

# Official Journal

## of the European Union

C 269



English edition

### Information and Notices

Volume 52

10 November 2009

| <u>Notice No</u> | <u>Contents</u>  | <u>Page</u> |
|------------------|--|-------------|
|                  | IV <i>Notices</i>  |             |
|                  | NOTICES FROM EUROPEAN UNION INSTITUTIONS AND BODIES  |             |
|                  | <b>Court of Auditors</b>   |             |
| 2009/C 269/01    | Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2008, together with the institutions' replies .....   | 1           |
| 2009/C 269/02    | Annual Report of the Court of Auditors on the activities funded by the seventh, eighth, ninth and tenth European Development Funds (EDFs) concerning the financial year 2008, together with the Commission's replies ..... | 257         |

EN

Price:  
EUR 9



## 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 last amended by Council Regulation (EC) No 1525/2007 of 17 December 2007 and Articles 139 and 156 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund

**the Court of Auditors of the European Communities, at its meeting of 24 September 2009, adopted its  
ANNUAL REPORTS  
concerning the financial year 2008.**

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

The Members of the Court of Auditors are:

Vítor Manuel da SILVA CALDEIRA (President), Hubert WEBER, Maarten B. ENGWIRDA, Máire GEOGHEGAN-QUINN, David BOSTOCK, Morten Louis LEVYSOHN, Ioannis SARMAS, Július MOLNÁR, Vojko Anton ANTONČIČ, Gejza HALÁSZ, Jacek UCZKIEWICZ, Josef BONNICI, Irena PETRUŠKEVIČIENĚ, Igors LUDBORŽS, Jan KINŠT, Kersti KALJULOID, Kikis KAZAMIAS, Massimo VARI, Juan RAMALLO MASSANET, Olavi ALA-NISSILÄ, Lars HEIKENSTEN, Karel PINXTEN, Ovidiu ISPIR, Nadejda SANDOLOVA, Michel CRETIN, Harald NOACK, Henri GRETHEN.



ANNUAL REPORT ON THE  
IMPLEMENTATION OF THE BUDGET

(2009/C 269/01)



## TABLE OF CONTENTS

|  | <i>Page</i> |
|--|-------------|
| General introduction .....   | 7           |
| Chapter 1 — The Statement of Assurance and supporting information .....                                | 9           |
| Chapter 2 — Commission internal control system .....   | 37          |
| Chapter 3 — Budgetary management .....   | 63          |
| Chapter 4 — Revenue .....  | 71          |
| Chapter 5 — Agriculture and natural resources .....  | 87          |
| Chapter 6 — Cohesion .....   | 121         |
| Chapter 7 — Research, energy and transport .....   | 139         |
| Chapter 8 — External aid, development and enlargement .....  | 157         |
| Chapter 9 — Education and citizenship .....  | 175         |
| Chapter 10 — Economic and financial affairs .....  | 193         |
| Chapter 11 — Administrative and other expenditure .....  | 213         |
| Annex I — Financial information on the general budget .....  | 231         |
| Annex II — List of Special Reports adopted by the Court of Auditors since the last Annual Report ..... | 255         |





## GENERAL INTRODUCTION

0.1. The European Court of Auditors is the EU institution established by the Treaty to carry out the audit of EU finances. As the EU's external auditor it contributes to improving EU financial management and acts as the independent guardian of the financial interests of the citizens of the Union. More information about the Court can be found in its annual activity report which, together with its special reports on specific subjects and its opinions on new or amended legislation, are available on the Court's website: [www.eca.europa.eu](http://www.eca.europa.eu)

0.2. This document covers the financial year 2008 and comprises the Court's 32nd Annual Report on the implementation of the general budget of the European Union. The replies of the Commission — or other EU institutions and bodies, where appropriate — are presented with the report. A separate annual report covers the European Development Funds.

0.3. The general budget of the EU is decided annually by the Council and the European Parliament. The Court's Annual Report provides a basis for the discharge procedure which brings the annual budgetary process to an end. A central part of this report is the Court's Statement of Assurance on the reliability of the annual accounts of the European Communities and on the legality and regularity of the transactions underlying them.

0.4. The expenditure from the Commission's section of the budget is divided into 23 titles covering the different policy areas. The policy areas constitute the way the Union's activities are planned and recorded, and those responsible for each area are held accountable for their management of the funds spent. EU spending is planned in 7-year cycles (financial frameworks), under six distinct headings. Policy areas relate mainly to individual headings, but some relate to several. The Court's report is organised around groups of policy areas as outlined in **Table 1.2** (23 titles for expenditure, 1 title for revenue and 9 sections for administrative expenditure). These correspond closely, but not entirely, to the 2007-2013 financial framework headings.

0.5. Chapter 1 of the report includes the Statement of Assurance and supporting information. Chapter 2 reports on the Commission's internal control system and Chapter 3 covers the Commission's management of the 2008 budget. The remaining Chapters — 4 to 11 — provide detailed audit findings in the form of specific assessments on Community revenue and the different areas of expenditure.

0.6. The specific assessments are mainly based on the results of the Court's testing of the regularity of transactions as well as on an assessment of the effectiveness of the principal supervisory and control systems governing the revenue or expenditure involved. The conclusions of this work form the basis for the Statement of Assurance.



## CHAPTER 1

**The Statement of Assurance and supporting information**

## TABLE OF CONTENTS

|  | <i>Paragraph</i> |
|--|------------------|
| The Court's Statement of Assurance provided to the European Parliament and the Council | I-XIII           |
| Opinion on the reliability of the accounts   | VII-VIII         |
| Opinion on the legality and regularity of the transactions underlying the accounts     | IX-XIII          |
| Information in support of the Statement of Assurance                                   | 1.1-1.49         |
| Introduction   | 1.1-1.3          |
| Reliability of the accounts  | 1.4-1.19         |
| General background   | 1.4-1.5          |
| Audit scope and approach   | 1.6              |
| Steps taken to strengthen the accruals based accounting system                         | 1.7-1.11         |
| Consolidated financial statements as at 31 December 2008                               | 1.12-1.15        |
| Other issues   | 1.16-1.18        |
| Conclusion   | 1.19             |
| Regularity of the transactions underlying the accounts                                 | 1.20-1.49        |
| Structure of the DAS specific assessments  | 1.20             |
| Explaining the DAS approach and results  | 1.21-1.31        |
| General overview of audit results 2008   | 1.32-1.38        |
| How to address weaknesses  | 1.39-1.49        |

## 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 'Annual Accounts of the European Communities' which comprise the 'Consolidated financial statements' <sup>(1)</sup> and the 'Consolidated reports on implementation of the budget' <sup>(2)</sup> for the financial year ended 31 December 2008; and
- (b) the legality and regularity of the transactions underlying those accounts.

**Management's responsibility**

II. In accordance with Articles 268 to 280 of the Treaty and the Financial Regulation, management <sup>(3)</sup> is responsible for the preparation and fair presentation of the 'Annual Accounts of the European Communities' and the legality and regularity of the transactions underlying them:

- (a) Management's responsibility in respect of the '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 <sup>(4)</sup>; and making accounting estimates that are reasonable in the circumstances. According to Article 129 of the Financial Regulation, the Commission approves the '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 <sup>(5)</sup> and bodies <sup>(6)</sup> and established a note, accompanying the consolidated accounts, declaring, *inter alia*, that he has reasonable assurance that they present a true and fair view of the financial position of the European Communities in all material aspects.
- (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).

<sup>(1)</sup> The 'Consolidated Financial Statements' comprise the balance sheet, the economic outturn account, the cash flow table, the statement of changes in net assets and a summary of significant accounting policies and other explanatory notes (including segment reporting).

<sup>(2)</sup> 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.

<sup>(3)</sup> 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.

<sup>(4)</sup> 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 2008 financial year are prepared (as they have been since the 2005 financial year) 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 cash movements.

<sup>(5)</sup> Before the adoption of the 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).

<sup>(6)</sup> The 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).

**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. The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions, 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 'Annual Accounts of the European Communities' are free from material misstatement and the transactions underlying them are legal and regular.

IV. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated accounts and the legality and the regularity of the transactions underlying them. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the 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 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 also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made, as well as evaluating the overall presentation of the consolidated accounts and the annual activity reports.

V. In the context of 'Revenue', the Court's audit of Value Added Tax (VAT)- and Gross National Income (GNI)-based own resources takes as its starting point the receipt by the Commission of the macroeconomic aggregates prepared by the Member States, and then assesses the Commission's systems for processing the data until they are included in the final accounts and the contributions by the Member States have been received. For traditional own resources, the Court examines the accounts of the customs authorities and analyses the flow of duties under custom surveillance until the amounts are recorded in the final accounts and received by the Commission.

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, the 'Annual Accounts of the European Communities' present fairly, in all material respects, the financial position of the Communities as of 31 December 2008, 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. Without calling into question the opinion expressed in paragraph VII, the Court notes that weaknesses in the accounting systems, which are partly due to the complex legal and financial framework, still put at risk the quality of financial information of certain Directorates-General of the Commission (in particular for pre-financing, the related cut-off and for invoices/cost claims) as well as for the fixed assets of the European Satellite Programme Galileo.

**Opinion on the legality and regularity of the transactions underlying the accounts**

IX. In the Court's opinion, 'Revenue', commitments for all policy groups and payments underlying the accounts for the year ended 31 December 2008 for the policy groups 'Education and Citizenship' and 'Administrative and other expenditure' in all material respects are legal and regular.

X. In the Court's opinion,

- (a) payments underlying the accounts for the year ended 31 December 2008 for the policy group 'Agriculture and natural resources', except for Rural Development, in all material respects are legal and regular. For this policy group, the integrated administrative and control system (IACS) generally continues to be effective. Issues need to be addressed in certain areas, in particular for Rural Development, for limiting the risk of irregular expenditure; and
- (b) payments underlying the accounts for the year ended 31 December 2008 for the policy group 'Economic and financial affairs', except for the Sixth Framework Programme for research and technological development (FP6) expenditure in this policy group, in all material respects are legal and regular. For this policy group, the supervisory and control systems in the policy area 'Enterprise', mostly due to weaknesses concerning FP6, are partially effective in preventing or detecting and correcting errors.

XI. In the Court's opinion, payments underlying the accounts for the year ended 31 December 2008 for the policy groups 'Cohesion', 'Research, energy and transport' and 'External aid, development and enlargement' are materially affected by error, although to different levels. For the above policy groups, except 'Cohesion', supervisory and control systems are partially effective in preventing or detecting and correcting the reimbursement of overstated or ineligible costs. For the policy group 'Cohesion', Member States' systems for correcting errors found by national controls are, in most cases, at least partially effective.

XII. The Court reiterates that complicated or unclear legal requirements (such as eligibility rules) have a significant impact on legality and regularity of transactions underlying the expenditure in the policy groups of 'Agriculture and natural resources', in particular Rural Development, 'Cohesion', 'Research, energy and transport' and 'Economic and financial affairs', in particular for FP6 spending.

XIII. The Court notes further progress in the Commission's supervisory and control systems, in particular concerning the impact of the reservations on the assurance given in the declarations by the Directors-General; and a greater consistency of these declarations with the Court's findings. However, the Court notes that the Commission is not yet able to demonstrate that its actions to improve supervisory and control systems have been effective in mitigating the risk of error in the policy groups and activities mentioned in paragraphs X and XI.

24 September 2009

Vítor Manuel da Silva Caldeira

*President*

European Court of Auditors

12, rue Alcide De Gasperi, L-1615 Luxembourg

## 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 EU activity.

1.2. The aim of the work on the reliability of the accounts of the European Communities is to obtain sufficient appropriate evidence to conclude on the extent to which revenue, expenditure, assets and liabilities have been properly recorded and that the annual accounts provide a true and fair view of the financial position as of 31 December 2008, and the results of their operations and cash flows for the year then ended (see paragraphs 1.4 to 1.18).

1.3. The objective of the Court's audit work on the regularity <sup>(?)</sup> of the transactions underlying the 2008 accounts is to gather sufficient appropriate evidence on which to base its opinion on whether they are in accordance with the applicable regulations or contractual provisions, and have been correctly calculated. See paragraphs 1.20 to 1.49 of this chapter for general issues and a summary of the results, and chapters 2 and 4 to 11 for details in the form of specific assessments.

---

<sup>(?)</sup> For the sake of brevity, the term 'regularity of transactions' is used throughout the report to denote 'legality and regularity of underlying transactions'.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

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

1.4. The Court's observations concern the annual accounts for the financial year 2008, 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<sup>(8)</sup> and received by the Court on 29 July 2009. 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 as well as the economic outturn account - and the 'consolidated reports on the implementation of the budget' - covering the revenue and expenditure for the year.

1.5. The Commission's Accounting Officer provided the Court with a representation letter confirming that the consolidated accounts are complete and reliable (see however paragraph 1.9) and that most of the Commission's local systems have been validated (see however paragraph 1.10).

***Audit scope and approach***

1.6. In its audit of the 2008 accounts the Court concentrated on the following elements:

- assessment of whether measures taken to remedy weaknesses identified in the accounting systems of certain Directorates-General<sup>(9)</sup> and decentralised bodies have contributed to improve the reliability of the accounts;
- verification of the reliability of the 2008 accounts, in particular on elements to which the Court drew attention in its opinion on the 2007 accounts<sup>(10)</sup> (pre-financings, the related cut-off, invoices/cost claims and assets held by the European Space Agency in the context of the Galileo programme<sup>(11)</sup>).

<sup>(8)</sup> Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p. 1), last amended by Regulation (EC) No 1525/2007 of 17 December 2007, (OJ L 343, 27.12.2007, p. 9) requires that the final accounts shall be sent before 31 July of the following financial year.

<sup>(9)</sup> See paragraph VIII of the Court's Statement of Assurance concerning the financial year 2007.

<sup>(10)</sup> See paragraph VIII of the Court's Statement of Assurance concerning the financial year 2007.

<sup>(11)</sup> The Galileo programme aims to develop and to operate a Global Navigation Satellite System.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Steps taken to strengthen the accruals based accounting system**

1.7. The measures introduced by the Commission's Accounting Officer in 2007 <sup>(12)</sup> to improve the accounting control environment at the level of individual Directorates-General also had an impact in 2008 and have contributed to a strengthening of the financial reporting framework and accounting systems. However, certain weaknesses still exist which need to be addressed so as to ensure the quality of accounting data (see paragraphs 1.10 and 1.11).

1.8. **Table 1.1** summarises and comments on the Commission's response to the Court's observations concerning the reliability of the 2007 accounts as well as the other points raised by the Court.

*Limitation presented in the management representation letter concerning the consolidated accounts*

1.9. The Commission's Accounting Officer highlighted in his management representation letter that less than half of the institutions and agencies had provided information about the validation of their accounting systems in their own management representations.

1.7. *The Commission welcomes the Court's acknowledgement of the progress made and accepts that some improvements are still necessary. Therefore, its accounting services will continue to address the issues raised and monitor the accounting work of the Directorates-General so as to improve the accuracy of the basic accounting data, for example through initiatives such as the ongoing accounting quality project.*

<sup>(12)</sup> See paragraph 1.10 of the Annual Report concerning the financial year 2007.

**Table 1.1 — Follow-up of the observations expressed in the Statement of Assurance concerning the financial year 2007 as to the reliability of the accounts and other observations made in the Annual Report concerning the financial year 2007**

| Observations in the Statement of Assurance concerning the financial year 2007   | Commission's replies in the Annual Report concerning the financial year 2007   | Developments in 2008   | Commission's replies   |
|---|--|--|--|
| <p>Due in part to the complex legal and financial framework, and despite improvements made, weaknesses in the accounting systems still put at risk the quality of the financial information of certain Directorates-General of the Commission. This is in particular the case for pre-financings, the related cut-off, for invoices/cost statements and for assets held by the European Space Agency in the context of the Galileo programme. This led to a number of corrections after the presentation of the provisional accounts.</p> | <p>The Commission's Accounting Officer considered the accounting data to be sufficiently accurate for the final accounts.</p> <p>For the assets held by the European Space Agency, there is some uncertainty and delay in the transfer to the European Communities. It is intended that the assets will be recognised once these transfer issues have been resolved.</p> | <p>Weaknesses in the accounting systems of certain Directorates-General of the Commission still put at risk the quality of financial information, in particular for pre-financings, related cut-off and invoices/cost statements. Consequently, a limited number of corrections had to be made after the presentation of the provisional accounts.</p> <p>As for the assets held by the European Space Agency, the programme is still being considered in its research phase and therefore no assets are recognised so far. However, the Commission should obtain the necessary information in order to establish an inventory list, verify the recognition criteria and assess the valuation of assets.</p> | <p><i>The accounting services will continue to address the issues raised and monitor the accounting work of the Directorates-General so as to improve the accuracy of the basic accounting data.</i></p> <p><i>The Commission is currently working together with the European Space Agency (ESA) to ensure that the relevant assets of the Galileo Programme will be transferred to the Commission and properly recorded in the accounts at the appropriate time. The transfer of the assets of the Galileo programme from ESA to the Commission is not foreseen to begin until the end of 2010 at the earliest.</i></p> |
| <b>Other observations made in the context of the Annual Report concerning the financial year 2007</b>   |  |  |  |
| <p>The Commission's Accounting Officer was still not able to provide validation to two local systems nor to validate a third system without qualification. As in previous years, the horizontal issues and other matters outstanding were important.</p>  | <p>Work is still ongoing with the aim to reach validation for the two systems. The qualification for the third system has been removed in 2008.</p>  | <p>The Commission's Accounting Officer was still not able to provide validation to one of the local systems nor to validate a second system subject to validation in 2008. Despite a considerable reduction in the number of open issues, the nature and importance of the remaining horizontal concerns still represent a risk for the reliability of the accounts.</p>   |  |
| <p>Errors have been identified in amounts registered in the accounting system as pre-financings and invoices/cost statements. Although the level of error in terms of financial impact as regards these items of the balance sheet was low, the frequency of these errors underlines the need for further improvement of the accuracy of the basic accounting data at the level of the operational Directorates-General.</p>  |  | <p>The Court found a low level of error in terms of financial impact as regards these items of the balance sheet. However, the frequency of these errors underlines again the need for further improvement of the accuracy of the basic accounting data at the level of the operational Directorates-General.</p>  | <p><i>The Commission accepts the point made by the Court and its accounting services will continue to address the issues raised and monitor the accounting work of the Directorates-General so as to improve the accuracy of the basic accounting data, for example through initiatives such as the ongoing accounting quality project.</i></p>  |

| Observations in the Statement of Assurance concerning the financial year 2007   | Commission's replies in the Annual Report concerning the financial year 2007  | Developments in 2008   | Commission's replies   |
|---|---|--|--|
| <p>Despite the improvements noted, further measures are necessary in order to ensure completeness and reliability of the accounting data and information presented in the explanatory notes concerning the financial correction activities made by the Member States and deductions from subsequent payments.</p> | <p>Under the action plans for Structural Funds, the Commission is making efforts to improve the reliability and completeness of the information received from Member states, by, amongst other things, carrying out on-the-spot audits in Member States. The accounting system has been adapted during 2008 so that all recoveries made by deduction from a subsequent payment can be identified and explained.</p> | <p>Notwithstanding the Commission's efforts, the notes to the financial statements do still not contain complete and reliable accounting data on the financial correction activities made by the Member States, in particular in the area of Structural Actions.</p> | <p><i>The Commission is continuing its efforts to improve the reporting so that complete and reliable data may be reported by all Member States.</i></p> |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Validation of local financial management systems*

1.10. Many Directorates-General use their own local IT-systems for financial management purposes and for the creation of transactions which are sent to the central accounting system (ABAC) via an interface. Most of these systems have been validated<sup>(13)</sup> by the Commission's Accounting Officer. However, in his recommendations, the Commission's Accounting Officer identifies a number of open cross-cutting issues<sup>(14)</sup>, the nature and importance of which means that they could still represent a risk to the reliability of the accounts<sup>(15)</sup>.

*Strengthening of cut-off procedures*

1.11. 'Cut-off' refers to the relevant procedures for deciding to which financial year a transaction should be attributed. Such procedures have to be applied by the Commission services for all accrued charges (more than 100 billion euro). In the ten Directorates-General which it has examined<sup>(16)</sup>, representing more than 90 % of the accrued charges, the Court has noted continuous improvements over the last three years. However, it has to be noted that some services use the cut-off during the closure procedure to adjust erroneous accounts instead of correcting the related individual error prone accounting entries (e.g. booking of wrong amounts, double or omitted bookings). This may lead to inaccuracies in the accounting data during the year (see paragraphs 1.13 to 1.15).

**1.10.** *The Accounting Officer's services regularly follow-up with the Directorates-General in order to find solutions to identified problems. Thus in 2008 they were able to close half of the recommendations following the progress made by the services. The same follow-up continues in 2009 with the intention of closing more outstanding recommendations. This should help to improve the overall situation and thus reduce further the risk to the reliability of the accounts.*

**1.11.** *The Commission accepts the point made by the Court and its accounting services will continue to address the issues raised and monitor the accounting work of the Directorates-General so as to improve the accuracy of the basic accounting data, for example through initiatives such as the ongoing accounting quality project.*

<sup>(13)</sup> Not validated by the end of 2008 were the local systems of the Directorate-General for External Relations and the Directorate-General for Justice, Freedom and Security.

<sup>(14)</sup> The number of outstanding issues, covering four levels of importance established by the Accounting Officer of the Commission (Critical-Very Important-Important-Desirable) from validation reports from 2005-2007 had a significant reduction in the course of 2008, from 161 to 81. However of these 81, five issues were considered as 'Critical' and 23 issues as 'Very Important'.

<sup>(15)</sup> Notably general issues regarding cut-off procedures, clearing and recording of pre-financings, timeliness of transactions' posting, ABAC contracts, assets management, varying knowledge on accrual accounting principles across the services, data consistency between local systems and ABAC.

<sup>(16)</sup> Directorate-General for Agriculture and Rural Development, Directorate-General for the Information Society and Media, Directorate-General for Research, Directorate-General for Energy and Transport, Directorate-General for Health and Consumers, Directorate-General for Regional Policy, Directorate-General for Employment, Social Affairs and Equal Opportunities, EuropeAid Co-operation Office, Directorate-General for Enlargement as well as Directorate-General for Education and Culture.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Consolidated financial statements as at 31 December 2008**

1.12. The Court's audit of the consolidated financial statements found them to be free of material misstatement. However, a number of issues were identified concerning particular elements which require further attention, as presented below.

*Consolidated balance sheet as at 31 December 2008***Pre-financings**

1.13. The Court's audit of a representative statistical sample of 80 pre-financings registered in the accounting system identified a low level of error in terms of financial impact as regards this item of the balance sheet. However, the frequency of these findings underlines the need for further improvement of the accuracy of the basic accounting data at the level of the operational Directorates-General. The most common types of errors are:

- missing or double entries or wrong amounts, which are generally corrected by cut-off adjustments;
- booking transactions on the wrong General Ledger account.

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

- the clearing of outstanding pre-financings is not always carried out correctly. A number of clearings were not carried out at all or booked for incorrect amounts;
- Directorates-General apply different methods to clear pre-financings. Whilst most Directorates-General clear a pre-financing when receiving the related cost claims or invoices and after having verified the eligibility, other Directorates-General wait until the end of a programme or even until the final audit report is received<sup>(17)</sup>. The different and inappropriate clearing of the pre-financings lead to less accurate results for the cut-off calculation at year-end.

**1.13.** *The Commission accepts the points made by the Court and its accounting services will continue to address the issues raised and monitor the accounting work of the Directorates-General so as to improve the accuracy of the basic accounting data, for example through initiatives such as the ongoing accounting quality project.*

<sup>(17)</sup> In particular Directorate-General for Research in the field of research.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Accounts payable**

1.15. The audit of a representative statistical sample of 80 invoices/cost statements from the population of accounts payable registered in the accounting system identified a low level of error in terms of financial impact as regards this balance sheet item. However, the frequency of accounting errors underlines the need for further improvement of the reliability of the basic accounting data at the level of the operational Directorates-General. Most of the errors concern the booking of invoices when received (prior to the eligibility checks) for incorrect amounts and the correction of wrong entries through cut-off adjustments.

**Other issues***Recovery of undue payments*

1.16. Following a recommendation of the Court, more information concerning the recovery of undue payments has been presented in the notes to the financial statements. The Court's audit shows that the Commission is reporting reliable figures on financial corrections as far as they result from its own audit activities. However, Member States often do not provide the Commission with complete and reliable information on the financial corrections they are carrying out themselves (see paragraph 6.30). As a result of the high proportion of ineligible expenditure repeatedly indicated in the Courts Annual Reports, the Court considers that, in the area of Structural Actions, complete and reliable accounting data on these correction mechanisms at the Member State level should be presented in the notes to the consolidated accounts.

1.17. Based on the examination of the certifying bodies work and the Commission's analysis referring to this, the Court reiterates its doubt as regards the reliability of the receivables from Member States in the area of agriculture (EAGF debtors' accounts) <sup>(18)</sup>. The Commission underlined shortcomings with respect to the debtors' accounts for one quarter of the paying agencies <sup>(19)</sup> and has proposed financial corrections <sup>(20)</sup> amounting to some 25,3 million euro. These corrections represent some 1,95 % of the 1 295 million euro that are to be recovered as at the end of financial year 2008. Whilst just below the 2 % level of materiality, they indicate that a risk of a material error at the overall level of the EAGF debtors' accounts exists (see paragraph 5.56).

**1.15.** *The Commission accepts the points made by the Court and its accounting services will continue to address the issues raised and monitor the accounting work of the Directorates-General so as to improve the accuracy of the basic accounting data, for example through initiatives such as the ongoing accounting quality project.*

**1.16.** *Concerning the information on financial corrections made by the Member States themselves, the Commission has made substantial efforts, under the Action Plan towards an integrated internal control framework to strengthen the Commission's supervisory role in structural actions, to improve the quality of data provided by Member States and it is continuing its efforts to improve the reporting so that complete and reliable data may be reported by all Member States. See also Commission's reply to paragraph 6.30.*

**1.17.** *The Commission obtained enough information on debtors for clearance and accounting purposes. In no case was the financial impact found to be material at the overall account level (and thus as regards the Decision).*

*The corrections of 25,3 million euro were proposed by the Commission based on its assessment of the information provided by the certification bodies in their reports, and its calculation of the most likely rates (and amounts) of error relating to debts in particular paying agencies. The same logic is used for debts as for the treatment (and possible correction) of errors arising from the detailed testing of Funds expenditure.*

*The financial errors found are recovered through the ordinary clearance of accounts procedure.*

<sup>(18)</sup> See paragraph 5.61 of the Annual Report concerning the financial year 2006 and paragraph 5.44 of the Annual Report concerning the financial year 2007.

<sup>(19)</sup> Article 10 of Commission Regulation (EC) No 885/2006 (OJ L 171, 23.6.2006, p. 90) by means of which the Commission communicates to the Member States the results of its verification of the information supplied.

<sup>(20)</sup> Financial corrections pursuant to Article 11 of Regulation (EC) No 885/2006.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Loans and borrowings*

1.18. In respect of Macro-economic financial assistance, Balance of Payments and Euratom loans, the Communities borrow funds on the capital markets and make them available 'back-to-back' to the intended beneficiaries. International accounting standards and EC accounting rule 11 require the differences between the offered and the market interest rates to be reflected in the accounts. However, this has not been shown. The reasons and the effects of this departure from the standards are not sufficiently disclosed in the explanatory notes to the Communities financial statements.

**1.18.** *Following the Council regulations concerning macro-economic financial assistance, balance of payments and Euratom loans, the Communities lend money borrowed on the capital market at the same interest rate to Member States and third beneficiaries. The purpose of the operations is to allow the beneficiaries to benefit from the EC's creditworthiness. Consequently the market rate is not relevant for these back-to-back transactions and the effective interest rate method as foreseen in EC accounting rule 11 is not applicable. The current accounting treatment reflects better the specific nature and the substance of the loans and borrowing transactions (substance over form principle).*

*As suggested by the Court, the Commission will disclose more explicit information in the notes to the EC annual accounts and will consider clarifying the accounting rule 11 to better reflect the specificities of these transactions.*

**Conclusion**

1.19. The Court concludes that the observations made do not have a material impact on the reliability of the accounts.

**Regularity of the transactions underlying the accounts*****Structure of the DAS specific assessments***

1.20. The Court provides specific assessments within chapters 5 to 11 on groups of Activity Based Budgeting (ABB) policy areas (see **Table 1.2**). Chapter 4 covers revenue. Each specific assessment provides an introduction to the policy group, findings and conclusions on the regularity of transactions and the effectiveness of systems, and a follow-up of previous observations.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

***Explaining the DAS approach and results***

1.21. The approach taken by the Court to audit the regularity of the transactions underlying the accounts comprises **two main pillars**: direct testing of transactions in order to ascertain how far they are regular; and an assessment of the effectiveness of supervisory and controls system in ensuring regularity. This is supplemented by evidence received from the relevant work of other auditors (where available) and analysis of management representations <sup>(21)</sup>.

*How the Court tests transactions*

1.22. Transaction testing is based on a **representative statistical sample** of receipts or payments taken from the population as a whole, normally the group of policy areas. This testing provides a statistical estimation of the extent to which the transactions in the population concerned are regular.

1.23. In order to determine the sample sizes the Court uses an **audit assurance model**. This involves an assessment of the inherent risk that errors occur in transactions and the risk that the supervisory and control systems do not prevent or detect and correct such errors (control risk). In most cases, the Court must rely primarily on its direct testing as the systems do not provide adequate assurance about the regularity of transactions.

1.24. Testing involves the **detailed examination** of the transactions selected to check if the claim or payment was correctly calculated and in compliance with the relevant rules and regulations governing the spending. When the transaction is incorrectly calculated, or does not meet a regulatory requirement or contractual provisions, it is considered to contain an **error**. Via its sample of accounting transactions recorded in the budgetary accounts, the Court traces the payment down to the level of the final recipient (e.g. farmer, organiser of training course, development aid project promoter) and tests compliance with the relevant conditions at each level, where appropriate.

---

<sup>(21)</sup> In particular Annual Activity Reports and the declarations of the Commission's Directors-General and their Synthesis Report.



Table 1.2 — Expenditure outturn in 2008 by Annual Report chapters

(million euro)

| Sections (S) and titles (T) <sup>(1)</sup> corresponding to the 2008 budgetary nomenclature allocated per chapter of the Court's Annual report   | Payments made in 2008 <sup>(2)</sup> |
|--|--------------------------------------|
| <b>Annual Report chapters</b>  |                                      |
| <b>Revenue</b>   | <b>53,7 <sup>(3)</sup></b>           |
| Taxation and customs union (T.14)  |                                      |
| <b>Agriculture and natural resources</b>   | <b>55 114,9</b>                      |
| Agriculture and rural development (T.05)<br>Environment (T.07)<br>Fisheries and maritime affairs (T.11)<br>Health and consumer protection (T.17)   |                                      |
| <b>Cohesion</b>  | <b>36 596,9</b>                      |
| Employment and social affairs (T.04)<br>Regional policy (T.13)   |                                      |
| <b>Research, energy and transport</b>  | <b>7 516,7</b>                       |
| Research (T.08)<br>Energy and transport (T.06)<br>Information society and media (T.09)<br>Direct research (T.10)   |                                      |
| <b>External aid, development and enlargement</b>   | <b>6 323,1</b>                       |
| External relations (T.19)<br>Development and relations with ACP States (T.21)<br>Enlargement (T.22)<br>Humanitarian aid (T.23)   |                                      |
| <b>Education and citizenship</b>   | <b>1 734,9</b>                       |
| Education and culture (T.15)<br>Communication (T.16)<br>Area of freedom, security and justice (T.18)   |                                      |
| <b>Economic and financial affairs</b>  | <b>621,4</b>                         |
| Economic and financial affairs (T.01)<br>Enterprise (T.02)<br>Competition (T.03)<br>Internal market (T.12)<br>Trade (T.20)   |                                      |
| <b>Administrative and other expenditure</b>  | <b>8 582,9</b>                       |
| Parliament (S. I)<br>Council (S. II)<br>Commission (S. III)<br>Court of Justice (S. IV)<br>Court of Auditors (S. V)<br>Economic and Social Committee (S. VI)<br>Committee of the Regions (S. VII)<br>European Ombudsman (S. VIII)<br>European Data-protection Supervisor (S. IX) |                                      |
| <b>Grand totals</b>  | <b>116 544,5</b>                     |

(1) The budgetary titles 24 to 31 of Section III of the General Budget concerning primarily Administrative expenditure are reported in the section for the European Commission of chapter 11.

(2) Administrative expenditure is deducted from policy groups and shown separately under its own heading; this leads to differences in comparison to chapters 4 to 10.

(3) This figure refers to 'operational expenditure' and not to the value of the 'revenue'.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*How the Court evaluates and presents the results of transaction testing*

1.25. Errors in transactions occur for a variety of reasons and take a number of different forms depending on the nature of the breach and specific rule or contractual requirement broken. They may relate to a condition for payment or to another compliance issue.

1.26. The Court classifies errors in the following two ways:

- (a) *Quantifiable* or *non-quantifiable*, depending on whether it is possible to measure how much of the amount paid from the EU budget was incorrect; and
- (b) *According to their nature*, *eligibility* error (payment does not meet the eligibility rules), *occurrence* error (reimbursement of a cost which is not proven to have been incurred), *accuracy* error (payment incorrectly calculated or not proven as correct) or *other compliance* error (an error that does not call into question the eligibility of the payment).

1.27. The Court expresses the **frequency** by which errors occur by presenting the proportion of the sample affected by errors (both quantifiable and non-quantifiable). This indicates how widespread errors are likely to be within the policy group as a whole (see 1.3 of part 1 of Annexes 1 in the different chapters).

1.28. The Court estimates the financial impact of errors on the basis of an **error rate**. It is calculated from quantifiable errors only. The Court evaluates the estimated error rate against a **materiality level** of 2 % to determine - together with other evidence - if the payments of the expenditure area are free from material error (an 'unqualified' opinion), or affected by a material level of error (an 'adverse' opinion<sup>(22)</sup>). For the purpose of presenting the results the error rate is classified as falling into one of the following three ranges:

---

<sup>(22)</sup> In addition the Court may issue a qualified opinion when only a small proportion of a population is affected by material error.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- (a) Below 2 %;
- (b) Between 2 % and 5 %; and
- (c) Above 5 %.

This information is provided in part 1 of Annexes 1 of Chapters 4 to 11, and summarised in **Table 1.3**.

*How the Court assesses systems and reports the results*

1.29. **Supervisory and control systems** are established by the Commission, (and Member and beneficiary States in the case of shared or decentralised management), to manage the risks to the budget, including the regularity of transactions. Assessing the effectiveness of systems in ensuring regularity is therefore a key audit procedure, and particularly useful for identifying recommendations for improvement.

1.30. Each policy group is governed by a multitude of individual systems, each of which takes a considerable time to test and assess. Each year the Court therefore normally selects a sample of systems to examine. The results of the **systems assessments** are presented in the form of a table called '*Assessment of selected supervisory and control systems*' given in part 2 of Annexes 1 of chapters 4 to 11. Systems are classified as being '*effective*' in mitigating the risk of error in transactions, '*partially effective*' (when there are some weakness affecting operational effectiveness) or '*not effective*' (when weaknesses are pervasive and thereby completely undermine operating effectiveness).

1.31. In addition, the Court provides an **overall assessment** of supervisory controls systems (also presented in part 2 of Annexes 1 of chapters 4 to 11) which take into account both the assessment of selected systems, as well as the results of transaction testing.

**General overview of audit results 2008**

1.32. For Revenue and in the policy group Administrative and other expenditure, the supervisory and control systems, taken as a whole, are effective (see paragraphs 4.29 to 4.30 and 11.20 to 11.21) and the Court estimates that the errors have a financial impact of less than 2 % of the total amounts (see **Table 1.3**). In addition, the Court's assessment of the declarations by Directors-General and authorising officers by delegation confirmed that no reservations had to be presented (see paragraphs 2.3 to 2.4 and 2.9 and **Table 2.1**).

**Table 1.3 — Summary of 2008 DAS results on the legality and regularity of underlying transactions**

| Specific assessments of the 2008 DAS Annual Report | Paragraphs in Annual Report | Functioning of supervisory and control systems | Error range    |
|--|-----------------------------|--|----------------|
| Revenue <sup>(1)</sup>                             | 4.29-4.30                   |  |                |
| Agriculture and natural resources                  | 5.62-5.67                   | <sup>(2)</sup>                                 | <sup>(3)</sup> |
| Cohesion   | 6.35-6.36                   | <sup>(4)</sup>                                 |                |
| Research, energy and transport                     | 7.40-7.41                   |  |                |
| External aid, development and enlargement          | 8.33-8.34                   |  |                |
| Education and citizenship                          | 9.31-9.32                   |  |                |
| Economic and financial affairs                     | 10.27-10.28                 | <sup>(5)</sup>                                 | <sup>(6)</sup> |
| Administrative and other expenditure               | 11.20-11.21                 |  |                |




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 (in particular concerning weaknesses of supervisory and control systems and types of error) 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 1.5 to 1.15).

*Legend:*

## Functioning of supervisory and control systems

|   |                                    |
|---|------------------------------------|
|  | Effective                          |
|  | Partially effective <sup>(7)</sup> |
|  | Not effective                      |

Error range <sup>(8)</sup>

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

<sup>(1)</sup> See scope limitations in paragraphs 4.4 and 4.7.

<sup>(2)</sup> As in previous years, the Court, based on the level of errors in transaction testing and its systems assessment, reiterates that IACS generally is an effective control system for limiting the risk of error or irregular expenditure (see paragraph 5.64).

<sup>(3)</sup> For Rural development expenditure the estimated level of error is above 2 % (see paragraphs 1.33 and 5.62).

<sup>(4)</sup> In 2007, the Court assessed the Member States' control systems as partially effective. For 2008, there were no major modifications in the regulatory framework affecting the control systems of the Member States (see paragraph 6.23). Since the programming period 2000-2006 is coming to an end, the Court considered that an additional full assessment of the Member States' 2000-2006 control systems will not provide added value. As there were almost no interim payments for the 2007-2013 period, the Court focused its assessment on the part of the Member States' systems set up for recording and correcting errors found by national controls and for reporting financial corrections to the Commission (see paragraphs 6.21 and 6.36).

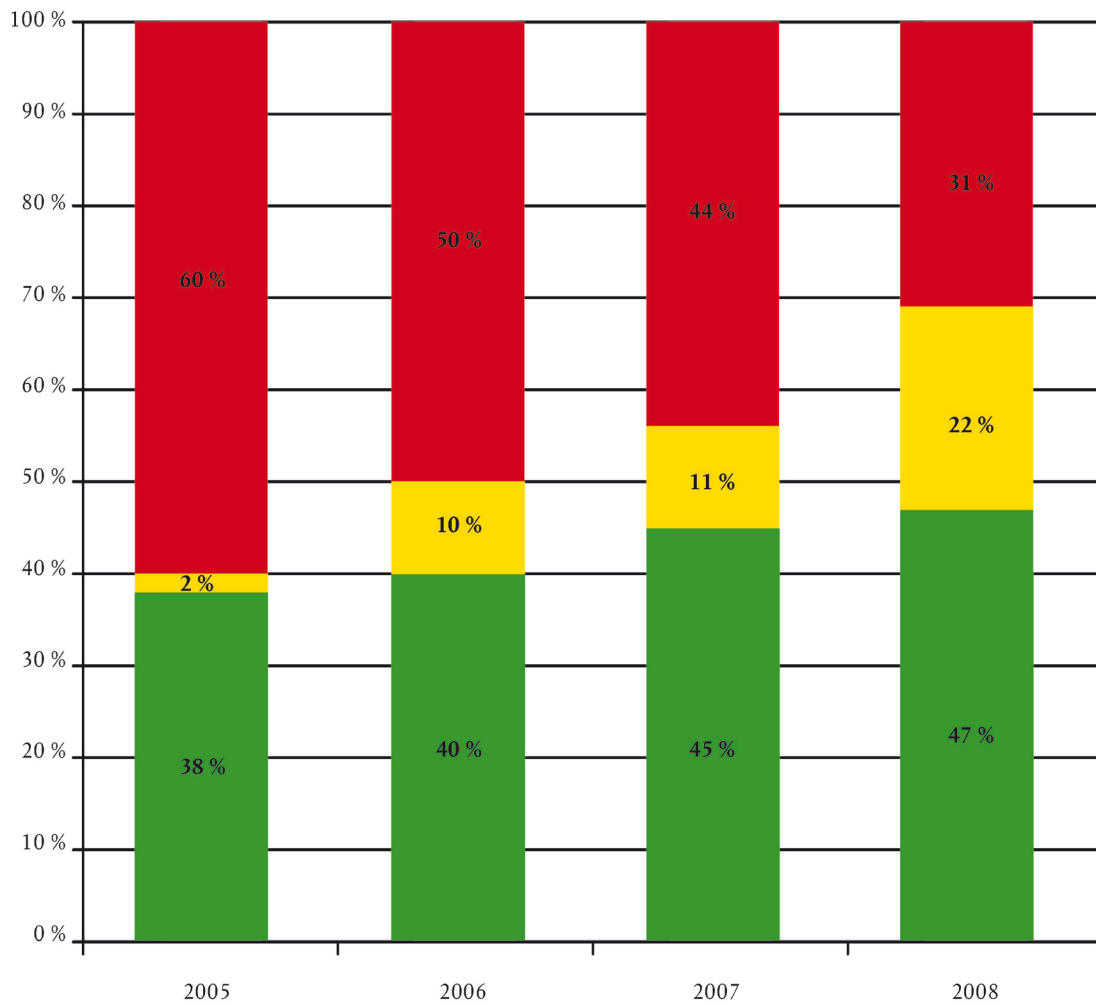
<sup>(5)</sup> This is not an overall assessment of the policy group systems. It relates to some of the systems examined and mainly reflects the weakness observed in the supervisory and control systems of the Sixth Framework Programme for research and technological development (FP6) (see paragraph 10.28).

<sup>(6)</sup> FP6 accounts for a disproportionately large part of the overall error rate (see paragraph 10.27).

<sup>(7)</sup> Systems are classified as 'partially effective' 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.

<sup>(8)</sup> The Court decided to present the error rates (see paragraph 1.28) in three intervals. These error ranges cannot be interpreted as a confidence interval (in a statistical sense).

Chart 1.1 — Year to year comparison (\*)



(\*) Percentage of the budget according to the relevant error range ■ < 2 % ■ 2-5 % ■ > 5 % for the different policy groups. In the case of 'Agriculture and natural resources', the chart distinguishes between its relevant component parts (Rural development and other expenditure for 2007 and 2008; IACS and non IACS for previous years).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.33. For the policy group Agriculture and natural resources and for the policy group Education and Citizenship the Court estimates that the overall financial impact of errors is less than 2 % of the total expenditure for each respective policy group. However, the Court found that Rural development expenditure within policy group Agriculture and natural resources was affected by a level of error exceeding 2 % (see paragraph 5.62) and the Court's testing suggests that the interim and final payments for policy group Education and Citizenship were affected by material error (see paragraph 9.31). For the policy group Economic and financial affairs the Court estimates the error rate to be slightly above 2 % of the total expenditure for this policy group. However, the Court found that payments made under the Sixth Framework programme for research and technological development account for a disproportionately large part of this overall error rate (see paragraphs 10.12 to 10.13).

1.34. The Court concludes that the supervisory and control systems for the policy group Agriculture and natural resources are partially effective in ensuring the regularity of payments (see paragraph 5.63). Whereas the Court reiterates that IACS generally is an effective control system for limiting the risk of error or irregular expenditure (see paragraph 5.64), it has identified issues which need to be addressed in SPS and SAPS schemes (see paragraph 5.65) and in the area of Rural development (see paragraph 5.66). The Court concludes that the supervisory and control systems for the policy group Education and Citizenship are partially effective (see paragraph 9.32)<sup>(23)</sup>. For the policy group Economic and financial affairs, the Court examined three supervisory and control systems. While two were assessed as effective, one was assessed as only partially effective<sup>(24)</sup> in ensuring the legality and regularity of payments (see paragraph 10.28).

**1.33.** *The Commission welcomes the positive overall assessment of these policy groups. It shares the Court's view that rural development expenditure is affected by a higher incidence of errors, but notes with satisfaction that the error rate is decreasing in this area.*

*The Commission notes that for Education and Citizenship the Court has found quantifiable errors in 4 out of 21 interim and final payments examined. See also reply to paragraph 9.31.*

*For the policy group Economic and financial affairs, as FP6 represents only 8 % of the payments, the Commission considers that the overall transaction error rate in this policy area, taken as a whole, is free of material error. As far as FP6 payments are concerned the findings and conclusions of the Court in this chapter are similar to those in Chapter 7. See also replies to paragraphs 10.12 and 10.13.*

**1.34.** *Over the years, a trend shows that, in general, the supervisory and control systems have improved in Agriculture and natural resources and are now effective, although improvements are still needed in the area of rural development. The Commission considers that some of the issues the Court suggests to address with regard to the SPS and SAPS schemes would lead to the introduction of further complicated rules which would result in a highly complex control system whose implementation would be costly and contrary to the simplification efforts of the Commission. Moreover, it would effectively reintroduce a form of coupling aid payments to production (see Commission reply to paragraph 5.65(b)).*

*In 2008, for the Directorate-General for Education and Culture, the supervisory and control system put in place for the 2007-2013 period provides for a sound framework. Significant progress was made in its implementation through the analysis of ex-post declarations of assurance and intensified monitoring visits and audits.*

*As regards the policy group Economic and financial affairs, the Court's findings and conclusions concerning FP6 are similar to those in Chapter 7 whilst the rest of the expenditure is free of material error. The Commission considers that the supervisory and control systems in place are cost-efficient, proportional and adequate as a whole (see replies to paragraphs 10.19 and 10.28).*

<sup>(23)</sup> Although the Court notes that the guidance issued to the National Agencies is well developed for use as a manual of procedures (see paragraph 9.33), it concludes that the current implementation of the supervisory and control system does not yet give satisfactory assurance that errors of regularity will be detected and corrected (see paragraphs 9.33 and 9.34).

<sup>(24)</sup> This is mostly due to the supervisory and control systems of the Sixth Framework Programme for research and technological development.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.35. In the policy groups Cohesion <sup>(25)</sup>, Research, energy and transport, External aid, development and enlargement and Economic and financial affairs, the Court concludes that the supervisory and control systems are partially effective, (see paragraphs 6.21, 6.23, 6.36, 7.41, 8.34 and 10.28 and **Table 1.3**). While for the policy groups Research, energy and transport, External aid, development and enlargement and Economic and financial affairs the Court's estimated error rate is between 2 % - 5 % of the total expenditure, for the policy group Cohesion, the estimated error rate is above 5 % (see paragraphs 6.17, 6.35, 7.40 and 8.33 and **Table 1.3**). For the policy groups Cohesion and External aid, development and enlargement, the Court's view is that the scope of the reservations expressed in the declarations by Directors-General and authorising officers by delegation should have been broader in order to reflect the significant deficiencies which still persist in these expenditure areas as manifest in the Court's audit findings (see paragraphs 2.6 to 2.7 and 2.10 to 2.11 and **Table 2.1**). Cohesion remains the most problematic area and its estimated error rate stands well above those for the other policy areas.

**1.35.** In the Cohesion area there were significant improvements in the implementation of the management and control systems of some programmes in 2008. The assessment of the effective functioning of the systems in 545 operational programmes in the annual activity reports for 2008 of Directorates-General Regional Policy and Employment, Social Affairs and Equal Opportunities show that 78 % of programmes work well or have deficiencies with moderate impact (57 % in 2007). While the error rate remains unacceptably high, the frequency of errors has decreased: 43 % of projects in the Court's sample were found to be affected by errors, compared to 54 % in 2007. The Commission points out that the audit sample underlying the findings only covers the 2000-2006 programme period because almost no reimbursements were made concerning the 2007-2013 programme period. See also Commission's replies to paragraphs 6.23, 6.35 and 6.36.

Considerable efforts have been made to improve the management of research policy within the limits of the applicable legal and financial framework. The Commission will continue the rigorous application of controls. The Commission will keep working to reduce the level of residual error in this policy group.

The reasonable assurance concerning the legality and regularity of the underlying transactions is given by Directors-Generals in the Annual Activity Reports. When a Director-General can base this reasonable assurance on the estimated error rate below the materiality threshold, as is the case for instance for the Directorate-General for Enlargement dealt with by the Court in policy group External aid, development and enlargement, no reservation has to be made.

For the area of External aid, Development and Enlargement, the Commission has designed its controls for this policy group to cover the full lifecycle of its multiannual projects so that it is able to prevent, or detect and correct most financial errors in the normal course of its controls. The mandatory financial audits foreseen under the Commission's control system should allow the Commission to detect and correct these prefinancing errors — in a later accounting year — before final payments are made. The Commission's ex-post controls confirm this low level of residual error.

See also reply to paragraph 8.34.

<sup>(25)</sup> See **Table 1.3**, footnote 4.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.36. Compared to previous years the following changes have been noted: a decrease in the estimated error rate for the policy groups Agriculture and natural resources<sup>(26)</sup> and Research, energy and transport<sup>(27)</sup>. For the policy group Agriculture and natural resources, the Court estimates that the overall error rate is slightly below 2 % (see paragraph 5.13), whereas for the policy group Research, energy and transport it is still above 2 % (see paragraph 7.40). For the policy group Education and citizenship, the Court estimates that the errors have a financial impact of less than 2 %. The Court considers that this is largely due to the large share of advances, which are relatively less affected by errors than interim and final payments (see paragraphs 9.6 to 9.7 and 9.31). In the policy group Economic and financial affairs, the estimated overall error rate for the financial year 2008 is slightly above 2 % (in 2007 slightly below 2 %) due to the errors detected in FP6 spending which, however, accounts for only 8 % of the policy group's expenditure see paragraph 10.27).

**1.36.** *The Commission welcomes the positive overall development of the Court's assessment, showing noticeable progress from the previous year.*

<sup>(26)</sup> The decrease has been identified for the expenditure for the policy group Agriculture and natural resources in general and Rural Development expenditure in particular. However, the latter is still affected by a higher level of errors than EAGF (see paragraph 5.62). The Court considers, based on the level of errors in transaction testing and its systems assessment, that, as in previous years, IACS generally is an effective control system for limiting the risk of error or irregular expenditure (see paragraph 5.64).

<sup>(27)</sup> Former 'Internal policies' are now covered under the policy groups 'Research, energy and transport', 'Education and citizenship' and 'Economic and financial affairs' (see **Table 2.1**).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.37. The Court emphasises that its audits show that complicated or unclear eligibility criteria or other complex legal requirements, particularly in the policy groups of Agriculture and natural resources, Cohesion, Research, energy and transport as well as Economic and financial affairs, contribute significantly to the risk of error (see paragraphs 5.17 to 5.26, 5.34 to 5.52, 6.18 to 6.20, 7.12 to 7.15 and 10.11 to 10.14).

1.38. In policy group External aid, development and enlargement as well as Economic and financial affairs the Commission jointly manages EU expenditure with international organisations<sup>(28)</sup> on the basis of agreements which also secure the audit rights of the Court. Nevertheless, the Court's access to UN generated audit reports and supporting documents or verification visits related to the DAS 2008 were partly or fully denied (see paragraphs 8.13 and 10.10).

**1.37.** A certain degree of complexity in rules and eligibility criteria is unavoidable as these are often fixed in order to achieve desired policy objectives, which are the outcome of a complex legislative procedure where the Legislative Authority has the last word.

Nevertheless, the Commission has committed itself to make proposals to the Legislative Authority for further simplification where possible. It will consider the scope for introducing further simplification of eligibility rules in its 2010 proposal for the triennial revision of the Financial Regulation. It will also study principles for further simplification of sectorial legislation for the next round of basic acts, to come into force from 2014.

For Agriculture and natural resources, the results have improved thanks to the continuous efforts to simplify the legal requirements/eligibility criteria under both pillars of the CAP. See also the specific replies to paragraphs 5.17 to 5.26, 5.34 to 5.52.

In the area of cohesion, modifications have been made to the regulations for 2007-2013, incorporating simplifications resulting from a joint Commission-Member States experts group. The Commission has also issued in early 2009 a digest of eligibility rules. See also the Commission's reply to paragraphs 1.41-1.42 and 6.37(a).

The 7th Framework Programme has been a step forward in simplification. As a result of the experience gained during the implementation of the programme, and if appropriate, the Commission may propose changes to its legal basis.

**1.38.** The Commission fully supports the Court's requests for information and access to documentation. The Standard Contribution Agreement with international organisations includes a text in relation to the Court's access.

See also reply to paragraph 8.13.

<sup>(28)</sup> This method of implementing the EU budget is stipulated in Article 53 of the Financial Regulation.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

***How to address weaknesses***

1.39. The Court noted last year that, despite the positive developments in the Commission's internal control framework, a substantial part of the transactions underlying the EU accounts remains subject to a material level of error (paragraph 1.42 of the Annual Report concerning the financial year 2007). In addition, the Court's DAS audit highlights differences – sometimes significant – in the type, incidence and level of irregularity between, and within, policy groups. The following paragraphs seek to provide further insight into the assessment of how progress can be made towards an effective Community internal control framework <sup>(29)</sup>.

1.40. Despite the Union having a single general budget there are many differences in the way the money is spent. These include: the kind of management mode; types of beneficiaries; periodicity of the aid; ways of claiming and different types of control and recovery systems. These differences arise in order to address the circumstances of the budgetary area involved and the individual objectives of the aid, and in recognition of the cost and complexity of administering and controlling the schemes.

*Need for simplification*

1.41. The rules governing the way the money is spent are established to ensure that the aid achieves the policy objectives sought - 'spending on the right things at the right time'. Some rules are common to all payment types whilst others depend on the type of spending. The type and complexity of the rules therefore may also be a function of the complexity of the policy objectives.

1.42. The more onerous and complex are the rules, the greater is the risk that they will not be followed, so increasing the risk of errors occurring in transactions and policy objectives not being met. Concurrently, excessive fine-tuning in establishing very specific programme targets is bound to increase the cost in checking whether such targets have been met. Otherwise put: well designed rules and regulations which are clear to interpret and simple to apply, decrease the risk of error (paragraph 1.45 of the Annual Report concerning the financial year 2007).

**1.41-1.42.** *The Commission agrees with the Court's analysis, but stresses that establishing the rules is about striking the right balance between meeting often specific policy objectives avoiding over-complexity. While the Commission's role is to propose legislation, complexity can be introduced during consideration by the Legislative Authority with which rests the final decision.*

*The Commission has committed itself to incorporating a description of the associated control arrangements in all relevant future legislative proposals.*

*Simplification is a major element of the Commission's better regulation programme. The Member States are also required to simplify the eligibility criteria in their national programmes. However, a certain level of complexity is unavoidable and should be taken into account in future discussions on a tolerable level of risk.*

*See also reply to paragraph 2.35(b).*

<sup>(29)</sup> Paragraphs 1.43 to 1.51 of the Annual Report concerning the financial year 2007.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.43. An element of caution is appropriate. Simplifying rules merely in order to reduce the risk of irregularity might have some disadvantages if more generic rules were to result in less focused spending. Furthermore, 'simplification' could suggest, in some areas (see for example paragraphs 9.6 and 9.7), the relaxation of the conditions for receiving advances and an increase in the amounts that can be paid as such. However, such simplification should be supported by effective systems as otherwise irregular expenditure would only become apparent when the programmes are partially completed or completely closed, which happens later in the process. Notwithstanding these qualifications, simplification needs to remain an overriding objective.

*In the Cohesion area, the ESF regulation for 2007-2013 already provided for the possibility to declare indirect costs on a flat-rate basis. The possibility to use flat rates, lump sums and standard scales of unit costs for the 2007-2013 programmes was generalised for both the ERDF and ESF by amending the fund regulations in May 2009. Other simplifications were adopted in December 2008 and in May 2009. In July 2009, the Commission has also brought forward proposals for further simplifications to implementing Regulation (EC) No 1828/2006 and to the general Regulation (EC) No 1083/2006.*

*The Commission, as a result of the experience gained during the implementation of the programme, and if appropriate, may propose changes to its legal basis.*

1.43. *The Commission recognises that simplification is a balance between the need for good stewardship of public funds and the achievement of often highly specific policy objectives. This balance is addressed differently in each policy area and results in different management modes and provisions, taking into account the involvement of various actors at different levels. The Commission is taking steps to ensure its control systems are as effective as possible, taking full account of the multiannual nature of many programmes and the need for an efficient and effective control system to operate the right controls at the right time.*

*As far as the policy area Education and culture is concerned, the design of the new programmes for 2007-2013 simplified the rules and made extensive use of lump sum financing. This, together with the rigorous approval of the national management and control systems, should reduce the risk linked to final payments.*

*See also reply to paragraph 9.7.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*The necessary response*

1.44. It has to be acknowledged that management of the EU budget has evolved piecemeal over time in response to the type of expenditure programmes which were introduced subsequently. The rules governing the spending as well as the management methods need to take into account the specificities of the various targets of budgetary spending. These targets, however, should not be overly detailed, resulting in an excessive administrative burden and regulations which are difficult to observe. This requires, on the part of the Commission, a judicious review of the underlying regulatory framework and management structure of specific expenditure programmes.

1.45. In this context, the first and essential task must be to ensure that reliable and comprehensive information is compiled to allow a credible evaluation of the existing costs of controls <sup>(30)</sup>.

1.46. Equally crucial must be a careful assessment as to whether the maximum benefit is being derived from the current level of expenditure on controls. If this were judged not to be the case; then the immediate goal should be to derive full advantage from the money which is already being spent and from the resources already deployed for such purpose <sup>(31)</sup>.

**1.44.** *The Commission stresses that establishing the rules is the competence of the Legislator. The Commission has recently made a number of proposals for simplification (and certain simplifications have been decided for the Structural Funds) and it will continue to propose simplifications where this is commensurate with achieving specific policy objectives.*

*In this respect, the Commission's work on the tolerable risk of error needs to be considered, as it promotes a clear view on the risk which can be controlled in the light of eligibility conditions and the control environment and hence on the risk which it is not cost-effective to control. The Commission will be making concrete proposals to the Budgetary Authority on tolerable risk in the research, energy and transport, rural development, external aid and administrative expenditure in 2010.*

*See also reply to paragraph 1.41-1.42.*

**1.45.** *The Commission will collect information on the costs of controls as part of its proposals on the tolerable risk of error, beginning with the research, energy and transport, rural development, external aid and administrative expenditure fields in 2010.*

**1.46.** *The Commission has fostered a continuing improvement in its internal control systems (as recognised in paragraph 1.39) and will vigorously pursue these efforts. These control systems are designed to provide reasonable assurance, being based on an appropriate balance between the different types of controls ('the right controls at the right time'). For instance, ex-ante controls can identify certain error types but not others, and it would not be cost effective to control all projects on the spot.*

<sup>(30)</sup> The Commission acknowledges in its Communication on the 'concept of tolerable risk of error' (COM(2008) 866 Final) on pages 8 and 10 that it has so far only undertaken a limited data gathering exercise.

<sup>(31)</sup> The Commission recognises in its COM(2008) 866 Final on page 7 that, for Structural Funds, the error rate could be reduced by 2-3 % at zero (or no significant) additional costs by '...improving existing ex-ante controls...'

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.47. Alongside necessary actions aiming to ensure effectiveness of systems, the indicated objective must be to determine the appropriate balance between the cost of controls and the benefits they bring (see recommendation by the Court in the Annual Report concerning the financial year 2007, paragraph 1.52).

1.48. It would be desirable if, whenever expenditure programmes are being considered for approval, the risks associated with them and the costs of administration and control necessary to contain these risks to a cost effective level are set out. In this manner, the relevant decisions by Council and Parliament would be taken on a more informed basis, explicitly considering the risks and costs involved.

1.49. The Court underlines the importance of reflecting further on simplification and the costs and benefits of controls. This review should be done in good time before proposals for the new multiannual financial framework are prepared <sup>(32)</sup>.

As a result of the Action Plan to improve supervision in the Structural Funds, the Commission has already taken ex-ante actions to improve control systems. It also points out that the 2 %-3 % reduction in the error rate through more effective ex-ante control (referred to for the ERDF in the illustrative case study presented in the 'tolerable risk' communication (COM(2008) 866) results from an assessment of errors identified by the Court in the DAS 2005 and is rather a measure of the 'control risk' (the risk that certain controls do not function effectively in some cases).

**1.47.** The concept of efficient and effective internal control is enshrined in the Financial Regulation (Article 28a). In line with this, each Commission service is required in its annual activity report to present the results of internal control, to report on its effectiveness and to take action to address identified weaknesses. Therefore, the Commission considers that, as improving control structures and simplifying procedures is an ongoing and continuous process, such efforts need to be permanent.

In line with the Court's suggestion, the Commission will further examine the balance between the costs and benefits of control in preparing its proposals on tolerable risk beginning with the research, energy and transport, rural development, external aid and administrative expenditure fields in 2010.

**1.48.** In the Communication 'Towards a common understanding of a concept of tolerable risk of error' (COM(2008) 866), the Commission has committed itself to incorporating a description of the associated control arrangements in all relevant future legislative proposals.

**1.49.** The Commission agrees on the importance of seeking an appropriate balance between the cost of controls and the level of simplification which is adopted and is reflecting on how to take this forward in time for the new financial perspectives.

See also reply to paragraph 1.37.

<sup>(32)</sup> See Court's response to the Commission's Communication 'Reforming the budget, changing Europe' (<http://eca.europa.eu/portal/pls/portal/docs/1/1481518.PDF>).



## CHAPTER 2

**Commission internal control system**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction  | 2.1-2.2          |
| Commission management representations                         | 2.3-2.22         |
| Annual Activity Reports and Declarations by Directors-General | 2.3-2.11         |
| Synthesis Report of the Commission                            | 2.12-2.17        |
| Assurance drawn from Annual Summaries                         | 2.18-2.22        |
| Commission's internal control standards                       | 2.23-2.25        |
| Introduction  | 2.23-2.24        |
| Effectiveness   | 2.25             |
| Action plan   | 2.26-2.28        |
| General assessment of implementation                          | 2.26-2.27        |
| Impact of Action Plan   | 2.28             |
| Overall conclusions and recommendations                       | 2.29-2.36        |
| Conclusions   | 2.29-2.33        |
| Recommendations   | 2.34-2.36        |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

2.1. This chapter examines the Commission's progress in 2008 in addressing the weaknesses in its supervisory and control systems in order to ensure the regularity of transactions financed by the EU budget. In particular, it analyses the extent to which:

- (a) the management representations contained in the annual activity reports and the declarations of the Directors-General and in the Commission's Synthesis report present a reliable picture (paragraphs 2.3 to 2.11);
- (b) the Commission has made progress on the functioning and effectiveness of the revised internal control standards and on the integrated internal control framework, and the extent to which it has been able to demonstrate their positive impact on 2008 expenditure (paragraphs 2.23 to 2.25).

2.2. The Court also examined the Annual Summaries <sup>(1)</sup> for Structural Actions and the European Fisheries Fund and for Agriculture to assess the added value they provide and how this was used by the Commission's services (paragraphs 2.18 to 2.22).

## COMMISSION MANAGEMENT REPRESENTATIONS

**Annual Activity Reports and Declarations by Directors-General**

2.3. 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 regularity of the underlying transactions, in 12 cases subject to reservations.

**2.1.** *The Commission considers that the internal control systems in place, with the limitations described in the 2008 annual activity reports, provide reasonable assurance that the resources assigned to its activities have been used for their intended purpose and in accordance with the principles of sound financial management. It also considers that the control procedures put in place give the necessary guarantees concerning the legality and regularity of underlying transactions for which the Commission takes overall responsibility pursuant to Article 274 of the EC Treaty.*

*The Commission is taking action to further improve its internal control system in the light of its own experience and to address issues raised by auditors. Actions taken in 2008 included the entry into force of the revised internal control standards for effective management as from 1 January 2008, the completion of the implementation stage of the Action Plan towards an Integrated Internal Control Framework and the improvement of the clarity and coherence of the Annual Activity Reports.*

<sup>(1)</sup> Article 53b(3) of the revised financial regulation provides that: 'Member States shall produce an annual summary at the appropriate national level of the available audits and declarations'. (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)).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

2.4. Of the 41 main Directorates-General or services who issued a declaration in 2008, 12 contain one or more reservations, the majority of which refer to weaknesses concerning the regularity of the underlying transactions. The total number of reservations fell from 17 (2007) to 15 (2008). The most significant reservations in the context of the regularity of transactions are presented on the left-hand side of **Table 2.1**.

2.5. In policy group Agriculture and Natural Resources, the Director-General for Agriculture and rural development has lifted his longstanding reservation (six years) relating to the insufficient implementation of IACS in Greece as the relevant authorities have set up a new Land Parcel Identification System and the reservation for Rural Development has been defined in more detail following the verification and validation of control statistics by the Member State certification bodies. However, the Director-General provides no assurance that the action plan set up and implemented by Greece was effective for the 2007 claim procedure. Furthermore, in the Court's opinion, the work done for the validation of control statistics by the Commission and the Certifying bodies in that Member State does not provide the high level of assurance required.

2.4. *The Commission points out that 8 out of the 15 reservations were based on financial exposure, and that the remaining 7 originate in issues that may have an impact on the reputation of the service for the Commission and whose financial impact was material by nature rather than financial.*

*Furthermore, 3 long-standing reservations were lifted in 2008 (Directorate-General for Agriculture and Rural development's' on the implementation of the IACS in Greece, Directorate-General for Communication's on the absence of an ex-post control system and Directorate-General for Enterprise and Industry's on the financing of European standardisation bodies).*

*In other policy areas like the Cohesion Policy, the scope of the reservations has been reduced, taking into account the corrective measures already implemented by Member States.*

2.5. *The reservation regarding the insufficient implementation of the IACS in Greece was based on the high reputational risk for the Community institutions, resulting from the persistent nature of these deficiencies in Greece, not on the financial risk for the EAGF, which was always adequately covered by the financial corrections imposed on Greece through the conformity clearance procedures. The audit missions to Greece up to February 2009 showed that the Greek authorities have, in compliance with their action plan from 2006, set up a new operational LPIS-GIS by 31 December 2008 which covers the whole of Greece. Thus, at the time of the signature of the Annual activity report 2008 by the Director General all elements of the IACS were in place and the reputational risk for the Commission resulting from the persistent nature of the deficiencies referred to above had disappeared. However, the remaining financial risk is estimated as a whole at less than the material level of error and is covered by the conformity clearance procedures for the claim years 2006-2008. Consequently, the reservations could be lifted.*

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

| Policy Group                      | Most important reservations of Directors-General (included in the declaration)                                      | 2007 | 2008  | Impact of these most important reservations on the Director-General's assurance in the Court's view <sup>(1)</sup> |      | Other significant weaknesses revealed by the Court's audit and / or the Commission (not included in the declarations)              | 2007 | 2008  | Evidence given by the annual activity report for the Court's audit conclusions <sup>(2)</sup> |      |
|-----------------------------------|---|------|---|--|------|--|------|---|---|------|
|                                   |   |      |   | 2007   | 2008 |  |      |   | 2007  | 2008 |
| Agriculture and natural resources | Insufficient implementation of IACS in Greece   | X    |   | B  | B    | There are as yet no reasonable indications that the action plan setup and implemented by the Greek authorities is fully effective. |      | X   | B   | B+   |
|                                   | Expenditure under Rural Development   | X    | X<br>(Axis 2 'improving the environment and the countryside') |  |      |  |      |   |   |      |
|                                   | Eligibility of costs reimbursed to Member States for expenditure in the field of control and enforcement of the CFP |      | X   |  |      |  |      |   |   |      |
|                                   | Management and control system for SAPARD in Bulgaria and Romania  |      | X   |  |      |  | X    | On the control, inspection and sanction systems relating to fisheries resources: catch data are incomplete and unreliable, inspection systems do not provide assurance. |   |      |

| Policy Group | Most important reservations of Directors-General (included in the declaration) | 2007   | 2008  | Impact of these most important reservations on the Director-General's assurance in the Court's view <sup>(1)</sup> |      | Other significant weaknesses revealed by the Court's audit and / or the Commission (not included in the declarations)               | 2007 | 2008 | Evidence given by the annual activity report for the Court's audit conclusions <sup>(2)</sup> |      |
|--------------|--|--|---|--|------|---|------|------|---|------|
|              |  |  |   | 2007   | 2008 |   |      |      | 2007  | 2008 |
| Cohesion     | ESF: management and control systems (2000/2006)                                | X<br>Spain, United Kingdom, France, Italy, Slovakia, Portugal, Belgium, Luxembourg                 | X<br>Spain, United Kingdom, France, Italy, Belgium, Luxembourg, Germany | B  | B    | There are as yet no reasonable indications that all the corrective actions taken in 2008 have been fully effective <sup>(3)</sup> . |      |      | B   | B    |
|              | ERDF: management and control systems (2000/2006)                               | X<br>Czech Republic, Finland, Greece, Germany, Ireland, Italy, Luxembourg, Poland, Slovakia, Spain | X<br>Belgium, Germany, Italy, Spain                                     |  |      |   |      |      |   |      |
|              | Interreg: management and control systems (2000/2006)                           | X<br>On a total of 51 programmes   | X<br>On a total of 21 programmes  |  |      |   |      |      |   |      |
|              | Cohesion Funds: management and control systems (2000/2006)                     | X<br>Bulgaria, Czech Republic, Slovakia, Hungary, Poland   | X<br>Bulgaria   |  |      |   |      |      |   |      |

| Policy Group                              | Most important reservations of Directors-General (included in the declaration)                                | 2007                         | 2008                         | Impact of these most important reservations on the Director-General's assurance in the Court's view <sup>(1)</sup> |      | Other significant weaknesses revealed by the Court's audit and / or the Commission (not included in the declarations)   | 2007 | 2008 | Evidence given by the annual activity report for the Court's audit conclusions <sup>(2)</sup> |      |
|---|---|------------------------------|------------------------------|--|------|---|------|------|---|------|
|   |   |                              |                              | 2007   | 2008 |   |      |      | 2007  | 2008 |
| Research, energy and transport            | Rate of residual errors with regard to the accuracy of cost claims  | X<br>6th Framework Programme | X<br>6th Framework Programme | B  | B    | There are as yet no reasonable indications on the impact of the systems related to financial corrections and recoveries or when those will have an impact on error rates during the FP6 management cycle <sup>(3)</sup> . |      | X    | B   | B    |
| External aid, development and enlargement | Phare: Potential irregularities in the management of Phare funds by certain Implementing Agencies in Bulgaria | X                            | X                            | A  | A    | Supervisory and control systems for the legality and regularity of underlying transactions at the level of implementing organisations need to be further improved to be fully effective.                                  | X    | X    | B   | B    |

| Policy Group              | Most important reservations of Directors-General (included in the declaration)  | 2007 | 2008 | Impact of these most important reservations on the Director-General's assurance in the Court's view <sup>(1)</sup> |      | Other significant weaknesses revealed by the Court's audit and / or the Commission (not included in the declarations) | 2007 | 2008 | Evidence given by the annual activity report for the Court's audit conclusions <sup>(2)</sup> |      |
|---------------------------|---|------|------|--|------|---|------|------|---|------|
|                           |   |      |      | 2007   | 2008 |   |      |      | 2007  | 2008 |
| Education and citizenship | Absence of a structured <i>ex-post</i> control system and of on-the-spot controls in the DG as well as controls carried out in the representations for the major part of the year — 10 out of 12 months | X    |      | B  | B    | <i>Ex-post</i> controls do not fully reflect the actual error rate in audited contracts.                              | X    | X    | B   | B    |
|                           | High number of errors in Transactions for grants and contracts  |      | X    |  |      |   |      |      |   |      |
|                           | Weaknesses in the management and control system of the European Refugee Fund in Italy for the programming period 2000-2004 and 2005-2007  | X    |      |  |      |   |      |      |   |      |
|                           | Limited assurance as to the underlying operations' legality and regularity implemented by 14 Member States in the framework of the European Refugee Fund II (2005-2007)                                 | X    |      |  |      |   |      |      |   |      |

| Policy Group                   | Most important reservations of Directors-General (included in the declaration)   | 2007 | 2008 | Impact of these most important reservations on the Director-General's assurance in the Court's view <sup>(1)</sup> |      | Other significant weaknesses revealed by the Court's audit and / or the Commission (not included in the declarations) | 2007 | 2008 | Evidence given by the annual activity report for the Court's audit conclusions <sup>(2)</sup> |      |
|--------------------------------|--|------|------|--|------|---|------|------|---|------|
|                                |  |      |      | 2007   | 2008 |   |      |      | 2007  | 2008 |
| Economic and financial affairs | Possibility that the new mitigating controls put in place following the results of the <i>ex-post</i> control report are not fully effective | X    | X    | B  | B    |   |      |      | A   | A    |
|                                | The rate of residual errors with regard to the accuracy of cost claims in Sixth Research Framework Programme — FP6                           | X    | X    |  |      |   |      |      |   |      |
|                                | Unsatisfactory functioning of the financing of European standardisation  | X    |      |  |      |   |      |      |   |      |
| Administrative expenditure     | —  | —    | —    | A  | A    |   |      |      | A   | A    |

Key:

<sup>(1)</sup> 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 but with qualifications concerning identified weaknesses in the internal control system.

C: no assurance.

<sup>(2)</sup> 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: supporting evidence for the Court's DAS conclusions after corrections.

