

# Official Journal

## of the European Union

C 303



English edition

### Information and Notices

Volume 53

9 November 2010

<u>Notice No</u>	<u>Contents</u>	<u>Page</u>
	IV <i>Notices</i>	
NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES		
<b>Court of Auditors</b>		
2010/C 303/01	Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2009, together with the institutions' replies .....	1
2010/C 303/02	Annual Report of the Court of Auditors on the activities funded by the eighth, ninth and tenth European Development Funds (EDFs) concerning the financial year 2009, together with the Commission's replies .....	243

EN

Price:  
EUR 9



## IV

*(Notices)*NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND  
AGENCIES

## COURT OF AUDITORS



In accordance with the provisions of Article 287(1) and (4) of the TFEU 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 Union, at its meeting of 9 September 2010, adopted its**

**ANNUAL REPORTS****concerning the financial year 2009.**

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, David BOSTOCK, Morten Louis LEVYSOHN, Ioannis SARMAS, Igors LUDBORŽS, Jan KINŠT, Kersti KALJULOID, Kikis KAZAMIAS, Massimo VARI, Juan RAMALLO, Olavi ALA-NISSILÄ, Lars HEIKENSTEN, Karel PINXTEN, Ovidiu ISPIR, Nadejda SANDOLOVA, Michel CRETIN, Harald NOACK, Henri GRETHEN, Eoin O'SHEA, Szabolcs FAZAKAS, Louis GALEA, Ladislav BALKO, Augustyn KUBIK, Milan Martin CVIKL, Rasa BUDBERGYTĖ.



ANNUAL REPORT ON THE  
IMPLEMENTATION OF THE BUDGET

(2010/C 303/01)



# TABLE OF CONTENTS

	<i>Page</i>
General introduction .....	7
Chapter 1 — The Statement of Assurance and supporting information .....	9
Chapter 2 — Revenue .....	37
Chapter 3 — Agriculture and natural resources .....	55
Chapter 4 — Cohesion .....	95
Chapter 5 — Research, energy and transport .....	115
Chapter 6 — External aid, development and enlargement .....	135
Chapter 7 — Education and citizenship .....	161
Chapter 8 — Economic and financial affairs .....	175
Chapter 9 — Administrative and other expenditure .....	195
Annex I — Financial information on the general budget .....	219
Annex II — List of Special Reports adopted by the Court of Auditors since the last Annual Report .....	242





## GENERAL INTRODUCTION

0.1. The European Court of Auditors is the institution established by the Treaty to carry out the audit of European Union (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 on the Court can be found in its annual activity report which, together with its special reports on EU spending programmes and revenue and its opinions on new or amended legislation, are available on its website: [www.eca.europa.eu](http://www.eca.europa.eu).

0.2. This is the Court's 33rd Annual Report and covers the 2009 financial year. Commitments totalling 142,5 billion euros and payments totalling 118,4 billion euros were made<sup>(1)</sup>. 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, together with its special reports, provides the basis for the discharge procedure, in which the European Parliament decides whether the European Commission has satisfactorily carried out its responsibilities for implementing the budget. In addition, the Court is this year, for the first time, forwarding its Annual Report to national parliaments at the same time as to the Council and the European Parliament, as provided for under Protocol No 1 to the Treaty of Lisbon.

0.4. The central part of this report is the Court's statement of assurance (the 'DAS') on the reliability of the annual accounts of the European Union and on the legality and regularity of transactions (referred to in the report as 'regularity of transactions'). The statement of assurance itself begins the report. Most of the material which follows reports on the audit work underlying the statement of assurance.

0.5. The report is organised as follows<sup>(2)</sup>:

- Chapter 1 provides an overview of findings: a summary of the principal results of the Court's audit on the reliability of accounts and on the regularity of transactions, and an analysis of the corrective capacity of supervisory and control systems,
- Chapters 2 to 9 provide detailed audit findings in the form of 'specific assessments' of EU revenue and expenditure. Chapter 2 deals with the revenue side of the EU budget; Chapters 3 to 9 with seven groups of the policy areas within which spending from the EU budget is authorised and recorded. These groups of policy areas correspond broadly to the headings used in the 2007-13 Financial Framework, which sets out the EU's broad multiannual spending plans.

0.6. The specific assessments are mainly based on: the results of the Court's testing of the regularity of transactions; on an assessment of the effectiveness of the principal supervisory and control systems governing the revenue or expenditure involved; and on a review of the reliability of Commission management representations.

0.7. The Commission's replies to the Court's observations — or those of other EU institutions and bodies, where appropriate — are presented within the document. The Court's description of its findings and conclusions takes into account the corresponding reply of the auditee. It is the Court's responsibility, as the independent external auditor, to report its findings, to draw conclusions from those findings, and thus to provide an impartial assessment of the reliability of accounts and of the legality and regularity of transactions.

<sup>(1)</sup> Detailed information on the implementation of the 2009 budget can be found in Part B II of the Annual Accounts of the European Union, Financial Year 2009 and from the Report on Budgetary and Financial Management, Financial Year 2009 prepared by DG Budget. Detailed figures are also provided in **Annex I** to this Annual Report.

<sup>(2)</sup> A change has been made to the structure of this year's Annual Report. The previous Chapters 2 and 3 (covering internal control and budgetary management respectively) are not included for 2009; observations relating to the Commission's internal controls have been integrated within the specific appraisals.



## 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 – independent auditor's report	I-X
Opinion on the reliability of the accounts	VII-VIII
Opinion on the legality and regularity of the transactions underlying the accounts	IX-X
Overview of findings	1.1-1.50
Introduction	1.1-1.5
Reliability of accounts	1.6-1.20
General background	1.6
Findings for the 2009 financial year	1.7-1.20
Regularity of transactions and effectiveness of systems	1.21-1.26
Structure of the DAS specific assessments	1.21
Findings for the 2009 financial year	1.22-1.25
Comparison with previous years' results	1.26
Reliability of Commission management representations	1.27-1.31
Annual Activity Reports and Declarations by Directors-General	1.27-1.28
Synthesis report of the Commission	1.29-1.31
Recovery and correction mechanisms	1.32-1.50
Introduction	1.32-1.36
Information provided by the Commission with the 2009 accounts	1.37-1.48
Conclusion concerning the corrective capacity of supervisory and control systems	1.49-1.50

## THE COURT'S STATEMENT OF ASSURANCE PROVIDED TO THE EUROPEAN PARLIAMENT AND THE COUNCIL – INDEPENDENT AUDITOR'S REPORT

I. Pursuant to the provisions of Article 287 of the Treaty on the Functioning of the European Union (TFEU) the Court has audited

- (a) the 'Annual Accounts of the European Union' 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 2009; and
- (b) the legality and regularity of the transactions underlying those accounts.

### *Management's responsibility*

II. In accordance with Articles 310 to 325 of the TFEU and the Financial Regulation, management <sup>(3)</sup> is responsible for the preparation and fair presentation of the 'Annual Accounts of the European Union' and the legality and regularity of the transactions underlying them:

- (a) Management's responsibility in respect of the 'Annual Accounts of the European Union' 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 Union' 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 Union in all material aspects.
- (b) The way in which management exercises its responsibility for ensuring the 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 Union (Article 317 of the TFEU).

<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 2009 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 European Union, 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 of the bodies 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 regularity of the 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 Union context. These standards require that the Court plans and performs the audit to obtain reasonable assurance whether the 'Annual Accounts of the European Union' 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 are selected based on the auditor's judgment, including an 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 Union, whether due to fraud or error. In assessing those risks, 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- and Gross National Income-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 Union' present fairly, in all material respects <sup>(7)</sup>, the financial position of the Union as of 31 December 2009, 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 of certain Directorates-General of the Commission (in particular accounting for pre-financing and the related cut-off as well as for invoices/cost claims) still need to be resolved.

### **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 policy groups 'Economic and financial affairs' and 'Administrative and other expenditure' for the year ended 31 December 2009 in all material respects are legal and regular.

<sup>(7)</sup> According to the International Standard on Auditing 700 'Forming an opinion and reporting on financial statements' (ISA 700, paragraph 35), the terms 'present fairly, in all material aspects' or 'give a true and fair view' are equivalent.

X. In the Court's opinion, payments underlying the accounts for the year ended 31 December 2009 for the policy groups 'Agriculture and natural resources', 'Cohesion', 'Research, energy and transport', 'External Aid, development and enlargement' and 'Education and Citizenship' are materially affected by error. The supervisory and control systems are partially effective in preventing or detecting and correcting the reimbursement of overstated or ineligible costs.

9 September 2010

Vítor Manuel da SILVA CALDEIRA

*President*

European Court of Auditors

12, rue Alcide De Gasperi, Luxembourg, LUXEMBOURG

## THE COURT'S OBSERVATIONS

**OVERVIEW OF FINDINGS****Introduction**

1.1. Pursuant to Article 287 of the Treaty on the Functioning of the European Union, 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 Union is to obtain sufficient appropriate evidence to conclude on the extent to which revenue, expenditure, assets and liabilities have been properly registered and that the annual accounts faithfully reflect the financial position as of 31 December 2009, and the results of its operations and cash flows for the year then ended (see paragraphs 1.6 to 1.20).

1.3. The aim of the Court's audit work on the regularity of the transactions underlying the 2009 accounts is to gather sufficient appropriate evidence, of a direct or indirect nature, to give an opinion on whether they are in accordance with the applicable regulations or contractual provisions, and have been correctly calculated (see paragraphs 1.21 to 1.25 for an overview of the results and chapters 2 to 9 for more details).

1.4. The Court analysed the reliability of Commission management representations, namely the Declarations of Directors-General and the Annual Activity Reports of the Commission's services and the related Synthesis Report in order to assess the extent to which they provide a fair assessment of the quality of financial management, and in particular the extent to which reservations are complete and sufficient (see paragraphs 1.27 and 1.28 and 'Reliability of Commission management representations' in chapters 2 to 9).

1.5. In addition, the Court examined the arrangements for making and reporting on recoveries and financial corrections (see paragraphs 1.32 to 1.50).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Reliability of accounts***General background*

1.6. The Court audited the annual accounts for the 2009 financial year, 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 23 July 2010. 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.

*Findings for the 2009 financial year*

1.7. The Court's audit of the consolidated financial statements found them to be free from material misstatements. However, the Court draws attention to the following matters which were also reported in 2008 and previous years:

- missing or incomplete representations by Accounting Officers for certain organisations whose accounts are consolidated with those of the Commission (see paragraph 1.8);
- the local financial management systems identified by the Commission's Accounting Officer (see paragraphs 1.9 and 1.10);
- the treatment of pre-financing and accounts payable during the year and in the cut-off procedure (see paragraphs 1.11 to 1.13);
- the disclosures concerning recoveries following irregularities (see paragraphs 1.14 to 1.19).

1.7. *The Commission welcomes the continuing positive assessment of the Court concerning the reliability of the accounts.*

- *The Commission has made progress in this area and would highlight the improvements made to these disclosures in the 2009 accounts. Note 6 has been improved and enlarged so as to provide more comprehensive information on all aspects of the recoveries process.*

<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 Council Regulation (EC) No 1525/2007 (OJ L 343, 27.12.2007, p. 9), requires that the final accounts shall be sent before 31 July of the following financial year.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**The Accounting Officer's letter of representation**

1.8. The Commission's Accounting Officer highlighted in the management representation letter concerning the consolidated accounts that the Accounting Officers of three consolidated entities had omitted or modified representations. In particular, the required information on the validation of the accounting and local systems was not provided <sup>(9)</sup>.

**Validation of local financial management systems <sup>(10)</sup>**

1.9. Due to continuing problems in the management of suspense accounts and asset accounting procedures, the Commission's Accounting Officer was still not able to validate the local systems of two Directorates-General <sup>(11)</sup>.

1.10. Most of the Accounting Officer's recommendations from previous years have been implemented. The remaining issues did not have a material impact on the reliability of the accounts in 2009, but their nature and significance are such that they should continue to receive the attention of the Commission, notably certain aspects of cut-off procedures, clearing and recording of pre-financings, timeliness of the recording of transactions and data consistency between local systems and ABAC.

**Pre-financing, accounts payable and cut-off procedures**

1.11. The Court audited representative samples of pre-financing representing 48 827 million euro after cut-off and of invoices/cost claims about 15 260 million euro. It identified accounting errors with an immaterial financial impact overall but a high frequency. This underlines the need for further improvement in the accuracy of the basic accounting data at the level of certain Directorates-General. The most common types of errors are:

- missing or duplicate entries;
- booking of incorrect amounts;
- transactions booked to the wrong account.

**1.8.** *The Commission notes that out of a total of 40 controlled entities only these 3 entities did not provide the complete required information in the representation letters they sent to the Court. This represents a significant improvement from the prior year.*

**1.9.** *Both Directorates General, RELEX and JLS, made steady progress in 2009 in dealing with identified insufficiencies. The accounting officer will keep demanding further progress towards full validation of the local systems.*

**1.11.** *The Commission takes note that the Court found there to be no material errors affecting the accounts, based on its samples. It will continue to work on improving the accuracy of its accounting data through ongoing actions like the accounting quality project and the validation of local systems.*

<sup>(9)</sup> European Agency for the Management of Operational Cooperation at the External Borders, European Police College and Innovative Medicines Initiative Joint Undertaking.

<sup>(10)</sup> 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. According to Article 61(1)(e) of the Financial Regulation the Accounting Officer has to verify these systems in order to assess their proper functioning.

<sup>(11)</sup> Directorates-General for External Relations and for Justice, Freedom and Security.

## THE COURT'S OBSERVATIONS

1.12. As regards accounting for amounts pre-financed, the Court also identified the following problems:

- The clearing of outstanding pre-financings is not always carried out correctly. A number of clearings were either not carried out at all or for incorrect amounts. This resulted in an immaterial overstatement in the pre-financing balance at the end of the year.
- Some Directorates-General in the Research family do not process the available information on progress made and related costs incurred and do not clear the corresponding pre-financing according to this progress, but use approximations when determining the cut-off (e.g. *pro rata temporis*).

1.13. As regards invoices/cost claims, some Directorates-General did not respect the requirement to register the invoices and cost statements within the five working days<sup>(12)</sup> after their reception.

#### Disclosures concerning recoveries and financial corrections

1.14. The Court's audit shows that the Commission's reporting of figures on financial corrections and recoveries varies largely between its different services (see also paragraphs 1.37 to 1.50).

