



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 21.1.2003  
COM(2003) 28 final

**COMMUNICATION FROM THE COMMISSION**

**The 2002 review of the implementation of activity-based management in the Commission, including clarification of the methodology for the establishment of Annual Activity Reports**

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## 1. INTRODUCTION

This communication stems from the conclusions of the Communication on “implementing activity-based management (ABM) in the Commission”,<sup>1</sup> whereby the Commission requested that “**an annual evaluation of ABM implementation be presented to the College starting with the 2002 exercise**”.

The first section summarises the main steps taken since 2001 to implement activity-based management.

Section 3 goes on to set out a number of adjustments to the instructions contained in the Communication on implementing activity-based management in the Commission.

## 2. THE COMMISSION’S INTERNAL MANAGEMENT SYSTEM: BREAKING NEW GROUND AND CONSOLIDATING THE FUNDAMENTAL PRINCIPLES AND INSTRUMENTS

The Commission is committed to modernising its internal management system as part of administrative Reform. The political objective at the centre of the Reform, i.e. placing the political priorities firmly at the heart of its organisation, will have a better chance of working if accompanied by the introduction of a management system that enables the Commission to allocate resources appropriately to priorities and core business. The first element has been implemented through the establishment of the strategic planning and programming cycle. The second element has been fulfilled with the introduction of activity-based management. These two elements serve the same political purpose in different contexts.

### 2.1. 2001: First year of implementation

Following the adoption of the White Paper on Reform, a strategic planning and programming function<sup>2</sup> was gradually set up in the fourth quarter of 2000 and started to operate at the beginning of 2001. The main task of this function is to design, set in motion and follow up the cycle that defines the Commission's policy priorities and ensure the right match between tasks and resources for the following year.

It was necessary to define the concepts and develop the practical instruments to enable services to translate priorities into operational terms, as well as following up all their activities and the use of resources in a coherent and uniform way. The Communication on Activity-Based Management<sup>3</sup> (ABM) set out the structure and the functioning of the new internal management system of the Commission.

### 2.2. 2002: Adjusting the internal management system to the strategic planning and programming cycle

In 2002 efforts focused on improving the internal management system to make the cycle function more effectively. The second cycle improved on the following points:

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<sup>1</sup> Communication of 25 July 2001 (SEC(2001)1197/6&7)

<sup>2</sup> Provided for by the Communication of 25 July 2001 (SEC(2001)1197/6&7)

<sup>3</sup> ABM Communication (SEC(2001)1197/6&7)

- The Commission singled out three priorities, which were broad in nature, spread over all Commission activities and complementary to each other, and able to give a lead to all services in the Commission.
- An inter-institutional dialogue was developed with both the European Parliament and the Council. It took place for the first time and the institutions have to become accustomed with this new procedure. Following the dialogue, the Parliament and the Council endorsed the three priorities for 2003 proposed by the Commission as being at the heart of the EU agenda. This dialogue was based on a timetable agreed with the Parliament, and in August the Commission took stock of the follow-up to the Annual Policy Strategy.
- The new Financial Regulation was adopted, which provides the legal instrument for the management of resources by objectives and indicators. The structure of the budget is based on the Policy Areas and Activities of the Commission, and the obligation to transmit Annual Activity Reports to the Budgetary Authority is defined.
- The Commission's Legislative and Work Programme for 2003 was prepared on the basis of the updated Annual Policy Strategy following the inter-institutional dialogue and announced for the first time which proposals would undergo an extended impact assessment in 2003.
- Following the different steps in the cycle, all services developed annual management plans, established on the basis of a common standard. A complete ABM Guide codifying ABM rules and practice was developed and put on line.
- IRMS, the specific IT tool designed to support activity-based management, was widely expanded and was used for the preparation of the list of initiatives attached to the Commission's Legislative and Work Programme.
- The first annual activity reports (AARs) for 2001 were prepared by all services. These were subsequently consolidated in the Synthesis of Annual Activity Reports.<sup>4</sup>

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<sup>4</sup> COM(2002)426, adopted on 24 July 2002

In brief:

**2002 has been a year of consolidation: the new Financial Regulation was adopted; a more meaningful Annual Policy Strategy in terms of policy and resources was followed by extended inter-institutional dialogue and the ensuing Work Programme; and the Commission prepared the first AARs and their Synthesis. At the same time, the internal management system has been developed and simplified. The introduction of IRMS was widely expanded and used for the 2003 Legislative and Work Programme and the management plan.**

### 2.3. Outlook and challenges for 2003

2003 will be the first year where, after consolidation, the political cycle and the internal management system servicing it will be fully operational.

- The Annual Policy Strategy (APS) will be adopted by the Commission for the third time. The 2004 APS will contain a reinforced multi-annual policy dimension, as a basis for inter-institutional discussion on the European Council's multi-annual strategic programming.
- In 2003, the 2004 Budget will be prepared for the first time following the Activity Based Budgeting (ABB) form.
- To strengthen the information base for policy-making, impact assessments will become a standing feature of the cycle. The Commission will decide which extended impact assessments to carry out at the time of the APS decision and the Legislative and Work Programme.
- Evaluation should inform the decision-making process on policy priorities and the corresponding allocation of resources, contribute to the appropriate implementation of the activities as well as being a regular reporting tool. These were the underlying goals of the Communication "Focus on results: strengthening evaluation of Commission activities".<sup>5</sup> The first two years of implementation of these measures have been covered in a report,<sup>6</sup> which proposes nine recommendations to further strengthen the use of evaluation in the Commission. These nine recommendations will be implemented by the central services and the operational DGs supported by the Commission's Evaluation Network.
- Monitoring the implementation of priorities and objectives will be developed both in the services, which will pursue a structured follow-up to their management plans, and at the level of the Commission, through a newly set up interservice co-ordination group that will ensure the follow-up of the Legislative and Work Programme and will monitor the delivery of key initiatives in the management plans.

