



COMMISSION OF THE EUROPEAN COMMUNITIES

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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND
THE COUNCIL**

Commission's report on the follow-up to 2002 Discharges

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PREAMBLE

According to Article 276 of the EC Treaty and Article 180b of the EAEC the “Commission shall take all appropriate steps to act on the observations in the decisions giving discharge and on other observations by the European Parliament relating to the execution of expenditure, as well as on comments accompanying the recommendations on discharge adopted by the Council. At the request of the European Parliament or the Council, the Commission shall report on the measures taken in the light of these observations and comments and in particular on the instructions given to the departments which are responsible for the implementation of the budget. These reports shall also be forwarded to the Court of Auditors”¹

The Commission, acting on requests from the Council and Parliament, accordingly produces the present Follow-up Report, which relates to the Council recommendation of 9 March 2004 and the Resolutions voted by the European Parliament on 21 April 2004. This Follow-Up Report relates to Discharges given for the 2002 financial year², as well as to the EP resolutions on "OLAF Assessment ", on "Fight against fraud and protection of the financial interests of the Communities" (Mr Bösch reports) and on the Eurostat resolution of 22 April 2004.

The Follow-up Report is presented to the European Parliament, the Council, and the Court of Auditors. It summarizes each sector or themes raised by the European Parliament and the Council, the actions that the Commission intends to take or has already taken and also the recommendations that Commission will not or is not able to follow-up.

This synthesised Follow-up Report is complemented with a Commission working document detailing the answers to each specific recommendation of both Council and Parliament.

¹ See also Article 147 of the Financial Regulation

² 2002 General Budget Discharge, 2002 EDF Discharge, 2002 Agencies Discharge, 2002 ECSC Discharge

I. EUROPEAN PARLIAMENT RESOLUTION ON GENERAL BUDGET

A) The Reform of the Commission

The Reform of the Commission was initiated in 2000 with the aim of improving the service culture of the Commission, more clearly identifying the Commission's political priorities, instituting a modern human resources policy and overhauling the Commission's systems of financial management and control.

Two of the key elements in the Reform process are the new Financial Regulation and the modernised Staff Regulation which respectively entered into force on 1 January 2003 and 1 May 2004. All the main instruments of the Reform are now part of the day-to-day functioning of the Commission and are contributing to the improvement of the Commission's management as well as increasing accountability and transparency.

The Commission agrees with the European Parliament that the Reform is a continuous process which does not end with the adoption of the legislative texts. It has therefore taken good note of the recommendations included in the resolution on the 2002 discharge and is to a very large extent in agreement with the ideas presented. However, the Commission does not agree with the European Parliament that it is appropriate already now to propose changes to the key elements of the financial reform introduced in the recast Financial Regulation. The Commission has undertaken to make a report by 1 January 2006 on the application of the provisions of the new FR and, if necessary, will submit appropriate proposals to the legislative authority in the framework of the triennial review foreseen in Article 184.

The European Parliament has also proposed changes in the internal organisation of the Commission, integrating the Internal Audit Service into the Commission Presidency. The Commission has taken good note of the proposals but believe it is up to the incoming Commission to decide. Among the many issues raised by the European Parliament, the Commission wishes to highlight the following:

(i) *Accounting Reforms*

The modernisation of the accounting system is on track. The Commission will continue to inform the European Parliament on a regular basis about progress made. At this point in time, the Commission does not have problems in recruiting the appropriate staff.

(ii) *Internal Controls*

Significant progress has been made, in the implementation of the internal control standards. In early 2004, an assessment of the DGs readiness to comply with the baseline requirements of the 24 standards showed that - across DGs - 91 per cent of the standards were fully achieved at the end of 2003 and 8 per cent were partially implemented, in some cases at an advanced stage. As far as effectiveness is concerned, there is still some work to be done. In future, the focus will be more on the underlying systems, verifying that the systems are working well in practice and that the necessary assurances are delivered.

(iii) *The Annual Activity Reports*

The Commission is aware that the Directors General must strike a balance between making a declaration which on the one hand truly reflects the picture on internal control, especially in areas under shared management, and on the other hand does not empty the declaration of its meaning. In the Annual Activity Reports for 2003, the DGs and services have expressed their reservations using a standard set of minimum requirements in order to increase the comparability of the reservations. The Commission has also carried out for the second time a peer review exercise, i.e. before finalisation of the Annual Activity Reports, draft reservations are reviewed by peers. Both initiatives have contributed to greater consistency in the approach.