C: no supporting evidence for the Court's DAS conclusions.

'+/-' where there is not enough evidence to justify a change in the evaluation rating, but nevertheless a significant improvement or deterioration has been observed by the Court, this is indicated by adding a '+' or '-' to the initial rating.

<sup>(3)</sup> Although included in the Annual Activity Report.

Source: Court of Auditors.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

2.6. For policy group Cohesion, Directorates-General for Regional Policy and for Employment, Social Affairs and Equal Opportunities maintained reservations pertaining to weaknesses in management and control systems for the 2000-2006 period although the total number of Member States and operational programmes concerned as well as the financial quantification decreased significantly. A total of 99 operational programmes were affected in 2008, against 185 in 2007. The Directorates-General quantified the impact of these reservations at 201 million euro, (2007, 726 million euro) <sup>(2)</sup>.

2.7. The reservations by the Directorates-General for policy groups Research, Energy and Transport and Economic and Financial Affairs are in line with the Court's findings that the rate of residual error (after off-setting and corrections) in the cost claims for the 6th Framework Programme (FP6) remain above materiality.

2.8. For policy group Education and Citizenship, the Director-General for DG Communication reported on the achievements in strengthening control systems, yet highlights that 9,4 % of the transactions checked were affected by error, albeit of low impact

2.9. The Court's analysis shown on the right-hand side of **Table 2.1** shows that the annual activity reports concur with the Court's DAS conclusions for administrative expenditure and economic and financial affairs only. In other words, for these policy areas the Court's or the Commission's audits revealed no significant weaknesses which have not been included in the declarations of the Directors-General. For policy area Agriculture and Natural resources the annual activity report of the Director-General for Agriculture and rural development is closer to the conclusions of the relevant DAS specific assessment than in previous years.

2.6. The Commission points out that the reservations put in the annual activity reports (AAR) of Directorates-General Regional Policy and Employment, Social Affairs and Equal Opportunities were based on a detailed analysis of each operational programme. The financial impact was calculated by using levels of flat rate corrections which would be applicable for the systems weaknesses identified and by applying them to payments for the affected parts of concerned programmes.

The reduction of the financial impact of reservations is clearly explained in the respective AARs and confirms that the Commission took its responsibilities, in accordance with its commitment to strengthen its supervisory role. The quantified impact results from the vigorous efforts of the Commission for all programmes in 2008, including also the follow up of all reservations in the 2007 AARs, the conclusion of 14 national remedial action plans and the application of corrections of more than 1,5 billion euro, which resulted in reservations being lifted in many cases.

See also reply to paragraph 2.17.

2.7. The Commission implements a control strategy designed to ensure the legality and regularity of payments on a multiannual basis. For the 6th Framework Programme (FP6), the objective of the strategy is to reduce, by the end of the fourth year of its implementation (2010), the residual error rate. The target objective is reassessed annually in view of the nature, frequency and amount of the errors detected, as well as cost-benefit considerations.

See also reply to paragraph 7.17.

2.8. An action plan for improving the quality of transactions in DG Communication has been implemented and, in particular, training actions are on-going.

2.9. The Commission welcomes the improvements noted and reiterates its commitment to achieving further progress in this area. The Commission is currently assessing the factors affecting the quality of the annual activity reports and will promote measures to further improve their quality.

<sup>(2)</sup> Based on an estimated 5 or 10 % flat-rate financial correction.

## THE COURT'S OBSERVATIONS

2.10. In the case of the cohesion policy group, the Court notes, as for 2007, that the scope and scale of the reservations understate the gravity of the problems of irregularity in this area of the budget (see paragraph 6.35).

2.11. In the policy group External Aid, Development and Enlargement the Court has found a material level of error (see paragraph 8.39) and that the supervisory and control systems are only partially effective in ensuring the regularity of payments (see paragraph 8.44). These findings are not adequately reflected by the Directors-General in their declarations. This is now the fourth consecutive year that the Court has made this particular observation <sup>(3)</sup>.

**Synthesis Report of the Commission**

2.12. By adopting the Synthesis Report the Commission assumes its political responsibility for the operational implementation of the EU budget through its Directors-General <sup>(4)</sup>. The report provides a retrospective assessment of the financial management during the whole mandate period of the outgoing Commission.

<sup>(3)</sup> Annual Report concerning the financial year 2007, paragraph 2.14 and Table 2.1, Annual Report concerning the financial year 2006, Table 2.1 and Annual Report concerning the financial year 2005, Table 2.1. The policy group External Aid, Development and Enlargement was previously called External Actions.

<sup>(4)</sup> Communication from the Commission to the European Parliament, the Council and the Court of Auditors — Synthesis of the Commission's management achievements in 2008, COM(2009) 256 final, 8.6.2009.

## THE COMMISSION'S REPLIES

**2.10.** *The Commission considers that the reservations made by the Directors General in the 2008 annual activity reports are in line with the materiality criteria established and the methodology applied. The Court's findings show that the error rate is concentrated on programmes for which the Commission had already taken actions in 2008 (see reply to paragraph 6.17.) For the programmes categorised in the AARs as functioning effectively or partially effectively, the Commission has audit evidence that the risk is lower. In addition, the 2008 Commission action plan included actions to set up the closure process, in order to ensure that remaining errors be discarded from final payments from the Commission.*

*The Commission will ensure that appropriate follow-up and corrective actions are taken for all the cases identified by the Court, as it did in previous years.*

**2.11.** *The errors detected by the Court in External aid, Development and Enlargement mostly concern expenditure in the form of advances made by organisations implementing projects on advance payments made by the Commission. Mandatory financial audits foreseen under the Commission's control system before the final payments should allow the Commission to detect and correct such errors before final payments are made. See also the replies to paragraphs 8.18 and 8.34.*

*However as part of its ongoing efforts to improve the overall internal control system and in conjunction with the Commission's work on tolerable risk of error, EuropeAid will launch a review of its control strategy in 2010.*



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

2.13. The Commission considers that for 2008 the 'control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions for which the Commission takes overall responsibility pursuant to Article 274 of the EC Treaty.'

2.14. The Commission refers to the outcome of an annual peer review exercise carried out in early 2009 that indicates that there is scope for further improving the quality of the Annual Activity Reports, one of the most crucial governance tools. The Commission expects that these improvements will be reflected from the 2009 AARs onwards.

2.15. The Synthesis Report provides some explanations of the Commission's approach to reservations. The Commission states that a reservation is systematically made for significant deficiencies unless there is reliable audit evidence that an action plan is in place and is working. However, the Court finds that the Commission should give greater attention to the need to derive more robust indications that the corrective measures contemplated within the action plans have been or are likely to be effective, and that in several cases the scope of the reservations should be greater (see the examples discussed in paragraphs 2.5, 2.10 and 2.11 and **Table 2.1**).

2.16. The Court notes that the Commission acknowledges the need for further actions to resolve identified issues in other areas. These actions are to address *inter-alia* such concerns as

(a) The evaluation of the effectiveness of internal controls;

**2.14.** *The Commission will carry out an assessment of the factors affecting the quality of AARs and will promote measures to further improve their quality in time for the report on 2009 activities. The Standing Instructions for annual activity reports are currently in the process of being streamlined and made more user-friendly. Special efforts will be made to design a dedicated training course on this subject targeting the staff drafting annual activity reports in late 2009.*

**2.15.** *The Commission's approach is that a reservation should not be made if effective mitigating controls exist or if audit evidence exists which shows that remedial action plans have been effectively implemented.*

*When Directors General express a reservation they are required to set out an action plan to address the identified weaknesses. The action taken is then reported and assessed in the subsequent Annual Activity Report. If there is sufficient evidence that the actions are having a measurable impact on the weaknesses, then the reservation may be lifted. Decisions to make or lift reservations are one of the key points discussed in the 'peer reviews', although the final decision is taken by the responsible Delegated Authorising Officer.*

*For the case of IACS in Greece, see reply to paragraph 2.5.*

*For the area of Cohesion Policy, see reply to paragraph 2.6.*

*The Commission also refers to its replies to paragraphs 2.10 and 2.11.*

**2.16.**

## THE COURT'S OBSERVATIONS

- (b) The concentration of resources on improving the control structure in place for the management of expenditure in the 2007-2013 financial framework and on remedying weaknesses in the previous one; and
- (c) Complete and reliable reporting on the correction of errors at the level of the Member States.

## THE COMMISSION'S REPLIES

- (b) Through the Action Plan to improve the Commission's supervisory role in structural actions, the Commission has focused its activity on preventive actions for the 2007-2013 period, as well as on the preparation for the closure of 2000-2006 programmes.*
- (c) Complete and reliable reporting on the correction of errors at the level of the Member States.*

*The Commission considers that, as a result of its actions, there has been progress in producing reliable evidence of the effective operation of the multi-annual corrective mechanisms. It is continuing its efforts to improve the completeness and quality of data provided by Member States.*

*For the period 2007-2013, the system for reporting of financial corrections by the Member States to the Commission has been considerably clarified and strengthened by the designation of a responsible authority and the provision of a reporting table (Article 61 of Regulation (EC) No 1083/2006 and Article 20 of Commission Regulation (EC) No 1828/2006).*

*The Commission also refers to its reply to paragraph 6.30.*

2.17. For Cohesion policy the Commission reports that it took more formal decisions to suspend interim payments (10 in 2008 against 1 in 2007) and applied much larger financial corrections (1 587 million in 2008 against 396 million in 2007). However, in respect of its action plan to strengthen its supervisory role under the shared management of Cohesion, the Commission acknowledges that 'further time is needed before the impact of the actions can be measured by a reduction of the error rate'.

*2.17. The Commission shows in its report on the implementation of the Action Plan to strengthen the Commission's supervisory role in structural actions (COM(2009) 42) that effective results were produced in 2008 in all 10 areas of action. This included the quicker launching of financial corrections procedures and the level of financial corrections achieved in 2008. It agrees that the impact of the Action Plan with regard to the period 2000-2006 cannot yet be fully assessed and has undertaken to report on the initial impact of the Action Plan in February 2010.*

*More generally, the Commission has put in place a multiannual control system based on prevention or detection and correction. The Commission's best estimate of financial corrections and recoveries decided in 2008 totalled 2,967 billion euro for all policy areas, thus demonstrating a particular effort on the detection and correction aspects of its control system (see section 6 'recovery of undue payments' of the notes to the annual accounts for the year 2008).*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Assurance drawn from Annual Summaries**

2.18. In its Annual Report 2007 the Court found that annual summaries, in their first year of existence, did not provide a reliable assessment of the functioning and effectiveness of the supervisory and control systems and recommended that the Commission take steps to improve the information provided <sup>(5)</sup>.

2.19. The Court analysed the 2008 Annual Summaries to determine whether the requirements of the Financial Regulation had been respected and whether Member States had provided supplementary information.

2.20. Not all Member States complied with the requirements as set out in the Financial Regulation nor did they follow the Commission's guidelines <sup>(6)</sup>. However, compared to last year, the quality of the analysis included in all annual summaries has improved.

**2.18.** For the cohesion area, in 2008, the Commission current legal basis (Article 53b(3) of the Financial Regulation) provides neither for a statement of assurance, nor for an overall national declaration. Nonetheless, the Commission followed the European Parliament and the Court's recommendations and urged the Member States to analyse the functioning of systems, diagnose problems and their solutions, describe good practices, and provide declarations on the degree of assurance that they derive from the systems.

In agriculture, all Member States with only one paying agency must provide a statement of assurance from the director of the paying agency and a certificate from the certification body which by definition constitute the annual summary referred to in the Financial Regulation and the Inter-Institutional Agreement. In addition, annual summaries, also called synthesis reports, are drawn up by those Member States with more than one paying agency.

**2.20.** Directorates-General Regional Policy and Employment, Social Affairs and Equal Opportunities have noted in their AARs for 2008 that the majority of Member States have complied or mostly complied with the minimum requirements. The Commission has taken appropriate steps to follow up all cases of non-compliance with the regulatory requirements. The information provided in the Annual Summaries was used as an additional source of assurance for the two Directorates-Generals' AARs for 2008.

<sup>(5)</sup> See paragraphs 2.19 and 2.41(b) of the Annual Report concerning the financial year 2007.

<sup>(6)</sup> For Cohesion policy, nine Member States provided information which was compliant, 11 Member States submitted information which was mostly compliant except for minor deficiencies involving incomplete or incorrect data in the tables. Three Member States submitted Annual Summaries which were non-compliant and returned by the Commission for resubmission and for a further four Member States the analysis had not been completed by the Commission as at 28 February 2009. A broadly similar conclusion is drawn by the Director-General of DG REGIO and a corresponding assessment is presented in the relevant Annual Activity Reports. The Court notes the follow-up actions taken by the Commission where Member States were found to be non-compliant.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Added Value*

2.21. Annual summaries are an element of internal control and the Court has encouraged the Commission to add value to the process by identifying common problems, possible solutions or best practices and using this information in its supervisory role <sup>(7)</sup>. The Commission has similarly encouraged the Member States to do likewise.

2.22. The Court's analysis showed that for 2008 a number of Member States <sup>(8)</sup> submitted elements or analyses which added value to the Annual Summaries, by seeking to identify and comment on systemic deficiencies or cross-cutting issues. The Directors-General for Cohesion have used the data in the annual summaries as an input into their own assessment of the national systems.

The Directorate-General for Agriculture and Rural Development has noted in its 2008 annual activity report that Member States have complied with their legal obligations and generally followed the guideline established by the Commission services. Compared to last year, the quality of analysis included in all annual summaries has improved, but in some cases the assessment of certain basic elements should still be improved further. The Commission has therefore raised this point with the Member States and has subsequently revised one of the guidelines.

**2.21.** The Commission has informed Member States to follow best practice in its assessment letters of the Annual Summaries. It will continue to encourage Member States to provide information which gives added value to the Annual Summaries by again updating its guidance note.

The Commission also refers to its reply in paragraph 2.18.

**2.22.** The Commission refers to its reply in paragraph 2.20.

For the cohesion area, seven Member States have included in the Annual Summaries the statement of assurance proposed in the Commission's guidelines. The Commission will analyse those declarations and statements which have been provided to date, with the aim of defining the key elements which can add value to the Annual Summaries. The results of this analysis will be taken into account for the update of the guidance note.

For agriculture and rural development, assurance on the accounts and on the legality and regularity of the underlying transactions is provided by the statement of assurance of the director of the paying agency. This statement is subject to an audit by and an opinion from the certification body, thereby enhancing the assurance. The synthesis report (drawn up by those Member States with more than one paying agency) provides added value by summarising this assurance at national level.

<sup>(7)</sup> Opinion of the Court 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, p. 3).

<sup>(8)</sup> 16 for Structural Actions and the European Fisheries Fund and 9 for Agriculture.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## COMMISSION'S INTERNAL CONTROL STANDARDS

**Introduction**

2.23. In October 2007 the Commission adopted a Communication revising the Internal Control Standards (ICS) and underlying framework<sup>(9)</sup>. It set out 16 revised internal control standards for effective management to replace the original set of 24 standards as from 1 January 2008.

2.24. In respect of 16 Directorates-General, the Court examined the ICSs related to ensuring the regularity of transactions and found a high level of implementation similar to previous years<sup>(10)</sup>.

**Effectiveness**

2.25. The revision of the ICSs was accompanied by the requirement for Directors-General to demonstrate the effective implementation of certain prioritised standards<sup>(11)</sup>. Most Directors-General chose to do so for 2008 for ICS 7-11 which largely cover the area devoted to 'Operations and Control Activities'<sup>(12)</sup>. By contrast, the standards relating to the areas of 'Planning and Risk Management Processes' (ICS 5 and 6), have been selected by only a small number of Directorates-General<sup>(13)</sup> despite their importance. The Commission has, however, been unable to demonstrate that the supervisory and control systems are sufficiently effective in mitigating the risk of error in the following policy areas/groups: rural development in Agriculture and Natural Resources (paragraph 5.63), Cohesion (paragraph 6.36), Research, Energy and Transport (paragraph 7.41) and External Aid, Development and Enlargement (paragraph 8.34).

**2.24.** *The Commission welcomes the Court's recognition of the fact that the internal control standards have been almost fully implemented by its services.*

**2.25.** *The Commission notes that its internal control systems are improving and having an impact on the error rates as reflected in the positive evolution of the Court's statement of assurance in recent years (see paragraph 1.36).*

*Thirteen Directorates-General (one third) chose to prioritise one or both of the Planning and Risk Management standards, including some major spending Directorates-General. The Commission considers that this is an appropriate reflection of the importance of these standards to the Directorates-General concerned.*

<sup>(9)</sup> Communication to the Commission: Revision of the Internal Control Standards and the Underlying Framework: Strengthening Control Effectiveness, SEC(2007) 1341. The Court commented positively on the transition, see paragraph 2.27 of the Annual Report concerning the financial year 2007.

<sup>(10)</sup> See paragraph 2.25 of the Annual Report concerning the financial year 2007. For 2007 and 2008 the level of implementation is calculated to be in excess of 96 %.

<sup>(11)</sup> Communication to the Commission 'Revision of the Internal Control Standards and Underlying Framework — Strengthening Control Effectiveness' (SEC(2007) 1341, 16.10.2007). This guidance allows Directorates-General to demonstrate effectiveness for certain ICS pre-selected 'prioritised' in the Directorates-General Annual Management Plans for the previous year.

<sup>(12)</sup> Commission services had the possibility to prioritise certain Standards, based on the services' specific activities and risks and to communicate the choice in their Annual Management Plan for 2008.

<sup>(13)</sup> A similar distribution applies also to the Annual Management Plans for 2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*For Agriculture and Natural Resources as a whole, the estimated value of the overall error is slightly below the materiality threshold of 2 %. Over the years, a trend shows that, in general, the supervisory and control systems have improved in this policy area and are now effective, although improvements are still needed in the area of rural development.*

*Through the implementation of the Action Plan to strengthen the Commission's supervisory role in the management of structural actions, the Commission has made significant progress in improving the supervisory systems and mitigating the risk of error. It has also undertaken additional actions, such as simplifying the rules for declaration of costs in the Cohesion Policy area through the introduction of flat rates, lump sums and standard scales of unit costs, and through strengthening the control framework for the 2007-2013 period. The Commission considers that the impact of such actions on the error rate can only be assessed over a longer period of time and will report in early 2010 on the first impact on 2007-2013 payments.*

*The Commission also refers to its reply in paragraph 2.17.*

*Considerable efforts have been made already to improve the management of Research, Energy and Transport policy within the limits of the applicable legal and financial framework. The Commission will continue the rigorous application of controls (see also reply to paragraph 7.42).*

*For the area of External aid, Development and Enlargement, the Commission has designed its controls for this policy group to cover the full lifecycle of its multi-annual projects so that it is able to prevent, or detect and correct most financial errors in the normal course of its controls. The mandatory financial audits foreseen under the Commission's control system should allow the Commission to detect and correct these prefinancing errors — in a later accounting year — before final payments are made. The Commission's ex-post controls confirm this low level of residual error.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## ACTION PLAN

**General assessment of implementation**

2.26. The Action Plan of 2006 sought to address specific gaps in the Commission's internal control framework<sup>(14)</sup>. The Commission's Communication of February 2009<sup>(15)</sup> provides an updated assessment of the results of the Action Plan based on indicators.

2.27. The Court's analysis of this Communication (see **Table 2.2**) shows that the Commission has implemented all of the 14 sub-actions identified as outstanding in the Court's previous Annual Report<sup>(16)</sup> and has thereby completed the implementation of the Action Plan.

**Impact of Action Plan**

2.28. The Commission provides a series of indicators and descriptors to measure and assess the impact of the Action Plan<sup>(17)</sup>. The Court's analysis (see **Table 2.2**) shows that most of these measure only output and Commission activity by (sub-) action rather than effectiveness. Although factually accurate, it is not possible to determine on their basis if the Action Plan has had a measurable impact on the supervisory and control systems and ultimately on the regularity of transactions.

**2.28.** *The Commission acknowledges that it is often difficult to demonstrate the impact of individual actions on error rates in underlying transactions. However, globally, it concluded in its latest 'impact report' (COM(2009) 43) that significant progress had been made in strengthening internal control systems during the mandate period of the current Commission. A part of this positive impact is due to actions launched before 2005, but there is certainly evidence that progress was significantly accelerated with the launch of the Action Plan in early 2006.*

*Furthermore, the Commission considers that the action plans of the last few years have created a common understanding among Member State authorities or external bodies on the measures needed to prevent errors in EU programmes. This is a very important impact, and it will constitute the foundation for future action and cooperation.*

<sup>(14)</sup> Communication from the Commission to the Council, the European Parliament and the European Court of Auditors — Commission Action Plan towards an Integrated Internal Control Framework COM(2006) 9 final, of 17.1.2006.

<sup>(15)</sup> Communication from the Commission to the European Parliament, the Council and the European court of Auditors — Impact Report on the Commission Action Plan towards an Integrated Internal Control Framework, COM(2009) 43 of 4.2.2009.

<sup>(16)</sup> See paragraph 2.30 of the Annual Report concerning the financial year 2007.

<sup>(17)</sup> This was not the case for the Commission's previous summary report for 2007, see paragraph 2.34 of the Annual Report concerning the financial year 2007.

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  | Commission's assessment of the impact achieved (February 2009) <sup>(1)</sup><br>Impact indicators presented by the Commission   | Court's assessment of the impact achieved as at 31.12.2008 <sup>(2)</sup>  |
|---|---|--|--|
| <b>Simplification and common control principles (Actions 1-4)</b> |   |  |  |
| 1   | Keep under consideration simplification of the rules for the 2007-2013 period concerning in particular the eligibility of expenditure in the structural funds and in the research programmes (31.12.2006).  | <ul style="list-style-type: none"> <li>— <i>Percentage of the budget executed through a simplified approach.</i></li> <li>— <i>Reduced ECA error rates due to clearer legislation and extensive guidance.</i></li> </ul> | There has been an increase in the percentage of the budget executed through a simplified approach. There is little evidence yet to make the link between reduced ECA error rates and clearer legislation / extensive guidance. |
| 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  |  |
| 3a  | Establish Internal Control Templates which outline the range of control components which would be expected in a given control environment (31.5.2006).  | <ul style="list-style-type: none"> <li>— <i>Improved evaluation by the ECA of the quality of AARs</i></li> <li>— <i>For action 3N see also under action 11N</i></li> </ul>   | The (sub-) actions have been implemented and improvements noted in the relevance and coherence of AARs, however the impact on error rates is not measurable <sup>(3)</sup> .   |
| 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).  |  |  |
| 3c  | Organise peer review to enhance coherence and consistency of control strategies per family (31.3.2007).   |  |  |
| 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). |  |  |
| 3e  | Organise peer review to enhance coherence and consistency of control strategies per family (31.12.2007).  |  |  |



| Reference  | Domain / (sub-)actions / deadline set in the action plan  | Commission's assessment of the impact achieved (February 2009) <sup>(1)</sup><br>Impact indicators presented by the Commission  | Court's assessment of the impact achieved as at 31.12.2008 <sup>(2)</sup>  |
|--|---|---|--|
| 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).  |   |  |
| 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   |  |
| <b>Management declarations and audit assurance (Actions 5-8)</b> |   |   |  |
| 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). | <ul style="list-style-type: none"> <li>— <i>Quality of summaries received and action taken to improve</i></li> <li>— <i>Receipt of ex-ante declarations of assurance in Education and Culture</i></li> <li>— <i>Member State initiatives on declarations</i></li> </ul> | <p>Annual summaries and national declarations are useful building blocks and promote transparency of EU expenditure.</p> <p>In particular, national declarations in the medium term have the potential to lower error rates by ensuring increased operational effectiveness of systems.</p> <p>The Court welcomes the information on the receipt and monitoring of the ex-ante declarations, but as yet sees no impact on error rates.</p> |
| 6a   | Develop guidelines on making management declarations more effective in research and other internal policies (30.9.2006).  | Combined with action 7  |  |
| 6b   | Extend guidelines on making management declarations more effective for external policies (31.12.2007).  | Withdrawn   |  |

| Reference   | Domain / (sub-)actions / deadline set in the action plan   | Commission's assessment of the impact achieved (February 2009) <sup>(1)</sup><br>Impact indicators presented by the Commission                         | Court's assessment of the impact achieved as at 31.12.2008 <sup>(2)</sup>  |
|---|--|--|--|
| 7a  | Establish criteria for certification audits in research and internal policies, focusing on the use of 'agreed-upon procedures' (31.12.2006).   | <ul style="list-style-type: none"> <li>— <i>Improved quality of reporting by external auditors</i></li> <li>— <i>Action 7b is withdrawn</i></li> </ul> | Despite progress made, the risk of error is not yet sufficiently mitigated.  |
| 7b  | Examine criteria, where these are not already in place, for certification audits in shared management 2007-2013, considering also the use of 'agreed-upon procedures' (31.3.2007).   |  |  |
| 7c  | Extend criteria for certification audits, focusing on the use of 'agreed-upon procedures', to other management modes, where appropriate (31.12.2007).  |  |  |
| 8   | Analysis of potential additional assurance from SAIs on existing practice related to EU funds (31.12.2006).  | <ul style="list-style-type: none"> <li>— <i>Number of SAIs in dialogue with the Commission</i></li> </ul>  | Such initiatives increase awareness, but have no direct impact on the error rate.  |
| 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 EU expenditure (31.12.2007). |  |  |
| <b>Single audit approach: sharing or results and prioritising cost benefit (Actions 9-11)</b> |  |  |  |
| 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).  | <ul style="list-style-type: none"> <li>— <i>Use of audit tool and improved coordination of audits</i></li> </ul>                                       | The Court shares the Commission's assertion that improved coordination increases the efficiency of audits rather than directly reducing error rates. |
| 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).                                |  |  |

| Reference | Domain / (sub-)actions / deadline set in the action plan  | Commission's assessment of the impact achieved (February 2009) <sup>(1)</sup><br>Impact indicators presented by the Commission | Court's assessment of the impact achieved as at 31.12.2008 <sup>(2)</sup>   |
|-----------|---|--|---|
| 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 2007-2013 (31.5.2007).   |  |   |
| 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). (See under sub-action 9b)  |  |   |
| 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).  |  |   |
| 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).  |  |   |
| 10a.1     | Assess costs of controls in shared management: define a common methodology (31.5.2006).   | — <i>Progress towards a common understanding of tolerable risk</i>   | The Commission has issued a communication on a common understanding of tolerable risk. This has no immediate impact on the rate of error. |
| 10a.2     | Assess costs of controls in shared management: launch initiative for data to be provided by Member States (30.9.2006).  |  |   |
| 10a.3     | Assess costs of controls in shared management: provision of data by Member States (28.2.2007).  |  |   |
| 10a.4     | Assess costs of controls in shared management: analysis of received information (30.9.2007).  |  |   |
| 10b       | Make a first estimation on the costs of control incurred in direct management expenditure (30.6.2007).  |  |   |
| 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). |  |   |

| Reference                                   | Domain / (sub-)actions / deadline set in the action plan   | Commission's assessment of the impact achieved (February 2009) <sup>(1)</sup><br>Impact indicators presented by the Commission   | Court's assessment of the impact achieved as at 31.12.2008 <sup>(2)</sup>   |
|---|--|--|---|
| 11  | Run a pilot-exercise for evaluating benefits in the context of control of internal policies (30.6.2007).   |  |   |
| 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).   | <ul style="list-style-type: none"> <li>— Reliability, consistency and completeness of recovery data</li> <li>— Effectiveness of the recovery process</li> <li>— Volume of financial corrections</li> </ul> | This sub-action has no immediate impact on the rate of error, but demonstrates that compensatory measures are being undertaken and that the quality of data for recoveries has improved.  |
| <b>Sector specific gaps (Actions 12-16)</b> |  |  |   |
| 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).   | <ul style="list-style-type: none"> <li>— Quality of control systems</li> <li>— Error rates in FP6</li> </ul>   | Directorates-General TREN, ENTR, RTD and INFSO have all issued reservations for the FP6 programme in 2008 concerning the residual rate of error with regard to the accuracy of cost claims. The impact of the sub-action as concerns the identification and correction of errors is not yet measurable. |
| 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). |  |   |
| 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).   | <ul style="list-style-type: none"> <li>— Quality of Member States' systems</li> </ul>  | This has no direct impact on the rate of error.   |
| 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 2007-2013 period (31.12.2007).  |  |   |

| Reference | Domain / (sub-)actions / deadline set in the action plan   | Commission's assessment of the impact achieved (February 2009) <sup>(1)</sup><br>Impact indicators presented by the Commission | Court's assessment of the impact achieved as at 31.12.2008 <sup>(2)</sup> |
|-----------|--|--|---|
| 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). | — <i>Member States' assessments against regulatory benchmarks</i>  | Impact not measurable   |
| 14b       | Provide in the context of the structural funds and indirect centralised management 2007-2013 guidelines for beneficiaries and/or intermediate levels on controls and responsibilities in the control chain (31.12.2007).   |  |   |
| 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).                         | — <i>Single audit approach extended under Contracts of Confidence</i>  | Impact not measurable   |
| 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).  | — <i>Level of awareness and consistency of approach in the Structural Funds</i>  | Impact not yet measurable   |
| 16b       | Develop common approaches to using risk and representative sampling in research and other internal policies, and external policies (31.12.2007).   |  |   |
| 16c       | Coordinate audit standards, error rate reporting, etc. for structural funds (31.12.2007).  |  |   |

<sup>(1)</sup> COM(2009) 43.

<sup>(2)</sup> The Commission also states that the impact of the various (sub-)measures on the reduction of errors or the increase in assurance will only build over time as they begin to have an impact on the underlying control systems.

<sup>(3)</sup> See paragraph 2.37 of the Annual Report concerning the financial year 2007, and paragraph 2.29 of this report.

Source: Court of Auditors.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## OVERALL CONCLUSIONS AND RECOMMENDATIONS

**Conclusions**

2.29. For 2008, the Court has identified further progress in the Commission's supervisory and control systems, in particular, the impact of the relevant reservations on the assurance given in the Directors-General declarations (paragraphs 2.5 to 2.8).

2.30. The Court's audits however identified for some annual activity reports and declarations continuing weaknesses in the scope and scale of reservations and in the assessment and functioning of the supervisory and control systems (paragraphs 2.9 to 2.11).

2.31. The Commission has made progress on managing the Annual Summaries such that they provide additional assurance and are used to add value to the declarations made by the Directors-General. However, not all Member States complied fully with the Financial Regulation (paragraphs 2.20 and 2.22).

2.32. The Commission is able to demonstrate the almost full implementation of the revised internal control standards (see paragraph 2.24), and has implemented the sub-actions in its action plan towards an integrated internal control framework (paragraph 2.27).

2.33. However, the Court notes that the Commission is not able to demonstrate that its actions to improve supervisory and control systems have been effective in mitigating the risk of error in some areas of the budget (see paragraph 1.33).

*2.29. The Commission welcomes the Court's assessment that the overall Commission internal control system was further strengthened in 2008. Important points of progress to be highlighted from 2008 include the effective implementation of the control standards in themselves and the improved quality of Member States' annual summaries or declarations of assurance.*

*2.30. For the cohesion area, the methodology applied for putting reservations is based on a detailed analysis of supervisory and control systems at national/local levels. The Commission considers that the reservations in the Annual Activity Reports give a fair view of the systems' deficiencies (see also the reply to paragraph 2.6).*

*The Commission welcomes the improvements noted in table 2.1 and reiterates its commitment to achieving further progress in this area. The Commission is currently assessing the factors affecting the quality of the Annual Activity Reports and will promote measures to further improve their quality.*

*See replies to paragraphs 2.9, 2.10 and 2.11.*

*2.31. In 2008, seven Member States have included in the Annual Summaries the statement of assurance proposed in the Commission's guidelines. The Commission will continue to develop its guidance so that Annual Summaries further add value to the process.*

*The Commission has also taken appropriate steps to follow up all cases of non-compliance with the regulatory requirements and has achieved to have Member States adding more value to their Annual Summaries compared to the previous year.*

*2.33. The Commission notes that the Court's statement of assurance has progressively improved over the last few years (taking policy groups as a whole: for 2003, 6 % of total expenditure received a 'green light' as regards the error rate detected, whereas the corresponding figure has increased to 56 % for 2008). The Commission considers that this is clearly the result of the efforts and action plans it has implemented to improve the internal control system, although it is not possible to isolate the impact of individual actions on the error rate.*

*The Commission also refers to its replies in paragraphs 2.17 and 2.25.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Recommendations**

2.34. Improving supervisory and control systems must be seen as an ongoing process where the relevant measures will take time before they can be deemed to be effective. This means that past recommendations made by the Court remain valid <sup>(18)</sup>.

2.35. Particular and additional attention needs to be primarily directed at those expenditure areas where the Court continues to report a high level of error. This must include:

(a) assessing the cost and value of controls in policies;

(b) favouring simplification in the conception of future policy proposals;

**2.34.** *The Commission pursues its efforts in implementing the Court's past recommendations. The analysis of its supervisory and control systems shows that the measures put in place have an increasing impact on reducing the risks of error over time. There is a reasonable expectation that the control strategy should ensure that the control objective is met over time particularly for multiannual programmes, since complementary checks are foreseen at the end of the programming period for the final clearance of accounts, on top of corrective actions during the implementation time of the programmes. The analysis of corrective actions taken by both the Member States and the Commission should necessarily take into account the element of multi-annuality.*

**2.35**

(a) *The Commission is committed to pursuing its initiative on the tolerable risk of error including assessment of the costs of control. It will begin by presenting concrete proposals on research, energy and transport, rural development, external aid and administrative expenditure in 2010. The remaining policy areas will be addressed in the subsequent years.*

(b) *A certain degree of complexity in rules and eligibility criteria is unavoidable as these are often fixed in order to achieve desired policy objectives, which are the outcome of a complex legislative procedure where the Legislative Authority has the last word. Nevertheless the Commission has committed itself to make proposals to the Legislative Authority for further simplification where possible. It will consider the scope for introducing further simplification of eligibility rules in its 2010 proposal for the triennial revision of the Financial Regulation. It will also study principles for further simplification of sectorial legislation for the next round of basic acts, to come into force from 2014.*

*The Commission refers to the Court's own conclusion in paragraph 1.39 that there may be tension between simplification and ensuring that aid achieves policy objectives. It notes in this regard that very focused policy objectives sometimes require complex rules in order to ensure that the objectives are achieved.*

<sup>(18)</sup> Paragraphs 2.41 and 2.42 of the Court's Annual Report concerning the financial year 2007.

## THE COURT'S OBSERVATIONS

- (c) continue improving the mechanism through which financial corrections, withdrawals or recoveries are intended to correct errors incurred, as well as taking the necessary steps such that this impact can be demonstrated in practice.

2.36. In those policy areas where there are legal requirements for annual submissions from the Member States, the Commission should ensure that maximum benefit is derived from such submissions. For example, annual summaries and *ex-ante* declarations. Due attention should also be given to voluntary initiatives by the Member States (in the form of National Declarations) or by Supreme Audit Institutions to obtain additional insight into all matters that could be relevant in ensuring the legality and regularity of expenditure under the EU budget.

## THE COMMISSION'S REPLIES

*For Cohesion Policy the Funds regulations have been modified in May 2009 to allow the use of flat rates, lump sums and standard scales of unit costs already for the 2007-2013 programmes. The Commission has strongly encouraged Member States to apply these simplified costs options. In July 2009 it has presented further proposals for simplification of the 2007-2013 regulatory Framework.*

- (c) *The Action Plan to strengthen the Commission's supervisory role in structural actions addressed both the causes and effects of the high rate of error found by the Court in structural actions expenditure. The Commission considers that the financial corrections mechanism has been strengthened, a fact which is confirmed by the number and level of suspensions and financial corrections in 2008. In addition, the Commission's closure strategy for the 2000-2006 will focus on reducing the residual error rate to acceptable levels. The Commission will maintain its efforts and has requested Member States to strengthen recovery procedures and reporting in 2009 and improved the regulatory requirements for annual reporting on financial corrections for the 2007-2013 period.*

*The correction of systematic errors is expected to gather pace in 2009 for the research area.*

**2.36.** *The Commission will continue its efforts to improve the quality and added value of the required Annual Summaries. It will also continue to encourage positive initiatives, such as the timely submission of voluntary national management declarations that provide assurance on the regularity of EU expenditure. The Commission has also welcomed and supported joint actions from Supreme Audit Institutions of Member States, which aimed at exchanging know-how and experiences. However, as stated by the Court in its opinion 6/2007 on annual summaries and national declarations, information provided in the latter can only be relied upon if the declarations are of adequate and comparable scope, approach and timing.*



## CHAPTER 3

**Budgetary Management**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction                              | 3.1              |
| Observations                              | 3.2-3.12         |
| Targets achieved by amending budgets      | 3.2-3.4          |
| Implementation of programmes              | 3.5-3.6          |
| Cohesion policies expenditure             | 3.5-3.6          |
| The European Economic Recovery Plan       | 3.7-3.8          |
| Outstanding budgetary commitments ('RAL') | 3.9-3.12         |
| Conclusions and recommendations           | 3.13-3.15        |

## 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 2008. It covers in particular the rate of budgetary implementation, the implementation of EU programmes, in particular EU cohesion policies expenditure, the amending budgets and the level of outstanding budgetary commitments.

## OBSERVATIONS

**Targets achieved by amending budgets**

3.2. The budgetary appropriations adopted for 2008 (voted budget and amending budgets) together with the carryover from 2007 totalled 132,3 billion euro in commitments and 117 billion euro in payments, an increase of 4,7 % and 1,7 % respectively compared to the final budget in 2007 <sup>(1)</sup>. Overall, the total budgetary commitment appropriations of the year were 2,2 billion euro below the financial framework ceiling, while payment appropriations remained below by 14,0 billion euro (see *Diagrams III* and *IV* in *Annex I*).

3.3. The 10 amending budgets voted during the year resulted in an overall 1,4 billion euro increase in appropriations for commitments and a 4,6 billion euro decrease in appropriations for payments. The decrease is mostly a reaction to lower than expected spending in the areas of Cohesion Policies (4,5 billion euro) and External Relations (0,3 billion euro). Reducing appropriations for payments through amending budgets represents good financial management by adjusting to changes and reducing the budgetary surplus <sup>(2)</sup> (allowing, in particular, own resources to be returned to Member States earlier).

3.4. The Commission produces a series of documents containing inter alia the following information on the implementation of the budget of the European Communities <sup>(3)</sup>:

<sup>(1)</sup> Assigned revenues 2008 excluded. Assigned revenues cover i.a. refunds arising from recovery of amounts paid in error, which are re-allocated to their budget line of origin, contributions from EFTA members increasing specific budget lines, or revenue from third parties where agreements have been concluded involving a financial contribution to EU activities.

<sup>(2)</sup> The budgetary surplus (budget outturn) is the result of the implementation of the budget. 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.

<sup>(3)</sup> Detailed information on budgetary implementation for 2008 can be obtained from Part II of the Annual Accounts of the European Communities, Financial Year 2008, the EC's (DG Budget) documents 'Report on budgetary and financial management — financial year 2008' as well as from the Report on the 'Analysis of the budgetary implementation of the Structural and Cohesion Funds in 2008'.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- the budgetary surplus at the end of 2008 (1,8 billion euro) remained at almost the same level as in 2007 (1,5 billion euro);
- utilisation rates in 2008 for both commitments and payments, at 99 % and 97 % respectively (after amending budgets), remain at a similar high level as in 2007, the first year of the new programming period (96 % and 98 %);
- 2,1 billion euro of unused payment appropriations (excluding assigned revenues, see footnote 1) were not cancelled but carried over from 2008 to 2009, a higher level than in 2007 (1,2 billion euro);
- for the area of 'Cohesion' <sup>(4)</sup> (included in the Titles 04, 05, 11 and 13 <sup>(5)</sup>) the 4,5 billion euro reduction in payment appropriations resulted in a final utilisation rate of 99 % (it would have been 88 % had the ninth amending budget not been adopted);
- Member States' forecasts for payments resulting from commitments to spend made between 2000 and 2006 have improved over the last three years. The overall over-estimation was reduced from 33 % in 2006 to 18 % in 2007 and 16 % in 2008. As concerns commitments made under the current programming period (2007-2013), the over-estimation of payments was 27 % in 2008.

**Implementation of programmes*****Cohesion policies expenditure***

3.5. Concerning the 2000-2006 Structural Funds programmes, the implementation of payment appropriations for 2008 turned out to be considerably higher than expected. Instead of the estimated 16,3 billion euro, the payments amounted to 24,0 billion euros. The initial estimation was based on the assumption that the amounts of payment claims in 2008 would slow-down, because the n+2 deadline <sup>(6)</sup> did not apply and no new commitments occurred since 2006. However, the expected slow-down did not occur.

<sup>(4)</sup> The term 'Cohesion' describing a policy area (see chapter 6) was introduced for the programming period 2007-2013 and covers the Structural Funds (European Regional Development Fund and European Social Fund) and the Cohesion Fund. Prior to that (for the programming period 2000-2006) the Structural Funds included the European Regional Development Fund, the European Social Fund, and also the Agricultural Fund-Guidance Section and the Financial Instrument for Fisheries/Guidance. The Cohesion Fund was not considered as a Structural Fund, having a separate legal basis. Since this chapter refers to the different programming periods, the two terms — 'Cohesion area' and 'Structural Funds' — are used intentionally.

<sup>(5)</sup> The titles cover policy areas 04: Employment and Social Affairs; 05: Agriculture and Rural Development; 11: Fisheries and Maritime Affairs; 13: Regional Policy.

<sup>(6)</sup> The n+2 deadline requires automatic de-commitment of all funds not spent by the end of the second year following the year of allocation.

## THE COURT'S OBSERVATIONS

3.6. The presentation by the Member States for approval by the Commission of the compliance statements, a prerequisite to the reimbursements from the Cohesion programmes of 2007-2013, has been slow (see paragraph 6.26). This led to the execution of payment appropriations being significantly lower than expected (12,6 billion euro). Almost all payments in 2008 for the new programming period represented initial advances.

**The European Economic Recovery Plan**

3.7. On 26 November 2008 the Commission outlined the structure for a European Economic Recovery Plan as a common European response to the current financial and economic crisis (7).

3.8. As part of the EU's contribution to this stimulus, the Plan proposed accelerating payments under the Structural Funds. It was proposed to simplify criteria for European Regional Development Fund (ERDF) and European Social Fund support, re-programme spending and step up advance payments from early 2009. This gave Member States earlier access to up to 1,8 billion euro of advance payments from the European Social Fund in order to reinforce active labour market policies, refocus support on the most vulnerable and step up action to boost skills. It was also planned to bring forward a further 4,5 billion euro of advance payments from the ERDF for cohesion funding. To improve energy interconnections and broadband infrastructure, the Commission intends to mobilise a further 5,00 billion euro for the period 2009-2010. This package covers a total of 3,98 billion euro for investments in carbon capture and storage, offshore wind projects and energy interconnections, and 1,02 billion euro to extend and upgrade high speed internet in rural communities as well as to respond to new challenges in the agro environmental field. The budgetary implications of the Recovery Plan will only be perceptible from 2009 onwards.

## THE COMMISSION'S REPLIES

**3.6.** *Member States have 12 months from approval of programmes to submit compliance assessment documents. In most cases, the Member States waited until the end of the deadline before submitting these documents and in some cases the submission was after the deadline. After the reception of the compliance assessments, the Commission has carried out its approval procedures within the regulatory deadlines.*

*In some cases Member States had not submitted interim payment claims, even when the compliance assessment documents had already been approved. This indicates that there has been slow implementation of many programmes on the ground.*

(7) Communication from the Commission to the European Council – A European Economic Recovery Plan (COM(2008) 800 final of 26.11.2008), amended by a proposal for a Decision of the European Parliament and of the Council amending the Interinstitutional Agreement of 17 May 2006 on budgetary discipline and sound financial management as regards the multiannual financial framework (COM(2009) 171 final of 8.4.2009).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Outstanding budgetary commitments ('RAL')**

3.9. Outstanding budgetary commitments (i.e. unused commitments carried forward to meet future spending), mainly on multiannual programmes, increased by 16,4 billion euro (11,8 %) to 155,0 billion euro. Referring exclusively to policy areas financed through differentiated appropriations<sup>(8)</sup>, the amount of outstanding commitments totalled 153,8 billion euro, which is the equivalent of 1,8 years worth of commitments or 2,3 years of payments at the 2008 spending rate in the respective policy areas. However, almost 80 % of the outstanding commitments are from 2007 and 2008 and therefore related to the 2007-2013 financial framework. The structure of the accumulated 'RALs' shows the impact of the efforts to settle outstanding commitments by payments prior to the application of the automatic decommitment rule which is applicable in the field of both Structural Funds and Cohesion Fund ('n+2'-rule/'n+3'-rule).

3.10. Outstanding budgetary commitments arise as a direct consequence of differentiated expenditure, where expenditure programmes take a number of years to be completed and commitments are made a number of years before the corresponding payments. As commitments are liquidated by payments, the long term effect of commitments significantly exceeding payments results in a build up of outstanding commitments, with the situation being rolled forward each year.

**3.9.** *The overall level of outstanding commitments corresponds to some two years of commitments which is a normal level for the Structural Funds.*

<sup>(8)</sup> The budget distinguishes between two types of appropriation: non-differentiated appropriations and differentiated appropriations. Non-differentiated appropriations are used to finance operations of an annual nature, e.g. administrative expenditure. Differentiated appropriations were introduced to manage multi-annual operations, the related payments can be made during the year of the commitment and during the following years. Differentiated appropriations are used mainly for the Structural Funds and the Cohesion Fund.

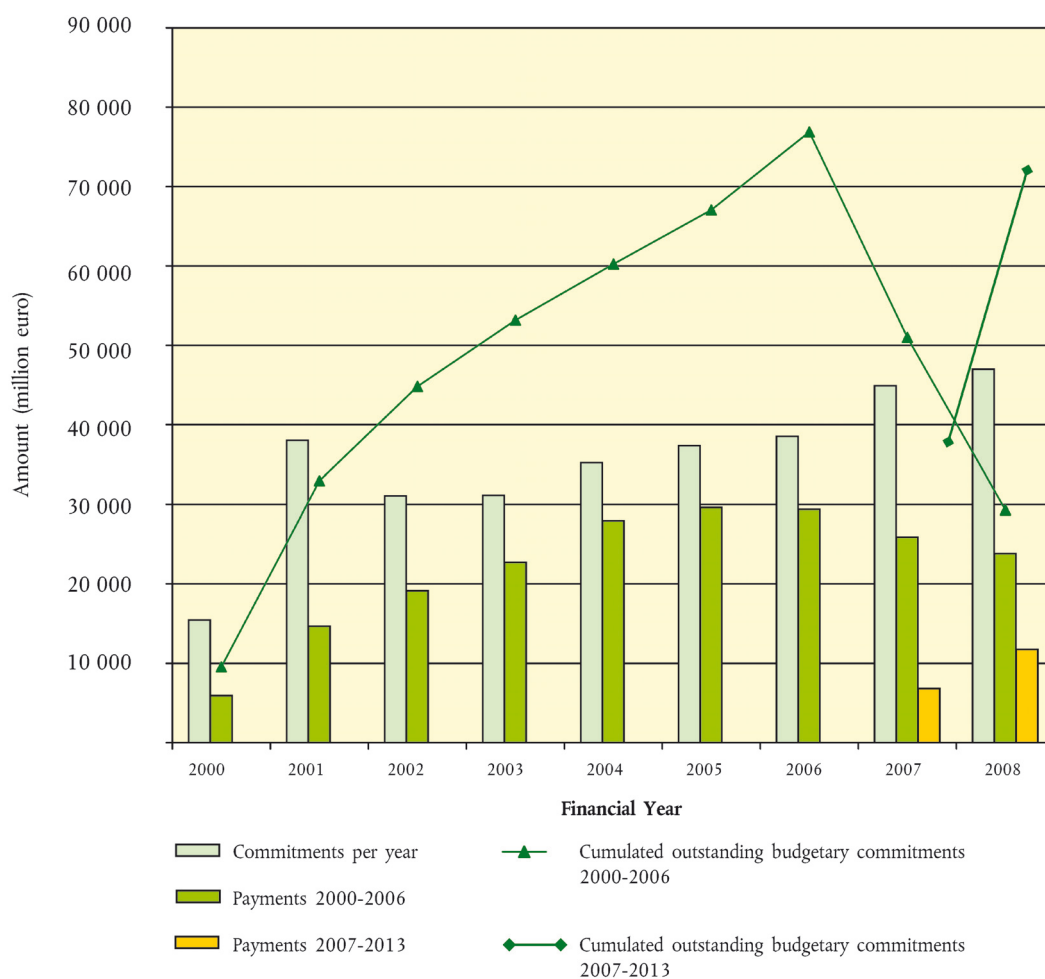
## THE COURT'S OBSERVATIONS

3.11. The highest proportion of outstanding commitments is related to the cohesion area (see **Graph 3.1**). In this field, outstanding commitments amounted to 103 billion euro<sup>(9)</sup> (around 66 % of the total amount), representing 2,2 years worth of commitments or 2,9 years worth of payments at the 2008 spending rate. The vast majority of outstanding commitments in this area (73,8 billion euro) refers to the current period 2007-2013. The outstanding commitments related to the financial framework 2000-2006 amount to 29,3 billion euro.

## THE COMMISSION'S REPLIES

**3.11.** *The level of outstanding commitments in the cohesion area is comparable to that of other areas with differentiated commitment appropriations (such as research, Trans-European networks or external actions). As the Court explains under 3.9, the multiannual financing of Cohesion policy imposes a system of carrying forward open commitments to subsequent years. Budgetary discipline is imposed by the automatic decommitment rule (n+2/n+3 rule), as quoted by the Court. This discipline is shown by the fact that outstanding commitments concern mainly 2007 and 2008, previous years having been subject already to the above-mentioned rule.*

**Graph 3.1 — Development of cumulated outstanding commitments for the Structural Funds 2000-2006 and Cohesion area 2007-2008<sup>(1)</sup>**



<sup>(1)</sup> Includes also the Cohesion Fund since the start of the programming period 2007-2013.

Source: Provisional Annual Accounts of the European Communities, Part II: Consolidated Reports on the Implementation of the Budget of the European Communities.

<sup>(9)</sup> For Cohesion see 'Report on budgetary and financial management, Financial year 2008', p. 41.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.12. Around 13,4 % of the total unused commitments (20,9 billion euro) concerned the Cohesion Fund, despite the fact that it represents only around 6,2 % of total authorised commitment appropriations for 2008. This is an increase of 2,8 billion euro or about 15,5 % compared to 2007. The high level of outstanding budgetary commitments regarding the Cohesion Fund represents 1,4 years worth of commitments or 4,9 years worth of payments at the 2008 spending rate.

**3.12.** According to the regulatory framework for the Cohesion Fund for the 2000-2006 period, the payments are stopped as soon as the project reaches 80 % of its budget (and not 95 % as it is the case for other structural funds programmes). The majority of these projects have already reached this ceiling, and therefore the high level of outstanding commitments is a natural consequence of the regulatory provisions.

*In addition, for Cohesion Fund projects there are no automatic decommitments in the period 2000-2006, contrary to the other Structural Funds.*

*For the 2007-2013 period, the Cohesion Fund is programmed along with the ERDF, and automatic decommitment rules apply to both funds. This will reduce outstanding commitments for the Cohesion Fund in the future.*

## CONCLUSIONS AND RECOMMENDATIONS

3.13. The spending rates in 2008 remained at a high level. In the case of the Cohesion policy area initial payments appropriations were reduced by 4,5 billion euro by amending budgets due to a delay in the implementation of the new 2007-2013 programmes.

**3.13.** As observed by the Court in paragraph 3.3 reducing appropriations for payments through amending budgets represents good financial management.

3.14. Member States improved their expenditure forecast in the area of Structural Funds reducing the over-estimation rate.

**3.14.** Although forecasts for the 2000-2006 period improved, the over-estimation for the 2007-2013 period (the first year forecasts were made) was 27 %.

3.15. Outstanding budgetary commitments on differentiated expenditure remain at a very high level exceeding the total budgetary commitment appropriations for 2008. However, most outstanding budgetary commitments are now from 2007 and 2008 and therefore related to the current financial framework. The Court recommends that the Commission encourages Member States to transmit the remaining compliance assessment documents of the Management and Control Systems as soon as possible and in sufficient quality in order to avoid further delays regarding the interim payments and a further increase of outstanding budgetary commitments.

**3.15.** A large share of the outstanding commitments (RAL) at the end of 2008 merely consists of the difference between the commitments on the new programming period and the advances paid. As a result of the limited interim payments, the RAL has necessarily increased.

*The Commission has taken steps in 2008 and 2009 to achieve progress in the compliance assessment procedure through transmission of reminder letters, contacts and meetings with Member States. The regulatory provisions relating to the reimbursement of pre-financing in the absence of an application for payments within 24 months, as well as the application of the automatic decommitment rule, will also impose pressure on Member States. See also reply to 3.6.*

*As at 30 June 2009, the total number of reports received and approved represent 93 % and 58 % of the 2007-2013 appropriations, respectively.*





## CHAPTER 4

**Revenue**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction  | 4.1-4.9          |
| Audit scope   | 4.3-4.9          |
| Traditional own resources   | 4.4-4.6          |
| VAT- and GNI-based own resources  | 4.7-4.9          |
| Regularity of transactions  | 4.10-4.12        |
| Traditional own resources   | 4.10-4.11        |
| VAT- and GNI-based own resources  | 4.12             |
| Effectiveness of systems  | 4.13-4.28        |
| Traditional own resources   | 4.13-4.16        |
| VAT-based own resources   | 4.17-4.21        |
| Monitoring of the application of the VAT directives                     | 4.18-4.19        |
| Report under Article 12 of Council Regulation (EEC, Euratom) No 1553/89 | 4.20-4.21        |
| GNI-based own resources   | 4.22-4.28        |
| Annual GNI data   | 4.22             |
| Compilation of National Accounts in Member States                       | 4.23-4.24        |
| General and specific reservations                                       | 4.25-4.27        |
| Verification of GNI inventories in the Member States                    | 4.28             |
| Conclusions and recommendations   | 4.29-4.36        |
| Traditional own resources   | 4.31-4.32        |
| VAT-based own resources   | 4.33-4.34        |
| GNI-based own resources   | 4.35-4.36        |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

4.1. This chapter presents the Court's specific assessment of Revenue. The revenue side of the budget of the European Union consists of own resources and other revenue. As shown in **Table 4.1** own resources constitute by far the main source of financing of budgetary expenditure (89,4 %).

**Table 4.1 — Revenue for the financial year 2008**

| Budget Title                      | Type of revenue                    | Description  | Revenue 2008 (million euro) | %            |
|-----------------------------------|------------------------------------|--|-----------------------------|--------------|
| 1                                 | Traditional own resources (TOR)    | Agricultural duties (Chapter 10)   | 1 278                       | 1,0          |
|                                   |                                    | Sugar and isoglucose levies (Chapter 11)   | 708                         | 0,6          |
|                                   |                                    | Customs duties (Chapter 12)  | 15 297                      | 12,6         |
| 1                                 | VAT-based own resource             | VAT (Value Added Tax) -based resource from the current financial year (Chapter 13)       | 17 966                      | 14,8         |
| 1                                 | GNI-based own resource             | GNI (Gross National Income) -based resource from the current financial year (Chapter 14) | 73 015                      | 60,1         |
| 1                                 | Correction of budgetary imbalances | UK correction (Chapter 15)   | 385                         | 0,3          |
|                                   |                                    | <b>TOTAL OWN RESOURCES</b>   | <b>108 649</b>              | <b>89,4</b>  |
| 3                                 |                                    | Surpluses, balances and adjustments  | 4 174                       | 3,4          |
| 4                                 |                                    | Revenue accruing from persons working with the Institutions and other Community bodies   | 977                         | 0,8          |
| 5                                 |                                    | Revenue accruing from the administrative operation of the Institutions                   | 353                         | 0,3          |
| 6                                 |                                    | Contributions and refunds in connection with Community agreements and programmes         | 5 564                       | 4,6          |
| 7                                 |                                    | Interest on late payments and fines  | 1 794                       | 1,5          |
| 8                                 |                                    | Borrowing and lending operations   | 34                          | 0,0          |
| 9                                 |                                    | Miscellaneous revenue  | 39                          | 0,0          |
|                                   |                                    | <b>TOTAL OTHER REVENUE</b>   | <b>12 935</b>               | <b>10,6</b>  |
| <b>Total revenue for the year</b> |                                    |  | <b>121 584</b>              | <b>100,0</b> |

Source: Annual Accounts, 2008.

4.2. On 26 January 2009 the Council adopted amended rules<sup>(1)</sup> implementing the new Decision on the system of the European Communities' own resources (2007/436/EC, Euratom)<sup>(2)</sup>, which came retroactively into effect from 1 January 2007 on 1 March 2009. As the ratification procedure had not been completed by the end of 2008, the necessary recalculations of the 2007 and 2008 Member States' VAT and GNI-based contributions were made in 2009.

<sup>(1)</sup> Council Regulation (EC, Euratom) No 105/2009 of 26 January 2009 amending Regulation (EC, Euratom) No 1150/2000 implementing Decision 2000/597/EC, Euratom on the system of the Communities' own resources (OJ L 36, 5.2.2009, p. 1).

<sup>(2)</sup> OJ L 163, 23.6.2007, p. 17.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Audit scope**

4.3. The Court selected a representative statistical sample of 60 recovery orders taken from the Commission's records of receipts of all revenue and examined the regularity of transactions at the Commission level (see **Annex 4.1**). The audit included a follow-up of certain previous findings (see **Annex 4.2**). Additional audit work carried out by the Court is described in paragraphs 4.4 to 4.8.

**Traditional own resources**

4.4. The Court's audit of the transactions underlying the accounts cannot cover undeclared imports or those that have escaped customs surveillance.

4.5. The Court carried out an assessment of supervisory and control systems in three Member States<sup>(3)</sup> and reviewed their accounting systems for traditional own resources. The auditors checked a random sample of 30 import declarations in each of these three Member States.

4.6. The Court assessed the supervisory and control systems at the Commission, including the latter's inspections in Member States. It examined the accounts for traditional own resources and analysed the flow of duties in order to obtain reasonable assurance that the amounts recorded were complete and correct. The supervisory role of ACOR<sup>(4)</sup> was also assessed.

**VAT- and GNI-based own resources**

4.7. The VAT- and GNI-based own resources are contributions resulting from the application of uniform rates to Member States' notionally harmonised VAT assessment bases or to the Member States' GNI, calculated in accordance with Community rules. These two own resources are based on macroeconomic statistics, for which the underlying data cannot be audited directly. For this reason the audit took as its starting point the receipt by the Commission of the macroeconomic aggregates prepared by the Member States, and then assessed the Commission's systems for processing the data until they are included in the final accounts. The audit thus covered the drawing up of the annual budget and the correctness of the contributions by Member States.

<sup>(3)</sup> Czech Republic, Greece and the Netherlands.

<sup>(4)</sup> Advisory Committee on Own Resources: Article 20 of Council Regulation (EC, Euratom) No 1150/2000 (OJ L 130, 31.5.2000, p. 1).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.8. The audit also assessed the Commission's supervisory and control systems which are intended to provide assurance that these resources are correctly calculated and collected, as well as the roles of the ACOR and GNI<sup>(5)</sup> Committees. Furthermore the Court examined the supervisory and control systems of the National Statistical Institutes (NSI) for the compilation of National Accounts in four Member States<sup>(6)</sup>.

4.9. The GNI-based resource is used to balance the budget. Any understatement of GNI for a particular Member State - while not affecting the overall GNI-based own resource - has the effect of increasing the contributions from the other Member States, until the problem is identified and corrected.

## REGULARITY OF TRANSACTIONS

**Traditional own resources**

4.10. Traditional own resources are established and collected by the Member States. Three quarters of these amounts are paid to the Community, the remaining quarter being retained to cover collection costs. Each Member State sends to the Commission a monthly statement of established duties (the 'A' account statement) and a quarterly statement of those established duties which are not included therein (the 'B' account)<sup>(7)</sup>.

4.11. The Court found that overall the Member States' statements sent to the Commission were free from material error.

**VAT- and GNI-based own resources**

4.12. The Court's audit found the calculation of Member States' contributions and their payment to be free from material error.

## EFFECTIVENESS OF SYSTEMS

**Traditional own resources**

4.13. On-the-spot audits carried out by the Court confirmed that overall the audited supervisory and control systems for customs and for traditional own resources accounting were functioning well.

<sup>(5)</sup> Article 4 of Council Regulation (EC, Euratom) No 1287/2003: the GNI regulation (OJ L 181, 19.7.2003, p. 1).

<sup>(6)</sup> Belgium, Italy, Luxembourg and Poland.

<sup>(7)</sup> When duties or levies remain unpaid and no security has been provided, or they are covered by securities but have been challenged, Member States may suspend making these resources available by entering them in this separate ('B') account.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.14. However, as in previous years the Court's audit highlighted problems affecting amounts included in the B accounts which, while not sufficiently material to affect the overall conclusion, should be remedied:

- delayed establishment and recovery of duties, even though the customs authorities<sup>(8)</sup> were already aware of the amounts due and the identity of the debtors, and
- lack of national instructions<sup>(9)</sup> to estimate the amount of debts whose recovery is unlikely.

4.15. Moreover, in a previous Annual Report<sup>(10)</sup> the Court noted that the frequency of physical checks on imports was very low. The Commission replied that this is compensated by later 'audit-based checks'. However, the Court has criticised the frequency of such audits based on post-clearance checks in several Member States<sup>(11)</sup>.

**4.14.** Because of the many B-accounts that are often kept locally by individual customs offices and usually contain complex cases of post-clearance recovery of customs duties, an examination of the B-accounts, in order to discover and remedy individual errors in these accounts, was a theme of the Commission's inspection in 2008 and is also one in 2009. Indeed an examination of the B-accounts has always been a general theme of Commission inspections over the years. This examination has been performed in all Member States. In addition, the Commission has also provided Member States with specific guidance on the B-accounts in 2007, in order to increase their awareness of the correct use of these accounts.

- The Commission will follow up these findings with the Member States concerned. Default interest will be requested in the case of delays in making the own resources available to the EU budget.
- The Court's recommendation to establish a formal procedure will be followed up with the two Member States in question.

**4.15.** Under the Community legal framework the Member States are themselves responsible for defining their control strategies to safeguard the EU's financial interests in the area of traditional own resources. The main focus in all control activities, however, should be on actual risks defined by using appropriate risk analysis methods. This facilitates achievement of the best results with the optimum use of resources. High-risk traders and transactions should be targeted, while also providing a reasonable coverage of medium-sized and low-risk traders.

For 2009 the Commission has selected Member States' control strategies for traditional own resources as a general inspection theme. In the course of these inspections it is examining the control strategy established, the use of risk analysis in the formulation of the control programmes, the implementation of the control programmes and the quality of the post-clearance controls carried out.

<sup>(8)</sup> Czech Republic, Greece and the Netherlands.

<sup>(9)</sup> Czech Republic and Greece.

<sup>(10)</sup> Paragraph 4.18 (footnote 21) of the Annual Report concerning the financial year 2006.

<sup>(11)</sup> Paragraph 3.15 of the Annual Report concerning the financial year 2004, paragraph 4.22 of the Annual Report concerning the financial year 2005, paragraph 4.18 (footnote 23) of the Annual Report concerning the financial year 2006, and paragraph 4.19 of the Annual Report concerning the financial year 2007.

## THE COURT'S OBSERVATIONS

4.16. In 2008 the Supreme Audit Institution (SAI) of one of these Member States published a report<sup>(12)</sup> which had similar findings to those of the Court and was critical of the system for the control of dutiable imports in that Member State. In particular it highlighted:

- that, whilst the customs authority had performed well in facilitating trade, it has yet to develop the necessary expertise and resource in the execution of documentary checks that it carries out;
- a decreasing number, and the inconsistent quality, of audits based on post-clearance checks, even though the number of errors found therein is increasing;
- the need to develop targets and standards for the frequency and quality of these audits to ensure fiscal control and regime integrity.

The Court notes that such SAI reports constitute an additional means to safeguard the financial interests of the Community.

**VAT-based own resources**

4.17 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. In 2008, 41 reservations were placed and 15 lifted, increasing the number of reservations in place to 163 at the end of the year (see **Table 4.2**). 34 of these relate to years prior to 2000. Of the 15 reservations lifted in 2008 none related to the three oldest years 1989, 1993 and 1995. The Commission still has no effective means of ensuring that Member States provide adequate and timely information which would enable it to lift outstanding VAT-based own resources reservations.

## THE COMMISSION'S REPLIES

**4.16.** *The Commission has already raised similar findings with the Member State concerned as a result of two inspections in 2006 and one in 2008, and the follow-up of these findings is continuing. The Member State's entire control strategy will be examined during the 2009 inspection. In the course of this inspection the findings of the Supreme Audit Institution (SAI) report will be taken into account and the inspection will include an examination of whether any remedial action has been taken as a result of those findings.*

*The Commission welcomes the national audit services' action, in particular in the area of traditional own resources. During its inspections the Commission consults, where available, national audit reports in order to complete its assessment.*

**4.17.** *In 2008, the Commission launched a new initiative to improve the pro-active management of reservations, based on a series of objective criteria. The Management Meetings between the Commission and the Member States that are organised in this context have proven to be an effective tool, not only in reducing the number of reservations earmarked as material, in particular those outstanding for more than five years, but also in improving the exchange of information between the Commission and the Member States involved. The results obtained so far are now having a significant effect on the number of long outstanding reservations and warrant the continuation of this new approach.*

<sup>(12)</sup> United Kingdom National Audit Office: HM Revenue and Customs: The Control and Facilitation of Imports, dated 7 November 2008 ([http://www.nao.org.uk/publications/0708/hmrc\\_import\\_control.aspx](http://www.nao.org.uk/publications/0708/hmrc_import_control.aspx)).

Table 4.2 — VAT reservations as at 31.12.2008

| Member States  | Number of reservations outstanding at 31.12.2007 | Reservations set in 2008 | Reservations lifted in 2008 | Number of reservations outstanding at 31.12.2008 | Oldest year to which reservations apply |
|----------------|--|--------------------------|-----------------------------|--|---|
| Belgium        | 8  | 0                        | 0                           | 8  | 1989                                    |
| Denmark        | 0  | 0                        | 0                           | 0  |   |
| Germany        | 18   | 0                        | 0                           | 18   | 1999                                    |
| Greece         | 10   | 0                        | 0                           | 10   | 1998                                    |
| Spain          | 6  | 1                        | 4                           | 3  | 2001                                    |
| France         | 4  | 0                        | 0                           | 4  | 1993                                    |
| Ireland        | 12   | 5                        | 1                           | 16   | 1998                                    |
| Italy          | 14   | 3                        | 3                           | 14   | 1995                                    |
| Luxembourg     | 1  | 2                        | 1                           | 2  | 2004                                    |
| Netherlands    | 2  | 3                        | 0                           | 5  | 2002                                    |
| Austria        | 8  | 3                        | 0                           | 11   | 1995                                    |
| Portugal       | 7  | 2                        | 0                           | 9  | 1996                                    |
| Finland        | 7  | 3                        | 2                           | 8  | 1995                                    |
| Sweden         | 9  | 0                        | 0                           | 9  | 1995                                    |
| United Kingdom | 5  | 1                        | 2                           | 4  | 1998                                    |
| Cyprus         | 3  | 0                        | 0                           | 3  | 2004                                    |
| Czech Republic | 1  | 8                        | 1                           | 8  | 2004                                    |
| Estonia        | 0  | 9                        | 1                           | 8  | 2004                                    |
| Latvia         | 1  | 1                        | 0                           | 2  | 2004                                    |
| Lithuania      | 2  | 0                        | 0                           | 2  | 2004                                    |
| Hungary        | 5  | 0                        | 0                           | 5  | 2004                                    |
| Malta          | 6  | 0                        | 0                           | 6  | 2004                                    |
| Poland         | 3  | 0                        | 0                           | 3  | 2004                                    |
| Slovakia       | 5  | 0                        | 0                           | 5  | 2004                                    |
| Slovenia       | 0  | 0                        | 0                           | 0  |   |
| Bulgaria       | 0  | 0                        | 0                           | 0  |   |
| Romania        | 0  | 0                        | 0                           | 0  |   |
| <b>Total</b>   | <b>137</b>                                       | <b>41</b>                | <b>15</b>                   | <b>163</b>                                       |   |
| EU-15          | 111  | 23                       | 13                          | 121  |   |
| EU-10          | 26   | 18                       | 2                           | 42   |   |

Source: European Commission.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Monitoring of the application of the VAT directives**

4.18. DG Taxud is responsible for ensuring the correct application of the VAT directives and should monitor the transposition and the conformity of the national implementing measures put in place by Member States. In 2008 two VAT directives<sup>(13)</sup> came into effect. However DG Taxud did not monitor all the national transposition measures concerning these two directives. An incorrect or incomplete transposition could affect the amount of VAT received and thus the amount paid in own resources. It could also distort the running of the Single market.

4.19. When the Commission considers that a Member State is not fulfilling its obligations under the VAT Directive it may bring the matter before the Court of Justice<sup>(14)</sup>. In 2008 there were three such cases<sup>(15)</sup>, one of which could lead to a reduction in VAT-based own resources. In this case over four years passed from the recording of the case in the single register of potential infringements to the sending of the letter of referral to the Court of Justice by the Commission in 2008, and over 20 months lapsed between this registration of the complaint and the sending the letter of formal notice<sup>(16)</sup>.

**4.18.** *The Commission regularly monitors the VAT legislation in the Member States and takes action appropriately.*

*As far as the two VAT directives, which came into effect in 2008, are concerned, the first<sup>(1)</sup> gives the possibility, not an obligation, for the Member States to adopt national provisions derogating from the normal rules contained in the VAT Directive in order to tackle tax fraud or tax avoidance. These measures have to be communicated to the VAT Committee and will have, if adopted, a positive impact on the VAT own resources. The other one<sup>(2)</sup> does not introduce material changes in the existing legislation and its substantive amendments are listed exhaustively in Art. 412 and were accordingly followed up in the Member States concerned.*

**4.19.** *The Commission acknowledges that the mentioned case has been extremely lengthy. However, it is also a particularly complex one.*

*The legal context in Member States is often detailed and complicated, requiring substantial analysis. The Commission pays particular attention to the preparation of cases on the interpretation of indirect taxation legislation.*

*Furthermore the Commission has changed its procedures last year, to allow for more frequent decision-taking in order to reduce the delays which occurred when Member State notifications were received shortly before the next procedural step was due to be taken, allowing for cases to progress as soon as the analysis of the new information has been completed. Where a potential impact on traditional own resources is identified, the Commission takes appropriate measures by making reservations.*

<sup>(13)</sup> Council Directive 2006/69/EC (OJ L 221, 12.8.2006, p. 9) and Council Directive 2006/112/EC (OJ L 347, 11.12.2006, p. 1) (the VAT Directive).

<sup>(14)</sup> After the infringement procedure: Article 226 of the Treaty establishing the European Community.

<sup>(15)</sup> Cases No 2004/4282 (Finland), which could lead to a reduction in VAT-based own resources; Nos 2005/4756 (United Kingdom) and 2005/5051 (France), without impact. See also **Annex 4.2** for the follow-up of a similar observation from 2007.

<sup>(16)</sup> The maximum deadline set by the Commission is 12 months (see COM(2002) 141).

<sup>(1)</sup> Council Directive 2006/69/EC (OJ L 221, 12.8.2006, p. 9).

<sup>(2)</sup> Council Directive 2006/112/EC (OJ L 347, 11.12.2006, p. 1) (the VAT Directive).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Report under Article 12 of Council Regulation (EEC, Euratom) No 1553/89**

4.20. The Commission presented the sixth Article 12 report<sup>(17)</sup> in November 2008, despite it being due at the end of 2007. The principal objective of this report is to enable the Commission, together with the Member State concerned, to consider whether any improvements can be made to enhance the effectiveness of the procedures applied for registering taxable persons and determining and collecting VAT, as well as the VAT control systems.

4.21. The sixth report critically assessed the value of previous reports. It concluded that the budgetary authority had not responded to nor debated any of the issues raised in the previous reports, and the Commission could find little or no evidence of recommendations leading directly to any changes in Member States. VAT collected is the starting point for assessing the amount to be paid by Member States in VAT-based own resources.

**GNI-based own resources****Annual GNI data**

4.22. Following the Member States' 2008 notification of GNI data to the Commission the GNI Committee considered that, taking due account of the existing reservations<sup>(18)</sup>, the data of EU-15 Member States were adequate for use for own resource purposes. The GNI Committee was not able to form an opinion on the data in respect of EU-12 Member States which are either open or covered by reservations, because the analysis of the GNI inventories<sup>(19)</sup> is still ongoing (see paragraphs 4.25 and 4.26).

<sup>(17)</sup> Article 12 of Council Regulation (EEC, Euratom) No 1553/89 of 29 May 1989 on the definitive uniform arrangements for the collection of own resources accruing from value added tax (OJ L 155, 7.6.1989, p. 9) requires the Commission to submit a report to Parliament and to Council every three years on the procedures applied in the Member States for registering taxable persons and determining and collecting VAT, as well as on the modalities and results of their VAT control systems. Member States are required to provide the Commission with the necessary information concerning these procedures.