1.15. Some services present figures for financial corrections in progress only when a final position letter is issued, while others base their calculation on statistical estimates extrapolating past experience even including corrections for amounts for which the clearance procedure has not yet started.

## THE COMMISSION'S REPLIES

**1.12.**

- *The Commission will analyse the situation regarding pre-financing in the different services and take corrective measures where necessary.*
- *The Commission acknowledges that there are improvements to be made in this area. This issue is already being addressed by initiatives such as the accounting quality programme and other central guidance and controls of the accounting services.*

**1.13.** *The Directorates-General have taken the actions necessary to reduce the delays and improvements have been noted. Delays in recording invoices/cost claims are being addressed as part of the accounting quality project.*

**1.14.** *The Commission makes reference to its replies on this matter given under paragraphs 1.38-1.50.*

**1.15.** *All the information related to recoveries are now in one disclosure, note 6 to the consolidated accounts. More detailed information is included under 'Financial corrections in progress'. In accordance with accounting policies and generally accepted accounting principles, the Commission can use estimates for the preparation of the annual accounts. This is the case for the amount of expenditure which is likely to be excluded from EU financing by such future conformity decisions. This estimate takes into account the most reliable information available. Since some corrections are decided per financial year of expense it is therefore possible to calculate the average of corrections per financial year closed and to extrapolate this percentage to more recent financial years for which the controls are still ongoing.*

*The reliability of this estimate is assessed on the basis of the comparison with the amounts of financial corrections in progress for the earlier years where this information is available.*

<sup>(12)</sup> As laid down in the internal instructions of the Commission's Accounting Officer of 10.7.2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.16. The information on the financial correction activities (withdrawals and recoveries) provided by the Member States, in the area of Cohesion and included in note 6 to the financial statements is not yet complete and reliable (see also paragraph 4.31).

1.17. Based on the examination of the certifying bodies' work and the Commission's analysis referring to this, the Court reiterates its doubts as regards the reliability of the receivables from Member States in the area of agriculture (EAGF debtors' accounts) <sup>(13)</sup> (see also paragraph 3.54).

1.18. Although the explanatory notes to the annual accounts contain information that some payments are likely to be corrected at a later date by the Commission's services or the Member States, the amounts and areas of expenditure which may be subject to further verification and clearance of accounts procedures are still not identified in the notes <sup>(14)</sup>.

**1.16.** Data submitted by Member States to the Commission in the first half of 2010 concerning the year 2009 is included in note 6 to the consolidated annual accounts. The on-the-spot review of Member States' data carried out by the Commission showed that the systems for recording and reporting data are not yet completely reliable in all Member States (see also replies to paragraphs 1.34 and 1.36). The Commission follows up any inconsistencies in these data and makes recommendations to Member States for improvements.

The Commission also refers to its reply to paragraph 4.31.

**1.17.** The Commission obtained from the certification bodies (independent professional audit bodies) reliable information on debtors for clearance and accounting purposes. Corrections amounting to EUR 14,8 million have been proposed by the Commission with regard to the financial year 2009 based on its assessment of the errors found by the certification bodies in their reports. The financial errors found are followed-up through the normal clearance of accounts procedures.

**1.18.** The Financial Regulation allows the Commission to make controls on all expenditure for several years after the actual year of expenditure. The accounts should not imply that, because of controls in future years, all the expenditure concerned remains to be accepted. Otherwise, all budgetary expenditure would be considered provisional until an ex-post check is made or the said limitation period has lapsed. Where the amounts of potential recoveries are quantifiable, they are disclosed in note 6 to the consolidated accounts.

In agriculture, a financial clearance decision is taken around six months after the end of the financial year in question, through which the Commission establishes the amount of expenditure recognised as chargeable to the EU budget for that year. This role of the financial clearance decision is not called into question by the fact that subsequently financial corrections may be imposed on Member States through conformity decisions. The amount of expenditure which is likely to be excluded from EU financing by such future conformity decisions is disclosed in a note to the financial statements.

<sup>(13)</sup> See paragraph 5.61 of the 2006 Annual Report, paragraph 5.44 of the 2007 Annual Report and paragraph 5.56 of the 2008 Annual Report.

<sup>(14)</sup> See paragraphs 1.10 and 1.11 of the 2002 Annual Report, paragraph 1.11 of the 2003 Annual Report, paragraphs 1.12 and 1.13 of the 2004 Annual Report, paragraph 1.57 of the 2005 Annual Report, paragraph 1.34 of the 2006 Annual Report and paragraph 1.28 of the 2007 Annual Report.

## THE COURT'S OBSERVATIONS

1.19. Given the complexity of recovery and financial correction mechanisms, the disparate nature of the elements treated therein and the need for a transparent and coherent presentation of the information (see also 1.37 to 1.50), the Commission should refine its financial reporting guidelines on revenue recognition and on contingent assets in order to lay down the accounting and disclosure requirements.

**Transfer of assets of Galileo**

1.20. For the Galileo programme the ownership of all assets created, developed or acquired was legally transferred to the Union in July 2008, based on a joint regulation of the European Parliament and the Council<sup>(15)</sup>. However, the transfer agreements made are not yet fully implemented. All expenditure incurred so far (approximately 2 000 million euro) is treated as research expenses. There is no impact on the balance sheet for 2009, but the Commission should continue its efforts to ensure that all necessary information is available at the time when the transfer takes place in order to safeguard assets effectively.

**Regularity of transactions and effectiveness of systems***Structure of the DAS specific assessments*

1.21. The Court provides specific assessments within chapter 2 on Revenue and chapters 3 to 9 on groups of Activity Based Budgeting (ABB) policy areas (see **Table 1.1**). Each specific assessment provides an introduction, findings and conclusions on the regularity of transactions, the effectiveness of systems as well as reliability of Commission management representations, and a follow-up of previous observations.

## THE COMMISSION'S REPLIES

**1.19.** *The Commission complies with the disclosure requirements laid out in its accounting rules, primarily rules 2, 4 and 10.*

*There is no general guidance in the international standards on making these specific, non-accounting, disclosures. Nonetheless, taking into account the observations of the Court, the Commission has improved the presentation of this information.*

**1.20.** *The transfer of the assets being created is not foreseen until the end of the In-Orbit Validation (IOV) phase, expected to be during 2012. The Commission is already working closely with the European Space Agency (ESA) to ensure that at the time of this transfer all the necessary accounting and technical information will be available to ensure a smooth handover.*

<sup>(15)</sup> Regulation (EC) No 683/2008 of the European Parliament and of the Council of 9 July 2008 on the further implementation of the European satellite navigation programmes (EGNOS and Galileo) (OJ L 196, 24.7.2008, p. 1).

Table 1.1 — Expenditure outturn in 2009 by Annual Report chapters

(million euro)

Sections (S) and titles (T) <sup>(1)</sup> corresponding to the 2009 budgetary nomenclature allocated per chapter of the Court's Annual Report	Payments made in 2009 <sup>(2)</sup> <sup>(3)</sup>
<b>Annual Report chapters</b>	
<b>Agriculture and natural resources</b>	56 318
Agriculture and rural development (T.05)	
Environment (T.07)	
Fisheries and maritime affairs (T.11)	
Health and consumer protection (T.17)	
<b>Cohesion</b>	35 467
Employment and social affairs (T.04)	
Regional policy (T.13)	
<b>Research, energy and transport</b>	7 966
Research (T.08)	
Energy and transport (T.06)	
Information society and media (T.09)	
Direct research (T.10)	
<b>External aid, development and enlargement</b>	6 596
External relations (T.19)	
Development and relations with ACP States (T.21)	
Enlargement (T.22)	
Humanitarian aid (T.23)	
<b>Education and citizenship</b>	2 153
Education and culture (T.15)	
Communication (T.16)	
Area of freedom, security and justice (T.18)	
<b>Economic and financial affairs</b>	732
Economic and financial affairs (T.01)	
Enterprise (T.02)	
Competition (T.03)	
Internal market (T.12)	
Trade (T.20)	
<b>Administrative expenditure</b>	9 129
Parliament (S. I)	
Council (S. II)	
Commission (S. III)	
Court of Justice (S. IV)	
Court of Auditors (S. V)	
Economic and Social Committee (S. VI)	
Committee of the Regions (S. VII)	
European Ombudsman (S. VIII)	
European Data-protection Supervisor (S. IX)	
<b>Grand totals</b>	<b>118 361</b>

<sup>(1)</sup> The budgetary titles 14 and 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 9.

<sup>(2)</sup> Administrative expenditure is deducted from policy groups and shown separately under its own heading; this leads to differences in comparison to chapters 3 to 8.

<sup>(3)</sup> The expenditure audited for each policy group is explained under 'Audit scope and approach' in chapters 3 to 8.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Findings for the 2009 financial year*

1.22. For Revenue <sup>(16)</sup> (117 285 million euro), commitments for all policy groups and payments for the policy group Administrative and other expenditure (9 129 million euro), the Court estimates that the errors have a financial impact of less than 2 % of the total amounts (see **Table 1.2**) and concludes that the supervisory and control systems are effective (see also paragraphs 2.33 to 2.38 and 9.28 to 9.29).

1.23. In the policy groups Agriculture and natural resources (56 318 million euro), Research, energy and transport (7 966 million euro), External aid, development and enlargement (6 596 million euro) and Education and Citizenship (2 153 million euro <sup>(17)</sup>) the most likely error rate estimated by the Court is between 2 % and 5 % of payments made, but for the policy group Cohesion (23 081 million euro reimbursed certified expenditure), the most likely error rate is above 5 % (see paragraphs 3.70, 4.34, 5.45, 6.51 and 7.18 and **Table 1.2**). For these policy groups <sup>(18)</sup>, the Court concludes that the supervisory and control systems are partially effective (see paragraphs 3.71 to 3.72, 4.36, 5.46 to 5.48, 6.52 and 7.19).

**1.23.** As regards Agriculture and natural resources, the Commission considers that the error rate is at the lower end of the range quoted by the Court, thereby confirming previous years' results. The risks identified by the Court are known to and addressed by the Commission as demonstrated by the reservations made in the annual activity report of the Directorate-General Agriculture and Rural Development.

Moreover, the conformity clearance procedures ensure that the risk to the EU budget is adequately covered. For the policy group Education and Citizenship, the Commission notes that the error rate for closures slightly exceeds 2 %.

In order to avoid the accumulation of pre-financing in its balance sheet, the Commission has proposed in May 2010 for the revision of the Financial Regulation, to ensure that advances and interim payments are cleared in a more timely manner.

For the policy group Research, energy and transport, the Commission welcomes the positive trend in the reduction of errors noted by the Court. This result is in line with the Commission's own findings.

For the policy group External aid, development and enlargement, the Commission welcomes the increase in the 'frequency' of transactions which the Court judges to be entirely 'regular' (83 %) in comparison with figures for 2008 and 2007.

In the Cohesion area, a significant reduction in the error rate has been noted compared to previous years. The frequency of errors has also decreased in the last three years, from 54 % in the Court's annual report for 2007 to 36 % this year, as noted in Annex 4.1 of the Court's report. (see also replies to paragraphs 1.26 and 4.34).

<sup>(16)</sup> For the scope of the Revenue audit see paragraphs 2.7 to 2.14.

<sup>(17)</sup> Of which 1 881 million euro relate to advance payments and 272 million euro to interim and final payments. The latter concern closures and settlements relating to expenses amounting to 1 399 million euro for which the underlying activities/projects were mainly initiated in 2004 and 2005 but were only approved by the Commission in 2009 (see paragraphs 7.8 and 7.19).

<sup>(18)</sup> For policy group Cohesion, the majority of the systems work relates to the new period and consisted of examining the compliance of the systems with regulatory requirements. This resulted in an assessment as 'partially compliant'.

## THE COURT'S OBSERVATIONS

1.24. For the policy group Economic and financial affairs (732 million euro) the Court estimates that the most likely error rate is less than 2 % of the total payments (see paragraph 8.30 and **Table 1.2**) and concludes that the supervisory and control systems are partially effective (see paragraph 8.31).

1.25. The Court estimates that overall payments are materially affected by error (the most likely error rate estimated by the Court lies between 2 % and 5 %) and concludes that supervisory and control systems for payments are, in general, partially effective.

## THE COMMISSION'S REPLIES

**1.25.** *The Commission welcomes this global assessment. It notes that the global error rate calculated for all chapters taken together has dropped substantially over the last years, including in 2009. It will maintain its efforts to reduce the number of transactions affected by error.*

**Table 1.2 — Summary of 2009 findings on the regularity of transactions**

Specific assessments	Revenue or operational expenditure (million euro)	Paragraphs in Annual Report	Functioning of supervisory and control systems	Error rate range
Revenue	117 285	2.33-2.34		
Agriculture and natural resources	56 318	3.71-3.73		
Cohesion	35 467	4.34-4.36	( <sup>1</sup> )	( <sup>2</sup> )
Research, energy and transport	7 966	5.45-5.46		
External aid, development and enlargement	6 596	6.51-6.52		
Education and citizenship	2 153	7.18-7.19	( <sup>3</sup> )	
Economic and financial affairs	732	8.30-8.31		
Administrative and other expenditure	9 129	9.28-9.29		




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 **Annex I.I**, paragraphs 3 to 18).

*Legend:*

## Functioning of supervisory and control systems

	Effective
	Partially effective ( <sup>4</sup> )
	Not effective

Error rate range (<sup>5</sup>)

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

(<sup>1</sup>) The majority of the work on systems relates to the new period and consisted of examining the compliance of the systems with regulatory requirements and resulted in an assessment as 'partially compliant' (see paragraph 4.36).

(<sup>2</sup>) Interim and final payments reimbursing certified expenditure amounting to 23 081 million euro (see paragraph 4.15).

(<sup>3</sup>) The assessment of the supervisory and control systems is based on the examination of the Commission's system for closures of programmes and projects (see paragraph 7.19).

(<sup>4</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>5</sup>) The Court decided to present the error rates (see **Annex I.I**, paragraphs 8 to 12) in three intervals. These error rate ranges cannot be interpreted as a confidence interval (in a statistical sense).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Comparison with previous years' results*

1.26. The Court's audit results show, compared to 2008, an increase in its estimate of the most likely error concerning the payments for the policy group 'Agriculture and natural resources' <sup>(19)</sup> and a significant decrease in its estimate of the most likely error concerning the payments for policy group 'Cohesion' <sup>(20)</sup>. Taken together, this confirms a continuing reduction in the most likely error rate, as estimated by the Court, for payments as a whole over recent years.

