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REPORT FROM THE COMMISSION

Member States' replies to the Court of Auditors' 2001 Annual Report

TABLE OF CONTENTS

1.	Introduction.....	3
2.	Main observations by the Court of Auditors, by sector	5
2.1.	Own resources.....	5
2.2.	Agriculture	6
2.3.	Structural Funds	8
2.4.	Other sectors.....	10
3.	Areas of agreement and disagreement	12
3.1.	Methodological problems	12
3.2.	DAS errors	12
4.	Conclusion	13

1. INTRODUCTION

- a) Given the importance of shared management and the place it occupies in the Court of Auditors' reports, it is particularly necessary to know the Member States' positions on the problems raised by the external auditor. Firstly, it allows the Member States to give their opinion on the observations of the Court.¹ Secondly, they can present the corrective measures they plan to implement. Lastly, this exercise is of particular significance as regards the improvement of management since it offers Member States the opportunity to express their views on the conclusions and recommendations drawn up by the Court; it also gives the Commission a general picture of various problems encountered at national level.

Since the 1996 Dublin European Council, and in line with its conclusions on sound and efficient financial management, the Commission has requested Member States to reply to the observations made by the Court of Auditors in its Annual Report and special reports and to provide information on any corrective measures they have adopted.

The new Financial Regulation has taken over the practice existing since this date and has formalised and provided a framework for this procedure, in particular by introducing strict time limits.²

- b) The Court of Auditors presented its 2001 Annual Report to the European Parliament on 5 November 2002 and to the Council Budget Committee on 6 November. When making this early submission, the Commission sent a letter to all the Permanent Representatives asking them to provide these replies before the end of December. In an attempt to provide a coherent and harmonised framework for the national contributions, the Commission's request was accompanied by a questionnaire drawn up in close collaboration with the Court of Auditors. It consisted of a list of specific references to each Member State in the Annual Report and a summary of Statement of Assurance (DAS) errors for each Member State.
- c) This report is therefore based on the contributions from the Member States. It should be pointed out that despite the creation of the general framework these contributions are still fairly heterogeneous both in form and in substance. The Member States thus replied in full or in part to the points or DAS errors submitted to them and sometimes made recommendations or more general observations, etc. The time limits set by the Commission were not fully complied with and some contributions arrived several weeks late.

¹ This in no way affects the contacts between the Commission and the Member States concerned in order to take follow-up action on the Court's observations. Follow-up action by the Commission and the Member States on the Court's sector letters is a specific exercise focusing on measure which may need to be taken to correct problems detected.

² Article 143(6): "As soon as the Court of Auditors has transmitted the annual report, the Commission shall inform the Member States concerned immediately of the details of that report which relate to management of the funds for which they are responsible under the rules applicable. Following receipt of such information, the Member States shall reply to the Commission within 60 days. The latter shall transmit a summary to the Court of Auditors, the Council and the European Parliament before 15 February."

- d) The Member States administer a large part of the Community budget and their systems of management and control are a central feature of the Annual Report by the Court of Auditors. The purpose of this procedure is to give the Member States an opportunity to put forward their views, observations and any recommendations following publication of a report which concerns them both directly and in the more general framework of the discharge procedure. Although they do not bear the responsibility for the implementation of the budget, their contribution, in summary form, throws particular light on the management of Community appropriations.

The national contributions can thus be used to identify a number of major issues which are of particular interest for analysing sectors involving shared management. They highlight in particular the specific problems encountered in the Member States and on the solutions which might be contemplated at that level. That is why the first part of the report concentrates on own resources, agriculture and the Structural Funds. The issues which have attracted the attention of several Member States are highlighted for each of these sectors.

After this presentation by sector, two more analytical parts give an account of areas of agreement and disagreement between the Member States and the Court of Auditors and then try to identify the main conclusions which can be drawn.

2. MAIN OBSERVATIONS BY THE COURT OF AUDITORS, BY SECTOR

2.1. Own resources

The Member States mentioned four main issues.