<sup>(18)</sup> Article 10(7) of Council Regulation (EC, Euratom) No 1150/2000 states that, after 30 September of the fourth year following a given financial year, any changes to GNP/GNI shall no longer be taken into account, except on points notified within this time limit either by the Commission or by the Member State. These points are known as reservations.

<sup>(19)</sup> In accordance with Article 3 of the GNI Regulation, Member States shall provide the Commission (Eurostat) with an inventory of the procedures and basis statistics used to calculate GNI and its components according to ESA 95.

**4.20.** *The delay in the production of the report resulted from the belated submission of data by some Member States and from a strategic reflection as to its content.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Compilation of National Accounts in Member States**

4.23. The Court examined key components of the supervisory and control systems underlying the process of compilation of GNI data notified in 2008 in four Member States and found weaknesses in the documentation of the procedures for the production of this data, that checks on the quality of statistics were not systematically documented and/or that the evaluation of the systems underlying statistical production was not always carried out.

4.24. The Court maintains its opinion<sup>(20)</sup> that the differences in the supervisory and control systems in the NSI could weaken the comparability, reliability and exhaustiveness of National Accounts.

**4.23.** *The Commission has taken note of the weaknesses in terms of documentation and evaluation, mentioned by the Court, with respect to supervisory and control systems in four Member States. The Commission will take account of these observations in the context of its GNI verification work on these countries.*

**4.24.** *The Commission considers that the reliability of national accounts depends primarily on the specific statistical sources and methods used and has based its approach of GNI validation on their verification and improvement. Well designed supervisory and control systems in national statistical institutes of Member States may help identify and mitigate the risks of errors occurring.*

*The Commission has taken account of the remarks of the Court on supervisory and control systems. In particular, the GNI Committee has discussed supervisory and control systems since 2006. Specific questions 3 and 4 on the description and the evaluation of supervisory and control systems were introduced in the updated Commission's GNI Inventory Assessment Questionnaire (GIAQ-document GNIC/081 of April 2007). A more detailed description of Member States' procedures is required in the revised GNI Inventory Guidelines (GNIC/053 rev. 2). The Commission will continue to promote share of best practices between countries in this domain, in particular by organising a seminar in December 2009.*

**General and specific reservations**

4.25. General reservations<sup>(21)</sup> existed at the end of 2008 on GNI data of EU-15 Member States in respect of the period 2002 to 2004, pending the analysis of the updated GNI inventories. General reservations for EU-10 Member States were set in June 2008 on GNI data covering years 2004 to 2006.

4.26. At the beginning of 2008 there were 25 open specific<sup>(22)</sup> GNI reservations relating to the period 1995 to 2001. During 2008 the Commission lifted 15 reservations leaving a balance of 10<sup>(23)</sup> at the year end.

**4.26.** *Six specific reservations were lifted in July 2009, leaving a balance of 4 on 10 July 2009.*

<sup>(20)</sup> See paragraphs 3.47 to 3.49 of the Annual Report concerning the financial year 2004. See paragraphs 4.23 to 4.25 of the Annual Report concerning the financial year 2005.

<sup>(21)</sup> A general reservation covers all the data of a Member State.

<sup>(22)</sup> A specific reservation covers discrete elements of the GNI inventory.

<sup>(23)</sup> These open reservations concern Greece and the United Kingdom and relate either to out-of-date sources underlying certain estimates or to methodological and compilation aspects.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.27. In its on-the-spot examination of the documentation provided by NSI the Court found that, for two reservations lifted by the Commission in 2008, not all the information was available to support the modifications made to the calculation of GNI-based own resources. In one case the expert's assessment used in the estimate of a national accounts component was not documented, and in the other the data provided to the Commission was not fully supported by underlying statistics, thereby preventing a complete audit trail. As in 2007 <sup>(24)</sup>, the Court found that the Commission's work to enable reservations to be lifted involved neither desk checks to corroborate the accuracy of the information provided by Member States through comparison with other sources, nor on-the-spot checks to corroborate the amended National Accounts aggregates.

**Verification of GNI inventories in the Member States**

4.28. By the end of 2008 the Commission had received updated or new GNI inventories <sup>(25)</sup> and carried out control visits in 16 Member States. In six cases direct verification on GNI aggregates was performed. However, in the absence of approved internal guidelines on how to implement this control approach, such as the criteria for selecting the GNI components to be so verified, there is a risk that the direct verification was not applied in a consistent manner in those Member States. Furthermore the Commission had not yet assessed the supervisory and control systems in the NSI for the compilation of National Accounts.

4.27. *The Commission considers that the desk checks it carried out in 2008 provided sufficient information for lifting the two specific reservations mentioned, also taking into account that the amounts involved are not significant. These desk checks included consideration of the expert judgement in one case and consistency checks in the other case. In the cases where reservations were lifted, the Commission desk checks did not demonstrate the necessity of on-the-spot missions, or the need for a comparison with other sources or underlying statistics. The Commission will continue its efforts to further improve the documentation of the checks that it has performed.*

4.28. *The Commission started applying direct verification in 2007. Based on this experience and the specific available expertise of its staff, draft guidelines were written and made available to the staff in September 2008. These guidelines were discussed and approved by the GNI Committee in April 2009. Given the specificities of the national accounts sources and methods used in the various Member States, a direct verification approach can only be applied in a manner tailored to each country's situation. Based on the specific expertise of its staff in the area, the Commission has not identified any inconsistencies in the ways in which its direct verification approach was conducted. The Commission continuously assesses Member States' statistical sources and methods on which its direct verification approach is based. The Commission is assessing supervisory and control systems in NSIs in the ways described in the reply to the paragraph 4.24.*

## CONCLUSIONS AND RECOMMENDATIONS

4.29. Based on its audit work the Court concludes that:

- Member State declarations and payments of traditional own resources,
- the Commission's calculation of Member States' contributions on the basis of the VAT and GNI data received from Member States, as well as
- other types of revenue

for the year ended 31 December 2008 were free from material error.

<sup>(24)</sup> Paragraph 4.35 of the Annual Report concerning the financial year 2007.

<sup>(25)</sup> Except Bulgaria and Romania, whose deadline is 31.12.2009. Luxembourg and Austria have not yet transmitted their process tables.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.30. Based on its audit work, the Court concludes that the supervisory and control systems are effective in ensuring the regularity of Revenue (see **Annex 4.1**). However the Court draws attention to the weaknesses which, while not being material to the effectiveness of the systems as a whole, require action as set out below.

**Traditional own resources**

4.31. The Court's audits continue to reveal problems with the use of the B accounts and therefore the Court recommends that the Commission continues its efforts to ensure their correct use and its surveillance of the establishment and recovery of duties (paragraph 4.14).

4.32. In view of the deficiencies in control strategy observed in previous Annual Reports, the Court recommends that the Commission takes these findings into consideration for its inspections in Member States. In particular it should foster an appropriate balance between physical checks at import and the post-clearance audits of operators. These should be of sufficient frequency and quality to protect the financial interests of the Community (paragraphs 4.15 and 4.16).

**VAT-based own resources**

4.33. The Commission still has no effective means of ensuring that Member States provide adequate and timely information which would enable it to lift outstanding VAT-based own resources reservations. The Court recommends that the Commission continues its efforts<sup>(26)</sup> in order to reach a solution in agreement with the Member States concerned, so that these reservations can be lifted as soon as possible and the necessary corrections to the Member States' VAT bases made (paragraph 4.17).

*4.31. The B accounts warrant continual inspections and therefore the Commission will continue its action of verifying that Member States correctly maintain these accounts. The Commission will address the weaknesses found by the Court with the relevant Member States and will, where appropriate, take measures to recover any amounts of own resources or interest due.*

*4.32. The Member States' customs control strategies as a whole are being examined during the 2009 TOR inspections in order to obtain assurance that the controls carried out by their customs authorities are efficient and effective to protect the Communities' financial interests.*

*4.33. The Commission has recently introduced Management Meetings as an efficient and effective tool to address reservations that merit special attention. So far four such meetings have been held and others are being planned. The results (15 reservations lifted) will have a significant effect on the number of long outstanding reservations from 2009 onward and justify the continuation of this approach which has also the positive side effect of increased effectiveness in the communication flows between the Member States and the Commission.*

<sup>(26)</sup> The Council's 2007 discharge recommendation repeated the call for the Commission, in cooperation with the Member States, to continue its efforts to ensure that reservations are lifted within reasonable timescales.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.34. In the context of the Article 12 report, the Court recommends that the Commission should include in its control visits the reliability of the assertions in the information provided by the Member States. This report would thus help ensure the full amount of VAT due is actually collected. VAT collected is the starting point for assessing the amount to be paid by Member States in VAT-based own resources (paragraph 4.21). This is all the more pertinent in view of the jurisprudence of European Court of Justice case No C-132/06 <sup>(27)</sup>.

**GNI-based own resources**

4.35. The Commission lifted 15 specific reservations in 2008 without either desk checks to corroborate the accuracy of the information sent by Member States or on-the-spot control visits to carry out direct verification (paragraph 4.27). In the Court's view this is not always sufficient to provide reasonable assurance on the accuracy of the amended data.

4.36. The Court recommends that the Commission draws up and applies specific rules for carrying out the examination of GNI inventories (paragraph 4.28) including the use of direct verification and taking into account the risks underlying the compilation of National Accounts, an assessment of supervisory and control systems in the NSI and the cost-benefit principle.

**4.34.** Community legislation does not confer, for VAT own resources purposes, any legal powers on the Commission to quantify amounts of VAT not collected because of evasion by individual taxpayers. The Commission's inspection activity focuses on ensuring that the VAT receipts actually collected in a given calendar year are properly declared, together with examining the correctness and exhaustiveness of the other data Member States supply in their annual VAT statements. The Commission monitors the impact that failures to apply Community VAT directives might have on VAT own resources; taking remedial action to ensure that the national VAT base is corrected to include the amount of VAT forgone plus charging interest, where appropriate.

**4.35.** In respect of the reservations lifted, the desk checks made in 2008 by the Commission in order to verify the information transmitted by Member States did not demonstrate the necessity of on-the-spot missions to carry out direct verification nor of further assessment work. The Commission considers that the information provided was sufficient to lift the reservations (see also response to paragraph 4.27). The Commission will continue its efforts to further improve the documentation of the checks that it has performed.

**4.36.** The Commission has set up a complete framework of GNI validation that is mainly based on the verification and improvement of the reliability and suitability of the sources and methods used for the compilation of GNI and their conformity with the European System of Accounts, taking risk analysis into account. The Commission considers that this approach is essential to reach conclusions on the reliability, comparability and exhaustiveness of GNI in accordance with the provisions (including the cost-benefit principle) of the GNI Regulation. Furthermore, the Commission started applying direct verification since 2007 (see reply to paragraph 4.28). On national supervisory and control systems, the Commission has taken account of the Court's remarks, and in particular is promoting the development and share of best practices, in the ways described in the response to paragraph 4.24.

<sup>(27)</sup> This judgment (paragraphs 37 to 39) states that 'it follows Articles 2 and 22 of the Sixth Directive, and from Article 10 EC, that every Member State is under an obligation to take all legislative and administrative measures appropriate for ensuring collection of all the VAT due on its territory. (...) Member States (...) enjoy in that respect a certain measure of latitude, inter alia, as to how they use the means at their disposal. That latitude is nevertheless limited by the obligation to ensure effective collection of the Community's own resources and not to create significant differences in the manner in which taxable persons are treated, either within a Member State or throughout the Member States. (...) Any action by Member States concerning VAT collection must comply with that principle'.

ANNEX 4.1  
RESULTS OF TESTING

PART 1: MAIN FEATURES OF SAMPLE-BASED TRANSACTION TESTING

1.1 — Size of the sample (of Revenue at the level of the Commission)

| Year        | Number of transactions tested (*) |
|-------------|-----------------------------------|
| <b>2008</b> | <b>60</b>                         |
| 2007        | 66                                |

1.2 — Structure of the sample (of Revenue at the level of the Commission)

| Percentage of transactions tested which were | 2008    |         |       |              |
|--|---------|---------|-------|--------------|
|  | TOR (*) | VAT/GNI | Other | Total        |
| Recovery orders                              | 10 %    | 78 %    | 12 %  | <b>100 %</b> |

(\*) Work done included the examination of the compilation of the underlying monthly statement and accounting records in the Member State concerned. An additional random sample of 30 import declarations was audited in each of the three Member States visited (see paragraph 4.5).

PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

2.1 — Assessment of selected supervisory and control systems

| Revenue type | Key internal control (Commission)  |                        |                    |                            | Key internal controls in national customs supervision / compilation of National Accounts in Member States audited | Overall assessment |
|--------------|------------------------------------|------------------------|--------------------|----------------------------|---|--------------------|
|              | Commission checks in Member States | Commission desk checks | Revenue management | Management of reservations |   |                    |
| TOR          |                                    |                        |                    | N/A                        | (2)   |                    |
| VAT          |                                    |                        |                    |                            | N/A   |                    |
| GNI          |                                    |                        |                    | (1)                        |   |                    |

(1) The work carried out by the Commission to enable GNI reservations to be lifted is not always sufficient to provide reasonable assurance on the accuracy of the amended data (paragraphs 4.27 and 4.35).

(2) In respect of TOR there is a risk that the rate of physical checks at import is too low and that post-clearance audits do not compensate (paragraphs 4.15 and 4.16).

| Overall assessment (*) | 2008 | 2007 |
|------------------------|------|------|
|                        |      |      |

(\*) See scope limitation referred to in paragraphs 4.4 and 4.7 (paragraphs 4.4 and 4.9 in respect of 2007).

Legend:

|     |  |
|-----|--|
|     | Effective                                      |
|     | Partially effective                            |
|     | Not effective                                  |
| N/A | Not applicable: does not apply or not assessed |

## FOLLOW-UP OF PREVIOUS DAS OBSERVATIONS

| Court observation  | Action taken   | Court analysis  | Commission reply  |
|--|--|---|---|
| <b>Traditional own resources: potential duties under discussion between the Commission and Germany</b>   |  |   |   |
| <p>In paragraph 3.23 of the Annual Report concerning 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.</p> <p>In 2005 the Court indicated that 22,7 million euro of potential duties remain under discussion between the Commission and Germany.</p> | <p>The balance of 22,7 million euro was still under discussion in 2007 and 2008. The Commission has asked Germany to provide the split between guaranteed and non guaranteed debts in the B-account for, say, 2005 and 2006 and use this data to gauge the strength of the assurance it can have on the amounts likely to be eventually recovered.</p> | <p>The definitive amount to be recovered should be quickly established in order to finally close this issue.</p>  | <p><i>The Commission report on the 2007 inspection concerning this complex issue was discussed in the December 2008 Advisory Committee on Own Resources. As a follow-up the Commission still needed to request further clarifications for a small proportion of the transactions involved. The Commission is looking forward to drawing its final conclusions once the reply has been received.</i></p>   |
| <b>VAT-based own resource: delays related to infringement procedure</b>  |  |   |   |
| <p>In its Annual Report concerning 2007 the Court pointed out that of three cases, dating back to 2003-2005 (one with an impact on own resources), none had been brought before the Court of Justice by the end of 2007 despite the decision to do so being taken in June 2007 (paragraph 4.24).</p>   | <p>These cases were eventually brought before the Court of Justice in April, June and November 2008.</p>   | <p>The Court reaffirms that the Commission should speed up the handling of cases and the management of the infringement procedure in order to refer cases to the European Court of Justice within the prescribed time limits.</p> | <p><i>The Commission has changed its procedures last year, to allow for more frequent decision-taking in order to reduce the delays which occurred when Member State notifications were received shortly before the next procedural step was due to be taken, allowing for cases to progress as soon as the analysis of the new information has been completed. Where a potential impact on own resources is identified, the Commission takes appropriate measures by making reservations.</i></p> <p><i>The legal context in Member States is often detailed and complex, requiring substantial analysis. The Commission pays particular attention to the preparation of cases on the interpretation of indirect taxation legislation.</i></p> |

| Court observation  | Action taken  | Court analysis   | Commission reply   |
|--|---|--|--|
| <b>GNI-based own resource: revision policy (including the follow-up of the Greek revision)</b>   |   |  |  |
| <p>In its Annual Report concerning 2006 the Court made observations on the revision to Greek GNI (paragraphs 4.24 to 4.26) and recommended in paragraph 4.32 that the Commission, in particular:</p> <p>(a) sets rules on communication and is forewarned, together with the GNI Committee, of major revisions,</p> <p>(b) implements a coordinated policy for National Accounts data revisions, including the requirement for a regular bench-marking, and</p> <p>(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.</p> <p>In its Annual Report concerning 2007 the Court took note of the progress made by the Commission and of the additional work needed, in cooperation with Member States, to implement the above-mentioned recommendations (paragraphs 4.28 to 4.32 and Annex 4.2).</p> | <p>(a) Following the receipt of the first pre-announcement letters of Member States' major revisions, the Commission implemented a system to monitor the application of the guidelines proposed by the Committee on Monetary, Financial and Balance of Payments Statistics (CMFB).</p> <p>(b) In the CMFB meeting of July 2008 Eurostat proposed a harmonised revision policy for National Accounts at European level, including the main aspects to be considered and analysed in the setting-up of a common revision policy.</p> <p>In the CMFB meeting of February 2009 Eurostat presented a first overview of national revision practices in the compilation of National Accounts, based on the results of questionnaires received from 17 Member States.</p> <p>(c) In 2008 Greece transmitted a complete GNP/ GNI Questionnaire and Quality Report.</p> <p>Pending the completion of the verification of the underlying calculations, the Commission, by the end of 2008, had not lifted the seven specific reservations set on GNP data of the period 1995-2001.</p> | <p>(a) The monitoring system implemented by the Commission should be assessed as soon as all steps of the communication process have been applied and the first major revisions to National Accounts have been carried out.</p> <p>(b) Despite the progress made, further work is needed by the Commission and Member States in order to implement a common revision policy in the European Union.</p> <p>(c) The Commission should complete its verification in 2009 of the Greek GNP data, in cooperation with the Greek authorities, in order to be able to lift the remaining specific reservations.</p> | <p>(a) <i>The Commission monitors continuously the application of the CMFB guidelines in particular by regularly reminding Member States of these guidelines in the GNI Committee. The results obtained so far are positive, thus calling for a continuation of this approach. Taking into account the Court's remarks, the Commission will also make a general assessment of the monitoring system once the first major national accounts revisions have been carried out.</i></p> <p>(b) <i>The Commission is continuing work and discussions with the Member States in order to implement a common revision policy in the EU, taking into account the remarks of the Court.</i></p> <p>(c) <i>Six out of a total seven reservations were lifted in July 2009. The Commission is continuing its cooperation with the Greek authorities in order to be able to lift the remaining specific reservation.</i></p> |



## CHAPTER 5

**Agriculture and Natural Resources**

## TABLE OF CONTENTS

|  | <i>Paragraph</i> |
|--|------------------|
| Introduction   | 5.1-5.12         |
| Specific characteristics of policy group Agriculture and Natural Resources               | 5.3-5.9          |
| Audit scope  | 5.10-5.12        |
| Regularity of transactions   | 5.13-5.26        |
| Agriculture and rural development  | 5.16-5.22        |
| Environment, Fisheries and Maritime Affairs, and Health and Consumer Protection          | 5.23-5.26        |
| Effectiveness of systems   | 5.27-5.61        |
| Policy area agriculture and rural development  | 5.27-5.59        |
| Systems related to regularity of transactions  | 5.27-5.52        |
| Systems related to recoveries and financial corrections                                  | 5.53-5.59        |
| Policy areas Environment, Fisheries and Maritime Affairs, Health and Consumer Protection | 5.60-5.61        |
| Conclusions and recommendations  | 5.62-5.67        |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

5.1. This chapter presents the Court's specific assessment of policy group Agriculture and Natural Resources, which comprises the following policy areas: 05 — Agriculture and rural development; 07 — Environment; 11 — Fisheries and Maritime Affairs; and 17 — Health and Consumer Protection. Detailed information on the activities covered, the spending for the year and type of management involved is provided in **Table 5.1**.

**Table 5.1 — Agriculture and Natural Resources — breakdown of payments by policy area**

(million euro)

| Budget Title                            | Policy area                       | Description                               | Payments 2008 | Budget Management Mode                  |
|---|-----------------------------------|---|---------------|---|
| 5                                       | Agriculture and rural development | Administrative expenditure <sup>(1)</sup> | 124           | Centralised direct                      |
|   |                                   | Interventions in agricultural markets     | 5 442         | Shared Management                       |
|   |                                   | Direct aids                               | 37 569        | Shared Management                       |
|   |                                   | Rural development                         | 10 527        | Shared Management                       |
|   |                                   | Pre-accession measures                    | 144           | Shared Management                       |
|   |                                   | Other                                     | - 3           | Shared Management                       |
|   |                                   | <b>53 803</b>                             |               |   |
| 7                                       | Environment                       | Administrative expenditure <sup>(1)</sup> | 82            | Centralised direct                      |
|   |                                   | Operational expenditure                   | 182           | Centralised direct/Centralised indirect |
|   |                                   | <b>264</b>                                |               |   |
| 11                                      | Fisheries and Maritime affairs    | Administrative expenditure <sup>(1)</sup> | 38            | Centralised direct                      |
|   |                                   | Operational expenditure                   | 841           | Centralised/Shared Management           |
|   |                                   | <b>879</b>                                |               |   |
| 17                                      | Health and consumer protection    | Administrative expenditure <sup>(1)</sup> | 102           | Centralised direct                      |
|   |                                   | Operational expenditure                   | 413           | Centralised direct/Centralised indirect |
|   |                                   | <b>515</b>                                |               |   |
| <i>Total administrative expenditure</i> |                                   |   | 346           |   |
| <i>Total operational expenditure</i>    |                                   |   | 55 115        |   |
| <b>Total payments for the year</b>      |                                   |   | <b>55 461</b> |   |
| <b>Total commitments for the year</b>   |                                   |   | <b>59 964</b> |   |

Source: Annual accounts of the European Communities financial year 2008, Annex B.

<sup>(1)</sup> Audit of administrative expenditure is reported on in Chapter 11.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.2. Under the Treaty, the Commission has overall responsibility for implementing the EU budget. Virtually all agricultural and rural development expenditure is carried out under shared management whereby implementation tasks are delegated to Member States. For the other areas, budgetary appropriations are spent under the direct management of the Commission with the exception of the European Fisheries Fund which is under shared management on the basis of multi-annual programmes.

**Specific characteristics of policy group Agriculture and Natural Resources**

5.3. The Community budget finances the common agricultural policy expenditure mainly through two Funds <sup>(1)</sup>: the European Agricultural Guarantee Fund (hereinafter 'EAGF'), for the financing of market measures and direct aids, and the European Agricultural Fund for Rural Development (hereinafter 'EAFRD'), for the financing of rural development programmes.

5.4. The main measures financed by EAGF are:

- The direct aid scheme '*Single Payment Scheme*' (SPS): the SPS was introduced in order to break the link between agricultural production and the payments made to farmers (decoupling). In order to qualify under the SPS farmers must first obtain 'entitlements'. The number and value of each farmer's entitlement was calculated by the national authorities according to one of the models provided for under EU legislation <sup>(2)</sup>. Every entitlement, together with one hectare of eligible land <sup>(3)</sup> declared by the farmer, gives rise to an SPS payment. SPS has been growing in importance and in 2008 represented 28 234 million euro of expenditure.

<sup>(1)</sup> Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.8.2005, p. 1).

<sup>(2)</sup> 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 to 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.

<sup>(3)</sup> 'Eligible hectare' shall mean any agricultural area of the holding taken up by arable land and permanent pasture except areas under permanent crops, forests or used for non-agricultural activities.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- The direct aid scheme 'Single Area Payment Scheme' (SAPS): it involves the payment of uniform amounts per eligible hectare of agricultural land. Eligible hectares are defined as agricultural areas which were kept in good agricultural condition (GAC) on 30 June 2003 <sup>(4)</sup>. The main difference between SAPS and SPS is that, under the former 'entitlements' are not established. SAPS is currently applied in 10 of the new Member States <sup>(5)</sup> and in 2008 accounted for 2 974 million euro of expenditure.
  
- Other direct aid schemes (coupled payments) <sup>(6)</sup>: they accounted for 6 361 million euro of expenditure.
  
- *Interventions in agricultural markets* the principal measures are intervention storage and export refunds. Expenditure has declined in recent years due to policy choices made in the context of the recent CAP reforms and prevailing market conditions (5 442 million euro).

5.5. Only farmers are eligible for EU direct aid. A farmer is defined as a natural or legal person who exercises an agricultural activity. An agricultural activity is defined to mean production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes or maintaining land in good agricultural and environmental condition (GAEC).

5.6. EU legislation provides that Member States shall define minimum requirements for GAEC on the basis of the framework set by EU legislation. As regards grassland the standards set by the EU legislation require a minimum livestock stocking rates and/or appropriate regimes for ensuring a minimum level of maintenance and avoiding the deterioration of habitats.

5.6. *In the framework of the Health Check it was decided that as of 1 January 2009 the livestock stocking rate has become optional.*

---

<sup>(4)</sup> For Bulgaria and Romania the eligible area consists of the utilised agricultural area maintained in GAC in accordance with national criteria.

<sup>(5)</sup> Bulgaria, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia.

<sup>(6)</sup> With the introduction of the SPS most farmers are paid independently of the volume of actual production. Nevertheless some aid schemes remain or may be coupled to output in order to avoid abandonment of production.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.7. The requirement to keep land in GAEC is established in the context of cross-compliance which applies to both SPS and SAPS. Where GAEC requirements are not complied with the direct aid shall be reduced or cancelled under cross-compliance <sup>(7)</sup>.

5.8. The European Agricultural Fund for Rural Development (EAFRD) finances *Rural Development* expenditure which covers 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 (10 527 million euro).

5.9. *Environment, Fisheries and Maritime Affairs as well as Health and Consumer Protection* are managed by the Commission under specific control systems. They cover measures in favour of public health, the environment, animal welfare, consumer protection, international fisheries agreements and the European Fisheries Fund (1 658 million euro).

**Audit scope**

5.10. In order to obtain reasonable assurance as to the regularity of the *transactions* underlying the EU accounts, the Court tested a single, representative, statistical sample of 204 transactions covering the whole of the expenditure dealt with in this chapter (see paragraph 5.1) and assessed the supervisory and control systems. A description of the DAS audit scope and methodology is provided in Chapter 1.

5.11. As regards *supervisory and control systems*, the Court examined the reliability of the systems applicable to *EAGF* claims in selected paying agencies in four Member States applying the Single Area Payment Scheme (SAPS) — Bulgaria, Estonia, Poland, Romania — and in four Member States applying the Single Payment Scheme (SPS): Belgium (Region Walloon), Spain (Catalonia), Slovenia and the United Kingdom (Scotland). It should be noted that for Bulgaria and Romania 2008 was the first full agricultural year of application. For *Rural Development* expenditure, the Court tested the supervisory and control systems in the Czech Republic, Ireland, Greece, Spain, Italy, Hungary and Portugal. The Court also audited supervisory and control systems for the *European Fisheries Fund*.

<sup>(7)</sup> Article 6(1) of Council Regulation (EC) No 1782/2003 (OJ L 270, 21.10.2003, p. 1).

## THE COURT'S OBSERVATIONS

5.12. In addition, the Court reviewed 62 of the *certification bodies' certificates and reports* related to 57 paying agencies <sup>(8)</sup>. For a further eight paying agencies with qualified certificates, the grounds for this were examined.

## REGULARITY OF TRANSACTIONS

5.13. Based on the results of its audit work, the Court concludes that for the payments for the year ended 31 December 2008 for the policy group taken as a whole the estimated value of the overall error rate is slightly below the materiality threshold of 2 %. Rural Development expenditure is still affected by a higher level of errors than EAGF, although the estimated error level is lower than in previous years.

5.14. Out of 204 transactions examined, 66 (32 %) were affected by error. 45 (48 %) of the errors were quantifiable affecting notably eligibility and accuracy. The result of the sample based transaction testing is provided in **Annex 5.1**. The Court's classification of errors is explained in chapter 1. Examples of the different types of errors found are given below.

5.15. The Annual Activity Report of the Director General for Agriculture contains reservations in respect of the expenditure under the SAPARD Programme in Bulgaria and Romania and for Rural Development measures under Axis 2 (improving the environment and the countryside) <sup>(9)</sup>. The Annual Activity Report of the Director General for Fisheries and Maritime Affairs (DG MARE) also contains a reservation for expenditure under the common fisheries policy <sup>(10)</sup>.

## THE COMMISSION'S REPLIES

**5.13.** *The Commission welcomes the positive overall assessment and shares the Court's view that rural development expenditure is affected by a higher incidence of errors, but notes with satisfaction that the error rate is decreasing in this area.*

<sup>(8)</sup> Paying agencies and the corresponding funds included in the DAS sample (this amounted to 57 certificates and reports for EAGF and five for EAFRD).

<sup>(9)</sup> The reservation concerning SAPARD related to 'significant deficiencies regarding the management and control system'. The reservation concerning rural development measures under Axis 2 related to 'an error rate (which) is significantly above the materiality threshold presently used by the European Court of Auditors'.

<sup>(10)</sup> The reservation states that 'a material level of ineligible expenditure was reimbursed to Member States under the activity Control and Enforcement of the CFP' (common fisheries policy).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Agriculture and rural development**

5.16. In the EAGF, out of 151 transactions sampled, 42 (28 %) were affected by errors. 30 (54 %) of the errors were quantifiable. With regard to EAFRD operations, out of 42 transactions sampled, 17 (40 %) were affected by errors. 11 (55 %) of the errors were quantifiable. However, these errors are relatively small in financial terms.

5.17. In its audit of EAGF, the Court found eligibility<sup>(1)</sup> errors of SAPS payments to beneficiaries not meeting the farmer definition as they had not carried out any agricultural activity nor maintained the land in GAEC (see paragraph 5.46).

5.17. The Commission has addressed the issue of the farmer definition referred to by the Court in the framework of the Health Check. It has proposed that Member States should exclude natural or legal persons from the direct payment schemes whose business objects do not consist in agricultural activities or whose agricultural activities are insignificant. However, the Council made this provision optional for Member States (Article 28(2) of Regulation (EC) No 73/2009). As regards the issue referred to by the Court, under the legislation applicable in 2008 natural or legal persons carrying out an agricultural activity or maintaining land in good agricultural condition (GAC) are entitled to receive SAPS payments.

## Example

A beneficiary made a SAPS claim on behalf of a number of farmers using common land owned by the local municipality. The payment was made to the claimant who stated that he then shared it with these farmers on a pro rata basis of the number of animals held. Eight parcels were selected for measurement; all had been claimed as permanent pasture in 2007. None of these parcels had any trace of being grazed by animals or having been mown over several years. Bushes and fern covered most of the areas and long rough vegetation the rest. All parcels seen were considered to be abandoned and not eligible for aid.

Municipalities benefitted from SAPS payments for common grassland which was used by local farmers to graze their animals. Some of the land was used to dump waste.

Example<sup>(1)</sup>

Following the decoupling of direct payments, no specific agricultural activity is required; it is sufficient if the farmer respects good agricultural conditions (GAC). Under the applicable legislation it is up to the Member State to define what constitutes good agricultural conditions (GAC). The Member State concerned has established criteria regarding the respect of GAC but, as allowed by the EU framework, these criteria do not include the obligation of grazing or mowing.

Natural or legal persons carrying out an agricultural activity or maintaining land in good agricultural condition (GAC) are entitled to receive SAPS payments. Since the land was kept in GAC, the municipalities concerned were entitled to receive SAPS payments.

To the extent aid has been granted for ineligible land, this will be followed up in the context of the conformity clearance procedure. See also Commission reply to 5.49.

<sup>(1)</sup> The beneficiary was not entitled to receive all or part of the payment.

<sup>(1)</sup> The Commission considers that these individual findings by the Court are not examples of systemic deficiencies in the aid schemes concerned.

## THE COURT'S OBSERVATIONS

5.18. In the EAFRD, concerning eligibility, the Court found cases of non-respect of specific conditions attached to the aid for agri-environmental and forestry measures; and ineligible areas claimed under agri-environmental measures.

## Example

Support was granted for agri-environmental commitments relating to fencing a pasture area and clearing a portion of the ground partially covered with shrubs. The objective of the action was to create larger areas for extensive grazing, as, due to the poor quality of the soil, the concentration of cattle in existing cleared areas was prejudicial to the renewal of the grass cover due to overgrazing. The Court's auditors found that the area cleared of shrubs did not fully correspond to the area for which aid had been applied and was slightly less than the total claimed. Consequently, the beneficiary was only entitled to approximately 90 % of the sum paid. Furthermore, a sanction of 18 % is applicable in this case.

5.19. In terms of *accuracy* <sup>(12)</sup> errors in EAGF, the majority of errors found by the Court relate to over-declarations of area claimed, leading to overpayment.

## Example

An overdeclaration was found (35 %) due mainly to the fact that the farmer claimed full hectares rather than the actual area used. There were also some small ineligible areas that should have been deducted. Such a large discrepancy (8 hectares out of 23 measured) should result in a cancellation of the SAPS payment.

5.20. In EAFRD, in terms of *accuracy*, the Court found errors of incorrect calculation of eligible costs and of the amount payable; over-declarations of area claimed; and non-respect of the minimum amount per hectare foreseen by Community rules.

## THE COMMISSION'S REPLIES

**5.18.** *In general the findings of the Court will be followed up through the conformity clearance procedure.*

**5.19.**

## Example

*Deficiencies detected in the Member State's control system regarding SAPS payments are followed up in the framework of the conformity clearance procedure.*

**5.20.** *As to the over-declarations found, the Commission agrees with the Court's findings.*

<sup>(12)</sup> The payment is not correctly calculated.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## Example

Because of the limitation of the funds available according to the financing plan of the rural development programme concerned, the national authorities were not able to pay farmers in disadvantaged areas the minimum amount per hectare required by Community rules.

5.21. In EAFRD, the Court found an error of occurrence<sup>(13)</sup> due to the non-execution of the totality of the works financed.

## Example

One of the transactions sampled concerned aid granted to a municipality to surface, with asphalt, a country lane. However, as one farmer had refused right of way on his land, some 8 % of the lane had not been asphalted. Instead, the contractor had been requested to asphalt accesses to parcels situated along the lane. As the project had not been formally modified, the Court considers that the municipality, though having paid the total price of the road works carried out, was entitled to only a approximately 90 % of the total aid received.

5.22. As for other types of error not belonging to the categories of eligibility, accuracy and occurrence, the Court found, in EAGF, failure to collect milk levy from producers, animal registers which were not updated and databases which were not in operation. Furthermore, an export refund payment was made three years too late by the Member State. In EAFRD, the Court could not identify, in two Member States, the borders of certain land parcels for which EU aid had been paid. In addition, the Court notes that certain serious errors which could not be quantified and which were raised in the Annual Report concerning the financial year 2007 still persist (see **Annex 5.2**).

5.22. The problems in the animal registers and the problems in the database for Animal Identification and Registration are known to the Commission and are subject to conformity clearance procedures.

The issue of 'Interest rate subsidies', indicated by the Court in its Annual Report 2007, has been followed up by the Commission. The Member State has introduced a new administrative system which from 2008 onwards makes it easier to track the loan from the bank to the final beneficiary. Furthermore, the Commission analysed the results of recent audits carried out by the Member State to determine the financial impact for the previous programming periods.

<sup>(13)</sup> The claimed cost or action did not exist.

## THE COURT'S OBSERVATIONS

## Example

According to Council Regulation (EC) No 1788/2003 <sup>(14)</sup> the national authorities are liable for payment of the milk levy and are required to collect it from the producers. Any money collected, together with interest in the case of late payment of the levy, is retained by the national authorities. Italy paid the levy for all producers concerned (174,5 million euro) but only managed to collect 21,5 million euro from them. In the case audited by the Court, the producer currently owes 614 157 euro plus 5 244 euro interest for the campaigns since 1995/1996.

## THE COMMISSION'S REPLIES

## Example

Member States are liable for payment of the milk levy to the Community budget as assigned revenue. Italy has paid its corresponding amounts, with the consequence that there is no loss for the Community budget. Italy is furthermore engaged in recovery actions against those producers, including the producer to whom reference is made, who have not paid the levy due yet and, in this context, is charging interests on the outstanding amounts as required by the applicable Community rules. The recovery procedure to be followed is governed by national law and Italy is bound by this law even if this leads to delays in the recovery process.

**Environment, Fisheries and Maritime Affairs, and Health and Consumer Protection**

5.23. As regards Environment, Fisheries and Maritime Affairs, and Health and Consumer Protection, out of 11 transactions sampled, seven (64 %) were affected by errors. Four (24 %) of the errors were quantifiable.

5.24. Concerning LIFE <sup>(15)</sup> instrument the Court found shortcomings in the public tendering procedures and errors in payments due to lack of appropriate supporting documents as well as the wrong calculation of staff costs.

## Example

In one case there was a complete lack of the public tender procedure and in another case a firm that had been involved in drafting the public tender for the beneficiary was awarded the same tender, notwithstanding legal advice against admitting the company. Moreover, the beneficiary did not declare the interest received on pre-financing.

5.23. As regards Health and Consumer Protection, the Commission does not share the interpretation of the Court (see reply to 5.26).

As regards Fisheries and Maritime Affairs, out of 7 transactions sampled, 4 were affected by errors, of which 2 were quantifiable.

As regards Environment, see Commission's reply to 5.24.

5.24. The findings from the Court concern payments which do not have a definitive character and are made on a reasonable assurance that the conditions for these payments are fulfilled. Supporting documents for the costs declared are generally not examined at this stage and are requested only with the final report. The Commission would thus normally detect and correct any errors before the final payment is made.

<sup>(14)</sup> OJ L 270, 21.10.2003, p. 123.

<sup>(15)</sup> LIFE – L'Instrument Financier pour l'Environment.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.25. Concerning the Financial Instrument for Fishery Guidance (FIFG), the Court found ineligible costs for the modernisation of a fishing vessel and ineligible subcontracting costs for employees.

*5.25. When deciding on its payments to the Member States concerned the Commission was not aware of possible errors identified by the Court that had occurred at the level of the final recipient. However, the Commission has put in place a control strategy and carries out ex post audit activity to verify that the management and control systems of the Member States function effectively to prevent such errors.*

## Example

Costs were claimed for the replacement of fishing gear which were specifically excluded by the regulation <sup>(16)</sup>.

## Example

*The Commission deducts ineligible amounts from subsequent expenditure claims (if any remain to be submitted) or at the latest before the closure of the programme.*

5.26. Concerning Transmissible Spongiform Encephalopathy (TSE) monitoring, the costs of the tests exceeded, in some cases, the ceilings set out in the legislation and some animals were below the age threshold.

*5.26. The Commission considers that the ceiling for test costs should be applied at national level.*

## EFFECTIVENESS OF SYSTEMS

**Policy area agriculture and rural development*****Systems related to regularity of transactions***

5.27. As regards agriculture and rural development expenditure, the main control system to ensure the regularity of transactions is the Integrated Administration and Control System (IACS) <sup>(17)</sup>.

5.28. IACS consists, in each Member State, of a database of holdings and applications, systems for identifying agricultural parcels and registering animals in case of coupled premiums 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 % on-farm inspections to be carried out by the paying agencies.

<sup>(16)</sup> Article 9 of Council Regulation (EC) No 2792/1999 (OJ L 337, 30.12.1999, p. 10).

<sup>(17)</sup> Regulation (EC) No 1782/2003, subsequently repealed and replaced by Regulation (EC) No 73/2009 (OJ L 30, 31.1.2009, p. 16), and Commission Regulation (EC) No 796/2004 (OJ L 141, 30.4.2004, p. 18).

## THE COURT'S OBSERVATIONS

5.29. IACS covers the main schemes audited at Member State level financed by EAGF, namely SPS and SAPS. In the case of EAFRD, and especially for agri-environment and less favoured areas, certain basic elements such as surface, number of animals are covered by IACS and others by specifically designed controls.

5.30. Regarding the audit of specific IACS supervisory and control systems at paying agency level, the Court assessed eight under the EAGF and seven under the EAFRD (see paragraph 5.11).

5.31. The Court's audit covered both the compliance with the provisions of the relevant regulations and an assessment of the effectiveness of the systems in terms of ensuring regularity of transactions. In particular, the following elements were examined:

- I) Administrative procedures and controls to ensure correct payment including quality of databases.
- II) Control systems based on on-the-spot checks.
- III) System to ensure implementation and control of Cross-compliance.

5.32. In general the results of the testing of the transactions in the EAGF sample that pass through the IACS indicate that it is an effective control system. The Court found that for five of the eight paying agencies audited the control systems in place were either fully or partially effective. Important failures were found in the application of key elements of the system in the UK (Scotland), Bulgaria and Romania. Hence the Court considers that in these Member States IACS is not effective in ensuring the regularity of payments. In the case of Bulgaria and Romania, the national inspection results reported to the Commission<sup>(18)</sup> are in line with the Court's assessment.

## THE COMMISSION'S REPLIES

**5.32.** *The Commission acknowledges that there are deficiencies in the IACS in the UK (Scotland), but does not consider that they render the system ineffective for the reasons set out below:*

- *The overlap of reference parcels in the LPIS is very limited since it concerns only 0,3 % of the eligible land (potentially 15 000 ha out of 4,5 million ha declared). An analysis of potential financial consequences including recovery of undue amounts for the previous period is being carried out (see also Commission reply to point 5.36).*
- *As regards the calculation of sanctions, similar deficiencies have been found in other Member States and are being followed up by the Commission in the framework of conformity clearance procedures.*

<sup>(18)</sup> The national inspection results for application checked on the spot with errors are: Bulgaria – 6,20 %; Romania – 12,57 % (Source: DG AGRI).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- As regards the potential overshoot of the UK ceiling for attributing entitlements, action is taken under the conformity clearance procedure.

*With regards to the IACS in Bulgaria and Romania, as indicated by the Court in point 5.11, the 2008 budget year was the first full year of application after the accession of these Member States. The deficiencies found by the Court had already been revealed by the Commission's audits in 2008 and concern in particular the quality of the land parcel identification system (LPIS) and the quality and the number of on-the-spot controls. They were disclosed in DG AGRI's Annual Activity Report 2008 and are being followed up through conformity clearance procedures.*

*Moreover, in order to address these deficiencies in a comprehensive and timely manner, both Member States, at the request of the Commission, have set up action plans in 2009.*

5.33. Concerning the seven EAFRD supervisory and control systems audited, the Court found that the systems are partially effective in ensuring the regularity of payments.

5.34. The Court's principal audit findings are outlined in the following paragraphs. A synoptic table with the Court's assessment per Member State is given in **Annex 5.1**.

*l) Administrative procedures and controls to ensure correct payment including quality of databases*

5.35. According to the legal provisions<sup>(19)</sup>, administrative checks shall be undertaken on all applications for support and payment claims, and shall cover all elements that are possible and appropriate to control by administrative means. The administrative checks shall include cross-checks wherever possible and appropriate, inter alia with data from the IACS. The Court's audit verified the quality of the databases as well as the adequacy of such checks in terms of identifying anomalies and taking corrective action. The major systems weaknesses found are set out below.

<sup>(19)</sup> Article 11 of Commission Regulation (EC) No 1975/2006 (OJ L 368, 23.12.2006, p. 74) and Article 24 of Regulation (EC) No 796/2004.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## EAGF

5.36. The *Land Parcel Identification System (LPIS)* is a database in which all the agricultural area of the Member State is recorded. The effectiveness of the administrative controls to establish eligibility of surfaces depends on the quality of the information recorded in the LPIS. The Court found substantial deficiencies of LPIS in two Member States that seriously affect the efficiency of administrative cross-checks (BG and UK). The Court also found in one Member State no adequate capping of payment based on ortho-photos (PL). In another Member State (ES) ineligible areas (partially wooded and/or rocky mountain grazing land) were accepted for payment due to the generous coefficients applied.

**5.36.** *As regards the UK (Scotland), the Commission refers to its reply to 5.32. The Commission is providing an appropriate follow-up through the conformity clearance procedure.*

*As far as Poland and Spain are concerned, the deficiencies are known to the Commission and are being followed up through conformity clearance procedures.*

*As regards Bulgaria, see below.*

## Example

In Bulgaria the LPIS does not contain the precise eligible area of reference parcels. Every reference parcel is classified under one of 5 eligibility percentage ranges. The on-the-spot visits carried out by the auditors showed that the eligibility percentage ranges indicated in the LPIS were not reliable. Furthermore, the maximum eligible area calculated on the basis of the eligibility percentages indicated in LPIS have no capping effect on the total area accepted for payment. Finally, it was noted that after claim year 2007 the Member State authorities transferred reference parcels from 'other agricultural use' and 'non-agricultural use' to other land use categories with higher eligibility percentages.

In the UK (Scotland), the LPIS was found to have more than 12 000 overlapping reference parcels resulting in double SPS payments for around 15 000 ha.

## Example

*With regard to Bulgaria, the Commission shares the view that their LPIS need further improvement. The action plan referred to in the Commission reply to point 5.32 will address the weaknesses identified.*

*This problem is very limited. An analysis of potential financial consequences including recovery of undue amounts for the previous period is being carried out (see also Commission reply to point 5.32).*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.37. A reliable *entitlements database* is a prerequisite for correct SPS payments to individual beneficiaries in the first year and all subsequent years. The total value of all entitlements allocated to farmers must respect the national ceiling provided by EU legislation <sup>(20)</sup>. The Court found cases of different data held nationally and regionally on the relevant component part of the national ceiling ES; and an incomplete, inaccurate and outdated database of entitlements UK.

5.37. *The Commission refers to its reply to 5.32.*

## Example

The UK divided its national ceiling for allocation of payment entitlements into four sub-ceilings, one for each regional paying agency. One of the regional paying agencies exceeded its sub-ceiling by more than 25 million euro representing 4 % of the Scottish sub-ceiling. The authorities reported that the national ceiling was overshoot by only 2,8 million euro because another regional paying agency was reported to have stayed considerably below its sub-ceiling. The Court was unable to verify the total value of entitlements for this regional paying agency because the database is unreliable — it is not complete, accurate or up to date, with more than 1 200 cases of entitlements containing discrepancies awaiting clarification.

## Example

*The 2,8 million euro overshoot reported by the UK authorities represents 0,1 % of the national ceiling. This issue is being followed up through the conformity clearance procedure.*

<sup>(20)</sup> See Article 41(1) of Regulation (EC) No 1782/2003.

## THE COURT'S OBSERVATIONS

5.38. With regard to the *correctness of payments*, the Court found substantial deficiencies in one Member State leading to cases of land claimed by municipalities in their own name and not redistributing the aid to those who grazed their animals on the land and kept the land in GAEC (RO); duplicate and overpayments as well as incorrect application of the 'obvious error' concept <sup>(21)</sup> (RO). The Court also found errors of systematic incorrect calculation of aid when claimants declare less set aside area than set aside entitlements held or where claimants were found to have less eligible hectares than claimed and held entitlements of different values (BE, UK, ES, SI);

## THE COMMISSION'S REPLIES

**5.38.** *As regards the issue of municipalities receiving SAPS payments, reference is made to the Commission reply under point 5.17.*

*Regarding the issue of double and overpayments in Romania, the Romanian paying agency quantified the problem and is taking remedial action in the context of its action plan. In addition, the Commission considers that in 2007 Romania applied the concept of obvious error correctly.*

*The problems related to the calculation of payments in Spain, Slovenia and the UK are known to the Commission and already subject to conformity clearance procedures.*

*For Belgium, information received indicates that the procedure applied for the calculation of aid in the cases referred to by the Court led to differences in the amount of aid granted that did not cause any loss to the Community budget.*

## Example

In Romania more than 5 500 farmers benefited from double/overpayments for a total amount of 2,2 million euro. In some cases where the farmer requested area reductions or withdrawals in respect of parcels for which the administrative cross-checks had revealed reference parcel overshoots, these requests were accepted without application of penalties contrary to EU legislation. The Member State also incorrectly applied the obvious error concept when accepting that area overshoots of reference parcels could be transferred to other reference parcels. There were 64 000 obvious error corrections made in this way.

## Example

*The Romanian paying agency detected the problem itself and is taking remedial action in the context of its action plan.*

<sup>(21)</sup> Article 19 of Regulation (EC) No 796/2004. An obvious error is one which is apparent as such from the application form and does not give rise to a penalty.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## EAFRD

5.39. Control systems based on administrative checks have been established by Commission Regulation (EC) No 1975/2006<sup>(22)</sup> for each type of rural development measure approved during the programming period 2007-2013. Similar systems apply to rural development measures approved during the previous programming period.

5.40. While the Integrated Administrative and Control System (IACS) comprises an identification system for agricultural parcels, it does not include forest and wooded parcels. However, these parcels may be eligible for specific Rural Development measures. Administrative checks based on this identification system were found to be not fully reliable in some cases where afforested parcels were still recorded in IACS as agricultural parcels (ES), and insufficient in other cases where wooded or otherwise not cultivated areas were eligible for rural development support (IT).

5.41. The audit also found weaknesses consisting in inadequate supporting documents (HU, PT), inaccurate or insufficiently documented administrative checks (PT, IT, IE), incorrect data input and calculation errors (IT, PT).

**5.40.** According to Article 7 of Regulation (EC) No 1975/2006, appropriate alternative systems to uniquely identify land, such as forest or land receiving agri-environmental payments, must be established.

## II) Control systems based on on-the-spot checks

5.42. According to the legal provisions<sup>(23)</sup>, the Member States shall, each year, carry out on-the-spot checks covering at least 5 % of all beneficiaries. The number of on-the-spot checks shall be increased if significant irregularities are revealed. The Court's audit focussed on the adequacy of risk analysis procedures to select beneficiaries for such checks, the quality of the checks and the adequacy of the corrections made. The analysis of the procedures as well as the re-performance of controls carried out by the Court found specific weaknesses in the on-the-spot controls.

<sup>(22)</sup> Regulation (EC) No 1975/2006 of 7 December 2006 laying down detailed rules for the implementation of Council Regulation (EC) No 1698/2005, as regards the implementation of control procedures as well as cross-compliance in respect of rural development support measures.

<sup>(23)</sup> Article 12 of Regulation (EC) No 1975/2006 and article 26 of Regulation (EC) No 796/2004.

## THE COURT'S OBSERVATIONS

5.43. In EAGF, the Court identified ineligible areas or parcels which should have been excluded by the national inspectors and found the non-fulfilment of the obligatory inspection rate (BG). Due to a high rate of irregularities detected in the initial 5 % sample of inspections Bulgaria had to increase its sample fivefold<sup>(24)</sup> but achieved only 10,1 % coverage. It accepted the remote sensing results without conducting a quality review. Furthermore, the Court inspected 34 parcels that had been reported, by the local services of the Ministry for Agriculture, to be eligible and found 12 of them to be fully covered with bushes and trees and not usable for agriculture or totally abandoned for many years or land used to dump waste.

5.44. In EAFRD, the Court noted weaknesses in the establishment of samples of beneficiaries to be checked on the spot based on an insufficient or not up-dated risk analysis (CZ, IT, ES, PT). Furthermore, the concentration of the checks in a limited period of time, as noted in certain Member States (IT, PT), makes it impossible to verify compliance with specific commitments that have to be fulfilled during other periods of the agricultural year.

5.45. Further weaknesses concerned cases where, despite a high rate of irregularities, the number of checks had not been increased (ES) and cases where control reports contained an incomplete indication or description of the verifications carried out (IE).

## THE COMMISSION'S REPLIES

**5.43.** *The Commission acknowledges that in 2007, Bulgaria inspected 10,1 % of the SAPS applications on the spot, beyond the obligatory 5 % minimum inspection rate but should have increased this rate even further. Bulgaria is following-up on the issues identified by the Court in the context of its action plan. Furthermore, the Commission is addressing these issues under the conformity clearance procedure.*

*As regards the eligibility of the parcels inspected, it is up to the Member State to define what constitutes good agricultural conditions (GAC). According to the definition established by the Bulgarian authorities for claim year 2007, no production, presence of animals or mowing was required to meet the GAC.*

**5.44-5.45.** *Similar weaknesses were noted during the Commission's own audits and will be followed up through the conformity clearance procedures.*

<sup>(24)</sup> According to Commission working document on increases in the percentages of area aid applications to be checked where significant irregularities are found (DS/2006/24 rev 1).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

III) *System to ensure implementation and control of Cross-compliance*

5.46. Cross-compliance links direct payments and certain wine payments under EAGF and certain payments under EAFRD to compliance with rules relating to the environment, public, animal and plant health, animal welfare, and to the maintenance of agricultural land in good agricultural and environmental condition (GAEC). The rules are set out in statutory management requirements (SMRs) and standards of GAEC. If a farmer does not respect these obligations, his payments may be reduced. The Court's audit verified the transposition into national legislation of the Community provisions, the respect of the relevant provisions by the selected beneficiaries and assessed the application of penalties applied for non-compliance.

5.47. In order to be eligible for aid, farmers must carry out an agricultural activity. An agricultural activity is defined to mean the production, rearing or growing of agricultural products including harvesting, milking, breeding animals and keeping animals for farming purposes, or maintaining the land in good agricultural and environmental condition (GAEC).

5.48. Community standards for GAEC <sup>(25)</sup> provide inter alia for appropriate measures against soil erosion and for grassland maintenance, the avoidance of the encroachment of unwanted vegetation and minimum livestock stocking rates and/or appropriate regimes. Member States have to define at national or regional level, minimum requirements for GAEC.

5.49. The Court found *shortcomings concerning the Member States' definition of what is required to maintain land in GAEC* such that certain beneficiaries are paid aid under SPS or SAPS without doing anything with the land concerned.

**5.46.** *Respect of cross-compliance criteria by farmers does not constitute an eligibility criterion. Farmers not respecting these criteria are entitled to receive direct payments, but their payments are reduced taking into account the severity, extent, permanence and repetition of the non-compliance found as well as negligence or intent of the beneficiary concerned.*

**5.49.** *The Commission has addressed the issue of farming activity referred to by the Court in the framework of the Health Check. It has proposed that Member States should exclude natural or legal persons from the direct payment schemes whose business objects do not consist of agricultural activities or whose agricultural activities are insignificant. However, the Council made this provision optional for Member States (Article 28(2) of Regulation (EC) No 73/2009).*

<sup>(25)</sup> Regulation (EC) No 1782/2003 and in particular Annex IV, subsequently repealed and replaced by Regulation (EC) No 73/2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*There is no obligation for Member States to impose grazing or mowing as the Court suggests in the examples for UK-Scotland, Bulgaria and Romania. As regards the GAEC, it is up to the Member State to define the criteria in the framework of the minimum conditions set out in the applicable Council Regulation (EC) No 1782/2003. These national criteria should not create an obligation to produce which would not be compatible with the WTO requirements.*

## Example

In Scotland the authorities accepted that SPS aid can be claimed for rough grazing land (mainly covered with heather and bracken) which requires no farming activity or any work by the beneficiary to keep it in GAEC <sup>(26)</sup>. As a result, claimants who purchased high value entitlements and do not carry out any agricultural activity rent large tracts of land for periods each year at very low rates (varying for the cases examined by the Court between 2 euro/ha and 18 euro/ha) in order to activate entitlements (worth up to several hundred euro/ha). Such land is 'maintained' naturally, often by wild deer, the only activity that takes place is occasional hunting.

In Bulgaria and Romania SAPS aid was granted for grassland to beneficiaries who did not carry out any production activity nor even a maintenance activity. Furthermore, the Court observed areas which have been abandoned and covered with bushes and trees.

## Example

*Following the decoupling of direct payments, it is sufficient if the agricultural parcel complies with the good agricultural conditions (GAC) for the beneficiary to receive aid. Both Member States have established criteria regarding the respect of GAC but, as allowed by the EU framework, these criteria do not include the obligation of grazing or mowing (see also the Commission reply to 5.17).*

<sup>(26)</sup> The GAEC obligations for rough grazing land consist of prohibiting certain activities such as undertaking new drainage works, ploughing, clearing, etc... but there is no obligation to have the land grazed or mown.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.50. Such beneficiaries do not meet the definition of 'farmers'. Under Community rules<sup>(27)</sup> 'no payment shall be made in favour of beneficiaries for whom it is established that they artificially created the conditions required for obtaining such payments with a view to obtaining an advantage contrary to the objectives of that support scheme'.

5.51. Concerning the *application of penalties*, the total value of cross-compliance sanctions for claim year 2007 was 17,5 million euro for the EAGF. With regard to the Member States subject to the Court's systems audits the average percentage of claimants sanctioned for non-compliance under both Funds (EAGF and EAFRD) was 27 %, ranging from 0 % for Romania to 86 % for Slovenia.

5.52. The main problems found for the Paying Agencies audited were cases of a flat rate penalty of 1 % being applied frequently for non-compliance with GAEC standards whereas in general a 3 % reduction of the payments is required (SI); and lack of supporting documents for the calculation of GAEC penalties (PL).

**Systems related to recoveries and financial corrections***The Commission's clearance of accounts procedures*

5.53. As the 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, although they are reported as payments in the financial statements submitted by the Commission. The final recognition of expenditure is determined through a two-stage procedure called the clearance of accounts. The two stages consist of an annual financial decision and multiannual conformity decisions taken by the Commission.

5.50. The Commission has addressed the issue of the farmer definition referred to by the Court in the framework of the Health Check. It has proposed that Member States should exclude natural or legal persons from the direct payment schemes whose business objects do not consist of agricultural activities or whose agricultural activities are insignificant. However, the Council made this provision optional for Member States (Article 28(2) of Regulation (EC) No 73/2009). As regards the issue referred to by the Court, under the legislation applicable in 2008 natural or legal persons carrying out an agricultural activity or maintaining land in good agricultural condition (GAC) are entitled to receive SAPS payments.

5.51. According to the figures available to the Commission and published in the Annual Activity Report for 2008, as an average in EU-27, 16,25 % of the claimants controlled for aid under the first and second pillar of the CAP were subject to sanctions for non-compliance.

5.52. The Commission has detected similar deficiencies in certain Member States and is pursuing them in the framework of the conformity clearance procedure.

5.53. The reimbursements by the Commission to Member States are, according to the legal rules, defined as monthly payments and not as advances<sup>(2)</sup>.

<sup>(27)</sup> Article 29 of Regulation (EC) No 1782/2003.

<sup>(2)</sup> Article 14 of Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Financial clearance**

5.54. On 29 April 2009 the Commission took three financial clearance decisions for the expenditure made under EAGF, EAFRD and TRDI and cleared all paying agencies accounts, except those shown in **Annex 5.3**. These decisions are mainly based on certificates provided by independent auditors (certification bodies). The Court's audit did not detect expenditure cleared by the Commission which should have been refused (disjoined) in the financial clearance decisions.

5.55. The financial decisions are however limited to the veracity, completeness and accuracy of the paying agencies' accounts. Legality and regularity of underlying payments (conformity issues) are outside the scope of the certification bodies' substantive testing and claims for EU aid are not usually checked on the spot by the certification bodies. Financial decisions do not therefore mean that the expenditure 'cleared' is free of irregular payments.

*5.55. The audit assurance given is not limited solely to accounting matters. Each certificate also provides an opinion on whether the paying agency's internal control system has functioned satisfactorily for the financial year in question and in this context on-the-spot checks are also assessed.*

*In addition, certification bodies provide a separate opinion on the Statement of Assurance provided by the directors of the paying agencies as well as an analysis of the effectiveness of the on-the-spot controls and the accuracy of the inspection statistics.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.56. The Commission introduced new rules for the disclosure of debts (debtors' accounts) for financial year 2006 and subsequently modified these rules with effect from financial year 2008<sup>(28)</sup>. Such modifications must be implemented by the paying agencies and involve significant work in a restricted timeframe they therefore imply a risk of misstatements in the debtors' accounts. Based on the examination of the certification bodies' work and the Commission analysis of that work, the Court reiterates its doubts as regards the reliability of the debtors' accounts<sup>(29)</sup>. The Commission raised shortcomings in respect of the debtors' accounts for one quarter of the paying agencies<sup>(30)</sup> and has proposed financial corrections<sup>(31)</sup> amounting to some 25,3 million euro. These corrections represent some 1,95 % of the 1 295 million euro that are to be recovered as at the end of financial year 2008. Whilst just below the 2 % level of materiality they indicate that a risk of a material error at the overall level of the debtors' accounts exists.

**5.56.** *The new rules and their subsequent modification, aim at improving the reporting from the Member States to the Commission in order to provide better protection for the Community's financial interest. The Commission considers that the changes have been introduced sufficiently in advance in order to allow the paying agencies to adapt to the new requirements and, thus, did not imply a risk of misstatement in the debtors' ledger.*

*The Commission obtained enough information on debtors for clearance and accounting purposes. In no case was the financial impact found to be material at the overall account level (and thus as regards the Decision).*

*The corrections of 25,3 million euro were proposed by the Commission based on its assessment of the information provided by the certification bodies in their reports, and its calculation of the most likely rates (and amounts) of error relating to debts in particular paying agencies. The same logic is used for debts as for the treatment (and possible correction) of errors arising from the detailed testing of Funds expenditure.*

*The financial errors found are recovered through the ordinary clearance of accounts procedures.*

<sup>(28)</sup> Prior to financial year 2006, Member States had to provide table 105 provided for by Article 3(6a) of Commission Regulation (EC) No 296/96 (OJ L 39, 17.2.1996, p. 5) which showed the total of debts by the end of the financial year, in financial years 2006 and 2007 Member States had to provide the tables provided for by Article 6(f) of Commission Regulation (EC) No 885/2006 (OJ L 171, 23.6.2006, p. 90) distinguishing between EAGF and EAFRD and here again between administrative and judicial procedures respectively and since financial year 2008 Member States have to provide the tables called annex III and IIIa provided for by Articles 6(h) and 6(i) of Regulation (EC) No 885/2006 which distinguish between irregularities and amounts due which are neither irregularities nor administrative errors respectively.

<sup>(29)</sup> Annual Reports concerning the financial year 2006, paragraph 5.61, and the Annual Report concerning the financial year 2007, paragraph 5.44.

<sup>(30)</sup> Article 10 of Regulation (EC) No 885/2006 by means of which the Commission communicates to the Member States the results of its verification of the information supplied.

<sup>(31)</sup> Financial corrections pursuant to Article 11 of Regulation (EC) No 885/2006.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Conformity clearance**

5.57. Conformity decisions are taken following additional verifications by the Commission of the expenditure declared by the Member States. They cover a number of years and have the objective of excluding expenditure from EU financing where the Commission has found that it 'has been incurred in a way that has infringed EU rules' <sup>(32)</sup>.

5.58. The Court in previous annual reports indicated the limitations which are partly inherent in the clearance system such as the retroactive and multiannual nature of the conformity clearance and the fact that the Member States, and not the final beneficiaries, are effectively charged with the financial corrections. In addition, the Commission's method of calculating the conformity adjustments, largely based on the use of a flat-rate corrections, means that no valid link can be made between the amounts thus recovered and the real amount of irregular payments <sup>(33)</sup>. Due to their inherent nature, these limitations persist in 2008 and were underlined in the European Parliament discharge resolution for 2007.

**5.58.** *What the Court describes as limitations are inherent to the system and were not objected to by the Court in the context of the adoption of Council Regulation (EC) No 1290/2005.*

*The conformity clearance is designed to exclude expenditure from Community financing which has not been effected in compliance with Community rules. 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.*

*Where undue payments to beneficiaries can be identified as a result of the conformity clearance, Member States are required to follow them up with recovery actions against these beneficiaries. However, even where recoveries from beneficiaries are not needed because the financial correction relates only to deficiencies in the Member States' management and control system and not to undue payments, these corrections are an important means to improve the Member States' systems and thus to prevent or detect and recover irregular payments to beneficiaries.*

*Financial corrections are determined on the basis of the nature and gravity of the infringement and the financial damage caused to the Community. The amount is calculated on the basis of the loss actually caused or on the basis of an extrapolation. Where this is not possible, flat-rates are used which take account of the severity of the deficiencies in the national control systems in order to reflect the financial risk for the Community. The Commission therefore considers there to be a valid link between this type of financial corrections and the level of irregular payments to final beneficiaries.*

*The use of flat rates has been accepted by the Court of Justice as being in conformity with the legal rules governing the conformity work and endorsed, under certain circumstances, by the European Parliament in its 2007 discharge resolution (§83).*

<sup>(32)</sup> Article 31 of Regulation (EC) No 1290/2005.

<sup>(33)</sup> Annual Report concerning the financial year 2006, paragraph 5.63, and the Annual Report concerning the financial year 2007, paragraph 5.47.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Member State controls under IACS and inspection results*

5.59. The IACS inspection results reported to the Commission by paying agencies assess the legality and regularity of claims submitted by farmers and had to be verified by the certifying bodies for the first time in 2007. However, most certifying bodies do not extend their work to final beneficiaries for the verification and validation of IACS statistics. Furthermore, although the Commission has undertaken to validate these statistics its coverage of this area is as of yet incomplete.

**5.59.** Certification bodies have been requested to check on the spot a sample of at least 10 inspections for each of the populations (i.e. 40 in total if it manages all type of expenditure) and to reconcile the information entered into the databases and records for at least 20 field inspection reports for each set of statistics (i.e. 60 in total if it manages all type of expenditure).

An analysis of the certification reports received shows that in around 75 % of the cases, the statistical information on direct aids and rural development has been reviewed by the certification bodies with regard to the quality of the underlying on-the-spot checks and the accuracy of the control statistics themselves, although the work carried out was not always as comprehensive as requested by the Commission (for the accuracy of the control statistics for rural development and the quality of the on-the-spot checks for rural development measures not covered by the IACS, the coverage was around 60 %). In more than 90 % of these cases (80 % for rural development measures not covered by the IACS), the certification bodies concluded positively on the quality of the on-the-spot checks and in around 65 % of the cases on the accuracy of the control statistics.

However, the Commission agrees that further improvements can and should be made and it is constantly raising the issue with the Member States. It concludes, despite the room for improvement, that these statistics constitute a valid tool for assessing the regularity and legality of agricultural expenditure.

**Policy areas Environment, Fisheries and Maritime Affairs, Health and Consumer Protection**

5.60. Environment, Fisheries and Maritime Affairs as well as Health and Consumer Protection are managed by the Commission under specific control systems. The audit examined the setting-up of the EFF for the period from 2007 to 2013.

*Approval of the national operational programmes and assessment of the national audit strategies of the European Fisheries Fund*

5.61. The Court's audit covered two of DG MARE's internal control systems, the first of which concerned approval of the European Fisheries Fund's (EFF) operational programmes, whilst the second concerned the assessment of the corresponding audit strategies. The existence and proper application of key controls was checked in respect of the programmes and audit strategies for which the related approval or acceptance procedures had been finalised during 2008. The Court's audit did not lead to any specific observation.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## CONCLUSIONS AND RECOMMENDATIONS

5.62. Based on its audit work, the Court concludes that, except for Rural Development <sup>(34)</sup>, the payments for the year ended 31 December 2008 for the policy group were free from material error. Rural Development expenditure is still affected by a higher level of errors than EAGF, although the estimated error level is lower than in previous years.

5.63. Based on its audit work, the Court concludes that, for the policy areas covered by this chapter, most of the supervisory and control systems are partially effective in ensuring the regularity of payments <sup>(35)</sup>.

5.64. As in previous years, the Court, based on the level of errors in transaction testing and its systems assessment, reiterates that IACS generally is an effective control system for limiting the risk of error or irregular expenditure. Nevertheless, the audit found that significant improvements are necessary in selected paying agencies in three Member States (see paragraph 5.32).

5.65. The Court's audit has shown that the following deficiencies should be addressed for the SPS and SAPS schemes:

- (a) to overcome the systems weaknesses leading to errors relating to overdeclarations of land or inaccurate entitlements, notably by ensuring that databases are reliable;

**5.62.** *The Commission welcomes the positive overall assessment according to which for the policy group taken as a whole including the policy area 'agriculture and rural development', the estimated value of the overall error rate is slightly below the materiality threshold of 2 %. It shares the Court's view that rural development expenditure is affected by a higher incidence of errors, but notes with satisfaction that the error rate is decreasing in this area.*

**5.63.** *For the policy areas covered by this chapter, the results of the Court's substantive testing are relatively stable over the past years and around the 2 % materiality level. This confirms that, in general, the supervisory and control systems are effective.*

**5.64.** *The Commission acknowledges that there are deficiencies in the IACS in the UK (Scotland), but does not consider that they render the system ineffective (see also Commission reply to point 5.32).*

*The deficiencies regarding the functioning of the IACS in Bulgaria and Romania are addressed in detailed and comprehensive action plans that the Commission has imposed on both Member States in 2009 and they are followed up in the conformity clearance procedure. These deficiencies were also duly reported in DG AGRI Annual Activity Report for 2008.*

**5.65.**

- (a) *Most of the weaknesses referred to by the Court are known and are being followed up in the conformity clearance. Member States are encouraged to improve their systems and to work closely together with the Commission services on the issues concerned.*

<sup>(34)</sup> The payments for Rural Development account for approximately 19 % of the policy areas covered by this chapter.

<sup>(35)</sup> This is mostly due to the supervisory and control systems of Rural Development.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(b) to tighten further the rules so that EU direct aid is not paid to claimants who have neither used the land for farming nor actively maintained it in GAEC;

(c) to enforce minimum requirements for grassland for EU direct aid.

5.66. The Court also reiterates that further efforts are required in the area of Rural Development to ensure the respect by beneficiaries of their obligations and to further simplify the rules and conditions.

5.67. Finally, effective measures need to be taken so that the issues identified in the policy areas of environment, fisheries, health and consumer protection are resolved.

(b) *The Commission has addressed the issue of the farmer definition referred to by the Court in the framework of the Health Check. It has proposed that Member States should exclude natural or legal persons from the direct payment schemes whose business objects do not consist of agricultural activities or whose agricultural activities are insignificant. However, the Council made this provision optional for Member States (Article 28(2) of Regulation (EC) No 73/2009).*

*The Commission considers the present system to be adequate and to provide sufficient guarantees that land is managed respecting the GAEC. Introducing further complicated rules would result in a highly complex control system whose implementation would be costly and contrary to the simplification efforts of the Commission. Moreover, it would effectively reintroduce a form of coupling.*

(c) *The present rules provide minimum requirements which the Member States have to respect when they are setting their GAEC. The Commission is auditing the respect of these requirements in the context of its conformity clearance work.*

**5.66.** *The Commission notes with satisfaction that the error rate in rural development is decreasing and attributes this, at least in part, to the new regulatory framework for the programming period 2007–2013, which has simplified rules and conditions and strengthened controls. In particular, Regulation (EC) No 1975/2006 now provides a comprehensive set of control rules for all rural development measures, and the Commission has taken actions to ensure the effective and efficient implementation of these rules by Member States. The Commission recognises, however, that further efforts are required in this respect.*

**5.67.** *The Commission duly follows-up all errors identified by the Court and will proceed, when needed, to financial corrections.*

## ANNEX 5.1

## PART 1: MAIN FEATURES OF SAMPLE BASED TRANSACTION TESTING

## 1.1 — Size of the sample

| Year | Number of transactions tested |
|------|-------------------------------|
| 2008 | 204                           |
| 2007 | 196                           |

## 1.2 — Structure of the sample

| Percentage of transactions tested which were | 2008        |             |                  |              | 2007         |
|--|-------------|-------------|------------------|--------------|--------------|
|  | EAGF        | RD          | SANCO, ENV, MARE | Total        |              |
| Final/interim payments                       | 74 %        | 21 %        | 5 %              | 100 %        | 100 %        |
| Advances                                     | 0 %         | 0 %         | 0 %              | 0 %          | 0 %          |
| <b>Total</b>                                 | <b>74 %</b> | <b>21 %</b> | <b>5 %</b>       | <b>100 %</b> | <b>100 %</b> |

## 1.3 — Frequency and estimated impact of errors

| Errors   | 2008      |           |                  |           | 2007                |
|--|-----------|-----------|------------------|-----------|---------------------|
|  | EAGF      | RD        | SANCO, ENV, MARE | Total     |                     |
| <b>Frequency</b> of transactions tested which were affected by errors                  | 28 % {42} | 40 % {17} | 64 % {7}         | 32 % {66} | 31 % {61}           |
| <b>Frequency</b> of errors which are quantifiable                                      | 54 % {30} | 55 % {11} | 24 % {4}         | 48 % {45} | 49 % {39}           |
| <b>Impact of quantifiable errors:</b><br>Most likely error rate falls in the range (*) | Below 2 % |           |                  |           | between 2 % and 5 % |

(\*) The Court distinguishes three ranges for most likely error rate: below 2 %, between 2 % and 5 %, above 5 %.  
The figures in the { } brackets are absolute numbers.