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<sup>5</sup> SEC(2000)1051 of 26.07.2000

<sup>6</sup> Report of 10.10.2002 on the implementation of the Communication: "Focus on results: strengthening evaluation of Commission activities". The report is available at the following address: <http://www.cc.cec/budg/networks/i/evaluation/en/notices/index.htm>. The recommendations are set out in section "Synthesis of conclusions and recommendations".

- Another important focus of the work carried out on the consolidation of the internal management system has been to clarify concepts, regarding both the management plan and the annual activity report.
- In the context of the interoperability exercise led by ADMIN/DI, IRMS will be developed on the basis of the experience gained to ensure it fulfils better its role as an IT vehicle to support the implementation of ABM in the Commission.

In brief:

**2003 will be the first year in which all the elements of the cycle are in place and the internal management system is set to support it, including the preparation of the first official ABB budget. Monitoring of results will be a priority both at DG level and Commission-wide.**

### **3. MAIN MANAGEMENT INSTRUMENTS FOR THE SERVICES: MANAGEMENT PLAN AND ANNUAL ACTIVITY REPORT**

The fundamental principles of the Commission's internal management system are translated from an operational point of view into two main instruments: the annual management plan and the annual activity report. These instruments have already been established in all services on the basis of common instructions. They have been designed to correspond to what the management system requires both at central and at service levels in terms of planning, monitoring and reporting.

Setting them up has required a high level of commitment and investment from all services, as normally happens when new management elements are introduced into an organisation. Moreover, major efforts to clarify and simplify have been made for 2003, which should facilitate the work in the services. If necessary, the Commission is ready to further rationalise the process in the coming years.

#### **3.1. The cornerstone of the system: the management plan**

The management plan is the tool by which the political orientations and priorities are translated into the operations of the Directorates-general, based on common standards and a common language, enabling comparability and accountability Commission-wide. It covers all the activities of a service,. It is the cornerstone of activity-based management in that it is the Commission-wide management instrument and the main information source for the cycle. On the one hand, it helps each service to plan, follow up and report on its activities, actions and resources in conformity with its mission statement and set objectives. On the other hand, it is the information base upon which the answers to the Annual Policy Strategy circular, to the budgetary circular (both for the following year) and to the Annual Activity Report circular will be built.

*Basic structure of the annual management plan:*

<b>Section 1</b> <b>Mission Statement</b>
<b>Section 2</b> <b>Service Level:</b> <b>Strategic objectives</b> <b>Key APS Initiatives</b> <b>Evaluation plan</b> <b>Total resources</b>
<b>Section 3</b> <b>Activity level:</b> <b>Specific objectives and indicators</b> <b>Resources per activity</b> <b>All actions (APS and others)</b>

*3.1.1. A consolidated structure*

The 2003 management plan consolidates the structure of the 2002 management plan:

- The mission statement is permanent, unless the service has undergone major internal changes.
- Strategic objectives at service level are normally relatively stable, and indicators are not necessarily required at this level; the key APS initiatives are well known through the development of the whole political cycle and confirmed in the Legislative and Work Programme; allocation of resources has to be adjusted to the budget adopted by the budgetary authority.
- The specific objectives at activity level should stem from the strategic objectives at service level and are measured by the relevant indicator(s) as appropriate. The means of achieving the specific objectives are the actions. An action is carried out over a certain period of time and consumes resources to produce outputs that help to achieve a specific objective. Actions are therefore at aggregate level for reasons of clarity; they entail a series of outputs which are normally the focus of middle management.

*3.1.2. Gradual introduction and simplification of concepts*

- A very flexible approach has been applied to objectives and indicators: for 2003, they are mandatory at activity level only (given that strategic objectives at service level may be replaced by the list of specific objectives for all activities). Moreover, only output indicators are mandatory at activity level, unless impact indicators are considered more appropriate by the service.
- Actions are not shown separately, but are integrated in the activity level, giving greater coherence to the presentation of the management plan. To make for clear and swift reporting, actions should be defined at an aggregated level, because a

reasonable number of actions facilitate follow-up and management. They may be developed in more detail internally for daily management purposes.

### *3.1.3. Importance of implementation*

Attention is drawn to the need to ensure thorough implementation of management plans. This will be a key element for 2003:

- An important aspect is the internal process: it is crucial for top management to take a lead in the preparation of the management plan by setting strategic and specific objectives. This gives direction to the bulk of the activities and motivates middle management and their staff to suggest appropriate actions to achieve the objectives. The process does not stop with the finalisation of the planning version at the beginning of January: after that it is necessary to set up a follow-up and review process that enables managers to monitor implementation of the management plan in a dynamic way and to readjust priorities, schedules and resource allocation where necessary.
- Thorough implementation of the annual management plan will make it easier to prepare the corresponding annual activity report.

## **3.2. The annual reporting instrument: the annual activity report**

The annual activity report is the other fundamental instrument in the internal management system, as it contains an overview of the results obtained by each service and reviewed by the Commission, through the Synthesis of annual activity reports. Therefore, it has value both as a management and as a policy tool. In line with the logic of the system, the annual activity report reports on the execution of the annual management plan. Much effort has been invested in the clarification of the structure and the methodology of annual activity reports.