2.1.1. Separate account (B account)

Several Member States (in particular SF, IRL, B, NL, S, I, F) have brought up this question and, on the whole, they do not dispute the Court's observations about the existence of errors. However, in a number of cases, they point to the lack of any financial impact, the negligible nature of the errors or the action taken to follow them up. Most of the Member States have also announced measures to improve the situation (e.g. the Italian or German computerised systems).

Only one State (SF) calls on the Commission to standardise the accounting rules in order to avoid errors or to avoid describing as errors simple divergences in the interpretation of the rules. As regards one error detected in Sweden, the Member State explains that the Court of Auditors is taking a different legal interpretation to that expressed by a national court and which the customs administration considers it has to respect.

2.1.2. Customs warehouses

Italy, France and Germany recognise to varying extents that their control systems might have led to errors or are open to improvement. They also announce corrective measures. However, one Member State (UK) considers that all the controls carried out make up for the shortcomings noted by the Court of Auditors, given the very specific nature of the problem detected. The Netherlands considers its controls to be adequate. Sweden states that it bases its controls on risk analysis; if no controls were carried out in 2001, this is because they were not considered necessary by this analysis. Detection of an error involving a small amount does not allow general conclusions to be drawn about the suitability of the existing control system. Sweden also considers that a low frequency of controls does not have any financial impact in itself.

2.1.3. UK rebate

The United Kingdom stresses that none of the Member States contest the method of calculation used and, although it is aware of the complexity of the system, points out that it is linked to the own resources decision and to the fact that it has agreed to abandon a method of calculation from which it derived excessive benefit.

2.1.4. Making own resources available

The Court has given a favourable assessment of the reliability of accounts in the own resources sector except for the deferred payment applied in Germany, on which it does not express an opinion. Germany has stated that the problem relating to documentation and to maintaining a transparent audit trail has been resolved. It also agrees that its control system is not fully satisfactory, but considers that the position expressed by the Court is exaggerated given the relative importance of the problem detected.

A number of errors of minor importance have also been corrected by the Member States concerned.

2.2. Agriculture

The Member States' contributions reveal three main issues: the Court's criticisms of the various systems of management and control, based on the errors detected, the clearance of accounts as regards the paying agencies and the CATS data base. Some Member States brought up other subjects.

2.2.1. Control systems and errors

In its specific appraisal for the purposes of the statement of assurance, the Court bases itself on an analysis of the management and control systems (e.g. the IACS) and on a sample of transactions to corroborate the systemic analysis. The examination of transactions occupies a large part of this chapter of the Annual Report and obviously lays the blame on the Member States on whose territory the errors are detected. The Court of Auditors states that many of the errors occur at final beneficiary level, which means that the controls carried out at national level have been inadequate.

In their replies the Member States addressed two aspects; each national contribution has established its own balance between them. The first, specific, aspect relates to the case at hand, i.e. the facts which led the Court of Auditors to establish an error; the second relates to the more general conclusions drawn from these errors.

Thus, generally speaking, few errors as such are contested and usually recovery or corrective measures are announced. However, a certain emphasis is placed on defending the quality of management and controls at national level. The Member States' replies can therefore be grouped into three categories depending on the extent to which they accept the Court of Auditors' criticisms.

- Few Member States question outright the Court of Auditors' observations on a specific sector. However, three of them have (F and D: the control in the rural development sector; and IRL: implementation of the controls relating to the extensification premiums).
- On the other hand, when Member States do not contest the errors, it is their importance which is mentioned in a number of replies which aim to play down the significance of the Court's findings. A number of arguments are put forward.

In some cases the fact that the errors were known to the national administrators was said to prove the effectiveness of the controls (P: rural development). The United Kingdom also states that the errors noted by the Court had been detected by the IACS before payment (which was not then made).