B) The European Anti-Fraud Office (OLAF)

The Commission has taken note of the European Parliament's remarks concerning the Commission proposal (COM (2004) 103) amending Regulation (EC) No. 1073/1999. These issues will be dealt with in the course of the deliberations of the legislative authority.

As regards the specific case "Blue Dragon", the Commission recalls that the Ombudsman produced a draft recommendation dated 16 February 2004. OLAF was asked to send a detailed opinion by 31 May 2004. OLAF transmitted its reply to the Ombudsman on 18 March 2004. The Ombudsman adopted his decision on the case on 22 July 2004. He concluded that OLAF had accepted his draft recommendation as it had examined the file and considered whether it was appropriate to reopen its inquiry or to open a new one. He considered that OLAF's decision not to reopen its inquiry or to open a new one was reasonable and closed the case.

Finally, the Commission would like to stress that all cases inherited from UCLAF have been closed. OLAF will submit a report on the matter to the OLAF Supervisory Committee.

c) Corruption

The Commission agrees with the European Parliament that anti-corruption strategies of the accession countries, candidate countries and Member States shall be supported. For the new Member States, several measures were initiated already during the pre-accession phase.

Furthermore, following the request of the European Parliament, a new budget line amounting to 3 million € was created in the 2004 Budget for special support to NGOs in the new Member States to act as watchdogs for civil society and uncover corruption practice in public administration.

The European Parliament has recommended that NGOs meet certain standards as regards accounts and audits as well as transparency. The Commission agrees but must recall that it is not entitled to monitor or intervene in the internal management of NGOs. However, NGOs must – as all other beneficiaries of funds from the general budget of the European Union – fulfil the requirements of the Financial Regulation. This includes inter alia the obligation to present final reports and accounts, as well as evidence on its integrity and, where necessary, the integrity of their legal representatives, previous to the awarding of grants or contracts.

D) Shared Management

The Commission agrees with the European Parliament that shared management is an issue that deserves – and already today is given – high priority. However, the many layers of administration involved combined with differences in administrative structures in Member States complicates the task of ensuring that the principles of sound financial management are respected. The Commission is grateful to the European Parliament for pointing out that “the Member States are obliged to carry out their part of the work in accordance with the guidelines adopted by the Union..”³

The Commission endeavours to ensure that the basic principles set out in the Treaty and in the Financial Regulation – in particular the principle of sound financial management (Art. 274 EC) – are integrated into proposals for new or modifications of existing sectoral legislation. Of course, it is only the legislative authority that can ensure that the principles are maintained in the final legislation.

The European Parliament has stressed the need for the Commission to lay down common standards and offer Member States the necessary guidance. The Commission's strategy for ensuring sound financial management already follows the approach of setting common basic standards for management in Member States, supervising their application and providing guidance in the form of manuals and practice notes. The lessons learned will be taken into account in the legislation for the new period.

The Commission is grateful for the European Parliament's support as regards the use of sunset clauses and financial corrections. Time limits such as the rule providing for decommitment at year $n + 2$ have proved to be effective instruments to improve levels of implementation and the Commission will therefore propose to maintain and reinforce such clauses in the future. Financial corrections and suspension of payments can also be effective in getting Member States to correct weaknesses in management and will therefore likewise be maintained.

However, the Commission does not agree with the European Parliament that a Member State should lose its right to agricultural support from the EAGGF Guarantee Fund if it fails to implement IACS⁴. The fact is that no Member State entirely fails to implement IACS but rather some component may not be (fully) in place. In light of this, the Commission has opted for the strategy of imposing ex post financial corrections. The amount of these corrections is linked to the level of risks of irregular payments arising from weaknesses in the IACS as implemented by a Member State.

Finally, the Commission welcomes the support of the European Parliament for application of the single audit approach, which can help to maximise the effectiveness of the overall audit effort by the Commission and Member States.

³ Point 6 in the European Parliament resolution accompanying the decision concerning discharge in respect of the implementation of the general budget of the European Union for the 2002 financial year.

