security Agency for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Network and Information Security Agency for the financial year 2006 | Being published |
| <i>European Centre for Disease Prevention and Control (ECDC, Stockholm)</i> | |
| — Report on the annual accounts of the European Centre for Disease Prevention and Control for the financial year 2005 | OJ C 312, 19.12.2006 |
| — Report on the annual accounts of the European Centre for Disease Prevention and Control for the financial year 2006 | Being published |
| <i>European GNSS Supervisory Authority (Brussels)</i> | |
| — Report on the annual accounts of the European GNSS Supervisory Authority for the financial year 2006 | Being published |
| <i>European Railway Agency (ERA, Valenciennes)</i> | |
| — Report on the annual accounts of the European Railway Agency for the financial year 2006 | Being published |
| <i>European Police College (CEPOL, Bramshill)</i> | |
| — Report on the annual accounts of the European Police College for the financial year 2006 | Being published |
| <i>European Agency for the Management of Operational Cooperation at the External Borders (FRONTEX, Warsaw)</i> | |
| — Report on the annual accounts of the European Agency for the Management of Operational Cooperation at the External Borders for the financial year 2006 | Being published |
| <i>Education, Audiovisual and Culture Executive Agency (EACEA, Brussels)</i> | |
| — Report on the annual accounts of the Education, Audiovisual and Culture Executive Agency for the financial year 2006 | Being published |
| <i>Intelligent Energy Executive Agency (IEEA, Brussels)</i> | |
| — Report on the annual accounts of the Intelligent Energy Executive Agency for the financial year 2006 | Being published |

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| Opinions | |
| — Opinion No 1/2002 on a proposal to amend the financial regulation of the Office for Harmonisation in the Internal Market (OHIM-Alicante) | Not published in OJ |
| — Opinion No 2/2002 on an amended proposal for a Council Regulation on the Financial Regulation applicable to the general budget of the European Communities | OJ C 92, 17.4.2002 |
| — Opinion No 3/2002 concerning a proposal for the Financial Regulation applicable to the budget of Eurojust | Not published in OJ |
| — Opinion No 4/2002 on an amended proposal for a Council Regulation amending Regulation (Euratom, ECSC, EEC) No 549/69 determining the categories of officials and other servants of the European Communities to whom the provisions of Article 12, the second paragraph of Article 13 and Article 14 of the Protocol on the Privileges and Immunities of the Communities apply | OJ C 225, 20.9.2002 |
| — Opinion No 5/2002 on a proposal for a Council Regulation introducing special measures to terminate the service of officials of the Commission of the European Communities as part of the reform of the Commission | OJ C 236, 1.10.2002 |
| — Opinion No 6/2002 on a proposal for a Council Regulation introducing special measures to terminate the service of officials of the General Secretariat of the Council of the European Union | OJ C 236, 1.10.2002 |
| — Opinion No 7/2002 on an amended proposal for a Council Regulation introducing special measures to terminate the service of European Parliament officials and temporary staff working in the Political Groups | OJ C 236, 1.10.2002 |
| — Opinion No 8/2002 concerning a proposal for a revised Financial Regulation applicable to the budget of the European Agency for Reconstruction | Not published in OJ |
| — Opinion No 9/2002 concerning the financing of the common agricultural policy | OJ C 285, 21.11.2002 |
| — Opinion No 10/2002 on a Commission proposal for amendment of the constituent acts of Community Bodies following the adoption of the new Financial Regulation | OJ C 285, 21.11.2002 |
| — Opinion No 11/2002 on a proposal for a Commission regulation on the framework financial regulation for the bodies referred to in Article 185 of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget | OJ C 12, 17.1.2003 |
| — Opinion No 12/2002 on the proposal for a Council regulation on a Financial Regulation applicable to the ninth European Development Fund under the ACP/EU Partnership Agreement signed at Cotonou on 23 June 2000 | OJ C 12, 17.1.2003 |
| — Opinion No 13/2002 concerning a draft Commission regulation laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities | OJ C 12, 17.1.2003 |
| — Opinion No 14/2002 on a proposal for a Council Regulation amending the Staff Regulations of officials and the Conditions of Employment of other servants of the European Communities | OJ C 21, 28.1.2003 |
| — Opinion No 1/2003 on a proposal for a regulation for the Budget Committee of the Office for Harmonisation in the Internal Market (Trade Marks and Designs) laying down the financial provisions applicable to the Office (Financial Regulation) | Not published in OJ |
| — Opinion No 2/2003 on a proposal for a regulation of the Administrative Council of the Community Plant Variety Office laying down the financial provisions applicable to the Office (Financial Regulation) | Not published in OJ |
| — Opinion No 3/2003 concerning the draft financial regulation of the European Food Safety Authority | Not published in OJ |