**1.26.** *The Commission welcomes the positive statement by the Court on the improvement of the overall situation over the years. For 2009 the large reduction of the error rate in cohesion more than offsets the small increase in agriculture, resulting in a much improved overall situation.*

*For Agriculture and natural resources, the Commission's view is that the error rate continues to oscillate around 2 %. For Cohesion, the reduction of the lower error limit from 11 % to 3 % seems to confirm the effectiveness of the reinforced control provisions in the 2007-2013 regulatory framework, as well as the first impact of the Commission's 2008 action plan to strengthen its supervisory role, including suspension and correction procedures. Suspensions may imply a trade-off with full budget implementation.*

*The Commission will continue its efforts to ensure that the error rate is further reduced.*

**Reliability of Commission management representations***Annual Activity Reports and Declarations by Directors-General*

1.27. All the Directors-General stated in their Annual Activity Reports 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 transactions. However, of the main Directorates-General or services who issued a declaration in 2009, 13 contain one or more reservations, the majority of which refer to weaknesses concerning the regularity of the underlying transactions <sup>(21)</sup>.

<sup>(19)</sup> See paragraphs 3.18 to 3.19 and **Annex 3.1** 'Results of transaction testing for Agriculture and natural resources' of this report and 2008 Annual Report, paragraphs 5.13 to 5.14 and Annex 5.1, Part 1 'Main features of sampled based transaction testing'.

<sup>(20)</sup> See paragraphs 4.17 to 4.19 and **Annex 4.1** (Results of transaction testing for Cohesion) and 2008 Annual Report, paragraphs 6.16 to 6.17 and Annex 6.1, Part 1 'Main features of sample based transaction testing'.

<sup>(21)</sup> The total number of reservations rose from 15 in 2008 to 20 in 2009.

## THE COURT'S OBSERVATIONS

1.28. The Court found that the Director-Generals' declarations and the Annual Activity Reports gave a fair assessment of financial management in relation to the regularity of transactions for 'Revenue' and for policy groups 'Cohesion', 'Research, energy and transport', 'Education and citizenship', 'Economic and financial affairs' and 'Administrative and other expenditure' (see paragraphs 2.32, 4.33, 5.44, 7.17, 8.29 and 9.11). For the policy group 'External aid, development and enlargement', Directorates-General for Humanitarian aid, for Enlargement and for External Relations gave a fair assessment (see paragraph 6.49), whereas the EuropeAid Cooperation Office only gave a partially fair assessment of financial management in relation to the regularity of transactions (see paragraph 6.50). For the policy group 'Agriculture and natural resources' the Court concludes that the Director-General's declarations and Annual Activity Report only gives a partially fair assessment of financial management in relation to the regularity of transactions (see paragraphs 3.66 to 3.69).

*Synthesis report of the Commission*

1.29. By adopting the Synthesis Report the Commission assumes its political responsibility<sup>(22)</sup> for the operational implementation of the EU budget by its senior management<sup>(23)</sup>. The report is the first to be adopted during the mandate of the current Commission. The Commission considers that for 2009 its efforts to enhance control mechanisms in order to ensure legality and regularity with a view to 'obtaining an unqualified DAS', continued with positive results.

1.30. The Commission acknowledges that there are still areas which require improvement and proposes actions to address these concerns, such as:

- further improvement of the design of funding schemes in order to strengthen management and control mechanisms;
- further simplification of grant schemes whilst still achieving policy objectives;
- setting appropriate benchmarks for assessing its management of risk (tolerable risk levels) which take full account of the costs and benefits of controls;
- close monitoring of annual summaries to allow these to be more useful for assurance purposes;
- further improvement of annual activity reports as the main vehicle through which senior management document their accountability to the College and as a source of evidence for the DAS.

## THE COMMISSION'S REPLIES

**1.28.** *The Commission welcomes the improvement in the assessment of the quality of its services Annual Activity Reports.*

*While the Court expresses an annual audit opinion on the legality and regularity of the underlying transactions, the opinion of the Directors-General focuses on whether funds have been used for their intended purpose, taking account of the multiannual nature of controls, and their effectiveness in detecting and correcting errors. Directors-General express a management opinion based on information which includes the Commission's own audit work, reports and observations of the Court of Auditors and, where relevant, the results of Member States' controls.*

*See also Commission replies in the sectoral chapters.*

<sup>(22)</sup> Pursuant to Article 317 of the Treaty on the Functioning of the European Union (TFEU).

<sup>(23)</sup> Communication from the Commission to the European Parliament, the Council, the Court of Auditors — Synthesis of the Commission's management achievements in 2009, COM(2010) 281 final, 2.6.2010.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.31. The Court previously identified other issues which remain unresolved:

— in several areas the scope or scale of reservations should be greater (see paragraphs 3.67 to 3.68, 6.50 and **Annexes 3.3** and **6.3**)<sup>(24)</sup>;

— data from Member States on recoveries or withdrawals is missing or incomplete (see paragraphs 1.16, 3.54 and 4.31)<sup>(25)</sup>; and

— financial correction mechanisms are not yet fully effective (see paragraphs 1.37 to 1.50)<sup>(26)</sup>.

1.31.

— *The Commission's responsibility (under Article 28a of the Financial Regulation) is to operate cost-effective control systems: that is within which 'the right control is carried out at the right time'. The assurance declarations in the Annual Activity Reports take account of the capacity of such systems to detect and correct errors during a programme's life with the aim of minimising the residual undetected error at the end of the programming period. As reported in the annual activity report of the Director-General for Regional Policy for 2009, such an exercise for the 1994-99 programming period for the ERDF showed that the risk of undetected error was substantially reduced.*

*The Commission has expressed its satisfaction that the action plans designed by authorised officers by delegation (AODs) are adequate to address weaknesses and mitigate the risks identified.*

*As regards Agriculture, the Commission considers that the reservations included in the 2009 annual activity report of the Director-General for Agriculture and rural development regarding rural development measures under Axis2 and the IACS in Bulgaria and Romania are exhaustive and that their potential impact has been adequately reflected in points 3.2.1 and 3.2.2 of that report. As regards Greece, the reservation in previous years was justified by the high reputational risk for the Commission which resulted from the insufficient implementation of the IACS in Greece and not by the financial risk for the EU budget resulting from the deficiencies, which has always been covered by the financial corrections imposed on Greece through the conformity clearance procedures. As Greece had completed its action plan to remedy the deficiencies by the end of 2008, and the effective functioning of the IACS system is being assessed on an ongoing basis, it was therefore fully justified to lift the reservation.*

*As regards External aid, development and enlargement, the Commission welcomes the Court recognition of the improvement by all the Directorates-General in the policy group in the quality of the information provided in their annual activity reports (see paragraph 6.51).*

*The Commission considers that the reservations made by the Directors-General in their 2009 annual activity reports or the absence of reservations were in line with its internal guidelines and correctly addressed the inherent risks of programmes.*

— *As regards Agriculture, see reply to paragraph 1.17.*

*For Cohesion, see replies to paragraph 1.16.*

— *See replies to paragraphs 1.38 to 1.50.*

<sup>(24)</sup> See also 2008 Annual Report, paragraph 2.15.

<sup>(25)</sup> See also 2008 Annual Report, paragraphs 1.16 and 1.17.

<sup>(26)</sup> See also 2008 Annual Report, paragraph 2.17.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Recovery and correction mechanisms***Introduction*

1.32. In implementing the EU budget, the Commission has to ensure effective and efficient internal control over the reliability of reporting, the safeguarding of assets and information, the prevention and detection of fraud and irregularities and the management of the risks relating to the regularity of transactions, taking into account the multi-annual character of programmes and the nature of the payments concerned <sup>(27)</sup>.

1.33. The Commission has the final responsibility for ensuring that supervisory and control systems provide reasonable assurance that errors in transactions underlying the accounts are either prevented or identified and corrected. It is also responsible for ensuring that reliable information is available for the purposes of its own management, for stakeholders and for the external auditors.

1.34. Amounts incorrectly paid should be recovered <sup>(28)</sup>. In practice:

- The Commission is only able to recover payments from beneficiaries where it directly manages expenditure (e.g. for most of the expenditure in the policy group Research, energy and transport).
- For expenditure subject to shared management (e.g. for most of the expenditure in the policy groups Agriculture and natural resources and Cohesion), decentralised management (e.g. in the area of Enlargement) and indirect centralised management (e.g. in the policy group Education and citizenship), the responsibility for recovering payments incorrectly made is delegated to Member States or third countries. For expenditure subject to joint management (e.g. in the area of Humanitarian aid) corrective mechanisms are defined in the agreements concluded with the international organisations. Nevertheless, in cases when the rules of EU expenditure schemes have been incorrectly applied the Commission can also make financial corrections (see paragraph 1.40).

**1.32.** *The Commission is required to ensure effective and efficient internal control and considers that both recoveries and financial corrections contribute to the protection of the financial interests of the Union (see reply to paragraph 1.50).*

**1.34.**

- *The Commission has made substantial efforts to improve the quality of information on recoveries and withdrawals transmitted by Member States for Cohesion programmes, through verification of data and on-the-spot audits of Member States' systems for recording and reporting corrections. In 2008 and 2009 it has checked systems in 19 Member States. Overall the functioning of those systems are not yet completely reliable in all Member States although there is evidence that the quality is improving and that there has been some improvement in comparison with previous years. The Commission has formulated appropriate recommendations and ensures their follow up. It will ensure that information is complete at closure of 2000-2006 programmes.*

*For the 2007-2013 period, there is a standardized procedure for submission of recovery statements and the Commission expects that this reporting procedure will further improve the quality of information at its disposal. Member States are also required to distinguish corrections deriving from those as a result of EU audits.*

<sup>(27)</sup> Article 28a of the Financial Regulation.

<sup>(28)</sup> Article 71(3) of the Financial Regulation.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.35. For several years the Court's audit has focused on how the Commission executes its supervisory role and how it applies these corrective mechanisms. The Court has also examined to what extent national authorities and international organisations provide to the Commission correct information on financial corrections and recoveries made.

1.36. The Court has regularly noted that the data on the corrective capacity of supervisory and control systems at the level of Member States have improved but are not yet complete and reliable, in particular in the area of Cohesion <sup>(29)</sup>. The Commission, however, is reporting reliable figures as concerns its own activities. Since the 2005 discharge procedure, the European Parliament and the Council have encouraged the Commission and Member States to implement the improvements necessary to ensure completeness and accuracy of the information available, with the aim of providing reliable evidence to allow the Court to assess the effectiveness of multi-annual correction mechanisms for EU spending.

*Information provided by the Commission with the 2009 accounts*

1.37. In the notes to the 2009 accounts the Commission has responded to these comments by including more detailed information about recoveries and financial corrections than it has done in the past <sup>(30)</sup>. In particular it provides information broken down by the stage which recovery or financial correction procedures have reached ('in progress', 'confirmed' or 'implemented' – see paragraph 1.42); by area of expenditure; where relevant by programming period; and in some cases by Member State concerned.

**1.36.** Since its 2005 annual report, the Court has recognised gradual improvements in the quality and scope of the information disclosed in the notes to the consolidated accounts on the subject of recoveries. The Commission has procedures in place to report reliable figures with regards to financial corrections based on its own audit work, as noted by the Court in its 2008 annual report (paragraph 1.16).

*In the Cohesion area, and for financial corrections executed by Member States following their own verification and audit work, the Commission depends on the quality of the information sent by Member States.*

*The Commission has made in the recent years notable efforts to improve the quality of information available on recoveries and withdrawals transmitted by Member States for Cohesion programmes. It has requested Member States to provide cumulative and yearly data on withdrawals and recoveries, despite that this is beyond the regulatory requirements. It has also audited on-the-spot the Member States' systems for recording and reporting corrections, with fairly good results. In case of identified needs for improvement, the Commission has formulated appropriate recommendations and ensures their follow-up.*

<sup>(29)</sup> A general observation on sundry debtors in 2002, 2003 and 2004 Annual Reports. Specific observations in 2005 Annual Report, paragraphs 6.36 to 6.41, 2006 Annual Report, paragraphs 2.26 to 2.30, 2007 Annual Report, paragraphs 1.29 to 1.31, 7.39 and 2008 Annual Report, paragraphs 1.16 to 1.17 and paragraph 2.16(c).

<sup>(30)</sup> See Annual Accounts of the European Union for the 2009 financial year — note 6 to the financial statements.

## THE COURT'S OBSERVATIONS

1.38. The Court welcomes the provision of this information. It points out however that weaknesses in the presentation as well as in the coherence of the information and the amounts presented by Member States for Cohesion need to be addressed and that care should be taken when interpreting the information (see also paragraphs 1.14 to 1.19 and below).

**Differences in focus and impact of corrective mechanisms**

1.39. Recovery from the beneficiaries of EU spending programmes of amounts incorrectly paid and other financial corrections are markedly different in focus and impact. Recoveries correct the receipt of irregular expenditure: in principle it is the recipients of such expenditure who repay sums incorrectly received; recoveries can therefore be seen as an error correction mechanism <sup>(31)</sup>.

1.40. Financial corrections (including the clearance of agricultural expenditure) however, predominantly address weaknesses in management systems. They withdraw funding from Member States or third countries which fail to ensure that EU rules are correctly applied. The financial consequences of such corrections are usually borne by national taxpayers not beneficiaries of an expenditure scheme which has been wrongly applied. Financial corrections contribute to the protection of the financial interests of the EU, but neither in principle or practice can they however be regarded as a means of correcting individual payments which have been incorrectly made.

## THE COMMISSION'S REPLIES

**1.38.** *The presentation of note 6 to the consolidated accounts has been reviewed for the 2009 accounts. The Commission has improved the presentation to respond to stakeholders' requests.*

**1.39.** *The Commission is obliged to comply with the different correction practices provided for by the different legal bases and management modes. For shared management these clearly allocate the primary responsibility to the Member States and limit the Commission's financial corrections to cases where the Member States failed to take the necessary action for individual or system weaknesses. This is explained in note 6 to the consolidated accounts.*

**1.40.** *In Cohesion, a financial correction is a mechanism intended to correct irregular expenditure that has been included for EU funding and therefore has a negative impact on the EU budget.*

*Member States should recover incorrect payments from beneficiaries. Recovery is made either by obtaining repayment of the sums concerned from the beneficiary or setting off the sums to be repaid against further payments due to the same beneficiary.*

*Where undue payments to beneficiaries can be identified as a result of the EU controls, Member States are required to follow them up with recovery actions against these beneficiaries. However, even where recoveries from beneficiaries are not possible 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.*

*The conformity clearance system in agriculture is designed to exclude expenditure from EU financing which has not been effected in compliance with EU rules. In contrast, it is not a mechanism by which irregular payments to beneficiaries are recovered, which according to the principle of shared management as defined in Article 53b(2)(c) of the Financial Regulation and Article 9(1)(a)(iii) of Council Regulation (EC) No. 1290/2005, is the sole responsibility of Member States.*

*The Commission considers therefore that certain financial corrections can be seen as error correction mechanisms insofar as the amounts concerned are recovered from the final beneficiary.*

<sup>(31)</sup> However in Agriculture, according to Council Regulation (EC) No 1290/2005 (OJ L 209, 11.8.2005, p. 1), 50 % of any undue payment which the Member States have not recovered from the beneficiaries within four years, or within eight years in the case of legal proceedings, will be automatically charged to their national budget (the so called 50/50 rule) (see paragraphs 3.50 and 3.51). Member States must continue recovery procedures and credit any recovered amounts to the EU budget.