In other cases, the Member States seek to play down the Court's findings. The errors detected are linked to very specific cases. Ireland states that errors were noted concerning the number of animals kept but that a review of the controls carried out revealed that this situation was confined to a specific region. The United Kingdom suggests a link between the outbreak of foot and mouth disease (suspension of on-site controls) and the number of errors, but emphasises that the rules provided for alternative controls, which were carried out. The Netherlands and Austria adopt the same argument in connection with animal premiums,

pointing out that the controls relating to animal premiums were concentrated on only one undertaking (NL) or that the pastures eligible were overestimated in only one case (A).

Sometimes they also underline the restricted significance of the Court of Auditors' findings. In the olive oil sector, Spain underlines the formal nature of the errors noted and states that the size of the sample audited by the Court does not allow general conclusions to be drawn. In one case in which the area declared was too large, Greece considers that the error is purely formal and sets out the system for the measurement and control of agricultural areas. In the cotton sector, Spain states that the Court has not been able to take account of its replies which were sent to the Court after the Annual Report was finalised and which show that it carries out the necessary controls.

- Finally, few Member States recognise the difficulties encountered, but set out the measures undertaken or planned. For example, this is the case in the olive oil sector with Greece, which recognises that the olive oil register is still in the introductory phase. However, three Member States (DK, UK, NL) have implicitly recognised that there is a general problem in implementing the IACS and/or the system for the identification and registration of bovine animals at national level. They have emphasised the need to make an effort in this field, but it is mainly a case of drawing conclusions from the Court of Auditors' observations and not recognising a problem which is specific to them.

2.2.2. *Clearance of accounts*

- The Court made a number of criticisms of the paying agencies and the certification of their accounts. It also points to Commission decisions establishing financial corrections. As regards the paying agencies, France, Greece and Portugal have accepted the validity of the Court's criticisms and reforms are planned or under way.
- As regards the financial corrections, most of the Member States concerned emphasise that the procedures are still under way internally or with the Commission. The corrections relating to milk quotas are the most contested. One Member State (E) has also referred corrections relating to the milk quota policy to the Court of Justice. On the same point, Italy has stressed that the problems in collecting the levy are due to internal administrative and legal procedures which should not lead to corrections. Germany, on the other hand, recognises the difficulties which have led to the flat-rate corrections following the control of export refunds (supervisory agencies) and states that it has taken far-ranging measures to resolve the problem.
- The problem of the CATS database containing all the data on payments by the EAGGF has prompted a large number of replies. The Court pointed out that the data provided by the Member States suffered from shortcomings. This finding has not been contested even though some of them try to play down the significance (for example, Netherlands complies with three of the four criteria, Finland mentions a 98.7% rate of data transmitted satisfactorily, Spain mentions that it sends written documents allowing reconciliation of the ledgers, while Austria and Denmark state that no further data were required). Moreover, virtually all the Member States expressing their position are implementing or planning corrective measures.

2.2.3. *Other issues*

Some Member States brought up, on their own initiative, specific issues in the Annual Report that were taken from special reports or were a follow-up to previous observations.

- As regards the special report on the extensification premium, Spain and France tend to confirm the Court's critical analysis of the scheme's incentive effect. Austria and Ireland question the Court's criticisms about implementation of the scheme. Austria states that the criticism is based on one very specific error while Ireland states that a management and control system which it considers effective was introduced between 1999 and 2000. The United Kingdom points out that this scheme has been in place for only a short time and that improvements will gradually be made.
- As for the reform of the CMO for sugar, the United Kingdom shares the Court's criticisms about the inadequacy of the Commission's proposals. However, it remains cautious about the need put forward by the Court to reduce aid to durum wheat, even though it supports the principle of revising the support scheme.

2.3. Structural Funds

The Member States' replies in this sector cover four main issues which cut across the main sections of Chapter 3 of the Annual Report:

- the under-implementation of payment appropriations;
- the closure of the oldest projects;
- the errors resulting in particular from the problem of inadequate checks of eligibility;
- compliance with Regulations Nos 2064/97 and 438/2001 on control of the Structural Funds.