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| — Opinion No 4/2003 concerning a draft Financial Regulation applicable to the Translation Centre for bodies of the European Union | Not published in OJ |
| — Opinion No 5/2003 on a proposal for a Council Regulation introducing, on the occasion of the accession of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia, special temporary measures for recruitment of officials of the European Communities | OJ C 224, 19.9.2003 |
| — Opinion No 6/2003 concerning the draft financial regulation of the European Agency for the Evaluation of Medicinal Products | Not published in OJ |
| — Opinion No 7/2003 on a proposal for a Council regulation amending Regulation (EC, Euratom) No 1150/2000 implementing Decision 2000/597/EC, Euratom on the system of the Communities' own resources | OJ C 318, 30.12.2003 |
| — Opinion No 8/2003 on a proposal for a decision of the European Parliament and of the Council establishing a Community action programme to promote activities in the field of the protection of the Community's financial interests | OJ C 318, 30.12.2003 |
| — Opinion No 9/2003 on a draft Commission regulation on a standard financial regulation for the executive agencies pursuant to Council Regulation (EC) No 58/2003 laying down the statute for executive agencies to be entrusted with certain tasks in the management of Community programmes | OJ C 19, 23.1.2004 |
| — Opinion No 10/2003 on a proposal for a Council regulation amending Regulation (EC, Euratom) No 2728/94 establishing a Guarantee Fund for external actions | OJ C 19, 23.1.2004 |
| — Opinion No 1/2004 on an amended proposal for a Council Regulation amending the Staff Regulations of officials and the Conditions of Employment of other servants of the European Communities | OJ C 75, 24.3.2004 |
| — Opinion No 2/2004 on the 'single audit' model (and a proposal for a Community internal control framework) | OJ C 107, 30.4.2004 |
| — Opinion No 1/2005 on the proposal for a Council Regulation on the financing of the common agricultural policy | OJ C 121, 20.5.2005 and OJ C 167, 7.7.2005 |
| — Opinion No 2/2005 on the proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund | OJ C 121, 20.5.2005 |
| — Opinion No 3/2005 on the draft Regulation (EC) of the Commission amending 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 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities | OJ C 124, 23.5.2005 |
| — Opinion No 4/2005 on a proposal for a Council Decision on the system of the European Communities' own resources and on a proposal for a Council Regulation on the implementing measures for the correction of budgetary imbalances in accordance with Articles 4 and 5 of the Council Decision of (...) on the system of the European Communities' own resources | OJ C 167, 7.7.2005 |
| — Opinion No 5/2005 on the draft Amendment of the financial regulation of the Community Plant Variety Office adopted by the Administrative Council of the Office on 16 September 2004 | Not published in OJ |
| — Opinion No 6/2005 on a proposal for a Regulation of the European Parliament and of the Council amending Regulations (EC) No 1073/1999 and (Euratom) No 1074/1999 concerning investigations conducted by the European Anti-Fraud Office (OLAF) | OJ C 202, 18.8.2005 |
| — Opinion No 7/2005 on a draft Commission Regulation amending Regulation (EC) No 1653/2004 as regards the post of accounting officers of executive agencies | OJ C 249, 7.10.2005 |

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| — Opinion No 8/2005 on a proposal for a Regulation of the European Parliament and of the Council on mutual administrative assistance for the protection of the financial interests of the Community against fraud and any other illegal activities | OJ C 313, 9.12.2005 |
| — Opinion No 9/2005 concerning a proposal for a Council Regulation amending Regulation (EC, Euratom) No 2728/94 establishing a Guarantee Fund for external actions (COM(2005) 130 Final) | OJ C 313, 9.12.2005 |
| — Opinion No 10/2005 on the draft Council Regulation amending Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities | OJ C 13, 18.1.2006 |
| — Opinion No 11/2005 on the draft Commission Regulation amending Regulation (EC, Euratom) No 2342/2002 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 C 13, 18.1.2006 |
| — Opinion No 1/2006 on the proposal for a regulation of the European Parliament and of the Council laying down the rules for the participation of undertakings, research centres and universities in actions under the Seventh Framework Programme and for the dissemination of research results (2007 to 2013) | OJ C 203, 25.8.2006 |
| — Opinion No 2/2006 on a proposal for a Council Decision on the system of the European Communities' own resources | OJ C 203, 25.8.2006 |
| — Opinion No 3/2006 on a proposal for a Council Regulation introducing, on the occasion of the accession of Bulgaria and Romania, special temporary measures for the recruitment of officials of the European Communities | OJ C 273, 9.11.2006 |
| — Opinion No 4/2006 on the draft Council Regulation amending Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities | OJ C 273, 9.11.2006 |
| — Opinion No 5/2006 on a proposal for an amendment to the Financial Regulation of the European Schools | Not published in OJ |
| — Opinion No 6/2006 on a proposal for a decision by the European Parliament and the Council amending and extending Decision No 804/2004/EC of the European Parliament and of the Council of 21 April 2004 establishing a Community action programme to promote activities in the field of the protection of the Community's financial interests (Hercule II programme) | OJ C 302, 12.12.2006 |
| — Opinion No 7/2006 on a proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1073/1999 concerning investigations conducted by the European Anti-Fraud office (OLAF) | OJ C 8, 12.1.2007 |
| — Opinion No 8/2006 on a proposal for a Council Regulation repealing Council Regulation (EC) No 2040/2000 on budgetary discipline | OJ C 8, 12.1.2007 |
| — Opinion No 1/2007 on the draft Commission Regulation (EC, Euratom) amending Regulation (EC, Euratom) No 2342/2002 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 C 46, 28.2.2007 |
| — Opinion No 2/2007 on the draft Council Regulation amending the Financial Regulation applicable to the ninth European Development Fund | OJ C 101, 4.5.2007 |
| — Opinion No 3/2007 on a proposal for a Regulation of the European Parliament and of the Council amending Council Regulation (EC) No 515/97 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters | OJ C 101, 4.5.2007 |

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| — Opinion No 4/2007 on a draft Commission Regulation (EC) amending Regulation (EC) No 1653/2004 on a standard financial regulation for the executive agencies pursuant to Council Regulation (EC) No 58/2003 laying down the statute for executive agencies to be entrusted with certain tasks in the management of Community programmes | OJ C 216, 14.9.2007 |
| — Opinion No 5/2007 on the proposal for a Council Regulation on the Financial Regulation applicable to the Euratom Supply Agency | Not published in OJ |
| — Opinion No 6/2007 on the annual summaries of Member States; 'national declarations' of Member States; and audit work on EU funds of national audit bodies | OJ C 216, 14.9.2007 |