## THE COURT'S OBSERVATIONS

1.41. Though the Commission recognises the difference between recoveries and financial corrections in the notes to the financial statements, its presentation, in other documents such as the Synthesis Report, does not yet make sufficiently clear the distinction between the two mechanisms. Although for 2009 almost 90 % of the confirmed amounts (some 2 900 million euro out of a total of 3 319 million euro) and almost 80 % of the implemented amounts (some 1 400 million euro out of a total of 1 843 million euro) presented by the Commission relate to financial corrections usually borne by national taxpayers, the comments are at times presented as if they were wholly or mainly recoveries.

**Different stages of the corrective mechanisms**

1.42. The Commission presents data for three main stages in the process:

- A correction is **in progress** when the recovery or financial correction is still in the process of being finalised (e.g. through legal or contradictory procedures at the Commission and/or the Member States).
- A correction is **confirmed/decided** when the amount of the recovery or financial correction is established and finalised (e.g. through a Commission decision or an agreement with the Member State).
- A correction is **implemented** when the recovery or financial correction is actually cashed (e.g. through the receipt of a repayment by the Commission or the deduction by the Member State from payment claims).

1.43. The Commission makes clear that the data presented concerning the different stages of the corrective mechanisms in the policy group Cohesion refer only to recoveries and financial corrections which it has imposed.

## THE COMMISSION'S REPLIES

**1.41.** *The Commission notes that the overall share of financial corrections cited by the Court is roughly in line with the part of the budget in shared management and the fact that this area is responsible for a large part of the errors detected by the Court. The Court's emphasis on differences between recoveries and financial corrections is already reflected in some reports and will be taken into account in future annual activity reports.*

*The EU annual accounts present in a fair way the amounts of financial corrections deriving from Commission's supervisory role.*

*Amounts presented as financial corrections indicate that the Commission has taken steps to protect the EU budget from unduly paid monies. Comments thereon aim at clarifying the procedure the Commission applies in doing this. These monies will eventually be recovered from beneficiaries through recovery procedures initiated by Member States, as it is in their interest to recover funds where possible.*

*The Commission also refers to its replies to paragraphs 1.36 and 1.40.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.44. In this respect, attention is drawn to the fact that for the policy group Cohesion only 20 % of the amounts confirmed in 2009 (2 411 million euro) have been implemented (476 million euro) in the same year. Added to the amounts outstanding from previous years, a total amount of 2 332 million euro still remains to be implemented at year-end 2009. Unless further expenditure declarations are submitted by Member States in subsequent years, the remainder will be implemented only at the closure of the programmes<sup>(32)</sup>.

**1.44.** *The annual accounts give detailed information on the financial corrections confirmed, implemented and to be implemented and explain the reasons for which an important amount is still to be implemented.*

*As the Court rightly points it out, implementation of financial corrections, from the recent years, will mainly occur at the closure of the programme where the regulatory ceiling for interim payments has been reached. Also, financial corrections confirmed during the life of the programmes may be implemented in subsequent payment claims. It is therefore difficult to make a direct link between amounts of financial corrections confirmed in a given year, and amounts implemented in the same year.*

*As a general rule, financial corrections confirmed during the life of the programmes are implemented in subsequent payment claims. As the ceiling for payments may have been reached for most programmes relating to the 2000-2006 period, it is inevitable that the deduction of the ineligible expenditure will be reflected only in the closure documents, which are due to be submitted by the Member State in 2010.*

*As soon as the Commission has evidence of the implementation of a correction by deduction of the ineligible expenditure from a closure payment request, it will report the financial correction as implemented. Detailed information on the implementation of financial corrections is provided in note 6 to the consolidated accounts.*

*Even though not all the individual financial corrections can be traced in the accounting system of the Commission, but only those with financial impact in terms of EU contribution, the financial corrections with evidence of implementation during 2010 will be reported as implemented in the accounts of the Commission for 2010.*

*The figures vary significantly between programmes and Funds, due to the nature and / or volume of the concerned corrections.*

<sup>(32)</sup> In 2009, for most operational programmes of the 2000-2006 programming period, the 95 % ceiling for declaring expenditure before closure has already been reached.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Lack of reliable information concerning the annual impact of corrective mechanisms**

1.45. In principle, if reliable information is available about the effect of corrective mechanisms in the past, it might be possible to estimate the likely effects of applying the same mechanisms in the future. It has also sometimes been incorrectly suggested that recoveries and corrections can be compared with or even netted off against the Courts estimates of error.

1.46. However, reliable annual information about the effects of corrective mechanisms is not available. The notes to the financial statements do not systematically show how sums recovered are linked to specific years, and in some cases an accumulation or back-log of prior year corrections have been identified and recorded in the current financial year.

**1.45.** *The Commission has observed that the Court's error rate (in particular for Cohesion) disclosed in its annual report has sometimes been translated into an absolute amount which has then been compared with the recoveries and corrections figures. The Commission does not agree with this practice.*

*The Commission has repeatedly confirmed that multiannual programmes are subject to multiannual control systems and that many errors detected by the Court in a given year would normally have been detected and corrected by Commission's systems in subsequent years. This can be demonstrated by calculating residual error rates at the time of closure of a programme, which have been shown in the past to be lower than during the implementation period.*

*The Commission agrees that a comparison of the Court's DAS error rates, which relate to an annual examination of transactions, with its own calculated error is not straightforward.*

**1.46.** *As mentioned by the Court itself in paragraph 1.44, most financial corrections in Cohesion accepted at this late stage of the programming period 2000-2006 will be implemented at the closure of the programme, and not in the year when they were made or when the financial correction was confirmed. This is the multiannual character of the corrective systems for shared management programmes.*

*In addition flat-rate corrections may be imposed in situations where weaknesses of control systems at Member States' level are identified but were not corrected by the Member State itself, with no relation to specific irregular expenditure or specific year.*

*It is therefore not possible to make a direct link between a financial correction and the year of the expenditure to which it relates.*

*Structural Funds are implemented in a multi-annual framework. If a financial correction has not been reported in year N it will be reported in year N+1, without this affecting the reliability of the procedure, whose main objective is to ensure that all irregular payments are corrected. This compensation between years within the programming period is necessary to give accurate, transparent and complete cumulative information on financial corrections.*

*Nonetheless, the notes to financial statements present information on financial corrections confirmed and implemented in a specific year, as well as cumulative information.*

*In contrast, in agriculture (EAGF and EAFRD), financial corrections are linked to expenditure of a specific financial year and this link is disclosed in each conformity decision adopted by the Commission.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

1.47. Moreover the cycles of many correction mechanisms may last for many years and variations in elements influencing the corrective capacity of many supervisory and control systems (legal and organisational framework; modalities of recovery procedures; type, size and duration of projects, etc.) may affect the capacity to estimate the likely impact in the future.

1.48. Finally, it should be recalled that the Commission's corrective mechanisms mainly involve financial corrections other than recoveries (see paragraphs 1.39 and 1.40).

*Conclusion concerning the corrective capacity of supervisory and control systems*

1.49. The Commission has taken steps in 2009 to increase and improve the information it provides on the corrective mechanisms applied to the EU budget. This is a positive development. However, the information it provides is not yet completely reliable because the Commission does not always receive reliable information from Member States. Furthermore, the need to refine the financial reporting guidelines pertaining to what information is to be included and how it should be treated should be examined. For some areas of expenditure, the Commission does not provide information reconciling the following: the year in which the payment concerned is made, the year in which the related error is detected and the year in which the resulting financial correction is disclosed in the notes to the accounts.

1.50. The vast majority of the corrections by value involve financial corrections on Member States or third countries, rather than recoveries from individual beneficiaries who received EU funds incorrectly. In contrast, the errors detected by the Court's testing are mostly amounts incorrectly claimed by, or paid to, beneficiaries. Taking this into consideration the Court concludes that it is not possible to make a meaningful comparison between its own estimate of error rates and the data for financial corrections and recoveries supplied by the Commission.

**1.48.** See reply to paragraph 1.39.

**1.49.** See replies to paragraphs 1.19, 1.40 and 1.46.

*A reconciliation of payments, errors and financial corrections made as suggested by the Court is not possible where the expenditure declaration system is cumulative over a multi-annual period or in some cases where they are systems corrections (see also reply to paragraph 1.50).*

**1.50.** *In direct management, the Commission corrects errors either by proceeding to a recovery (recovery order or compensation from a subsequent payment) or requests a corrected cost statement.*

*The vast majority of the EU budget, some 80 %, is implemented in shared management where Member States are primarily responsible for ensuring the regularity of expenditure declared to the Commission and hence for detecting and correcting irregularities. In this management mode the Commission is also responsible for ensuring that the systems put in place by the national authorities are effective and, if not, the Commission may impose financial corrections. The system of financial corrections foreseen by the applicable legislation is therefore such that the Commission recovers/corrects from the Member States, which in turn have to recover the irregular payment from the beneficiary. However, where financial corrections are linked to systemic weaknesses they are usually based on flat or extrapolated rates, and not to errors identified at the level of beneficiaries.*

## THE COMMISSION'S REPLIES

As a consequence, a distinction must be made regarding:

- the information related to financial corrections following EU controls and audits, which is complete and reliable, but in case of systemic weaknesses cannot be directly linked to errors in payments to a beneficiary nor necessarily to a particular year;
- the information transmitted to the Commission on withdrawals and recoveries of irregular expenditure by the Member States: while for Agriculture the information available is adequate (see reply to paragraph 1.17), for Cohesion the 2008 action plan for structural actions specifically addressed the quality and completeness of this data. As a consequence, data for 2009 submitted by the Member States to the Commission in the 1<sup>st</sup> half of 2010 are of better quality and more complete.

The Commission agrees that a comparison of the Court's DAS error rates, which by virtue of the Treaty relate to an annual examination of a sample of transactions, with figures on financial corrections is not relevant. Due to the different types of financial corrections as indicated above, it is not possible, in the field of Cohesion, to make a direct link between a financial correction and the year of the expenditure to which it relates. However, the impact of the financial corrections can clearly be identified when calculating a residual error rate after the closure of a programme. For example, DG REGIO's non-statistical closure audit enquiry on a sample of 1994-1999 ERDF programmes finalised in January 2010 gives an indication that at closure, and after all financial corrections have been made, the overall risk of error was substantially reduced.

The Commission ensures the protection of the financial interests of the Union by applying the management and control systems and procedures as provided for in the financial and sector regulations decided by the legislator in order to prevent, detect and correct errors harming the EU budget.

## ANNEX 1.1

**AUDIT APPROACH AND METHODOLOGY****PART 1 — Audit approach and methodology for the reliability of accounts**

1. In order to assess whether the consolidated accounts, consisting of the consolidated financial statements and the consolidated reports on the implementation of the budget <sup>(1)</sup> present fairly, in all material respects, the financial position of the European Union, and the results of operations and cash flows at the year end, the main assessment criteria are:

- (a) *legality and regularity*: the accounts are drawn up in accordance with the rules, and budgetary appropriations are available;
- (b) *completeness*: all revenue and expenditure transactions and all assets and liabilities (including off-balance sheet items) proper to the period are entered in the accounts;
- (c) *reality of the transactions and existence of the assets and liabilities*: each revenue and expenditure transaction is justified by an event which pertains to the entity and is proper to the period; the asset or liability exists at the balance sheet date and is proper to the reporting entity;
- (d) *measurement and valuation*: the revenue and expenditure transaction and the asset or liability is entered in the accounts at an appropriate value, bearing in mind the principle of prudence;
- (e) *presentation of information*: the revenue and expenditure transaction, asset or liability is disclosed and described in accordance with the applicable accounting rules and conventions and the principle of transparency.

2. The audit consists of the following basic elements:

- (a) an update of the evaluation of the accounting control environment;
- (b) checking of the functioning of key accounting procedures and the year end closure process;
- (c) analytical checks (consistency and reasonableness) on the main accounting data;
- (d) analyses and reconciliations of accounts and/or balances; and
- (e) substantive tests of commitments, payments and specific balance sheet items based on representative samples.

**PART 2 — Audit approach and methodology for the regularity of transactions**

3. 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 control systems in ensuring the regularity of transactions.

4. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of management representations <sup>(2)</sup>.

*How the Court tests transactions*

5. Transaction testing is based on a **representative statistical sample** of receipts (in the case of revenue) and payments contained within the policy group concerned. This testing provides a statistical estimation of the extent to which the transactions in the population concerned are regular.

6. In order to determine the sample sizes necessary to produce a reliable result the Court uses an **audit assurance model**. This involves an assessment of the risk of errors occurring in transactions (inherent risk) and the risk that the supervisory and control systems do not prevent or detect and correct such errors (control risk). When systems are tested and found to be effective, they can provide part of the assurance on the regularity of transactions. In practice, the Court relies primarily on its direct testing of transactions.

<sup>(1)</sup> Including the explanatory notes.

<sup>(2)</sup> In particular Annual Activity Reports and the declarations of the Commission's Directors-General (see paragraphs 16 to 17) and the Synthesis Report.

7. 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. The Court samples the transactions recorded in the budgetary accounts and 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. When the transaction (at any level) is incorrectly calculated or does not meet a regulatory requirement or contractual provision, it is considered to contain an **error**.

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

8. 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 not followed. They may relate to a 'condition for payment' or to an 'other compliance' issue.