⁴ Point 13 in the European Parliament resolution accompanying the decision concerning discharge in respect of the implementation of the general budget of the European Union for the 2002 financial year.

E) Eurostat

The European Parliament has raised several concerns in the framework of the Discharge procedure on the Eurostat case. The Commission as already pointed out on different occasions and especially at the plenary session in April 2004, has taken the necessary measures or has already embarked on doing so. The Commission would also like to point out that it has regularly kept Parliament informed through its Budgetary Control Committee during the various steps of the procedure leading to the granting of the Discharge.

It is particularly the case when European Parliament requested that Commission should establish safeguards against concealment of critical information or when it asked for the review of relations between the different actors and the individual Commissioners as well as the College itself in the functioning of the accountability chain.

The Commission confirms its assessment presented to the European Parliament on two occasions in September & November 2003; on these occasions the President of the Commission pointed out that all main facts, as identified by the Audit Report and by the inquiries, occurred before the present Commission's mandate and prior to the Reform engaged by it.

Furthermore he recognised the problem of informing the political level, identifying the reasons of this situation and committed the Commission to finding a solution in the context of the Action Plan which was adopted by the Commission on 10 February 2004. This Action Plan and the adopted measures aim to make more explicit the existing rules on the communication of sensitive information and insist on active information.

As far as the request of making a full and complete written evaluation by 31 July 2004 of the circumstances of the Eurostat case including all OLAF reports is concerned, the Commission considers that a new assessment of the deficient circulation of information within the Commission is not necessary and would not bring new elements. It is necessary to ensure the implementation of the new mechanisms in place.

Regarding the demands addressed to the Commission to ensure full and thorough implementation of the specific actions of the White Paper, the rehabilitation of whistleblowers or the drawing up of the Annual Activity Reports by the Directors Generals reflecting their responsibilities as Authorising Officers, the Commission has already implemented them.

However, in some cases, the Commission could not follow the requests of the European Parliament, for example the publication of the IAS and IAC reports or the creation of central management supervision of the control systems operating in individual departments.

As far as the revision of the Financial Regulation is concerned, the Commission has not identified any weaknesses in the new Financial Regulation which may expose the Community Budget to the risk of fraud. In any case, the Commission will assess carefully the fraud-proofing of financial rules in the first review of the Financial Regulation that will be carried out in 2005 according to article 184 of that Regulation which foresees a review every three years.

F) Own Resources

The Commission is ready to fulfil most of the requests of the European Parliament. Thus the Commission **has published** a report on the possibilities of introducing a more direct link between taxpayers and the EU budget. Concerning the Community's transit system, the Commission has in June 2004 presented a survey showing the implementation of the 38 recommendations made by the first temporary committee of inquiry in 1997. Furthermore the Commission continues to promote the transition to phase 3.2 of the New Computerized Transit System (NCTS) which should take place in all Member States by 31 December 2005. The utilisation of NCTS has been steadily increasing as shown by the figures transmitted.

However, the Commission considers that an amendment to the Customs Code concerning the need to put an end to the practice of regarding incorrectly or falsely declared goods as not being involved in the transit procedure would be inappropriate. Otherwise, it would make the guarantor of transit operations liable for a customs debt which has already been incurred prior to the transit operation and would put at risk the balance of the existing legislation.

Concerning the number of staff required for physical duties in the customs administrations of the Member States, under the current legal framework, it is the responsibility of the national governments to establish the necessary structure and ensure adequate staffing of their administrations.

G) Agriculture

On the main issues raised in the Parliament Resolution, the Commission has already taken or planned corrective actions. Concerning the setting of export subsidy rates, this has been done in the context of the implementation of the Commission's comprehensive action plan. However, the Commission is not able to submit documentation for the information selected when setting the export subsidy rates as this information is too commercially sensitive to be released.

On the prefinancing of export refunds, the Commission carried out a review of the system, and decided to retain prefinancing but limit the scope of its application. The effectiveness of these new rules will be assessed before any new decision.

The Less Favoured Areas Scheme was evaluated in the context of the ex-post evaluation of Regulation (EC) 950/97 finalised in July 2003. The final report on this study has been published on the Commission Website⁵. Currently the Commission is preparing a specific evaluation of the Less Favoured Areas Scheme under the Rural Development Regulation. The results of this study will be available in late 2005. The effective implementation of the management, control and sanctions system by the Member States is assessed during audits by the Commission's services. The Commission will follow up on this issue, as deemed appropriate.