## 1.4 — Types of errors in the sample

| Percentage of errors in transactions tested which concern | 2008         |              |                  |              | 2007         |
|---|--------------|--------------|------------------|--------------|--------------|
|   | EAGF         | RD           | SANCO, ENV, MARE | Total        |              |
| Eligibility   | 5 %          | 15 %         | 18 %             | 10 %         | 18 %         |
| Occurrence  | 0 %          | 5 %          | 0 %              | 1 %          | 1 %          |
| Accuracy  | 50 %         | 35 %         | 12 %             | 40 %         | 31 %         |
| Other with no financial impact                            | 45 %         | 45 %         | 70 %             | 49 %         | 50 %         |
| <b>Total</b>  | <b>100 %</b> | <b>100 %</b> | <b>100 %</b>     | <b>100 %</b> | <b>100 %</b> |

## PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

## 2.1 — Assessment of selected supervisory and control systems — IACS Monitoring elements — SPS/SAPS

| Member State     | Scheme | Expenditure (million euro) | Administrative procedures and controls to ensure correct payment including quality of databases | On-the-spot inspection methodology, selection, execution, quality control and reporting of individual results | Implementation and control of GAEC/Cross-compliance (*) | Overall assessment (**) |
|------------------|--------|----------------------------|---|---|---|-------------------------|
| Belgium Wallonia | SPS    | 230                        | 1, 2  |   |   |                         |
| UK Scotland      | SPS    | 579                        | 1, 2, 3, 4  |   | a   |                         |
| Spain Catalonia  | SPS    | 178                        | 1, 2, 5   |   | b   |                         |
| Slovenia         | SPS    | 49                         | 1   |   |   |                         |
| Estonia          | SAPS   | 40                         |   |   |   |                         |
| Bulgaria         | SAPS   | 166                        | 6, 7, 8   | A, B, C   | b   |                         |
| Roumania         | SAPS   | 421                        | 8, 9, 10  |   | b   |                         |
| Poland           | SAPS   | 1 123                      | 11, 12  |   | c   |                         |

(\*) In accordance with the provisions of Article 143b(6) of Regulation (EC) No 1782/2003 new Member States have no obligation to implement statutory management requirements (Cross Compliance) until 31 December 2008 (for Bulgaria and Romania until 31 December 2011). Therefore only GAEC compliance has been audited in the New Member States.

(\*\*) The overall assessment cannot be any better than the assessment of the administrative procedures and controls.

|  |                     |
|--|---------------------|
|  | Effective           |
|  | Partially effective |
|  | Not effective       |

- 1 Incorrect aid calculation in cases where area determined is insufficient for activation of all entitlements claimed or where the farmer did not declare all set aside entitlements held.
- 2 Incorrect determination of entitlements to be surrendered to the national reserve.
- 3 Scottish sub-ceiling overshoot by 25,4 million euro, respect of UK national ceiling impossible to assess due to unreliable English database.
- 4 LPIS contains more than 12 000 overlapping reference parcels, which have led for claim year 2007 to double payments for around 15 000 ha.
- 5 Discrepancies between regional and central database of entitlements.
- 6 No precise eligible area recorded in LPIS.
- 7 Eligible area recorded in LPIS found unreliable and had no capping effect on area admitted and paid.
- 8 Claims submitted by a natural person or a municipality for land actually farmed by other people.
- 9 Substantial number of corrections of claims without application of penalties.
- 10 Double and overpayments for 5 500 farmers.
- 11 Payment of areas in excess of eligible areas recorded in LPIS.
- 12 Vectorisation not completed for all reference parcels.
- A Unverified remote sensing results accepted for payment.
- B Obligatory inspection rate not achieved.
- C Ineligible land accepted for SAPS.
- a No agricultural activity and no GAEC maintenance required for substantial rough grazing areas admitted under SPS.
- b Insufficient national GAEC/CC requirements for grassland.
- c No audit trail for GAEC penalties.

## 2.2 — Assessment of selected supervisory and control systems — Rural Development

| Member State   | Administrative procedures and controls to ensure correct payment including quality of databases | On-the-spot inspection methodology, selection, execution, quality control and reporting of individual results | Implementation and control of GAEC/Cross-compliance | Overall assessment |
|----------------|---|---|---|--------------------|
| Czech Republic |   |   | N/A   |                    |
| Greece         |   |   |   |                    |
| Hungary        |   |   | N/A   |                    |
| Ireland        |   |   | N/A   |                    |
| Italy          |   |   | N/A   |                    |
| Portugal       |   |   | N/A   |                    |
| Spain          |   |   |   |                    |

|     |   |
|-----|---|
|     | Effective   |
|     | Partially effective   |
|     | Not effective   |
| N/A | Not applicable (Payments audited not subject to cross compliance) |

## 2.3 — Overall assessment of supervisory and control systems

| Overall assessment | 2008 | 2007 |
|--------------------|------|------|
|                    |      |      |

|  |                     |
|--|---------------------|
|  | Effective           |
|  | Partially effective |
|  | Not effective       |

## ANNEX 5.2

## FOLLOW UP OF KEY STATEMENT OF ASSURANCE OBSERVATIONS (\*) (\*\*)

| Court observation  | Action taken  | Court analysis  | Commission reply  |
|--|---|---|---|
| <b>Rural development</b>   |   |   |   |
| Interest rate subsidies: the procedures in place do not ensure an adequate audit trail with the result that the regularity of the payment of the EU subsidies to the final beneficiaries cannot be verified (France) (paragraph 5.15 (*)).   | France recognises that the existing system is imperfect and intends to set up a new system allowing to reconcile the administration's databases with the banks'. Once in operation, this system will make it easier to track the loan from the bank to the final beneficiary.   | The problem noted by the Court will persist at least as long as the new system is not fully operational.          | <i>This issue has been followed up by the Commission. The Member State has introduced a new administrative system which from 2008 onwards makes it easier to track the loan from the bank to the final beneficiary. Furthermore, the Commission analyzed the results of recent audits carried out by the Member State to determine the financial impact for the previous programming periods.</i>   |
| <b>Rural development</b>   |   |   |   |
| The imprecise definitions in national legislation of some eligibility conditions and the often complex rules, particularly those related to agri-environmental measures, adversely affect the quality of the controls carried out to verify the farmers' compliance with the relevant requirements (paragraph 5.32 (*)). | No noticeable action was taken in 2008 in order to simplify the rules governing rural development expenditure. The Commission considers that 'since agri-environmental measures are complex by nature, there is only very limited scope for simplification without jeopardising their objectives' (Annual Activity Report 2008 of Directorate General for Agriculture and Rural Development, page 117). | Simplification of complex rules, in particular those applying to agri-environmental measures, is still desirable. | Concrete actions started and/or envisaged are: <ul style="list-style-type: none"> <li>— a modification of Regulation (EC) No 1975/2006 in order to further clarify certain issues and to better align its rules to those applicable in the first pillar;</li> <li>— the ongoing simplification exercise, which has resulted in a number of proposals for simplification also for the second pillar;</li> <li>— the setting up of an enhanced procedure to discuss difficulties encountered by Member States in implementing and controlling rural development measures with the aim to foster the exchange and sharing of experience and expertise between Member States. The outcome of these meetings could then be used to further improve and update the existing guidelines, which in turn could help to improve the design, implementation and controls of the measures concerned.</li> </ul> |

| Court observation  | Action taken  | Court analysis  | Commission reply   |
|--|---|---|--|
| <b>IACS</b>  |   |   |  |
| <p>The LPIS in Greece is incomplete and contains errors in the referencing of parcels. Furthermore, in some countries the graphical layer of the LPIS (GIS) contains only aerial photos that are more than five (France, and Sweden) years old. In Portugal the update is carried out with significant delays (5.30(b), 5.30(c) (*)).</p> <p>The 2007 Annual Activity Report of the Director General for Agriculture contains again a reservation in respect of insufficient implementation of the IACS in Greece.</p> | <p>According to the 2008 Annual Activity Report of the Director General for Agriculture, as of the 2009 claim procedure, all the elements of the IACS in Greece are in place and operational and the reservation can be lifted.</p> <p>This is without prejudice to the ongoing conformity clearance procedures covering the financial risks which result from the deficiencies in the IACS for the years 2006 — 2008. In the framework of these procedures, the consequences of, in particular, the persistent deficiencies in the LPIS-GIS need to be assessed.</p> | <p>The Court will audit the SPS and IACS/LPIS in Greece in 2009.</p>  | <p><i>The Commission closely monitors the situation in Greece. A new Commission audit mission is scheduled for autumn 2009.</i></p>  |
| <b>SPS</b>   |   |   |  |
| <p>The audit found systematic shortcomings in calculation of the entitlements (5.22 (*) to 5.26 (*)).</p> <p>The re-performances of controls carried out by the Court found a number of specific weaknesses in the quality of the on-the-spot controls and identified ineligible areas or parcels that should have been excluded by the national inspectors (Greece, Italy, Spain, Portugal) (5.28 (*)).</p>   | <p>The issues named in the Annual Report 2006 and 2007 are generally already followed up through conformity procedures.</p>   | <p>The Court found cases of different data held nationally and regionally on the national ceiling (Spain) and incomplete, inaccurate and outdated database of entitlements (UK) (5.37 (**)).</p> <p>The court also found errors of systematic incorrect calculation of aid when claimants declare less area than entitlements held and have entitlements of different values (5.38 (**)).</p> | <p><i>As regards the potential overshoot of the UK ceiling for attributing entitlements, action is taken under the conformity clearance procedure.</i></p> <p><i>On the calculation of the payments, the Commission is aware of the situation in Spain, Slovenia and the UK and action has already been taken under the conformity clearance procedure.</i></p> <p><i>For Belgium, information received indicates that the procedure applied for the calculation of aid in the cases referred to by the Court led to differences in the amount of aid granted that did not cause any loss to the Community budget.</i></p> |
| <b>Olive oil</b>   |   |   |  |
| <p>The impact of the accuracy of the olive oil GIS on the integration of the production aid scheme into the SPS has been confirmed in Greece and Italy where four out of five olive oil SPS transactions audited contained errors, some of which led to significant over payments (5.14(c) (*)).</p>   | <p>According to the Commission, further financial corrections on olive oil production aid have been applied in 2007 and 2008.</p>   | <p>The Court found again errors resulting from inappropriate calculation of entitlements from olive oil production (Greece).</p>  | <p><i>The Commission confirms that the deficiencies referred to by the Court are subject to conformity clearance procedures.</i></p>   |



| Court observation  | Action taken  | Court analysis  | Commission reply  |
|--|---|---|---|
| <b>Ex-post scrutiny</b>  |   |   |   |
| <p>The Court's analysis of the certifying bodies' reports has shown a need for improvements in the verification and reporting by the Paying Agencies on the follow up of the potential irregularities reported (5.36 (*)).</p> | <p>With regard to the verification and reporting by paying agencies on the follow-up of potential irregularities, an assessment was made by certification bodies in 90 % of the cases (although the work carried out was not always as comprehensive as requested by the Commission) and in 74 % of them the statement on the follow-up given by the paying agencies is a positive one.</p> | <p>The corrections applied by the Commission indicate that a risk of material error at the overall level of the debtors accounts exists. Therefore, the Court reiterates its doubts as regards the reliability of the debtors'accounts.</p> | <p><i>The Commission obtained enough information on debtors for clearance and accounting purposes. In no case was the financial impact found to be material at the overall account level (and thus as regards the Decision). The financial errors found are recovered through the ordinary conformity clearance procedures.</i></p> |
| <p>(*) Paragraph number in the ECA 2007 Annual Report.<br/> (**) Paragraph number in the ECA 2008 Annual Report.</p>   |   |   |   |

## ANNEX 5.3

## PAYING AGENCY ACCOUNTS DISJOINED FOR 2008

(million euro)

| Member State | Paying agency      | Accounts disjoined <sup>(1)</sup> |            |          |
|--------------|--------------------|-----------------------------------|------------|----------|
|              |                    | EAGF                              | EAFRD      | TRDI     |
| Belgium      | ALV                | 274                               | 29         |          |
| France       | ODARC              |                                   | 7          |          |
| Germany      | Baden-Württemberg  | 421                               |            |          |
| Germany      | Bayern             |                                   | 127        |          |
| Germany      | Brandenburg        |                                   | 47         |          |
| Germany      | Niedersachsen      |                                   | 70         |          |
| Germany      | Schleswig-Holstein |                                   | 29         |          |
| Greece       | OPEKEPE            | 2 461                             | 224        |          |
| Italy        | ARBEA              | 102                               | 18         |          |
| Malta        | MRRA               | 2                                 |            | 3        |
| Portugal     | IFAP               | 720                               | 253        |          |
| Romania      | PIAA               | 462                               |            |          |
| Slovakia     | APA                |                                   | 98         |          |
| Spain        | Galicia            |                                   | 40         |          |
| <b>Total</b> |                    | <b>4 442</b>                      | <b>942</b> | <b>3</b> |

<sup>(1)</sup> Accounts which the Commission considered not to be able to clear in its decisions of 29 April 2009. This due to reasons attributable to the Member States concerned which require additional inquiries.

Source: Commission Decisions 2009/366/EC, 2009/367/EC and 2009/373/EC (OJ L 111, 5.5.2009 and OJ L 116, 9.5.2009).

## CHAPTER 6

**Cohesion**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction  | 6.1-6.15         |
| Specific characteristics of Cohesion Policies           | 6.2              |
| Policy objectives and instruments                       | 6.3-6.5          |
| How the money is spent                                  | 6.6-6.8          |
| Supervisory and control systems                         | 6.9-6.11         |
| Financial corrections                                   | 6.12-6.15        |
| Regularity of transactions                              | 6.16-6.20        |
| Effectiveness of systems                                | 6.21-6.34        |
| Systems related to the regularity of transactions       | 6.23-6.28        |
| 2000-2006 period  | 6.23             |
| 2007-2013 period  | 6.24-6.28        |
| Systems related to recoveries and financial corrections | 6.29-6.34        |
| Member states (2000-2006 period)                        | 6.29-6.30        |
| Commission's supervision (2000-2006 period)             | 6.31-6.34        |
| Conclusions and recommendations                         | 6.35-6.37        |
| Conclusions   | 6.35-6.36        |
| Recommendations   | 6.37             |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

6.1. This chapter presents the Court's specific assessment of policy group Cohesion which comprises policy areas 4 - Employment and Social Affairs and 13 - Regional Policy <sup>(1)</sup>. Detailed information is provided on the activities covered, the spending for the year and the management type involved in **Table 6.1**.

**6.1.** The Commission notes that budget headings 4 and 13 are wider in scope than Cohesion policy. They include social dialogue, gender equality policy, pre-accession assistance and operational grants to European Agencies.

**Table 6.1 — Payments for policy areas 4 and 13 in 2008**

| Budget Title                                    | Policy area                   | Description  | Payments 2008 (million euro) | Budget Management Mode |
|---|-------------------------------|--|------------------------------|------------------------|
| 4   | Employment and Social Affairs | Administrative expenditure                                       | 25,93                        | Centralised direct     |
|   |                               | European Social Fund   | 8 788,53                     | Shared                 |
|   |                               | Working in Europe — Social dialogue and mobility                 | 56,63                        | Centralised direct     |
|   |                               | Employment, social solidarity and gender equality                | 105,14                       | Centralised direct     |
|   |                               | European Globalisation Adjustment Fund                           | 49,04                        | Shared                 |
|   |                               | Instrument for Pre-Accession Assistance                          | 0,00                         | Decentralised          |
| 13  | Regional Policy               | Administrative expenditure                                       | 15,64                        | Centralised direct     |
|   |                               | European Regional Development Fund and other regional operations | 21 455,21                    | Shared                 |
|   |                               | Cohesion Fund (including ex-ISPA)                                | 5 826,46                     | Shared                 |
|   |                               | Pre-Accession operations related to the structural policies      | 42,71                        | Decentralised          |
|   |                               | Solidarity Fund  | 273,19                       | Shared                 |
| Total administrative expenditure <sup>(1)</sup> |                               |  | 41,57                        |                        |
| Total operational expenditure                   |                               |  | <u>36 596,91</u>             |                        |
| <b>Total payments for the year</b>              |                               |  | <b><u>36 638,48</u></b>      |                        |
| <b>Total commitments for the year</b>           |                               |  | <b><u>48 189,59</u></b>      |                        |

<sup>(1)</sup> Audit of administrative expenditure is reported in Chapter 11.

### Specific characteristics of Cohesion Policies

6.2. EU spending on cohesion is planned in multiannual 'programming periods'; payments relating to each programming period continue for some years beyond the end of it. EU funding of cohesion is granted in the form of co-financing. The principal focus of this chapter is expenditure in respect of the 2000-2006 programming period; few reimbursements (interim payments) for the 2007-2013 programming period were made in 2008 (see paragraph 6.8).

**6.2.** The Commission notes that the Court's observations concentrate on payments from the Structural and Cohesion Funds for the period 2000-2006 only, which represents approximately 68 % of Cohesion policy payments in 2008. Pre-financing for the period 2007-2013 amounted to 32 %.

<sup>(1)</sup> Rural development and fisheries expenditure are reported in policy areas 5 - Agriculture and rural development, and 11 - Fisheries.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Policy objectives and instruments**

6.3. In the programming period 2000-2006, Cohesion Policies expenditure was directed to three objectives:

- (a) structural adjustment of regions whose development was lagging behind (Objective 1);
- (b) economic and social conversion of areas facing structural difficulties (Objective 2);
- (c) modernisation of systems of education and employment (Objective 3);

and to a series of more specific 'Community Initiatives' covering, for example, interregional cooperation in the EU, urban regeneration and promotion of equal opportunities in the labour market.

6.4. EU funding is mainly provided by two Structural Funds and the Cohesion Fund <sup>(2)</sup>:

- (a) the European Regional Development Fund (ERDF) supports Objectives 1 and 2 by funding investment in infrastructure, creation or preservation of jobs, local development initiatives and the activities of small and medium-sized enterprises;
- (b) The European Social Fund (ESF) supports Objectives 1, 2 and 3 by granting financial assistance to combat unemployment, develop human resources and promote integration into the labour market;
- (c) The Cohesion Fund supports improvement of environment and transport infrastructure in Member States whose gross national product per capita is below 90 % of the European Union average.

<sup>(2)</sup> These three funds covered 97 % of the payments in 2008 under titles 4 and 13 of the General Budget. The remaining 3 % were provided by the other instruments set out in **Table 6.1**.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.5. For the 2007-2013 programming period, the ERDF, ESF and Cohesion Fund are directed towards three objectives (convergence, regional competitiveness and employment and European territorial cooperation). The programmes are designed to promote innovation, entrepreneurship, employment and the knowledge-based economy; develop regional economies and create new and better jobs.

**How the money is spent**

6.6. The Structural Funds co-finance **projects** within the framework of multiannual **operational programmes**. Member States must also contribute to the projects supported. For 2000-2006 there were 545 operational programmes, varying in size from under 500 000 euro to over 8 billion euro. Project expenditure within these programmes varied from a few hundred euro for an individual beneficiary, up to hundreds of millions of euros for a major infrastructure project. In 2000-2006 the Cohesion Fund co-financed individual projects: there were no operational programmes. For this period there were 1 170 Cohesion Fund projects ranging from 50 000 euro to over 1 billion euro. For all funds and operations for both policy areas referred to in **Table 6.1**, the total reimbursements were 24,8 billion euro in 2008.

6.7. The co-financing of a project by a Structural Fund or the Cohesion Fund generally takes the form of the **reimbursement** of costs<sup>(3)</sup> based on **expenditure declarations** by the project promoters, which are aggregated into payment claims addressed by the paying/certifying authority to the Commission<sup>(4)</sup>. A project promoter usually receives prefinancing, submits one or several interim expenditure declarations and a final one at the end of the project.

6.8. The financing mechanisms have not been substantially changed for 2007-2013 from the previous period. Start-up of the programmes has been slow. Payments for the year 2008 were 11,8 billion euro, out of which 11,7 billion were pre-financing payments.

**6.8.** *The Commission considers that there has been an important change in the financing mechanism in the period 2007-2013, because the basis for co-financing is now set at priority axis level. This simplification should reduce the errors linked to co-financing rates set at project level, which occurred in previous programming periods.*

<sup>(3)</sup> Depending on the type and complexity of the project there can be many items and types of cost supporting a reimbursement request.

<sup>(4)</sup> Project promoters are beneficiaries which range from private individuals to associations, private or public companies to local, regional or national bodies.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Supervisory and control systems**

6.9. Responsibility for the legality and regularity of spending on Cohesion Policies starts in the Member States, but the Commission bears the ultimate responsibility for the correct implementation of the budget.

6.10. There are two levels of control for Cohesion Policies projects. The first level is the control system in a Member State. It is intended to prevent or detect and correct incorrect reimbursements of project cost and other irregularities. The second level is the Commission's supervision. It is intended to ensure that Member State control systems are established and operating as required and mitigate the risk of control failures.

6.11. In the Regulations relating to the new 2007-2013 programming period<sup>(5)</sup>, control provisions are strengthened and the respective responsibilities of Commission and Member States clarified. The audit provisions are considerably enhanced. The Member States are required to submit for acceptance to the Commission an independent audit body's compliance assessment report and opinion for each operational programme's systems description, as well as an audit strategy. Annual control reports containing results of the systems audits and of the audit of a representative sample of transactions resulting in an annual audit opinion are also required.

**Financial corrections**

6.12. In the field of Cohesion policy, expenditure not meeting the conditions for funding should be excluded from EU financing through the application of the financial correction procedures.

*6.9. Member States are responsible under the sectoral regulations for ensuring the regularity of expenditure declared to the Commission for co-financing. The Commission, under shared management arrangements, has a supervisory role to verify the effective functioning of Member States' control systems, and to take corrective measures where it concludes that this is not the case, in order to assume its responsibility for the implementation of the budget (Article 53b(4) of the Financial Regulation). The Commission performs its supervisory role through its audit activity, but also through programme negotiations, monitoring committees, annual meetings with managing and audit authorities, guidance and seminars.*

*6.11. An important innovation in the period 2007-2013 is the establishment, for each programme, of an Audit Authority which is responsible for verifying that the management and control system is set up and functions effectively throughout the lifetime of the programme. The annual control report and opinion submitted by the Audit Authority should significantly enhance the assurance provided by the national control systems. The Audit Authority is also required to report on the error rates resulting from its audits of statistical samples of operations.*

<sup>(5)</sup> Notably Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25) and Commission Regulation (EC) No 1828/2006 (OJ L 371, 27.12.2006, p. 1).

## THE COURT'S OBSERVATIONS

6.13. Member States bear the primary responsibility for making financial corrections in relation to irregular expenditure certified to the Commission. When national control systems detect errors in certified expenditure, the Member State must take action to recover the undue payments made to final beneficiaries and to withdraw as appropriate the ineligible expenditure from the claim <sup>(6)</sup>.

6.14. If Commission audits find that Member States have failed to correct irregular expenditure or there are serious failings in the management and control systems, it 'shall suspend the interim payments' <sup>(7)</sup> and request the Member State take action to remedy the serious system failures and/or to carry out financial corrections. If they make the financial corrections requested, Member States have the possibility to replace the excluded expenditure with other eligible expenditure.

6.15. If the Member State does not carry out the requested remedial action and/or financial corrections, the Commission may apply financial corrections through Commission Decision, which represents a net reduction of the funds available.

## REGULARITY OF TRANSACTIONS

6.16. A summary of findings on the regularity of transactions of EU funding of Cohesion is presented in **Annex 6.1, 1.3** and **1.4**.

6.17. In 2008 again a large number of reimbursements to the Cohesion projects were affected by errors, i.e. a large number of projects were over-reimbursed. The proportion of projects in the representative statistical sample affected by errors (see paragraphs 1.9 to 1.12) is 43 % <sup>(8)</sup>. The Court estimates that at least 11 % <sup>(9)</sup> of the total amount reimbursed <sup>(10)</sup> should not have been reimbursed.

## THE COMMISSION'S REPLIES

**6.13.** *Member States are responsible in the first instance for detecting irregularities before certification of expenditure to the Commission, and also in certified expenditure.*

**6.17.** *The Commission notes that most of the projects with high quantifiable errors are concentrated in only three Member States. The Commission was already aware of the existence of deficiencies in five out of the six programmes concerned and had taken appropriate remedial measures including the implementation of action plans and the launching of suspension procedures, out of which two decisions were adopted in 2008 affecting three programmes.*

<sup>(6)</sup> These financial corrections are reported as 'withdrawals', 'recoveries' or 'pending recoveries' by Member States to the Commission.

<sup>(7)</sup> Article 39(2) of Council Regulation (EC) No 1260/1999 (OJ L 161, 26.6.1999, p. 1).

<sup>(8)</sup> See **Annex 6.1, 1.3**. In 2007, the corresponding figure was 54 %.

<sup>(9)</sup> In 2007, the corresponding figure was 11 % (Annual Report concerning the financial year 2007, paragraph 6.27) and in 2006 12 % (Annual Report concerning the financial year 2006, paragraph 6.39).

<sup>(10)</sup> This ratio refers to the 24,8 billion euro in reimbursements mentioned in the last sentence of paragraph 6.6.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

The Commission also underlines that 58 % of errors are non-quantifiable, including compliance errors, and many of these would have had no impact on the reimbursement of expenditure, even if detected beforehand. Examples of the latter include delays in publication of contract award notices, weaknesses in the audit trail or insufficient publicity at project level.

Out of 73 projects affected by the errors referred in **Annex 6.1** there are six cases where the Commission does not consider that the circumstances identified by the Court provide a basis for the application of financial corrections, or at least not at the level proposed. In particular, this concerns four errors in public procurement, which contribute to the overall error rate.

The Commission also refers to its reply to point 6.2.

6.18. A major part of the estimated error rate is attributable to eligibility errors, which are the most common type of quantifiable errors in the audit sample. They were found in 41 reimbursements audited. The causes of the eligibility errors were:

(a) projects or beneficiaries did not meet the specific fund conditions;

(b) serious failure to respect procurement rules; and

(c) inclusion of costs which are not reimbursable.

**6.18.** The Commission will follow up all the findings in order to ensure that appropriate measures are taken.

**(b)** The Commission also notes breaches of public procurement rules as a major source of irregularities, which is why it has targeted its own audit work at this risk area and taken other steps, such as the issuing of guidance to Member States on the financial correction levels to apply. However, the Commission also refers to its reply in paragraph 6.17, related to the quantification of such errors.

The first two of the three causes of eligibility errors outlined above account for almost 80 % of the estimated error rate.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## Examples

- (a) In one ERDF project, the declared expenditure consisted only of purchase of land. However, according to the ERDF eligibility rules, land purchase may not represent more than 10 % of the total eligible expenditure. In spite of this, the Managing Authority had approved the project for reimbursement. The cost claim of 25 million euro is ineligible for Structural Funds co-financing.
- (b) In another ERDF project, the scope was to develop an IT system. The contracting authority was obliged to attribute a service contract exceeding the value of 236 000 euro using the proper tendering procedures. The regional authorities, who were the final beneficiary of this project, contracted directly a company without any tendering procedure making the 1,8 million euro of expenditure declared for this project ineligible.
- (c) Expenditure needs to be related to the co-financed operations in order to be eligible. In one ESF project, the salary of an administrator, several suppliers' invoices and some equipment purchases were declared to the project although this expenditure was related also to the beneficiary's other activities. In addition, for equipment purchases only depreciation is eligible, but the whole purchase price was declared. The resulting over declaration was 88 705 euro or 13,5 %.

6.19. In two ERDF Operational Programmes in the Court's sample national authorities declared seven projects which had originally been financed by national funds. These projects had already been finalised before being submitted for EU co-financing either to create additional new expenditure or to substitute ineligible expenditure. The Court found that these projects were more error prone than those selected in the normal way<sup>(11)</sup>. They had not been subject to effective *ex-ante* verification by national authorities for compliance with the EU funding rules<sup>(12)</sup>. As the 2000-2006 programming period is coming to an end, national authorities are under pressure to absorb the EU funds committed. This increases the risk that ineligible projects could be reimbursed by the EU budget.

**6.19.** In 2005 the Commission provided guidance stating that such projects could be included in programmes only if they met all the requisite conditions, including fulfilment of the programme selection criteria, performance of controls, publicity, etc. Commission representatives have reminded Member States' authorities of these requirements when the inclusion of such projects has been discussed at monitoring committee meetings. In certain cases, where the Commission considered that the required conditions were not met, it made financial corrections.

*In four of the five projects considered by the Court to be totally ineligible because they were not operational, the Commission considers that the rules allow a determination on this issue only at programme closure. If the circumstances remain unchanged, the projects will not be co-financed. In the other case the national authorities have agreed to withdraw the project.*

<sup>(11)</sup> Out of the seven projects five were totally ineligible for co-financing and one had serious errors.

<sup>(12)</sup> The fund specific eligibility rules and other Community rule such as EU public procurement rules as well as State aid rules.

## THE COURT'S OBSERVATIONS

## Example

One ERDF project supported the construction of three equalisation towers on a water pipeline distributing water from a local dam. It was implemented during 2000-2004. The pipeline was never used because the dam was never filled with water.

The Managing Authority knew that the project could not attain the specific objectives set and that it was thus ineligible. However, it decided to include it into the Operational Programme to replace another project rejected by the Commission. Amount of expenditure declared to the Commission for this project was 5,7 million euro.

## THE COMMISSION'S REPLIES

## Example

*The Commission will verify at programme closure whether this project is operational and, if not, it will apply the requisite financial correction.*

6.20. 58 % of the errors found in the audit sample are non-quantifiable and therefore not included in the estimation of the error rate. Most of them were compliance errors, i.e.:

- (a) shortcomings in tendering and contracting procedures;
- (b) non-respect of publicity rules.

6.20.

## Example

In the tendering of two contracts in an ERDF project, a formula of average prices was used in the evaluation of the financial offers. This formula penalises the lowest offers without giving the bidder the option to justify it.

According to the judgment of the European Court of Justice (Case SECAP SpA, C-147/06), the abovementioned practice is discriminatory.

Furthermore, with this practice the offer selected may not be the one with the lowest price, which would in certain cases be in contradiction with Council Directive 93/37/EEC of 14 June 1993 concerning the coordination of procedures for the award of public works contracts<sup>(13)</sup>, notably in the determination of the economically most advantageous tender.

## Example

*The Commission has encountered this type of error in its own audits and has taken corrective measures where necessary.*

<sup>(13)</sup> OJ L 199, 9.8.1993, p. 54.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## EFFECTIVENESS OF SYSTEMS

6.21. Since the programming period 2000-2006 is coming to an end, the Court considered that an additional full assessment of the Member States' 2000-2006 control systems will not provide added value. As there were almost no interim payments for the 2007-2013 period (see paragraph 6.8), the Court focused its assessment on the part of the Member States' systems set up for processing detected errors and reporting on financial corrections to the Commission.

6.22. Furthermore, the Court examined the Commission's supervision over the Member States' control systems. This examination was twofold. The Court examined:

- (a) the Commission's audits related to operation of the Member States' systems for the programming period 2000-2006; and
- (b) the Commission's approval of the design of the Member States' control systems for the programming period 2007-2013. The Court reviewed, among other things, the Commission's approval of compliance statements and audit strategies prepared by the Member States for the current programming period.

## Systems related to the regularity of transactions

*2000-2006 period*

6.23. In 2007, the Court assessed the Member States' control systems as partially effective. For this year, there were no major modifications in the regulatory framework affecting the control systems of Member States. Furthermore, the level of error detected in previous years and the current year remains significantly higher than the materiality threshold.

**6.21.** *The system for reporting of financial corrections by the Member States to the Commission has been considerably clarified and strengthened for the period 2007-2013, by designation of a responsible authority and the provision of an annual reporting table (Article 61 of Regulation (EC) No 1083/2006 and Article 20 of Commission Regulation (EC) No 1828/2006).*

**6.22.** *In addition to the two elements of its supervision over the Member States' control systems examined by the Court, the Commission's supervisory role also includes a wide range of activities, as described under the Commission Action Plan to strengthen its supervisory role in structural actions (COM(2008) 97).*

*The Commission also refers to its reply in paragraph 6.9.*

**6.23.** *The Commission considers that, in 2008, there were significant improvements in the implementation of the management and control systems of some programmes as a result of its actions in previous years, and particularly under the 2008 Action Plan to strengthen the Commission's supervisory role in structural actions.*

*The Directorates-General for Regional Policy and Employment, Social Affairs and Equal Opportunities have set out the results of their assessments of the effective functioning of the systems in 545 operational programmes in their respective AARs for 2008. The analysis of global figures shows a marked gradation as follows:*

- 31 % of systems work well (31 % for 2007),
- 47 % of systems work but need improvement (deficiencies with moderate impact) (26 % for 2007),
- 16 % of systems work but need improvement (deficiencies with significant impact) (29 % for 2007),
- 6 % of systems are ineffective (14 % for 2007).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**2007-2013 period**

6.24. For the 2007-2013 programming period (as explained in paragraph 6.11), new elements have been introduced to the control systems in order to reduce the risk of error on transactions right from the beginning. Before the first interim payment for a programme or at the latest 12 months after programme approval, the Member States have to submit for the Commission's approval a system description accompanied by a compliance assessment from an independent audit body. Furthermore, audit authorities are also required to present an audit strategy to the Commission within nine months of programme approval.

6.25. The Court's audit shows that the Commission has carried out its approval procedures within the deadlines set, both for compliance assessments and audit strategies. Approvals of systems descriptions and compliance assessments have been justified and rejections have clearly been based on deficiencies (incomplete and therefore not in compliance with the rules and/or insufficient quality) of the documents submitted by the Member States.

6.26. By the end of 2008, the Commission had received systems descriptions and compliance assessments for 282 (65 %) out of the 432 approved programmes, and had approved 88 (20 %). In 38 % of the cases, the Member States had submitted the documents late for the Commission's approval.

6.27. The situation was similar for the approval of Member States' audit strategies. By the end of 2008, the Commission had received audit strategies for 363 (84 %) out of the 432 approved programmes. 206 strategies (47 %) had been approved. The Member States had submitted 39 % of these documents late.

6.28. The 2007-2013 projects are already under implementation. Project expenditure is being declared by the beneficiaries to the national authorities or by the national authorities to the Commission before the control systems have been approved<sup>(14)</sup>. The Court sees a risk that late approvals of the Member States' systems descriptions, compliance assessments and audit strategies increase the probability that the control systems do not prevent and detect errors at the start-up phase.

**6.26.** *As at 30 June 2009 the Commission had received compliance assessment reports for 88 % of all programmes and had, following examination within the regulatory deadlines, approved reports for 48 % of all programmes.*

**6.27.** *As at 30 June 2009 the Commission had received audit strategies for 91 % of all programmes and had, following examination within the regulatory deadlines, approved audit strategies for 85 % of all programmes.*

**6.28.** *The Commission has carried out its approval procedures within the deadlines set. The risk identified by the Court is inherent in the length of time for the submission and approval of compliance assessment reports and audit strategies provided for in the regulations for the 2007-2013 programmes. The Commission considers that this is a limited risk because control systems may comply with requirements and may function effectively even without compliance assessment reports having been approved yet. Each programme audit authority will have to present to the Commission conclusions from the results of the audit of a representative sample of operations, which will cover expenditure declared in 2008 and subsequent years and an opinion on the functioning of the systems. The Commission has also taken this risk into account in its own audit strategy for 2009.*

<sup>(14)</sup> The approval of the systems descriptions and compliance statements is a pre-condition for the first interim payment.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Systems related to recoveries and financial corrections****Member States (2000-2006 period)**

6.29. The Court assessed the Member States' systems for recording and correcting errors found by the various national *ex-post* controls and the reporting of financial corrections to the Commission. This was done in order to test the reliability of the Commission's information on financial corrections applied by the Member States. The Court checked whether the errors already detected by the Member States' control systems are accurately and completely recorded at Member States level, are corrected within reasonable deadlines and if these corrections were properly<sup>(15)</sup> registered in the national systems and reported to the Commission<sup>(16)</sup>.

6.30. **Annex 6.1, Part 2** shows that the least satisfactory aspect in the audited systems related to recoveries and financial corrections concerns the reporting of corrections to the Commission. In four of the operational programmes examined it was unsatisfactory and in six others it was partially satisfactory. In some instances information concerning financial corrections was not communicated at all to the Commission, in others it had not been presented as foreseen in the instructions sent by the Commission (DG REGIO), and it was not possible to conclude that the figures communicated were reliable. This means that the Commission does not have complete and reliable information on these financial corrections from all Member States.

**Commission's supervision (2000-2006 period)**

6.31. The Court examined the Commission's key supervisory activities, which comprise *ex-post* audits undertaken by the Commission<sup>(17)</sup>, and the application of suspension and financial correction procedures.

**6.30.** *The Commission notes that, for 11 out of 16 systems audited by the Court, all aspects are satisfactory or partially satisfactory. The Commission has made substantial efforts to improve the quality of data provided by Member States. In 2008 it carried out audits similar to those of the Court in 10 Member States, under the Commission Action Plan. It is maintaining its efforts to improve the reporting so that complete and reliable data for all Member States are available. The Commission also refers to its replies under 6.21 and 6.36.*

**6.31.** *The Commission refers to its replies under 6.9 and 6.22.*

<sup>(15)</sup> Member States are required to report to the Commission on their own financial corrections, by making a distinction between withdrawals, recoveries and pending recoveries (as explained in paragraph 6.13).

<sup>(16)</sup> The Court did not assess whether the Member States were effective in detecting errors.

<sup>(17)</sup> The results of the Court's follow-up of audit reports are summarised under **Annex 6.2**.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.32. During 2008, the Commission launched 52 procedures for the formal suspension of payments and adopted 10 <sup>(18)</sup> suspension decisions <sup>(19)</sup> relating to the 2000-2006 period. As a consequence, the volume of financial corrections relating to 2000-2006 programmes applied in 2008 for ERDF, ESF and Cohesion Fund have increased from 220 million euro <sup>(20)</sup> in 2007 to 1 169 million euro <sup>(21)</sup> in 2008 <sup>(22)</sup>. Around 60 % of the reported financial corrections have actually been implemented (i.e. withdrawn, repaid or decommitted) during 2008. 94 % of the implemented financial corrections were carried out by Member States through withdrawing ineligible expenditure, which they could replace by declaring additional new eligible expenditure. This indicates that Member States are accepting to correct irregularities themselves in order to avoid a Commission decision resulting in a net reduction of the committed funds.

6.33. The Court highlights that the practice of replacing ineligible with new expenditure (withdrawal) without effective *ex-ante* verification by Member States does not ensure that all irregular expenditure will be excluded from EU funding by programme closure.

6.34. Regarding the 'Action plan to strengthen the Commission's supervisory role under shared management of structural actions' <sup>(23)</sup>, the Commission reports that it has implemented 28 out of 37 actions. The most significant five actions having a potential impact on the errors relate to *ex-post* audits, financial corrections, suspensions and remedial action plans remain ongoing, as they are an inherent and integral part of the Commission's control responsibilities. The Action Plan's impact cannot yet be assessed as errors committed in previous years are still affecting the expenditure reimbursed by the Commission.

**6.33.** *The Commission has also identified this issue and will target it specifically in its strategy for the closure of 2000-2006 programmes. The Commission also refers to its reply in paragraph 6.19.*

**6.34.** *The Commission agrees that the impact of the Action Plan with regard to the period 2000-2006 cannot yet be fully assessed. The Commission has therefore undertaken to present a report on the initial impact of its action plan in February 2010.*

*Nonetheless, the Commission shows in its final report on the implementation of the Action Plan (COM(2009) 42) that significant results have been obtained as a result of the implementation of the Commission Action Plan in 2008, such as the adoption of 10 suspension decisions and the implementation of 14 national action plans. In addition, an amount of 1,527 billion euro from cumulative 2000-2006 payment claims (and final claims from previous periods) has been corrected in 2008, while a further 2,832 billion euro were in the course of being recovered.*

<sup>(18)</sup> The comparative figure for 2007 is one.

<sup>(19)</sup> The initiation of a suspension procedure is the first step during programme implementation towards the possible application of a financial correction by the Commission. If a Member State does not carry out itself the required remedial actions and financial corrections, the Commission may suspend payments and adopt a financial correction decision.

<sup>(20)</sup> The total amount of 220 million euro relates to financial corrections without a Commission decision.

<sup>(21)</sup> 1 109 million euro without Commission decision and 60 million euro with Commission decision.

<sup>(22)</sup> The cumulative amount of financial correctons relating to the 2000-2006 period as a result of the Commission's supervisory actions is 3 313 million euro.

<sup>(23)</sup> COM(2008) 97, approved on 19 February 2008 and the final implementation report COM(2009) 42/3.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## CONCLUSIONS AND RECOMMENDATIONS

**Conclusions**

6.35. Based on its audit work (see paragraph 6.17) the Court concludes that the payments (reimbursement of expenditure) for the year ended 31 December 2008 for the policy group Cohesion were affected by material error.

6.36. The Court found that the Member States' systems for correcting errors found by national controls were in most cases at least partially effective.

**Recommendations**

6.37. The Court recommends the Commission to:

- (a) focus the guidance given to the Member States to the most error prone areas - on eligibility issues and procurement;
- (b) seek to ensure that the detection and correction of errors work efficiently on the Member State level, including the recovery procedures and reporting to the Commission;
- (c) continue risk based auditing of the Operational Programmes, focusing on the most error prone issues and programmes;
- (d) ensure the rigorous application of the corrective mechanisms on Operational Programmes for which problems have been detected, at the same time ensuring that new errors do not stem from this process.

**6.35.** Most of the important errors identified by the Court are concentrated in a few Member States. The Commission was already aware of the system deficiencies in most cases and had taken appropriate remedial measures in these programmes in 2008. During 2008, the implementation of the Action Plan to strengthen the Commission's supervisory role in structural actions has shown effective results. Strengthened control arrangements for the period 2007-2013 and the Commission's efforts for the start-up of the period should have an impact on the level of errors in Community payments for the new period.

**6.36.** The Commission notes that most of the systems for corrections audited by the Court functioned satisfactorily or partially satisfactorily. It considers that there has been progress in producing reliable evidence of the effective operation of the multiannual corrective mechanisms. It is continuing its efforts to improve the quality of data provided by Member States and in 2009 will carry out again on-the-spot audits similar to those of the Court, as performed under the Action Plan in 2008.

**6.37.**

- (a) The Commission focused actions in its Action Plan in 2008 on this recommendation, and is continuing its efforts in 2009. It has provided guidance on important eligibility issues, such as revenue-generating investments and the simplified cost options (flat rates and lump sums) introduced in the recent amendments to the 2007-2013 rules. The Commission has organised workshops on public procurement issues and will continue to participate actively in the training of Member States' authorities.
- (b) The Commission focused on this issue in several actions of its Action Plan in 2008. It will maintain its efforts and has requested Member States to strengthen recovery procedures and reporting in 2009, in view of the closure of the 2000-2006 programmes.
- (c) The Commission focused action 1.1 of its Action Plan in 2008 on this recommendation. In 2009 it will pursue this objective, as indicated in its joint audit strategy for the Structural Funds 2009-2011.
- (d) The Commission focused actions 8.1 and 8.2 of its Action Plan in 2008 on this recommendation and will continue to verify — up to and including at closure — that withdrawn irregular expenditure is replaced by eligible expenditure.



## ANNEX 6.1

## PART 1: MAIN FEATURES OF SAMPLE BASED TRANSACTION TESTING

## 1.1 — Size of the sample

| Year | Number of transactions tested |
|------|-------------------------------|
| 2008 | 170 (*)                       |
| 2007 | 180                           |

(\*) The 170 interim reimbursements represent 180 sampling units. The Court uses Monetary Unit Sampling, where reimbursements can be selected more than once, if their monetary value exceeds the sampling interval.

## 1.2 — Structure of the sample

| Percentage of transactions tested which were | 2008        |             |               |              | 2007         |
|--|-------------|-------------|---------------|--------------|--------------|
|  | ESF         | ERDF        | Cohesion Fund | Total        |              |
| Final/interim payments                       | 29 %        | 55 %        | 16 %          | 100 %        | 100 %        |
| Advances                                     | —           | —           | —             | —            | —            |
| <b>Total</b>                                 | <b>29 %</b> | <b>55 %</b> | <b>16 %</b>   | <b>100 %</b> | <b>100 %</b> |

## 1.3 — Frequency and estimated impact of errors

| Errors   | 2008      |           |               |           | 2007      |
|--|-----------|-----------|---------------|-----------|-----------|
|  | ESF       | ERDF      | Cohesion Fund | Total     |           |
| <b>Frequency of:</b><br>transactions tested which were affected by errors              | 18 % {9}  | 51 % {48} | 59 % {16}     | 43 % {73} | 54 % {97} |
| <b>Frequency of:</b><br>errors which are quantifiable                                  | 44 % {4}  | 47 % {37} | 21 % {4}      | 42 % {45} | 43 % {63} |
| <b>Impact of quantifiable errors:</b><br>most likely error rate falls in the range (*) | Above 5 % |           |               |           | Above 5 % |

(\*) The Court distinguishes three ranges for most likely error rate: below 2 %, between 2 % and 5 %, above 5 %.  
The figures in {} brackets are absolute numbers of transactions.

## 1.4 — Types of errors in the sample

| Percentage of errors in transactions tested which concern | 2008         |              |               |              | 2007         |
|---|--------------|--------------|---------------|--------------|--------------|
|   | ESF          | ERDF         | Cohesion Fund | Total        |              |
| Eligibility   | 22 %         | 46 %         | 16 %          | 38 %         | 34 %         |
| Occurrence  | 0 %          | 0 %          | 0 %           | 0 %          | 5 %          |
| Accuracy  | 33 %         | 10 %         | 10 %          | 12 %         | 18 %         |
| Other (compliance, not affecting the payment)             | 45 %         | 44 %         | 74 %          | 50 %         | 43 %         |
| <b>Total</b>  | <b>100 %</b> | <b>100 %</b> | <b>100 %</b>  | <b>100 %</b> | <b>100 %</b> |

## PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

## 2.1 — Assessment of selected supervisory and control systems — Systems related to recoveries and financial corrections at the Member State level

|   | Recording of errors | Correction of errors | Recording of corrections | Correction reporting to COM | Irregularity reporting to OLAF |
|---|---------------------|----------------------|--------------------------|-----------------------------|--------------------------------|
| ERDF — Greece — Epirus                          |                     |                      |                          |                             |                                |
| ERDF — INTERREG Germany/Poland — System Germany |                     |                      |                          |                             |                                |
| ERDF — INTERREG Germany/Poland — System Poland  |                     |                      |                          |                             |                                |
| ERDF — INTERREG Spain/Portugal                  |                     |                      |                          |                             |                                |
| ERDF — Italy — Calabria                         |                     |                      |                          |                             |                                |
| ERDF — Italy — Puglia                           |                     |                      |                          |                             |                                |
| ERDF — Spain — Andalusia                        |                     |                      |                          |                             |                                |
| ERDF — Poland — Competitiveness                 |                     |                      |                          |                             |                                |
| ERDF — Portugal — Accessibility and transport   |                     |                      |                          |                             |                                |
| ERDF — Spain — obj. 1                           |                     |                      |                          |                             |                                |
| ERDF — UK — Cornwall obj. 1                     |                     |                      |                          |                             |                                |
| ESF — Belgium — Hainaut                         |                     |                      |                          |                             |                                |
| ESF — France — obj. 3                           |                     |                      |                          |                             |                                |
| ESF — Greece — Competitiveness                  |                     |                      |                          |                             |                                |
| ESF — Netherlands — obj. 3                      |                     |                      |                          |                             |                                |
| ESF — Sweden — obj. 3                           |                     |                      |                          |                             |                                |

Legend:

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

## FOLLOW-UP OF KEY STATEMENT OF ASSURANCE OBSERVATIONS

| Court observation  | Action taken   | Court analysis   | Commission reply   |
|--|--|--|--|
| <b>1. The Commission's actions to improve the management of Cohesion projects</b>  |  |  |  |
| <p>The Court has repeatedly detected a material level of error in Cohesion projects. The Court has assessed the control systems in the Member States as ineffective or moderately effective and identified that the Commission's own supervision is not effective at preventing errors at Member State level.</p> <p>(See, for example, the Annual Reports concerning the financial year 2007, paragraphs 6.22 to 6.32, financial year 2006, paragraphs 6.37 to 6.45, financial year 2005, paragraphs 6.38 to 6.45, financial year 2004, paragraph 5.47 to 5.54, and financial year 2003, paragraphs 5.55, 5.56 and 5.66 to 5.69).</p> | <p>In early 2008 the Commission adopted an action plan to strengthen its supervisory role under shared management of structural actions (COM(2008) 97 final, published 19.2.2008).</p> | <p>The Commission is in the process of implementing the action plan, and in 2008 28 out of 37 actions were reported to be completed. The impact of the Commission's actions can however only be assessed in the coming years when the results of the measures taken will become available.</p> | <p><i>The Commission has undertaken to present a report on the initial impact of its action plan in February 2010.</i></p>   |
| <b>2. Statement of Assurance 2006: Follow-up by the Commission to the Court's observations</b>   |  |  |  |
| <p>In 2006, the Court identified a material level of errors in the project expenditure declarations across all audited programmes. Of the 177 projects audited from the 2000 to 2006 programming period, 77 were affected by material error.</p> <p>(Annual Report concerning the financial year 2006, paragraphs 6.13 to 6.15 and 6.26 to 6.28).</p>  | <p>The Commission further improved the follow-up of audit observations, consisting also of payment suspensions and financial corrections.</p>  | <p>The Court examined the follow-up by the Commission to the observations following from 20 audits carried out by the Court and reported upon in the Statement of Assurance concerning the financial year 2006. The Court's analysis shows that all cases were followed up.</p>                | <p><i>The Commission has improved its monitoring and follow-up of audit results, including Court's findings, as a result of the implementation of its 2008 Action Plan to strengthen its supervisory role.</i></p> |

| Court observation  | Action taken  | Court analysis  | Commission reply  |
|--|---|---|---|
| <b>3. Follow-up of the key findings of the Commission's audit activity</b>   |   |   |   |
| <p>For the Annual Report 2006, 15 audits carried out by DG REGIO and DG EMPL were assessed. Just over half of these Commission's audits had all qualities of an effective supervisory instrument. (Annual Report concerning the financial year 2006, paragraphs 6.23 and 6.36, Table 6.3. See also Annual Report concerning the financial year 2007, paragraph 6.30)</p> | <p>Under the Action Plan for the structural actions the Commission has committed itself to taking measures to increase the impact of its audit work by speeding up the application of suspensions and financial corrections (See Annual Report concerning the financial year 2007, Commission reply to paragraph 6.30).</p> | <p>The Court selected for its follow-up review a new sample of 15 audits carried out by the Commission and assessed the audit trail and documentation of significant matters as well as reviewed the audit work. The Court concluded that for these 15 cases DG REGIO and DG EMPL have applied reasonable audit procedures to assess the functioning of the Member States' management and control systems.</p> <p>However, some improvements are needed regarding the documentation of the audit work carried out, especially for the completeness of the audit procedures.</p> | <p><i>The Commission considers that in most cases documentation was complete. It is committed to continue to apply high quality review and documentation standards.</i></p> |

## CHAPTER 7

**Research, energy and transport**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction  | 7.1-7.10         |
| How the money is spent                                  | 7.6-7.10         |
| Regularity of transactions                              | 7.11-7.16        |
| Effectiveness of systems                                | 7.17-7.39        |
| Systems related to regularity of transactions           | 7.18-7.34        |
| <i>Ex-ante</i> desk checks of cost statements           | 7.18-7.20        |
| Audit certification of cost statements                  | 7.21-7.27        |
| The Commission's <i>ex-post</i> audit strategy          | 7.28-7.34        |
| Systems related to recoveries and financial corrections | 7.35-7.39        |
| Conclusions and recommendations                         | 7.40-7.42        |
| Conclusions   | 7.40-7.41        |
| Recommendations   | 7.42             |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

7.1. This chapter presents the Court's specific assessment of policy group Research, Energy and Transport, which comprises policy areas 06-Energy and Transport; 08-Research; 09-Information Society and Media; and 10-Direct Research. Detailed information is provided on the activities covered, the spending for the year and management type involved in **Table 7.1**.

7.2. Energy and transport policies aim to provide European citizens and businesses with competitive energy and transport systems, to make energy production and consumption more sustainable, to create the conditions for continuous and secure energy supply and transport services for the EU, to enhance transport and energy safety, and to project the Union's policies of competitive, sustainable, secure and safe transport and energy internationally.

7.3. Research policy is directed towards the achievement of the European Research Area (ERA). Together with the completion of the Single Market, the ERA is central to the implementation of the Lisbon strategy for employment, international competitiveness, economic reform and social cohesion, in particular through the establishment of an area of education, training, research and innovation.

7.4. Information society and media policies are focused on the EU's i2010 strategic initiative, supporting innovation and competitiveness through research and development of information and communication technologies, and contributing to a stronger European audiovisual sector.

7.5. Direct research expenditure funds research and related activities of the Joint Research Centre (JRC), which is a Directorate-General of the Commission. The aim of the JRC is to provide customer-driven scientific and technical support for the conception, development, implementation and monitoring of EU policies.

Table 7.1 — Breakdown of payments by policy area

| Budget Title                            | Policy area                   | Description   | Payments 2008 (million euro) | Budget Management Mode  |
|---|-------------------------------|---|------------------------------|---|
| 6                                       | Energy and Transport          | Administrative expenditure <sup>(1)</sup>                 | 128                          | Centralised direct  |
|   |                               | Inland, air and maritime transport                        | 278                          | Centralised direct  |
|   |                               | Trans-European Networks (TENs)                            | 888                          | Centralised direct  |
|   |                               | Conventional and renewable energies                       | 72                           | Centralised direct  |
|   |                               | Nuclear energy  | 215                          | Centralised direct<br>Centralised indirect<br>Decentralised and joint |
|   |                               | Research related to energy and transport (FP7)            | 108                          | Centralised direct  |
|   |                               | Completion of previous framework programmes (FP5 and FP6) | 92                           | Centralised direct  |
|   |                               | Security and protection of energy and transport users     | 3                            | Centralised direct  |
|   |                               | <b>1 784</b>  |                              |   |
| 8                                       | Research                      | Administrative expenditure <sup>(1)</sup>                 | 241                          | Centralised direct  |
|   |                               | FP7   | 2 223                        | Centralised direct  |
|   |                               | ITER  | 96                           | Centralised indirect  |
|   |                               | Completion of previous framework programmes (FP5 and FP6) | 1 836                        | Centralised direct  |
|   |                               | Other   | 42                           | Centralised direct  |
|   |                               | <b>4 438</b>  |                              |   |
| 9                                       | Information Society and Media | Administrative expenditure <sup>(1)</sup>                 | 129                          | Centralised direct  |
|   |                               | FP7   | 749                          | Centralised direct  |
|   |                               | Media   | 82                           | Centralised direct  |
|   |                               | CIP and others  | 141                          | Centralised direct  |
|   |                               | Completion of previous programmes                         | 607                          | Centralised direct  |
|   |                               | <b>1 708</b>  |                              |   |
| 10                                      | Direct research               | Staff, running costs and investments <sup>(2)</sup>       | 306                          | Centralised direct  |
|   |                               | FP7   | 38                           | Centralised direct  |
|   |                               | Historical liabilities resulting from nuclear activities  | 23                           | Centralised direct  |
|   |                               | Completion of previous framework programmes (FP5 and FP6) | 22                           | Centralised direct  |
|   |                               | <b>389</b>  |                              |   |
| <i>Total administrative expenditure</i> |                               |   | 804                          |   |
| <i>Total FP7 <sup>(2)</sup></i>         |                               |   | 3 214                        |   |
| <i>Total Previous FPs</i>               |                               |   | 2 557                        |   |
| <i>Total TENs</i>                       |                               |   | 888                          |   |
| <i>Total Other</i>                      |                               |   | 857                          |   |
| <i>Total operational expenditure</i>    |                               |   | 7 516                        |   |
| <b>Total payments for the year</b>      |                               |   | <b>8 320</b>                 |   |
| <b>Total commitments for the year</b>   |                               |   | <b>9 157</b>                 |   |

<sup>(1)</sup> Audit of administrative expenditure is reported in Chapter 11.

<sup>(2)</sup> The Seventh Framework Programme for research and technological development (FP7) is the European Union's chief instrument for funding research over the period 2007-2013. Expenditure in 'Previous FPs' means interim and final payments made to projects selected under the previous framework programmes (i.e. FP6 (2002-2006) or FP5 (1998-2002)). See also paragraph 7.6.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**How the money is spent**

7.6. Around 80 % of the operational expenditure in this policy group is on research projects, under multiannual Framework Programmes (FPs), which have multiple funding schemes, supporting various thematic areas and types of projects.

7.7. The Commission generally makes payments to beneficiaries without the involvement of national, regional or local authorities in the Member States. Since 2008, the EU contribution to certain major research projects, such as the development of the ITER nuclear fusion facility, is channelled through Joint Undertakings. These are Community bodies which manage funding provided by the Commission and other public and private partners.

7.8. Beneficiaries may be research institutes, universities, public administrations, companies or individuals. The beneficiaries or partners<sup>(1)</sup> usually work on a project as a consortium across Member States or associated states. Typically, projects last several years. Funding is provided through a grant agreement with the Commission. Grants range from about 20 000 euro for individual researchers up to 30 million euro for major collaborative projects. Although there are more than 15 000 beneficiaries, the 240 largest receive around 50 % of total payments.

7.9. A further major category of expenditure (around 12 % of the total) is for major energy and transport projects under the trans-European networks programme<sup>(2)</sup>. The beneficiaries are usually Member State authorities but may also be public or private companies.

7.10. For both research and transport and energy projects, the grants are paid in instalments: an advance upon signature of the grant agreement, followed by interim and final payments which reimburse eligible expenditure reported by the beneficiaries in periodic cost statements.

**7.6-7.10.** *Research Framework Programmes involve technically and financially complex projects. The control environment is characterised by a large number of beneficiaries, each operating their own control systems.*

*The management of the Research Framework Programmes can be divided into four distinct stages: evaluation of proposals; proposal selection and contract negotiation; project and contract management; and financial audits and other ex-post controls.*

*Many of the errors made by the beneficiaries cannot be detected by the Commission before payments are made. In order to overcome this, the Commission implements a control strategy aimed to ensure the legality and regularity of the payments on a multiannual basis. It is based on the systematic detection and correction of any errors which could not be identified before making the payment. This has been achieved by an increased ex-post audit effort, which is a key element of the control strategy, and recovering any amounts found to be overpaid to audited beneficiaries.*

*Furthermore, for FP7, initiatives have been taken to reinforce other controls. The Research DGs have introduced 'agreed upon procedures' for better audit certificates, as well as the ex-ante certification of the beneficiary's accounting methodology, for the use of average personnel costs and/or overall cost accounting (including indirect costs).*

*As far as other programmes covered by this chapter are concerned, such as the Trans-European Networks and the Nuclear Decommissioning Funds, their control strategies differ to varying degrees from that set up for the research FP in order to take into account their particular characteristics.*

<sup>(1)</sup> Each project has on average around 20 partners, although the number may range from 4 to 95. Partners may participate in several projects.

<sup>(2)</sup> In 2008, 434 ongoing transport (TEN-T) projects with an average grant of 16,43 million euro and 53 ongoing energy (TEN-E) projects with an average grant of 1,34 million euro.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## REGULARITY OF TRANSACTIONS

7.11. The results of transaction testing are summarised in **Annex 7.1, Part 1**. The Court found that 33 of the sample of 150 payments were affected by error. No errors were found in the 63 FP7 advances and one interim payment audited. The most likely error rate identified by the Court lies between 2 % and 5 %.

7.12. Most of the errors concern the reimbursement of ineligible costs in interim and final payments to FP6 research projects. In these cases, the Commission has either not detected the ineligible costs before making payment or has incorrectly calculated the eligible amount of reimbursement.

7.13. These findings are consistent with those of the Commission's own programme of audits and the reservations concerning the accuracy of FP6 cost claims made by the Directors-General of the research DGs in their Annual Activity Reports.

7.14. The most common type of error remains the reimbursement of ineligible personnel and indirect costs. In effect, the beneficiary frequently fails to comply with the regulatory requirement to declare the actual costs incurred on the project, in particular by using incorrect charging rates for personnel working on the project. This is illustrated by the example below.

**7.12-7.14.** *The majority of errors are attributable to incorrect declaration of costs related to personnel and overheads. Many of these errors can only be detected by an audit at the premises of the beneficiaries. The Commission has therefore put a control strategy in place and developed an ex-post audit activity. The corrective actions taken have contributed to a reduction of the error rate in recent years. Further corrective actions have been initiated for FP7, in particular concerning audit certification.*

## THE COURT'S OBSERVATIONS

## Example: Ineligible personnel and indirect costs

The Court's sample of transactions included a FP6 project, with more than 30 partners in several Member States, concerning research and development of transport systems. The project is of several years' duration with EU funding of more than 10 million euro.

The Court audited a cost statement of one of the partners for the period January to December 2006, for which the Commission made a reimbursement in 2008.

The standard eligibility conditions in the grant agreement between the Commission and the beneficiary state that 'eligible costs ... must be actual, economic and necessary for the implementation of the project ...'. In addition, in order to be eligible for reimbursement, the costs '... must be recorded in the accounts of the contractor (i.e. the project partner) ...' and '... the accounting procedures used ... shall ... permit the direct reconciliation between the costs and receipts incurred for the implementation of the project and the overall statement of accounts relating to the overall business activity of the contractor.'

The beneficiary calculated the costs of personnel to be charged to the project on the basis of hourly rates for the two categories of personnel (senior engineer/project manager and engineer/technician) who worked on the project. The Court found that the rates used did not reflect the actual expenditure incurred by the beneficiary in performing the project activities set out in the grant agreement.

The Court's auditors recalculated the personnel costs on the basis of the actual salary costs recorded in the accounts of the beneficiary. This showed that the beneficiary had overcharged personnel costs for the project by more than 13 000 euro. This also requires a proportionate reduction of the eligible indirect costs to be charged to the project.

In total, the beneficiary overstated eligible costs by more than 16 000 euro and the Commission made an undue reimbursement of just over 8 000 euro (at a co-financing rate of 50 %).

## THE COMMISSION'S REPLIES

## Example

*In this specific case the Commission will proceed with the necessary compensation in the next reporting period. However, the Commission would like to point out that only an ex-post audit could detect this type of error.*

*In FP6, project costs have to be 'determined in accordance with the usual accounting principles' of the participant. This was interpreted by the Commission services as permitting average costs (as long as the other eligibility requirements were met), if their use formed part of the usual accounting principles of the participant. However, it was not clear to what extent variation between average costs and real costs of the persons working on the project could be accepted.*

*In the FP7 Rules for Participation, average costs are permitted as long as they do not 'differ significantly' from actual costs. For this reason, the Commission has established the possibility to approve certificates from participants on their methodology for the use of average personnel cost (see reply to paragraphs 7.6 to 7.10 and 7.27).*

*This should result in a decrease in errors in the average personnel costs declared.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

7.15. Other significant errors found by the Court were:

- (a) reimbursement to a FP6 beneficiary who could not provide evidence that the claimed costs had actually been incurred and that any significant project activity had taken place;
- (b) a data input error in the Commission's calculation table for an interim FP6 reimbursement, which was not detected during the payment approval procedures, so that the beneficiary received a 76 % overpayment;
- (c) reimbursement to a beneficiary of substantial subcontracting costs for a FP5 project in the absence of the required prior approval of the Commission;
- (d) for a TEN-T project, reimbursement of costs incurred outside the eligible period defined in the funding agreement between the Commission and the beneficiary.

7.16. The Court also followed up previous observations, as reported in **Annex 7.2**. The Court found that the Commission has taken corrective action for the errors reported in the DAS 2006, although with some delays. For late payments, the Court found that the Commission has considerably improved its performance in 2008 in making timely payments to beneficiaries.

## EFFECTIVENESS OF SYSTEMS

7.17. The results of the Court's assessment of the effectiveness of the supervisory and control systems are summarised in **Annex 7.1, Part 2**. The assessment focused on FP6 which accounts for 82 % of the sampled interim and final payments in 2008. The Court found that the systems were partially effective in ensuring the regularity of transactions.

**7.15.**

- (a) *Problems with this beneficiary had already been identified and were being addressed by the Commission's own control system, before the announcement of the audit by the Court.*
- (b) *The control measures in place at the Commission are designed to avoid this type of error as far as possible. For this particular case, the Commission has taken corrective action by recovering the amount in subsequent reporting periods.*
- (c) *Indeed, the prior approval of these costs had not been given at the time of the payment. The Commission had detected the problem before proceeding with the final payment and thus asked the contractor for further evidence. In view of the additional information provided the Commission considered that there was sufficient justification to proceed with the payment.*
- (d) *This was an error of form, based on a clerical oversight by the Commission. In substance the costs were justified.*

**7.16.** *The Commission welcomes the positive observations of the Court on the follow-up of audits and timely payments. Considerable efforts have been made in both areas and results have already been observed in 2008. The Commission will continue to monitor these matters closely.*

**7.17.** *The Commission implements a control strategy designed to ensure the legality and regularity of payments on a multiannual basis. For FP6, the objective of the strategy is to ensure that, by the end of the fourth year of its implementation (2010), the residual error rate is below the materiality threshold of 2 %. This objective is reassessed annually in view of the nature, frequency and amount of the errors detected, as well as cost-benefit considerations.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Systems related to regularity of transactions*****Ex-ante desk checks of cost statements***

7.18. *Ex-ante* desk checks mainly consist of accounting and arithmetical verification of cost statements by the Commission before making reimbursement. In some cases, the checks may also include verification of individual cost items based on supplementary information, such as invoices or payslips, requested from the beneficiary.

7.19. The Court examined the guidelines and procedures, and the reporting and monitoring arrangements for *ex-ante* desk reviews in DG INFSO. The Court tested the operation of the checks for 30 transactions <sup>(3)</sup>.

7.20. The audit did not identify any specific weaknesses and confirmed the checks to be operating as intended. The Court notes that, while desk checks permit the detection of basic deficiencies in cost statements, many errors may only be found by performing checks at the beneficiary. This limitation in the desk checks needs to be compensated by the other elements of the supervisory and control systems (audit certification and *ex-post* audits).

***Audit certification of cost statements***

7.21. When required by the grant agreement <sup>(4)</sup>, beneficiaries' cost statements submitted for reimbursement have to be accompanied by an audit certificate issued by an independent auditor. The auditor certifies that he has reasonable assurance that the declared costs meet the eligibility requirements.

7.22. For the 39 transactions audited at the beneficiary where a certificate had been provided, the Court compared the results of its own testing with the certificate. In 17 or 43 % of cases, the Court found errors in cost statements which had received an unqualified opinion from the certifying auditor before submission for reimbursement.

**7.22.** *The Commission shares the concern of the Court about the correctness of the FP6 audit certificates, which do not fully provide the additional assurance initially expected regarding the legality and regularity of cost declarations. It is clear, however, that this instrument has made a significant contribution to the prevention and early correction of errors, resulting in a decrease of the error rates in FP6 compared with FP5.*

<sup>(3)</sup> 14 cases from the substantive testing sample, plus 16 further selected cases.

<sup>(4)</sup> Under FP6, each project partner should provide at least one audit certificate covering the whole duration of the project. A certificate is always required when the Community contribution requested by a partner exceeds 750 000 euro for a specific reporting period.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

7.23. In most such cases, the certifying auditor has failed to identify overstated eligible costs, notably in the categories of personnel and indirect costs, which are the main source of error in beneficiaries' cost statements (see paragraph 7.14).

7.24. This finding is consistent with the previous year's results and with the findings reported in Chapter 10. It confirms the need for the Commission to continue to provide support and guidance to beneficiaries and certifying auditors, in order to improve the reliability of this control <sup>(5)</sup>.

*Ex-ante certification of beneficiaries' costing methodologies under FP7*

7.25. The Commission has sought to simplify procedures by reforming the audit certification system under FP7. The main innovation is a waiver on the obligation to provide certificates for interim cost statements through the *ex-ante* certification of beneficiaries' costing methodologies.

7.26. In addition to reducing the administrative burden on beneficiaries, this measure is intended to promote the use of correct costing methodologies and therefore reduce the level of error in cost statements.

7.27. However, the Commission has not yet produced a clear definition of the necessary criteria for assessing whether the beneficiaries' costing methodologies comply with the regulatory requirements. At the end of 2008, this new form of *ex-ante* certification had been approved in only one case.

***The Commission's ex-post audit strategy***

7.28. The other main element of the Commission's control system for research expenditure is its programme of *ex-post* (i.e. after reimbursement) financial audits at beneficiaries. The audits are performed by Commission auditors and by external audit firms under the supervision of the Commission. The purpose of *ex-post* audits is to detect and correct errors which have not been prevented or detected by earlier controls.

**7.23-7.24.** In order to improve the situation the audit certification has been adapted in FP7.

FP7 audit certification is based on 'agreed upon procedures', which require the certifying auditor to perform pre-defined procedures and report on that basis on the factual findings. Guidance notes are available to the beneficiaries and certifying auditors on the Cordis website (<http://cordis.europa.eu/>), see also 7.33. This approach should lead to a reduction in errors of interpretation of the eligibility rules by the auditors which occurred in FP6, and is a further step towards improving this control.

**7.25-7.26.** The certification on methodology for both personnel and indirect costs has indeed been introduced in order to simplify procedures for those beneficiaries of multiple grants whose systems could provide reasonable assurance that the methodologies applied conform to the provisions of the grant agreement. This certification is optional.

**7.27.** Setting up criteria for evaluating the costing methodology is a difficult exercise. The Commission has clarified the criteria for *ex-ante* certification of the costing methodology for beneficiaries using average personnel costs in a Commission decision adopted on 23 June 2009 (C(2009) 4705).

After a slow start, the number of certificates on methodologies assessed has increased in 2009.

<sup>(5)</sup> Annual Report concerning the financial year 2007, paragraphs 7.31 to 7.33 and 7.43(c).

## THE COURT'S OBSERVATIONS

7.29. In 2008, the research DGs of the Commission <sup>(6)</sup> continued to increase their ex post audit activity, in line with the FP6 common *ex-post* audit strategy introduced in 2007. The strategy provides for reinforced *ex-post* audits and is designed to increase assurance on the regularity of FP6 expenditure, which accounts for 42 % of total expenditure for the research Framework Programmes in 2008.

7.30. The Court reviewed progress by the Commission in implementing the strategy, based on its key objectives:

- (a) to increase the audit coverage;
- (b) to reinforce the coherence and consistency of *ex-post* audit activities among the research DGs;
- (c) to implement a new centralised IT audit management information system and audit-sharing tool;
- (d) to reinforce the audit certification process; and
- (e) to ensure a common approach by the research DGs in dealing with the external audit firms contracted to perform audits on behalf of the Commission.

7.31. In 2008, the coverage of expenditure by *ex-post* audits increased considerably (**Graph 7.1**), responding to previous criticisms of the Court. The number of completed audits increased from 432 at the end of 2007 to 1 084 at the end of 2008.

7.32. The research DGs consistently follow a coherent approach to the *ex-post* audits, and have made efforts to closely coordinate and monitor the implementation of the audit strategy. However, the distribution of the activities between the research DGs, together with the lack of use of an integrated management information system renders coordination more difficult; in particular for the follow-up of audit results.

## THE COMMISSION'S REPLIES

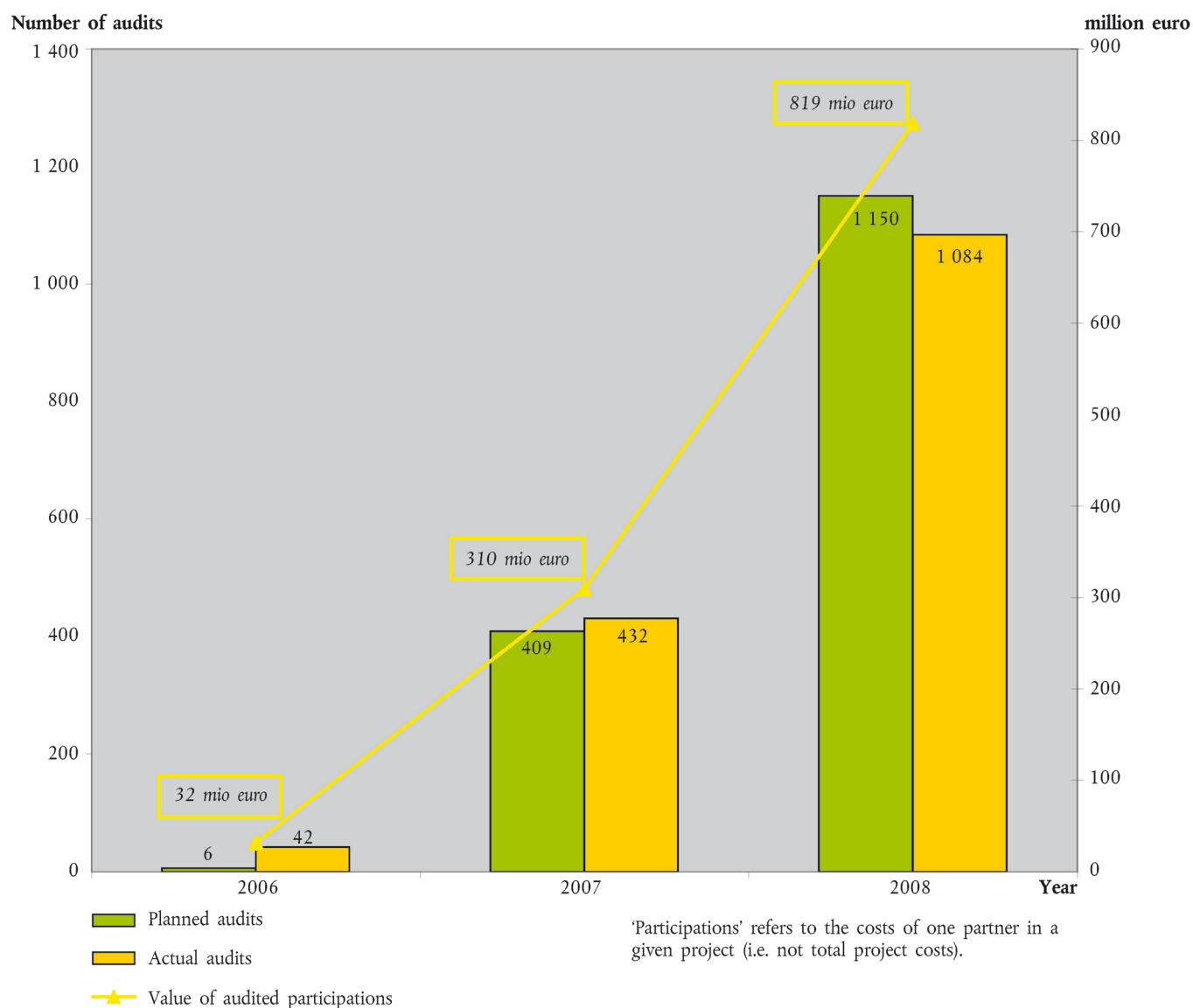
**7.31.** *The Commission takes note of the Court's favourable comment regarding the increased audit coverage of expenditure.*

**7.32.** *The Commission welcomes the positive observations of the Court concerning the consistent and coherent approach adopted by the research DGs regarding the implementation of the common audit strategy.*

*The absence of a dedicated IT tool does not as such prevent coordination. A high level of coordination is achieved through the inter-departmental working groups in place among the research DGs. The monthly audit summary report meetings represent a good example of this effective cooperation (see also 7.34).*

*The Research Executive Agency and the European Research Council Executive Agency will be integrated into those co-ordination activities during 2009.*

<sup>(6)</sup> DG RTD, DG INFSO, DG TREN and DG ENTR.