### *3.2.1. Clarification of the structure of the annual reports*

**The content of the annual report mirrors the management plan and is structured around the following sections:**

- global overview of the year, with reference to the global environment, policy (including both APS priorities and core business) and management main events and results; state of play in the implementation of the Reform; global resources;
- analysis activity by activity of the attainment of objectives, with comparison between actual results and expected results; highlights on APS actions carried out in 2002; table of resources;
- if appropriate, answers to the recommendations expressed by the European Court of Auditors and in the finalised audits of the Internal Audit Service and follow-up to the plan of action stemming from the annual activity report of the previous year;
- appraisal of internal control systems;
- general conclusions;



- declaration of the Director-General or Head of Service, accompanied if appropriate by reservations.

The annual report will have three annexes:

- a description of the internal process used to establish the annual report, including internal consultations, information flow and sources and relevant documentation;
- draft accounts of the service;
- table reporting on the implementation in the service of the Commission's internal control standards.

### 3.2.2. *Clarification of the methodology*

In the Synthesis of the first annual reports exercise, the Commission noted the need to improve and clarify the methodology for the annual reports, in particular regarding reservations, materiality, sub-delegations and cascading.

**After examination, the following clarifications are considered appropriate:**

1. The prime objective of the declaration is not the assessment of policy results, but an undertaking that the service concerned functions properly. The authorising officer by delegation therefore gives "management assurance" as to the regularity and legality of financial transactions (and the principles of sound financial management), based on the existence and smooth functioning of internal control systems. This management assurance has to be distinguished from the "audit assurance" given by auditors, whether internal or, as is the case in the DAS, the European Court of Auditors.

The declaration is an expression of the responsibilities conferred under the Charter in the field of control systems, of sound financial management and of the legality and regularity of transactions. The declaration represents an explicit demonstration of the personal responsibility and accountability for the management of the resources at the disposal of the Director General.

In analysing the functioning of his/her service to express this responsibility, the Authorising Officer by delegation may come across organisational shortcomings or deficiencies within the service concerned. In such cases, (s)he may express a reservation, in order to inform the Commission of the problem, and indicate the measures and timeframe planned to resolve it.

The non-achievement of some of the policy objectives assigned to the service due to unmanageable risks, as well as immaterial deficiencies (see below) cannot be expressed by a reservation, but may be identified as a specific "observation" in the body of the annual report.

2. Judgment as to the level of risks in the service belongs exclusively to the Director-General, who decides on the level of materiality according to his/her service's circumstances. However, as reservations were not interpreted consistently during the first exercise, a common qualitative and quantitative threshold needs to be defined beyond which deficiencies are generally significant or material and a reservation

should be made. A deficiency may be **presumed** to be material (and therefore highlighted in the form of a reservation) when it falls under the following categories:

- if it concerns the non-implementation of one or more internal control standards;
- if it affects or is likely to affect the Commission's reputation;
- if it concerns one issue which is relevant for the reporting period and is raised by the European Court of Auditors in its published annual reports, specific reports and opinions, or a critical or important issue identified by the Internal Audit Service in its finalised audit reports.

The quantitative materiality threshold is 2%, i.e. when the amount of the transaction (in the broad sense) affected by the deficiency represents more than 2% of the budget allocated to the ABB activity of the service concerned.

DGs and Services may decide to deviate from this threshold if they deem that the nature of the risks and controls, based on the DG's assessment of the risk and control environment in which the DG/Service operates, makes the standard threshold inappropriate. In such circumstances, the specific thresholds established should be justified and documented in the Annual Activity Report.

A reservation will normally be lifted the following year, as a result of the remedial measures taken, but where its impact lasts more than one year, Directors-General will have to repeat it.

3. **On cross delegations**, the transitional measures applied in 2002 are confirmed (i.e. the sub-delegated funds will be reported on in the AAR and declaration of the authorising officer by delegation), with the additional requirement that in the written sub-delegation understanding the authorising officer by delegation should clearly state the conditions under which the sub-delegation is granted (e.g. regular reporting, controls, etc.).
4. In conformity with the reporting requirements set out in the Charters for sub-delegated authorising officers, no provision is made for the **cascading** of responsibilities down through the lower hierarchical levels by way of declarations similar to the one signed by the Director-General. The declaration has, however, to be based on documented reporting from within the DG. Annex 1 to the report (see point 3.2.1) will provide all the necessary information on the internal process and the flow of information.

More detailed instructions to services are to be found in the updated guidelines on the declaration of the authorising officer by delegation in Annex 1, which are mandatory. More instructions on the preparation of the 2002 Annual Report are circulated by the Secretary-General and the Director-General for the Budget.

### 3.2.3. *Clarification of the process*

- In order to improve the coherence of declarations and reservations made in application of these guidelines, a peer review process will be held whereby Directors-General will submit the reservations that they intend to lodge 4 weeks before the deadline for submission of the annual reports, so that they can be

reviewed, in particular regarding materiality, in one of the Directors-General meetings prior to finalisation of the Annual Reports. This is without prejudice to the individual responsibility of Directors-General in signing their declarations.

- The person responsible for preparing the annual report and signing the declaration for year  $n$  in the case of a change of Director-General should be the Director-General in office at the time the annual report has to be finalised and the declaration signed (April of year  $n+1$ ). The need to ensure the continuity of the service between the outgoing and the incoming Director-General means that the successor has to endorse all the responsibilities and tasks of his/her new function.