2.3.1. Under-implementation

This point attracted the attention of the United Kingdom, Austria and France. France subscribes to the Court's comments while the United Kingdom emphasises that this is due partly to the delays incurred in the programming for 2000-06 and partly to the inadequate quality of the expenditure forecasts. As regards the latter point, it calls on the Commission to go further than its current initiatives and suggests a revision of the expenditure estimates every six months.

Austria emphasises the pressure exerted on the Member States by a number of factors, in particular the time limits for approval of the programmes, adoption and interpretation of the financial rules. Austria is worried about the consequences of late commitments in 2001 underlined by the Court of Auditors. It considers that this imposes a particular constraint on implementation in the Member States given the rule that appropriations are automatically decommitted in n+2. It expressed its concern about the pressure on the utilisation of appropriations in connection with the new rules limiting the number of annual payment requests to three. As regards this specific point, the United Kingdom does not approve the introduction of a restriction on presenting payment requests.

2.3.2. Delays in the closure of the oldest projects

The Court points to considerable delays in the closure of programmes and the problems which this generates (finding the documentation, detecting errors, etc.).

Generally speaking, the Member States which have replied recognise that problems may have been encountered, thus generating excessive delays. However, the United Kingdom and Portugal have stated that the outstanding cases are the most difficult. Nevertheless, the United Kingdom points out that, except for those cases which are still covered by legal procedures, the rule calling for the automatic decommitment of appropriations at the end of 2002 should resolve a large number of cases and help reduce the level of outstanding commitments. France too stressed the importance of this rule.

2.3.3. Errors resulting in particular from ineligibility of expenditure

The Member States have replied in various ways to the Court's observations.

Two Member States consider that their control systems prevent the emergence of any errors, especially in the new programming period. Portugal and Finland do not agree with the Court of Auditors' conclusions. Portugal also states that the expenditure incurred is entered in a separate account and checked in detail in both the private and the public sector.

In a number of cases, Member States point out that their observations following Court audits have not been included in the annual report (D, DK). Spain states that it is unable to express an opinion on the Court's findings as they are not specific enough (two cases).

In the case of other errors, the facts themselves are contested, by Ireland (one case involving the Cohesion Fund) and by the United Kingdom (one error was reported in connection with Objective 2 in Northern Ireland although this area does not qualify). Denmark contests certain legal interpretations by the Court of Auditors and thus the errors (ineligibility) which it lists. Spain also disagrees with the Court in two cases, stating that, in one of them, its replies to the Court of Auditors had not been taken into consideration and that, in the other, a control carried out by the Commission had not revealed any problem.

Finally, several cases have been accepted, in particular by Ireland, the United Kingdom, Italy, Greece and France. In their replies, these Member States set out the measures which they have taken or are planning to correct the errors detected (during the payments of balances in France, Greece and Italy) as well as to improve their control systems (French ministerial circular to ensure reliable controls on declared expenditure).

2.3.4. Controls

The Court of Auditors analysed implementation of Regulations Nos 2064/97 and 438/2001 which set standards for the control of the Structural Funds in the 1994-99 and 2000-06 programming periods. Two main aspects are examined: introduction of reliable controls in accordance with the legal provisions and implementation of the controls themselves.

In their replies, most of the Member States link the problems of the two programming periods because of the closeness of the two regulations as well as the continuity of their activities in the Structural Funds sector.

The core of their argument is linked to the time limits for adopting the rules and the working and explanatory documents. The delays might thus have led to a succession of time-lags, for example between the closure of operations from the period 1994-99 and their control or between adoption of the new programmes and the introduction of systems to control them.

- As regards the period 1994-99 in particular, several Member States put forward arguments based on the late adoption of the regulatory framework. Three Member States (D, IRL, A) also claim that they did not receive all the necessary documents until very late (2002). These time-lags, in addition to the time needed to establish the necessary structures and procedures and the extent of the control to be carried out on operations relating to 1994-99, could have led to delays. Portugal puts forward an argument based on the fact that Regulation No 2064/97 has increased control standards and requirements, adding to the time needed (P).