Graph 7.1 — Implementation of the Commission's common *ex-post* audit strategy

## THE COURT'S OBSERVATIONS

7.33. The Commission's *ex-post* audit strategy aims to reinforce the audit certification process by increased support to beneficiaries and certifying auditors. While the Commission has made efforts to improve guidance and disseminate best practices, in 2008 the problems previously observed by the Court have persisted (paragraph 7.22).

7.34. A common approach to dealing with external audit firms is reinforced by monthly audit summary report meetings and by the use of quality control procedures on audit reports.

## THE COMMISSION'S REPLIES

7.33. The new initiatives developed under FP7, such as the *ex-ante* certificate on the methodology and the certificate on average personnel costs, which are designed to prevent incorrect practices in cost declarations and which have been the subject of an extensive communication campaign, are expected to further reduce the extent of the problems encountered by the Court (see also paragraph 7.23).

7.34. The Court's observation confirms that the research DGs have developed effective cooperation with the external auditors (see reply to paragraph 7.32).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Systems related to recoveries and financial corrections**

7.35. The increased *ex-post* audit coverage provides a broader base for the Commission to take corrective actions and increase assurance on the legality and regularity of the expenditure.

7.36. Additional corrective effects are planned or being implemented through the targeting of large beneficiaries and subsequent extrapolation of systemic audit findings to non-audited contracts at the audited beneficiaries.

7.37. The considerable increase in audit activity implies a significantly higher workload related to the implementation of the audit results (extrapolation of errors, imposing adjustments, recoveries and sanctions). Moreover, it requires considerable efforts of coordination between the research DGs.

7.38. In July 2007, DG INFSO set up an internal network of *ex-post* audit liaison officers for the implementation of audit results. In September 2008, DG RTD set up a new unit to deal with recoveries. The unit has issued guidelines on the implementation of audit results to project officers within the DG.

7.39. However, at the end of 2008, the Commission had initiated only a low amount of recoveries, as illustrated by **Graph 7.2**, and had still not imposed any sanctions <sup>(7)</sup>, despite the fact that an extended system of sanctions was one of the main corrective measures introduced at the start of FP6 in 2002 <sup>(8)</sup>.

**7.39.** *As observed by the Court, the continuous increase of audit activities impacts significantly on the workload of the DGs. It requires strengthened coordination and the setting up of a comprehensive internal control system to ensure follow-up of audit recommendations by issuing recovery orders or offsetting the amounts in subsequent payments, as well as using liquidated damages (see footnote 7).*

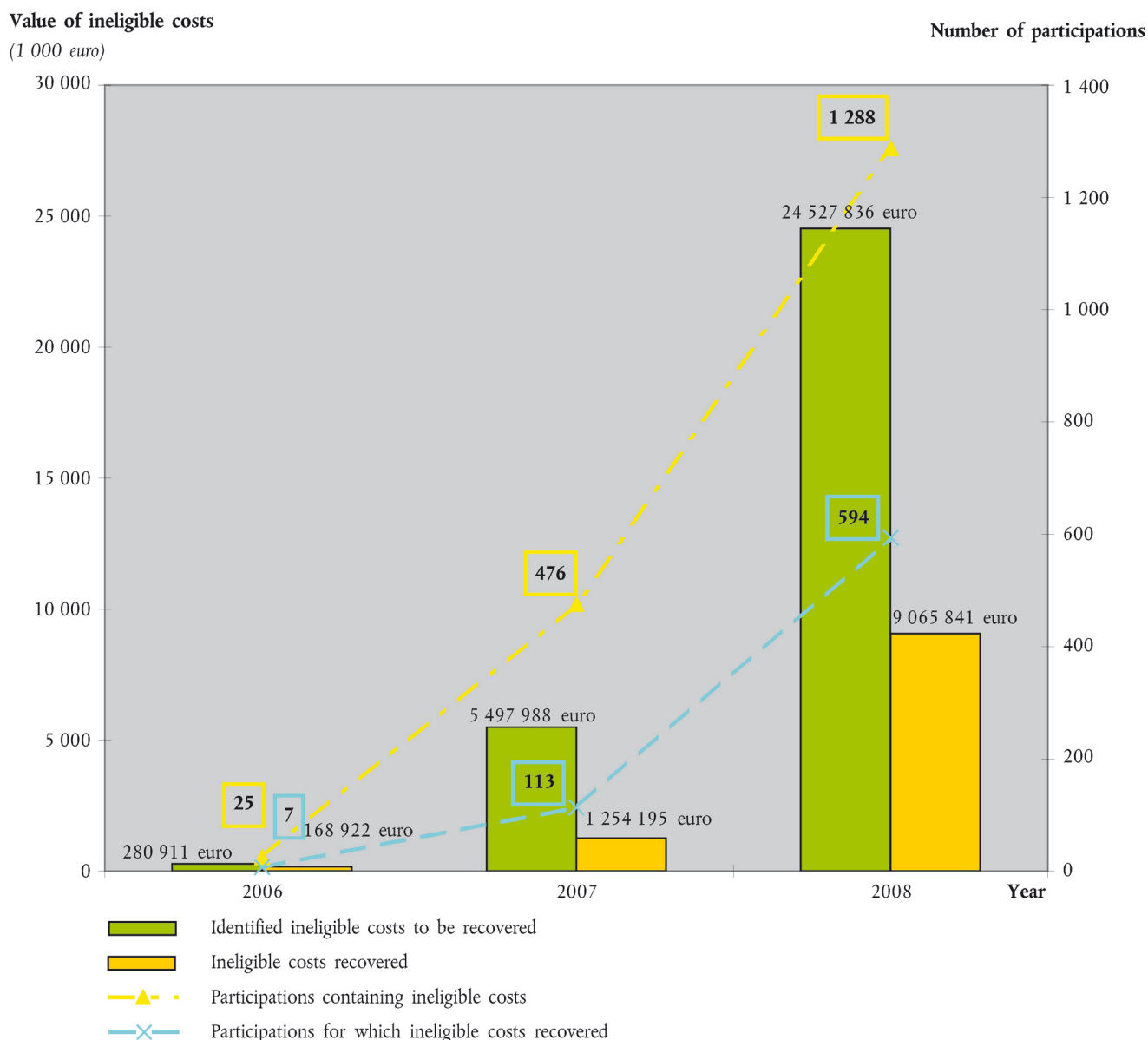
*By the end of 2008, the management processes required to implement the multi-annual control strategy were largely in place.*

<sup>(7)</sup> In addition to the recovery of funds, the Commission is entitled to claim compensation (liquidated damages) from a beneficiary who is found to have overstated eligible costs and consequently received an unjustified contribution from the EU. Any beneficiary found to be persistently in breach of its contractual obligations may also be liable to penalties.

<sup>(8)</sup> Annual Report concerning the financial year 2007, paragraph 7.23.



Graph 7.2 — Implementation of financial corrections following audits



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## CONCLUSIONS AND RECOMMENDATIONS

**Conclusions**

7.40. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2008 for policy group Research, energy and transport were affected by material error. The most likely error rate lies between 2 % and 5 %.

7.40. The Commission will continue to work towards a level of residual error conducive to an unqualified DAS in this policy group.

## THE COURT'S OBSERVATIONS

7.41. Based on its audit work, the Court concludes that the supervisory and control systems for policy group Research, energy and transport are partially effective in ensuring the regularity of payments.

**Recommendations**

7.42. In recent years, the Commission has reinforced its control systems and simplified the funding rules for research projects. These measures have contributed to a reduction in the level of error for this policy group. In order to maintain this positive trend, the Commission should:

- (a) ensure rigorous application of the controls, in particular by improving the reliability of audit certificates and through effective implementation of its *ex-post* audit strategy, imposing penalties where appropriate and making timely recoveries or adjustments in cases of undue reimbursement of claimed costs;
- (b) in line with the recent Commission paper on streamlining financial rules <sup>(9)</sup>, further simplify the funding rules for the next research Framework Programme (FP8), while maintaining the objective of a cost-effective control system sufficient to provide reasonable assurance of the regularity of the expenditure.

## THE COMMISSION'S REPLIES

7.42. *The Commission accepts the Court's recommendations.*

- (a) *The Commission is fully aware of the importance of an efficient control system and is constantly striving for improvement. Considerable efforts have been made already to improve the management of research policy within the limits of the applicable legal and financial framework. The Commission will continue the rigorous application of controls.*
- (b) *The Commission agrees that further simplification in the financial rules would be desirable in FP8 and that an effective control system should be maintained. The Commission will continue to simplify and improve delivery in the implementation of the budget in order to accompany its recovery plan in line with the Commission's communication on 'streamlining financial rules and accelerating budget implementation to help economic recovery'. The Commission will pursue its work on the cost-effectiveness of control systems, and propose tolerable risks of error for research and other areas in 2010.*

<sup>(9)</sup> Communication from Mrs Grybauskaitė in agreement with the President to the Commission (SEC(2009) 477 final, 8.4.2009).

## ANNEX 7.1

## PART 1: MAIN FEATURES OF SAMPLE BASED TRANSACTION TESTING

## 1.1 — Size of the sample

| Year | Number of transactions tested |
|------|-------------------------------|
| 2008 | 150                           |
| 2007 | 180                           |

## 1.2 — Structure of the sample

| Percentage of transactions tested which were   | 2008       |             |             |            |  |             |              |    | 2007         |     |
|--|------------|-------------|-------------|------------|--|-------------|--------------|----|--------------|-----|
|  | FP5        | FP6         | FP7         | TEN        | Nuclear Decommissioning <sup>(4)</sup> | Other       | Total        |    |              |     |
| Advances <sup>(1)</sup>                        | —          | —           | 42 %        | 3 %        | 1 %                                    | 3 %         | 49 %         | 74 | 33 %         | 59  |
| Interim and final payments <sup>(2)</sup>      | 1 %        | 33 %        | 1 %         | 3 %        | 3 %                                    | 3 %         | 44 %         | 65 | 61 %         | 109 |
| Payments other than to projects <sup>(3)</sup> | —          | —           | —           | 1 %        | —                                      | 6 %         | 7 %          | 11 | 6 %          | 12  |
| <b>Total</b>                                   | <b>1 %</b> | <b>33 %</b> | <b>43 %</b> | <b>7 %</b> | <b>4 %</b>                             | <b>12 %</b> | <b>100 %</b> |    | <b>100 %</b> |     |

<sup>(1)</sup> 74 advances: 63 FP7, 5 TEN, 2 nuclear decommissioning (paid directly to the beneficiary), 2 Intelligent Energy Executive Agency, 1 Education and Culture Executive Agency, 1 European Space Agency (Galileo).

<sup>(2)</sup> 65 interim and final payments: 1 FP7, 50 FP6, 2 FP5, 4 TEN, 4 nuclear decommissioning (paid to International Support Funds), 2 Education and Culture Executive Agency, 1 Research Fund for Coal and Steel, 1 invoice for services contract with IST programme.

<sup>(3)</sup> 11 payments other than to projects: e.g. invoices for services and supplies, payment to a loan guarantee instrument for TEN-T projects, subsidy for the Risk-Sharing Finance Facility of FP7, operating subsidies to research agencies and to the ITER Joint Undertaking.

<sup>(4)</sup> Programme under joint management by the Commission (DG TREN) and the European Bank for Reconstruction and Development (EBRD).

## 1.3 — Frequency and estimated impact of errors

| Errors   | 2008                |           |     |          |                         |          |           | 2007                |  |
|--|---------------------|-----------|-----|----------|-------------------------|----------|-----------|---------------------|--|
|  | FP5                 | FP6       | FP7 | TEN      | Nuclear Decommissioning | Other    | Total     |                     |  |
| Frequency of transactions tested which were affected by errors                             | 100 % {2}           | 44 % {22} | —   | 30 % {3} | 67 % {4}                | 12 % {2} | 22 % {33} | 48 % {86}           |  |
| Frequency of errors which are quantifiable   | 50 % {1}            | 91 % {20} | —   | 20 % {1} | 0 % {0}                 | 67 % {2} | 68 % {24} | 44 % {61}           |  |
| Impact of quantifiable errors:<br>Most likely error rate falls in the range <sup>(1)</sup> | Between 2 % and 5 % |           |     |          |                         |          |           | Between 2 % and 5 % |  |

<sup>(1)</sup> The Court distinguishes three ranges for most likely error rate: below 2 %, between 2 % and 5 %, above 5 %.

The figures in {} brackets are absolute numbers of transactions.

## PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

## 2.1 — Assessment of selected supervisory and control systems

| System concerned                | Key internal control (Commission) |                     |                          | Key internal controls in national administrations | Overall assessment |
|---------------------------------|-----------------------------------|---------------------|--------------------------|---|--------------------|
|                                 | Desk checks before payment        | Audit certification | Ex-post financial audits |   |                    |
| Sixth Framework Programme (FP6) |                                   |                     |                          | N/A   |                    |

| Overall assessment | 2008 | 2007 |
|--------------------|------|------|
|                    |      |      |

## Legend:

|     |  |
|-----|--|
|     | Effective                                      |
|     | Partially effective                            |
|     | Not effective                                  |
| N/A | Not applicable: does not apply or not assessed |

## FOLLOW-UP OF KEY STATEMENT OF ASSURANCE OBSERVATIONS

| Court observation  | Action taken  | Court analysis   | Commission reply  |
|--|---|--|---|
| <b>1. Statement of Assurance 2006: a material level of error in payments</b>   |   |  |   |
| <p>In 2006, the Court detected errors in 26 out of 150 transactions audited. The most frequent types of errors were: inadequate supporting evidence to justify costs claimed, in particular for personnel costs, which is usually the largest single cost category; use of budgeted figures rather than actual costs; unjustified allocation of indirect costs to the project; claims for costs incurred outside the eligibility period; inclusion of various other ineligible costs.</p> <p>(Annual Report concerning the financial year 2006, paragraphs 7.10 to 7.11).</p>  | <p>For four cases, responsibility for follow-up now lies with DGs outside the policy group.</p> <p>In six cases, the Commission has concluded that no corrective action is necessary.</p> <p>In 13 cases, the Commission has made financial corrections, either by issuing a recovery order or by adjusting payments to the beneficiaries in subsequent periods.</p> <p>In three cases, the Commission has initiated corrective action which remains to be completed.</p> | <p>The Commission has followed up the errors and taken corrective actions, although in three cases the financial corrections are not completed. Outstanding amounts due to the Commission should be recovered as rapidly as possible in the interests of sound financial management.</p> | <p><i>The Commission has taken the corrective actions to ensure the follow-up of the three cases still open. In two of the three cases the process for proceeding with the payment and the recovery process has started. In the third case, an audit has been launched for which the final report is awaited.</i></p> |
| <b>2. Late payments by the Commission</b>  |   |  |   |
| <p>The Commission has incurred undue delays in making payments to beneficiaries in a significant number of cases.</p> <p>In 2005, 11 out of 69 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 %). In 2007, the Court found late payments in 30 out of 180 cases audited (i.e. 17 %).</p> <p>In 2008, the Court found fewer late payments: 12 cases out of 150 payments audited (i.e. 8 %).</p> <p>(Annual Report concerning the financial year 2005, paragraph 7.10; Annual Report concerning the financial year 2006, paragraph 7.29 and Annex 7.1; Annual Report concerning the financial year 2007, Annex 7.2).</p> | <p>The Commission has improved the monitoring of delays, introduced streamlined procedures, adapted its IT tools and increased its training programme for staff involved in the payment process.</p>  | <p>The Commission's performance in making timely payments has considerably improved during 2008.</p>   | <p><i>The improvements reported by the Court reflect the efforts made by the Commission. The Commission will continue to monitor this matter closely.</i></p>   |



## CHAPTER 8

**External aid, Development and Enlargement**

## TABLE OF CONTENTS

|  | <i>Paragraph</i> |
|--|------------------|
| Introduction   | 8.1-8.13         |
| Specific characteristics of the External aid, Development and Enlargement policy group | 8.2-8.11         |
| Audit scope  | 8.12-8.13        |
| Regularity of transactions   | 8.14-8.17        |
| Effectiveness of systems   | 8.18-8.32        |
| Systems relating to regularity of transactions   | 8.18-8.32        |
| EuropeAid  | 8.20-8.24        |
| DG RELEX   | 8.25-8.26        |
| DG ELARG   | 8.27-8.28        |
| DG ECHO  | 8.29-8.30        |
| Common RELEX Information System (CRIS)   | 8.31-8.32        |
| Conclusions and recommendations  | 8.33-8.37        |
| Conclusions  | 8.33-8.34        |
| Recommendations  | 8.35-8.37        |
| Follow-up of previous non statement of assurance observations                          | 8.38-8.46        |
| Follow-up review of Special Report No 5/2006 on the MEDA programme                     | 8.38-8.46        |
| Introduction   | 8.38-8.39        |
| Follow-up of the recommendations   | 8.40-8.45        |
| Conclusion and recommendations   | 8.46             |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

8.1. This chapter presents the Court's specific assessment of the External aid, Development and Enlargement policy group, which comprises the following policy areas: 19 - External relations, 21 - Development and Relations with African, Caribbean and Pacific (ACP) States <sup>(1)</sup> 22 - Enlargement, and 23 - Humanitarian aid. Detailed information is provided on the activities covered, the spending for the year and management type involved in **Table 8.1**.

**Table 8.1 — Breakdown of payments by policy area**

| Budget Title | Policy area                               | Description  | Payments 2008 (million euro) | Budget Management Mode                      |
|--------------|---|--|------------------------------|---|
| 19           | External relations                        | Administrative expenditure   | 336                          | Centralised direct                          |
|              |   | Multilateral relations, cooperation with third countries in the areas of migration and asylum and general external relations matters | 54                           | Centralised direct /                        |
|              |   | Common foreign and security policy   | 192                          | Centralised indirect <sup>(1)</sup> / Joint |
|              |   | European Instrument for Democracy and Human Rights (EIDHR)   | 109                          | Centralised direct                          |
|              |   | Relations and cooperation with industrialised non-member countries   | 16                           | Centralised direct                          |
|              |   | Crisis response and global threats to security   | 199                          | Centralised direct                          |
|              |   | European Neighbourhood Policy and relations with Russia  | 1 475                        | Centralised direct / decentralised          |
|              |   | Relations with Latin America   | 310                          | Centralised direct / decentralised          |
|              |   | Relations with Asia, Central Asia and Middle Eastern countries   | 667                          | Centralised direct / decentralised / joint  |
|              |   | Policy strategy and coordination   | 22                           | Centralised direct                          |
|              |   | <b>3 380</b>   |                              |   |
| 21           | Development and relations with ACP States | Administrative expenditure   | 248                          | Centralised direct                          |
|              |   | Food security  | 258                          | Centralised direct                          |
|              |   | Non-State actors in development  | 172                          | Centralised direct                          |
|              |   | Environment and sustainable management of natural resources, including energy  | 76                           | Centralised direct                          |
|              |   | Human and social development   | 127                          | Centralised direct / joint                  |
|              |   | Geographical cooperation with African, Caribbean and Pacific (ACP) States  | 223                          | Centralised direct / decentralised / joint  |
|              |   | Development cooperation actions and ad hoc programmes  | 24                           | Centralised direct                          |
|              |   | Policy strategy and coordination   | 13                           | Centralised direct                          |
|              |   | <b>1 141</b>   |                              |   |

<sup>(1)</sup> Aid provided through the European Development Funds is reported separately as it is not financed from the General Budget.



| Budget Title | Policy area      | Description                            | Payments 2008 (million euro) | Budget Management Mode                        |
|--------------|------------------|--|------------------------------|---|
| 22           | Enlargement      | Administrative expenditure             | 71                           | Centralised direct                            |
|              |                  | Enlargement process and strategy       | 1 388                        | Centralised direct / indirect / Decentralised |
|              |                  | Post-accession financial support       | 66                           | Centralised direct / Decentralised            |
|              |                  | Information and communication strategy | 9                            | Centralised direct                            |
|              |                  |  | <b>1 534</b>                 |   |
| 23           | Humanitarian aid | Administrative expenditure             | 21                           | Centralised direct                            |
|              |                  | Humanitarian aid                       | 862                          | Centralised direct / Joint                    |
|              |                  |  | <b>883</b>                   |   |

|   |              |
|---|--------------|
| Total administrative expenditure <sup>(2)</sup> | 676          |
| Total operational expenditure                   | 6 262        |
| <b>Total payments for the year</b>              | <b>6 938</b> |

|                                       |              |
|---------------------------------------|--------------|
| <b>Total commitments for the year</b> | <b>7 415</b> |
|---------------------------------------|--------------|

(<sup>1</sup>) According to article 53 of the Financial Regulation direct centralised management mode applies when implementation tasks are performed directly by the Commission's departments and indirect centralised management mode applies when the Commission delegates budget implementation tasks in accordance with articles 54 to 57 of the Financial Regulation.

(<sup>2</sup>) The audit of administrative expenditure is reported on in Chapter 11.

Source: Annual accounts of the European Communities financial year 2008, Volume II, Annex B.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

### Specific characteristics of the External aid, Development and Enlargement policy group

8.2. External relations and Development expenditure is implemented by the EuropeAid Co-operation Office (EuropeAid) and also by the Directorate-General for External Relations (DG RELEX). Enlargement expenditure is implemented by the Directorate-General for Enlargement (DG ELARG), and Humanitarian aid, including food aid, by the Directorate-General for Humanitarian Aid (DG ECHO).

8.3. Expenditure implemented by EuropeAid includes:

- financial and technical assistance to, and economic cooperation with, countries in Asia and Latin America;
- European neighbourhood policy, including the strategic partnership with Russia;
- thematic programmes, including food security, non-state actors and local authorities, environment, health and education, democracy and human rights.

8.4. The majority of the expenditure is subject to direct centralised management by Commission services either at Commission Headquarters or at the Commission's Delegations in the third countries concerned. Aid delivered through international organisations is subject to joint management.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.5. A large proportion of the expenditure includes budget support payments and payments (advances/prefinancing) made to the organisations implementing development projects, including government institutions, NGOs, and international organisations.

8.6. The development projects supported are dispersed through more than 150 countries, and the implementing organisations vary greatly both in size and competence. Within each of the projects there is a large number of individual payments, which are subject to complex rules, in particular concerning tendering and the origin of supplies.

8.7. With respect to expenditure managed by DG RELEX, the following management modes apply:

- (a) indirect centralised or joint management with international organisations as far as the Common Foreign and Security Policy is concerned; and
- (b) direct centralised management for both relations and cooperation with industrialised non-member countries (Industrialised Countries Instrument) and for crisis response and global threats to security (Instrument for Stability). Projects are implemented either by Headquarters or by Delegations.

8.8. DG ELARG manages expenditure linked with the enlargement strategy and process mainly under the instrument for pre-accession assistance, the Phare programme including post-accession aid, CARDS <sup>(2)</sup>, and pre-accession financial assistance for Turkey.

8.9. In general, payments are made on the basis of either centralised or decentralised management modes. In the case of decentralised management, ex-ante controls of contract award decisions are carried out by the Commission Delegation while, under specific conditions, the ex-ante control is waived.

8.10. In the case of EU financial assistance to potential candidates (Albania, Bosnia and Herzegovina, Montenegro, Serbia and Kosovo <sup>(3)</sup>) as well as to the former Yugoslav Republic of Macedonia, the expenditure concerned is mainly directly managed by the Delegations. This includes, from October 2008 onwards, the part of the assistance that was previously channelled through the EAR (European Agency for Reconstruction).

8.11. Expenditure implemented by DG ECHO is managed at Headquarters level. Approximately half of the appropriations committed are related to NGOs (direct centralised management) and half to UN or other international organisations (joint management).

---

<sup>(2)</sup> Phare was the main financial instrument of the pre-accession strategy for Central and Eastern European countries. The CARDS programme is Community Assistance for Reconstruction, Development and Stability in the Balkans.

<sup>(3)</sup> Under UN Security Council Resolution 1244/99.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Audit scope**

8.12. The audit was based on three main components:

- (a) substantive testing of payments made in 2008 by means of a representative statistical sample of 180 items (see **1.1** and **1.2** of **Annex 8.1**). It consisted of payments to implementing organisations, budget support payments and payments to trust funds and other payments made directly by the Commission, for example, on the basis of works, service or supply contracts;
- (b) an assessment of the Commission's supervisory and control systems at Headquarters as well as in Delegations, including:
  - (i) ex-ante checks on contracts and payments,
  - (ii) management and supervision activities,
  - (iii) external audits,
  - (iv) the internal audit;
- (c) a follow-up of previous DAS observations (see **Annex 8.2**).

8.13. It should be noted that for payments made to United Nations (UN) Agencies, the Court's auditors face difficulties in getting audit reports on project expenditure and the necessary supporting documents from the UN. This is in spite of steps taken by the Commission to facilitate the audit work carried out by the Court.

**8.13.** *The Commission fully supports the Court's requests for information from the UN agencies in the framework of the Financial and Administrative Framework Agreement (FAFA) signed between the European Community and the United Nations on 29 April 2003.*

## REGULARITY OF TRANSACTIONS

8.14. The substantive testing for the External aid, Development and Enlargement policy group revealed a material level of error. The results of this testing are presented and further analysed in **Annex 8.1**.

8.15. The transactions tested include payments made by the Commission services either directly to contractors and consultants or to implementing organisations. A material level of error was detected for both types of payment.

8.16. In respect of payments made by the Commission services directly to contractors and consultants, the most significant errors identified concern:

- (a) quantifiable eligibility errors (e.g. VAT and other taxes, essential conditions required not met);

**8.16.**

- (a) *For one of the Court's examples, the Commission considers that it cannot be qualified as a quantifiable error only on the basis that formal requirements of the contract were not respected.*

## THE COURT'S OBSERVATIONS

- (b) quantifiable accuracy errors (e.g. calculation errors including cases of budget support payments); and
- (c) non-quantifiable compliance errors (e.g. non-respect of time limits, absence of essential supporting documents, irregularities in procurement procedures).

8.17. Regarding implementing organisations the errors identified consist mainly of:

- (a) quantifiable eligibility errors (inclusion of ineligible expenditure in the projects' cost claims and irregularities in the tendering and contract award procedures);

- (b) one quantifiable accuracy error (incorrect exchange rates).

## EFFECTIVENESS OF SYSTEMS

**Systems relating to regularity of transactions**

8.18. The systems assessed by the Court relating to regularity of transactions include the ex-ante checks carried out on payments and contracts (on the basis of the results of the substantive testing), the management and supervision activities, the system of external audits and ex-post controls and the internal audit function. The overall assessment of supervisory and control systems is partially effective for all DGs (see **Part 2** of **Annex 8.1**).

8.19. In addition, and on the basis of the results of the audit work carried out, the Court also analysed the effectiveness of the Common RELEX Information System (CRIS). This is an important tool at the disposal of EuropeAid, DG RELEX and DG ELARG, at both Headquarters and Delegation levels, for the management of the expenditure under their responsibility.

## THE COMMISSION'S REPLIES

- (c) *Regarding the respect of payment time limits, the Commission has on occasion not notified contractors of the suspension of payments — in the interests of sound financial management — where there has been a suspicion of financial irregularity, while investigations were pursued.*

**8.17.**

- (a) *The Commission does not share the Court's classification as a quantifiable eligibility error of one case related to an irregularity perpetrated by a subcontractor, for which the Commission in full knowledge and thorough assessment of the situation decided to proceed with a reduced payment in accordance with the provisions of Articles 81, 113 and 119 of the Financial Regulation. This impacts on Annex 8.1 in terms of both the level of transactions affected by an error and the general error rate given.*

*The mandatory financial audits before final payments foreseen under the Commission's control system allow the Commission to detect and correct the advances/prefinancing errors found by the Court of Auditors, in a later accounting year.*

**8.18.** *The Commission believes that the control environment for the external aid, development and enlargement policy group has significantly improved compared to previous years (and the recommendations of the Court in past years have been implemented). For example EuropeAid's ex-ante controls have been considerably strengthened during this period, notably for (ex-ante and ex-post) auditing, where new standard terms of reference, IT systems and methodologies have been brought on stream since 2007. The Commission's own ex-post controls (in EuropeAid and DG ECHO) confirm a very low level of residual error at the point of final payment/project closure.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**EuropeAid**

8.20. EuropeAid manages expenditure funded by both the EU budget and the European Development Funds. A more detailed assessment of the effectiveness of the control systems in place is reported on in a separate report, published together with this Annual Report, concerning the activities funded by the seventh, eighth, ninth and tenth European Development Funds (EDFs).

8.21. The Court noted that EuropeAid has continued to introduce improvements in its supervisory and control systems.

8.22. However, regarding ex-ante checks, weaknesses were noted including:

(a) ineffective and insufficient preventive controls at the level of the Commission services (the auditors found cases of payments made in the absence of essential supporting documents and cases of irregularities at the level of tendering and contract award procedures carried out by the Commission services);

(b) insufficient monitoring of, and support to, organisations in charge of the implementation of EU-funded projects (for example among the organisations implementing EU-funded projects it is not always fully clear which accounting rules must be used for the preparation of the required financial reports);

(c) in the case of budget support payments, weaknesses in the processes for verifying the fulfilment of the payment conditions.

8.23. In respect of the use of external audits, one of the most important components of EuropeAid's internal control framework, the Court noted improvement in the processes. However, it concludes that these controls remain partially effective overall. In addition, the risk management process was found to be partially effective.

**8.22.**

*(b) Support to organisations in charge of the implementation of EU-funded projects is significant and includes provision of printed guidelines, a well maintained finance and contracts EuropeAid website, training in the field and on-the-spot advice from the finance and contracts staff in Delegations. For example for the European Neighbourhood Policy Instrument, 29 days of finance and contracts training were offered in the field in 2008 of which 76 % (151) of the (200) places were taken up by technical ministries and project staff.*

*Financial management support, monitoring and training needs can always be further expanded and improved. A Financial Management Toolkit for implementing organisations is under preparation and should be finalised in 2010.*

*(c) The Commission is promoting widespread awareness throughout its services of the need to ensure a more structured and formal approach when assessing budget support payments. In February 2009 the Commission strengthened the role of verification by finance and contracts staff in the payment approval process.*

**8.23.** *Substantial progress has been made in audit methodology since 2007 and many of the recent reforms will bring additional benefits in time, e.g. when all audit results are based on the 2007 standard terms of reference.*

## THE COURT'S OBSERVATIONS

8.24. The weaknesses that remained in 2008 were mainly inconsistencies and shortcomings in the Annual Audit Plan (AAP), in the CRIS audit module and in the overall monitoring of the results of the audits carried out. They include, among others:

- (a) a low AAP implementation rate;
- (b) incomplete information in the CRIS audit module;
- (c) inconsistencies between the results of the audits carried out, and lack of analysis of them.

**DG RELEX**

8.25. The Court assessed in detail DG RELEX's supervisory and control systems for ensuring the regularity of transactions. Important shortcomings were identified in respect of the ex-post controls component. For example, concerning ex-post controls, three on-the-spot checks were planned but only two were carried out, and out of six planned external audits none was actually launched.

8.26. In addition, the analysis carried out revealed weaknesses concerning the financial management and the supervision of financial information concerning the projects. As an illustration, Commission Delegations use CRIS, the management information system owned by EuropeAid, to manage the financial information relating to devolved DG RELEX projects (Instrument for Stability). However there is no automated interface with Headquarters follow-up of the implementation of the budget, which is performed separately on the basis of spreadsheets extracted from ABAC. This can result in differences in management information.

## THE COMMISSION'S REPLIES

*The Commission is continuing its efforts to raise awareness of the risk management process. Risk management was a prioritised Internal Control Standard in 2008, and a number of training events took place at Headquarters and in all external assistance regions. Further training improvements are planned for the risk management exercise 2010, including the provision of web-based learning.*

**8.24.** *Based on lessons learned, the Annual Audit Plan (AAP) methodology was substantially revised during 2008 for the exercises 2009 and is in the process of further revisions for the exercise 2010. Since 2007, CRIS audit has undergone root and branch development.*

- (a)** *The number of audits finalised during a year has steadily increased over the past years. A total of 455 audits were finalised in 2008, which represents a 35 % increase compared to the number of audits finalised in 2007 (337).*

*However, the timing of most audits must mirror the pace of implementation of project activities.*

- (b)** *2008 was the first year of the compulsory use of CRIS Audit and overall, the results have been very positive. The Commission recognises nevertheless that progress needs to be made in the timely upload of documents.*

- (c)** *At present, there is a comprehensive analysis of audit results focused on audits contracted under the framework contract (FWC) system.*

**8.25.** *The Commission considers that in 2009, ex-post controls should play a more important role for assurance for DG RELEX in the light of the increasing size of the budget. The implementation of the planning will be monitored closely throughout 2009 and the use of the results of audits and controls will be optimised.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**DG ELARG**

8.27. The Court's overall assessment found the systems to be partially effective due to weaknesses identified in the DG's Internal Audit Capability and in its ex-post controls. The IAC work plan was based on a risk assessment, but its multiannual programme was not sufficiently developed. Furthermore, in view of the increasing volume of funds the Court underlines the importance of a specific strategy for the ex-post controls of centrally managed projects as foreseen in the AMP for 2008. The effectiveness of the ex-ante control component was found to be satisfactory.

8.28. In addition fundamental weaknesses remain concerning potential irregularities in the management of Phare funds by two implementing agencies in Bulgaria. The Court maintains its assessment of the key internal controls in the national administration in Bulgaria as only partially effective (*see Annex 8.2*).

**DG ECHO**

8.29. The Internal Audit Capability was created in 2008 (previously DG ECHO was served in this respect by EuropeAid's IAC). In the Court's opinion, 2008 was a transitional year for the IAC and full benefit of the new organisation can be expected from 2009 onwards.

8.30. As regards the system of external audits, in particular the DG's audit strategy, the Court notes the efforts made to increase the proportion of projects subject to field audits.

**Common RELEX Information System (CRIS)**

8.31. During the transaction testing it was noted that the information kept in CRIS is not always fully accurate. Errors of codification of both payment and commitment data were detected (for example, in the case of projects and / or contracts where the CRIS country code is wrongly entered. Other errors could affect the reliability of the Commission's financial statements (for example, concerning bank guarantee expiry dates and project/contract management modes).

8.32. In addition, the auditors noted the existence of technical constraints that the users of the system frequently face and that may affect the regularity of the transactions processed (it is common to find cases of payments made after the deadlines set because of the unavailability of the system).

**8.27.** *The Commission does not fully share the Court's assessment of the effectiveness of the ex-post control and audit systems taking into account the introduction of improvements.*

*DG ELARG's fast moving environment renders IAC's multiannual planning difficult and it therefore requires continuous adjustments.*

*In early 2009, DG ELARG adopted a comprehensive control strategy which covers all management modes, including centralised management. It is considering the adoption of a specific policy for ex-post controls in centralised management, based on the experience gained with a pilot action carried out in 2008 and taking into account cost/benefit considerations.*

**8.28.** *Due to the discovery of a number of system weaknesses, the Commission suspended all payments as of end February 2008 and withdrew the accreditation of the two agencies concerned in July 2008. Even if any system weaknesses were to remain, there is no longer the potential for entering into irregular contracts, since the contracting of Phare funds was terminated.*

**8.31.** *A number of measures are being pursued to increase data quality in CRIS. Firstly, clear, more documented rules are being developed for data entry and the CRIS system is being regularly reviewed and developed accordingly. Secondly, efforts are underway to improve the quality of data already in the system, including a data quality audit (to identify root causes), data cleansing and data quality monitoring to provide an ongoing overview of the data quality status.*

**8.32.** *CRIS was unavailable for some periods during 2008 mostly due to the technical demands of the integration of the European Development Fund accounts into the Commission's central accounting system in February 2009, which was a one-off exercise. However, a number of steps have since been taken to reduce periods of unavailability of CRIS.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## CONCLUSIONS AND RECOMMENDATIONS

**Conclusions**

8.33. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2008 for the External aid, Development and Enlargement policy group were affected by material error.

8.34. Based on its audit work, the Court concludes that the supervisory and control systems for the External aid, Development and Enlargement are partially effective in ensuring the regularity of payments.

**Recommendations**

8.35. The Court recommends that:

(a) measures should be adopted to improve the effectiveness of the Commission's ex-ante control system for payments and contracts (EuropeAid and DG RELEX);

(b) further support should be provided to the organisations implementing EU-funded projects and they should be subjected to closer monitoring;

(c) audits and ex-post controls should be planned in a more realistic way, taking into account the resources available for the purpose, so that the resulting plans may be duly accomplished;

**8.33.** *The Commission has designed its controls to cover the full lifecycle of its multiannual projects. The Court of Auditors' approach is annual and accumulates all errors found in a specific year. The majority of the type of financial errors identified by the Court would also be found by the Commission, in the normal course of ex-ante controls, and be corrected in a subsequent accounting year before the project accounts are closed, leaving a low level of residual error.*

**8.34.** *The Commission believes that the control environment for the external aid, development and enlargement policy group has significantly improved compared to previous years (and the recommendations of the Court in past years have been implemented). Indeed many of the significant elements of the key control systems have been assessed as effective.*

**8.35.**

**(a)** *The Commission does not fully share the Court's assessment of the effectiveness of the ex-ante controls for EuropeAid taking into account the introduction of improvements. Nevertheless, the Commission recognises that as part of its ongoing efforts to improve the overall internal control system, further work is needed on the architecture of the control systems for external aid. With this in mind, and in conjunction with the Commission's work on tolerable risk of error, EuropeAid will launch a review of its control strategy in 2010.*

*The Commission agrees that the reliance on ex-ante controls in DG RELEX should be better documented.*

**(b)** *The Commission recognises that financial management support and monitoring needs to be further expanded and improved. A Financial Management Toolkit for implementing organisations is in preparation and should be finalised in 2010.*

**(c)** *Commission Headquarters will continue to provide assistance to Audit Task Managers – especially in Delegations – to improve their audit planning. In the context of the preparation of the AAP 2009, Delegations have been invited to pay specific attention to the availability of resources.*

*For ex-post transactional controls, annual targets are reached every year.*



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- (d) the implementation of the audits and ex-post controls planned should be closely followed up, so that any deviations may be promptly noted and remedied;
- (e) the results of the audits and ex-post controls carried out should be properly recorded and systematically analysed;
- (f) a further developed strategy for ex-post audits in centralised management should be approved and implemented (DG ELARG).

- (d) *The implementation of the annual planning will be monitored closely throughout 2009 and the use of the results of audits and controls will be optimised...*
- (e) *The Commission is planning improvements to CRIS to allow improved analysis of audit data.*
- (f) *In early 2009, DG ELARG adopted a comprehensive Control Strategy which covers all management modes, including centralised management. It is considering the adoption of a specific policy for ex-post controls in centralised management, based on the experience gained with a pilot action carried out in 2008 and taking cost/benefit consideration into account.*

8.36. The Court also recommends that adequate measures should be adopted and actions implemented in order to improve the quality of the data entered in the different management information systems at the disposal of the Commission's services.

**8.36.** *A number of measures are being pursued to increase data quality in CRIS. Firstly, clear, more documented rules are being developed for data entry and the CRIS system is being regularly reviewed and developed. Secondly, efforts are underway to improve the quality of data already in the system.*

8.37. Furthermore, the Court recommends that as regards budget support payments, the efforts made so far to introduce performance indicators that are more oriented towards output and outcome should be continued.

**8.37.** *The Commission will inject further precision into the design and measurement of indicators in budget support operations. General Budget Support Guidelines are currently being revised to improve the design and assessment of eligibility conditions and specific results oriented indicators in order to achieve a more rigorous results orientated approach, making use of process output and outcome indicators.*

## FOLLOW-UP OF PREVIOUS NON-STATEMENT OF ASSURANCE OBSERVATIONS

**Follow-up review of Special Report No 5/2006 on the MEDA programme****Introduction**

8.38. In August 2006 the Court published Special Report No 5/2006 concerning the MEDA programme<sup>(4)</sup>. As the MEDA Regulation was expiring in 2006, the Court's recommendations were aimed at the new European Neighbourhood and Partnership Instrument (ENPI), which took effect from 2007. The Court recommended that the Commission should:

**8.38.** *The Commission has taken the necessary steps to follow up the recommendations of Special Report No 5/2006 concerning the MEDA programme.*

- ensure a smooth and quick transition to the new country programmes, to avoid negative consequences for future implementation,
- define more clearly in the new country programming documents its strategic objectives and establish appropriate indicators, to allow for better monitoring and evaluation of impact,

<sup>(4)</sup> OJ C 200, 24.8.2006.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- continue to focus its support on a limited number of intervention areas to ensure coherence and to keep the programmes manageable,
- continue to search for best practices in managing projects to avoid delays.

8.39. The European Parliament and the European Council adopted the recommendations of the Court. The Discharge Authority additionally noted issues related to the visibility of actions financed by the EU, and the enhancement of the planning and implementation of the new instrument.

***Follow-up of the recommendations***

8.40. The Commission prepared on time the country reports, the action plans and the corresponding strategy programming documents. The flow of EU financial aid was unaffected during the transition from the old (MEDA) to the new (ENP) instrument. Moreover, for the years 2007 and 2008, both commitments and disbursements (for MEDA and ENPI jointly) were even higher than to the previous years' average.

8.41. The strategy programming documents incorporated elaborated strategic objectives, which were in line with the Country Action Plans but were mostly described in general terms, making it difficult to assess the impact of EU funding at the end of the period established in the strategy documents. The quality of the performance indicators established at this level differed substantially from country to country. Generally, baselines and targets, related to the indicators, were not defined in the strategy documents.

**8.41.** See reply to 8.46.

8.42. The Commission has focused its support on a limited number of intervention areas. The intervention areas were aligned with the needs assessment of each individual beneficiary country. In addition, the Commission took care to continue the support of specific areas or even maintain sector programmes under the new ENP instrument. The Commission also supported a number of high priority areas common to most of the beneficiary countries.

8.43. The Commission worked in accordance with the provisions established by the ENPI Regulation, which improved the transparency of EU funding through international trust funds. Recently, two comprehensive evaluation reports have also been produced on the Commission's aid delivery through development banks and the European Investment Bank, and through the organisations of the United Nations family. The Evaluation Unit<sup>(5)</sup> commissioned external consultants to produce the reports with the aim of assessing the added value of these modes of channelling aid.

<sup>(5)</sup> Evaluation Unit common to EuropeAid, DG Development and DG External Relations.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.44. In 2008, the Commission prepared a communication and visibility manual. Specific agreements on communication, visibility and reporting were also signed with the UN and the World Bank in 2006.

8.45. The Commission took measures to implement most of the recommendations of the mid-term evaluation report on MEDA II. However, the final evaluation report expected by mid 2008 will not be finalised until later in 2009.

**Conclusion and recommendations**

8.46. The Commission has taken steps which are largely in line with the recommendations of the report. The Commission:

- took the necessary measures to ensure a smooth and quick transition to the new country programmes;
- did not establish, however, strategic objectives and indicators of satisfactory quality in all strategy programming documents. The Court therefore continues to recommend that the Commission should define strategic objectives and adequate performance indicators that would allow an efficient impact assessment of the EU actions for the period as a whole;
- focused its support on a limited number of intervention areas, in line with the Action Plans and the needs assessment of each individual beneficiary country;
- continued to seek to apply best practices in planning and managing programmes and projects. However, the Commission is late with the final MEDA evaluation report, which could have added valuable recommendations for the implementation of the initial phase of ENPI.

8.45. See reply to 8.46.

8.46.

- According to the ENPI regulation, the baseline and performance indicators are specified at a later stage, when setting up the Annual Action Programmes. It is indeed at the moment of formulation of a programme, when they tend to become more relevant and better defined, that those indicators are established. The Country Strategy Papers have as their objectives the provision of an overall outline of the situation in the country and the presentation of the priority strategic areas of intervention in order to meet the major challenges identified in the country.
- The mid-term evaluation report was finalised only in July 2005. Due to the fact that new MEDA financing decisions were still being adopted during 2006 and that, as a consequence, many of the actions relating to these decisions were still being implemented in 2008 and 2009; it was decided to postpone the final evaluation report by 1 year. This report is now scheduled for the close of 2009.



## PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

## 2.1 — Assessment of selected supervisory and control systems

| System concerned         |     | Key internal controls (Commission)       |                            |                                |                 | Key internal controls in national administrations | Overall assessment |
|--------------------------|-----|--|----------------------------|--------------------------------|-----------------|---|--------------------|
|                          |     | Ex-ante checks on contracts and payments | Management and supervision | External audits/closure audits | Internal audits |   |                    |
| EuropeAid <sup>(1)</sup> | HQ  |  |                            |                                |                 | N/A   |                    |
|                          | DEL |  |                            |                                |                 |   |                    |
| DG RELEX                 |     |  |                            |                                |                 | N/A   |                    |
|                          |     |  |                            | <sup>(2)</sup>                 |                 |   |                    |
| DG ELARG                 |     |  |                            |                                |                 |   |                    |
| DG ECHO                  |     |  |                            |                                |                 | N/A   |                    |

| Overall assessment | 2008 | 2007 |
|--------------------|------|------|
|                    |      |      |

Legend:

|     |  |
|-----|--|
|     | Effective                                      |
|     | Partially effective                            |
|     | Not effective                                  |
| N/A | Not applicable: does not apply or not assessed |

<sup>(1)</sup> This assessment corresponds to the one published in the EDF Report.<sup>(2)</sup> Ex-posts controls.

## FOLLOW-UP OF PREVIOUS DAS OBSERVATIONS

| Court observation  | Action taken   | Court analysis  | Commission reply  |
|--|--|---|---|
| <b>External relations and development</b>  |  |   |   |
| <i>Budget support payments</i>   |  |   |   |
| <p>Budget support can be granted if the partner country's management of public spending is sufficiently transparent, reliable and effective, and where it has put in place properly formulated sectoral or macroeconomic policies approved by its principal donors, including where relevant the international financial institutions. On that basis the Commission developed specific guidelines establishing the conditions for disbursement of funds, the payment of successive tranches being conditional on satisfactory progress towards achieving the objectives. However, the performance indicators used to measure the progress achieved were not in all the cases examined time-bound, clear and unambiguous, and achievable.</p> <p>(Annual Report concerning the financial year 2007, paragraph 8.14)</p> | <p>Introduction of performance indicators which are more oriented towards output and outcome.</p>      | <p>It is already possible to verify the results of the actions taken in this respect.</p>                             | <p><i>The Commission recognises the need to inject further precision into the design and measurement of indicators in the budget support operations. General Budget Support Guidelines are currently being revised to improve the design and assessment of eligibility conditions and specific results oriented indicators in order to achieve a more rigorous results orientated approach, making use of process and output indicators, in addition to outcome indicators.</i></p> |
| <i>System of external audits</i>   |  |   |   |
| <p>EuropeAid commissions additional project audits, selected on a risk-analysis basis, in order to provide a further layer of assurance. However complete procedures have not yet been developed so as to draw full benefit from these audits.</p> <p>(Annual Report concerning the financial year 2007, paragraph 8.25)</p>   | <p>Closer monitoring of the implementation of the AAP and better use of the results of the audits.</p> | <p>The measures adopted have not yet been fully effective and further efforts are still required in this respect.</p> | <p><i>The Commission is planning improvements to CRIS to allow improved analysis of audit data.</i></p>   |

| Court observation  | Action taken   | Court analysis   | Commission reply   |
|--|--|--|--|
| <b>Enlargement</b>   |  |  |  |
| <i>Extended Decentralised Implementation System (EDIS)</i>   |  |  |  |
| <p>In Bulgaria it was found that in spite of EDIS accreditation having been given (thus waiving the Delegation's ex-ante control) the systems in question contain significant weaknesses.</p> <p>(Annual Report concerning the financial year 2007, paragraph 8.12)</p>                              | <p>An action plan has been set up to ensure that improvements are made, payments to two Implementing Agencies having been suspended in February 2008 and their accreditation withdrawn in July 2008.</p> | <p>In spite of the actions taken the fundamental weaknesses which led to the suspension of payments and withdrawal of the EDIS accreditation still remain.</p> | <p><i>The situation is improving. However, even if any system weaknesses were to remain, there is no longer the potential for entering into irregular contracts, since the contracting of Phare funds was terminated.</i></p>  |
| <i>Ex-post controls (closure audits)</i>   |  |  |  |
| <p>Following a change of methodology, the number of audit reports was exceptionally high in 2007, and some have not received timely follow-up.</p> <p>(Annual Report concerning the financial year 2007, paragraph 8.26)</p>   | <p>Serious efforts were made by the Commission to monitor and process the audit reports.</p>   | <p>There has been significant improvement in processing the files.</p>   | <p><i>In 2008, 133 reports were processed among which 89 could be closed, whereas for the 5 first months of 2009, 71, among which the 44 not closed in 2008, were processed and 38 closed.</i></p>   |
| <b>Humanitarian aid</b>  |  |  |  |
| <i>External audits</i>   |  |  |  |
| <p>In 2007 DG ECHO significantly increased the number of field audits, although, as in 2006, the majority of audits were done at partner's headquarters where the reality of expenditure cannot be completely checked.</p> <p>(Annual Report concerning the financial year 2007, paragraph 8.27)</p> | <p>The Commission already increased the number of field audits in 2007.</p>  | <p>The Court notes the efforts made to increase the proportion of field audits of projects.</p>  | <p><i>The reality of expenditure is continually checked through monitoring of projects by Technical assistants, the use of field audits, the on-the-spot missions carried out by Commission staff and by the progress and financial reports submitted by the partner. Following the Courts recommendation DG ECHO has rebalanced the numbers of Headquarter and field audits so as to achieve an optimum and cost-effective balance.</i></p> |





## CHAPTER 9

**Education and Citizenship**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction  | 9.1-9.7          |
| Specific characteristics of Education and Citizenship | 9.1-9.4          |
| Audit Scope   | 9.5-9.7          |
| The audit of advances                                 | 9.6-9.7          |
| Regularity of transactions                            | 9.8-9.11         |
| Effectiveness of systems                              | 9.12-9.30        |
| Systems related to the regularity of transactions     | 9.12-9.30        |
| Systems for the Lifelong Learning Programme           | 9.13-9.25        |
| Ex-post controls at DG EAC                            | 9.26             |
| External Borders Fund                                 | 9.27-9.29        |
| DG Communication                                      | 9.30             |
| Conclusions and recommendations                       | 9.31-9.34        |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

**Specific characteristics of Education and Citizenship**

9.1. This chapter presents the Court's specific assessment of policy group Education and Citizenship which comprises policy areas 15-Education and Culture, 16-Communication; and 18-Freedom, Security and Justice. Detailed information is provided on the activities covered, the spending for the year and management type involved in **Table 9.1**.

**Table 9.1 — Education and Citizenship, 2008 payments by policy area***(million euro)*

| Budget Title                            | Policy area                   | Description  | Payments 2008 | Budget Management Mode                   |
|---|-------------------------------|--|---------------|--|
| 15                                      | Education and Culture         | Administrative expenditure <sup>(1)</sup>                              | 111           | Centralised direct                       |
|   |                               | Lifelong learning, including multilingualism                           | 1 060         | Centralised indirect                     |
|   |                               | Developing cultural cooperation in Europe                              | 48            | Centralised indirect                     |
|   |                               | Encouraging and promoting cooperation in the field of youth and sports | 134           | Centralised indirect                     |
|   |                               | Fostering European Citizenship   | 24            | Centralised indirect                     |
|   |                               |  | <b>1 378</b>  |  |
| 16                                      | Communication                 | Administrative expenditure <sup>(1)</sup>                              | 104           | Centralised direct                       |
|   |                               | Communication and the media  | 25            | Centralised direct                       |
|   |                               | 'Going Local' communication  | 35            | Centralised direct                       |
|   |                               | Analysis and communication tools                                       | 23            | Centralised direct                       |
|   |                               |  | <b>186</b>    |  |
| 18                                      | Freedom, Justice and Security | Administrative expenditure <sup>(1)</sup>                              | 58            | Centralised direct                       |
|   |                               | Solidarity — External borders, visa policy and free movement of people | 189           | Shared management / Centralised indirect |
|   |                               | Migration flows — Common immigration and asylum policies               | 80            | Shared management                        |
|   |                               | Fundamental rights and citizenship                                     | 26            | Direct                                   |
|   |                               | Security and safeguarding liberties                                    | 28            | Direct                                   |
|   |                               | Justice in criminal and civil matters                                  | 42            | Direct                                   |
|   |                               | Drugs prevention and information                                       | 15            | Direct                                   |
|   |                               | Policy strategy and coordination                                       | 7             | Direct                                   |
|   |                               |  | <b>445</b>    |  |
| <i>Total administrative expenditure</i> |                               |  | 274           |  |
| <i>Total operational expenditure</i>    |                               |  | 1 735         |  |
| <b>Total payments for the year</b>      |                               |  | <b>2 009</b>  |  |
| <b>Total commitments for the year</b>   |                               |  | <b>2 323</b>  |  |

<sup>(1)</sup> Audit of administrative expenditure is reported on in Chapter 11.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

9.2. The three budget titles in this area are almost exclusively managed by three corresponding Directorates-General (DGs) of the Commission. These are DG Education and Culture (DG EAC) for budget line 15, DG Communication (DG COMM) for budget line 16 and DG Justice, Freedom and Security (DG JLS) for budget line 18. The majority of expenditure in this area is managed in an indirect centralised way or through shared management, with the implementation of actions in the form of multiannual programmes delegated to the Education, Audiovisual and Culture Executive Agency, national agencies<sup>(1)</sup> or similar management structures in Member States. The responsible entities in Member States allocate grants and contracts to projects or measures carried out by private and public beneficiaries. The grants are usually paid in instalments, as described in paragraphs 9.6 and 9.7.

9.3. The implementation of the programmes under the new Financial Framework for 2007-2013 was accompanied by a change in the internal control structure with an increased level of responsibility for the Member States. For Lifelong Learning Programme (LLP) contracts to be initiated, for example, national authorities (see paragraph 9.13) were required to give an *ex-ante* declaration of assurance in respect of the financial management of expenditure in the Member State in question. Each year, the authority must provide an *ex-post* declaration of assurance on the correct use of resources and the reliability of systems and control procedures put in place<sup>(2)</sup>.

9.3. DG EAC has adapted its supervision and control system based on a single audit approach. It consists of:

- (a) assessment of the national authorities' *ex-ante* declaration of assurance given in the beginning of the programme period 2007-2013;
- (b) system monitoring and control visits on the spot;
- (c) assessment of the yearly *ex-post* declaration;
- (d) financial audits;
- (e) training activities with the national agencies and national authorities;
- (f) continuous information and communication with the stakeholders;
- (g) a common and regularly updated set of procedures.

The assessment of the yearly *ex-post* declaration of assurance was a new and additional element of control in 2008.

<sup>(1)</sup> Having a contractual relationship with the Commission.

<sup>(2)</sup> Article 7(3) of C(2007) 1807 final, Commission Decision of 26/IV/2007 relating to the respective responsibilities of the Member States, the Commission and the National Agencies in implementation of the Lifelong Learning Programme (2007-2013).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

9.4. EU support in the domains of Education and Citizenship is characterised by a multiplicity of funding schemes for various thematic areas and types of projects such as grants to actions in favour of Citizenship or for mobility in the education and training sectors. Projects are carried out not only by teaching organisations, but also by private firms and public administrations. The final beneficiaries are individuals, mostly EU citizens. Management of some programmes, namely the External Borders Fund, the Integration Fund, the Return Fund and the European Refugee Fund is, however, shared with Member States.

**Audit Scope**

9.5. The specific assessment is based on:

- (a) the substantive testing of a representative statistical sample of 150 payments (see **Table 9.2**);
- (b) testing and evaluation of Lifelong Learning Programme control systems in six Member States, comprising national authorities and national agencies <sup>(3)</sup>;
- (c) an assessment of the Commission's supervisory checks on the yearly declarations of assurance for 2007 (*ex-post* certifications) of national authorities for the Lifelong Learning Programme;
- (d) an assessment of the operation of supervisory and control systems for the External Borders Fund (EBF);
- (e) a follow-up of the principal observations by the Court in recent Statements of Assurance (see **Annex 9.2**).

---

<sup>(3)</sup> The six agencies concerned were EPOS vzw — Europese Programma's voor Onderwijs, Opleiding en Samenwerking — Agentschap (Belgium), DAAD — Deutscher Akademischer Austauschdienst (Germany), FRSE — Fundacja Rozwoju Systemu Edukacji (Poland), OAPEE — Organismo Autónomo Programas Educativos Europeos (Spain), Léargas (Ireland) and ISFOL — Istituto per lo Sviluppo della Formazione e dell'Orientamento Professionale dei Lavoratori (Italy).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

***The audit of advances***

9.6. In line with the expenditure pattern for the financial year 2008, the Court's sample of payments for substantive testing included 129 transactions for which the conditions for payment are largely formal. These mostly concern advances to EU agencies and national agencies, and a small number of quarterly contributions to their operating costs. These payments are made after the signature of a contract or acceptance of a work programme, or in the case of most second and third prefinancings, on the acceptance by the Commission that 70 % of the funds already advanced have been disbursed. These advances normally accumulate to 100 % of the maximum allowed. The limited conditionality resting on these payments means that the risk of error is very low.

9.7. In turn, the agencies themselves make grant agreements with participating organisations<sup>(4)</sup>, and consume the Commission advances they have received by making advances to these organisations of between 80 % and 100 %, depending on the type of programme. These projects are completed within a period of up to two years, leading to final reports and closures between the agency and beneficiaries. After all projects deriving from the work programme of a given year have been closed, the agency submits a consolidated final report to the Commission which then calculates the final balance and makes the settlement. The closures between beneficiary and agency are expected to be of a higher risk than advances, subject to the normal risks associated with this field of eligibility and occurrence of declared expenditure. However, these closures can only be audited once they have been made, several years after the initial advances have been paid.

**9.7.** *The Commission also believes the risks are higher with final payments, which is why the Commission makes greater controls and supervision at this stage to mitigate these risks.*

*As far as DG EAC is concerned, the design of the new programmes for 2007–2013 has taken into account the Court's recommendations of previous years to simplify the rules and to make extensive use of lump sum financing. This should reduce the risk linked to final payments.*

## REGULARITY OF TRANSACTIONS

9.8. The Court found the transactions in the policy area as a whole to be free from material error. However, a material level of error was found in the interim and final payments examined.

**9.8.** *The Commission welcomes the Court's finding that the payments in 2008 for the policy group Education and Citizenship were free from material error. This is a noticeable progress from the previous year.*

*The Commission notes that the Court has found quantifiable errors in 4 out of 21 interim and final payments examined (see the reply to 9.9).*

<sup>(4)</sup> Participating organisations are usually universities, schools or colleges, who manage payments to beneficiaries such as students or teachers.

## THE COURT'S OBSERVATIONS

9.9. Of the 21 final and interim payments <sup>(5)</sup> appearing in the total sample of 150, the Court found a significant level of error for regularity in six of these payments. Four payments contained quantifiable errors and four were subject to non-quantifiable errors, with two payments containing both types of error. **Table 9.2** shows the distribution of the errors according to payment type and policy area.

9.10. Concerning the 129 advance payments tested <sup>(6)</sup>, nine contained significant non-quantifiable error and related to advances made by DG JLS and DG EAC to agencies, either because a commitment was made before the necessary financing decision having been adopted, or without sufficiently detailed cash-flow forecasts.

## THE COMMISSION'S REPLIES

**9.9.** *The Commission will follow up the errors found by the Court, and where appropriate, funds unduly paid will be recovered.*

*The errors concerning DG EAC are related to smaller actions under the former legal framework. The design of the new programmes 2007–2013 with simplified rules and extensive use of lump sum financing should reduce the risks linked to final payments.*

**9.10.** *The Commission would like to point out that the necessary financing decisions were taken although formally late (six days for the JLS case). The Commission was aware of the cash and budgetary requirements of the agencies at the time.*

*In order to avoid such non-quantifiable errors, Commission financing decisions are now taken well in advance, and cash flow forecasts are requested for all payments to the agencies (e.g. through a Memorandum of Understanding).*

**Table 9.2 — Structure of the sample, number of transactions examined (number of transactions affected by error in brackets)**

| Type of payment (*)    | Policy area                 |                     |                                     | Total           |
|------------------------|-----------------------------|---------------------|-------------------------------------|-----------------|
|                        | 15<br>Education and Culture | 16<br>Communication | 18<br>Freedom, Justice and Security |                 |
| Final/interim payments | 10 (3)                      | 6 (1)               | 5 (2)                               | 21 (6)          |
| Advances               | 100 (5)                     | 0 (0)               | 29 (4)                              | 129 (9)         |
| <b>Total</b>           | <b>110 (8)</b>              | <b>6 (1)</b>        | <b>34 (6)</b>                       | <b>150 (15)</b> |

(\*) Four interim payments, representing administrative contributions to agencies, are grouped with advances subject to similar conditions.

<sup>(5)</sup> Not including four payments classed as 'interim payments' but representing contributions to agency administrative costs and, like advances to agencies, conditional only on the signing of a grant agreement.

<sup>(6)</sup> Including four interim payments (see paragraph 9.9).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

9.11. As shown in **Table 9.2**, interim and final payments are relatively more affected by errors than advance payments. Examples of errors found in final and interim payments were:

- (a) costs claimed from periods not covered by the grant agreement (eligibility);
- (b) recoverable VAT claimed as cost (eligibility);
- (c) the absence of documentation relating to the selection process for the awarding of grants (occurrence);
- (d) inadequate supporting evidence to justify the costs claimed (occurrence).

**9.11.** *The Commission carefully follows up all the Court's findings. Where appropriate, the recovery procedure has already been or will be launched. Remedial actions have also been taken for the new generation of programmes for 2007–2013 to reduce the risks linked to final payments (see also reply to 9.9).*

## EFFECTIVENESS OF SYSTEMS

**Systems related to the regularity of transactions**

9.12. The Court examined three individual control systems in different Directorates-General, pertaining to *ex-post* controls at DG EAC, the Lifelong Learning Programme and the External Borders Fund.

***Systems for the Lifelong Learning Programme***

9.13. The Lifelong Learning (LLP) and Youth in Action (YiA) programmes are implemented through centralised indirect management by 63 national agencies (NAs) in participating countries, designated and supervised by national authorities (NAUs). Due to their proximity to final beneficiaries, the national agencies have been charged with the role of managing the highly numerous but relatively small amounts that are paid as grants in this field. Altogether, the actions managed by NAs represent about 68 % of the budget under Title 15. Other education programmes, such as Jean Monnet and Erasmus Mundus, as well as certain segments of LLP and YiA, are managed by the Education, Audiovisual and Culture Executive Agency.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

9.14. The responsibilities within the LLP control environment are set out in Commission Decision C(2007) 1807. These comprise:

- (a) primary controls managed by the NA including the analysis of final reports, desk-checks of supporting material for costs claimed, on-the-spot checks during actions, audits after the action, and systems audit of recurrent beneficiaries such as universities. NAs must send a yearly report to the Commission and NAU which includes information on the primary controls undertaken;
- (b) secondary controls implemented by the NAU, to provide assurance and support for a yearly *ex-post* declaration that the systems and primary controls are effective;
- (c) controls implemented by the Commission, mainly including assessment of yearly declarations and monitoring visits.

9.15. In the context of the 2008 DAS, the Court undertook a systems audit relating to six of the national agencies and their supervising national authorities.

*Primary controls*

9.16. In its audit of the national agencies, the Court found an overall high level of compliance with the requirements set out by the Commission in its 'Guide for national agencies'. However, in two cases there were problems with the implementation of primary controls, which are fundamental to the legal and regular use of Community funds in an area with such a large number of direct beneficiaries. In some cases, there was no evidence documenting the analysis or desk-checks performed, or no systems audits made on universities, despite the Commission setting requirements on the minimum numbers of such audits to be performed before the end of 2008. Among other deficiencies were the inexistence of exceptions registers, treasury policy which did not ensure that funds were placed on interest-bearing accounts and late submission of yearly reports to the Commission.

**9.16.** *The Commission welcomes the fact that the Court found an overall high level of compliance with the requirements of the 'Guide for national agencies' and takes it as a confirmation that the multi-channel supervisory and control strategy (including training seminars and steady information and communication with the national agencies and the national authorities) paid off.*

*One of the national agencies could not fulfil the requirement of the system audits made to universities due to lack of staff but caught up with its obligations in the first semester 2009.*



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Secondary controls*

9.17. The *ex-ante* declarations on the quality of the NA management and control systems required to be made by the NAUs prior to the start of the programmes were reported on in the Court's Annual Report for 2007. Following the first year of implementation, 2007, and every year thereafter, the NAUs are required to make an *ex-post* declaration on the reliability of the financial systems and procedures implemented in the previous year, the probity of the accounts and on the assurance derived from the control procedures put in place.

9.18. Commission Decision C(2007) 1807, Article 8(3), stipulates that 'the national authority shall establish the system of secondary controls whose objective is to give reasonable assurance that the systems and primary controls are effective. It may entrust performance of secondary controls to an external audit body'.

9.19. The Court's audit found approaches of varying quality used by the national authorities to obtain a basis for the *ex-ante* and *ex-post* declarations of assurance and differences in the degree of disclosure of procedures carried out by these authorities. In three of the six NAUs the secondary controls were performed satisfactorily, with either an external contractor or NAU agents thoroughly testing that the systems and primary controls put in place by the NA comply with Commission guidelines. In the other NAUs, secondary controls were either non-existent, insufficient, inadequately documented or contracted out to an external firm without any proper supervision to ensure that appropriate controls were made. Consequently, the assurance in the declaration provided by these NAUs was not substantiated.

9.20. Furthermore, only 10 of the 40 *ex-post* declarations for 2007 were sent to the Commission before the 30 April 2008 deadline. The delays can be partly attributed to the fact that the Commission guidance on information to be provided in the reports was only made available in March 2008. However, the rate of compliance had not improved by March 2009. The *ex-post* declarations for 2008 were due on 30 April 2009 but only six declarations were received on time.

**9.19.** *Taking into account different national situations, the regulatory framework does not impose a 'one size fits all' control system, but puts the responsibility on the Member States to reach the control objectives according to the common standards.*

*However, based on the first experience of declarations, the Commission has further defined the control objectives for the checks by the national authorities in guidelines provided to the Member States in February 2008 and updated in March 2009.*

*The national authorities have now to describe in detail the secondary controls carried out in the new Annex 4 to the yearly declaration of assurance.*

**9.20.** *All ex-post declarations for 2007 were assessed in due time in 2008 in order to contribute to DG EAC's declaration of assurance.*

*DG EAC's supervision system obtains assurance during the year from different elements and not only at the moment of the reception of the declarations of assurance from national authorities (see also 9.3).*

## THE COURT'S OBSERVATIONS

9.21. While the guidance for national agencies is well-developed, both in legislative terms (7), (8) and in the 'Guide for national agencies implementing the Lifelong Learning Programme' issued by the Commission, this is not the case for the national authorities. Though guidance (9) has been issued by the Commission clarifying the responsibilities, there is no sufficiently detailed prescriptive guidance containing specific procedures for the authorities to follow.

*Commission controls*

9.22. The Court audited the assessment process for the *ex-ante* declarations for the period 2007 to 2013 and for the *ex-post* declarations for 2007. The Court found that the application of both the *ex-ante* and the *ex-post* declaration procedure provided limited assurance for the quality of the management of the expenditure for the years concerned. However, as reported last year, the Court considers the design of the system — if properly applied — could provide an adequate basis for assurance in the future.

9.23. The Commission's assessment was based on a desk review of systems and controls and systems monitoring visits to 11 countries in 2008. However, only in some cases did the Commission verify the reality and the quality of the primary and secondary controls referred to in the yearly declarations and the information presented in the yearly reports.

9.24. Based on its assessment of both the *ex-ante* and *ex-post* declarations, the yearly reports from the NAs and the results of its monitoring visits to the NAs and NAUs, the Commission has established a list of qualifications to be remedied by NAs and NAUs. During 2008, 169 LLP reservations were lifted, and 98 added, so that at the end of the year, there were 162 outstanding qualifications. None of these were classified by the Commission as 'critical' but 62 were rated as 'very important'. Of the 162 qualifications, 110 related to control systems: 94 in the national agencies and 16 in the national authorities.

## THE COMMISSION'S REPLIES

**9.21.** *The Commission welcomes the fact that the Court considers the Guide for national agencies as well developed. The Commission agrees that further steps towards a simpler and more harmonised approach can also be made for national authorities, taking into account the specific situation in different Member States.*

**9.22.** *The ex-ante and ex-post declarations are new and additional elements of the reinforced supervisory and control system (see also replies to 9.3 and 9.20).*

**9.23.** *DG EAC's supervisory strategy is multiannual, risk-based and process-oriented. All yearly declarations of assurance were assessed in due time based on an in-depth desk review and qualifications were issued as necessary. Checks of the reality and quality of the primary and secondary controls were part of the systems monitoring visits and sometimes resulted in qualifications (see 9.24).*

**9.24.** *In line with the process-oriented supervisory strategy qualifications can be lifted or added during a year. This shows that the work is done continuously and that the qualifications are systematically followed up.*

*The average number of open qualifications was around 4 per national agency at the end of 2008.*

*Most of the 'very important' qualifications are related to primary checks to be carried out until the end of decentralised actions agreements in order to raise awareness of the NAs.*

(7) C(2007) 1807 final.

(8) Decision No 1720/2006/EC of The European Parliament and of the Council of 15 November 2006 establishing an action programme in the field of lifelong learning (OJ L 327, 24.11.2006, p. 45).

(9) 'Lifelong Learning and Youth in Action programmes 2007-2013, Yearly Declaration of Assurance 2008, Guidelines for National Authorities', Brussels, 2.3.2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

9.25. Deficiencies in the internal control systems identified in the qualifications mentioned above represent a risk for the regularity of payments made to final beneficiaries and for payments to the national agencies. A continued follow-up of qualifications, in the form of more thorough monitoring visits, and a closer supervision by the Commission of the annual *ex-post* declaration procedure is needed to provide assurance for the coming years that national agencies meet the requirements in respect of management and control of expenditure.

***Ex-post controls at DG EAC***

9.26. The 2008 Annual Activity Report of DG EAC reports that the results of the financial audits of projects, carried out by a private audit firm on behalf of the Commission, show an average error in the audited contracts of 0,01 % for LLP. However, an error rate calculated on the projects closed during the year would be much higher. Furthermore, as these audits were mainly carried out at the level of the NA, which does not normally receive all justifying documents, they do not cover all eligibility criteria.

***External Borders Fund***

9.27. The framework programme 'Solidarity and Management of Migration Flows', foreseen for the period 2007/2008 to 2013, represents around 50 % of DG JLS operational expenditure and is implemented under shared management with Member States. It consists of four financial instruments<sup>(10)</sup>, the largest being the External Borders Fund (EBF), representing over 50 % of the expenditure within the programme.

9.28. Although the EBF was established for the period beginning 1 January 2007, the legal base was adopted only on 23 May 2007 and the implementing rules on 5 March 2008. In addition, some Member States have submitted the initial versions of Descriptions of Management and Control Systems (MCS) as well as of the programming documents with substantial delays or insufficient quality. Consequently the first prefinancing payments to MS could not be made by the Commission until the final months of 2008.

**9.25.** *The audit plan 2009 reinforces the monitoring visits that focus on the existence and implementation of management procedures and checks as described by Member States.*

**9.26.** *The Commission's Annual Activity Report covers the financial activity for the year and therefore analyses payments made during the year (advances and final payments alike). The Commission will re-examine its approach to the calculation of the error rate disclosed in the Annual Activity Report.*

*Given the fact that beneficiaries receive generally small grants, the right balance between the number of controls and their costs has to be taken into account.*

<sup>(10)</sup> The four instruments are: the External Borders Fund, the Integration Fund, the Return Fund, the European Refugee Fund.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

9.29. In the context of the 2008 DAS, therefore, the Court's audit was restricted to DG JLS's review of Descriptions of Management and Control Systems (MCS) submitted by Member States in relation to the EBF. No significant weaknesses were identified in this review; but it will only be possible to assess the actual effectiveness of the MCS once these systems are operational.