#### 3.2.4. *Budget execution of shared or decentralised managed activities*

Whilst the key principles referred to above with regard to making reservations apply to most aspects of the budget, it is clear that the part of the budget dealing with shared management and/or decentralised arrangements warrants special attention in order to reflect the particular control and risk issues faced when responsibilities are shared between the Commission and third parties.

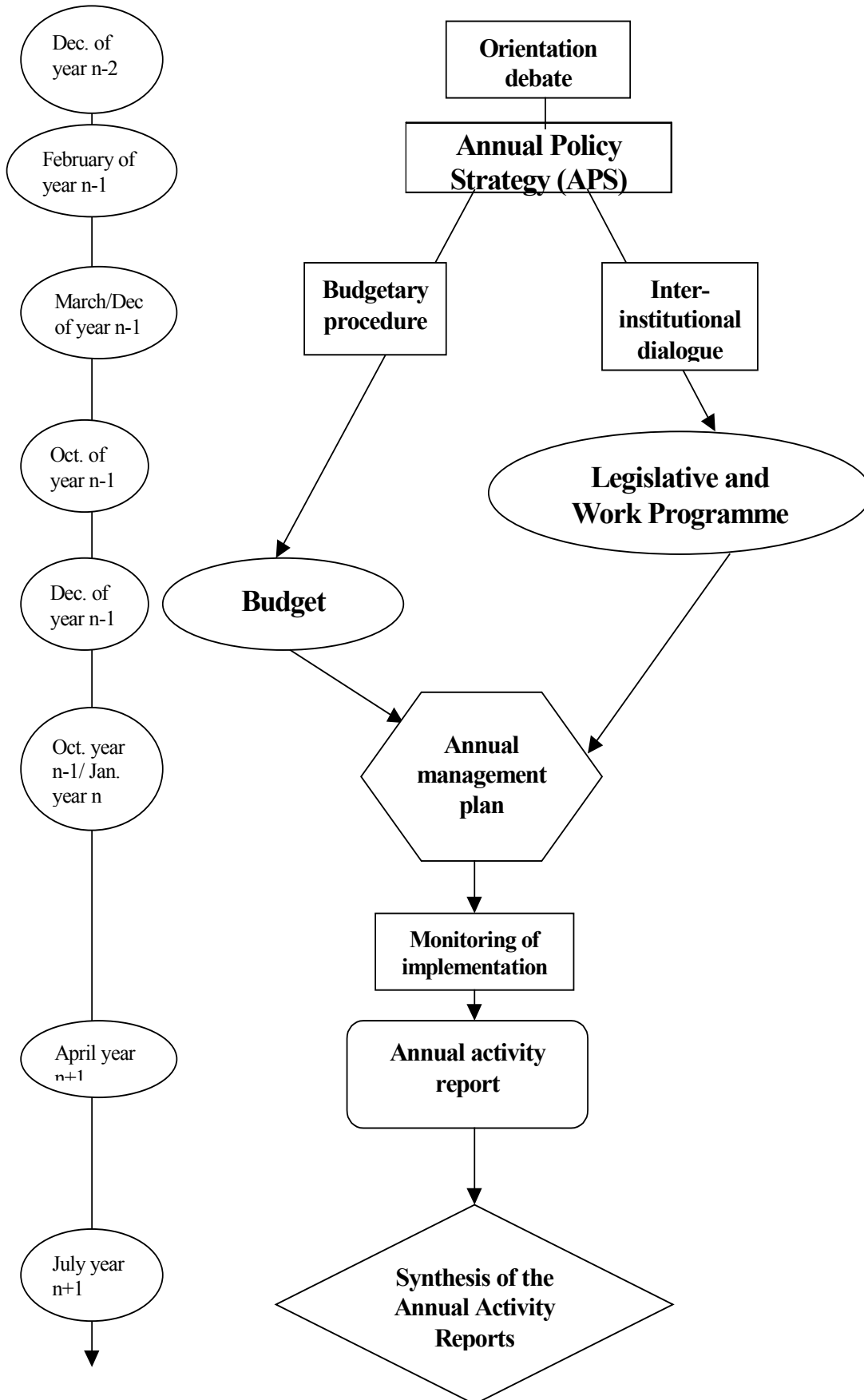
From the user's perspective it is essential for the nature of the control and risk environment to be conveyed as clearly as possible in the body of the main report in order to fully understand the context of any reservations made by the AOD.

With this in mind DGs should expand and clarify in the body of their Annual Activity Reports the nature of those responsibilities and ensure that the Declaration is free of any ambiguities.

## 4. **GENERAL CALENDAR AND CHART OF THE CYCLE**

A considerable amount of work has gone into improving synergies between the components of the cycle and the information base contained in the main management tool, the annual management plan. As a result, all the information in the management plan will be used across the cycle to feed into the Annual Policy Strategy, the Preliminary Draft Budget, the Legislative and Work Programme and the Annual Activity Reports.