9. The Court **classifies errors** as follows:

- whether they are *quantifiable*; or
- *non-quantifiable*, in the event that it is not possible to measure how much of the amount paid or received from the EU budget was incorrect or the error relate to an 'other compliance' issue <sup>(?)</sup>; and
- in terms of their *nature*, in particular *eligibility* (payment does not meet the eligibility rules) *occurrence* (reimbursement of a cost which is not proven to have been incurred) or *accuracy* (payment incorrectly calculated).

10. The Court expresses the **frequency** by which errors occur by presenting the proportion of transactions in the sample affected by errors (both quantifiable and non-quantifiable). This indicates how widespread errors are likely to be within the policy group.

11. The Court estimates the overall financial impact of quantifiable errors to arrive at a most likely **error rate**. The most likely error rate is classified as falling into one of the following three ranges:

- below 2 %;
- between 2 % and 5 %; or
- above 5 %.

12. The results of the Court's testing of transactions are shown in Annexes 1 to each of chapters 2 to 9 and are summarised in **Table 1.2**.

*How the Court assesses systems and reports the results*

13. **Supervisory and control systems** are established by the Commission, (and Member and beneficiary States), to manage the risks to the EU 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.

14. 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 selects a sample of systems to examine. The results of the **systems assessments** are presented in the form of a table called '*Results of the examination of systems*' given in the Annexes 2 of chapters 2 to 9. Where it has been possible to design and implement the audit so as to assess the effectiveness of the systems, these 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). For the remaining areas / policy groups, the systems have been assessed for their compliance with regulatory requirements.

15. If sufficient appropriate audit evidence has been obtained, the Court also provides an **overall assessment** of supervisory and controls systems (also presented in Annexes 2 of chapters 2 to 9) which takes into account both the assessment of selected systems, as well as the results of transaction testing.

<sup>(?)</sup> In some cases expenditure schemes place legal requirements on beneficiaries but provide that failure to comply with the requirement does not affect the recipient's entitlement to payment; instead it leads to a financial correction or fine. A notable example is 'cross-compliance' under agriculture. These requirements derive from legislation on the protection of the environment, the public, animal and plant health, animal welfare (Statutory Management Requirements) and the maintenance of agricultural land in good agricultural and environmental condition (GAEC). If a recipient of direct payments under the CAP does not respect the related cross-compliance requirements a reduction or exclusion is made in the amount of direct payments. When the Court detects infringements in cross-compliance requirements it classifies them as non-quantifiable errors and they are not therefore included in the most likely error rate.

*How the Court assesses Commission management representations and reports the results*

16. Each Directorate-General prepares — and publishes — an Annual Activity Report in which it reports on the achievement of policy objectives and the management and control systems in place to ensure the regularity of transactions and sound use of resources. Each Annual Activity Report is accompanied by a declaration of the Director-General on *inter alia* the extent to which resources have been used for their intended purpose, and control procedures ensure the regularity of transactions <sup>(4)</sup>. The report and declaration taken together represent a key element of internal control.

17. The Court assesses the Annual Activity Reports and accompanying declarations in order to determine how far they provide a fair reflection of financial management in relation to regularity of transactions. This is done through review and analysis, including comparison with the Court's findings on the area(s) in question.

*How the Court arrives at its opinion*

18. The Court evaluates the estimated most likely error rate against the materiality level of 2 % to determine — together with other evidence — if the transactions are free from material error (an 'unmodified' opinion), affected by a material level of error (an 'adverse' opinion) or if the material level of error only affects a limited part of the population (a 'qualified opinion').

<sup>(4)</sup> Further information on these processes, as well as links to the most recent reports can be found at [http://ec.europa.eu/atwork/synthesis/index\\_en.htm](http://ec.europa.eu/atwork/synthesis/index_en.htm).

## CHAPTER 2

**Revenue**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	2.1-2.14
Specific characteristics of the budget area	2.2-2.6
Audit scope and approach	2.7-2.14
Traditional own resources	2.8-2.12
VAT- and GNI-based own resources	2.13-2.14
Regularity of transactions	2.15-2.18
Traditional own resources	2.16
VAT- and GNI-based own resources	2.17
Other revenue	2.18
Effectiveness of systems	2.19-2.31
Traditional own resources	2.20-2.24
VAT-based own resources	2.25-2.26
GNI-based own resources	2.27-2.31
Compilation of National Accounts in Member States	2.27-2.28
General and specific reservations	2.29-2.30
Verification of GNI inventories in the Member States	2.31
Reliability of Commission management representations	2.32
Conclusions and recommendations	2.33-2.39

## THE COURT'S OBSERVATIONS

## INTRODUCTION

2.1. This chapter presents the Court's specific assessment of Revenue which comprises own resources and other revenue. Key financial information on Revenue is provided in **Table 2.1**. Own resources constitute by far the main source of financing of budgetary expenditure (94,1 %).

Table 2.1 — Revenue — Key information

*(million euro)*

Budget Title	Type of Revenue	Description	Revenue 2009	%
1	Traditional own resources (TOR)	Sugar production charge (Chapter 11)	132	0,1
		Customs duties (Chapter 12)	14 397	12,3
	VAT-based own resource	VAT (Value Added Tax)-based resource from the current financial year (Chapter 13)	13 743	11,7
	GNI-based own resource	GNI (Gross National Income)-based resource from the current financial year (Chapter 14)	82 413	70,3
	Correction of budgetary imbalances	UK correction (Chapter 15)	- 315	- 0,3
	Gross reduction in the annual GNI-based contribution	Granted to the Netherlands and Sweden (Chapter 16)	4	0,0
		<b>TOTAL OWN RESOURCES</b>	<b>110 373</b>	<b>94,1</b>
3		Surpluses, balances and adjustments	330	0,3
4		Revenue accruing from persons working with the Institutions and other Community bodies	781	0,7
5		Revenue accruing from the administrative operation of the Institutions	258	0,2
6		Contributions and refunds in connection with Community agreements and programmes	4 545	3,9
7		Interest on late payments and fines	933	0,8
8		Borrowing and lending operations	4	0,0
9		Miscellaneous revenue	61	0,1
		<b>TOTAL OTHER REVENUE</b>	<b>6 912</b>	<b>5,9</b>
<b>Total revenue for the year</b>			<b>117 285</b>	<b>100,0</b>

Source: Annual Accounts 2009.



## THE COURT'S OBSERVATIONS

**Specific characteristics of the budget area**

2.2. There are three categories of own resources <sup>(1)</sup>: traditional own resources (customs duties collected on imports and sugar production charge — TOR), own resources calculated on the basis of value added tax (VAT) collected by Member States, and own resources derived from Member States' gross national income (GNI).

2.3. TOR are established and collected by the Member States. Three quarters of these amounts are paid to the Union, 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>(2)</sup>.

2.4. 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 respectively, calculated in accordance with Union rules.

2.5. In accordance with Decision 2007/436/EC, Euratom certain Member States benefit from a reduced call rate for VAT <sup>(3)</sup> and of a gross reduction in their annual GNI contribution <sup>(4)</sup> for the period 2007-2013. In addition the United Kingdom is granted a correction in respect of budgetary imbalances ('the UK correction') which involves a reduction in its payments of GNI own resources.

2.6. The GNI-based own 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.

<sup>(1)</sup> See Council Decision 2007/436/EC, Euratom of 7 June 2007 on the system of the European Communities' own resources (OJ L 163, 23.6.2007, p. 17), and Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources (OJ L 130, 31.5.2000, p. 1), as amended by Regulation (EC, Euratom) No 105/2009 (OJ L 36, 5.2.2009, p. 1).

<sup>(2)</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.

<sup>(3)</sup> Germany, the Netherlands, Austria and Sweden.

<sup>(4)</sup> The Netherlands and Sweden.

## THE COURT'S OBSERVATIONS

**Audit scope and approach**

2.7. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of Revenue a representative statistical sample of 62 recovery orders taken from the Commission's records of receipts of all revenue was tested at the Commission level (see **Annex 2.1**).

*Traditional own resources*

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

2.9. The Court carried out an assessment of supervisory and control systems in three Member States<sup>(5)</sup> and reviewed their accounting systems for TOR. It examined the flow of duties from establishment to declaration to the Commission, in order to obtain reasonable assurance that the amounts recorded were accurate. The auditors checked a random sample of 30 import declarations in each of these three Member States.

2.10. For five recoveries concerning traditional own resources of the sample referred to in paragraph 2.7, the Court reconciled the selected monthly statements with the underlying accounting records of Member States<sup>(6)</sup>.

2.11. The Court assessed the supervisory and control systems at the Commission, including the latter's inspections in Member States. The supervisory role of ACOR<sup>(7)</sup> was also assessed.

2.12. The Court took into account the results from its specific audit carried out in 2008 and 2009 on simplified customs procedures for imports in nine Member States<sup>(8)</sup>.

*VAT- and GNI-based own resources*

2.13. VAT- and GNI-based own resources are based on macroeconomic statistics, for which the underlying transactions 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 in order to determine the amounts to be included in the final accounts. The Court thus examined the drawing up of the budget and the correctness of the contributions by Member States.

<sup>(5)</sup> Germany, Ireland and Latvia.

<sup>(6)</sup> Germany, France, Italy, Slovenia and the United Kingdom.

<sup>(7)</sup> Advisory Committee on Own Resources: Article 20 of Regulation (EC, Euratom) No 1150/2000, as amended.

<sup>(8)</sup> Belgium, Ireland, France, Italy, Hungary, the Netherlands, Slovenia, Sweden and the United Kingdom.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

2.14. 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>(9)</sup> Committees.

**REGULARITY OF TRANSACTIONS**

2.15. The results of transaction testing are summarised in **Annex 2.1**.

**Traditional own resources**

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

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

2.17. The Court's audit found the calculation of Member States' contributions and their payment to be free from material error. However, in December 2009 the Commission detected an error in its calculation of provisional estimates of the UK correction for years 2008 and 2009, representing an overestimation of 138 million euro and 458 million euro respectively. As the UK correction for year 2008 was entered in the 2009 budget, Member States who finance it made a higher contribution than necessary in 2009. This will only be corrected when revised estimates are entered in the budget of following years.

*2.17. These anomalies once spotted by the Commission were communicated to Member States and the Court. All Member States agreed that the necessary remedial measures be taken as part of the routine procedures for revisions and updates.*

**Other revenue**

2.18. The Court found that overall the transactions tested in respect of Other revenue were free from material error.

**EFFECTIVENESS OF SYSTEMS**

2.19. The results of the examination of systems are summarised in **Annex 2.2**.

<sup>(9)</sup> Article 4 of Council Regulation (EC, Euratom) No 1287/2003: the GNI Regulation (OJ L 181, 19.7.2003, p. 1).

## THE COURT'S OBSERVATIONS

**Traditional own resources**

2.20. As in previous years<sup>(10)</sup>, the Court highlighted problems in the procedures and systems which affect the amounts included in the B accounts which should be remedied. These concerned in particular delayed recovery of duties and late making available of recovered amounts<sup>(11)</sup>, and unjustified write-off of customs duties<sup>(12)</sup>.

2.21. In two of the Member States<sup>(13)</sup> audited the national authorities were not able to fully justify the amounts recorded in the B statements, because they did not match the underlying documents. Furthermore similar differences were identified by the Court in its reconciliation of the A accounts<sup>(14)</sup>.

2.22. The Commission has taken the view that, in cases where goods unlawfully introduced in the customs territory of the Community have been seized, there is no obligation to make an entry in the B accounts of customs debts incurred. In its judgement of April 2009<sup>(15)</sup>, the Court of Justice has considered that such seizures of goods must take place before those goods go beyond the first customs office situated inside that territory in order to lead to the extinction of the customs debts. Thus in the view of the Court of Auditors debts incurred on goods seized after this stage should indeed be entered into the accounts.

2.23. On-the-spot audits carried out by the Court revealed deficiencies in national customs supervision, in particular as regards the performance of risk analysis for the selection of traders and imports to be subject to customs controls<sup>(16)</sup>. This increases the risk of irregularities remaining undetected which could lead to a loss of TOR.

## THE COMMISSION'S REPLIES

**2.20.** *The Commission will request the Member States concerned to take remedial action to address the shortcomings found and where necessary Traditional Own Resources underpaid will be requested as well as any late payment interest due.*

**2.21.** *The Member States concerned will be requested to justify the amounts in the accounts, to make good any short-payments of Traditional Own Resources discovered, and where late making available has occurred, late payment interest will be demanded.*

**2.22.** *The Commission's position has been based on Article 867a of Regulation (EEC) No 2454/93 implementing the Customs Code according to which goods seized and confiscated are to be considered to have been entered for the customs warehousing procedure. For goods entered under this procedure no customs debt is established and entered in the accounts. The Court of Justice judgment of 2009 did not cover the relevance of Article 867a as to the treatment of the customs debt for seized goods and therefore the Commission awaited the outcome of another similar case, C-230/08. The Commission is assessing the consequence of the recent judgment in this case and the follow-up to be given. In any event, when the Modernised Customs Code enters into force, for seized goods the customs debt will always be extinguished, regardless of the place where the goods are seized.*

**2.23.** *It is for the Member States to establish their Customs control systems based on appropriate methods of risk analysis. The deficiencies referred to by the Court concern three Member States. In one of these identical findings were made in the Court's audit of Simplified Procedures and the Commission is following up the action being taken. In the remaining two they relate to the absence of a random element in the declaration/trader selection system. The national authorities have taken remedial measures in one. In the other a random element was used but was not incorporated in the automated system for the selection of import declarations/traders for examination.*

<sup>(10)</sup> For example paragraph 4.14 of the 2008 Annual Report.

<sup>(11)</sup> Germany, Ireland, Italy and Latvia.

<sup>(12)</sup> Germany.

<sup>(13)</sup> Ireland and Latvia.

<sup>(14)</sup> Ireland.

<sup>(15)</sup> Case number C-459/07 of 2 April 2009.

<sup>(16)</sup> Germany, Ireland and Latvia.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

2.24. Furthermore, in its recent special report<sup>(17)</sup> on simplified customs procedures for imports<sup>(18)</sup>, the Court found significant control weaknesses in all Member States visited and a high frequency of errors in most of them. Considering that these Member States account for more than half of the total TOR collection and that about two thirds of all EU customs declarations are made using simplified procedures, these control weaknesses have an impact on the functioning of supervisory and control systems of Member States in the area of TOR. This in turn leads to the risk that incorrect amounts of TOR may be collected.