⁵ See page: http://europa.eu.int/comm/agriculture/eval/reports/950/index_en.htm

H) Structural Funds

The Commission regularly informs the Discharge Authority of the measures taken for better budget implementation. The preparation of the next Structural Funds Regulations will incorporate the lessons learnt and any measure like the $n + 2$ rule that accelerates the implementation will be continued with the improvements required when applicable.

The Commission considers that sanctions mechanisms on Member States for poor budgetary estimates, provision of SAPARD notes in all languages of the acceding countries and a quarterly breakdown of the situation as regards the application of the $n + 2$ rule are inappropriate. It already informs Parliament each year of the actual application of $n + 2$ rule as soon as the final figures are known.

Finally, the Commission disseminates good practices based on the results of monitoring and evaluation, but experience shows that successful management of Structural Funds depends on a wide range of factors.

I) Internal Policies and Research

On internal control, the Commission regularly reviews its internal control framework in view of making the implementation of internal control standards more effective. In this context, the Research DGs contribute to the self assessment exercises aimed at identifying areas where the implementation effort must be intensified.

Measures to reinforce the process of recovering amounts unduly paid is already being set up: the Commission has taken stock of the improvements decided in the field of recoveries at the Cocobu meeting of 3 November 2003. The improvements introduced in the domain of the recovery are threefold: they concern the new procedures, new IT tools and organisational structures.

Management and co-ordination of the on site audits is carried out in a harmonised manner in all Research DGs. Monthly meetings take place between the Audits Units of five Research DGs to discuss audit practices, the implementation of audit results and audit strategies and exchange audit experiences.

The Commission will indeed report on the audits carried out in relation to the 5th Research Framework Programme at the end of the activities concerned. A great deal of information on the ex-post audit situation is already available in the Annual Activity Reports.

J) Enlargement

The Commission supports the European Parliament's view, that information to be provided by the Commission to the Discharge authority and to the public should be as accessible and comprehensible as possible – also after enlargement. The Commission believes that it already today meets the majority of the recommendations listed by the European Parliament. Some are still outstanding, e.g. the structure of the annual report on budgetary and financial management will only be changed in order to reflect policy areas as of the financial year 2004 which was the first year where the budget was presented in ABB format.

Furthermore, the European Parliament has rightly stressed the importance of ensuring that shared management is implemented in accordance with the principles of sound financial management. As

stated by the European Parliament, it is a complicated exercise involving many administrative bodies in each Member State. However, the appropriate standards are in place and will be continuously developed and refined as necessary.

The Commission would also like to highlight the issue of twinning. A revised manual for twinning projects entered into force on 1 May 2004 and includes inter alia streamlined payment procedures as well as new requirements for the setting of objectives and results. A global report on the projects approved between 1998 and 2001 has been produced and is available on http://europa.eu.int/comm/enlargement/phare_evaluation_pdf/interim_s_zz_eur_01006_fv.pdf

K) External policies

The Commission has taken due note of the European Parliament's recommendations concerning controls relating to external measures. In 2002 the Commission (EuropeAid) launched a major initiative aimed at improving both the coverage and the quality of audits conducted by external auditors. It has i.a. elaborated annual audit plans for 2003 and 2004 and tightened general requirements concerning the selection of auditors and their compliance with international standards, in particular auditor's independence.

Furthermore, the Commission is taking or has taken the recommended actions regarding the Neighbourhood and the PHARE Programmes as well as the aid allocated to education and health. It has systematically been reviewing outstanding commitments in order to reduce the amount of old or dormant RAL. For the implementation of humanitarian aid, the Commission has already selected over 160 partner humanitarian organisations under a new Framework Partnership Agreement entered into force on 1 January 2004.

II. EUROPEAN PARLIAMENT RESOLUTION ON EUROPEAN DEVELOPMENT FUND (EDF)

The Commission accepts the Parliament's recommendations and already has or is currently taking the necessary action. Furthermore, the Commission welcomes the Parliament's support to the proposal of budgetising the EDF, i.e. integrating the EDF into the general budget of the European Union. The proposal is currently under discussion in Council.