## The strategic planning and programming cycle



	2002			2003												2004						
	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	
<b>APS</b> - Orientation debate - APS circular - Services' answers to the circular - CIS Draft APS - Adoption of APS			•	•	•											•	•					
<b>Budgetary procedure</b> - PDB circular - Services' answers to the circular - Hearings - Draft PDB - Adoption of PDB - Adoption of Budget					•	•	•	•							•		•	•	•			
<b>APS ±</b> - Dialogue EP / Council - Request for contributions - Contributions - CIS Draft APS + - Adoption of APS +						•	•	•	•	•	•							•	•	•	•	•
<b>Work Programme</b> - CWP circular - Services answers to the circular - CIS CWP - Adoption of CWP										•	•	•	•									
<b>Annual Mat Plan</b> - AMP circular - AMP preparation - AMP finalisation																						•
<b>Annual Activity Report</b> - AAR circular - AAR preparation - AAR finalisation - CIS AAR Synthesis - Adoption of AAR Synthesis			•												•							•

## Annex

### **Guidelines on the declaration of the Authorising Officer by Delegation and his/her reservations in the annual activity report**

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## 1. INTRODUCTION

The content and scope of the annual activity reports (hereinafter called 'annual reports') and declarations, as well as the related procedures, were set out for the first time in two **Communications** (SEC(2001)875/6 and SEC(2001)1197/6&7) adopted by the Commission. Working on the basis of specifications laid down in the above Communications and internal guidelines addressed to Directors-General on 8 April 2002, a first cycle of annual reports was carried out in 2002 for 2001. The Commission adopted a Synthesis of the Annual Reports of its Directors-General on 24 July 2002, which was transmitted to Parliament and Council together with the annual reports concerned. This Synthesis contains an action plan containing specific provision for the methodology for preparing annual reports to be clarified (Action 10).

In accordance with the **Charter for authorising officers by delegation (AODs)**, each Director-General or Head of Service has to report annually on the activity of his/her Directorate-General or Service and the management of its resources. This obligation takes the form of a report and a declaration.

In line with Action 10 of the Synthesis of annual reports for 2001<sup>7</sup> and with the Communication on “The 2002 review of the implementation of activity-based management in the Commission, including clarification of the methodology for the establishment of Annual Activity Reports”, these **guidelines**<sup>8</sup> aim to:

- promote a common understanding of the founding elements of the declaration;
- clarify the scope and use of reservations;
- define materiality;
- outline certain specific cases.

## 2. THE FOUNDING ELEMENTS OF THE DECLARATION

### 2.1. Scope and content

In terms of **scope**, the declaration covers a narrower area than the Annual Report.

The overall objective of the **Annual Report** is for the Director-General to report on the policies for which (s)he is responsible and on the achievement of the policy objectives set in relation to the political priorities and key initiatives targeted by the Commission. It also takes in other core activities assigned to the DG or service concerned. It is therefore an assessment of the policy results achieved by the service

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<sup>7</sup> Action 10: the Secretariat-General, acting in conjunction with DG for Budget, DG for Personnel and Administration and the Internal Audit Service, will review and enhance before the end of 2002 the methodology and guidance for producing the Annual Reports for 2002, paying particular attention to the question of materiality, to the definition of the scope of potential reservations to be included in the accompanying declarations and to the handling of cross delegations.

<sup>8</sup> These Guidelines also apply to the management of the European Development Fund.

with the resources allocated. In this respect it is a mirror image of the Management Plan of the service, since it reports on the delivery of the objectives and activities identified in the Management Plans with the resources allocated to the service. In a separate chapter, the Director-General reports on specific control and the risk environment faced and on the progress made in implementing sound systems of internal control which are in line with the requirements of the Commission-wide internal control standards. The report also includes the relevant accounts.

The declaration annexed to the Annual Report is an expression of the responsibilities conferred under the Charter to maintain the internal control systems necessary to provide reasonable assurance as to the legality and regularity of transactions, and the achievement of sound financial management and use of the allocated resources for their intended purposes. The declaration therefore represents an explicit demonstration of the personal responsibility and liability for the management of the resources at his/her disposal.

In reviewing the evidence to support this declaration, the Authorising Officer by delegation may discover organisational shortcomings or internal control weaknesses within the service concerned. In such cases, (s)he may express a reservation, in order to inform the Commission of the problem and indicate the measures and timeframe planned to resolve it. Non-achievement of the political objectives assigned to the service and not linked to sound financial management should not be expressed by a reservation, but could take the form of a specific observation in the body of the annual report.

In the declaration the Director General or Head of Service signs following the standard text in the annex, s/he shall

- declare that the information contained in his/her report give a true and fair view (the concept of true and fair view is a term which has a precise meaning for the accounting and auditing professions. In the context of the Annual activity reports, it means that the contents of the annual report give a reliable, complete (no material omissions) and correct view of the state of affairs in the service);
- state that (s)he has reasonable assurance that the resources assigned to the activities described in this report have been used for their intended purpose and in accordance with the principles of sound financial management, and that the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions;
- confirm that (s)he is not aware of any matter not reported in the declaration which could harm the interests of the institution.

Directors-Generals or Heads of Services will be able to base their declarations on their knowledge of activities and staff and on all the elements at their disposal and in particular on the results of the **self-assessment** exercise, internal controls conducted on an ex-ante and ex-post basis, including ongoing work of the **internal audit capability**, observations by the **Internal Audit Service, Financial Control** and OLAF, and any lessons which could be learnt from the reports of the **Court of Auditors**. In taking into account this information Directors-General should pay particular attention to the elements of the internal control system (and any relevant reviews thereof) which have been specifically designed, implemented and used to



provide management assurance on the use of resources, sound financial management and legality and regularity of transactions.