**VAT-based own resources**

2.25. The starting point for the calculation of VAT-based own resources is the VAT actually collected in the Member States<sup>(19)</sup>. A study to quantify and analyse the VAT gap in the EU-25 Member States (except Cyprus)<sup>(20)</sup>, published by the Commission in September 2009, estimates the gap between accrued VAT receipts and a theoretical net VAT liability to be an average of 13 % for the period 2004-2006. For the Member States whose VAT base is not capped<sup>(21)</sup>, if the VAT gap were eliminated, their VAT-based contribution to the EU budget would increase. This would reduce the GNI-based contributions, although the incidence on individual Member States would differ.

2.26. Reservations are a means to keep doubtful elements in the VAT statements submitted by Member States open for correction after the statutory time-limit of four years. In 2009 67 reservations were placed and 63 were lifted. At the end of the year, a total of 167 were in place (see **Table 2.2**). Even though the Court noted improvements in the lifting of long-outstanding VAT reservations, 20 of these were still in place at the end of 2009 covering years prior to 2000, compared to 34 at the end of 2008.

2.24. The Commission agrees with the Court that Customs controls could be improved and need to evolve in the light of experience and best practice.

The Commission has been taking action to assist the Member States with the evolving procedures. Detailed guidelines have been provided, as has training on how best to apply them. The results will be examined during monitoring visits to be made during 2010 and 2011. In addition throughout 2009 and 2010 the Commission has carried out specific inspections, in every Member State, of their Customs Control Strategies. On the basis of these inspections and the Court's audit observations the Commission has already requested remedial action. It will prepare, in the course of 2010, a thematic report on the Customs Control Strategy in the Member States, incorporating the Court's findings as well as those of the Commission. This will be discussed with Member States at ACOR with the objective of seeking improvements in this field.

2.25. As the Court acknowledges the starting point for calculating the annual VAT base, on which the amount of VAT own resources contributions is in turn fixed, is the value of VAT receipts actually collected during that one year. Although a diminution in the VAT gap, could theoretically result in an increase in the VAT own resources paid, the legislator opted for a method in which any increase in VAT own resources would be neutralised, from a budgetary point of view, by a corresponding reduction in the amount raised from GNI resources.

2.26. Proactive measures to lift long-outstanding reservations continue. In 2008 the Commission categorised, on a risk basis, all long-outstanding reservations and began, with the Member States concerned, to resolve the items taking those relative priorities into account. The strategy began to bear fruit in 2009 and is continuing: a further seven of the oldest reservations have been lifted during 2010. The Commission considers good progress has been achieved. Further management meetings are to be scheduled in 2010/2011.

<sup>(17)</sup> Special Report No 1/2010.

<sup>(18)</sup> The simplified declaration and the local clearance procedure for release of goods for free circulation. Under such procedures, economic operators can have goods released only by lodging partially completed customs declarations or by an entry in their records. A full detailed customs declaration and the duty payment are made usually in the following month.

<sup>(19)</sup> Article 3 of Council Regulation (EEC, Euratom) No 1553/89 (OJ L 155, 7.6.1989, p. 9).

<sup>(20)</sup> [http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/tax\\_cooperation/combating\\_tax\\_fraud/reckon\\_report\\_sep2009.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_cooperation/combating_tax_fraud/reckon_report_sep2009.pdf).

<sup>(21)</sup> Pursuant to article 2(1)(b) of Decision 2007/436/EC, Euratom.

Table 2.2 — VAT reservations as at 31.12.2009

Member State	Number of reservations outstanding at 31.12.2008	Reservations set in 2009	Reservations lifted in 2009	Number of reservations outstanding at 31.12.2009	Oldest year to which reservations applied at 31.12.2009
Belgium	8	0	5	3	2000
Bulgaria	0	1	0	1	2007
Czech Republic	8	1	0	9	2004
Denmark	0	5	0	5	2004
Germany	18	1	15	4	2001
Estonia	8	0	0	8	2004
Ireland	16	1	0	17	1998
Greece	10	4	3	11	1998
Spain	3	0	1	2	2001
France	4	6	0	10	1993
Italy	14	2	7	9	1995
Cyprus	3	1	1	3	2004
Latvia	2	4	1	5	2004
Lithuania	2	12	7	7	2005
Luxembourg	2	1	0	3	2004
Hungary	5	3	4	4	2004
Malta	6	4	0	10	2004
Netherlands	5	3	1	7	2002
Romania	0	0	0	0	—
Austria	11	4	10	5	2002
Poland	3	3	0	6	2004
Portugal	9	1	0	10	1996
Slovenia	0	3	0	3	2004
Slovakia	5	0	2	3	2004
Finland	8	4	2	10	1995
Sweden	9	2	4	7	1995
United Kingdom	4	1	0	5	1998
<b>Total</b>	<b>163</b>	<b>67</b>	<b>63</b>	<b>167</b>	

Source: European Commission.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**GNI-based own resources***Compilation of National Accounts in Member States*

2.27. In its report on Greek government deficit and debt statistics<sup>(22)</sup> to the (Ecofin) Council, the Commission called into question the quality of Greek macroeconomic statistics, including those of National Accounts. The Commission and the Council raised doubts on the effective functioning of supervisory and control systems at the National Statistical Service of Greece, which also produces GNI data for the calculation of own resources.

2.28. In its previous Annual Reports<sup>(23)</sup>, the Court expressed the opinion that differences in the supervisory and control systems in the National Statistical Institutes (NSI) of Member States could weaken the comparability, reliability and exhaustiveness of National Accounts. Eurostat has not yet completed its assessment of the supervisory and control systems in the NSI and has not yet adopted guidelines on the application of such systems in the Member States.

*General and specific reservations*

2.29. General reservations<sup>(24)</sup> existed at the end of 2009 on GNI data of EU-15 Member States in respect of the period 2002 to 2006, and on EU-10 Member States in respect of the period 2004 to 2006, pending the completion of the analysis of the updated or new GNI inventories.

2.30. At the beginning of 2009 there were ten open specific<sup>(25)</sup> GNI reservations relating to the period 1995 to 2001. During 2009 the Commission lifted six reservations relating to Greece leaving a balance of four<sup>(26)</sup> at the year end.

2.27. The Report quoted deals with deficit and debt data of general government in Greece. A thorough analysis of the potential impact of the issues which emerged from this deficit and debt verification did not reveal a significant impact on GDP/GNI levels.

Greece has started addressing the issues raised in the Commission Report of 8 January 2010, with the adoption of a new law on the Hellenic Statistical System including the creation of a new statistical authority (ELSTAT) in order to guarantee the independence and integrity of statistics.

2.28. 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 (SCS) in national statistical institutes of Member States may help identify and mitigate the risks of errors occurring. The Commission has already taken account of the remarks of the Court on SCS in the ways mentioned in its replies to paragraph 4.24 of the 2008 report. Furthermore, during the GNI verifications, the Commission collected information on Member States' practices, in particular for the purposes of the workshop it organised in December 2009. In accordance with the objectives of this workshop, the Commission will identify and develop best practices for use in the Member States, as well as assessment procedures in this domain.

2.30. The Commission is continuing its cooperation with the two countries that still have GNP reservations for the period 1995-2001 (1 for Greece, and 3 for United Kingdom) so that these reservations can be lifted.

<sup>(22)</sup> COM(2010) 1 final of 8 January 2010 and Minutes of the (Ecofin) Council meeting of 19 January 2010.

<sup>(23)</sup> Paragraphs 3.47 to 3.49 of the 2004 Annual Report, paragraphs 4.23 to 4.25 of the 2005 Annual Report and paragraphs 4.23 to 4.24 of the 2008 Annual Report.

<sup>(24)</sup> Article 10(7) of Regulation (EC, Euratom) No 1150/2000, as amended, 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. A general reservation covers all the data of a Member State.

<sup>(25)</sup> A specific reservation covers discrete elements of the GNI inventory.

<sup>(26)</sup> These open reservations concern Greece and the United Kingdom and mainly relate to methodological and compilation aspects.



## THE COURT'S OBSERVATIONS

*Verification of GNI inventories in the Member States*

2.31. In 2009 the Commission (Eurostat) carried out visits in 16 Member States to verify GNI inventories<sup>(27)</sup> and performed direct verification. However, this was restricted to a very small number of GNI components in the Member States visited. As set out in Eurostat guidelines, this direct verification approach is not normally expected to draw conclusions on all parts of GNI estimates.

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

2.32. The results of the review of Commission management representations are summarised in **Annex 2.3**. The Court draws attention to the recent special report on simplified customs procedures for imports detailed in paragraph 2.24. The Commission will need to take account of the conclusions from this report together with the follow-up of its own findings from inspections of simplified procedures and Member States' control strategy in its 2010 annual activity report.

**CONCLUSIONS AND RECOMMENDATIONS**

2.33. Based on its audit work, the Court concludes that:

- Member State declarations and payments of TOR,
- 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 revenue

for the year ended 31 December 2009 were free from material error.

2.34. Based on its audit work, the Court concludes that the supervisory and control systems were effective in ensuring the regularity of Revenue. 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**

2.35. The Court's audits continue to reveal problems with the use of the B accounts and therefore it recommends that the Commission continue its efforts to ensure their correct use, in particular regarding the timely establishment and making available of customs duties (paragraph 2.20).

## THE COMMISSION'S REPLIES

**2.31.** *The Commission applies direct verification as a supplement to the verification of the countries' GNI Inventories based on the GNI Inventory Assessment Questionnaire (GIAQ). The Commission considers that the number of components it had selected was sufficient for the purposes of direct verification, in accordance with the 'Guidelines for direct verification' approved by the GNI Committee.*

**2.32.** *The Commission in its inspections of Simplified Procedures and Member States' control strategy has also found weaknesses in the control procedures in Member States and will continue to follow up the Court's and its own findings. As soon as this follow-up is completed, the Commission will have a more comprehensive basis for an assessment.*

**2.35.** *The Commission will continue its regular examination of the B accounts to identify any weaknesses which might impact on the timely establishment and making available of Traditional Own Resources.*

<sup>(27)</sup> In accordance with Article 3 of the GNI Regulation, Member States shall provide the Commission (Eurostat) with an inventory of the procedures and statistics used to calculate GNI and its components according to ESA 95.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

2.36. The weaknesses identified by the Court's specific audit on the effectiveness of controls on simplified procedures and in its other audit work in 2009 led the Court to conclude that supervisory and control systems of Member States in the area of TOR are only partially effective at ensuring that customs duties recorded are complete and correct (paragraphs 2.23 and 2.24).

**VAT-based own resources**

2.37. Long-outstanding reservations still exist. The Commission should continue to press the Member States to provide quickly adequate information which would enable it to lift these reservations as soon as possible and make any necessary corrections to the Member States' VAT bases (paragraph 2.26).

**GNI-based own resources**

2.38. The Commission has not yet prepared assessment reports on GNI of Member States and set specific reservations on the period 2002 onwards. To do so, it should complete its verification of GNI inventories in Member States, taking into account its evaluation of supervisory and control systems in the NSI for the compilation of National Accounts (paragraphs 2.28 and 2.31). The Commission should also make clear the scope of the opinion it provides in its assessment of Member States' GNI data (paragraph 2.31).

2.39. A follow-up of previous observations is presented in **Annex 2.4**.

*2.36. The Commission will follow up these weaknesses in conjunction with the findings from its own inspections.*

*2.37. So far a further seven of the longest-outstanding reservations have been lifted in 2010. Further management meetings are to be scheduled in 2010/2011.*

*2.38. The Commission will complete the verification of Member States' GNI inventories and produce assessment reports at end 2010/early 2011. The Commission considers that the approach it applies (desk checks of the GNI Questionnaires, the verification of GNI Inventories using the GIAQ supplemented by a direct verification) is appropriate for a final assessment of the Member States' GNI. In this context, supervisory and control systems (SCS) are of an organisational nature and do not give specific indications on the reliability of the accounts, which depends primarily on the statistical sources and methods used, even though SCS may help mitigate risks of errors in national accounts.*

## ANNEX 2.1

## RESULTS OF TRANSACTION TESTING FOR REVENUE

	2009				2008	2007
	TOR	VAT/GNI/UK Correction	Other	Total		
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>						
Total transactions (of which):	5	43	14	<b>62</b>	60	66
Recovery orders	5	43	14	<b>62</b>	60	66
<b>RESULTS OF TESTING</b>						
<i>(in % and number of transactions)</i>						
Transactions not affected by error	80 % {4}	100 % {43}	86 % {12}	<b>95 % {59}</b>	100 %	100 %
Transactions affected by error	20 % {1}	0 % {0}	14 % {2}	<b>5 % {3}</b>	0 %	0 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>						
Most likely error rate:						
< 2 %	<b>X</b>				<b>X</b>	<b>X</b>
2 % to 5 %						
> 5 %						

## ANNEX 2.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR REVENUE

## Assessment of selected supervisory and control systems

Revenue type	Key internal control (Commission)			Key internal controls in Member States audited
	Commission checks in Member States	Commission desk checks and revenue management	Commission management of reservations	
TOR			N/A	( <sup>1</sup> )
VAT				N/A
GNI				N/A

(<sup>1</sup>) In respect of TOR the Court takes into account weaknesses encountered in its 2009 DAS work and reported in its Special Report No 1/2010 on simplified customs procedures (paragraphs 2.23, 2.24 and 2.36).