However, all the Member States have pointed out that the problems encountered with their systems are now limited and, if not resolved, had at least being largely cleared up (F, UK, P). As for compliance with the 5% objective, some Member States consider that they have already met this objective (F, SP, SF), while others are confident that they will soon be able to meet it and report more or less considerable progress (I, B, UK, P).

- For the new programming period covered by Regulation No 438/2001, most of the Member States admit that they needed time to introduce reliable control systems. Similarly, as regards the objective of checking a sample of operations, they also usually agree that the controls carried out in 2001 were limited in number. However, they play down these observations on the basis of four arguments.

First, they point out that the Regulation was not adopted until March 2001, the necessary explanations and interpretation left them only limited time to comply with all the provisions (I, B, SF, P, A, with the latter underlining the Commission's shortcomings in connection with the explanatory documents leading up to implementation of the regulation).

Second, they state that 2001 was largely devoted to introducing and checking the systems to ensure that they were fully operational in 2002 or 2003 (F, SF, P, G).

In addition, the means available have been concentrated on completing the controls covering the previous programming period, resulting in a certain time-lag. (I, B, F, P, D, A).

Finally, slow implementation of the programmes limited the number of operations which could be covered by a control by sampling, restricting the possibility and/or value of the overall objective of checking 5% of expenditure (B, SF, P, D, A, G). Some Member States consider that they have achieved the objectives (SP, UK).

Generally speaking, the United Kingdom agrees with the Court of Auditors' observation that the reform of the Structural Funds had not attained all its objectives as regards simpler and swifter procedures. France's suggestion that elaboration of the regulatory framework for the next programming period should be brought forward may also be related to this.

2.4. Other sectors

Some Member States have drawn up replies on subjects which have nothing to do with shared management. Their main concern is to express their views on the forthcoming reforms which were recommended by the Court or which they themselves deem necessary. It is interesting in this respect to see the situations in which the Member States agree and the cases in which the national contributions are opposed.

- Internal policies: The Court of Auditors concentrated on the research sector and it is this sector which attracted most comments from the Member States, particularly in connection

with the recommendations made. France is the only Member State to express its clear support for the recommendations, and in particular the recommendation on the simplification of reimbursement schemes in order to make it easier to carry out controls and the recommendation that it should be possible to sanction beneficiaries.

Austria, on the other hand, stressed the improvements introduced by the 6th research framework programme and, like the United Kingdom, opposes the Court of Auditors' supplementary recommendations. It also considers that the research sector possesses specific features which make it acceptable for a number of irregularities to be noted.

- External action: some convergence of views may be noted between France and the United Kingdom for the reform of the management of external aids undertaken by the Commission (decentralisation, in particular) and they are also worried about the difficulties in implementing pre-accession aid. However, the United Kingdom is more critical and points to the recurrent nature of the Court of Auditors' criticism of external action. It emphasises the slow or unsatisfactory progress made in terms of budget implementation (outstanding commitments) and improvement of financial or personnel management (decentralisation). It therefore calls for a firm undertaking from the Commission in these fields and suggests that a precise timetable be drawn up. As regards pre-accession in particular, the United Kingdom is also concerned about the administrative institutional problems underlying the underutilisation of payments and the consequences they have or will have on payments, including after accession.
- Banking and financial instruments, administrative expenditure and the EDF:
 - The Member States adopt varying positions on the geographical distribution of EIF appropriations. Ireland intends simply to promote this instrument while Sweden considers that it is up to the Commission to remedy this situation. The United Kingdom feels that a financial instrument like the EIF need not comply with considerations as to the geographical distribution of appropriations even though it welcomes the measures planned by the Commission in this field. France favours an even distribution of appropriations and considers that balance was restored in 2002.

The Court observed that some SMEs benefited from the EIF as well as from the ERDF without any real control on this cumulation of assistance. Austria contests this assessment and considers that cumulation was normal (action under a number of arrangements corresponding to different situations and requirements) and was carefully monitored. Portugal, on the other hand, does not consider that it has sufficient information to reply to this observation by the Court of Auditors.