## 2.2. Reservations

During the first annual reporting exercise, a certain amount of confusion was created by the fact that a large number of reservations were entered which did not correspond to the scope and definition set out below, but were general remarks to highlight general risks in the functioning of the service, its environment, or the policy objectives assigned to it, which were not technically meant to describe deficiencies qualifying the declaration. Often the terms “observation”, “qualification” and “reservation” were used and considered as equivalent, in the sense that they accompany the declaration.

A deficiency could be:

- a weakness in the design or operation of the internal control structure,
- a shortcoming in the achievement of sound financial management,
- failure to comply with the principles of legality and regularity,
- a risk which is not sufficiently addressed though appropriate mitigating controls, or
- an error or omission in the financial statements.

In order to have a common understanding of the basic concept of reservation, only material deficiencies as defined below should be subject to a reservation mentioned in the declaration. Non-manageable risks and **non-material** (see below) observations should be clearly expressed, if necessary, in the body of the annual report, and identifiable as such in the text.

**An internal control deficiency does therefore not necessarily imply a reservation. Not every deficiency is significant enough to warrant a separate disclosure.**

In making this judgement the Director-General should have in mind the responsibilities given to him/her and for which (s)he is accountable. They should also take into account the fact that the Annual Activity Report, the declaration and accompanying financial information are addressed to the Commission. One should expect to have a reasonable degree of assurance as to the accuracy of the information presented, but the nature of internal control systems means that it is unreasonable to expect absolute precision and no system can provide absolute certainty against the risk of error or misappropriation of resources.

Deficiencies which, because of their magnitude or significance, either in terms of quantity, particular nature or context (or all three), should be subject to separate disclosure in the form of a reservation in the declaration are said to be **material**. Only material deficiencies should be included as reservations in order to ensure that the declaration remains meaningful. A deficiency is therefore considered to be material if it is probable that the judgement of a reasonable person relying upon the

declaration and any related information would have been changed or influenced by disclosing the problem in question. Similarly, a deficiency is material if its omission would have the same effect.

The key question, therefore, is how to determine materiality.

### 2.3. The concept of materiality

Whether a deficiency is material or not can be considered in quantitative and/or qualitative terms, but it should always be seen in the context of the situation which gave rise to that deficiency, whether this be a weakness in the design and functioning of internal control, sound financial management, specific risks or known errors or omissions.

Deficiencies can also be material by nature and/or context. A deficiency which is material **by nature** is concerned with inherent characteristics rather than just its monetary value (e.g. reputational risk). Although it may not be material by nature or amount, a deficiency may be material **by context** because of the circumstances in which it arises.

Determining **quantitative levels of materiality** requires the AOD to consider the level at which a deficiency in monetary terms should be reported as a separate disclosure in the declaration. Using quantitative thresholds aids the reporting process in determining the most important issues and provides the information on which to base decisions.

A deficiency may be **presumed** to be material when it falls under the following categories:

- if it concerns the non-implementation of one or more internal control standards;
- if it affects or is likely to affect the Commission's reputation;
- if it concerns a critical or important issue raised by the European Court of Auditors, or in the finalised audits of the Internal Audit Service;

The quantitative materiality threshold is 2%, i.e. when the amount of the transaction (in the broad sense) affected by the deficiency represents more than 2% of the budget allocated to the ABB activity of the service concerned.

DGs and Services may decide to deviate from this threshold if they deem that the nature of the risks and controls, based on the DG's assessment of the risk and control environment in which the DG/Service operates, makes the standard threshold inappropriate. In such circumstances, the specific thresholds established should be justified and documented in the Annual Activity Report.

However, it should be emphasised that the above criteria are only indicative. They aim at assisting Directors-General in reaching a final judgement on what is material in the specific circumstances of their own service. **Directors-General may decide to depart from the above guidelines** where a different level of materiality is more appropriate according to the specific circumstances of the service concerned. They should explain in the report the level of materiality applied for their declaration.

All material deficiencies will be presented in the annual report and disclosed in the declaration, by reference to the relevant section(s) of the annual report. When a deficiency is considered for disclosure but discarded as not being material, the authorising officer by delegation should ensure that his/her service retains all documentation relevant to it.

#### **2.4. Requirements for making and reporting reservations**

Reservations should be reported in the following format:

- specific in terms of their cause (internal control system deficiency, specific risk, etc.) and what part of the declaration they affect (legality and regularity, sound financial management, use of resources);
- quantifiable in terms of monetary amounts or scope;
- including a brief assessment of the potential impact, for example, in terms of the operations of the DG/Service, accuracy of the financial information, etc., and potential impact on the assurances provided in the declaration itself;
- including brief details of corrective action planned to deal with the issue raised and the prospective timescales.

**The use of reservations should be limited to material deficiencies which directly impact on the wording of the declaration itself and which the Director-General believes would influence the users of the information.**

As regards the timeline for corrective actions, where the deficiency cannot be corrected before the next annual report, the reservation should be repeated and progress reported.

Reservations should not make the declaration meaningless. In extreme circumstances, it is quite possible that the Director-General may not be able to give the assurance required by the declaration.

### **3. PROCEDURAL ISSUES**

#### **3.1. Procedure concerning the lodging of reservations/Reservations concerning the functioning of another service**

If a Director-General/Head of Service wants to express a reservation on material weaknesses in his/her internal control systems caused by another DG or Service, (s)he may do so, but (s)he has to report this to the other DG at least one month before finalising his/her report, within the context of the peer review procedure. In this case, it is important to organise a dialogue between the parties concerned and to focus on common action plans to be proposed to the Commission.