## Overall assessment of supervisory and control systems

Overall assessment	2009	2008	2007

## Legend:

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

## ANNEX 2.3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR REVENUE

Main DGs concerned	Nature of declaration given by the Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
BUDG	without reservations concerning own resources	N/A	—	A

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity

B: The Director-General's declaration and the annual activity report give a partially fair assessment of financial management in relation to regularity

C: The Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity

## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR REVENUE

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 2004 Annual Report 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 remained under discussion between the Commission and Germany.</p>	<p>The balance of 22,7 million euro was still being discussed at the end of 2009.</p>	<p>The definitive amount to be recovered should be quickly established in order to finally close this issue.</p>	<p><i>In 2009 the Commission still needed to ask Germany for further clarifications for a small proportion of the transactions involved. After receiving them the Commission has concluded that there is reasonable assurance that no further amounts of Traditional Own Resources and interest, in addition to those already paid by Germany, are due and has therefore closed this issue.</i></p>
<b>VAT-based own resource: delays related to infringement procedure</b>			
<p>In its 2008 and 2007 Annual Reports (respectively paragraphs 4.19 and 4.24), the Court noted the length of infringement procedures that could have an impact on VAT-based own resources.</p>	<p>The Commission has changed its procedures to allow for more frequent decision-taking in order to accelerate the process.</p>	<p>In 2009, delays were noted in the infringement procedures at different stages of the process, which might defer the payment of the correct amounts concerning the VAT-based own resources.</p> <p>The Court maintains its position that the Commission should reduce the time taken between the recording of infringement cases in the single register of potential infringement and the referral of cases to the Court of Justice of the European Union.</p>	<p><i>The Commission re-affirms that it has changed its procedures to allow for more frequent decision-taking in order to accelerate the process. This procedural change will have its effect but some time is needed before the positive impact of these changes become visible.</i></p> <p><i>Nevertheless out of a total of eight infringement procedures respectively mentioned within paragraphs 4.19 and 4.24 of the 2008 and 2007 Annual Reports, five cases have in the meantime been closed.</i></p>

Court observation	Action taken	Court analysis	Commission reply
<b>GNI-based own resource: EU revision policy (including the follow-up of the Greek revision)</b>			
<p>In its 2006 Annual Report 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:</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>(a) Four Member States presented major revisions in their 2009 GNP/GNI Questionnaires and Quality Reports. Belgium and Estonia did not send any official letters to notify their major revision in National Accounts, although reminders were sent by Eurostat. Malta and Latvia sent official letters after the deadline set.</p> <p>(b) In the CMFB (Committee on Monetary, Financial and Balance of Payments Statistics) meeting of July 2009, the Commission and the European Central Bank made a proposal for a concrete joint revision policy of National Accounts and Balance of Payments.</p> <p>The members of the CMFB decided that Member States should carry out an assessment of the impact of the proposed EU revision policy on national statistical production processes.</p>	<p>(a) In none of the four cases guidelines on communications of major statistical revisions set up by the CMFB were applied. Eurostat should take appropriate measures in order to ensure that such guidelines are followed by Member States.</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><b>(a)</b> <i>The Commission (Eurostat) constantly reminds the Member States of the need to apply the guidelines, particularly during GNI Committee meetings and in bilateral contacts. Although, for the cases of revisions completed in 2009 mentioned by the Court, some information was given in advance by the concerned Member States during GNI Committee meetings, the Commission will continue to monitor and to stress the importance of Member States' compliance with this procedure.</i></p> <p><b>(b)</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>

Court observation	Action taken	Court analysis	Commission reply
<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 2007, 2008, and 2009 Annual Reports 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.</p>	<p>(c) In July 2009, the Commission lifted six out of the seven Greek specific reservations.</p>	<p>(c) The Commission (Eurostat) should continue its work in 2010, in cooperation with Greece, in order to complete the verification of the Greek GNP data for the period 1995-2001.</p>	<p>(c) <i>The Commission (Eurostat) is continuing its cooperation with the Greek authorities in order to be able to lift the one remaining GNP reservation for the period 1995-2001.</i></p>
<b>GNI-based own resource: measurement of illegal activities in National Accounts</b>			
<p>ESA95 <sup>(1)</sup>, in its Articles 1.13(g) and 3.08, requires that illegal activities, which fulfil the characteristics of an economic transaction, should be included in the measure of GDP/GNI.</p> <p>In its 2004 Annual Report (paragraph 3.54(c)), the Court recommended that the Commission ensure that all Member States comply with ESA95 requirements in respect of illegal activities.</p>	<p>The GNI Committee discussed the measurement of illegal activities in National Accounts in March 2004. Because of the serious difficulties encountered in defining guidelines in this area, the GNI Committee recommended not to introduce explicit adjustments to cover illegal activities until better compilation methods and sources are available.</p> <p>In April 2008 and April 2009, the GNI Committee examined measurement issues relating to certain categories of illegal activities on the basis of the results of recent studies carried out by some Member States.</p> <p>The Commission (Eurostat) planned to conclude its review of the state of play concerning estimates of illegal activities in National Accounts and to propose guidelines for Member States in 2010, taking into account the opinions expressed by the GNI Committee.</p>	<p>Despite the progress made on the measurement of illegal activities in National Accounts, further work is needed by the Commission and Member States.</p>	<p><i>The GNI Committee discussed, at its meeting on 29 April 2010, issues related to the last category of illegal activities it had identified for national accounts purposes. Further to this discussion, the Commission will propose solutions on the issue of the measurement of illegal activities in national accounts in the first half of 2011.</i></p>

Court observation	Action taken	Court analysis	Commission reply
<b>GNI-based own resource: Financial intermediation services indirectly measured (FISIM)</b>			
<p>Financial intermediation services indirectly measured (FISIM) represent a part of the production of financial institutions which is not delivered under the form of direct sale of services with a fixed price, but by means of charging a higher rate of interest for loans than the one used for deposits.</p> <p>The allocation of FISIM within ESA95 was defined by Council Regulation (EC) No 448/98 <sup>(2)</sup>, and was implemented from 1 January 2005 onwards by Commission Regulation (EC) No 1889/2002 <sup>(3)</sup>. By way of derogation, Article 8(1) of the first Regulation provides that the decision to allocate FISIM for the purposes of the Communities's budget and its own resources shall be adopted by the Council, acting unanimously, on a proposal from the Commission.</p> <p>In its 2005 Annual Report (paragraph 4.30(e)), the Court recommended that the Commission presents a proposal for FISIM to be included in the GNI used for the calculation of own resources.</p>	<p>In their September/October 2008 transmission of ESA95 data, all Member States made available National Accounts data with the allocation of FISIM (increasing GNI of Member States by more than 1 % on average).</p> <p>In May 2009, the Commission made a proposal for a Council decision, with retroactive effect as from 1 January 2005, on the allocation of FISIM for the establishment of GNI used for the purposes of own resources.</p> <p>The Council Working Party on Own Resources discussed this Commission proposal and raised concerns about the methodology of calculation of the FISIM, and timing of the entry into force and retroactivity of the proposal.</p> <p>In October 2009, a revised presidency proposal was made, proposing that the Council decision take effect on 1 January 2010. In March 2010 Council Decision 2010/196/EU, Euratom <sup>(4)</sup> was adopted.</p>	<p>The Court will follow up in its future audits the allocation of FISIM in the GNI used for the calculation of own resources.</p>	
<p><sup>(1)</sup> Council Regulation (EC) No 2223/96 (OJ L 310, 30.11.1996, p. 1), as amended.  <sup>(2)</sup> OJ L 58, 27.2.1998, p. 1.  <sup>(3)</sup> OJ L 286, 24.10.2002, p. 11.  <sup>(4)</sup> OJ L 87, 7.4.2010, p. 31.</p>			



## CHAPTER 3

**Agriculture and Natural Resources**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	3.1-3.17
Specific characteristics of the policy group	3.3-3.16
Audit scope and approach	3.17
Regularity of transactions	3.18-3.26
Agriculture and rural development	3.20-3.23
Environment, Maritime Affairs and Fisheries, and Health and Consumer Protection	3.24-3.26
Effectiveness of systems	3.27-3.64
Policy area agriculture and rural development	3.27-3.61
Systems related to regularity of transactions	3.27-3.49
Systems related to recoveries and financial corrections	3.50-3.61
Policy areas Environment, Maritime Affairs and Fisheries, Health and Consumer Protection	3.62-3.64
Reliability of Commission management representations	3.65-3.69
Conclusions and recommendations	3.70-3.77

## THE COURT'S OBSERVATIONS

## INTRODUCTION

3.1. This chapter presents the Court's specific assessment of Agriculture and Natural Resources, which comprises policy areas 05-Agriculture and rural development, 07-Environment, 11-Maritime Affairs and Fisheries and 17-Health and Consumer Protection. Key information on the activities covered and the spending in 2009 is provided in **Table 3.1**.

Table 3.1 — Agriculture and Natural Resources — Key information

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
5	Agriculture and rural development	Administrative expenditure	128	Centralised direct
		Interventions in agricultural markets	7 006	Shared
		Direct aids	39 114	Shared
		Rural development	8 738	Shared
		Pre-accession measures	254	Decentralised
		Other	- 31	Shared
		<b>55 209</b>		
7	Environment	Administrative expenditure	87	Centralised direct
		Operational expenditure	269	Centralised direct/Centralised indirect
			<b>356</b>	
11	Fisheries and Maritime affairs	Administrative expenditure	39	Centralised direct
		Operational expenditure	553	Centralised/Shared
			<b>592</b>	
17	Health and consumer protection	Administrative expenditure	111	Centralised direct
		Operational expenditure	416	Centralised direct/Centralised indirect
			<b>526</b>	
Total administrative expenditure <sup>(1)</sup>			366	
Total operational expenditure (consisting of):			56 318	
– advances			518	
– interim/final payments			55 800	
<b>Total payments for the year</b>			<b>56 684</b>	
<b>Total commitments for the year</b>			<b>62 165</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in Chapter 9.

Source: Annual Accounts 2009.

---

THE COURT'S OBSERVATIONS

---

3.2. Under the Treaty, the Commission has overall responsibility for implementing the EU budget. For agricultural and rural development virtually all 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 and indirect 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 the policy group**

#### **Policy area agriculture and rural development**

3.3. The objectives <sup>(1)</sup> of the common agricultural policy as set out in the Treaty are to increase agricultural productivity, thus to ensure a fair standard of living for the agricultural community, to stabilise markets, to assure the availability of supplies and to ensure that supplies reach consumers at reasonable prices.

3.4. The EU budget finances the common agricultural policy expenditure mainly through two Funds <sup>(2)</sup>: the European Agricultural Guarantee Fund (hereinafter 'EAGF'), which fully finances EU direct aid and market measures <sup>(3)</sup> as explained hereunder, and the European Agricultural Fund for Rural Development (hereinafter 'EAFRD'), which co-finances at varying rates rural development programmes.

---

<sup>(1)</sup> Article 39 of the Treaty on the functioning of the European Union.

<sup>(2)</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>(3)</sup> With the exception of certain measures such as promotion measures and the school fruit scheme which are co-financed.

## THE COURT'S OBSERVATIONS

3.5. The main measures financed by EAGF are:

- The direct aid scheme '*Single Payment Scheme*' (SPS) which was introduced in order to decouple the payments made to farmers from production ('decoupling'). To qualify under the SPS farmers must first obtain 'entitlements' <sup>(4)</sup> each of which, together with one hectare of eligible land declared by the farmer, gives rise to an SPS payment at least until 2013 <sup>(5)</sup>. SPS has been growing in importance and in 2009 represented 28 806 million euro of expenditure.
- The direct aid scheme '*Single Area Payment Scheme*' (SAPS) which provides for the payment of uniform amounts per eligible hectare of agricultural land. SAPS is currently applied in ten of the new Member States <sup>(6)</sup> and in 2009 accounted for 3 723 million euro of expenditure.
- Other direct aid schemes (coupled payments) designed to maintain production in areas which would otherwise be at risk of abandonment of production. The amounts involved, which in general are declining due to further decoupling and integration of other support schemes in the SPS, accounted for 6 585 million euro of expenditure.
- *Interventions in agricultural markets*: the principal measures are intervention, storage and export refunds and other measures such as specific support for the wine, fruit and vegetable and food programmes (in total amounting to 3 988 million euro) and Sugar Restructuring Fund (3 018 million euro).

## THE COMMISSION'S REPLIES

3.5.

- *Payments made from the Sugar Restructuring Fund were financed by contributions from producers holding quota which are revenue assigned to the EAGF.*

<sup>(4)</sup> 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. 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>(5)</sup> Based on Article 137 of Council Regulation (EC) No 73/2009 (OJ L 30, 31.1.2009, p. 16), payment entitlements allocated to farmers before 1 January 2009 shall be deemed legal and regular as from 1 January 2010, except in cases of allocation on the basis of factually incorrect applications unless the farmer could not reasonably have detected the error.

<sup>(6)</sup> Bulgaria, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.6. The European Agricultural Fund for Rural Development (EAFRD) co-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 (8 992 million euro) <sup>(7)</sup>. In 2009, in the framework of the so called CAP Health Check <sup>(8)</sup> and the European Economic Recovery Plan <sup>(9)</sup>, additional funding has been channelled via Rural Development to finance priorities such as broadband internet infrastructure, climate change, renewable energies, water management, biodiversity and measures accompanying restructuring of the dairy sector. However, no expenditure has been incurred under the latter measures during 2009.

3.7. Under all EAGF direct aid schemes covered by Council Regulation (EC) No 1782/2003 <sup>(10)</sup> and certain EAFRD aid schemes, beneficiaries of EU aid have to fulfil 'cross compliance' requirements. These requirements relate to the protection of the environment, the public, animal and plant health, animal welfare (Statutory Management Requirements) and to the maintenance of agricultural land in good agricultural and environmental condition (GAEC) <sup>(11)</sup>. EU legislation provides that when non-compliance with those requirements is noted, a reduction or exclusion <sup>(12)</sup> shall be applied on the overall amount of direct payments made in respect of the applications submitted in the course of the calendar year of the finding. The Court's testing of payments to farmers includes only a limited number of cross compliance requirements (see paragraph 3.17, third indent). When infringements are detected they are classified as non-quantifiable errors and therefore not included in the error rate calculation.

3.6. Member States started implementing the new priorities identified in the Health Check and the European Economic Recovery Plan already in 2009, but only declared expenditure to the Commission as of the end of 2009 because the programme modifications had not been approved before.

The figure (8 992 million) relates to payment appropriations for chapters 0504 and 0505, which includes:

- operational technical assistance;
- genetic resources measures;
- recoveries from former EAGGF guarantee programmes (EU15);
- pre-accession instruments (SAPARD), which are not part of EAFRD and in fact are under a separate budget heading as well as another heading within the Financial Perspectives.

<sup>(7)</sup> This amount entails expenditure in respect of previous programming period as well as pre-accession instruments.

<sup>(8)</sup> Council Regulation (EC) No 74/2009 (OJ L 30, 31.1.2009, p. 100).

<sup>(9)</sup> Council Regulation (EC) No 473/2009 (OJ L 144, 9.6.2009, p. 3).

<sup>(10)</sup> OJ L 270, 21.10.2003, p. 1.

<sup>(11)</sup> Whilst GAEC standards, as referred to in Annex IV of Regulation (EC) No 1782/2003, apply in all Member States, Statutory Management Requirements (SMRs) as referred to in Annex III of that regulation are mandatory only in EU-15. For the EU-10, SMRs are being phased in between 2009 and 2013, and for EU-2 between 2012 and 2014.

<sup>(12)</sup> According to Articles 66 and 67 of Commission Regulation (EC) No 796/2004 (OJ L 141, 30.4.2004, p. 18), the level of the reduction per SMR or GAEC not complied with can vary between 1 % and 5 % in case of negligence and can lead to full rejection of the aid in case of intentional non-compliance.