**DG Communication**

9.30. The Court examined DG Communication's Annual Activity Report for 2008, which showed (see also **Annex 9.2**) an error rate of 0,05 % detected by the DG's second level *ex-ante* checks. This could indicate that the regular *ex-ante* checks have improved since last year.

## CONCLUSIONS AND RECOMMENDATIONS

9.31. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2008 for policy group Education and Citizenship were free from material error. However, the Court's testing suggests that the interim and final payments were affected by material error.

9.32. The Court concludes that the supervisory and control systems for the policy group Education and Citizenship are partially effective in ensuring the regularity of payments.

9.33. As stated in paragraph 9.21, the guidance issued to the national agencies is well-developed for use as a manual of procedures. There is, however, no such guidance for the national authorities and it is recommended that the Commission introduce a more prescriptive framework showing the specific actions to be taken.

**9.31.** *The Commission welcomes the Court's conclusion that the payments for the year ended 31 December 2008 for the policy group Education and Citizenship were free from material error. This is a noticeable progress from the previous year.*

*The Commission notes that the Court has found quantifiable errors in 4 out of 21 interim and final payments examined.*

*The Commission will follow up the errors found by the Court, and where appropriate, funds will be recovered.*

**9.32.** *The supervisory and control system put in place for the 2007-2013 period provides for a sound framework. In 2008, for DG EAC, significant progress was made in its implementation through the analysis of ex-post declarations of assurance and intensified monitoring visits and audits.*

**9.33.** *The Commission welcomes the fact that the Court considers the Guide for national agencies as well developed. The Commission agrees that further steps towards a simpler and more harmonised approach can also be made for national authorities, taking into account the specific situation in different Member States.*

## THE COURT'S OBSERVATIONS

9.34. As stated in paragraphs 9.22 to 9.25, the Court considers that the NAU LLP declaration procedure, and control system which should underpin it, could provide an adequate basis for assurance in the future. However, although progress has been made, the current implementation of the supervisory and control system does not yet give satisfactory assurance that errors of regularity will be prevented or detected and corrected. Therefore, it is recommended that the Commission engage in closer supervision of the annual *ex-post* declaration process, with more thorough monitoring visits and direct verification that the controls described are adequate and fully applied.

## THE COMMISSION'S REPLIES

**9.34.** *The Commission welcomes the statement of the Court on the adequacy of the integrated control and supervision system in place.*

*The Commission agrees with the need for closer supervision of the yearly ex-post declarations. Therefore, the audit plan 2009 reinforces the monitoring visits that focus on the existence and implementation of management procedures and checks as described by Member States.*

## ANNEX 9.1

## RESULTS OF TESTING

## PART 1: MAIN FEATURES OF SAMPLE-BASED TRANSACTION TESTING

## 1.1 — Size of the sample

| Year | Number of transactions tested |
|------|-------------------------------|
| 2008 | 150                           |
| 2007 | 150                           |

## 1.2 — Structure of the sample

| Percentage of transactions tested which were | 2008                        |                     |                                     |              | 2007       |
|--|-----------------------------|---------------------|-------------------------------------|--------------|------------|
|  | 15<br>Education and Culture | 16<br>Communication | 18<br>Freedom, Justice and Security | Total        |            |
| Final/interim payments                       | 6,7                         | 4,0                 | 3,3                                 | 14,0         | 37         |
| Advances                                     | 66,7                        | 0,0                 | 19,3                                | 86,0         | 63         |
| <b>Total</b>                                 | <b>73,3</b>                 | <b>4,0</b>          | <b>22,7</b>                         | <b>100,0</b> | <b>100</b> |

## 1.3 — Frequency and estimated impact of errors

| Errors  | 2008      |          |          |           | 2007                |
|---|-----------|----------|----------|-----------|---------------------|
|   | 15        | 16       | 18       | Total     |                     |
| Frequency of transactions tested which were affected by errors                  | 7 % {8}   | 17 % {1} | 18 % {6} | 10 % {15} | 21 % {31}           |
| Frequency of errors which are quantifiable                                      | 18 % {2}  | 0 % {0}  | 25 % {2} | 20 % {4}  | 26 % {10}           |
| Impact of quantifiable errors:<br>Most likely error rate falls in the range (*) | Below 2 % |          |          | Below 2 % | Between 2 % and 5 % |

(\*) The Court distinguishes three ranges for most likely error rate: below 2 %, between 2 % and 5 %, above 5 %  
The figures in the {} brackets are absolute numbers.

## PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

## 2.1 — Assessment of selected supervisory and control systems

| LLP system concerned | National Authority | National Agency | Commission | Overall assessment |
|----------------------|--------------------|-----------------|------------|--------------------|
| Belgium (EPOS)       |                    |                 |            |                    |
| Germany (DAAD)       |                    |                 |            |                    |
| Spain (OAPPE)        |                    |                 |            |                    |
| Ireland (Léargas)    |                    |                 |            |                    |
| Italy (ISFOL)        |                    |                 |            |                    |
| Poland (FRSE)        |                    |                 |            |                    |

| Overall assessment | 2008 | 2007 |
|--------------------|------|------|
|                    |      | N/A  |

Legend:

|     |  |
|-----|--|
|     | Effective                                      |
|     | Partially effective                            |
|     | Not effective                                  |
| N/A | Not applicable: does not apply or not assessed |

## FOLLOW-UP OF PREVIOUS DAS OBSERVATIONS

| Court observation   | Action taken   | Court analysis  | Commission reply  |
|---|--|---|---|
| <b>Observation 1: Weaknesses in the <i>ex-ante</i> declaration procedure for LLP</b>  |  |   |   |
| <p>The Court noted the following weaknesses in the <i>ex-ante</i> declaration procedure for the LLP reducing the value of the procedure as an element of the supervisory and control system:</p> <ul style="list-style-type: none"> <li>— varying approaches taken by the National Authorities to obtain a basis for the <i>ex-ante</i> declaration of assurance and differences in the degree of disclosure of the procedures has led to differences in the scope of reliance placed by the Commission on the declarations;</li> <li>— the effective operation of systems and controls was not verified by the Commission as its assessment was limited to a desk review;</li> <li>— the Commission approved declarations from Member States with various qualifications to be remedied by the end of 2007 without including a precautionary measure in its contractual relationship with the agencies. Additionally, rigorous follow-up of corrective actions was missing, deadlines were frequently not respected and number of qualifications had not yet been lifted by the end of 2007;</li> <li>— certain criteria used by the Commission within the assessment procedure were not adequately defined causing uncertainty about the meaning of completion of the assessment process and precautionary measures.</li> </ul> <p>(Annual Report concerning the financial year 2007, paragraphs 9.16 and 9.17)</p> | <p>DG EAC notes that the <i>ex-ante</i> declaration was a new requirement and a 'one-shot-operation' at the start of the new programmes. In the meantime, DG EAC has undertaken the following actions in order to remedy this weakness:</p> <ul style="list-style-type: none"> <li>— More precise guidelines for the yearly declarations have been issued and specific meetings with the National Authorities have been organised in March and in November 2008.</li> <li>— More on-the spot visits have been organised (including financial audits and the start of the programme for supervisory controls).</li> <li>— An enhanced follow-up of corrective actions has been ensured by using a rating method.</li> <li>— A clear link between the rating and the precautionary measures to take has been established.</li> </ul> | <ul style="list-style-type: none"> <li>— Although the Commission did indeed issue some guidelines in March 2009, the Court's on-the-spot visits showed that National Authorities still have different interpretations on how to carry out secondary controls.</li> <li>— In 2008, on-the-spot visits to National Agencies and Authorities were carried out in 11 countries. Even for the countries visited on-the-spot, the Commission did not check the reality of the primary and secondary controls referred to in the yearly declarations.</li> <li>— The Commission has now a rolling follow-up of the qualifications for each Member State, but a large number (162) of LLP qualifications had not yet been lifted by the end of 2008.</li> </ul> | <p><i>Guidelines were already issued in February 2008 and updated in 2009. Control objectives are set but the way to reach them is up to the NAU taking into account the specific situation in the Member States.</i></p> <p><i>Checks of the reality and quality of the primary and secondary controls were part of the systems monitoring visits and sometimes resulted in qualifications.</i></p> <p><i>In line with the process-oriented supervisory strategy qualifications can be lifted or added during a year. This shows that the work is done continuously and that the qualifications are systematically followed up.</i></p> <p><i>The average number of open qualifications was around 4 per national agency at the end of 2008.</i></p> |



| Court observation  | Action taken  | Court analysis  | Commission reply   |
|--|---|---|--|
| <b>Observation 2: Partially effective supervisory checks carried out by the Commission for ERF II</b>  |   |   |  |
| <p>The preliminary assessment of the supervisory and control systems for ERF II carried out by the Commission has not been fully effective. The Court has noted the following: there are shortcomings in the descriptions of management and control procedures provided by Member States; only a limited number of monitoring visits to Member States have been performed and often not respecting the 12-month rule; follow-up procedure to monitor the progress made by Member States is not systematic.</p> <p>(Annual Report concerning the financial year 2007, paragraphs 9.20 and 9.21)</p> | <p>According to the AAR 2008 of DG JLS: 'the monitoring visits to the 14 MS (i.e. those not yet visited) were all carried out in 2008. These visits provide a generally clear and satisfactory view of the situation, even if there are weaknesses in the management and control systems of some MS. Following these monitoring visits, DG JLS judges that reasonable assurance has been provided in 4 cases, acceptable assurance in 7 cases, and limited assurance in 3 cases. As regards the latter 3, the main issue was the lack of independence on the part of the certification authority, and JLS has put in place a suitable action plan: 2 will be checked ex-post and the contradictory procedure is being carried out. The third MS is currently reviewing its control system on the basis of comments from JLS.'</p> | <p>No issues noted.</p>   |  |
| <b>Observation 3: Ineffective system for ex-ante checks for Communication expenditure</b>  |   |   |  |
| <p>Most of the errors detected by the Court (7 out of 12) concerning Communication expenditure had not been identified by the Commission's ex-ante checks.</p> <p>(Annual Report concerning the financial year 2007, paragraphs 9.22 and 9.23)</p>   | <p>According to the AAR 2008 of DG COMM, the DG: '... uses check-lists. In order to use them more consistently and improve the quality of their checks before initiating a payment, more training will be provided for the authorising officers by sub-delegation, the heads of administration and the operational staff.'</p>  | <p>DG COMM use a system of 2nd level ex-ante checks, based on MUS. According to the AAR 2008 of DG COMM, 5 % of transactions, representing 43 % of the total value of the transactions, were subject to a 2nd level ex-ante check in 2008, with the following result: 'Le taux d'erreur global relevé sur les transactions contrôlées est de 9,4 % en nombre et de 0,05 % en valeur directe.'</p> <p>The low error rate (in value) observed during the 2nd level ex-ante checks suggest that 'normal' ex-ante checks have improved since last year.</p> | <p><i>An action plan for improving the quality of transactions has been implemented and, in particular, training actions are on-going.</i></p> |



## CHAPTER 10

**Economic and Financial Affairs**

## TABLE OF CONTENTS

|  | <i>Paragraph</i> |
|--|------------------|
| Overview   | 10.1             |
| Specific assessment in the context of the Statement of Assurance | 10.2-10.31       |
| Introduction   | 10.2-10.11       |
| Audit scope  | 10.7-10.10       |
| Main risk to regularity  | 10.11            |
| Regularity of transactions                                       | 10.12-10.14      |
| Effectiveness of systems   | 10.15-10.26      |
| <i>Ex-ante</i> desk checks on payment requests                   | 10.17-10.21      |
| Audit certification of project cost statements                   | 10.22-10.23      |
| <i>Ex-post</i> controls  | 10.24-10.26      |
| Conclusions and recommendations                                  | 10.27-10.31      |
| Conclusions  | 10.27-10.28      |
| Recommendations  | 10.29-10.31      |
| Results of the Audit of the Guarantee Fund for External Actions  | 10.32-10.36      |
| Results of the Audit of the ECSC in Liquidation                  | 10.37-10.41      |
| Follow-up of previous observations                               | 10.42            |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## OVERVIEW

10.1. Chapter 10 consists of four parts. First it contains the specific assessment of policy group Economic and Financial Affairs in the context of the Statement of Assurance (see paragraphs 10.2 to 10.31). This is followed by the results of the recurrent audits on the Guarantee Fund for External Actions (see paragraphs 10.32 to 10.36) and the European Coal and Steel Community in Liquidation (see paragraphs 10.37 to 10.41). The chapter concludes with a follow-up of previous years' observations.

## SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE

**Introduction**

10.2. This part presents the Court's specific assessment of the policy group Economic and Financial Affairs, which comprises the following policy areas: 01-Economic and Financial Affairs, 02-Enterprise, 03-Competition, 12-Internal Market, and 20-Trade. Detailed information is provided in **Table 10.1** on the activities covered, the spending for the year and the management type involved.

Table 10.1 — 2008 payment and commitment appropriations

(million euro)

| Budget Title                            | Policy area                    | Description  | Payments made in 2008 | Budget Management Mode        |
|---|--------------------------------|--|-----------------------|-------------------------------|
| 1                                       | Economic and Financial Affairs | Administrative expenditure <sup>(1)</sup>  | 59                    | Centralised direct            |
|   |                                | Economic and monetary union  | 13                    | Centralised direct            |
|   |                                | International economic and financial affairs   | 42                    | Centralised direct            |
|   |                                | Financial operations and instruments   | 172                   | Centralised indirect or joint |
|   |                                | <b>286</b>   |                       |                               |
| 2                                       | Enterprise                     | Administrative expenditure <sup>(1)</sup>  | 110                   | Centralised direct            |
|   |                                | Competitiveness, industrial policy, innovation and entrepreneurship                  | 94                    | Centralised direct            |
|   |                                | Internal market for goods and sectoral policies                                      | 142                   | Centralised direct            |
|   |                                | Cooperation — space and security   | 131                   | Centralised direct            |
|   |                                | <b>477</b>   |                       |                               |
| 3                                       | Competition                    | Administrative expenditure <sup>(1)</sup>  | 79                    | Centralised direct            |
|   |                                | Cartels, anti-trust and liberalisation   | 8                     | Centralised direct            |
|   |                                | <b>87</b>  |                       |                               |
| 12                                      | Internal Market                | Administrative expenditure <sup>(1)</sup>  | 52                    | Centralised direct            |
|   |                                | Policy strategy and coordination for the Directorate-General for the Internal Market | 6                     | Centralised direct            |
|   |                                | Internal market for services   | 0                     | Centralised direct            |
|   |                                | <b>58</b>  |                       |                               |
| 20                                      | Trade                          | Administrative expenditure <sup>(1)</sup>  | 63                    | Centralised direct            |
|   |                                | Trade policy   | 13                    |                               |
|   |                                | <b>76</b>  |                       |                               |
| <b>Total</b>                            |                                |  | <b>984</b>            |                               |
| <i>Total administrative expenditure</i> |                                |  | 363                   |                               |
| <i>Total operational expenditure</i>    |                                |  | 621                   |                               |
| <b>Total payments for the year</b>      |                                |  | <b>984</b>            |                               |
| <b>Total commitments for the year</b>   |                                |  | <b>1 131</b>          |                               |

<sup>(1)</sup> The audit of administrative expenditure is reported on in Chapter 11.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.3. The main programmes in this policy group, accounting for almost 80 % (or 493 million euro) of the group's total operational expenditure, are financed by 01-Economic and Financial Affairs and 02-Enterprise policy areas. These programmes are presented in **Table 10.2**.

**Table 10.2 — Main programmes of the policy group Economic and Financial Affairs**

| Budget Title | Programmes   | Payments 2008<br>(million euro) | % of the total operational expenditure |
|--------------|--|---------------------------------|--|
| 01           | Financial instruments under Competitiveness and Innovation Framework Programme (CIP) and Multiannual Programme for Enterprise and Entrepreneurship (MAP) | 139                             | 22 %                                   |
| 01           | Macroeconomic assistance   | 41                              | 7 %                                    |
| 02           | Funding of EU Agencies <sup>(1)</sup>  | 111                             | 18 %                                   |
| 02           | Seventh Framework Programme for research and technological development (FP7)   | 77                              | 12 %                                   |
| 02           | Competitiveness and Innovation Framework Programme (CIP) — Entrepreneurship and Innovation Programme (EIP)   | 76                              | 12 %                                   |
| 02           | Sixth Framework Programme for research and technological development (FP6)   | 49                              | 8 %                                    |
| <b>Total</b> |  | <b>493</b>                      | <b>79 %</b>                            |

<sup>(1)</sup> The two EU agencies are the European Chemicals agency (ECHA) and the European Medicines agency (EMA). The Court issues annual audit reports concerning both agencies.

10.4. The CIP and MAP programmes financed by the 01-Economic and Financial Affairs policy area aim to support small and medium-sized enterprises (SMEs) with access to equity, venture capital and loan finance, through Community financial instruments operated on behalf of the Commission by the European Investment Fund (EIF) <sup>(1)</sup>. The Macroeconomic assistance is a financial instrument for balance-of-payments support to third countries. It takes the form of medium/long term loans and/or grants. The assistance is granted, provided that economic and financial policy conditions are complied with.

10.5. The aim of the Entrepreneurship and Innovation Programme (EIP), which is financed by 02-Enterprise policy area, is to foster the competitiveness of enterprises, and in particular SMEs, so as to promote innovation, including eco-innovation, and to support enterprise and administrative reform.

<sup>(1)</sup> The EIF is the Community's specialised institution for providing venture capital and guarantee instruments for SMEs. These programmes are managed by the EIF under 'fiduciary and management agreements'.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.6. The aim of the actions carried out under the Seventh Community Framework Programme (2007-2013) is to support a European space programme and to develop technologies and knowledge for the protection of citizens from threats such as terrorism as well as from the impact and consequences of incidents such as natural disasters or industrial accidents. Besides support to European space projects, the Sixth Community Framework Programme (2002-2006) also financed specific actions to promote technological innovation, the exploitation of research results and the setting-up of technology businesses within the Community and all its regions.

**Audit scope**

10.7. This specific assessment is based on:

- (a) substantive testing of a representative statistical sample of 80 payments made by the Commission in 2008;
- (b) an assessment of the effectiveness of the following supervisory and control systems:
  - *ex-ante* desk checks for payments of grants and procurement contracts by the Commission, mainly through an examination of a sample of 120 payments;
  - audit certification of project cost statements provided by independent auditors;
  - *ex-post* controls, notably in the context of the FP6 audit strategy.

10.8. Payments examined included grants to final beneficiaries<sup>(2)</sup>, transfers to the fiduciary accounts<sup>(3)</sup> under the MAP and the CIP programmes, the EIF capital increase, transfers to the two EU Agencies and payments related to procurement or service contracts.

10.9. The audit was carried out at the level of the final beneficiary for 10 out of the 80 payments. The remaining transactions, including the payments to the fiduciary accounts under MAP and CIP and to the two EU agencies, were audited at the level of the Commission.

<sup>(2)</sup> Mostly advances for FP7 and interim and final payments for FP6.

<sup>(3)</sup> For the execution of the programmes, funds are transferred from the General Budget to fiduciary accounts held by the EIF to cover possible future payments.

## THE COURT'S OBSERVATIONS

10.10. The sample of payments mentioned in paragraph 10.7(a) also included one payment made to the OECD under a grant agreement<sup>(4)</sup>. The Commission on behalf of the European Communities entered into an agreement with OECD to set up the administrative matters for Community projects implemented by the OECD. The OECD is interpreting this agreement in a way which limits the Court's audit powers. In this specific case, the audit was performed by the OECD's internal auditor. The Court assessed the results of this audit by examining the audit working papers and all available supporting documentation.

**Main risk to regularity**

10.11. The majority of the grants under the policy group are paid out on the basis of cost statements presented by the beneficiaries. The main risk to legality and regularity is that eligible costs in the cost statements are overstated and that this is not detected by the Commission's supervisory and control systems. In view of the significant number of cost statements, the Commission is not in a position to check each one on the spot at the level of the beneficiary. The risk to regularity of payments made on the basis of cost statements is therefore assessed by the Court as high.

**Regularity of transactions**

10.12. The results of the transaction testing are summarised in **Annex 10.1**. The Court found that 14 % of the payments (11 out of 80) were affected by 13 errors. 46 % of these errors (6 out of 13) concerned the eligibility of declared expenditure. The most likely error rate identified by the Court lies slightly above 2 %. Most of these errors related to projects financed by the Sixth Framework Programme for research and technological development (FP6). This outcome confirms the risk assessment mentioned in paragraph 10.11 and is corroborated by the findings of the Commission's *ex-post* controls<sup>(5)</sup>, the Court's conclusion in Chapter 10 of the 2007 Annual Report and the Court's audit results reported in Chapter 7.

## THE COMMISSION'S REPLIES

**10.10.** *In the Commission's view, the 'best endeavours' clause contained in the cover note to the interpretative letter dated 17 November 1994 does not limit the Court's powers to proceed with checks, as laid down by the Treaty. The Commission will contact the OECD to ensure the Court's audit powers are not limited.*

**10.11.** *The risk that beneficiaries could overstate costs is largely due to the inherent complexity of the funding mechanisms provided by the applicable regulatory framework which are based on reimbursement of the actual costs. This complexity also limits the scope of the desk reviews that can be conducted before reimbursement of expenditure.*

*The majority of errors are attributable to misdeclaration of costs related to personnel and overheads. The Commission cannot detect these errors before making the payment and has therefore put in place a control strategy and developed *ex-post* audits. The corrective action taken is aimed at reducing the error rate. Further corrective action has been initiated for FP7, in particular concerning audit certification. The Commission recovers any amount overpaid to the audited beneficiaries.*

**10.12.** *The Commission disagrees with the Court's quantification of two cases, where work was performed, results of the work accepted and costs were incurred, therefore justifying a partial reimbursement. However the Court, based on its interpretation of 'contractual agreement' in these two cases, considered most of the declared costs ineligible. If the Commission's assessment of the rate of error for these two cases is taken into account the overall error rate for this policy area would fall below 2 %.*

<sup>(4)</sup> This grant agreement provides Community support to the project 'better regulation in Europe and OECD assessment of the regulatory capacity in 15 Member States'.

<sup>(5)</sup> See reservation concerning the rate of residual errors with regard to the accuracy of cost claims in FP6 grants in the Declaration of the Authorising Officer by Delegation in the 2008 Annual Activity Report of the Directorate General Enterprise and Industry.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.13. As can be seen in **1.3** of **Annex 10.1**, the most likely error rate for this policy group is mostly attributable to the errors found on FP6 payments. Most of the errors concern the reimbursement by the Commission of overstated eligible costs declared by beneficiaries in their cost statements. The errors found were due to:

- inadequate or missing supporting evidence to justify the costs claimed (e.g. no invoice);
- the use of budgeted figures or average costs which did not comply with the contractual requirements to use actual costs;
- claiming costs incurred outside the eligibility period;
- inclusion of various ineligible costs (e.g. costs incurred by a third-party) or non-existing costs;
- incorrect calculation of the final grant amount by the Commission.

10.14. 38 % of the errors (5 of the 13) (all classified as other compliance issues) affected the policy area 20-Trade and were caused by the absence of documents which form part of the procurement procedures. This should have been detected by the Commission's supervisory and control systems.

**10.13.** *The Court's assessment is based on the audit of 80 transactions, in which only five quantifiable errors were observed in payments under FP6. Furthermore FP6 represents only 8 % of the payments (refer to table 10.2 — Main programmes of the policy group Economic and Financial Affairs). All findings concerning FP6 expenditure are similar to those in Chapter 7.*

*The Commission is taking the necessary action to recover the amounts of funding relating to ineligible costs.*

- *The Commission agrees that supporting evidence was not always available. Nevertheless it considers that the errors have a financial impact lower than that considered by the Court. Even though some costs were not fully supported by formal documents, the work had been carried out and there was proof of payment.*
- *The Commission agrees with this finding, which is related to the specific risk mentioned by the Court in paragraph 10.11. The Commission has put in place a comprehensive ex-post control strategy aiming at reducing significantly the error rate.*
- *The Commission agrees with this finding, which is related to the specific risk mentioned by the Court in paragraph 10.11. The Commission has put in place a comprehensive ex-post control strategy aiming at reducing significantly the error rate.*
- *In two of the projects where errors were observed, the beneficiaries of the EU grant were SMEs with a complex legal structure. Although no employment contracts were available, evidence was produced of a contractual relationship between the beneficiary and the people carrying out the work.*
- *The control measures in place at the Commission are designed to avoid this type of situation.*

**10.14.** *The Commission accepts the Court's findings, but would draw attention to the fact that most of the errors noted by the Court relate to procurement procedures which took place in 2004 or 2005.*

*Since then control procedures have been significantly tightened up and the Commission would not expect such errors to recur. A recent audit on procurement procedures in DG TRADE carried out by the IAC confirmed this positive assessment.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Effectiveness of systems**

10.15. The Commission established various controls in order to mitigate the risk of irregular payments being made. The main ones are:

- *ex-ante* desk checks on payment requests;
- audit certification of project cost statements; and
- *ex-post* controls following interim or final payments carried out on a sample of beneficiaries.

10.16. The results of the Court's assessment of the effectiveness of the supervisory and control systems are summarised in **Annex 10.1, Part 2**. The assessment focused on three policy areas which accounts for almost all of the sampled payments in 2008.

**10.16.** *The Commission considers that the ex-ante checks on payments are effective. The weaknesses observed by the Court, concerning the ticking of boxes in checklists have no significant impact on the effectiveness of the supervisory and control systems (see also paragraph 10.19).*

***Ex-ante desk checks on payment requests***

10.17. The purpose of the *ex-ante* desk checks is to verify whether the operation is legal, regular and compliant with the principle of sound financial management. They also aim to ensure that all tasks were carried out correctly and in conformity with the requirements of the contract or the grant agreement, before the payment was made.

10.18. The Court assessed the financial circuits at the Directorates-General charged with the implementation of the policy areas 01-Economic and Financial Affairs, 02-Enterprise and 20-Trade<sup>(6)</sup>. The consistent application of the financial circuit and the adequacy of the *ex-ante* desk checks were examined for each payment selected for these three DGs in the sample of the 80 payments mentioned in paragraph 10.7. The additional sample of 120 payments was used to assess the effectiveness of the operation of the *ex-ante* controls in three programmes managed by DG Enterprise and Industry<sup>(7)</sup> and in 30 payments made by DG Trade.

<sup>(6)</sup> The audit was confined to the two Directorates-General of the largest policy areas and to one of the small policy areas.

<sup>(7)</sup> The three programmes managed by DG Enterprise and Industry were grants paid under FP6, the enterprise networks financed under MAP and grants paid for standardisation and approximation of legislation.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.19. The Court found that in the case of the 02-Enterprise policy area, checklists and calculation sheets were used aiming, amongst other things to identify and prevent errors on cost statements. However, the following weaknesses were noted:

— sufficient details regarding the controls carried out by the *ex-ante* verification agents were not always provided <sup>(8)</sup>;

— the checklist used to review the external audit certificates submitted by the beneficiaries did not include an overview of the work performed on each certificate examined; and

**10.19.** *The Commission is convinced that the control systems in place are cost-efficient and proportional and that the checklists are an essential tool for processing transactions. The weaknesses noted do not have any implications for consistent application of the financial circuit and the adequacy of the ex-ante desk checks.*

*A checklist is not an aim in itself. The primary purpose of the checklists is to ensure that all the necessary checks are carried out.*

— *All controls are proportionate and relevant to the legality and regularity of the transaction. The assessment of the Court applies to: (i) checklists where the second verification agent just signed and did not tick individual boxes and (ii) to five instances where the Court considered boxes had been ticked erroneously. The Commission does not consider any of these findings to have significant impact on the effectiveness of the supervisory and control systems. More specifically:*

*(i) The design of checklists is the responsibility of the authorising officer by delegation. The signature of the verification agent confirms that the controls have been carried out. Establishing checklists on which the controls are confirmed by ticks or a signature has no impact on the effectiveness of the ex-ante controls.*

*(ii) In some cases boxes on checklists might not have been ticked correctly but there is no evidence that — beyond this formality with no financial impact — the checks were not performed correctly.*

*Further to all this, a reminder was made to all staff participating in workflows to ensure that all checklists are comprehensibly filled after checks have been made.*

— *The audit certificates for each partner bound by the contract are already included in the file for ex-ante verification. The checklist used to review the audit certificate summarises the verifications carried out.*

*Establishment of checklists corresponding to the level of risk involved is the responsibility of the authorising officer by delegation. The Commission does not consider it cost-effective to have a separate checklist for each individual audit certificate.*

<sup>(8)</sup> For instance, in the case of the standardisation and approximation of legislation payments, the checklist used did not provide a trace of the work performed by the *ex-ante* verification agent and in the case of FP6 payments, checks were indicated as performed, although on the basis of the available documentation, they could not have been carried out.

## THE COURT'S OBSERVATIONS

— two instances of insufficient *ex-ante* controls exercised over the transfer of funds to an EU Agency which led to financial corrections at a later stage.

10.20. The Court also noted that 30 % of the payments made under two programmes<sup>(9)</sup> were not made within the payment deadline specified in the Implementing Rules. In the case of the third programme examined no delays were noted.

10.21. As regards the grants and payments executed for policy areas 01-Economic and Financial Affairs and 20-Trade, no significant weaknesses were found in the operation of the *ex-ante* desk checks.

***Audit certification of project cost statements***

10.22. Article 180 of the Implementing Rules<sup>(10)</sup>, requires a certificate to be issued by an approved auditor for cost statements above a certain threshold, confirming the accuracy, occurrence and eligibility of the declared costs. These audit certificates are a key control for the Commission in projects financed under the policy area 02-Enterprise.

## THE COMMISSION'S REPLIES

— *The control measures in place at the Commission are designed to avoid this type of situation to the greatest possible extent.*

*In one of the two instances the error was detected immediately after payment, which demonstrates that sufficient controls are already in place to ensure an adequate control environment. Corrective action had been taken before the Court started to analyse the file. There was no financial risk, as these were pre-financing payments and as EU agencies reimburse, year by year, any amounts received in excess of their expenditure.*

**10.20.** *The Commission has significantly reduced payment delays and continues working towards reducing late payments even more. The payments in the sample to which the Court refers were made by Enterprise and Industry DG, which has achieved again a marked improvement in the first half of 2009 (only 6 % of payments delayed) compared with the results of 2008 (13 % delayed) and 2007 (34 % delayed). This achievement was possible only after a wide range of measures were put in place to include clearer and fully revised procedures, efficient *ex-ante* controls and simplified workflows.*

<sup>(9)</sup> The two programmes are the FP6 and the standardisation and approximation of legislation.

<sup>(10)</sup> Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities, as amended (O) L 357, 31.12.2002, p. 1).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.23. For the payments audited at beneficiary level for which a certificate had been provided, the Court compared the results of its own audit with the certificate. In 71 % of the cases (5 out of 7) for which an unqualified opinion had been issued by the approved auditor, the Court detected quantifiable errors<sup>(11)</sup>. The majority of those projects were financed under the FP6. This finding is consistent with the previous year's results<sup>(12)</sup> and with the results of Chapter 7, and shows that audit certificates are only partially reliable.

**Ex-post controls**

10.24. Primarily due to the high number of payments, the Directorates-General in charge of the implementation of the policy areas 01-Economic and Financial Affairs and 02-Enterprise have established *ex-post* control functions.

10.25. Regarding policy area 01-Economic and Financial Affairs, the Court found that no work programme for *ex-post* controls had been established for 2008. Most of the resources used for *ex-post* controls were dedicated to only one specific, but nonetheless important, control and consequently there is a backlog of pending controls.

**10.23.** The Commission shares the Court's concern about the correctness of the FP6 audit certificates which do not fully provide the additional assurance initially expected regarding the legality and regularity of cost declarations. It is, however, clear that this instrument has made a major contribution to prevention and early correction of errors, resulting in a significant decrease in the error rates in FP6 compared with FP5.

**10.24.** As far as Directorate-General in charge of the implementation of the policy area 02-Enterprise is concerned, *ex post* control functions were put in place because they are a necessary element of the integrated internal control framework if a significant part of expenditure is based on grants in the research domain.

**10.25.** Part of the backlog was cleared in 2008 and the rest should be cleared during 2009.

A revised work programme endorsed by the Internal Control Management Group of DG ECFIN in July 2007 set out the priorities ahead, the first of which were the checks on the additionality requirements in the SME Guarantee Facility involving large amounts. This revised work programme stressed the uncertainties regarding the timeframe of the controls.

At the end of 2007, these top-priority checks were still pending for various reasons relating to the complexity of the issues at stake. Consequently, as the priorities set in July 2007 were still valid, the agreed strategy was to complete the 2007 programme.

Concerning the backlog, the specific control referred to by the Court was extremely important and has led to significant improvements in the integrated control structure in place for the successor programme.

Additional control work was carried out concerning the Business and Consumers Surveys and the PRINCE Programme.

<sup>(11)</sup> The errors related to the incorrect calculation of eligible costs (e.g. over declared personnel costs) and ineligible costs (e.g. expenditure not supported by invoices). These errors should have been identified by the approved auditors.

<sup>(12)</sup> See Annual Report concerning the financial year 2007, paragraphs 10.27 to 10.30 (OJ C 286, 10.11.2008).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.26. Regarding policy area 02-Enterprise, the cornerstone of the supervisory and control system for research expenditure is its programme of *ex-post* (i.e. after reimbursement) financial audits at beneficiaries. The audits are performed by Commission auditors and by external audit firms under the supervision of the Commission. The purpose of *ex-post* audits is to detect and correct errors which have not been prevented or detected by earlier controls. The Court reports on the *ex-post* audits on projects financed under FP6 in paragraphs 7.28 to 7.34 of Chapter 7.

**Conclusions and recommendations****Conclusions**

10.27. Based on its audit work, the Court concludes that, except for the payments made under the Sixth Framework Programme for research and technological development (FP6) <sup>(13)</sup>, the payments for the year ended 31 December 2008 for policy group Economic and Financial Affairs were free from material error.

10.28. The Court examined three supervisory and control systems for policy group Economic and Financial Affairs. While two were assessed as effective, one was assessed as only partially effective <sup>(14)</sup> in ensuring the legality and regularity of payments.

**Recommendations**

10.29. The Commission should intensify its actions with the aim of reducing the errors arising as a result of the declaration of ineligible costs in the beneficiaries' cost statement under the Sixth and Seventh Framework Programmes for research and technological development.

**10.27.** *Because FP6 represents only 8 % of the payments (refer to table 10.2 Main programmes of the policy group Economic and Financial Affairs) the Commission considers that the overall transaction error rate in this policy area, which taken as a whole, is free of material error.*

*As far as FP6 payments are concerned the findings and conclusions of the Court in this chapter are similar to those in Chapter 7.*

**10.28.** *The Commission considers that the systems of control in place are adequate and that the checklists contribute to the essential control in the processing of transactions. The weaknesses noted do not have an implication on the consistent application of the financial circuit and the adequacy of the ex-ante desk checks.*

**10.29.** *The Commission will check which further action can be taken to reduce errors, taking into account cost-benefit considerations. In general, the Commission agrees on the general need for more in depth action and asks the legislator to support the adaptations to the legal basis that would be necessary in this respect for preparation of the 8th Framework Programme. FP7 has brought about a number of significant simplifications already and the Commission is continuing to work on simplification of the cost reimbursement system.*

<sup>(13)</sup> The payments of the Sixth Framework Programme for research and technological development account for almost 8 % of the policy group's total operational expenditure.

<sup>(14)</sup> This is mostly due to the supervisory and control systems of the Sixth Framework Programme for research and technological development.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.30. Two of the main reasons for errors in cost statements are: a) the persistent failure of the beneficiaries to understand the eligibility rules and b) the fact that these rules are not strictly applied. In this respect, the Commission should:

- increase its information efforts to raise the beneficiaries' awareness of the eligibility rules; and
- actively disseminate to the certifying auditors a typology of most frequent errors in order to raise their awareness and improve the reliance that can be placed on the audit certificates.

10.31. In addition, the Commission should further improve the application of its supervisory and control systems, in particular by further enhancing the quality of its *ex-ante* procedures.

## RESULTS OF THE AUDIT OF THE GUARANTEE FUND FOR EXTERNAL ACTIONS

10.32. The purpose of the Guarantee Fund for External Actions<sup>(15)</sup> (the Fund), which guarantees loans to third countries, is to reimburse the Community's creditors<sup>(16)</sup> in the event of a beneficiary's defaulting on a loan and to avoid direct calls on the Community budget. The administrative management of the Fund is carried out by the Directorate-General for Economic and Financial Affairs (DG ECFIN) while the European Investment Bank (EIB) is responsible for its treasury management.

**10.30.** Many of the errors made by the beneficiaries cannot be detected by the Commission before making the payments. In order to overcome this situation, the Commission implements an *ex-post* control strategy to ensure the legality and regularity of the payments on a multiannual basis. It is based on systematic detection and correction of any errors which could not be identified before making the payment. This is achieved by stepping up the *ex-post* audit effort which is a key component of the control strategy and thoroughly recovering any amount found to be overpaid to audited beneficiaries.

- Further steps will be taken to inform beneficiaries and certifying auditors about the requirements to use actual costs and to provide supporting evidence to substantiate the costs claimed and also about frequently committed errors.
- When significant errors in audit certificates are detected, the certified auditors are informed by letter about the correct amounts and methodology and are invited to take this into account for subsequent certifications.

As the choice of the certifying auditor is free for beneficiaries, the Commission will remind beneficiaries, in writing, of the need to inform their certifying auditors of the specific rules and regulations that govern the eligibility of costs in the research programmes and about the information that is available on CORDIS about the most frequent errors.

**10.31.** The Commission considers that the supervisory and control systems are adequate, cost-effective and rigorously applied.

<sup>(15)</sup> Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994 establishing a Guarantee Fund for external actions (OJ L 293, 12.11.1994, p. 1), as last amended by Regulation (EC, Euratom) No 89/2007 (OJ L 22, 31.1.2007, p. 1).

<sup>(16)</sup> Principally the EIB, but also Euratom external lending and EC macro financial assistance (MFA) loans to third countries.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.33. At 31 December 2008, the Fund's total resources were 1 091 million euro, compared with 1 152 million euro at 31 December 2007. The decrease in the Fund's total resources is mainly due to the Fund's repayment of 126 million euro to the Community budget. The repayment was the result of the value of the Fund at 31 December 2006 being more than the target amount<sup>(17)</sup>. No guarantee calls were made to the Fund in the year under review.

10.34. The EIB and the Commission use a benchmark index to review the Fund's annual performance. The return on the Fund's portfolio in 2008 amounted to 6,4 %, compared with a benchmark return of 7,5 %. The EIB attributes this relative underperformance of 1,1 % to the fact that the financial instruments included in the benchmark were less affected by the financial crisis.

10.35. The Court identified weaknesses in the controls performed by DG ECFIN on the investment restrictions set by the management agreement. However, in the cases reviewed there was no impact on the results of the compliance controls.

10.36. Overall, the Court considers that the Guarantee Fund was managed during 2008 in a satisfactory manner and that appropriate actions have been taken to monitor the impact of the financial crisis on the Fund's portfolio.

**10.35.** *Relevant controls on compliance with investment restrictions set by the Management Agreement have been performed by DG ECFIN regularly. They showed that the investments did comply with the relevant investment restrictions set in the Agreement. Following the Court's audit, a further control has been introduced in order to enhance compliance even on marginal issues falling outside the restrictions set by the Management Agreement.*

## RESULTS OF THE AUDIT OF THE ECSC IN LIQUIDATION

10.37. 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<sup>(18)</sup>. 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.

<sup>(17)</sup> The target amount is set at 9 % of the outstanding loans to third countries granted or guaranteed by the Community plus unpaid interest due. Regulation (EC, Euratom) No 89/2007 states that any surplus between the target amount and the value of the Fund's net assets in year n-1 shall be paid to the general budget of the European Union in year 'n+1'.

<sup>(18)</sup> 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).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

10.38. At 31 December 2008, the total assets of the ECSC i.L. were 2 045 million euro, compared with 2 152 million euro at 31 December 2007. The net loss for 2008 was 14,8 million euro compared with a net profit of 5,3 million euro in 2007. The net loss was mainly due to a loss in the fair value of the financial derivatives used for hedging purposes in the ECSC i.L.'s financial operations.

10.39. The net revenue of ECSC i.L. investments in 2008 amounted to 56 million euro and will be made available to the Community budget for financing research for coal and steel projects. The Court noted that as at 31 December 2008 the unused budget available for financing coal and steel research had accumulated to 235 million euro <sup>(19)</sup>.

10.40. The performance of the ECSC i.L. portfolio was 5,4 % for the year 2008 while the return of the benchmark, serving as reference rate for the ECSC i.L., was 7,4 %. The relative underperformance of 2 % was mainly due to the lower return on bonds from new EU Member states which were not included in the benchmark.

10.41. The winding-up of the financial operations of the ECSC i.L. is proceeding in compliance with the relevant legislation, including the multiannual financial guidelines. The Court noted that appropriate actions had been taken to monitor the impact of the financial crisis on the assets of the ECSC i.L.

## FOLLOW-UP OF PREVIOUS OBSERVATIONS

10.42. See *Annex 10.2*.

**10.38.** *The net loss from derivatives relates mainly to a book loss on a cross-currency swap transaction (EUR/GBP) which served to hedge a loan-related currency position entered into by the ECSC over 19 years ago. The swap contract in question expired on 13 March 2009 with no actual loss being made on this hedging operation. No other swap transactions are on the books of ECSC i.L.*

**10.39.** *The Research Programme financed by DG RTD's Research Fund for Coal and Steel (RFCS) is used exclusively for research, outside the Framework Programme, in sectors related to the coal and steel industry, in accordance with the its legal basis (the Protocol annexed to the Treaty establishing the European Community and acts adopted subsequently on this basis). The amount of EUR 235 million includes:*

- *on the one hand, allocations for 2010 (EUR 56 million) and allocations for 2009 which have not yet been committed; and*
- *on the other hand, outstanding amounts related to contracts signed since 2003 (the start of the RFCS Research Programme) for which closure of the accounts has not yet been completed.*

**10.40.** *The ECSC i.L. portfolio regularly allocates part of its investments to securities issued by the new Member States, with the purpose of both improving diversification and targeting some extra return over the long run.*

*The financial crisis (which started in July 2007 and further developed into 2008) led to a flight to quality/liquidity process that was the main driver of relative performance over that period. In this process, securities issued by new Member States (perceived by the market as less liquid and secure than those of 'core' issuers like Germany and France) were harder hit.*

*The ECSC i.L. portfolio, however, did fairly well in terms of absolute return, despite the financial crisis, posting the third-best result in absolute terms since the inception of performance measurement: + 5,4 %, a result beaten only in 2002 (+ 6,3 %) and 2004 (+ 5,8 %).*

<sup>(19)</sup> Including the allocations for 2009 of 52 million euro and for 2010 of 54 million euro.

## ANNEX 10.1

## PART 1: MAIN FEATURES OF SAMPLE BASED TRANSACTION TESTING

## 1.1 — Size of the sample

| Year | Number of transactions tested |
|------|-------------------------------|
| 2008 | 80                            |
| 2007 | 55                            |

## 1.2 — Structure of the sample

| Percentage of transactions tested which were | 2008                           |             |             |                 |            |              | 2007         |
|--|--------------------------------|-------------|-------------|-----------------|------------|--------------|--------------|
|  | Economic and Financial Affairs | Enterprise  | Competition | Internal Market | Trade      | Total        |              |
| Final/interim payments                       | 35 %                           | 16 %        | 1 %         | 0 %             | 4 %        | 56 %         | 72 %         |
| Advances                                     | 0 %                            | 44 %        | 0 %         | 0 %             | 0 %        | 44 %         | 27 %         |
| <b>Total</b>                                 | <b>35 %</b>                    | <b>60 %</b> | <b>1 %</b>  | <b>0 %</b>      | <b>4 %</b> | <b>100 %</b> | <b>100 %</b> |

## 1.3 — Frequency and estimated impact of errors

| Errors   | 2008   |                     |                        | 2007      |
|--|--|---------------------|------------------------|-----------|
|  | Economic and Financial Affairs, Trade, Competition and Internal Market | Enterprise          | Total                  |           |
| <b>Frequency</b> of transactions tested which were affected by errors                  | 9 % {3}  | 17 % {8}            | 14 % {11}              | 7 % {4}   |
| <b>Frequency</b> of errors which are quantifiable                                      | 0 % {0}  | 88 % {7}            | 54 % {7}               | 43 % {3}  |
| <b>Impact of quantifiable errors:</b><br>Most likely error rate falls in the range (*) | N/A  | Between 2 % and 5 % | Between 2% and 5% (**) | Below 2 % |

(\*) The Court distinguishes three ranges for most likely error rate: below 2 %, between 2 % and 5 %, above 5 %.

(\*\*) The Sixth Framework Programme for research and technological development (FP6) accounts for a disproportionate large part of the overall error rate (see paragraph 10.27).

The figures in { } brackets are absolute numbers.

## 1.4 — Types of errors in the sample

| Percentage and number of errors in transactions tested which concern | 2008   |          |              |          |              |           | 2007         |          |
|--|--|----------|--------------|----------|--------------|-----------|--------------|----------|
|  | Economic and Financial Affairs, Trade, Competition and Internal Market |          | Enterprise   |          | Total        |           |              |          |
| Eligibility  | 0 %  | 0        | 75 %         | 6        | 46 %         | 6         | 29 %         | 2        |
| Occurrence   | 0 %  | 0        | 0 %          | 0        | 0 %          | 0         | 0 %          | 0        |
| Accuracy   | 0 %  | 0        | 12,5 %       | 1        | 8 %          | 1         | 29 %         | 2        |
| Other  | 100 %  | 5        | 12,5 %       | 1        | 46 %         | 6         | 42 %         | 3        |
| <b>Total</b>   | <b>100 %</b>   | <b>5</b> | <b>100 %</b> | <b>8</b> | <b>100 %</b> | <b>13</b> | <b>100 %</b> | <b>7</b> |

## PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

## 2.1 — Assessment of selected supervisory and control systems

| System concerned   | Key internal controls (Commission) |                     |                         | Overall assessment |
|--|------------------------------------|---------------------|-------------------------|--------------------|
|  | Ex-ante checks                     | Audit Certification | Ex-post financial audit |                    |
| Payments under policy area 01 – Economic and Financial Affairs |                                    | N/A                 |                         |                    |
| Payments under policy area 02 – Enterprise                     |                                    |                     | N/A                     |                    |
| Payments under policy area 20 – Trade                          |                                    | N/A                 | N/A                     |                    |

## Legend:

|     |  |
|-----|--|
|     | Effective                                      |
|     | Partially effective                            |
|     | Not effective                                  |
| N/A | Not applicable: does not apply or not assessed |

## FOLLOW-UP OF THE COURT'S PREVIOUS OBSERVATIONS

| Court observation  | Action taken  | Court analysis  | Commission reply   |
|--|---|---|--|
| <b>1. Risk capital operations (RCO) — Provision of risk capital through investment funds</b>   |   |   |  |
| <p>The Court's audit revealed that the investment funds included in the RCO portfolio did not fully comply with the MEDA Regulation as:</p> <ul style="list-style-type: none"> <li>— the portfolio included investment funds which were located outside the EU;</li> <li>— investment funds made investments outside the list of eligible partner territories and countries. This was notably due to the fact that the investment rules of the funds did not include the necessary investment restriction.</li> </ul> <p>In addition, 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.</p> <p>(Annual Report concerning the financial year 2006, paragraphs 11.8 and 11.9)</p> | <p>Since 2003 the Commission ensures that the eligibility provisions of the MEDA Regulation regarding the geographical location of both the investment funds and the investment funds' target region are monitored at the time of approval.</p> <p>The Commission also intervenes at the time of approval when it believes that cross-investments could become a problem.</p> <p>For both 2007 and 2008, the Commission also received from the European Investment Bank (EIB) annual reports on RCO providing information on the actual investments made.</p> | <p>The Commission's monitoring controls have significantly improved at the time of investment fund approval however, monitoring of the geographical location and cross investments during the life of the funds should be further enhanced.</p> <p>In addition, the annual reports provided by the EIB do not give detailed information on the investments financed by global loans. Thus, the Commission cannot verify the respect of these provisions as far as global loans are concerned.</p> | <p><i>The new Framework Agreement between the EIB and the Commission, currently under negotiation, will ensure that the operational and accounting information provided by the EIB will allow better monitoring of the geographical location and cross-investments during the life of the funds. This will include information regarding global loans.</i></p> |
| <b>2. Risk capital operations (RCO) — Weaknesses in the valuation of RCO</b>   |   |   |  |
| <p>RCO are valued by the Commission at historic costs less any provisions for impairment. The provisions for impairment were based on the provisional or definitive write-offs. This method was 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 showed that the convention between the Commission and the EIB needed to be updated so that the Commission receives all relevant information in time to allow it to take it into</p>  | <p>In its reply to the Court's observation, the Commission stated that the EIB and the Commission were following developments and were reviewing the situation together, looking for the best cost-benefit solution. As at the first quarter of 2009, the Commission and the EIB are still reviewing the situation and trying to find a cost-effective solution.</p>  | <p>The Court noted that progress has not been made. The Commission should aim to resolve this issue prior to the closing of the 2009 financial year.</p>  | <p><i>The Commission's requirement will be included in the new Framework Agreement.</i></p>  |

| Court observation   | Action taken  | Court analysis  | Commission reply  |
|---|---|---|---|
| <p>account in the application of its accounting rules. Furthermore, the Commission should more actively monitor the application of the convention rather than rely entirely on the information provided by the EIB.</p> <p>(Annual Report concerning the financial year 2006, paragraph 11.11)</p>  |   |   |   |
| <b>3. Reporting obligation towards the Budgetary Authorities</b>  |   |   |   |
| <p>Since the start of the MEDA programme in 1996 the Commission has been 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 did not provide sufficient information on progress achieved through the financial instruments.</p> <p>(Annual Report concerning the financial year 2006, paragraph 11.14)</p> | <p>The Commission continued to publish a general annual report on development cooperation and not a specific report for each legal basis.</p> | <p>The level of information provided on MEDA in the general annual reports is quite varied. The Court considers that the Commission should have provided sufficient information in annual reports as required by the MEDA Regulation.</p> | <p><i>In 2001 EuropeAid decided to produce a general report instead of a special report for each legal basis. This decision was taken in order to make better use of the limited human resources at its disposal. In subsequent years, EuropeAid took the budgetary authorities' observations into account when drafting this report.</i></p> |



## CHAPTER 11

**Administrative and other expenditure**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction  | 11.1-11.5        |
| Regularity of transactions                          | 11.6             |
| Compliance of systems with the Financial Regulation | 11.7             |
| Specific observations                               | 11.8-11.19       |
| Parliament  | 11.9             |
| Council   | 11.10            |
| Commission  | 11.11-11.13      |
| Court of Justice                                    | 11.14            |
| Court of Auditors                                   | 11.15            |
| European Economic and Social Committee              | 11.16            |
| Committee of the Regions                            | 11.17            |
| European Ombudsman                                  | 11.18            |
| European Data Protection Supervisor                 | 11.19            |
| Conclusions   | 11.20-11.21      |
| European Union agencies                             | 11.22-11.23      |
| European schools                                    | 11.24-11.25      |

## THE COURT'S OBSERVATIONS

## INTRODUCTION

11.1 This chapter presents the Court's specific assessment of administrative expenditure of the institutions. Detailed information is given in **Table 11.1** which sets out the institutions covered, the payments by spending year and the budget management mode.

**Table 11.1 — Breakdown of payments in policy area**

(million euro)

| Budget title                            | Policy areas                         | Description                         | Payments 2008 | Budget management mode |
|---|--------------------------------------|-------------------------------------|---------------|------------------------|
| 24-27 and 29                            | Administrative and other expenditure | European Parliament                 | 1 489         | Centralised direct     |
|   |                                      | Council                             | 618           | Centralised direct     |
|   |                                      | Commission                          | 5 867         | Centralised direct     |
|   |                                      | Court of Justice                    | 288           | Centralised direct     |
|   |                                      | Court of Auditors                   | 116           | Centralised direct     |
|   |                                      | Economic and Social Committee       | 114           | Centralised direct     |
|   |                                      | Committee of the Regions            | 79            | Centralised direct     |
|   |                                      | European Ombudsman                  | 8             | Centralised direct     |
|   |                                      | European Data Protection Supervisor | 4             | Centralised direct     |
| <i>Total administrative expenditure</i> |                                      |                                     | 8 583         |                        |
| <i>Total operational expenditure</i>    |                                      |                                     | 0             |                        |
| <b>Total payments for the year</b>      |                                      |                                     | <b>8 583</b>  |                        |
| <b>Total commitments for the year</b>   |                                      |                                     | <b>8 826</b>  |                        |

11.2. Administrative expenditure mainly comprises expenditure for human resources and expenditure for buildings, equipment, energy, communications, and information technology. This chapter also covers expenditure considered in the general budget as operational although its purpose and object is in most cases the functioning of the Commission's administration rather than policy delivery <sup>(1)</sup>.

<sup>(1)</sup> This expenditure includes the following titles of the general budget: title 24 ('fight against fraud'), title 25 ('Commission's policy coordination and legal advice'), title 26 ('Commission's administration'), title 27 ('budget') and title 29 ('statistics'). Some of these titles also include operational expenditure. Title 27 includes for 2008 an amount of 200 million euro as 'Temporary and lump-sum compensation for the new Member States'.



### THE COURT'S OBSERVATIONS

11.3. A sample of 57 transactions, drawn randomly from all the administrative expenditure referred to in paragraph 11.2 (see also **1.1** in **Annex 11.1**), was tested. In addition, the Court assessed the compliance of the supervisory and control systems applied by each institution with the requirements of the Financial Regulation. The Court also audited selected topics <sup>(2)</sup>.

11.4. The Court of Auditors is audited by an independent external audit firm <sup>(3)</sup> which issued an assurance report concerning the legality and regularity of the use of the Court's resources, and the control procedures in place for the period from 1 January 2008 to 31 December 2008 (see paragraph 11.15).

11.5. This chapter also gives information on the results of the Court's audits of the Agencies of the European Union and other decentralised bodies as well as of the European schools.

### REGULARITY OF TRANSACTIONS

11.6. The audit of the sample of 57 transactions found them to be free of material error.

### COMPLIANCE OF SYSTEMS WITH THE FINANCIAL REGULATION

11.7. The Court's audit of the compliance of the systems designed to ensure the regularity of transactions with the provisions of the Financial Regulation (see paragraph 11.3) found no material weakness.

---

<sup>(2)</sup> The selected topics audited are the following: procurement contracts in all the institutions except the European Ombudsman and the European Data Protection Supervisor; procurement management of Information Technology contracts at the Parliament, the Council, the Commission; extension of contracts at the Economic and Social Committee and the Committee of the Regions; late payment penalties in all the institutions; payments on carried-over appropriations at the Parliament; transfers of acquired pension rights in all the institutions except the European Ombudsman and the European Data Protection Supervisor.

<sup>(3)</sup> PricewaterhouseCoopers, Société à responsabilité limitée, Réviseur d'Entreprises.

## THE COURT'S OBSERVATIONS

## SPECIFIC OBSERVATIONS

11.8. The specific observations that follow and which are presented by institution are based on the Court's audit of the supervisory and control systems applied by each institution and on the selected topics (see paragraph 11.3). These findings do not call into question the assessments set out in paragraphs 11.6 and 11.7.

**Parliament**

11.9. Parliament signed a contract in December 2007 concerning the fitting-out of premises which provided that the invoices were to be presented monthly after each period, on the basis of work completed. The audit of this expenditure showed that one invoice dated 17 November 2008 had been endorsed 'certified correct' and 'passed for payment', when in fact it represented advances for works not yet performed. The total amount paid irregularly in advance was 1 547 915 euro.

**11.9. EUROPEAN PARLIAMENT REPLIES**

*Invoice No 8101025356 in the sum of EUR 1 547 915,33 was created on and dated 17 November 2008 and officially registered by the Accounting Officer on 19 November 2008. That sum was purportedly in respect of works for the period of December 2008 set out in periodic progress report No EA 008 validated by an external consultant, and two duly authorised agents of the Parliament on 4 December 2008 when the invoice was endorsed certified correct and passed for payment. The payment order in respect of this payment was validated by the Authorising Officer by Delegation on 9 December 2008.*

*It is acknowledged that this payment was irregularly made in advance of the works being carried out for the period in question. That payment was based on an erroneous assessment of the risks attaching to a failure to use appropriations carried over from 2007 to 2008 before the end of 2008. The payment was covered by a bank guarantee provided by the contractor and thus entailed no adverse budgetary consequences for the institution.*

*These circumstances were drawn to the Authorising Officer by Delegation's attention following the Court of Auditors' controls in the context of preparing the 2008 DAS. After discussing the matter with the Internal Auditor and informing the Secretary-General, the Authorising Officer by Delegation decided, in acknowledgment of the mistake and assuming responsibility for it, to refer the matter himself on 20 May 2009 to the Financial Irregularities Panel, pursuant to Article 75(1), second subparagraph, of the Financial Regulation.*

*In the meantime, the Bureau has decided wide structural changes in DG INLO which will have the effect of centralising these responsibilities at the level of Director-General.*

## THE COURT'S OBSERVATIONS

**Council**

11.10. The target completion date for the Secured European System for Automatic Messaging (SESAME) used to prepare the Council's annual budgets <sup>(4)</sup> was consistently overly optimistic. As a result, the annual budget for SESAME was over-estimated each year up to 2008. For the period 2005 to 2008, expenditure on SESAME by the Council amounted to less than 2 million euro, while over the same period the Council's budget allocated 59 million euro. The resulting over budgeting of 57 million euro was then available for transfer to other Council budget lines. The continued over-budgeting for SESAME, which evidenced a weakness in its planning and implementation, did not comply with the budgetary principle of accuracy required by the Financial Regulation (Article 5(3)), as most of the amounts included in each year's initial budgets for SESAME were not used as intended.

**11.10. REPLY OF THE COUNCIL**

1. *The Council takes note of the observations of the Court of Auditor's following the contradictory procedure in relation to the SESAME programme (see annex) and is pleased to note that no other comments were made in relation to the 2008 accounts.*

2. *The basic objective of this innovative programme is to replace the current CORTESY and ESDP- NET communication systems by a single integrated system, with a network classification split: the first layer of the system should allow the handling of information up to RESTREINT UE, the second information classified CONFIDENTIEL UE and SECRET UE. The programme is therefore more than a replacement project; additional communication structures and business functions will be introduced.*

3. *The budget amounts have always been based on expenditure estimates for the coming year in line with agreed policy decisions. The reasons for the delay, and the consequential budget slippage over recent years, stem mainly from changes in the programme's scope after the date that the Secretariat introduced the proposal for the coming budget year and the number of stakeholders and Council preparatory bodies involved.*

*A much greater degree of certainty now exists on the future development of the programme; the requirements have been established and the main programme steps have been approved. There is therefore a reasonable prospect that the programme will shortly move to the next phase.*

4. *In the light of this experience, the Council is currently considering ways of improving its coordination on structures for the governance of major IT projects such as SESAME.*

<sup>(4)</sup> SESAME is a secure communication system that has been under development by the Council since 2002. The initial target implementation date for the new system was July 2004. In January 2009, the target implementation date was further postponed to the end of 2012. There were many changes to the initial project design, and by the end of 2008, planning for SESAME had still not been finalised as there was no agreement among Member State delegations to one of the key committees on how to treat certain kinds of sensitive information. The rigorous accreditation procedure to obtain the Council's security clearance, and the technical complexity of the project were initially underestimated.

## THE COURT'S OBSERVATIONS

## Commission

**Implementation of the Individual Rights Information System**

11.11. In June 2008 the Office for Administration and Payment of Individual Entitlements (PMO) implemented a new system called the Individual Rights Information System (IRIS) for the management of staff entitlements, including salaries. The migration towards IRIS led to numerous problems in the calculation of salaries. A task force set up by the PMO estimated that more than 8 000 staff members' files might include erroneous data which could affect the calculation of salaries. Work to check all individual files is still ongoing. Emergency measures to correct inconsistencies included manual interventions in the payroll calculation system, which were not adequately supervised. There was insufficient system testing of IRIS, and the old and the new systems were not run in parallel until evidence that the new system was operating satisfactorily had been obtained.

**11.11. REPLY OF THE COMMISSION**

*The launch of the new IRIS system, which feeds the system for calculating remuneration, revealed discrepancies between historical data, particularly concerning family composition, and the data used for the payment of salaries. The main effect of these discrepancies was that the pay calculation system rejected the old data.*

*This resulted in the retroactive cancellation of amounts paid on the basis of these data. The Commission suggested the figure of 8 000 on the basis of an analysis of potentially flawed files, which were to be analysed in greater detail in future.*

*Pending correction of the data, the calculation of retroactive entitlements was blocked to avoid unjustified recoveries. This has already made it possible to limit the number of files containing errors. The danger of inconsistent data giving rise to incorrect payments was thus kept under control, but the downside is that this measure has also blocked retroactive corrections which were due, and which are still blocked. Checks on inconsistent data are underway and may affect some old payments, but not current salaries.*

*Some files were corrected directly by manual encoding in the payment calculation system, but this has always been possible and the usual control procedures were followed. Nevertheless, this method entails greater risk and its use should therefore be kept to a minimum.*

*A large number of tests were carried out over a very long period and the result was finally deemed satisfactory in mid-2008. It must be recognised with hindsight that the result has not entirely lived up to expectations. In future the PMO will evaluate tests much more strictly before accepting the launch of any new system or the modification of an existing system.*

## THE COURT'S OBSERVATIONS

**Transfer of acquired pension rights**

11.12. In some cases, the institutions have to reimburse staff members a fraction of the capital value of transferred pension rights <sup>(5)</sup>. The Court's examination of controls implemented to ensure that calculations are performed correctly and that reimbursements are recovered in the event of erroneous calculations identified a weakness. The audit found that the Office for Administration and Payment of Individual Entitlements (PMO) had wrongly reimbursed a total amount of 138 000 euro to two members of staff and that these cases were still unresolved.

**11.12. REPLY OF THE COMMISSION**

*As soon as the Court of Auditors identified these two cases and formulated its conclusions, the PMO took appropriate measures. It modified the calculation of pension rights and prepared the recovery of the unduly reimbursed amounts. This concerns the recovery of the part of the transferred capital that should have produced additional pension rights in the European Community pension scheme, rather than being paid back to the beneficiaries.*

*In the long term (from an actuarial point of view) the financial impact is neutral for the Community budget, as the unduly reimbursed money will be compensated by lower pension payments in future and inversely, recoveries will be compensated by the attribution of supplementary pension rights.*

*In parallel, action has been taken to reinforce the internal control in the field of transfers of pension rights.*

**Pension scheme for local staff at Commission Delegations**

11.13. In 1996, the External Service Directorate of the General Directorate for External Relations established a pension scheme for the local staff employed at Commission delegations. The scheme relies on a fund constituted by monthly contributions from the staff concerned and from the Commission. Since 1996, this scheme has been administered on the basis of provisional rules. These rules fail to address the question of the Commission's responsibility for the safeguarding and the return of the fund's assets, neither do they define the detailed provisions for the settlements of the staff's rights. The fund's assets were valued at about 34 million euro at the end of 2008.

**11.13. REPLY OF THE COMMISSION**

*The Local Staff Provident Fund was created in order to offer at least basic social security for local Commission staff working in delegations. It is a complementary fund managed outside the EU budget that works with capitalisation of pre-defined contributions. Local staff are kept up to date about the Provident Fund and can exert control to a justified extent. The Commission is currently exploring how to make such a scheme permanent, and its legal and financial implications. The current fund's assets are considered sufficient to cover the individual rights of local staff. A detailed actuarial study is planned in view of the legislative proposal.*

<sup>(5)</sup> Article 11(2) of Annex VIII of the Staff Regulations provides that officials may transfer pension rights acquired during previous employment to the pension scheme of European officials (PSEO). The capital value of transferred pension rights is translated into years of pensionable service in the PSEO. The audit examined whether institutions have adequate procedures to correctly value transferred pension rights and to adequately perform transfers. While procedures operate satisfactorily in most cases, the complexity of the applicable provisions of the Staff Regulations and of national pension legislations result in delays to process individual transfers and in numerous clerical errors in calculations.

## THE COURT'S OBSERVATIONS

## Court of Justice

11.14. In 2008 the Court of Justice concluded a contract for the provision of services, following a joint open tender procurement procedure with a Member State. The Court's audit of the contract showed weaknesses in the internal control system for performing this tendering procedure. These led to an overly short deadline for tenderers to obtain the tender specifications<sup>(6)</sup>, and the announcement in the contract notice both of the obligation to submit tenders in one language only<sup>(7)</sup> and of the holding of a closed meeting for the opening of tenders<sup>(8)</sup>. Enhanced procurement procedures should be established by the Court of Justice in order to help authorising services organise tendering procedures and control adherence to regulatory obligations.

## 11.14. REPLY OF THE COURT OF JUSTICE

*After recalling that the procurement procedure referred to by the Court of Auditors concerns the new building complex and was the Court of Justice's first experience of a joint contract with a Member State under the recent provisions of Article 91 of the Financial Regulation, the Court of Justice wishes to offer the following clarification regarding the weaknesses noted by the Court of Auditors in that procedure.*

*With regard first of all to the scheduling of the procedure, the joint contracting authorities were required to reconcile, in their own interest and in that of the tenderers, the need to award the contract at a date enabling the successful tenderer to be operational as soon as the new building complex was delivered with the need, having regard to the complexity of the contract, to provide for a period of sufficient length to allow the tenderers to prepare their tender in good conditions.*

*That is why the timetable, although observing the time-limits formally prescribed by the financial regulation, was unavoidably constricted as regards the period allowed for the candidates to request the call for tender documents.*

*As for the weak points concerning two particular headings in the contract notice, they were the result of administrative mistakes and were, of course, not deliberate. With regard to the language rules, only a want of coordination explains why the contract notice provided for tenders to be submitted in French only (the custom in practice in the Member State concerned), whereas the contract documents provided that tenders could be submitted in any of the official languages of the European Union (the practice followed by the Court of Justice). So far as concerns the committee meeting for the opening of tenders, it is to be borne in mind that if any tenderers had appeared, they would naturally have been permitted to be present, in accordance with the provisions of the financial regulation.*

*So far as concerns the Court of Auditors' recommendation relating to the improvement of the help given to the authorising departments in the field of tendering procedures, the Court of Justice began as long ago as June 2008, and in response to a recommendation of its internal auditor, to take real steps in that direction. It will use its best endeavours, so far as the number of staff available permits, to continue to improve its arrangements in this field.*

<sup>(6)</sup> Article 98 of the Financial Regulation states that arrangements for submitting tenders shall be such as to ensure that there is genuine competition. The corresponding Implementing Rules (IR) set out minimal time limits to be observed by the contracting authorities.

<sup>(7)</sup> Article 125c of the Implementing Rules (IR) of the Financial Regulation provides that, in the case of a joint procurement between one institution and the contracting authority from one or more a Member States, the procedural provisions applicable to the institution, which include the linguistic regime, shall apply.

<sup>(8)</sup> Article 118(3) IR states that, in the case of an open procedure, the meeting of the opening committee shall be open to the tenderers.

## THE COURT'S OBSERVATIONS

### **Court of Auditors**

11.15. The external auditor's report (see paragraph 11.4) states that, in the auditors' opinion, 'these financial statements give a true and fair view of the financial position of the European Court of Auditors as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002, the Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of the said Council Regulation and the European Court of Auditor's Accounting Rules'. The report will be published in the Official Journal.

### **European Economic and Social Committee**

11.16. The audit did not identify any reportable weakness in respect of the topics audited.

### **Committee of the Regions**

11.17. The audit did not identify any reportable weakness in respect of the topics audited.

### **European Ombudsman**

11.18. The audit did not identify any reportable weakness in respect of the topics audited.

### **European Data Protection Supervisor**

11.19. The audit did not identify any reportable weakness in respect of the topics audited.

## CONCLUSIONS

11.20. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2008 for the institutions' administrative expenditure were free from material error (see paragraph 11.6).

11.21. Based on its audit work, the Court concludes that the supervisory and control systems for the institutions' administrative expenditure comply with the requirements of the Financial Regulation (see paragraphs 11.7 to 11.19).

## THE COURT'S OBSERVATIONS

## EUROPEAN UNION AGENCIES

11.22. Audits of the European Union's agencies and other decentralised bodies are the subject of Specific Annual Reports which are published separately in the Official Journal<sup>(9)</sup>. The Court audited 29 Agencies for the financial year 2008. Their budgets totaled 1 488,5 million euro in 2008. The principal data concerning the agencies are set out in **Table 11.2**.

11.23. The Court issued unqualified opinions on the reliability of the accounts and the legality and regularity of the underlying transactions for all Agencies except for the European Police College.

## EUROPEAN SCHOOLS

11.24. The Court's Specific Annual Report on the European Schools (not published in the Official Journal) is submitted to the Board of Governors as the discharge authority. The Schools' 2008 budget of 258,0 million euro was financed mainly by a Commission grant (138,9 million euro) and by contributions from the Member States (54,5 million euro)<sup>(10)</sup>. The principal data concerning the European Schools are set out in **Table 11.3**.

11.25. The Court found no material errors that might call into question the reliability of the accounts that it audited (Karlsruhe and Mol schools and the Central Office), which were drawn up under the provisions of the Financial Regulation of 24 October 2006 applicable to the budget of the European Schools, and the legality and regularity of the transactions underlying these accounts. However, based on the Court's review, the consolidated accounts are not presented fairly and transparent, in all material respects, in accordance with the relevant accounting standards, with regard to (a) the unsatisfactory application of the accrual based accounting principle and (b) the inclusion of the surplus of the previous year as a revenue of the present year.

<sup>(9)</sup> The Court's annual reports on the Agencies accounts are presented on its site (<http://www.eca.europa.eu>) and will be published in the Official Journal except for the Euratom Supply Agency.

<sup>(10)</sup> Source: European Schools, *clôtures des comptes* 2008.



Table 11.2 — EU Agencies — Principal Data

| Agencies and other decentralised bodies of the European Union                        | Headquarters            | First year of financial autonomy | Budget <sup>(1)</sup> (million euro) |                | Authorised post |                |
|--|-------------------------|----------------------------------|--------------------------------------|----------------|-----------------|----------------|
|  |                         |                                  | 2008                                 | 2007           | 2008            | 2007           |
| <b>Agencies</b>  |                         |                                  |                                      |                |                 |                |
| Euratom Supply Agency  | Luxembourg              | 1960                             | —                                    | 0,3            | —               | —              |
| European Centre for the Development of Vocational Training                           | Thessalonica            | 1977                             | 18,3                                 | 17,4           | 99              | 97             |
| European Foundation for the Improvement of Living and Working Conditions             | Dublin                  | 1977                             | 21,0                                 | 20,2           | 101             | 94             |
| European Environment Agency  | Copenhagen              | 1994                             | 37,1                                 | 35,1           | 123             | 116            |
| European Training Foundation   | Turin                   | 1994                             | 22,4                                 | 25,5           | 96              | 100            |
| European Monitoring Centre for Drugs and Drug Addiction                              | Lisbon                  | 1995                             | 15,1                                 | 13,8           | 82              | 82             |
| European Medicines Agency  | London                  | 1994                             | 182,9                                | 163,1          | 481             | 441            |
| Translation Centre for the Bodies of the European Union                              | Luxembourg              | 1995                             | 59,9                                 | 46,1           | 233             | 200            |
| Community Plant Variety Office   | Angers                  | 1995                             | 12,5                                 | 13,4           | 43              | 42             |
| Office for Harmonization in the Internal Market                                      | Alicante                | 1995                             | 318,4                                | 276,0          | 643             | 647            |
| European Agency for Safety and Health at Work  | Bilbao                  | 1996                             | 14,9                                 | 14,9           | 44              | 42             |
| European Fundamental Rights Agency   | Vienna                  | 1998                             | 15,0                                 | 14,5           | 49              | 46             |
| European Agency for Reconstruction   | Thessalonica            | 2000                             | 235,0                                | 250,0          | 93              | 108            |
| European Police College  | Bramshill               | 2006                             | 8,7                                  | 7,4            | 22,5            | 22,5           |
| Eurojust   | The Hague               | 2002                             | 24,8                                 | 18,4           | 175             | 147            |
| European Aviation Safety Agency  | Cologne                 | 2003                             | 102,0                                | 72,0           | 452             | 467            |
| European Maritime Safety Agency  | Lisbon                  | 2003                             | 50,2                                 | 48,2           | 181             | 153            |
| European Food Safety Authority   | Parma                   | 2003                             | 66,4                                 | 52,2           | 335             | 300            |
| European Network and Information Security Agency                                     | Heraklion               | 2005                             | 8,4                                  | 8,3            | 44              | 44             |
| European Railway Agency  | Valenciennes            | 2006                             | 18                                   | 16,6           | 116             | 116            |
| European Centre for Disease Prevention and Control                                   | Stockholm               | 2005                             | 40,6                                 | 28,9           | 130             | 90             |
| European Agency for the Management of Operational Cooperation at the External Border | Warsaw                  | 2006                             | 71,2                                 | 42,2           | 94              | 49             |
| European GNSS Supervisory Authority  | Brussels <sup>(2)</sup> | 2006                             | 10,5                                 | 7,0            | 50              | 39             |
| Community Fisheries Control Agency   | Vigo                    | 2007                             | 9,5                                  | 5,0            | 47              | 38             |
| European Chemicals Agency <sup>(3)</sup>   | Helsinki                | 2008                             | 66,4                                 | —              | 220             | —              |
| <b>Executive Agencies</b>  |                         |                                  |                                      |                |                 |                |
| Executive Agency for Competitiveness and Innovation                                  | Brussels                | 2006                             | 11,5                                 | 6,9            | 36              | 35             |
| Education, Audiovisual and Culture Executive Agency                                  | Brussels                | 2006                             | 38,2                                 | 36,0           | 92              | 83             |
| Executive Agency for Health and Consumers <sup>(4)</sup>                             | Luxembourg              | 2007                             | 4,4                                  | 4,1            | 42              | 28             |
| Trans-European Transport Network Executive Agency <sup>(3)</sup>                     | Brussels                | 2008                             | 5,2                                  | —              | 32              | 2              |
| <b>Total</b>   |                         |                                  | <b>1 488,5</b>                       | <b>1 243,5</b> | <b>4 155,5</b>  | <b>3 626,5</b> |

<sup>(1)</sup> Payment appropriations.<sup>(2)</sup> Provisional seat.<sup>(3)</sup> Agency having acquired its financial independence in 2008.<sup>(4)</sup> Known as Public Health Executive Agency up to May 2008.