#### **3.2. Change of Director-General**

The person responsible for preparing the annual report and signing the declaration for year *n* in the case of a change of Director-General should be the Director-General in office at the time the annual report has to be finalised and the declaration signed

(April of year  $n+1$ ). The need to ensure the continuity of the service between the outgoing and the incoming Director-General means that the successor has to endorse all the responsibilities and tasks of his/her new function.

The Charter on the mission and responsibilities of the authorising officer by delegation does not provide for any exception to this principle. Moreover, the carryover should allow the successor to obtain all the information needed to prepare the report and sign the declaration. This, obviously, does not affect the scope of the respective responsibilities of both Directors-General, as set out in the Staff Regulations, the rules of the Financial Regulation and the Charter<sup>9</sup>.

The Director-General who signs the annual report will receive a “testament” (internal, for the use of his/her successor) from his/her predecessor (including “acting” Directors-General), in which the latter reports on his/her management for the part of the year when (s)he was in charge. His/her successor then has the right to comment on the situation left by his/her predecessor in the annual report that (s)he subsequently signs.

The report of the outgoing Director-General should include, in particular, the following elements:

- a description of achievements against objectives (see annual management plan);
- a description of the measures taken to ensure the proper handover of documentation and information on political, operational, financial and organisational issues, including internal controls and, as appropriate, an accounting annex with the level of execution of commitments and payments, in order to ensure the continuity of activities and identify potential problems;
- indication of problems, existing or potential, that could give rise to a reservation in the next annual report and measures taken or proposed to solve the problems identified.

A draft of the report should be addressed by the outgoing Director-General to the incoming Director-General in good time before the change takes place. A dialogue should be conducted between both Directors-General to avoid any misunderstanding and lack of clarity of the information transmitted. The report should be communicated to the Commissioner before the change of Director-General takes place.

Finally, the Synthesis of annual reports for 2001 provides that Commissioners can ask the Director-General to present his/her activity report to the Parliamentary Committee concerned. Here again the principle which should prevail is that of the continuity of the service. Therefore, at the request of the Commissioner responsible, the Director-General in charge of a service when Parliament examines the Synthesis report should present the annual report relating to the previous year, whether or not (s)he was responsible for this service during that year.

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<sup>9</sup> See Annex 1 to the Memorandum to the Commission on the annual report and declaration - SEC(2001)875/6 of 27 June 2001.

### **3.3. Sub-delegation to an AOD**

This section only refers to sub-delegations between AODs<sup>10</sup>.

- The delegating AOD and the authorising officer by sub-delegation sign an understanding which contains the instructions given by the former on the frequency of reports and controls to be carried out by the latter.
- The authorising officer by sub-delegation informs the AOD in writing of the likely reservations and solutions that (s)he proposes to apply to the management of the sub-delegated funds.
- The declaration of the authorising officer by delegation covers the sub-delegated funds and, if need be, (s)he expresses any reservations (and solutions) that seem appropriate to him/her on the basis of the reporting of the authorising officer by sub-delegation.
- Where the authorising officer by sub-delegation does not meet his/her obligation to report on the management of the sub-delegated funds, (s)he will retain full responsibility for this breach of the understanding and the authorising officer by delegation will clearly indicate this in his/her declaration.

### **3.4. Budget execution of shared or decentralised managed activities**

Whilst the key principles referred to above with regard to making reservations apply to most aspects of the budget, it is clear that the part of the budget dealing with shared management and/or decentralised arrangements warrants special attention in order to reflect the particular control and risk issues faced when responsibilities are shared between the Commission and third parties.

For operations carried out under shared or decentralised management<sup>11</sup>, the Charter for Authorising Officers by Delegation requires the annual report to contain a description of measures taken by the Authorising Officer by delegation to:

- determine to what extent the beneficiary States have put in place appropriate management and control systems and to what extent these systems give satisfactory assurance as to the regularity of the underlying operations in terms of the law applicable;
- check the accuracy of the amounts declared;
- make financial corrections where the beneficiary State's control procedures have proved inadequate.

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<sup>10</sup> It is recalled that this section is based on the contents of the Charter of Authorising Officers by Sub-delegation.

<sup>11</sup> It has to be noted that budgetary support in the context of external aid is a form of centralised management.

From the user's perspective it is essential for the nature of the control and risk environment to be conveyed clearly in the body of the main report in order for them to fully understand the context of any reservations made by the Director-General. The particular concerns expressed by the Court of Auditors in respect of the annual reports and declarations made for 2001 related to inconsistencies and ambiguities concerning shared and decentralised management issues and need to be addressed. The Court felt it was not always clear what the declaration covered in terms of responsibilities, citing certain services with shared management arrangements where the declaration appeared to cover the whole of the budget whereas the annual report itself focused mainly on issues more directly under its control.

Directors-General should expand and clarify in the body of their annual reports the nature of those responsibilities and ensure that the declaration is free of any ambiguities. To this effect, Directors-General should, in the report itself, set out:

- the nature and extent (monetary amounts) of the activities covered under shared management and/or decentralised arrangements;
- the basis for establishing the control framework and the allocation of responsibilities, i.e. brief outline of the decision-making processes, including the legal basis, used by the Commission and third parties to establish that framework;
- a summary of the key responsibilities and tasks exercised by both the Commission and relevant third parties;
- a summary of the details of the control framework third parties have to abide by and the supervision arrangements established by the Commission.