Among the recommendations made by Parliament, the Commission would like to highlight the following:

(i) *Budgetary support*

The Commission agrees that budgetary support funds, after having been released to an ACP State once the conditions set out in the financing agreement have been fulfilled, become part of the beneficiary State's budget, and therefore are managed and spent according to national (and not EDF) financial management procedures. The Commission has changed its supervision and control systems in order to take account of the particular challenges arising from increased use of the budgetary support instrument. Inter alia delegations in ACP States receiving budgetary support have been instructed to extensively report every six months on the quality of public finance management, using standards developed by the Commission Headquarters. This complements the analysis and reviews of public finance management which are regularly carried out by other Donors working in co-operation with the Commission.

(ii) *Audit and evaluation strategy*

The European Parliament has highlighted the need for the Commission to ensure coordination and cooperation between Delegations and Headquarters. The Commission supports this objective and has inter alia taken the necessary steps to ensure better coverage and quality of audits conducted by external auditors. Likewise, new guidelines for evaluations entered into force in July 2003. The audit and evaluation strategy is linked to a risk assessment which was transmitted to the European Parliament, Council and the Court of Auditors on 12 March 2004 (SEC (2004)318).

(iii) *Financial Management Report*

The European Parliament has asked for several new issues to be included in the Financial Management Report. The Commission has taken all these recommendations on board in the Financial Management Report for 2003 on the 6th, 7th, 8th and 9th European Development Funds which was transmitted to the European Parliament on 22 June 2004.

III. **EUROPEAN PARLIAMENT RESOLUTION ON ECSC**

The Commission has taken note of the recommendations made by the European Parliaments on ECSC and will be taking the necessary actions in due course. In particular, it has undertaken to carry out a study on the work of the ECSC during its fifty years of activity, with the intention of publishing an overview suitable for the general public by the end of 2004

IV. **EUROPEAN PARLIAMENT RESOLUTION ON AGENCIES**

The European Parliament decisions on the discharge concerning the agencies are directed to the Director of each individual agency. Moreover, the resolutions accompanying the decision on the discharge contain a number of horizontal recommendations regarding both the agencies and the Commission. Thus the institutional relations between agencies and the Commission have been considerably reinforced in the new Financial Regulations, i.a. concerning accounting and internal audit.

In general, the Commission arranges regular meetings with the Agencies to discuss accounting matters in particular to provide updates on the progress of the modernisation project. For accounting matters, the Commission has a designated contact point for Agencies to answer questions they may have.

In accordance with article 185 of the new Financial Regulation the Commission's internal auditor (IAS) shall exercise the same powers in the Agencies receiving Community financial support as he does within the Commission. Given initial staffing levels, the IAS has first put focus on the analysis and the evaluation of the structures of internal control in order to prioritise subsequent audit work and to provide initial consultancy input.

Moreover, the Commission is taking the recommended actions concerning, i.a., a harmonised operating framework for the agencies, staff policy and other assistance to the individual agencies. On the other hand, the Commission considers that further general studies of the activities of the agencies as well as their administrative expenditures are not appropriate. It further recalls that financial contributions from a Member State hosting an agency are entirely voluntary.

V. RECOMMENDATION OF THE COUNCIL ON GENERAL BUDGET

The Commission has taken due note of the annexed comments to the Council Recommendation in which it recommends the European Parliament to give a discharge to the Commission in respect of the implementation of the budget of the European Communities for the financial year 2002.

The Commission joins the Council in its hopes to see the results of the improvements made by the Commission with regard to the legality and regularity of underlying transactions reflected in practice in the shortest possible timeframe so that a positive DAS can be obtained. Thus the Commission will continue its efforts to ensure that its supervisory systems provide reasonable assurance regarding its management of the risk of error in underlying transactions.

The Commission also agrees with Council that cooperation with national control authorities is as an important means of improving shared management. It is therefore taking action to strengthen that cooperation. In the Structural Funds the Commission is seeking to progress towards a “single audit” approach, based on the increased exchange of information and the coordination of audit work.

Moreover, the Commission is taking the necessary actions to follow up on the comments of the Council regarding the individual chapters of Court of Auditor’s Annual Report.

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