Table 11.3 — European Schools — Principal Data

| European School        | Country        | Budget <sup>(1)</sup> <sup>(2)</sup><br>(million euro) |              | Grant received from the<br>Commission <sup>(2)</sup><br>(million euro) |              | School Population <sup>(3)</sup> |               |
|------------------------|----------------|--|--------------|--|--------------|----------------------------------|---------------|
|                        |                | 2008   | 2007         | 2008   | 2007         | 2008                             | 2007          |
| Office                 | Belgium        | 9,2  | 9,3          | 7,0  | 7,5          | —                                | —             |
| Luxembourg I           | Luxembourg     | 37,4   | 35,1         | 22,8   | 21,1         | 3 437                            | 3 376         |
| Luxembourg II          | Luxembourg     | 7,0  | 7,0          | 3,4  | 2,9          | 888                              | 897           |
| Brussels I (Uccle)     | Belgium        | 32,1   | 30,4         | 22,7   | 21,0         | 3 057                            | 3 045         |
| Brussels II (Woluwé)   | Belgium        | 31,5   | 29,3         | 21,5   | 19,2         | 2 904                            | 2 893         |
| Brussels III (Ixelles) | Belgium        | 29,1   | 26,2         | 19,8   | 16,7         | 2 649                            | 2 621         |
| Brussels IV            | Belgium        | 5,5  | 2,4          | 3,4  | 1,8          | 438                              | 172           |
| Mol                    | Belgium        | 11,3   | 11,2         | 6,0  | 6,0          | 718                              | 657           |
| Varese                 | Italy          | 18,7   | 17,9         | 9,3  | 8,8          | 1 341                            | 1 317         |
| Karlsruhe              | Germany        | 12,9   | 11,9         | 2,4  | 3,5          | 979                              | 1 001         |
| Munich                 | Germany        | 19,5   | 18,9         | 0,6  | 0,4          | 1 756                            | 1 666         |
| Frankfurt              | Germany        | 10,6   | 10,3         | 3,9  | 3,8          | 1 053                            | 978           |
| Alicante               | Spain          | 11,9   | 11,3         | 5,2  | 4,2          | 1 029                            | 1 017         |
| Bergen                 | Netherlands    | 9,8  | 9,8          | 5,1  | 4,6          | 565                              | 554           |
| Culham                 | United Kingdom | 11,4   | 11,1         | 5,7  | 5,9          | 835                              | 827           |
| <b>Total</b>           |                | <b>258,0</b>   | <b>242,1</b> | <b>138,9</b>   | <b>127,4</b> | <b>21 649</b>                    | <b>21 021</b> |

<sup>(1)</sup> 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.

<sup>(2)</sup> Source: European Schools, clôture des comptes 2008.

<sup>(3)</sup> Source: 2008 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.

ANNEX 11.1  
RESULTS OF TESTING

PART 1: MAIN FEATURES OF SAMPLE BASED TRANSACTION TESTING

1.1 — Size of the sample

| Year | Number of transactions tested |
|------|-------------------------------|
| 2008 | 57                            |
| 2007 | 56                            |

1.2 — Structure of the sample

| Percentage of transactions tested which were | 2008  |                               |                |            | 2007       |
|--|---|-------------------------------|----------------|------------|------------|
|  | Expenses related to staff of the Institutions | Expenses related to buildings | Other expenses | Total      |            |
| Final/interim payments                       | 55  | 19                            | 26             | 100        | 100        |
| Advances                                     | 0   | 0                             | 0              | 0          | 0          |
| <b>Total</b>                                 | <b>55</b>                                     | <b>19</b>                     | <b>26</b>      | <b>100</b> | <b>100</b> |

PART 2: OVERALL ASSESSMENT OF SUPERVISORY AND CONTROL SYSTEMS

2.1 — Assessment of selected supervisory and control systems

| Overall assessment | 2008 | 2007 |
|--------------------|------|------|
|                    |      |      |

Legend:

|     |  |
|-----|--|
|     | Effective                                      |
|     | Partially effective                            |
|     | Not effective                                  |
| N/A | Not applicable: does not apply or not assessed |

## FOLLOW-UP OF KEY STATEMENT OF ASSURANCE OBSERVATIONS

| Court observation   | Action taken  | Court analysis  | Institution's reply  |
|---|---|---|--|
| <b>Multiplication factor applicable to salaries</b>   |   |   |  |
| <p>Annual Report concerning the financial year 2007, paragraphs 11.7 to 11.11:</p> <p>The Parliament and the Economic and Social Committee do not apply the provisions of the Staff Regulations concerning the multiplication factor in the same way as the other institutions. This resulted in the granting of a financial advantage to their staff, which the other institutions do not grant, and in higher expenses.</p>   | <p>The Parliament and the Economic and Social Committee continue to apply their current practice while waiting for the Court of Justice's final rulings in cases brought in this respect by staff of the institutions.</p>  | <p>The Court of Auditors will monitor the follow-up to the Court of Justice ruling.</p>   | <p>The European Parliament's replies</p> <p><i>The European Parliament fully shares the cautious approach as defined by the Court and will continue to examine the substance of the issue.</i></p>   |
| <b>Reimbursement of accommodation costs incurred on mission</b>   |   |   |  |
| <p>Annual Reports concerning the financial years 2004 to 2007, most recently Annex 11.2 to the 2007 report:</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 Parliament's Bureau confirmed its support for the existing scheme of flat-rate reimbursement while agreeing to a modification of the system. As a result, the Parliament continues to pay accommodation costs on a lump-sum basis for claims relating to overnight stays in Luxembourg, Strasbourg and Brussels.</p> | <p>The Parliament should 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>Parliament indicated in the context of the 2007 DAS procedure that it would be reviewing certain aspects of its rules on missions following a report by the institution's Internal Auditor.</i></p> <p><i>While Parliament's Bureau, having regard to the particular difficulties confronting the institution (to which the attention of the Court has been drawn in previous replies) reaffirmed its continuing support for a flat-rate regime, the operation of the latter has been modified.</i></p> <p><i>Following a change in the relevant internal rules, as from 1 September 2008, only nights spent within duly certified times of work can be claimed for on a flat-rate basis.</i></p> <p><i>Moreover in spring 2009, a new set of implementing rules and internal rules were put in place in order to clarify the situation.</i></p> <p><i>This package is due to enter into force in early September 2009.</i></p> |

| Court observation   | Action taken  | Court analysis   | Institution's reply  |
|---|---|--|--|
|   |   |  | <p>The European Parliament's replies</p> <p><i>Lastly, in the context of the budget for 2010, the remarks against Item 3000, 'Expenses on staff missions', have been amended. Budget Item 3000 will in future be headed 'Expenses on staff missions and duty travel between the three working places' while the remarks explicitly state that the appropriations are intended to cover expenditure on duty travel by staff of the institution, seconded national experts and trainees between the place of employment and any of the European Parliament's three places of work (Brussels, Luxembourg and Strasbourg) and on missions to any location other than the three places of work, thus providing the budgetary basis for the rules which Parliament applies to travel between the three places of work.</i></p> <p><i>Ultimately, Parliament intends to propose amendments to the Staff Regulations of Officials in this context in order to ensure that the special nature of duty travel between the three places of work, as against normal missions, is properly highlighted.</i></p> |
| <b>Allowances for assistance to Members of the European Parliament (MEPs)</b>   |   |  |  |
| <p>Annual Report concerning the financial year 2006, paragraphs 10.10 to 10.12, and Annex 11.2 to the 2007 report:</p> <p>In its Annual Report for 2006, the Court of Auditors considered that there was insufficient documentation to demonstrate that MEPs actually employed or engaged the services of assistants, and that the duties or services mentioned in the contracts signed by the MEPs had been really carried out. The Bureau should take action in order to obtain the documents considered essential to prove that the expenditure was justified.</p> | <p>From the new parliamentary term starting in 2009, assistance to Members will be provided by accredited parliamentary assistants chosen by MEPs, engaged by the Parliament, and by local agents engaged by Members.</p> <p>Council Regulation (EC) No 160/2009 (OJ L 55, 27.2.2009, p. 1) amended the conditions of employment of other servants of the European Communities and created a category for accredited parliamentary assistants, which will be recruited starting from the new parliamentary term. These will be chosen by MEPs, employed by the European Parliament and paid at standard pay scales. They will be based in Parliament's offices, and provide assistance to specific Members of Parliament.</p> | <p>The Court will monitor the clearance by the Parliament of the MEPs' statements of expenditure related to the financial years 2004-2007.</p> <p>For the 2008 financial year, the Parliament should clear all statements of expenditure, including checks on original invoices.</p> | <p>The European Parliament's replies</p> <p><i>The regularisation exercise for Parliamentary Assistance Expenses paid during the years 2004 and 2006 is 100 % completed. For the years 2005 and 2007, there is one single file open for each of these years, for an amount of about 10 000 euro (less than 0,1 % of the total expenditure). Specifically as regards the outstanding file for 2005, the EP services are waiting the reimbursement of an amount excessively paid from the Belgian Social Security Administration. The 2007 file is the subject of litigation and is presently being dealt with by the Legal Service.</i></p>   |

| Court observation  | Action taken   | Court analysis | Institution's reply  |
|--|--|----------------|--|
| <p>According to the Bureau's amended rules of December 2006, invoices and fee statements issued by paying agents and service providers are no longer required to be submitted by MEPs, but must be retained by them. Instead, MEPs are required to submit copies of 'statements of expenditure' and 'statements of amounts invoiced' issued by paying agents and service providers. These new rules apply for periods since July 2004.</p> <p>The Annual Report for 2007 included a recommendation that the Parliament should further enhance controls over the parliamentary assistance allowance, including random checks of invoices that the Members have in their possession.</p> | <p>Implementing measures for local assistants engaged by Members of Parliament, for the new parliamentary term, were adopted by the Bureau on 7 July 2008. The use of paying agents by Members of Parliament becomes obligatory; payments to MEP's family members are excluded; and paying agents are required to submit annual statements of expenses by 30 March of the following year.</p> <p>The Parliament's administration has obtained over 98 % of statements of expenditure and amounts invoiced for 2004 and 2005; over 99 % for 2006 and 2007, and 87 % for 2008. Parliament's services are still finalising the collecting of statements of expenditure relating to 2008.</p> <p>The Parliament performed random ex-post checks in 2008 on statements received from Members relating to 2007 payments, and on internal procedures used by the Parliament's services to correctly process these statements. Only in some cases, these checks included the examination of invoices that MEPs had in their possession in support to the summary statements.</p> |                | <p>The European Parliament's replies</p> <p><i>In every single case where doubts of information existed, the services have requested from Members proper explanations, including the presentation of bills and invoices. Where formal errors were detected, improper use of allowances established or where doubts persisted, Members have been requested to reimburse. In specific cases the matter was also referred to OLAF.</i></p> <p><i>With regard to the financial year 2008, Parliament considered it desirable to keep in place the verification arrangements by means of which very significant results had been obtained for the years 2004 to 2007. Incidentally, the establishment of the new parliamentary assistance system will take up all the resources available, which would have made it inopportune or even counterproductive to change the arrangements for 2008.</i></p> <p><i>Indeed, as from the new Parliamentary term which has commenced 14 July 2009, the system of Parliamentary Assistance Allowance was overhauled to include two separate categories of assistants. In particular, under the new rules accredited assistants (working in the premises of the Parliament) assume the status of other agents of the institution. They will be employed under contracts concluded with Parliament and will be subject to payment procedures similar to other staff working for the institution. This alleviates the need for regularisation papers. Local assistants, operating in the Members' Member State of election, will continue to conclude private law contracts with Members which will be governed by the applicable national law. However, the new rules provide that, from now on, all contracts must be compulsorily managed by a duly authorised paying agent. Moreover, self-employed service providers will henceforth be paid only upon presentation of invoices or fee statements which must be certified by the paying agent as complying with the applicable national law before being submitted to Parliament's services for payment. Accordingly, the new legal framework is expected to ensure proper compliance with the relevant rules and principles and in many respects goes even beyond what a procedure of ex-post control could achieve since such a procedure is, by definition, limited to a random selection of cases. Rather, the general application of the new procedure with increased requirements at the start of the payment cycle will provide the best guarantee of transparency, legality and the sound financial management of the parliamentary assistance allowance.</i></p> |

| Court observation   | Action taken   | Court analysis   | Institution's reply   |
|---|--|--|---|
|   |  |  | <p>The European Parliament's replies</p> <p><i>The newly established framework must be especially welcomed as it constitutes a significant step towards further developing and improving the safeguards in place and in meeting the abovementioned aims, while avoiding excess red tape and bureaucracy.</i></p>  |
| <b>Additional pension scheme for Members of the European Parliament</b>   |  |  |   |
| <p>Annual Report concerning the financial year 2006, Table 10.2, and Annex 11.2 to the 2007 report:</p> <p>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>At 31 December 2008, the Funds incurred an actuarial deficit of 121 844 000 euro. At the same date, the Funds evaluated the remaining benefits to be paid to the Members of the Scheme at 276 984 000 euro.</p> <p>In March 2009, Parliament's Legal Service issued an opinion on the application of the new Statute for the Members of Parliament, which states that Parliament is bound to guarantee acquired pension rights.</p> <p>Following the above, the Bureau took various decisions during its meeting of 1 April 2009:</p> <p>(a) to raise the retirement age from 60 to 63 years, subject to certain transitional measures;</p> <p>(b) to abolish the option of drawing a reduced pension from age 50;</p> <p>(c) to abolish the option of receiving a lump sum equivalent to 25 % of pension rights.</p> | <p>Parliament's liabilities have been reflected in the financial statements as at 31 December 2008, as recommended by the Court in its Opinion No 5/99 (paragraph 1.23).</p> <p>A new actuarial study should be performed in order to assess the impact of the decisions made by the Bureau concerning the measures applicable to the members of the scheme.</p> <p>Parliament should clarify its role in the management and supervision of the Fund's assets.</p> | <p>The European Parliament's replies</p> <p><i>Parliament's liabilities are reflected in the financial statements as at 31 December 2008.</i></p> <p><i>Parliament will commission a new independent actuarial study to assess the impact of the decision taken by the Bureau during its meeting of 1 April 2009 and the consequences of the entering into force of the Members' statute. This study will, in particular, yield an estimate of Parliament's commitments, which should be reflected in its annual balance sheet.</i></p> <p><i>The role of the European Parliament in the management and supervision of the Fund's assets is conditioned by the present legal framework governing the Fund's independent bodies. Furthermore, it has to be underlined that following a claim before the Court by some members of the Fund, the matter is sub judice. It is therefore not opportune to take action in this field pending the judgment of the Court.</i></p> <p><i>Nevertheless, the President of the European Parliament, by letter of 4 May 2009, has officially asked to the president of the Fund to ensure a prudent investment strategy so as to safeguard the Parliament's interests.</i></p> |

| Court observation  | Action taken  | Court analysis  | Institution's reply  |
|--|---|---|--|
| <b>Follow-up of family allowances by the Commission</b>  |   |   |  |
| <p>Annual Reports concerning the financial year 2005, paragraph 10.12; 2006, table 10.2; and 2007, Annex 11.2:</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.</p> <p>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>Since September 2008, an administrative clerk works full time checking entitlements to household allowances for agents without children. This led to the recovery of 88 000 euro in 2008. However there was still no evidence that 926 out of 2 001 Commission staff concerned based in Brussels in 2008 had been requested to confirm or update their original situation.</p> <p>Checks concerning receipt of national dependent child allowances continued to be insufficient in 2008.</p> | <p>The Commission should continue these checks.</p> <p>The Commission should take further action to check such cases.</p>                                   | <p>The Commission's replies</p> <p><i>The PMO is currently designing, on the basis of a risk analysis, a high-performance (cost-effective, efficient and effective) ex-ante and ex-post control strategy for all entitlements associated with taking up a post and for all family allowances.</i></p> <p><i>It will include a control strategy for family allowances received from other sources.</i></p> <p><i>Checks on household allowances for staff members with a spouse but without children are still being carried out.</i></p> |
| <b>Salary payments (PMO)</b>   |   |   |  |
| <p>Annual Report concerning the financial year 2007, paragraph 11.17:</p> <p><i>Ex-post</i> checks carried out by the PMO showed that, following a file processing error, in January 2007 a total amount of over 365 000 euro was paid to 118 former temporary staff, even though they no longer worked for the Commission. The error was not detected by <i>ex-ante</i> controls before the final payroll run. Recoveries were still being made in 2008.</p>  | <p>In most cases, the Commission recovered the amounts paid unduly.</p>   | <p>The Commission should implement more efficient <i>ex-ante</i> controls to prevent the risk of undue payments to staff who have left the institution.</p> | <p>The Commission's replies</p> <p><i>The payment error was the result of an erroneous correction upstream of the NAP (new payroll application) on 29 December, the day of the definitive calculation of payment, when the ex-ante controls on the amended data were already over. Following this incident, the PMO issued several reminders about compliance with the agreed procedures to the staff responsible for input into the NAP, in order to avoid the payment of amounts not due.</i></p>                                      |



## 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
  - 7.3. Implementation of expenditure
  - 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 <sup>(1)</sup> <sup>(2)</sup> (Articles 268 to 280 EC and Articles 171 to 183 Euratom) and by the financial regulations <sup>(3)</sup>.

## 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 nine 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 (IX) 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 <sup>(4)</sup>.

Besides own resources, there are other 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,

<sup>(1)</sup> Treaty of Rome (25 March 1957): Treaty establishing the European Economic Community (EEC).

<sup>(2)</sup> Treaty of Rome (25 March 1957): Treaty establishing the European Atomic Energy Community (Euratom).

<sup>(3)</sup> Mainly the Financial Regulation (FINREG) of 25 June 2002 (OJ L 248, 16.9.2002).

<sup>(4)</sup> Principal legal acts relating to own resources: Council Decision 2007/436/EC, Euratom of 7 June 2007 (OJ L 163, 23.6.2007); 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); Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax (OJ L 347, 11.12.2006); Council Directive 89/130/EEC, Euratom of 13 February 1989 on the harmonisation of the compilation of gross national product at market prices (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.

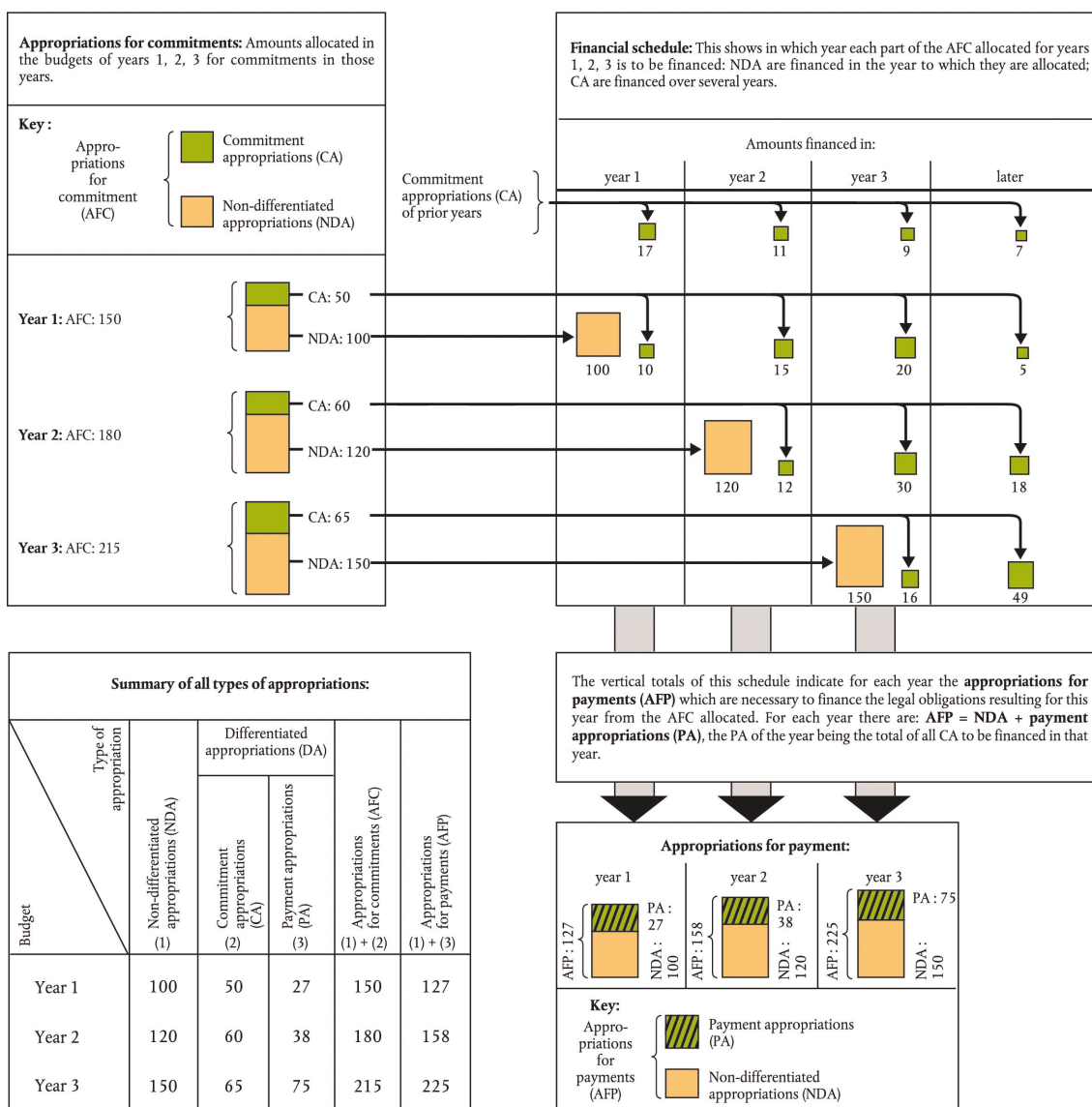
(b) non-differentiated appropriations (NDA) make it possible to ensure the commitment and payment of expenditure relating to annual activities during each financial year.

It is thus important to establish the following two totals for each financial year:

- (a) the total of appropriations for commitments (AFC) <sup>(5)</sup> = non-differentiated appropriations (NDA) + commitment appropriations (CA) <sup>(5)</sup>;
- (b) the total of appropriations for payments (AFP) <sup>(5)</sup> = non-differentiated appropriations (NDA) + payment appropriations (PA) <sup>(5)</sup>.

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.



<sup>(5)</sup> 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 <sup>(6)</sup>. 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 (EAGF and Cohesion) 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 <sup>(7)</sup>. 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;
- (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;

<sup>(6)</sup> See Articles 274 of the EC Treaty, 179 of the Euratom Treaty and 50 of the FINREG.

<sup>(7)</sup> See Articles 69 to 74 of the FINREG and Regulation (EC, Euratom) No 1150/2000.

- (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 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. The provisional accounts are forwarded not later than 31 March of the following year; the final accounts are due on 31 July of that year.

### 9. EXTERNAL AUDIT

Since 1977 the external audit of the budget has been carried out by the Court of Auditors of the European Communities <sup>(8)</sup>. 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 <sup>(9)</sup>: 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.

<sup>(8)</sup> 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.

<sup>(9)</sup> 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  |
| BG              | Bulgaria   |
| 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-27           | Total for the 27 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                                      |
| RO  | Romania                                       |
| 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 2008 AND BUDGETARY IMPLEMENTATION DURING THE FINANCIAL YEAR 2008

|         |  |
|---------|--|
| DIA I   | Budget 2008 — Estimated revenue and final appropriations for payments    |
| DIA II  | Budget 2008 — Appropriations for commitments                             |
| DIA III | Appropriations for commitments available in 2008 and utilisation thereof |
| DIA IV  | Appropriations for payments available in 2008 and utilisation thereof    |
| DIA V   | Own resources in 2008, by Member State                                   |
| DIA VI  | Payments made in 2008, in each Member State                              |

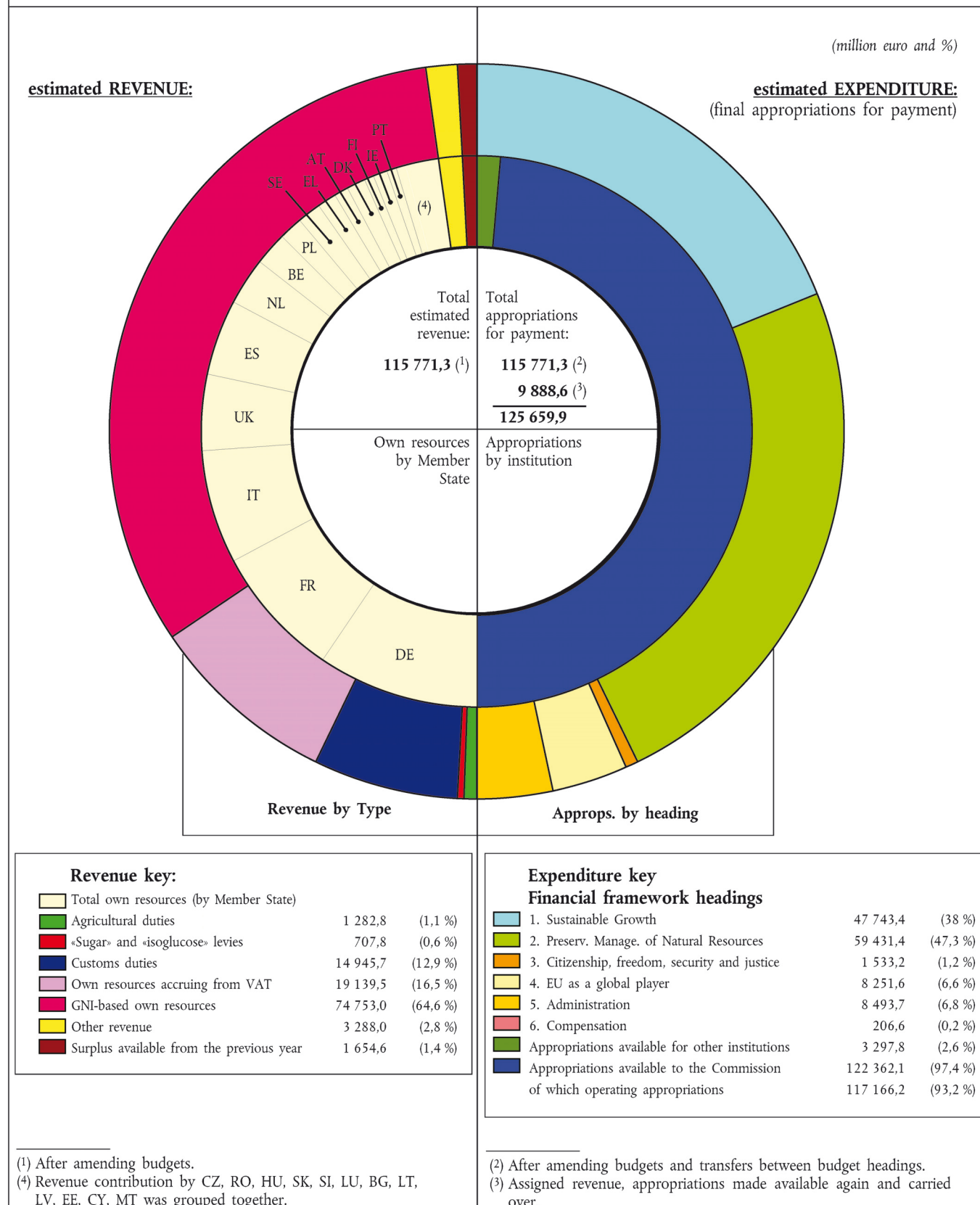
## CONSOLIDATED ACCOUNTS FOR THE FINANCIAL YEAR 2008

|          |                                       |
|----------|---------------------------------------|
| DIA VII  | Consolidated balance sheet            |
| DIA VIII | Consolidated economic outturn account |



**Diagram I**  
**Budget 2008 — Estimated revenue and final appropriations for payments**

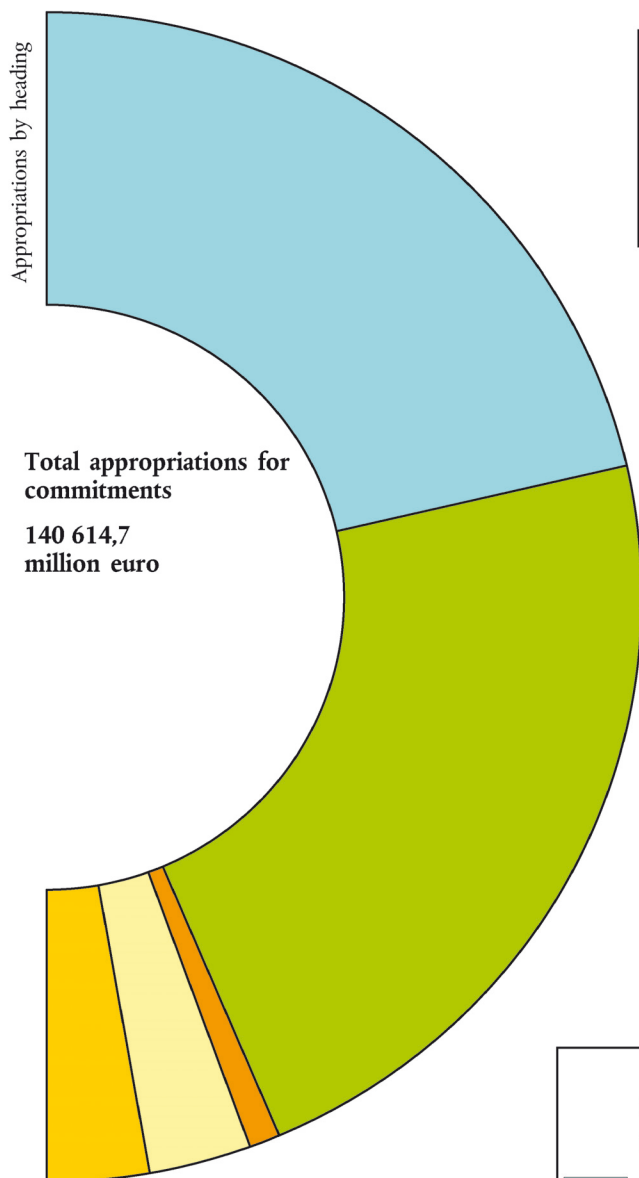
[for revenue criteria, see «Background information on the budget», paragraph 7.2; for expenditure criteria, see «Background information on the general budget», paragraph 7.3 and for more detailed information, see Diagram IV, column (a)]











**Diagram II****Budget 2008 — 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 2008 as the commitment appropriations also include amounts to be financed by budgetary revenue from subsequent years.

**Expenditure key****Financial framework headings:**

|   |   |          |          |
|---|---|----------|----------|
|  | 1. Sustainable Growth                         | 59 879,3 | (42,6 %) |
|  | 2. Preserv. and Managem. of Natural Resources | 63 037,9 | (44,8 %) |
|  | 3. Citizenship, freedom, security and justice | 1 722,2  | (1,2 %)  |
|  | 4. EU as a global player                      | 7 973,3  | (5,7 %)  |
|  | 5. Administration                             | 7 795,4  | (5,5 %)  |
|  | 6. Compensation                               | 206,6    | (0,1 %)  |



**Diagram III**  
**Appropriations for commitments available in 2008 and utilisation thereof**

(million euro and %)

| Sections (S) and titles (T) corresponding to the 2008 budgetary nomenclature and financial framework headings | Financial Framework | Final appropriations |              | Utilisation of appropriations |                      |                         |            |                |                       |
|---|---------------------|----------------------|--------------|-------------------------------|----------------------|-------------------------|------------|----------------|-----------------------|
|   |                     | Amount (1)           | Rate (%)     | Commitments entered into      | Utilisation rate (%) | Carry-overs to 2009 (2) | Rate (%)   | Cancellations  | Rate (%)              |
|   |                     | (a)                  | (b)          | (b)/(a)                       | (c)                  | (c)/(b)                 | (d)        | (d)/(b)        | (e) = (b) - (c) - (d) |
| <b>Budgetary nomenclature</b>   |                     |                      |              |                               |                      |                         |            |                |                       |
| I Parliament (S. I)   |                     | 1 556,2              |              | 1 472,3                       | 94,6                 | 41,6                    | 2,7        | 42,2           | 2,7                   |
| II Council (S. II)  |                     | 743,3                |              | 693,8                         | 93,3                 | 34,6                    | 4,6        | 15,0           | 2,0                   |
| III Commission (S. III) (3)   |                     | 137 660,0            |              | 131 748,3                     | 95,7                 | 5 062,0                 | 3,7        | 849,7          | 0,6                   |
| III.1 Economic and financial affairs (T.01)   |                     | 284,4                |              | 278,8                         | 98,0                 | 1,3                     | 0,5        | 4,2            | 1,5                   |
| III.2 Enterprise (T.02)   |                     | 659,5                |              | 620,4                         | 94,1                 | 31,1                    | 4,7        | 7,9            | 1,2                   |
| III.3 Competition (T.03)  |                     | 95,8                 |              | 93,7                          | 97,8                 | 1,5                     | 1,6        | 0,6            | 0,6                   |
| III.4 Employment and social affairs (T.04)  |                     | 11 061,8             |              | 11 029,7                      | 99,7                 | 9,2                     | 0,1        | 22,9           | 0,2                   |
| III.5 Agriculture and rural development (T.05)  |                     | 61 570,0             |              | 57 905,3                      | 94,0                 | 3 555,3                 | 5,8        | 109,4          | 0,2                   |
| III.6 Energy and transport (T.06)   |                     | 2 894,0              |              | 2 830,2                       | 97,8                 | 54,7                    | 1,9        | 9,2            | 0,3                   |
| III.7 Environment (T.07)  |                     | 425,7                |              | 394,1                         | 92,6                 | 17,4                    | 4,1        | 14,1           | 3,3                   |
| III.8 Research (T.08)   |                     | 4 646,8              |              | 4 355,4                       | 93,7                 | 286,7                   | 6,2        | 4,7            | 0,1                   |
| III.9 Information society and media (T.09)  |                     | 1 634,7              |              | 1 568,6                       | 96,0                 | 62,4                    | 3,8        | 3,7            | 0,2                   |
| III.10 Direct research (T.10)   |                     | 708,2                |              | 403,2                         | 56,9                 | 298,7                   | 42,2       | 6,2            | 0,9                   |
| III.11 Fisheries and maritime affairs (T.11)  |                     | 1 020,8              |              | 974,5                         | 95,5                 | 3,6                     | 0,4        | 42,7           | 4,2                   |
| III.12 Internal market (T.12)   |                     | 64,0                 |              | 62,7                          | 98,1                 | 1,0                     | 1,5        | 0,3            | 0,4                   |
| III.13 Regional policy (T.13)   |                     | 37 335,2             |              | 37 291,1                      | 99,9                 | 24,9                    | 0,1        | 19,3           | 0,1                   |
| III.14 Taxation and customs union (T.14)  |                     | 128,2                |              | 119,3                         | 93,1                 | 1,8                     | 1,4        | 7,1            | 5,6                   |
| III.15 Education and culture (T.15)   |                     | 1 547,9              |              | 1 432,1                       | 92,5                 | 108,9                   | 7,0        | 6,9            | 0,4                   |
| III.16 Communication (T.16)   |                     | 210,9                |              | 206,6                         | 98,0                 | 1,3                     | 0,6        | 3,0            | 1,4                   |
| III.17 Health and consumer protection (T.17)  |                     | 703,2                |              | 690,2                         | 98,2                 | 7,9                     | 1,1        | 5,1            | 0,7                   |
| III.18 Area of freedom, security and justice (T.18)   |                     | 804,7                |              | 704,2                         | 87,5                 | 84,3                    | 10,5       | 16,2           | 2,0                   |
| III.19 External relations (T.19)  |                     | 4 151,0              |              | 4 090,4                       | 98,5                 | 29,4                    | 0,7        | 31,1           | 0,8                   |
| III.20 Trade (T.20)   |                     | 79,9                 |              | 75,8                          | 94,9                 | 1,1                     | 1,4        | 3,0            | 3,7                   |
| III.21 Development and relations with ACP States (T.21)   |                     | 1 759,1              |              | 1 402,8                       | 79,7                 | 352,6                   | 20,0       | 3,6            | 0,2                   |
| III.22 Enlargement (T.22)   |                     | 1 217,3              |              | 1 164,4                       | 95,7                 | 51,0                    | 4,2        | 1,9            | 0,2                   |
| III.23 Humanitarian aid (T.23)  |                     | 958,5                |              | 955,8                         | 99,7                 | 2,1                     | 0,2        | 0,7            | 0,1                   |
| III.24 Fight against fraud (T.24)   |                     | 74,4                 |              | 72,5                          | 97,4                 | 0,0                     | 0,0        | 1,9            | 2,6                   |
| III.25 Commission's policy coordination and legal advice (T.25)   |                     | 185,7                |              | 180,4                         | 97,1                 | 3,3                     | 1,8        | 2,1            | 1,1                   |
| III.26 Commission's Administration (T.26)   |                     | 1 051,1              |              | 987,6                         | 94,0                 | 42,5                    | 4,0        | 21,1           | 2,0                   |
| III.27 Budget (T.27)  |                     | 274,7                |              | 265,5                         | 96,6                 | 1,4                     | 0,5        | 7,9            | 2,9                   |
| III.28 Audit (T.28)   |                     | 10,7                 |              | 10,2                          | 95,4                 | 0,3                     | 2,6        | 0,2            | 2,0                   |
| III.29 Statistics (T.29)  |                     | 135,1                |              | 124,9                         | 92,5                 | 2,6                     | 1,9        | 7,6            | 5,6                   |
| III.30 Pensions (T.30)  |                     | 1 080,5              |              | 1 049,5                       | 97,1                 | —                       | —          | 31,0           | 2,9                   |
| III.31 Language Services (T.31)   |                     | 434,8                |              | 408,4                         | 93,9                 | 23,7                    | 5,5        | 2,7            | 0,6                   |
| III.40 Reserves (T.40)  |                     | 451,6                |              | —                             | —                    | —                       | —          | 451,6          | 100,0                 |
| IV Court of Justice (S. IV)   |                     | 296,6                |              | 291,3                         | 98,2                 | 1,6                     | 0,6        | 3,7            | 1,2                   |
| V Court of Auditors (S. V)  |                     | 133,3                |              | 120,8                         | 90,7                 | 0,3                     | 0,2        | 12,1           | 9,1                   |
| VI Economic and Social Committee (S. VI)  |                     | 118,3                |              | 113,2                         | 95,6                 | 0,3                     | 0,2        | 4,9            | 4,1                   |
| VII Committee of the Regions (S. VII)   |                     | 93,1                 |              | 80,8                          | 86,8                 | 10,8                    | 11,6       | 1,5            | 1,6                   |
| VIII European Ombudsman (S. VIII)   |                     | 8,5                  |              | 7,8                           | 91,5                 | —                       | —          | 0,7            | 8,5                   |
| IX European Data-protection Supervisor (S. IX)  |                     | 5,3                  |              | 4,6                           | 86,1                 | —                       | —          | 0,7            | 13,9                  |
| <b>Grand total appropriations for commitments</b>   | <b>132 797,0</b>    | <b>140 614,7</b>     | <b>105,9</b> | <b>134 532,9</b>              | <b>95,7</b>          | <b>5 151,2</b>          | <b>3,7</b> | <b>930,6</b>   | <b>0,7</b>            |
| <b>Financial Framework</b>  |                     |                      |              |                               |                      |                         |            |                |                       |
| 1 Sustainable Growth  | 57 653,0            | 59 879,3             |              | 58 514,2                      | 97,7                 | 820,5                   | 1,4        | 544,6          | 0,9                   |
| 2 Preservation and Management of Natural Resources  | 59 193,0            | 63 037,9             |              | 59 306,6                      | 94,1                 | 3 571,3                 | 5,7        | 159,9          | 0,3                   |
| 3 Citizenship, freedom, security and justice  | 1 362,0             | 1 722,2              |              | 1 565,5                       | 90,9                 | 133,3                   | 7,7        | 23,5           | 1,4                   |
| 4 EU as a global player   | 7 002,0             | 7 973,3              |              | 7 512,9                       | 94,2                 | 435,2                   | 5,5        | 25,2           | 0,3                   |
| 5 Administration  | (4) 7 380,0         | 7 795,4              |              | 7 427,0                       | 95,3                 | 190,9                   | 2,4        | 177,5          | 2,3                   |
| 6 Compensation  | 207,0               | 206,6                |              | 206,6                         | 100,0                | —                       | —          | —              | —                     |
| <b>Grand total appropriations for commitments</b>   | <b>132 797,0</b>    | <b>140 614,7</b>     | <b>105,9</b> | <b>134 532,9</b>              | <b>95,7</b>          | <b>5 151,2</b>          | <b>3,7</b> | <b>930,6</b>   | <b>0,7</b>            |
| <b>Grand total appropriations for payments</b>  | <b>129 681,0</b>    | <b>125 659,9</b>     | <b>96,9</b>  | <b>116 544,5</b>              | <b>92,7</b>          | <b>7 333,3</b>          | <b>5,8</b> | <b>1 782,2</b> | <b>1,4</b>            |

(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 framework 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 2006 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 500 million euro at 2004 prices for the period 2007-2013. In 2008 this reduction amounts to 77,3 million euro.



**Diagram IV**  
**Appropriations for payments available in 2008 and utilisation thereof**

(million euro and %)

| Sections (S) and titles (T) corresponding to the 2008 budgetary nomenclature and financial framework headings | Final appropriations <sup>(1)</sup> | Utilisation of appropriations |                      |                     |            |                   |            |
|---|-------------------------------------|-------------------------------|----------------------|---------------------|------------|-------------------|------------|
|   |                                     | Payments made in 2008         | Utilisation rate (%) | Carry-overs to 2009 | Rate (%)   | Cancellations     | Rate (%)   |
|   |                                     | (a)                           | (b)/(a)              | (c)                 | (c)/(a)    | (d) = (a)-(b)-(c) | (d)/(a)    |
| <b>Budgetary nomenclature</b>   |                                     |                               |                      |                     |            |                   |            |
| I Parliament (S. I)   | 1 807,4                             | 1 488,9                       | 82,4                 | 244,6               | 13,5       | 74,0              | 4,1        |
| II Council (S. II)  | 798,5                               | 618,1                         | 77,4                 | 154,7               | 19,4       | 25,7              | 3,2        |
| III Commission (S. III) <sup>(2)</sup>  | 122 362,1                           | 113 827,9                     | 93,0                 | 6 880,1             | 5,6        | 1 654,1           | 1,4        |
| III.1 Economic and financial affairs (T.01)   | 358,1                               | 285,9                         | 79,8                 | 17,5                | 4,9        | 54,6              | 15,3       |
| III.2 Enterprise (T.02)   | 603,1                               | 477,3                         | 79,1                 | 64,4                | 10,7       | 61,4              | 10,2       |
| III.3 Competition (T.03)  | 103,6                               | 87,4                          | 84,4                 | 14,4                | 13,9       | 1,7               | 1,6        |
| III.4 Employment and social affairs (T.04)  | 9 414,9                             | 9 092,0                       | 96,6                 | 25,6                | 0,3        | 297,3             | 3,2        |
| III.5 Agriculture and rural development (T.05)  | 58 507,9                            | 53 803,2                      | 92,0                 | 4 499,8             | 7,7        | 204,9             | 0,4        |
| III.6 Energy and transport (T.06)   | 2 168,6                             | 1 784,5                       | 82,3                 | 126,7               | 5,8        | 257,4             | 11,9       |
| III.7 Environment (T.07)  | 319,2                               | 263,9                         | 82,7                 | 25,8                | 8,1        | 29,5              | 9,2        |
| III.8 Research (T.08)   | 5 146,4                             | 4 438,5                       | 86,2                 | 686,1               | 13,3       | 21,8              | 0,4        |
| III.9 Information society and media (T.09)  | 1 889,7                             | 1 708,4                       | 90,4                 | 170,7               | 9,0        | 10,6              | 0,6        |
| III.10 Direct research (T.10)   | 671,7                               | 389,4                         | 58,0                 | 269,0               | 40,1       | 13,2              | 2,0        |
| III.11 Fisheries and maritime affairs (T.11)  | 931,5                               | 878,9                         | 94,3                 | 8,3                 | 0,9        | 44,4              | 4,8        |
| III.12 Internal market (T.12)   | 69,2                                | 58,4                          | 84,3                 | 8,1                 | 11,7       | 2,8               | 4,0        |
| III.13 Regional policy (T.13)   | 27 891,2                            | 27 674,5                      | 99,2                 | 195,2               | 0,7        | 21,5              | 0,1        |
| III.14 Taxation and customs union (T.14)  | 121,0                               | 105,3                         | 87,0                 | 10,3                | 8,5        | 5,4               | 4,5        |
| III.15 Education and culture (T.15)   | 1 554,6                             | 1 377,7                       | 88,6                 | 147,2               | 9,5        | 29,7              | 1,9        |
| III.16 Communication (T.16)   | 223,8                               | 186,3                         | 83,2                 | 18,5                | 8,3        | 19,1              | 8,5        |
| III.17 Health and consumer protection (T.17)  | 603,7                               | 515,1                         | 85,3                 | 38,2                | 6,3        | 50,5              | 8,4        |
| III.18 Area of freedom, security and justice (T.18)   | 549,7                               | 444,6                         | 80,9                 | 19,9                | 3,6        | 85,2              | 15,5       |
| III.19 External relations (T.19)  | 3 603,8                             | 3 449,1                       | 95,7                 | 71,8                | 2,0        | 82,9              | 2,3        |
| III.20 Trade (T.20)   | 85,2                                | 75,3                          | 88,3                 | 7,2                 | 8,4        | 2,8               | 3,2        |
| III.21 Development and relations with ACP States (T.21)   | 1 400,7                             | 1 229,0                       | 87,7                 | 118,5               | 8,5        | 53,2              | 3,8        |
| III.22 Enlargement (T.22)   | 1 642,5                             | 1 554,6                       | 94,6                 | 57,5                | 3,5        | 30,4              | 1,8        |
| III.23 Humanitarian aid (T.23)  | 903,6                               | 895,1                         | 99,1                 | 6,8                 | 0,8        | 1,7               | 0,2        |
| III.24 Fight against fraud (T.24)   | 76,2                                | 62,8                          | 82,4                 | 5,9                 | 7,7        | 7,5               | 9,9        |
| III.25 Commission's policy coordination and legal advice (T.25)   | 200,9                               | 176,9                         | 88,0                 | 21,0                | 10,4       | 3,0               | 1,5        |
| III.26 Commission's Administration (T.26)   | 1 181,6                             | 970,9                         | 82,2                 | 171,1               | 14,5       | 39,6              | 3,4        |
| III.27 Budget (T.27)  | 283,7                               | 263,4                         | 92,8                 | 11,7                | 4,1        | 8,6               | 3,0        |
| III.28 Audit (T.28)   | 11,5                                | 10,3                          | 89,3                 | 0,9                 | 8,0        | 0,3               | 2,8        |
| III.29 Statistics (T.29)  | 130,3                               | 109,6                         | 84,1                 | 14,5                | 11,2       | 6,2               | 4,8        |
| III.30 Pensions (T.30)  | 1 080,5                             | 1 049,5                       | 97,1                 | —                   | —          | 31,0              | 2,9        |
| III.31 Language Services (T.31)   | 462,3                               | 410,3                         | 88,7                 | 47,4                | 10,2       | 4,6               | 1,0        |
| III.40 Reserves (T.40)  | 171,2                               | —                             | —                    | —                   | —          | 171,2             | 100,0      |
| IV Court of Justice (S. IV)   | 309,6                               | 288,5                         | 93,2                 | 16,3                | 5,3        | 4,8               | 1,6        |
| V Court of Auditors (S. V)  | 142,1                               | 116,5                         | 81,9                 | 12,6                | 8,9        | 13,0              | 9,2        |
| VI Economic and Social Committee (S. VI)  | 125,6                               | 114,0                         | 90,7                 | 5,9                 | 4,7        | 5,7               | 4,6        |
| VII Committee of the Regions (S. VII)   | 99,2                                | 78,7                          | 79,3                 | 17,6                | 17,8       | 2,9               | 2,9        |
| VIII European Ombudsman (S. VIII)   | 9,1                                 | 7,7                           | 84,6                 | 0,6                 | 6,7        | 0,8               | 8,7        |
| IX European Data-protection Supervisor (S. IX)  | 6,3                                 | 4,3                           | 68,1                 | 0,9                 | 14,3       | 1,1               | 17,6       |
| <b>Grand total appropriations for payments</b>  | <b>125 659,9</b>                    | <b>116 544,5</b>              | <b>92,7</b>          | <b>7 333,3</b>      | <b>5,8</b> | <b>1 782,2</b>    | <b>1,4</b> |
| <b>Financial Framework</b>  |                                     |                               |                      |                     |            |                   |            |
| 1 Sustainable Growth  | 47 743,4                            | 45 611,4                      | 95,5                 | 1 431,1             | 3,0        | 700,9             | 1,5        |
| 2 Preservation and Management of Natural Resources  | 59 431,4                            | 54 812,7                      | 92,2                 | 4 361,1             | 7,3        | 257,7             | 0,4        |
| 3 Citizenship, freedom, security and justice  | 1 533,2                             | 1 310,6                       | 85,5                 | 91,3                | 6,0        | 131,3             | 8,6        |
| 4 EU as a global player   | 8 251,6                             | 7 310,7                       | 88,6                 | 527,3               | 6,4        | 413,6             | 5,0        |
| 5 Administration  | 8 493,7                             | 7 292,5                       | 85,9                 | 922,5               | 10,9       | 278,8             | 3,3        |
| 6 Compensation  | 206,6                               | 206,6                         | 100,0                | —                   | —          | —                 | —          |
| <b>Grand total appropriations for payments</b>  | <b>125 659,9</b>                    | <b>116 544,5</b>              | <b>92,7</b>          | <b>7 333,3</b>      | <b>5,8</b> | <b>1 782,2</b>    | <b>1,4</b> |

<sup>(1)</sup> 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.

<sup>(2)</sup> For Section III (Commission) the titles (T) correspond to the activities/policy areas as defined by the institution for implementing activity based budgeting (ABB).

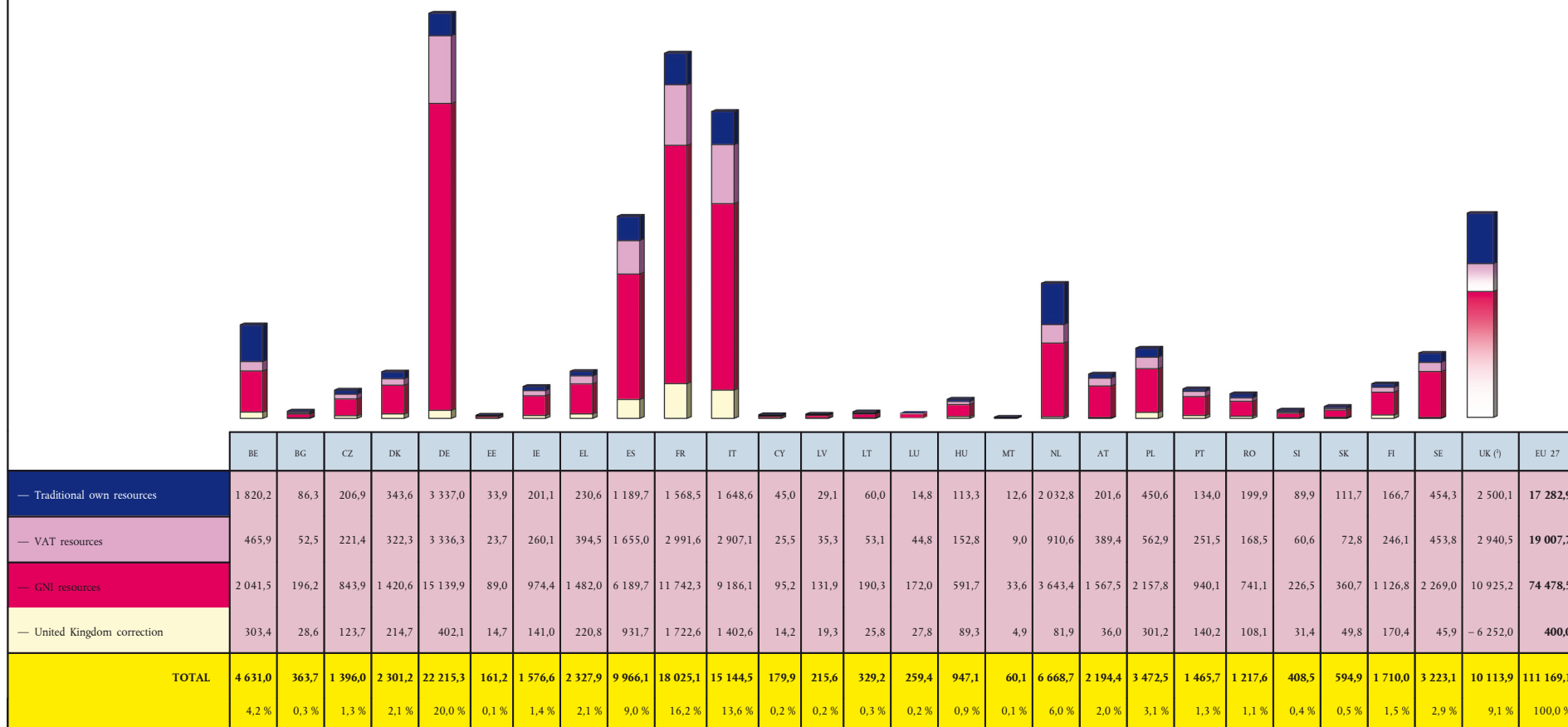




Diagram V  
Own resources in 2008, by Member State

## Revenue Outturn

(million euro and %)



(\*) For the United Kingdom a correction (6 252 million euro) is applied to the gross amount of own resources (16 365,9 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 2008, in each Member State <sup>(1)</sup>

Note: Payments made in 2008 = payments against 2008 operating appropriations plus payments against carry-overs from 2007.

## Financial framework headings

(million euro and %)

|                                     | BE             | BG           | CZ             | DK             | DE              | EE           | IE             | EL             | ES              | FR              | IT              | CY           | LV           | LT             | LU           | HU             | MT          | NL             | AT             | PL             | PT             | RO             | SI           | SK             | FI             | SE             | UK             | Third Countries and misc. <sup>(2)</sup> | Total            |
|-------------------------------------|----------------|--------------|----------------|----------------|-----------------|--------------|----------------|----------------|-----------------|-----------------|-----------------|--------------|--------------|----------------|--------------|----------------|-------------|----------------|----------------|----------------|----------------|----------------|--------------|----------------|----------------|----------------|----------------|--|------------------|
| — Sustainable Growth                | 1 178,5        | 271,7        | 1 742,8        | 239,5          | 4 124,7         | 251,4        | 296,1          | 4 868,5        | 4 785,6         | 3 288,5         | 4 569,3         | 61,0         | 401,0        | 808,8          | 73,2         | 1 250,9        | 51,0        | 1 112,6        | 450,9          | 4 738,7        | 2 684,1        | 695,7          | 273,0        | 848,7          | 420,6          | 391,1          | 2 994,8        | 2 738,8                                  | <b>45 611,4</b>  |
| Competitiveness                     | 781,1          | 48,6         | 63,4           | 141,5          | 1 042,7         | 14,4         | 82,5           | 156,1          | 538,9           | 975,9           | 880,5           | 13,7         | 17,6         | 178,6          | 63,5         | 62,3           | 7,0         | 441,8          | 219,0          | 129,9          | 115,3          | 47,2           | 38,3         | 39,2           | 206,9          | 237,4          | 894,5          | 2 662,8                                  | <b>10 100,7</b>  |
| Cohesion                            | 397,4          | 223,0        | 1 679,4        | 98,0           | 3 082,1         | 237,0        | 213,6          | 4 712,4        | 4 246,7         | 2 312,6         | 3 688,7         | 47,3         | 383,4        | 630,2          | 9,6          | 1 188,6        | 43,9        | 670,8          | 231,9          | 4 608,7        | 2 568,9        | 648,5          | 234,6        | 809,5          | 213,7          | 153,7          | 2 100,3        | 76,0                                     | <b>35 510,7</b>  |
| — Preserv. of Natural Resources     | 984,8          | 420,1        | 699,5          | 1 245,6        | 6 641,2         | 97,4         | 1 849,6        | 3 539,7        | 7 332,1         | 10 151,5        | 6 351,9         | 55,7         | 227,6        | 253,2          | 53,0         | 728,3          | 13,7        | 1 082,9        | 1 228,9        | 2 663,1        | 1 428,8        | 1 060,5        | 192,5        | 392,3          | 868,1          | 989,8          | 4 087,6        | 173,5                                    | <b>54 812,7</b>  |
| — Citiz., freedom, sec. and justice | 115,6          | 5,0          | 12,4           | 11,6           | 81,1            | 8,2          | 7,5            | 117,5          | 58,4            | 116,3           | 125,5           | 8,7          | 9,6          | 27,0           | 9,4          | 27,0           | 16,7        | 53,6           | 32,6           | 82,7           | 27,0           | 16,9           | 22,8         | 11,2           | 11,7           | 52,6           | 205,4          | 36,7                                     | <b>1 310,6</b>   |
| — EU as a global player             | 152,2          | 201,5        | 6,1            | 2,2            | 26,1            | 3,4          | 0,2            | 3,4            | 19,5            | 34,1            | 24,5            | 15,0         | 3,8          | 34,6           | 2,1          | 15,2           | 0,1         | 10,3           | 5,1            | 125,3          | 4,3            | 744,9          | 3,4          | 11,6           | 3,4            | 12,1           | 52,6           | 5 793,5                                  | <b>7 310,7</b>   |
| — Compensation                      | —              | 64,0         | —              | —              | —               | —            | —              | —              | —               | —               | —               | —            | —            | —              | —            | —              | —           | —              | —              | —              | —              | 142,7          | —            | —              | —              | —              | —              | —  | <b>206,6</b>     |
| <b>TOTAL</b>                        | <b>2 431,1</b> | <b>962,3</b> | <b>2 460,9</b> | <b>1 498,9</b> | <b>10 873,1</b> | <b>360,4</b> | <b>2 153,4</b> | <b>8 529,1</b> | <b>12 195,6</b> | <b>13 590,5</b> | <b>11 071,1</b> | <b>140,4</b> | <b>641,9</b> | <b>1 123,6</b> | <b>137,6</b> | <b>2 021,4</b> | <b>81,4</b> | <b>2 259,4</b> | <b>1 717,6</b> | <b>7 609,8</b> | <b>4 144,2</b> | <b>2 660,7</b> | <b>491,6</b> | <b>1 263,8</b> | <b>1 303,8</b> | <b>1 445,6</b> | <b>7 340,4</b> | <b>8 742,5</b>                           | <b>109 252,0</b> |
|                                     | 2,2 %          | 0,9 %        | 2,3 %          | 1,4 %          | 10,0 %          | 0,3 %        | 2,0 %          | 7,8 %          | 11,2 %          | 12,4 %          | 10,1 %          | 0,1 %        | 0,6 %        | 1,0 %          | 0,1 %        | 1,9 %          | 0,1 %       | 2,1 %          | 1,6 %          | 7,0 %          | 3,8 %          | 2,4 %          | 0,4 %        | 1,2 %          | 1,2 %          | 1,3 %          | 6,7 %          | 8,0 %                                    | 100,0 %          |

<sup>(1)</sup> 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.<sup>(2)</sup> 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.



| <b>Diagram VII</b>                       |                  |                  |
|--|------------------|------------------|
| <b>Consolidated balance sheet</b>        |                  |                  |
| <i>(million euro)</i>                    |                  |                  |
|  | 31.12.2008       | 31.12.2007       |
| <b>Non-current assets:</b>               |                  |                  |
| Intangible assets                        | 56               | 44               |
| Property, plant and equipment            | 4 881            | 4 523            |
| Long-term investments                    | 2 078            | 1 973            |
| Loans                                    | 3 565            | 1 806            |
| Long-term pre-financing                  | 29 023           | 14 015           |
| Long-term receivables                    | 45               | 127              |
|  | <b>39 648</b>    | <b>22 488</b>    |
| <b>Current assets:</b>                   |                  |                  |
| Inventories                              | 85               | 88               |
| Short-term investments                   | 1 553            | 1 420            |
| Short-term pre-financing                 | 10 262           | 20 583           |
| Short-term receivables                   | 11 920           | 12 051           |
| Cash and cash equivalents                | 23 724           | 18 756           |
|  | <b>47 544</b>    | <b>52 898</b>    |
| <b>Total assets</b>                      | <b>87 192</b>    | <b>75 386</b>    |
| <b>Non-current liabilities:</b>          |                  |                  |
| Employee benefits                        | - 37 556         | - 33 480         |
| Long-term provisions                     | - 1 341          | - 1 079          |
| Long-term financial liabilities          | - 3 349          | - 1 574          |
| Other long-term liabilities              | - 2 226          | - 1 989          |
|  | <b>- 44 472</b>  | <b>- 38 122</b>  |
| <b>Current liabilities:</b>              |                  |                  |
| Short-term provisions                    | - 348            | - 369            |
| Short-term financial liabilities         | - 119            | - 135            |
| Accounts payable                         | - 89 677         | - 95 380         |
|  | <b>- 90 144</b>  | <b>- 95 884</b>  |
| <b>Total liabilities</b>                 | <b>- 134 616</b> | <b>- 134 006</b> |
| <b>Net assets</b>                        | <b>- 47 424</b>  | <b>- 58 620</b>  |
| Reserves                                 | 3 115            | 2 806            |
| Amounts to be called from Member States: |                  |                  |
| <i>Employee benefits</i>                 | - 37 556         | - 33 480         |
| <i>Other amounts</i>                     | - 12 983         | - 27 946         |
| <b>Net assets</b>                        | <b>- 47 424</b>  | <b>- 58 620</b>  |



| <b>Diagram VIII</b>   |                  |                  |
|---|------------------|------------------|
| <b>Consolidated economic outturn account</b>                  |                  |                  |
| <i>(million euro)</i>   |                  |                  |
|   | 31.12.2008       | 31.12.2007       |
| <b>Operating revenue</b>                                      |                  |                  |
| Own resource and contributions revenue                        | 112 713          | 112 084          |
| Other operating revenue                                       | 9 731            | 9 080            |
|   | <b>122 444</b>   | <b>121 164</b>   |
| <b>Operating expenses</b>                                     |                  |                  |
| Administrative expenses                                       | - 7 720          | - 7 120          |
| Operating expenses  | - 97 214         | - 104 682        |
|   | <b>- 104 934</b> | <b>- 111 802</b> |
| <b>Surplus from operating activities</b>                      | <b>17 510</b>    | <b>9 362</b>     |
| Financial revenue   | 698              | 674              |
| Financial expenses  | - 467            | - 354            |
| Movement in employee benefits liability                       | - 5 009          | - 2 207          |
| Share of net surplus (deficit) of associates & joint ventures | - 46             | - 13             |
| <b>Economic outturn for the year</b>                          | <b>12 686</b>    | <b>7 462</b>     |





## ANNEX II

**List of Special Reports adopted by the Court of Auditors since the last Annual Report:**

- Special Report No 8/2008 — Is cross compliance an effective policy?
- Special Report No 9/2008 — The effectiveness of EU support in the area of freedom, security and justice for Belarus, Moldova and Ukraine
- Special Report No 10/2008 — EC Development Assistance to Health Services in Sub-Saharan Africa
- Special Report No 11/2008 — The management of the European Union support for the public storage operations of cereals
- Special Report No 12/2008 — Instrument for Structural Policies for Pre-accession (ISPA), 2000-2006
- Special Report No 1/2009 — Banking measures in the Mediterranean area in the context of the MEDA programme and the previous protocols
- Special Report No 2/2009 — The European Union's Public Health Programme (2003-2007): an effective way to improve health?
- Special Report No 3/2009 — The effectiveness of Structural Measures spending on waste water treatment for the 1994-1999 and 2000-2006 programme periods
- Special Report No 4/2009 — The Commission's management of Non-State Actors' involvement in EC Development Cooperation
- Special Report No 5/2009 — The Commission's Treasury Management
- Special Report No 6/2009 — European Union food aid for deprived persons: an assessment of the objectives, the means and the methods employed
- Special Report No 7/2009 — The management of the Galileo programme's development and validation phase
- Special Report No 8/2009 — 'Networks of excellence' and 'Integrated projects' in Community Research policy: did they achieve their objectives?
- Special Report No 9/2009 — The efficiency and effectiveness of the personnel selection activities carried out by the European Personnel Selection Office
- Special Report No 10/2009 — Information provision and promotion measures for agricultural products
- Special Report No 11/2009 — The sustainability and the Commission's management of the LIFE-Nature projects
- Special Report No 12/2009 — The effectiveness of the Commission's projects in the area of Justice and Home Affairs for the western Balkans
- Special Report No 13/2009 — Delegating implementing tasks to executive agencies: a successful option?
- Special Report No 14/2009 — Have the management instruments applied to the market in milk and milk products achieved their main objectives?

These reports can be accessed for consultation or downloading on the European Court of Auditors' website:  
[www.eca.europa.eu](http://www.eca.europa.eu)

A paper copy or a CD-ROM version may be obtained on request to the Court of Auditors:

**European Court of Auditors  
Communication and Reports Unit  
12, rue Alcide De Gasperi  
1615 Luxembourg  
LUXEMBOURG  
Tel: + (352) 4398-1  
e-mail: [auraud@eca.europa.eu](mailto:auraud@eca.europa.eu)**

or by filling in an electronic order form on EU-Bookshop.

**ANNUAL REPORT ON THE ACTIVITIES  
FUNDED BY THE SEVENTH, EIGHTH, NINTH  
AND TENTH EUROPEAN DEVELOPMENT  
FUNDS (EDFS)**

(2009/C 269/02)



**Annual Report on the activities funded by the seventh, eighth, ninth and tenth European Development Funds (EDFs)**

## TABLE OF CONTENTS

|   | <i>Paragraph</i> |
|---|------------------|
| Introduction  | 1-4              |
| Chapter I — Implementation of the seventh, eighth, ninth and tenth EDFs   | 5-8              |
| Financial implementation  | 5-7              |
| The Commission's annual report on the financial management of the seventh to tenth European Development Funds   | 8                |
| Chapter II — Statement of Assurance by the Court of Auditors on the EDFs  | 9-56             |
| Statement of Assurance by the Court of Auditors on the seventh, eighth, ninth and tenth European Development Funds (EDFs) for the financial year 2008 | I-XII            |
| Information in support of the Statement of Assurance  | 9-49             |
| Audit scope and approach  | 9-12             |
| Reliability of the accounts   | 13-15            |
| Regularity of transactions  | 16-26            |
| Annual Activity Report and Declaration by the Director-General of EuropeAid   | 27-32            |
| Effectiveness of the systems  | 33-49            |
| Conclusions and recommendations   | 50-56            |

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

1. The European Development Funds (EDFs) are the result of international conventions or agreements <sup>(1)</sup> between the Community and its Member States, on the one hand, and certain African, Caribbean and Pacific (ACP) States, on the other hand, and of Council Decisions on the association of overseas countries and territories (OCT).

2. The Commission has responsibility for and takes charge of the management of most of the expenditure of the EDFs. The EDF's investment facility has been fully managed by the European Investment Bank (EIB) since 1 April 2003. This facility is not covered by the Court's Statement of Assurance or the European Parliament's discharge procedure <sup>(2)</sup> <sup>(3)</sup>.

3. The structure of the EDF is presented in **Diagram 1**. The EDFs are managed under different arrangements: the centralised, joint and decentralised management modes <sup>(4)</sup>. In the centralised management mode, the Commission manages contract award procedures and payments to final beneficiaries itself. In the joint management mode, certain implementation tasks are entrusted to international organisations provided that the accounting, audit, control and procurement procedures of the organisations offer guarantees equivalent to internationally accepted standards. In the decentralised management mode, the daily management is ensured by the National Authorising Officer (NAO) <sup>(5)</sup> of each beneficiary country and the Commission (see **Diagram 2**). They are responsible for:

- (a) checking regularly that operations have been properly implemented;
- (b) taking appropriate measures to prevent irregularities and serious non-compliance with laws and regulations and, if necessary, bringing prosecutions to recover funds wrongly paid.

<sup>(1)</sup> The Yaoundé I Convention dates back to 1964. The most recent agreement (Cotonou) dates from 23 June 2000 and was revised on 25 June 2005.

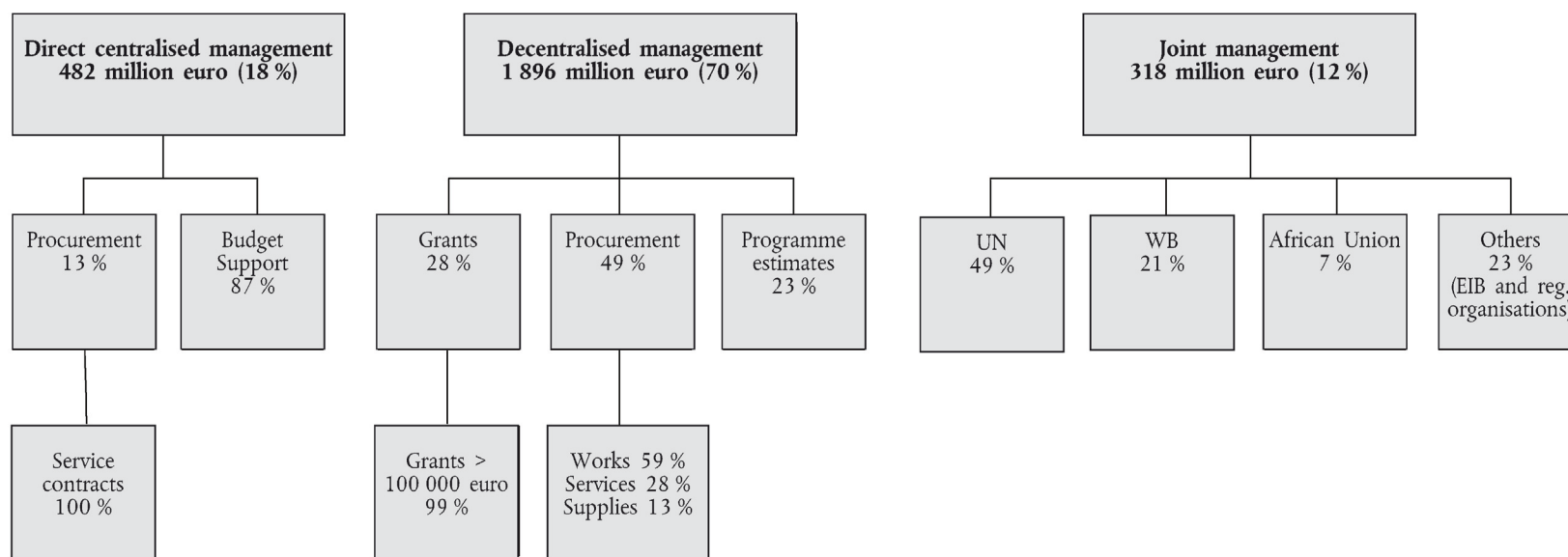
<sup>(2)</sup> See Articles 118, 125 and 134 of the Financial Regulation of 18 February 2008 applicable to the tenth EDF (OJ L 78, 19.3.2008). In its Opinion No 9/2007 on the proposal for this Regulation (OJ C 23, 28.1.2008), the Court stressed that these provisions reduce the scope of the European Parliament's powers of discharge.

<sup>(3)</sup> A tripartite agreement between the EIB, the Commission and the Court (Article 134 of the Financial Regulation of 18 February 2008 applicable to the tenth EDF referred to above) sets out rules for the audit of these operations by the Court.

<sup>(4)</sup> Articles 21 to 29 of the Financial Regulation applicable to the tenth EDF.