- As regards administrative expenditure, only France has spoken up to call on the institutions to display vigilance concerning regularity and discipline in respect of remunerations.
- As regards the EDF, the Netherlands states that it lodged its instrument for the ratification of the 9th EDF on 20 December 2002. Austria is confident that the new Financial Regulation will have a positive effect on the 9th EDF, but points out that delays in implementation do not necessarily pose a problem given the specific constraints on development aid.

3. AREAS OF AGREEMENT AND DISAGREEMENT

3.1. Methodological problems

As with the report concerning 2000, the Member States still express a number of methodological criticisms about the Court of Auditors' procedures, especially for the examination of transactions. Several of them feel that they are unable to express their point of view properly, either because the cases mentioned by the Court cannot be identified or because the deadlines have not allowed their replies to sector letters to be taken into account by the Court of Auditors. This sort of observation indirectly raises the question of the application of the principle of the adversarial examination of the auditors' findings. It also limits the scope of the Member States' replies to the annual report as some States do not feel able to submit their comments.

Faced with this situation, the Court of Auditors has already stated that, generally speaking, the arguments put forward by the Member States (which are systematically analysed) rarely lead to any change of opinion. It has also pointed out in the past that its controls are regularly carried out on the spot, often in the presence of representatives of the Member States, who are then able to present their arguments.

More fundamentally, irrespective of obvious disagreements, it appears that in a large number of cases the Member States try to play down the significance of the observations in the Annual Report. Some contributions concerning the 2000 Annual Report openly expressed doubts about the validity of the conclusions drawn by the Court from a number of cases. This year, as there were fewer replies to the DAS errors, this position appears less clear. In several cases, the national contributions point instead to the specific nature of the problems detected (e.g. limited to a region or undertaking) or to the fact that there is little or no financial impact (error relating to intermediate payments). This approach allows a more or less implicit objection to the general conclusions on the reliability of management and control systems. In this connection, the United Kingdom openly wonders about the basis for the Court's claim that the IACS could not detect all the errors.

3.2. DAS errors

It may be noted that the Member States devoted less attention to the DAS errors and that few of them replied systematically to the cases referred to them on 6 November 2002. No specific conclusions can thus be drawn from examining them.

4. CONCLUSION

A number of conclusions, lessons and recommendations may be drawn from an analysis of the Member States' replies to the Court of Auditors' Annual Report for 2001.

The national contributions are clearly an attempt by the Member States to defend the validity of their management and the controls they carry out. This approach occurs at a number of levels: formal disagreement with the Court of Auditors, playing down the significance of its findings and the conclusions it draws, and presentation of specific or structural corrective measures to remedy the shortcomings detected. This stratification of arguments presented in their defence varies, of course, from one Member State to another; some are more inclined to question the Court's observations against them.

As a result, the number of structural reforms announced remains fairly limited, except for implementation of Regulation No 438/2001 concerning the Structural Funds. In fact, it appears that there is more of a question of adapting existing structures, for example by making an effort with training, information, interpretation and auditing the systems. Few in-depth reforms are actually planned. Only a handful of fairly radical measures may be noted, such as the withdrawal of a paying agency's accreditation or the amendment of certain rules on the making available of own resources.

Similarly, the Commission has made only a small number of recommendations which are generally limited to one or a few Member States and, in most cases, follow the same lines as those made by the Court of Auditors. This is the case, for example, with the reform of the CMO for sugar (UK), the monitoring of macrofinancial aid (F), controls in connection with internal policies (F), the geographical distribution of the EIF (S) and the standardisation of the rules for keeping the B account (SF).

On the other hand, like last year, a general demand for the simplification of Community rules emerges either explicitly or implicitly from a number of contributions (F, UK, NL in particular). It appears that the complexity of the legislation is a source of errors as well as delays resulting from the need to give clarification and seek interpretation.