When making reservations Directors-General should apply the requirements as outlined in Paragraph 2.4 above, i.e. state the cause, quantify the scope, assess the impact and outline corrective action already undertaken or planned. To ensure that the user fully understands the reservation, the Director-General should, in addition:

- state where the operational responsibility for the weakness lies, either with the Director-General's service, Member States or third countries - (or combinations of these);
- for each weakness, state the amounts involved, and specifically, the amounts impacted by the control weaknesses, and for which a Commission decision on exclusion of financing is being prepared but has not yet been taken;
- disclose the amounts paid over the years to give an indication as to the level of uncertainty on the regularity and legality of the underlying transactions, in those cases where Community funds have started to flow, although Member States and third countries have not yet implemented the control framework for the management of Community funds or, though such a framework exists, it has not yet been reviewed by the Director-General's services. This disclosure corresponds systematically to a reservation;

- make an estimate of the amounts not covered by the declaration on legality and regularity of the underlying transactions, in cases where the Director-General's service did review the control framework, but where supervision has not been performed in full or where the potential financial exclusion has not yet been assessed. This also requires a reservation;
- assess the coherence, in the light of the extent and scope of the reservations made, between those reservations and the assurances contained in the declaration.

**ANNEX 1: TEXT OF THE DECLARATION IN ENGLISH AND FRENCH**

I, the undersigned,

Director-General of  
Head of Service of

In my capacity as authorising officer by delegation

Declare that the information contained in this report gives a true and fair view<sup>1</sup>.

State that I have reasonable assurance that the resources assigned to the activities described in this report have been used for their intended purpose and in accordance with the principles of sound financial management, and that the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions.

This reasonable assurance is based on my own judgement and on the information at my disposal, such as the results of the self-assessment, *ex post* controls, the work of the internal audit capability, the observations of the Internal Audit Service<sup>2</sup> and Financial Control<sup>2</sup> and the lessons learnt from the reports of the Court of Auditors<sup>2</sup> for years prior to the year of this declaration.

Confirm that I am not aware of anything not reported here which could harm the interests of the institution.

However the following reservations should be noted:

*[where appropriate*

*the authorising officer by delegation could, by way of reservations, note any particular risks which may have been run in using appropriations, or report any malfunctions; in this case an indication should be given of remedial measures taken or planned by the authorising officer by delegation].*

Place ....., date .....

.....(signature)

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<sup>1</sup> True and fair in this context means a reliable, complete and correct view on the state of affairs in the service.

<sup>2</sup> Delete if not applicable



**Modèle de déclaration de l'ordonnateur délégué  
couvrant le rapport d'activité annuel à partir de 2002**

Je soussigné

Directeur général de  
Chef de Service de

en ma qualité d'ordonnateur délégué

Déclare par la présente que les informations contenues dans le présent rapport sont sincères et véritables<sup>1</sup>.

Affirme avoir une assurance raisonnable que les ressources allouées aux activités décrites dans le présent rapport ont été utilisées aux fins prévues et conformément au principe de bonne gestion financière et que les procédures de contrôle mises en place donnent les garanties nécessaires quant à la légalité et la régularité des opérations sous-jacentes.

Cette assurance raisonnable se fonde sur mon propre jugement et sur les éléments d'information à ma disposition, comme, par exemple, les résultats de l'auto-évaluation, des contrôles ex post, des travaux de "l'internal audit capability", des observations du Service d'audit interne<sup>2</sup> et du Contrôle financier<sup>2</sup> ainsi que des enseignements retirés des rapports de la Cour des comptes<sup>2</sup> relatifs aux exercices antérieurs à celui de cette déclaration

Confirme en outre n'avoir connaissance d'aucun fait non signalé pouvant nuire aux intérêts de l'institution.

Toutefois les réserves suivantes doivent être relevées :

*[le cas échéant.*

L'ordonnateur délégué pourra au titre des réserves relever notamment les risques particuliers auxquels l'exécution de ses crédits auront été exposés, ou relever des dysfonctionnements; dans ce cas, elles doivent être accompagnées de l'indication des mesures prises ou envisagées par l'ordonnateur délégué pour y remédier].

Fait à ....., le .....(signature)

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<sup>1</sup> Sincère et véritable dans ce contexte signifie une vue fiable, complète et correcte de l'état des affaires dans le service.

<sup>2</sup> Supprimer si non applicable

## ANNEX 2: TERMINOLOGY

In order to avoid any misunderstanding with the DAS approach of the Court of Auditors, it is proposed that the declaration should be known as the “**declaration of the Authorising Officer by delegation**”.

**Legality** addresses the issue of compliance with the regulations in force. **Regularity** means compliance with internal procedures, guidelines and standards of behaviour. The principle of **sound financial management** corresponds to the principles of economy, efficiency and effectiveness. According to the definition quoted in the new financial regulation, the principle of economy requires that the resources used by the Institution to engage in its activities must be made available in good time, in appropriate quantity and quality and at the best cost. The principle of efficiency is concerned with the relationship between resources employed and results achieved, while the principle of effectiveness is concerned with attaining the specific objectives set and the intended results, using the available resources.

**The self-assessment** reflects, as felt by the management of the DG, the level of compliance of the internal control systems with the standards in place for the period concerned. In addition, it allows weaknesses of the internal control systems to be identified, taking into account the properties of the DGs' transactions and environment. Finally, management assessment helps to identify the major risk areas for the sound functioning of the Directorate-General/Service.

**Internal audit** is defined as the unit or service that provides independent, objective assurance and consulting services designed to add value to and improve on an organisation's operations. The internal audit activity helps an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.