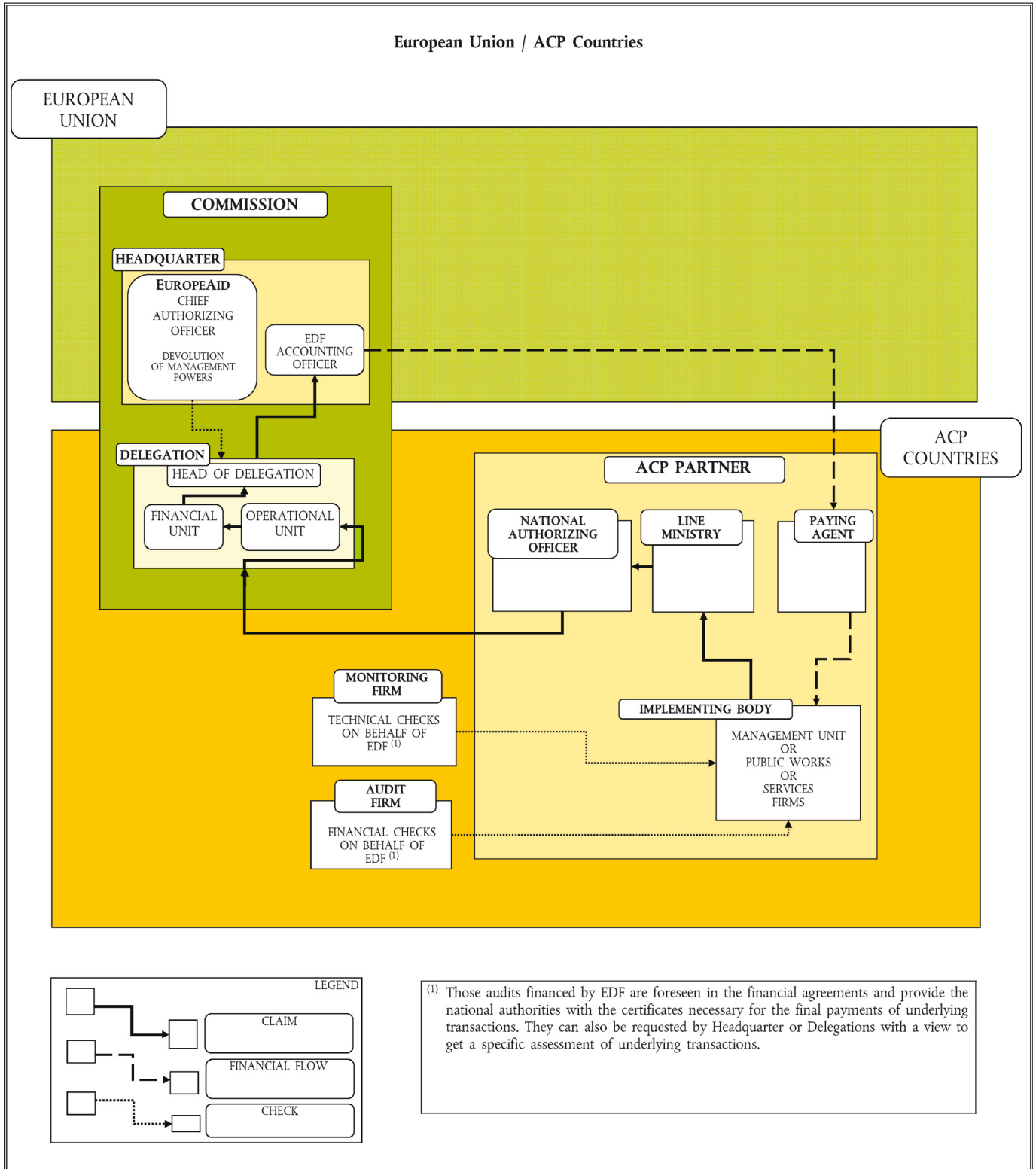
<sup>(5)</sup> Cotonou Agreement, Annex IV, Article 35.

**Diagram 1 — Structure of the EDF (in terms of contract value)**



Source: AIDCO Annual Activity report for 2008 (Annex 5 - Internal Control Templates).

Diagram 2 — Principle of decentralised management





## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4. Within the Commission, almost all of the EDF programmes are managed by the EuropeAid Cooperation Office (hereinafter called EuropeAid), which is also responsible for the management of most of the External Relations and Development expenditure financed by the General Budget of the European Union <sup>(6)</sup>. A small proportion of the EDF projects <sup>(7)</sup> relates to humanitarian aid and is managed by the Directorate-General for Humanitarian Aid (DG ECHO).

## CHAPTER I — IMPLEMENTATION OF THE SEVENTH, EIGHTH, NINTH AND TENTH EDFs

**Financial implementation**

5. In 2008, the seventh, eighth, ninth and tenth EDFs were implemented simultaneously. The Authorising Officer of the EDF closed the seventh EDF on 31 August 2008 <sup>(8)</sup>. At closure 10 381 million euro had been paid (98,3 % of the 10 559 million euro allocated to aid measures). The balance of 178 million euro was transferred to the ninth EDF.

6. The tenth EDF covering the period from 2008 to 2013 and providing for Community aid of 22 682 million euro entered into force on 1 July 2008. Of this amount, 21 966 million euro is allocated to the ACP countries, 286 million euro to the OCTs. These amounts include 1 500 million euro and 30 million euro to the Investment Facility managed by the EIB for the ACP countries and OCTs respectively. Lastly, 430 million euro are foreseen for the Commission's expenditure for programming and implementation of the EDF.

7. **Table I** shows the cumulative use of EDF resources managed by the Commission and their financial implementation. **Charts I** and **II** show the cumulative resources and cumulative decisions by sector of intervention. In 2008 the financial implementation forecasts set by the Commission for global commitments, individual commitments and payments were all exceeded, reaching record levels for global commitments (4 723 million euro), individual commitments (2 649 million euro) and net payments (3 143 million euro). This is partly explained by the fact that the implementation of the tenth EDF got off to a quick start, and by the strong increase in budget support operations, with global commitments and payments reaching 2 583 million euro and 606 million euro respectively. Outstanding payments increased by 15 %, which is reasonable, given the record level of commitments reached during the year. At the same time, old and dormant outstanding payments decreased by 33 %.

5. *In the interests of sound financial management of the EDF, the Commission has continued its efforts to wind down old projects, and the 7th EDF was closed as planned on 31 August 2008.*

7. *This year the Commission has again performed exceptionally well as regards commitments and payments and in the management of outstanding amounts. This proves that the efforts made in recent years to speed up programme implementation have borne fruit.*

<sup>(6)</sup> See Chapter 8 of the Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2008.

<sup>(7)</sup> Representing 0,6 % of 2008 payments.

<sup>(8)</sup> Commission Decision PE/2008/4803 of 29.8.2008.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**The Commission's annual report on the financial management of the seventh to tenth European Development Funds**

8. The Financial Regulation applicable to the tenth EDF <sup>(9)</sup> requires the Commission to report each year on the financial management of the EDFs. In the Court's opinion, the report on the financial management presents an accurate description of the achievement of the Commission's operational objectives for the financial year (particularly concerning financial implementation and control activities), the financial situation and the events that had a significant influence on the activities carried out in 2008.

---

<sup>(9)</sup> Articles 118 and 124.

Table 1 — Cumulative use of EDF resources at 31 December 2008

(million euro)

|   | Situation at end of 2007 |                                    | Budgetary implementation during the financial year 2008 |         |         |          |                 | Situation at end of 2008 |          |          |          |                              |                                    |
|---|--------------------------|------------------------------------|---|---------|---------|----------|-----------------|--------------------------|----------|----------|----------|------------------------------|------------------------------------|
|   | Global amount            | Implementation rate <sup>(2)</sup> | 7th EDF   | 8th EDF | 9th EDF | 10th EDF | Global amount   | 7th EDF Closed           | 8th EDF  | 9th EDF  | 10th EDF | Global amount <sup>(3)</sup> | Implementation rate <sup>(2)</sup> |
| <b>A — RESOURCES <sup>(1)</sup></b>     | <b>37 328,7</b>          |                                    | - 765,0   | - 53,4  | 725,4   | 21 260,1 | <b>21 167,1</b> | 0,0                      | 10 785,9 | 16 631,8 | 21 260,1 | <b>48 677,7</b>              |                                    |
| <b>B — USE</b>                          |                          |                                    |   |         |         |          |                 |                          |          |          |          |                              |                                    |
| <b>1. Financial commitments</b>         | <b>37 279,4</b>          | 99,9 %                             | - 765,0   | - 53,4  | 774,7   | 4 766,4  | <b>4 722,7</b>  | 0,0                      | 10 785,8 | 16 631,8 | 4 766,4  | <b>32 184,1</b>              | 66,1 %                             |
| <b>2. Individual legal commitments</b>  | <b>32 046,0</b>          | 85,8 %                             | - 699,2   | 54,6    | 3 163,2 | 130,4    | <b>2 649,1</b>  | 0,0                      | 10 539,2 | 14 207,4 | 130,4    | <b>2 649,1</b>               | 51,1 %                             |
| <b>3. Payments</b>                      | <b>26 700,0</b>          | 71,5 %                             | - 522,8   | 323,1   | 3 253,0 | 89,8     | <b>3 143,1</b>  | 0,0                      | 9 928,6  | 10 006,7 | 89,8     | <b>20 025,1</b>              | 41,1 %                             |
| <b>C — Outstanding payments (B1-B3)</b> | <b>10 579,4</b>          | 28,3 %                             |   |         |         |          |                 | 0,0                      | 857,3    | 6 625,1  | 4 676,6  | <b>12 159,0</b>              | 25,0 %                             |
| <b>D — Available balance (A-B1)</b>     | <b>49,3</b>              | 0,1 %                              |   |         |         |          |                 | 0,0                      | 0,0      | 0,0      | 16 493,7 | <b>16 493,7</b>              | 33,9 %                             |

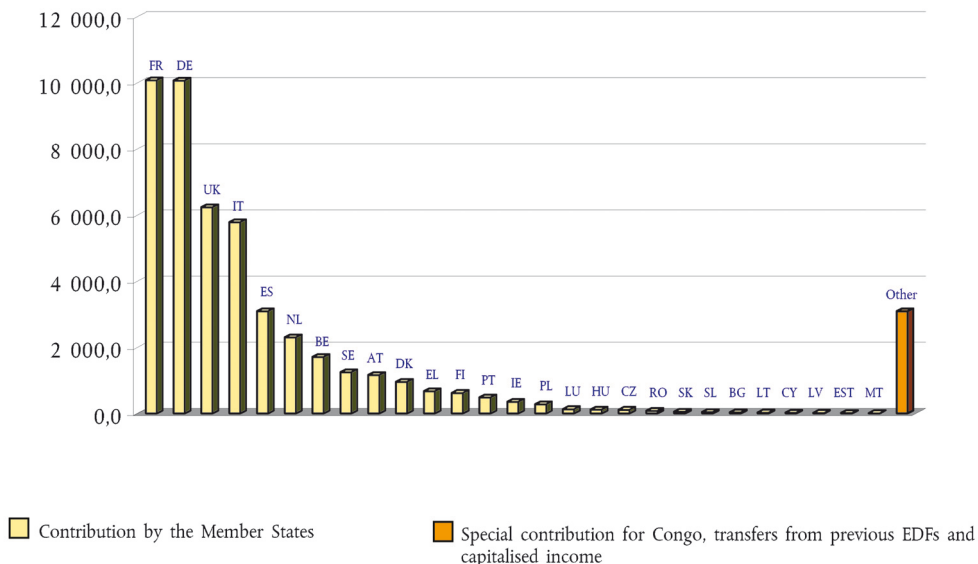
<sup>(1)</sup> Initial allocations to the 7th, 8th, 9th and 10th EDFs, interest, sundry resources and transfers from previous EDFs.<sup>(2)</sup> As a percentage of resources.<sup>(3)</sup> These figures do not include an amount of 9 818 million euro for the 7th EDF which was closed during the year.

Source: Court of Auditors, based on the EDF Reports on financial implementation and Financial statements at 31 December 2008.

**Charts illustrating the consolidated eighth, ninth and tenth EDFs as at 31 December 2008**

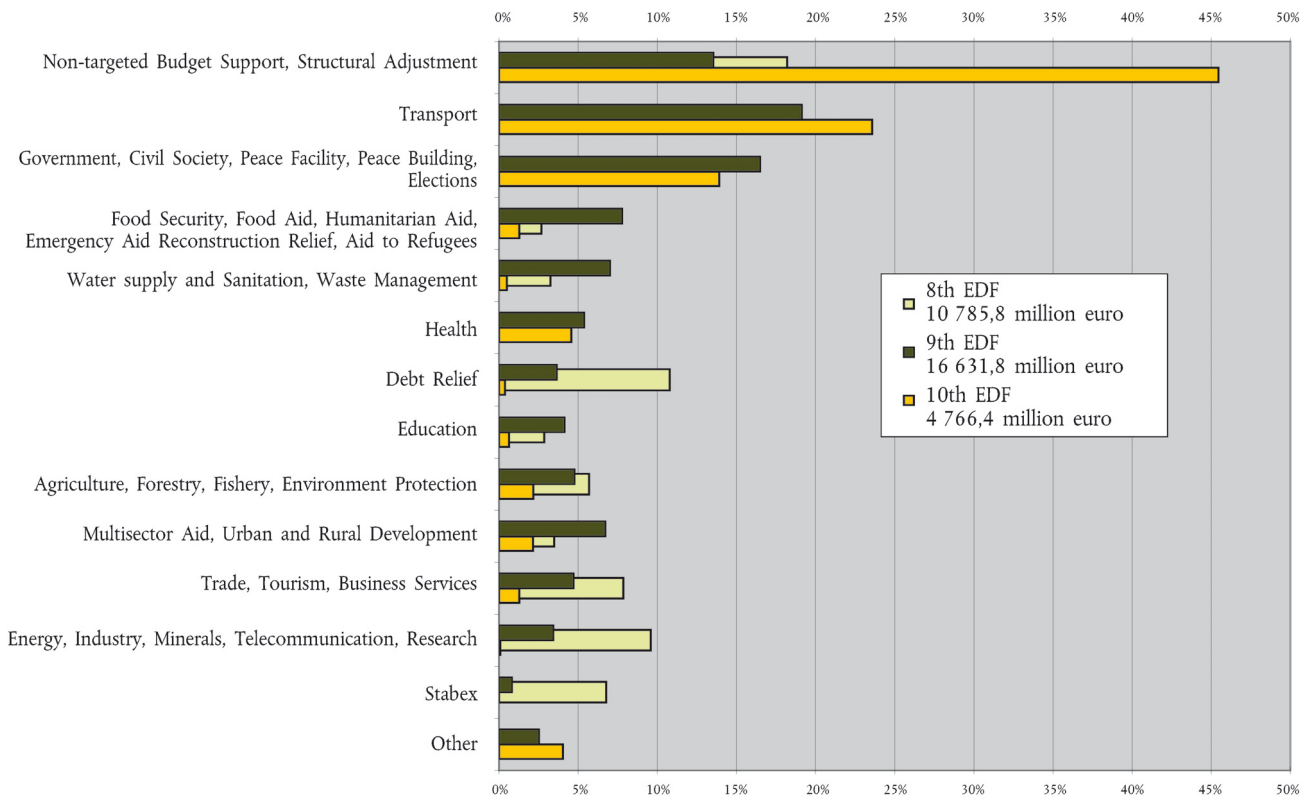
**Chart I: Cummulative resources**

**Total = 48 677,73 million euro**



**Chart II: Cummulative decisions**

**Total = 32 184,06 million euro <sup>(1)</sup>**



Source: Court of Auditors, on the basis of the data in the accounting system.

<sup>(1)</sup> The difference between the cumulative resources (48 677,73 million euro) and the cumulative decisions (32 184,06 million euro), equals the available balance to be allocated (16 493,67 million euro).

## CHAPTER II — STATEMENT OF ASSURANCE BY THE COURT OF AUDITORS ON THE EDFs

**Statement of Assurance by the Court of Auditors on the seventh, eighth, ninth and tenth European Development Funds (EDFs) for the financial year 2008**

- I. Pursuant to the provisions of Article 248 of the Treaty the Court has audited:
- (a) the 'Final annual accounts for the financial year 2008 of the seventh, eighth, ninth and tenth European Development Funds' which comprise the consolidated financial statements<sup>(10)</sup> and the consolidated report on the financial implementation of the seventh, eighth, ninth and tenth EDFs; and
  - (b) the legality and regularity of the underlying transactions within the legal framework of the EDFs in respect of the part of the EDF resources for whose financial management the Commission is responsible<sup>(11)</sup>.

**Management's responsibility**

II. In accordance with the Financial Regulations applicable to the seventh, eighth, ninth and tenth EDFs, management<sup>(12)</sup> is responsible for the preparation and fair presentation of the final annual accounts of the EDFs and the legality and regularity of the underlying transactions:

- (a) The management's responsibility concerning the final annual accounts of the EDFs 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 EDF accounting officer<sup>(13)</sup>, and making accounting estimates that are reasonable in the circumstances. The Commission approves the final annual accounts of the EDFs.
- (b) The way in which management exercises its responsibility for legality and regularity of underlying transactions depends on the method of implementation of the EDFs. In the case of direct centralised management, implementation tasks are performed by the Commission's departments. Under decentralised management implementation tasks are delegated 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. 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 EDFs.

<sup>(10)</sup> The consolidated financial statements comprise the balance sheet, the statement of economic outturn, the statement of cash flow and the table of items payable to the European Development Funds. The financial statements and information supplied by the EIB are not covered by this Statement of Assurance (see footnote 11).

<sup>(11)</sup> Pursuant to Articles 1 and 103(3) of the Financial Regulation applicable to the ninth EDF and Articles 2, 3, 4 and 125(3) of the Financial Regulation applicable to the tenth EDF the Statement of Assurance does not extend to the part of the ninth and tenth EDFs resources that are managed by the EIB and for which it is responsible.

<sup>(12)</sup> At the level of the Commission management includes the Members of the Institution, Authorising Officers by delegation and sub-delegation, the Accounting Officer and the leading staff of financial, audit or control units. At the level of Beneficiary States, management includes National Authorising Officers, Accounting Officers, Paying Agents and the leading staff of implementing organisations.

<sup>(13)</sup> The accounting rules adopted by the EDF 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 2008 are prepared on the basis of these accounting rules adopted by the EDF accounting officer, which adapt accruals based accounting principles to the specific environment of the Communities, while the consolidated reports on implementation of the EDFs continue to be primarily based on movements of cash.

**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. The Court conducted its audit in accordance with the IFAC and INTOSAI International Auditing Standards and Codes of Ethics. These standards require that the Court plans and performs the audit to obtain reasonable assurance whether the final annual accounts of the EDFs are free from material misstatement and the underlying transactions, taken as a whole, are legal and regular.

IV. 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 EDFs, 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.

V. The Court did not obtain all the necessary information and documentation concerning 10 sampled payments made to international organisations. For this reason, the Court is not able express an opinion on the regularity of expenditure amounting to 190 million euro, or 6,7 % of the annual expenditure.

VI. Subject to the limitation mentioned in paragraph V, 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, the final annual accounts of the seventh, eighth, ninth and tenth EDFs present fairly, in all material respects, the financial position of the EDFs as of 31 December 2008, 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 accounting officer.

VIII. Without qualifying the opinion expressed in paragraph VII, the Court draws attention to the fact that the method used to estimate the provision for costs incurred is not valid for certain types of contracts and to the Commission's decision to refine it from the financial year 2009 onward.

**Opinion on legality and regularity of the transactions underlying the accounts**

IX. In the Court's opinion the revenue and commitments of the seventh, eighth, ninth and tenth European Development Funds for the year ended 31 December 2008 were free from material error.

X. Without calling into question the opinion expressed in paragraph IX, the Court draws attention to the high incidence of non-quantifiable error that occurred in budget support commitments albeit not included in the estimation of total error.

XI. In the Court's opinion the payments by the seventh, eighth, ninth and tenth European Development Funds for the year ended 31 December 2008 were affected by material error.

XII. The Court has identified significant improvements in the Commission's supervisory and control systems. The Court notes that there is scope for clearer conclusions as to how the results of various controls contribute to the Director-General's assurance and for improving the design and/or implementation of certain systems. The Court also draws attention to the need for the Commission to pursue its efforts to substantiate its decisions on the eligibility of budget support. This requires a structured and formalised demonstration that the recipient countries have a relevant reform programme.

16 and 17 September 2009

Vítor Manuel da Silva Caldeira

*President*

European Court of Auditors  
12, rue Alcide De Gasperi, L-1615 Luxembourg

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Information in support of the Statement of Assurance*****Audit scope and approach***

9. The observations regarding the reliability of the accounts of the EDFs, set out in paragraphs VII and VIII of the Statement of Assurance, are based on an audit of the consolidated financial statements<sup>(14)</sup> and the consolidated report on the financial implementation of the seventh, eighth, ninth and tenth EDFs<sup>(15)</sup>. The audit comprised an appropriate range of audit procedures designed to examine, on a test basis, evidence relating to the amounts and disclosures. It included an assessment of the accounting principles used, significant estimates made by management and the overall presentation of the consolidated accounts.

10. The observations regarding the regularity<sup>(16)</sup> of transactions, set out in paragraphs IX to XII of the Statement of Assurance, are based on the following components:

- (a) substantive testing of a representative statistical sample of 225 items, corresponding to 45 financial and individual legal commitments and 180 payments made by EuropeAid central services and Delegations, including 40 advance payments. Where necessary, implementing organisations and final beneficiaries were visited on the spot in order to verify underlying payments declared in financial reports or cost statements;
- (b) an assessment of the effectiveness of supervisory and control systems at EuropeAid's central services and in the Delegations, including the follow-up of previous key Statement of Assurance observations (see **Annex 2**):
  - (i) ex-ante checks of contracts and payments by authorising officers,
  - (ii) monitoring of implementing organisations,
  - (iii) external audits,
  - (iv) monitoring by EuropeAid central services,
  - (v) internal audit;
- (c) an assessment of the Annual Activity Report and Declaration by the Director-General of EuropeAid.

<sup>(14)</sup> See Article 122 of the Financial Regulation of 18 February 2008 applicable to the tenth EDF: the financial statements shall comprise the balance sheet, the statement of economic outturn, the statement of cash flow, and the table of items payable to the EDF.

<sup>(15)</sup> See Article 123 of the Financial Regulation of 18 February 2008 applicable to the tenth EDF: the reports on financial implementation shall comprise tables describing the appropriations, the commitments and the payments.

<sup>(16)</sup> For the sake of brevity, the term 'regularity of transactions' is used throughout the report to denote 'legality and regularity of underlying transactions'.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

11. In the context of the audit, five countries were visited on the spot in order to perform detailed auditing of the transactions: Angola, the Republic of Congo, Malawi, Mozambique and Mauritania.

12. The Court's audit included a review of the procedures in place concerning the accounting and monitoring of the recovery orders issued.

**Reliability of the accounts**

13. The 2008 annual accounts are the fourth set of accounts prepared under the accruals-based accounting rules. The Court has indicated in its previous Annual Reports that the EDF accounting system did not have all the features necessary for efficient and effective reporting of economic information on an accruals basis, increasing the risk of accounting errors as a result of the extensive manual operations required to convert cash-based data into accrual-based annual accounts. However, despite this risk, the Court's audit found the annual accounts to be free from material error.

14. The new accrual based accounting system ABAC FED was opened in February 2009. All the EDF operational, financial and accounting data have been transferred to the new system. This should further strengthen the EDF accounting environment.

15. The annual accounts contain a provision of 2 113 million euro for the costs incurred in the reporting period but for which no invoices have been received at the year-end. This provision is estimated on the basis of a number of assumptions, notably the linearity of contract expenditure. As announced in its reply to the Court's Annual Report on the EDF concerning the financial year 2007 <sup>(17)</sup>, the Commission carried out a study which confirmed that this assumption is not valid for certain types of contracts. As indicated in the Notes to the annual accounts, the Commission has decided to refine its method from the financial year 2009.

**Regularity of transactions**

16. The main features and results of sample-based substantive testing are presented in **Annex I**.

*Revenue*

17. The Court's audit of revenue transactions found them to be free from material error.

*Project commitments*

18. The Court's audit of project commitments found them to be free from material error.

**13.** The introduction of the new accounting system in 2009 has overcome the past limitations. The new system has all the features required for efficient and effective accrual based reporting. In the financial year 2008, as in previous years, the manual processing is subject to rigorous controls in order to reduce risks.

**15.** A study was conducted to check the validity of the method used to estimate the provision for invoices receivable. It concluded that the method was valid in the great majority of cases. In the light of the study's conclusions, the Commission will refine the method for the closure for 2009.

<sup>(17)</sup> Paragraph 17.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Budget support commitments*

19. The Court's audit of budget support commitments found them to be affected by a high level of non-quantifiable errors. In comparison with previous years, the Court found that the Commission's assessments of compliance with the Cotonou Agreement requirements are improving; the demonstration is better structured and formalised, notably for Millennium Development Goals (MDG) contracts. However, the Court still found frequent cases where the Commission did not demonstrate in a structured and formalised manner that public finance management was sufficiently transparent, accountable and effective (see paragraphs 44 to 46).

*Project payments*

20. The Court's audit of advance payments found them to be free from material error.

21. In spite of the Commission's intervention in order to facilitate the audit work to be carried out, the Court did not obtain all the necessary information and documentation concerning 10 transactions managed by international organisations<sup>(18)</sup>. The Court is therefore not in a position to express an opinion on the regularity of these transactions. The Court notes that the verifier mandated by the Commission to perform a verification mission at one of these organisations<sup>(19)</sup> had reported a similar problem.

22. The Court's audit revealed a material level of error affecting the amount of the payments audited<sup>(20)</sup>. The frequency and types of errors, as well as the impact of quantifiable errors, are presented in **Annex 1 (Part 1, 1.3 and 1.4)**.

23. The main types of quantifiable errors detected are the following:

- (a) eligibility: expenditure incurred outside the implementation period, exceeding the budget allowed, or relating to ineligible items;
- (b) occurrence: absence of invoices or other supporting documents;
- (c) accuracy: calculation errors.

**19.** *The Commission welcomes the recognition by the Court that its continuous and ongoing efforts to improve the clarity and structure of assessments of compliance with the Cotonou Agreement with regard to budget support eligibility (Article 61 of the Agreement) are showing noticeable results. The Commission's focus is on continuing the process of improvement in a bid to eliminate any cases of ambiguity in its assessments. This is to be achieved through further refinements to the guidance on budget support, training and promoting awareness of the importance of demonstrating eligibility in a structured and formal way.*

*To further improve its analysis of the credibility of beneficiaries' public finance management reform programmes, the Commission is developing an assessment methodology for use by Delegations.*

**21.** *The Commission fully supports the Court's requests for information. It recognises that for two organisations representing five transactions the requested documentation came too late despite the Commission's intervention. However, these organisations are increasingly willing to cooperate. The Commission has since reminded these organisations of the importance of the timely delivery of information requested on account of the Court's tight work deadlines.*

**22.** *The Commission has put in place a control system based on the work of external auditors, supervisors, and internal checks which prevent or detect and correct many errors before payments are made. It must be recognised, however, that some Delegations have to work in particularly difficult circumstances, as was the case in Angola which formed part of the Court's audit. The Commission continues to improve its control system, seeking an appropriate balance of cost-effectiveness that provides reasonable assurance.*

<sup>(18)</sup> African Union, World Bank, World Health Organisation.

<sup>(19)</sup> World Health Organisation.

<sup>(20)</sup> The Court sets the materiality threshold at 2 %.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

24. The non-quantifiable errors detected mainly concern compliance with legally prescribed bank guarantees, the contract type used, the visibility of EDF financial support, prior approval of procurement documents and contractual deadlines for the presentation of financial reports.

25. Most of the errors should have been detected and corrected by the local supervisors or the authorising officers before the payments were authorised (see paragraphs 33 and 34). Most of the cases of missing supporting documentation relate to the closure of old seventh EDF projects in Angola, which had been implemented in a period of armed conflict and political turmoil. This difficult context and the length of time since the end of the projects meant that it was extremely difficult for the Delegation, which, moreover, had not been responsible for the management of these projects, to retrieve all necessary supporting documents.

*Budget support payments*

26. The Court's audit of budget support payments found them to be affected by a high level of non-quantifiable errors. The cases encountered include a lack of evidence that the foreign exchange transfers had been accounted for according to the applicable provisions, assessment by the Commission of compliance with conditions made on the basis of outdated data or not carried out, insufficient analysis of factors hindering the implementation of the public finance management reform programme and the use of an incorrect reference period for the assessment of the achievement of indicators (see paragraphs 44 to 46).

***Annual Activity Report and Declaration by the Director-General of EuropeAid***

27. In its examination of the annual activity report and the declaration by the Director-General of EuropeAid for the financial year 2008, the Court has assessed the extent to which they present a fair picture (i.e. with no significant distortions) of the effectiveness of the procedures in place. In particular, it examined whether the supervisory and control systems generate the necessary assurance insofar as the regularity of transactions are concerned.

24. Following the Court's recommendations, the Commission has taken measures to tighten up checks on bank guarantees, and new instructions on visibility are being finalised. The other points raised by the Court are very much linked to project implementation and hence to constraints on the ground.

25. There are specific risks involved in managing cooperation in countries affected by particular difficulties such as war, riots, etc., as was the case in Angola. The scale of the problem of missing documentation observed by the Court in Angola must not in any way be viewed as the general rule across all ACP cooperation management, as demonstrated by the excellent results in the other audited bodies.

26. The Commission notes that in a number of cases these non-quantifiable errors are due to the lack of clarity in financing agreements that were drawn up before the most recent guidance was adopted in 2007. More recent financing agreements drawn up in line with the 2007 guidance are more clearly structured. It is expected that payments made on the basis of these more recent agreements will give rise to clearer assessments and substantially fewer errors. In addition, the Commission is promoting widespread awareness throughout its services of the need for a more structured and formal approach to assessing budget support payments.

Furthermore, in February 2009 the Commission revised the financial circuits for budget support payments to strengthen the role of financial verification in the approval process. This is expected to further improve the rigour of payment assessments and hence compliance with the conditions set out in the financing agreements.

## THE COURT'S OBSERVATIONS

28. As indicated in paragraph 4, EuropeAid's mission is to implement most of the external assistance instruments<sup>(21)</sup> financed from the General Budget of the European Community and the EDFs. The annual activity report and the declaration make no distinction between the General Budget and the EDF-financed operations, which present the same inherent risks and are governed by largely similar implementation arrangements. Therefore, unless otherwise specified, the Court's observations concerning the annual activity report and the declaration, as well as the supervisory and control systems, refer to the whole area of responsibility of EuropeAid.

29. The annual activity report is consistent with the Court's findings concerning the implementation and results of the supervisory and control systems in place. In comparison with previous years, the Court notes that the quality of the annual activity report has significantly improved: it is better structured, clearer and more informative, notably through a greater use of quantitative indicators. However, there is scope for more explicit conclusions on how the results of the various controls contribute to the Director-General's assurance. A key indicator for the estimated financial impact of residual errors after all ex-ante and ex-post controls have been implemented would also provide the Director-General with a stronger basis for determining whether it remains below the materiality criteria set.

30. The annual activity report refers to significant staff constraints<sup>(22)</sup>. The high proportion of short-term staff in EuropeAid's central services and the related turnover in recruitment are said to result in a loss of institutional memory, which has detrimental effects on the continuity and visibility of operational management and on the efficient use of resources. In the Delegations the vacancy rate is presented as being dangerously high and on an upward trend.

## THE COMMISSION'S REPLIES

29. *The Commission recognises that as part of its ongoing efforts to improve the overall internal control system, further work is needed on the architecture of the control systems for external aid and their contribution to the Director-General's Statement of Assurance. With this in mind, and in conjunction with the Commission's work on tolerable risk, EuropeAid will launch a review of its control strategy in 2010.*

30. *The turnover issue is related to the constraint caused by the maximum duration of three years for contractual agents in Brussels. In order to reduce the risk of losing institutional memory because of turnover, EuropeAid has put in place a number of measures: debriefing, compulsory hand-over notes in the framework of the Internal Control Standards, systematic supervision of Contractual Agents by officials in Delegation.*

<sup>(21)</sup> Except pre-accession aid, assistance to the West Balkans, humanitarian aid, macro-financial aid, Common Foreign and Security Policy (CFSP) and the Rapid Reaction Mechanism.

<sup>(22)</sup> Page 43.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

31. In its Annual Report on the EDFs concerning the financial year 2007 the Court recommended that a review should be carried out to assess whether EuropeAid's central services and the Delegations have the level and type of human resources required to ensure the quality of control<sup>(23)</sup>. It also recommended that a human resources policy should be developed on the basis of an analysis of the skills and knowledge needed in relation to the management of budget support in view of its increasing importance<sup>(24)</sup>.

32. The Director-General of EuropeAid declares that he has obtained reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions, whereas the Court's audit revealed a material level of error. The Court found that, whilst significant progress continued to be made, the effect of certain recent measures were not yet fully visible in 2008 and there is scope for improving the design or implementation of certain controls (see paragraphs 33 to 43). A summary of the results of the Court's follow-up of key Statement of Assurance observations can be found in **Annex 2**.

### *Effectiveness of the systems*

#### **Ex-ante checks by authorising officers**

33. The Court assessed ex-ante checks as partially effective at detecting and correcting errors, particularly in respect of the calculation of the amounts claimed, the availability of the required supporting documents and compliance with procurement rules. As indicated in paragraph 25, the errors found in Angola are due to exceptional circumstances and do not call into question the Delegation's ex-ante check system.

**31.** *In the zero growth environment for Commission posts until 2013 EuropeAid addresses staffing matters through three elements:*

*Detailed needs assessment based on workload assessments on a yearly basis for both Operational and Finance, Contracts and Audit sections in Delegations. Selection and recruitment of staff with qualifications and skills that are required to match needs; the selection panels are composed of all relevant geographic and thematic services; an extensive training programme which responds to the current needs of external aid management in Delegation and headquarters.*

*Candidates for budget support related posts are tested and selected based on proven budget support knowledge and skills. Budget support training delivered in the field has increased from 7 available courses in 2006 to 14 in 2007 and 24 in 2008. This is in addition to headquarters training, where the average participation from Delegations is 40 %. Annual regional seminars are also organised for budget support practitioners.*

**32.** *EuropeAid has designed its controls to cover the full lifecycle of its multi-annual projects so that it is able to prevent or detect and correct most of the financial errors in the normal course of its controls. The Commission's ex-post controls confirm — and further reduce — this very low level of residual error, which informs the EuropeAid Director-General's Statement of Assurance.*

*Nevertheless, the Commission accepts that the effects of recent enhancements in the overall control architecture were not yet fully visible in 2008 and that there is still scope for further improvement.*

<sup>(23)</sup> Paragraph 55(b).

<sup>(24)</sup> Paragraph 56(f).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Monitoring of implementing organisations**

34. As in previous years, significant weaknesses were detected in the financial procedures and controls of implementing organisations, supervisors and National Authorising Officers (NAOs):

- (a) the main weaknesses at implementing organisations were inadequate procedures concerning supporting documents and filing and accounting systems that do not ensure that the expenditure is correctly recorded and reported;
- (b) in some cases, the quality of the controls carried out by supervisors on works contracts was inadequate;
- (c) the lack of capacity or ownership in most of the NAO services results in poorly documented and ineffective checks.

35. In general, the Delegations were aware of these weaknesses and had placed limited reliance on these controls. They had also taken appropriate measures to address the weaknesses identified, in particular by requiring mandatory audits and expenditure verifications before the financial closure of projects, commissioning technical audits of ongoing works contracts and providing technical assistance to strengthen the capacity of the NAO services. Moreover, in 2008 EuropeAid initiated work aimed at producing better guidance and communication tools to address recurrent weaknesses identified at the level of final beneficiaries and implementing organisations.

**34.** Support to organisations in charge of the implementation of EDF-funded projects is already significant and includes provision of print guidelines, a well maintained finance and contracts EuropeAid website, training in the field and on the spot advice from the finance and contracts staff in Delegations. In the ACP region, 150 days of finance and contracts training and 20 audit trainings were offered in the field in 2008 of which 94 % places were taken up by NAO staff, technical ministries and project staff.

- (a) The Commission has developed various information and management tools, aimed mainly at technical assistants (specific guide) and NGOs (a seminar was held on 23 and 24 March 2009 with the Concorde group on these issues). It is continuing its efforts to provide a financial management toolkit for beneficiary organisations in the near future.
- (b) The Commission has defined specific terms of reference for the technical audit of infrastructure, which have been available to delegations since 2009.
- (c) A new training contract was signed in 2009 to guarantee the continuity of training for NAO services. In addition, a large number of programmes have been set up in support of NAOs in order to boost their capacity.

**35.** The Commission welcomes the Court's appraisal of the measures taken by delegations to address weaknesses identified in NAO services and of the support work for beneficiaries and implementing organisations

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**External audits**

36. Financial and systems audits of projects before final payments are a key component of EuropeAid's supervisory and control systems<sup>(25)</sup>. Although they were not yet fully operational in 2008, as that was the first year of implementation, the use of the new standardised terms of reference for about two-thirds of the audits launched and the introduction of an audit management information system (CRIS Audit) are important steps forward for ensuring more consistent reporting from auditors and appropriate monitoring of audit activities and analysis of audit results<sup>(26)</sup>.

37. The Court's audit found that the Delegations did not consistently follow EuropeAid's operational guidelines when preparing their annual audit plan for 2008 and that there was a lack of clarity as to how risk-based audits had been selected and, thus, the extent to which these contribute to the Director-General's assurance. EuropeAid is, however, well aware of the need to make improvements in this respect; it prioritised Internal Control Standard 6 'Risk management' in its Annual Management Plan for 2008 and a number of actions have been adopted, in particular staff training, to ensure more effective implementation of this standard.

38. The level of implementation of the annual audit plans was low: 56 % of audits in the annual audit plan for 2008 were launched within the year, the others being postponed or sometimes cancelled, and 67 % in the annual audit plan for 2007 were completed by the end of 2008. This is partly due to inadequate planning of the annual audit plan, the duration of the audit process and the Delegations' limited capacity to organise and follow up audits.

39. Despite repeated reminders from EuropeAid central services, many Delegations did not record data in CRIS Audit in a timely and complete manner, which undermines the usefulness of this IT system. EuropeAid's guidelines of November 2008 for audit task managers address this weakness.

<sup>(25)</sup> Audits include both assurance audits and other types of assignments, in particular conformity checks ('four pillar') on international organisations' accounting, internal control, audit and procurement procedures against internationally accepted standards and subsequent verification missions.

<sup>(26)</sup> More recent improvements, which will take effect as of 2009, concern a modified planning process for the annual audit plan and new guidance to Audit Task Managers issued in November 2008.

**36.** *The widespread use of the standardised terms of reference and of CRIS Audit will contribute to improving the consistency in quality of audits and the consolidation of audit results.*

**37.** *In order to increase consistency in the contribution of Delegations to the Annual Audit Plan, a harmonised format will be compulsory as of the AAP 2010. The risk analysis foresees a degree of flexibility, which is necessary in a complex and constantly varying external aid context. However, basic principles detailed in the methodology will have to be respected. The Commission believes that these revisions will increase the transparency and consistency of the AAP.*

**38.** *The Commission would underline the steady progress made in the implementation of the annual audit plans. Indeed, 455 audits were finalised in 2008, which is a 35 % increase on 2007 (337).*

*Since June 2008, AAP execution has been regularly monitored by EuropeAid management.*

*EuropeAid's central services will continue to provide assistance to Delegations to improve their audit planning. In the context of the preparation of the 2009 AAP, Delegations have been invited to pay specific attention to the availability of resources.*

**39.** *2008 was the first year of compulsory use of CRIS Audit. Overall, CRIS Audit was correctly used. The Commission recognises nevertheless that progress needs to be made in the timely upload of documents.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Monitoring by EuropeAid central services**

40. Audits mandated by EuropeAid's central services under the framework contract agreement are subject to quality review. EuropeAid also analyses the results of these audits and follows up recurrent findings at the level of final beneficiaries and implementing partners, as mentioned in paragraph 35. It also carried out a quality review on a sample of audits mandated by the Delegations. No overall analysis of the findings and recommendations of the audits mandated by the Delegations has yet been performed.

41. The introduction of CRIS Audit is to be welcomed. Certain refinements still need to be made to allow for the assessment of the audit coverage of expenditure and more efficient use of this system for collating, analysing and acting upon audit findings and recommendations.

42. In 2008 EuropeAid's central services performed eight monitoring missions. These missions were well designed and identified relevant recommendations to improve internal control in the Delegations examined.

43. As indicated in Court's Annual Report on the EDFs for the financial year 2007 <sup>(27)</sup>, EuropeAid's transactional ex-post control system provides an effective mechanism for the identification of compliance errors affecting transactions but is less effective at identifying errors which have an impact upon the amount of the payment. The Court noted that, in respect of the EDF operations, the responsible Directorate had extended the scope of these controls during 2008: it performed systematic checks on a sample of documents supporting the declared expenditure and on the accuracy of calculations regarding price revisions. Furthermore, it introduced a half-yearly follow-up of actions taken by the Delegations in response to the findings of these controls. This type of approach is likely to improve the relevance and effectiveness of transactional ex-post controls both as regards the examination of the regularity of transactions and the assessment of the quality of ex-ante checks performed by the authorising officers.

40. As of 2009, EuropeAid central services will focus their quality review of audit reports on non-framework contractors. In addition, a number of improvements to be incorporated in CRIS Audit will make it easier to analyse the findings of auditors outside the framework contract.

41. CRIS Audit functionalities are constantly being improved in an effort to make optimum use of the database.

43. As regards transactional ex post controls, EuropeAid is currently assessing whether the checks conducted by the Directorate responsible for ACP countries could be extended to other regions of activities. This will, however, be subject to priority allocations and resources constraints.

<sup>(27)</sup> Paragraph 46.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Budget support**

44. The Cotonou Agreement states that budget support shall be granted where public expenditure management is sufficiently transparent, accountable and effective<sup>(28)</sup>. The Commission interprets this condition in a dynamic manner<sup>(29)</sup>. In its view, the weaknesses affecting public finance management at the time of the financing decision do not preclude the launch of a budget aid programme, provided that a commitment to reform exists and the reforms planned are deemed to be satisfactory. The European Parliament has questioned the Commission's 'dynamic interpretation' of the eligibility criteria for budget support and stated that budget support should only be undertaken in countries that already meet a minimum standard of credible management of public finances<sup>(30)</sup>.

45. In its Annual Reports on the EDFs concerning the financial years 2006<sup>(31)</sup> and 2007<sup>(32)</sup>, the Court recommended that compliance with the Cotonou Agreement should be benchmarked against baseline requirements. The Commission did not accept this recommendation because it considers the setting of common minimum standards to be uniformly applied to all countries is inappropriate. As the European Parliament pointed out in its report on discharge for the financial year 2007<sup>(33)</sup>, this approach gives the Commission a high degree of discretion which must be counterbalanced by an equally high degree of transparency. As stated by the Court in its Special Report No 2/2005 concerning EDF budget aid to ACP countries<sup>(34)</sup> this requires the assessment of compliance with the Cotonou Agreement requirements to be presented in a structured and formalised manner.

44. *The Commission has extensively justified its approach to assessing eligibility for budget support in response to the positions adopted by the Court and Parliament respectively. In particular, the letter from Commissioner Michel of 9 January 2009 to the Court, with copy to the European Parliament, sets out the detailed background to the Commission's position. This stresses that the Commission's approach is in line with that of other key donors (e.g. the International Monetary Fund and the World Bank). At the same time, it notes that an approach based on minimum standards would not be consistent with OECD guidelines on support for public financial management reform, or with the Paris and Accra principles on aid effectiveness.*

45. *The Commission understands and accepts the demand for even greater transparency in the treatment of budget support. In this context, the Commission proposes to provide more in-depth coverage of budget support issues in future annual reports on the 'European Community's Development and External Assistance Policies and their Implementation'.*

*The Commission recognises that improvements can be made by taking a more structured and formalised approach to assessing budget support eligibility, in line with the Cotonou Agreement. The Commission is therefore in the process of further refining its guidance on budget support to reinforce its approach.*

<sup>(28)</sup> Article 61(2)(a).

<sup>(29)</sup> See paragraphs 28 and 29 of Special Report No 2/2005 concerning EDF budget aid to ACP countries (OJ C 249, 7.10.2005).

<sup>(30)</sup> Resolution of the European Parliament of 22 April 2008 with observations forming an integral part of the decision on discharge in respect of the implementation of the budget of the Sixth, Seventh, Eighth and Ninth European Development Funds for the financial year 2006, paragraph 32 (OJ L 88, 31.3.2009).

<sup>(31)</sup> Paragraph 55 (OJ C 259, 31.10.2007).

<sup>(32)</sup> Paragraph 56(a) (OJ C 286, 10.11.2008).

<sup>(33)</sup> Resolution of the European Parliament of 23 April 2009 with observations forming an integral part of the decision on discharge in respect of the implementation of the budget of the Seventh, Eighth and Ninth European Development Funds for the financial year 2007, paragraphs 46 and 47.

<sup>(34)</sup> Paragraph 85.

## THE COURT'S OBSERVATIONS

46. As mentioned in the Court's Annual Report on the EDFs concerning the financial year 2007 <sup>(35)</sup>, the financing agreements of budget support programmes financed under the ninth EDF are often incomplete or unclear, and thus do not provide a sufficiently clear framework to carry out such a structured and formalised assessment. In 2008 the Court noted a significant improvement with the financing agreements of budget support programmes financed under the tenth EDF. In some cases there is scope for further improvement in the identification of both priority public financial management measures to be implemented by the recipient country as well as the sources of information to check compliance with the agreed conditions.

**Internal audit**

47. The Internal Audit Capability (IAC) operated effectively and in compliance with its primary objective to provide the Director-General with assurance as to the effectiveness and efficiency of risk management, control and internal governance processes in EuropeAid. In the opinion of the IAC, the results of the work performed in 2008 indicate that there are no important systemic weaknesses that might adversely affect the functioning of the internal control system taken as a whole. The Court draws attention to the fact that the IAC audit could not obtain full assurance as to the CRIS-EDF system's capacity to produce reliable and accurate operational information data as from January 2009.

48. The Commission's Internal Audit Service (IAS) carried out a joint audit with the IAC on the financial management procedures of the Directorate responsible for ACP countries, regarding its devolved delegations, and another audit on recoveries <sup>(36)</sup>. The audit findings are in line with those of the Court as regards the management of bank guarantees (see paragraph 24), the utilisation of CRIS Audit (see paragraph 39), and the centralised follow-up of audits mandated by the Delegations (see paragraph 40).

49. The IAS performed a follow-up audit on the implementation of the FAFA <sup>(37)</sup>. It concludes that the control environment should be strengthened, both at partner and project level, notably by improving coordination and understanding with the UN bodies on verification and assurance issues.

<sup>(35)</sup> Paragraph 27.

<sup>(36)</sup> Report from the Commission to the European Parliament and Council: Annual report to the discharge Authority on internal audits carried out in 2008 (COM(2009) 419 final of 5.8.2009).

<sup>(37)</sup> Financial and Administrative Framework Agreement.

## THE COMMISSION'S REPLIES

46. *The Commission welcomes the Court's recognition of the improvement in the clarity of recent financing agreements. At the same time, the Commission also recognises that further improvements can be made and is thus further refining its guidance in order to address the points raised by the Court with regard to establishing clear reform expectations in the area of public financial management and the monitoring of progress in these areas.*

47. *When the IAC audit was conducted, the new CRIS system was still at the development stage. However, all the necessary measures had been taken to enable the system to start up in early 2009. Migration to the new CRIS/ABAC system was carried out according to timetable and operations started as normal in early 2009.*

49. *The report recognised the progress made on the implementation of the majority of the recommendations. The verification issue was discussed at the 6th FAFA meeting in Brussels (April 09). The terms of reference are used consistently by the Commission during the verification missions to UN partners.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Conclusions and recommendations**

50. Based on its audit work, the Court concludes that the EDF accounts for the financial year ending 31 December 2008 present fairly, in all material respects, the financial position of the EDFs 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 accounting officer. The Court draws attention to the observation in paragraph 15 concerning the provision for costs incurred.

51. Due to the circumstances described in paragraph 21, the Court was not able to fully audit the 10 sampled payments made to certain international organisations. Therefore, the Court is unable to express an opinion on the regularity of expenditure amounting to 190 million euro, i.e. 6,7 % of the annual expenditure.

52. Subject to the limitation mentioned in the preceding paragraph and based on its audit work, the Court concludes that for the financial year ending 31 December 2008:

(a) revenue and commitments of the EDFs were free from material error; and

(b) the payments of the EDFs were affected by material error. The most likely error rate lies between 2 % and 5 %.

53. Based on its audit work, the Court concludes that the supervisory and control systems of EuropeAid are partially effective in ensuring the regularity of payments. **Annex I, Part 2** gives an overview of the Court's assessment of EuropeAid's supervisory and control systems <sup>(38)</sup>.

52.

*(b) The Commission would point out that the overall error rate was very strongly affected by one delegation having to work in a post-conflict environment.*

<sup>(38)</sup> See Chapter 8, External aid, development and enlargement, of the Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2008 for an assessment of the supervisory and control systems of DG ECHO.

## THE COURT'S OBSERVATIONS

54. In 2008 EuropeAid continued to make significant improvements to its supervisory and control systems. It started to use the new terms of reference for audits and implemented a management information system, CRIS Audit, which should improve EuropeAid's capacity to plan and monitor audits, as well as to analyse and follow up audit findings and recommendations. The Annual Activity Report is better structured, clearer and more informative, particularly because of greater use of quantitative indicators. There is scope for clearer conclusions on how the results of the various controls contribute to the Director-General's assurance and for developing a key indicator on the estimated financial impact of residual errors after all ex-ante and ex-post controls have been implemented.

55. EuropeAid has set up a comprehensive control strategy and is pursuing its efforts to ensure more efficient and effective implementation of controls. The following recommendations should be considered in this context:

- (a) ex-ante checks should be improved by focusing more on key risks;
- (b) annual audit plans should be prepared on the basis of more structured risk analysis and more realistic assessment of the resources available for the purpose;
- (c) the implementation of annual audit plans should be closely monitored throughout the year in order to detect significant deviations and take corrective action in a timely manner;
- (d) the functionalities of CRIS Audit should be developed to enable more efficient and effective monitoring of audit activities as well as analysis and follow-up of audit findings and recommendations;

## THE COMMISSION'S REPLIES

54. *The Commission recognises that as part of its ongoing efforts to improve the overall internal control system, further work is needed on the architecture of the control systems for external aid and their contribution to the Director-General's Statement of Assurance. With this in mind, and in conjunction with Commission's work on tolerable risk, EuropeAid will launch a review of its control strategy in 2010.*

55.

- (a) *Ex-ante checks of each and every transaction before it is authorised is the primary assurance mechanism for regularity. Ex-ante controls are important as they prevent errors and avoid the need for ex-post corrective action. The level of risk is taken into account in the checks performed. EuropeAid has implemented a number of measures in particular as regards training to take better into account recurrent risks.*
- (b) *The risk analysis to be conducted in the preparation of the Annual Audit Plan foresees a degree of flexibility, which is necessary in a complex and constantly varying external aid context. However, basic principles detailed in the methodology will have to be respected.*

*In the context of the preparation of the 2009 AAP, Delegations have been invited to pay specific attention to the availability of resources.*

- (c) *Since June 2008, AAP execution has been regularly monitored and presented at management meetings. The breakdown of implementation per geographical zone and headquarters/Delegations allows appropriate corrective action to be taken.*
- (d) *CRIS Audit is being improved on a regular basis.*

*For example, since the beginning of 2009, each audit contracted in CRIS is automatically linked to a CRIS Audit number, which completes the registration process in CRIS Audit.*

*Other improvements are scheduled in the coming months, such as more accurate registration of audit findings and of ineligible expenditure.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(e) EuropeAid should ensure that the Delegations record data in CRIS Audit in a comprehensive and timely manner;

(f) in the light of the results of the approach adopted by Directorate responsible for ACP countries, EuropeAid should carry out a review of the transactional ex-post control system with a view to assessing the need and feasibility of extending the scope of such controls.

56. As regards budget support, the Court recommends that EuropeAid:

(a) pursues its efforts to support its decisions on the eligibility of budget support with a structured, formal demonstration that the recipient country has a relevant reform programme to address all significant weaknesses over a foreseeable timetable and that there is commitment on the country's part to implement it;

(b) ensures that all future financing agreements provide a comprehensive and clear basis for the assessment of compliance with payment conditions.

(e) *At the beginning of 2008, an instruction note was sent by the Director-General requiring the services concerned (headquarters and Delegations) to enter all audits in CRIS Audit. This was monitored in 2009 and the units responsible have regularly reminded the Audit Tasks Managers of this obligation.*

(f) *As regards transactional ex post controls, EuropeAid is currently assessing whether the checks conducted by Directorate responsible for ACP countries could be extended to other Directorates. This will, however, be subject to priority allocations and resources constraints.*

56.

(a) *The Commission agrees and is further revising its guidance to address this point. It is expected that this will be completed by the end of 2009. The Commission also intends to further improve the transparency of its budget support by enhancing its reporting.*

(b) *The Commission is further revising its guidance to address this point. It is expected that this will be completed by the end of 2009.*

## ANNEX 1

## PART 1: MAIN FEATURES OF SAMPLE BASED TRANSACTION TESTING

## 1.1 — Size of the sample

| Year | Number of Commitments tested | Number of Payment transactions tested |
|------|------------------------------|---------------------------------------|
| 2008 | 45                           | 170                                   |
| 2007 | 60                           | 148                                   |

## 1.2 — Structure of the sample

| Percentage of transactions tested which were | 2008        |                |              | 2007         |
|--|-------------|----------------|--------------|--------------|
|  | Projects    | Budget Support | TOTAL        |              |
| <b>Commitments</b>                           |             |                |              |              |
| Global commitments                           | 33 %        | 22 %           | 56 %         | 50 %         |
| Individual legal commitments                 | 44 %        | 0 %            | 44 %         | 50 %         |
| <b>Total</b>                                 | <b>78 %</b> | <b>22 %</b>    | <b>100 %</b> | <b>100 %</b> |
| <b>Payments</b>                              |             |                |              |              |
| Advances                                     | 24 %        | 0 %            | 24 %         | 0 %          |
| Interim/Final                                | 65 %        | 12 %           | 76 %         | 100 %        |
| <b>Total</b>                                 | <b>88 %</b> | <b>12 %</b>    | <b>100 %</b> | <b>100 %</b> |

## 1.3 — Frequency and estimated impact of errors in the sample of interim/final payments

| Errors   | 2008                |                |                     | 2007                |
|--|---------------------|----------------|---------------------|---------------------|
|  | Projects            | Budget Support | TOTAL               |                     |
| <b>Frequency of error:</b>   | 25 % {27}           | 40 % {8}       | 27 % {35}           | 37 % {55}           |
| <b>Frequency of quantifiable errors:</b>   | 38 % {15}           | 9 % {1}        | 31 % {16}           | 53 % {31}           |
| <b>Impact of quantifiable errors:</b><br>Most likely error rate falls in the range (*) | Between 2 % and 5 % | Below 2 %      | Between 2 % and 5 % | Between 2 % and 5 % |

(\*) The Court distinguishes three ranges for most likely error rate: below 2 %, between 2 % and 5 %, above 5 %.  
The figures in the {} brackets are absolute numbers.

## 1.4 — Types of errors in the sample of interim/final payments

| Percentage of errors in transactions tested which concern                     | 2008         |                |              | 2007         |
|---|--------------|----------------|--------------|--------------|
|   | Projects     | Budget Support | TOTAL        |              |
| <b>Quantifiable errors</b>  |              |                |              |              |
| Eligibility   | 47 %         | 0 %            | 44 %         | 68 %         |
| Occurrence  | 47 %         | 0 %            | 44 %         | 23 %         |
| Accuracy  | 7 %          | 100 %          | 13 %         | 10 %         |
| <b>Total</b>  | <b>100 %</b> | <b>100 %</b>   | <b>100 %</b> | <b>100 %</b> |
| <b>Non-quantifiable errors</b>  |              |                |              |              |
| Non-quantifiable error that may have financial impact                         | 20 %         | 60 %           | 31 %         | 79 %         |
| Non-quantifiable error where the financial impact is not possible to quantify | 32 %         | 40 %           | 34 %         | 0 %          |
| Non-quantifiable error with no financial impact                               | 48 %         | 0 %            | 34 %         | 21 %         |
| <b>Total</b>  | <b>100 %</b> | <b>100 %</b>   | <b>100 %</b> | <b>100 %</b> |

PART 2: ASSESSMENT OF SELECTED SUPERVISORY AND CONTROL SYSTEMS

| System concerned           | Ex-ante checks | External Audit |   | Monitoring          |          |                  |  |  | Internal Audit | Overall assessment |
|----------------------------|----------------|----------------|---|---------------------|----------|------------------|--|--|----------------|--------------------|
|                            |                | Quality        | Quantity/implementation of the audit plan | Monitoring missions |          | Ex-post controls | Audit  |  |                |                    |
|                            |                |                |   | Quality             | Quantity |                  | Follow-up of individual audit findings/Effective recovery procedures | Overall monitoring by central services of audits commissioned by Delegations |                |                    |
| Central services EuropeAid |                |                |   |                     |          |                  |  |  |                |                    |
| Delegations                |                |                |   | N/A                 | N/A      | N/A              |  | N/A  |                |                    |

Legend:

|     |  |
|-----|--|
|     | Effective                                      |
|     | Partially effective                            |
|     | Not effective                                  |
| N/A | Not applicable: does not apply or not assessed |

## FOLLOW-UP OF KEY STATEMENT OF ASSURANCE OBSERVATIONS

|    | Court observation   | Court analysis   | Court recommendations  | Commission reply   |
|----|---|--|--|--|
| 1. | <p>EuropeAid's control strategy should include key indicators supporting the level of assurance to be given by the Director-General, the coverage of some controls, the coordination between ex-ante and ex-post controls, as well as the human resources required.<br/>(Annual Report concerning the financial year 2007, paragraph 55(a))</p> | <p>In 2008 EuropeAid continued to make significant improvements to its supervisory and control systems. It started to use the new terms of reference for audits and implemented a management information system, CRIS Audit, which should improve EuropeAid's capacity to plan and monitor audits, as well as to analyse and follow up audit findings and recommendations. The Annual Activity Report is better structured, clearer and more informative, particularly because of greater use of quantitative indicators.<br/>(Annual Report concerning the financial year 2008, paragraph 54)</p> <p>EuropeAid has set up a comprehensive control strategy and is pursuing its efforts to ensure a more efficient and effective implementation of some controls.<br/>(Annual Report concerning the financial year 2008, paragraph 55)</p> | <p>There is scope for clearer conclusions on how the results of the various controls contribute to the Director-General's assurance and for developing a key indicator on the estimated financial impact of residual errors after all ex-ante and ex-post controls have been implemented.<br/>(Annual Report concerning the financial year 2008, paragraph 54)</p> | <p><i>The Commission recognises that as part of its ongoing efforts to improve the overall internal control system, further work is needed on the architecture of the control systems for external aid and their contribution to the Director-General's Statement of Assurance. With this in mind, and in conjunction with its work on tolerable risk, EuropeAid will launch a review of its control strategy in 2010.</i></p> |
| 2. | <p>A review should be carried out to assess whether EuropeAid's central services and the Delegations have the level and type of human resources required to ensure the quality of controls.<br/>(Annual Report concerning the financial year 2007, paragraph 55(b))</p>   | <p>The annual activity report refers to significant staff constraints. The high proportion of short-term staff in EuropeAid's central services and the related turnover in recruitment are said to result in a loss of institutional memory, which has detrimental effects on the continuity and visibility of operational management and on the efficient use of resources. In the Delegations the vacancy rate is presented as being dangerously high and on an upward trend.<br/>(Annual Report concerning the financial year 2008, paragraph 30)</p> <p>In the zero growth environment for Commission posts until 2013 EuropeAid addresses staffing matters through three elements:</p>  | <p>Satisfactory action has been taken in the context of the zero growth environment.</p>   |  |



|    | Court observation  | Court analysis   | Court recommendations  | Commission reply  |
|----|--|--|--|---|
|    |  | <p>Detailed needs assessment based on workload assessments on a yearly basis for both Operational and Finance, Contracts and Audit sections in Delegations. Selection and recruitment of staff with qualifications and skills that are required to match needs; the selection panels are composed of all relevant geographic and thematic services; an extensive training programme which responds to the current needs of external aid management in Delegation and headquarters.</p> <p>(Commission's reply to paragraph 31 of the Annual Report concerning the financial year 2008)</p>   |  |   |
| 3. | <p>The management of implementing organisations should be better supported. This should involve greater presence of Delegation staff in the field, supporting accounting systems and training especially for projects implemented by programme estimates.</p> <p>(Annual Report concerning the financial year 2007, paragraph 55(e))</p>                               | <p>In general, the Delegations were aware of these weaknesses and had placed limited reliance on these controls. They had also taken appropriate measures to address the weaknesses identified, in particular by requiring mandatory audits and expenditure verifications before the financial closure of projects, commissioning technical audits of on going works contracts and providing technical assistance to strengthen the capacity of the NAO services. Moreover, in 2008 EuropeAid initiated work aimed at producing better guidance and communication tools to address recurrent weaknesses identified at the level of final beneficiaries and implementing organisations.</p> <p>(Annual Report concerning the financial year 2008, paragraph 35)</p> | Satisfactory action has been taken.  |   |
| 4. | <p>Checks performed by Delegations before authorising payments should better scrutinise the payment requests and intensify the focus on the reality, eligibility and accuracy of the expenditure. The quality of work performed by supervisors and auditors should be better monitored.</p> <p>(Annual Report concerning the financial year 2007, paragraph 55(d))</p> | <p>The Court assessed ex-ante checks as partially effective at detecting and correcting errors, particularly in respect of the calculation of the amounts claimed, the availability of the required supporting documents and compliance with procurement rules. As indicated in paragraph 25, the errors found in Angola are due to exceptional circumstances and do not call into question the Delegation's ex-ante check system.</p> <p>(Annual Report concerning the financial year 2008, paragraph 33)</p>   | <p>Ex-ante checks should be improved by focusing more on key risks.</p> <p>(Annual Report concerning the financial year 2008, paragraph 55(a))</p> | <p><i>Ex-ante checks of each and every transaction before it is authorised is the primary assurance mechanism for legality and regularity. Ex-ante controls are important as they prevent errors and avoid the need for ex-post corrective action. The level of risk is taken into account in the checks performed.</i></p> <p><i>The Commission has defined specific terms of reference for the technical audit of infrastructure, which have been available to Delegations since 2009.</i></p> <p><i>Furthermore, EuropeAid central services are performing quality reviews of audit reports.</i></p> |

|    | Court observation   | Court analysis   | Court recommendations  | Commission reply  |
|----|---|--|--|---|
| 5. | <p>The implementation of CRIS Audit should allow monitoring of the audit coverage and the audit results. Qualitative information as to the recommendations made and the improvements which should be put in place to address the findings is vital to ensure that the ultimate objectives of commissioning audits are met.</p> <p>(Annual Report concerning the financial year 2007, paragraph 55(e))</p> | <p>Although they were not yet fully operational in 2008, as that was the first year of implementation, the use of the new standardised terms of reference for about two-thirds of the audits launched and the introduction of an audit management information system (CRIS Audit) are important steps forward for ensuring more consistent reporting from auditors and appropriate monitoring of audit activities and analysis of audit results.</p> <p>(Annual Report concerning the financial year 2008, paragraph 36)</p>   | <p>The functionalities of CRIS Audit should be developed to enable a more efficient and effective monitoring of audit activities as well as analysis and follow-up of audit findings and recommendations.</p> <p>(Annual Report concerning the financial year 2008, paragraph 55(d))</p>   | <p><i>CRIS Audit is being improved on a regular basis and new functionalities are operational (linkage of a CRIS audit contract to a CRIS audit number) as 2009. New Improvements are scheduled in the coming months, such as more accurate registration of audit findings and of ineligible expenditure.</i></p> |
| 6. | <p>Transactional ex-post controls should include a better examination of supporting documentation to ensure that transactions are not affected by errors of eligibility and occurrence as well as to verify whether checks performed before the payment was authorised were adequate.</p> <p>(Annual report concerning the financial year 2007, paragraph 55(f))</p>                                      | <p>EuropeAid's transactional ex-post control system provides an effective mechanism for the identification of compliance errors affecting transactions but is less effective at identifying errors which have an impact upon the amount of the payment. The Court noted that, in respect of the EDF operations, the Directorate responsible for ACP countries had extended the scope of these controls during 2008: it performed systematic checks on a sample of documents supporting the declared expenditure and on the accuracy of calculations regarding price revisions. Furthermore, it introduced a half-yearly follow-up of actions taken by the Delegations in response to the findings of these controls. This type of approach is likely to improve the relevance and effectiveness of transactional ex-post controls both as regards the examination of the regularity of transactions and the assessment of the quality of ex-ante checks performed by the authorising officers.</p> <p>(Annual Report concerning the financial year 2008, paragraph 43)</p> | <p>In the light of the results of the approach adopted by the Directorate responsible for ACP countries, EuropeAid should carry out a review of the transactional ex-post control system with a view to assessing the need and feasibility of extending the scope of such controls.</p> <p>(Annual Report concerning the financial year 2008, paragraph 55(f))</p> | <p><i>As regards transactional ex-post controls, EuropeAid is currently assessing whether the checks conducted by the Directorate responsible for ACP countries could be extended to other regions. This will, however, be subject to priority allocations and resources constraints.</i></p>                     |

|    | Court observation   | Court analysis  | Court recommendations  | Commission reply  |
|----|---|---|--|---|
| 7. | <p>The standardised methodology for monitoring missions should be finalised and the number of such missions increased. The new methodology should maintain the focus on the examination of the set-up and functioning of the supervisory and control systems.</p> <p>(Annual Report concerning the financial year 2007, paragraph 55(g))</p>  | <p>In 2008 EuropeAid's central services performed eight monitoring missions. These missions were well designed and identified relevant recommendations to improve internal control in the Delegations examined.</p> <p>(Annual Report concerning the financial year 2008, paragraph 42)</p>   | <p>Satisfactory action has been taken.</p>   |   |
| 8. | <p>Compliance with the Cotonou Agreement should be benchmarked against baseline requirements, such as the availability of timely published and audited accounts, to be met before budget support is granted.</p> <p>(Annual Report concerning the financial year 2007, paragraph 56(a))</p> <p>EuropeAid should ensure, before the start of a budget support programme, that there is a clear and complete assessment of the public finance management and that the recipient country has a credible and relevant reform programme to address all significant weaknesses over a foreseeable timetable.</p> <p>(Annual Report concerning the financial year 2007, paragraph 56(d))</p> | <p>In its Annual Reports on the EDFs concerning the financial years 2006 and 2007, the Court recommended that compliance with the Cotonou Agreement should be benchmarked against baseline requirements. The Commission did not accept this recommendation because it considers the setting of common minimum standards to be uniformly applied to all countries is inappropriate. As the European Parliament pointed out in its report on discharge for the financial year 2007, this approach gives the Commission a high degree of discretion which must be counter-balanced by an equally high degree of transparency. As stated by the Court in its Special Report No 2/2005 concerning EDF budget aid to ACP countries, this requires the assessment of compliance with the Cotonou Agreement requirements to be presented in a structured and formalised manner.</p> <p>(Annual Report concerning the financial year 2008, paragraph 45)</p> | <p>EuropeAid should pursue its efforts to support its decisions on the eligibility of budget support with a structured and formalised demonstration that the recipient country has a relevant reform programme to address all significant weaknesses over a foreseeable timetable and that there is commitment on the country's part to implement it.</p> <p>(Annual Report concerning the financial year 2008, paragraph 56(a))</p> | <p><i>The Commission agrees and is further revising its guidance to address this point. It is expected that this will be completed by the end of 2009</i></p> |
| 9. | <p>The performance indicators used should permit clear evidence of progress in public finance management to emerge where appropriate. This could be achieved by strengthening indicators which measure progress of results over time in combination with process indicators on the performance of one-off events.</p> <p>(Annual Report concerning the financial year 2007, paragraph 56(b))</p>  | <p>The Court will follow-up these observations in its non-DAS audits</p>  |  |   |

|     | Court observation  | Court analysis   | Court recommendations  | Commission reply   |
|-----|--|--|--|--|
| 10. | <p>In order to set out its conclusions as regards progress in public finance management in a structured manner, the Commission should ensure that the data used as a basis for disbursement decisions is reliable and should rely more on measurements of events that have already taken place than on predictions of future occurrences.</p> <p>(Annual Report concerning the financial year 2007, paragraph 56(c))</p> | <p>The Court will follow-up these observations in its non-DAS audits</p>   |  |  |
| 11. | <p>The quality of Financing Agreements should be improved by including general conditions in all cases, unambiguous stipulations and clear requirements for progress of public finance management.</p> <p>(Annual Report concerning the financial year 2007, paragraph 56(e))</p>  | <p>As mentioned in the Court's Annual Report on the EDFs concerning the financial year 2007, the financing agreements of budget support programmes financed under the ninth EDF are often incomplete or unclear, and thus do not provide a sufficiently clear framework to carry out such a structured and formalised assessment. In 2008 the Court noted a significant improvement with the financing agreements of budget support programmes financed under the tenth EDF. In some cases there is scope for further improvement in the identification of both priority public financial management measures to be implemented by the recipient country as well as the sources of information to check compliance with the agreed conditions.</p> <p>(Annual Report concerning the financial year 2008, paragraph 46)</p> | <p>EuropeAid should ensure that all future financing agreements provide a comprehensive and clear basis for the assessment of compliance with payment conditions.</p> <p>(Annual Report concerning the financial year 2008, paragraph 56(b))</p> | <p><i>The Commission welcomes the recognition by the Court that its ongoing efforts to improve the clarity and structure of eligibility assessments are showing noticeable results. Our focus is on continuing the process of improvement with the objective of eliminating any cases of ambiguity in our assessments. This is to be achieved through further refinements to guidance on budget support, training and promoting awareness of the importance of demonstrating eligibility in a structured and formal way.</i></p> |
| 12. | <p>A human resources policy should be developed on the basis of an analysis of the skills and knowledge needed in relation to the management of budget support in view of its increasing importance.</p> <p>(Annual Report concerning the financial year 2007, paragraph 56(f))</p>  | <p>Candidates for budget support related posts are tested and selected based on proven budget support knowledge and skills. Budget support training delivered in the field has increased from 7 available courses in 2006 to 14 in 2007 and 24 in 2008. This is in addition to headquarters training, where the average participation from Delegations is 40 %. Annual regional seminars are also organised for budget support practitioners.</p> <p>(Commission's reply to paragraph 31 of the Annual Rapport concerning the financial year 2008)</p>   | <p>Satisfactory action has been taken.</p>   |  |







## 2009 SUBSCRIPTION PRICES (excluding VAT, including normal transport charges)

|   |   |  |
|---|---|--|
| EU Official Journal, L + C series, paper edition only   | 22 official EU languages                  | EUR 1 000 per year (*)                   |
| EU Official Journal, L + C series, paper edition only   | 22 official EU languages                  | EUR 100 per month (*)                    |
| EU Official Journal, L + C series, paper + annual CD-ROM  | 22 official EU languages                  | EUR 1 200 per year                       |
| EU Official Journal, L series, paper edition only   | 22 official EU languages                  | EUR 700 per year                         |
| EU Official Journal, L series, paper edition only   | 22 official EU languages                  | EUR 70 per month                         |
| EU Official Journal, C series, paper edition only   | 22 official EU languages                  | EUR 400 per year                         |
| EU Official Journal, C series, paper edition only   | 22 official EU languages                  | EUR 40 per month                         |
| EU Official Journal, L + C series, monthly CD-ROM (cumulative)  | 22 official EU languages                  | EUR 500 per year                         |
| Supplement to the Official Journal (S series), tendering procedures for public contracts, CD-ROM, two editions per week | multilingual:<br>23 official EU languages | EUR 360 per year<br>(= EUR 30 per month) |
| EU Official Journal, C series — recruitment competitions  | Language(s) according to competition(s)   | EUR 50 per year                          |

(\*) Sold in single issues: up to 32 pages: EUR 6  
from 33 to 64 pages: EUR 12  
over 64 pages: Priced individually.

Subscriptions to the *Official Journal of the European Union*, which is published in the official languages of the European Union, are available for 22 language versions. The Official Journal comprises two series, L (Legislation) and C (Information and Notices).

A separate subscription must be taken out for each language version.

In accordance with Council Regulation (EC) No 920/2005, published in Official Journal L 156 of 18 June 2005, the institutions of the European Union are temporarily not bound by the obligation to draft all acts in Irish and publish them in that language. Irish editions of the Official Journal are therefore sold separately.

Subscriptions to the Supplement to the Official Journal (S Series — tendering procedures for public contracts) cover all 23 official language versions on a single multilingual CD-ROM.

On request, subscribers to the *Official Journal of the European Union* can receive the various Annexes to the Official Journal. Subscribers are informed of the publication of Annexes by notices inserted in the *Official Journal of the European Union*.

## Sales and subscriptions

Priced publications issued by the Publications Office are available from our commercial distributors. The list of commercial distributors is available at:

[http://publications.europa.eu/others/agents/index\\_en.htm](http://publications.europa.eu/others/agents/index_en.htm)

**EUR-Lex (<http://eur-lex.europa.eu>) offers direct access to European Union legislation free of charge. The *Official Journal of the European Union* can be consulted on this website, as can the Treaties, legislation, case-law and preparatory acts.**

**For further information on the European Union, see: <http://europa.eu>**