## THE COURT'S OBSERVATIONS

3.8. Only farmers are eligible for EU area aid. A farmer is defined to be a person who carries out an agricultural activity. An agricultural activity is defined as 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) <sup>(13)</sup>. According to the relevant EU rules, if no other agricultural activity is carried out by the applicant, the maintenance of land in GAEC constitutes the minimum agricultural activity required of the applicant to be eligible for aid.

3.9. Expenditure under both funds is channelled through some 80 national or regional paying agencies. Before these paying agencies can claim any expenditure from the EU-budget, they must be accredited on the basis of criteria laid down by the Commission. These paying agencies make payments to the beneficiaries and prior to doing so, they must, either directly or through delegated bodies, satisfy themselves of the eligibility of the aid applications. The accounts and payments of the paying agencies are examined by independent audit bodies (certification bodies) which report to the Commission in February of the following year.

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

3.10. The Union's policy on the *environment* should contribute to protecting and improving the quality of the environment, human health, and rational utilisation of natural resources, including at international level. The Financial Instrument for the Environment (LIFE) <sup>(14)</sup> is the most important instrument in terms of funding covering the EU contribution for projects in the Member States in favour of nature and biodiversity, as well as environment policy, governance, information and communication.

3.11. The European Fisheries Fund <sup>(15)</sup> is the main instrument for the policy area *Maritime Affairs and Fisheries*. The Common Fisheries Policy pursues the same objectives as the Common Agricultural Policy (see paragraph 3.3).

3.12. Concerning *Health and Consumer Protection*, the EU contributes, on the one hand, to human, animal and plant health protection and, on the other hand, to consumer welfare.

## THE COMMISSION'S REPLIES

**3.9.** According to Article 5 of Commission Regulation (EC) No 885/2006, in addition to the annual accounts, the internal control procedures of the paying agencies are also examined and certified by the certification bodies on an annual basis.

<sup>(13)</sup> See Article 1 and Article 2(a) and (c) of Regulation (EC) No 1782/2003.

<sup>(14)</sup> Regulation (EC) No 614/2007 of the European Parliament and of the Council (OJ L 149, 9.6.2007, p. 1).

<sup>(15)</sup> The Financial Instrument for the Fisheries Guidance (FIFG) has been replaced by the EFF for the new programming period (2007-2013) – Council Regulation (EC) No 1198/2006 (OJ L 223, 15.8.2006, p. 1).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Advances and interim/final payments**

3.13. For EAGF the expenditure mainly consists of reimbursement of subsidies paid to farmers and other beneficiaries by the Member States.

3.14. For EAFRD and EFF, an advance corresponding to 7 % of the EU contribution to each programme was paid after the adoption of the programme by the Commission <sup>(16)</sup>. In 2009, the payments charged to the EAFRD concerned only interim payments whereas for the EFF they comprised also advances.

3.15. Payments for Health and Consumer Protection do not include advances, Member States are reimbursed on the basis of their declared expenses. For Environment, pre-financing of up to 40 % of the EU contribution for a LIFE project, as established in the grant agreement, is foreseen.

**Budgetary implementation**

3.16. In the area of EAFRD budgetary appropriations for 1 650 million were cancelled at the end of 2009 <sup>(17)</sup> primarily as a consequence of a slowdown in Member States' expenditure due to difficulties in providing national co-financing and, in the case of Romania and Bulgaria, lack of experience in the implementation of rural development programmes <sup>(18)</sup>.

**3.16.** *The cancellation of the EAFRD budgetary appropriations for 1 650 million euro at the end of 2009 was also due to the late initial approval of programmes in a number of cases. In addition, reprogramming to take account of the Health Check and the European Recovery Package may also have led to some delays in the launch of new projects by Member States pending adoption of the revised Rural Development programmes.*

**Audit scope and approach**

3.17. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of policy group Agriculture and Natural Resources the following specific points should be noted:

— a sample of 241 payments was tested,

<sup>(16)</sup> For EFF a second pre-financing amount of 7 % was paid upon request according to Council Regulation (EC) No 744/2008 (OJ L 202, 31.7.2008, p. 1).

<sup>(17)</sup> Amending budget No 10, adopted by the European Parliament on 16 December 2009.

<sup>(18)</sup> Budget item 05.04.05.01: the payments amounted to a total of 8 209,4 million euro in 2009. The payment appropriations available in the initial budget amounted to 9 135,3 million euro and a further 774,9 million euro had been carried over from 2008.

## THE COURT'S OBSERVATIONS

- the assessment of supervisory and control systems covered for EAGF selected paying agencies in four Member States applying the SAPS — Cyprus, Latvia, Lithuania and Slovakia — and in four Member States applying the SPS: Malta, Greece, Italy (Emilia-Romagna) and Spain (Basque Country). Additionally, in the case of Malta the audit covered the allocation of entitlements following the introduction of SPS in 2007. For *Rural Development* expenditure, the Court tested the supervisory and control systems in Austria, Germany (Bavaria), United Kingdom (England), Greece, Czech Republic, Romania, Bulgaria and France. For *Health and Consumer Protection* the Court audited supervisory and control systems relating to the animal disease eradication and monitoring programmes,
  
- as regards cross compliance, when auditing area related payments the Court limits its testing to GAEC obligations (minimum soil cover, encroachment of unwanted vegetation) for which evidence can be obtained and a conclusion reached at the time of the audit visit. Certain statutory management requirements (protection of groundwater and soil against pollution, animal identification and animal welfare) were tested in respect of EAFRD payments. Furthermore, in the context of its IACS systems audits the Court has analysed the implementation at national level of the GAEC standards and the control systems put in place by the Member States,
  
- in addition, in order to assess the basis for the Commission's financial clearance decisions the Court reviewed 60 of the certification bodies' certificates and reports related to 54 paying agencies <sup>(19)</sup>.

## THE COMMISSION'S REPLIES

## REGULARITY OF TRANSACTIONS

3.18. The results of transaction testing are summarised in **Annex 3.1**. On this basis the Court's estimate of the most likely error for Agriculture and Natural Resources lies between 2 % and 5 %.

**3.18.** *The Commission considers that an error rate which over the recent years oscillates around 2 % confirms the overall positive assessment of previous years.*

*Moreover the risk to the EU budget is adequately covered by the conformity clearance procedure.*

<sup>(19)</sup> The number of paying agencies included in the DAS sample amounted to 56 for EAGF and seven for EAFRD. However, for three paying agencies (two for EAGF and one for EAFRD) no report and certificate were submitted in due time by the competent certification bodies, and thus no review was performed. For the same reason the Commission disjoined the accounts of these three paying agencies.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.19. In 2009, out of 241 transactions examined, 66 (27 %) <sup>(20)</sup> were affected by error. 42 (64 %) <sup>(21)</sup> of these transactions were affected by quantifiable errors notably concerning eligibility and accuracy. Examples of the types of error are given below.

*Agriculture and rural development*

3.20. In the EAGF, out of 148 transactions sampled, 35 (24 %) <sup>(22)</sup> were affected by errors. 24 (69 %) of these transactions were affected by quantifiable errors. With regard to Rural Development expenditure, out of 80 transactions sampled, 25 (31 %) were affected by errors. 16 (64 %) of these transactions were affected by quantifiable errors.

3.21. Examples of *eligibility* errors found by the Court are the following:

**3.20.** *The Commission notes that most of the quantifiable errors are relatively small in financial terms and mainly concern small differences in the re-measurement of parcels carried out by the Court (see paragraph 3.22). Also, several errors were already identified by the Member State concerned prior to the Court's audit.*

**3.21.**

<sup>(20)</sup> In 2008, the corresponding figure was 66 (32 %).

<sup>(21)</sup> In 2008, the corresponding figure was 45 (68 %).

<sup>(22)</sup> One transaction sampled was the subject of a conformity clearance procedure under Article 11 of Commission Regulation (EC) No 885/2006 (OJ L 171, 23.6.2006, p. 90) and therefore no final assessment was possible at the time of the audit.

## THE COURT'S OBSERVATIONS

## Examples EAGF

A SAPS payment was made to a beneficiary without any proof of carrying out an agricultural activity: the beneficiary, a limited company owned by a municipality, made a SAPS claim for more than 530 hectares of meadows and pasture parcels. No proof could be provided to the auditors that the company qualified for aid by carrying out an agricultural activity — i.e. production or growing of agricultural products, rearing or keeping animals for farming purposes, or maintaining land in good agricultural condition (GAC) — with the result that payment of the aid (30 000 euros) was not justified. The Court considers that this case is a further example of the problem that the Court had already pointed out in its 2008 Annual Report <sup>(23)</sup>.

An SPS payment was made to a beneficiary who incorrectly declared an area of rented poor pasture land. The land in question was public land for which another farmer (the lessor) declared having grazing rights granted by the municipality. The beneficiary, a retired farmer, who had disposed of his original holding but had retained part of his entitlements entered into two specific contracts with the lessor ostensibly to meet the requirements of the regulation:

- a rental contract for 57 hectares of the above mentioned pasture land,
- a 'back to back' contract ceding the grazing rights back to the lessor.

The municipality, however, had not granted any grazing right to the lessor for the parcel in question. In any case, any subletting (in whole or in part) of grazing rights is explicitly forbidden by municipality rules.

Thus, the land was neither at the disposal of the lessor nor of the beneficiary. Consequently, the provisions of EU legislation <sup>(24)</sup> were not respected.

The latter cases considered to be a clear breach of the provisions of article 29 of the governing regulation which stipulates that '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'.

## THE COMMISSION'S REPLIES

## Examples EAGF

*Natural or legal persons are entitled to receive SAPS payments if they carry out an agricultural activity or maintain the land in good agricultural condition (GAC) <sup>(1)</sup>. Thus, no specific agricultural activity is required. It is sufficient that the beneficiary respects good agricultural conditions (GAC).*

*This case does not concern the regularity under the relevant EU rules, but rather the political choice made by the EU legislator during the Health Check by leaving it to the Member States to decide whether to grant direct payments to natural or legal persons whose principal business objects do not consist of exercising an agricultural activity or whose agricultural activities are insignificant. Further reflexion on this point is taking place in the context of the post-2013 reform of the Common Agricultural Policy.*

*Evidence from the payment file shows that in September 2008, the national authorities concerned checked the land claimed on the spot, including some of the parcels inspected by the Court, and determined the payment on the basis of the area which they found to be in good agricultural condition. An on-the-spot visit of the Commission in May 2010 confirmed that the corresponding area paid continues to be in good agricultural conditions.*

<sup>(23)</sup> In its 2008 Annual Report (paragraph 5.17) the Court reported on SAPS payments made to ineligible beneficiaries who failed to meet the farmer definition as they did not carry out any agricultural activity. It provided as an example the case of municipalities benefiting from SAPS payments for common grassland used by local farmers for grazing their animals.

<sup>(24)</sup> Article 44(1) and (3) of Regulation (EC) No 1782/2003.

<sup>(1)</sup> See the Commission's reply to point 5.17 of the Court's Annual Report 2008.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.22. Most of the quantifiable errors were *accuracy* errors (87 % in EAGF and 81 % for Rural Development) and furthermore, most of the *accuracy* errors were over-declarations of eligible land. Other examples of accuracy errors found by the Court were the following:

## Examples EAGF

In two out of 12 transactions audited in a Member State payments were calculated on the basis of incorrect entitlements recorded in the database leading to around 20 % overpayment in each case.

In another Member State an SPS payment was calculated on the basis of the average value of entitlements held by the farmer and not on the basis of the average value of entitlements declared by the farmer in his application as provided by EU legislation, thereby resulting in an underpayment of around 20 %.

3.23. As for non-quantifiable errors, the Court found for example, in **EAGF**, that parcels were not clearly identified in the application, payments were made after the legal deadline and the date on which claimants have to have exclusive use of the parcel claimed was not specified. In **EAFRD**, the Court noted a case where certain conditions applying to an aid paid for organic farming had not been fully complied with.

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

3.24. As regards Environment, Maritime Affairs and Fisheries, and Health and Consumer Protection, out of 13 transactions sampled, 6 (46 %) were affected by errors. 2 (33 %) of these transactions were affected by quantifiable errors.

3.25. Concerning the Financial Instrument for Fishery Guidance (FIG), the Court found cases of projects completed outside the eligibility period.

3.22.

## Examples EAGF

*In both cases, the national authorities had already detected, prior to the Court, that payments were calculated on the basis of incorrect entitlements and that any overpayments would need to be recovered.*

*The Commission regrets that, such underpayments, which do not result in any loss to the EU budget, are extrapolated to the whole of the expenditure in such a way as to increase the overall error rate, thus giving the incorrect impression that the error rate is an indication of the magnitude of the overpayment.*

3.23. *The Commission systematically checks compliance with payment deadlines for direct aid and where necessary makes financial corrections. The other errors mentioned are formal and without financial consequences.*

3.24. *When deciding on its payments under shared management to the Member States 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 environment to verify that the management and control systems of the Member States function effectively to prevent such errors.*

*With regard to one transaction in the area of Maritime Affairs and Fisheries, the Commission's calculation of the interim payment was a correct application of the applicable rules for the calculation of such payments as laid down in Article 76 of Council Regulation (EC) No 1198/2006 which does not allow the Commission to use a different method of calculation at its discretion.*

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

## THE COURT'S OBSERVATIONS

## Example

National authorities reimbursed expenditure incurred nine months after the deadline established for the construction of a fishing vessel. In light of the legislation this expenditure is ineligible since only in cases of 'force majeure' occurring within the project duration can such a deadline be set aside.

3.26. The Court also found non-quantifiable errors.

## Examples

FIFG: a final beneficiary declared, amongst others, expenses for own staff and machinery which have been estimated at selling prices rather than based on costs actually incurred for implementing the project. As the actual costs incurred by the beneficiary could not be provided, this error has been classified as a non-quantifiable error.

SANCO: in the case of a payment concerning the broadcasting of TV advertisements for an anti smoking campaign, the Court found that the Commission had not adequately verified that all the services paid for had actually been delivered.

## THE COMMISSION'S REPLIES

## Example

*Within the framework of the closure exercise the Commission will take all the appropriate measures to deduct from the final statement of expenditure and final payment claim the ineligible amount.*

3.26.

## Examples

*FIFG: Within the framework of the closure exercise the Commission will take all the appropriate measures to deduct from the final statement of expenditure and final payment claim the ineligible amount.*

*SANCO: The Commission services carried out a certain number of checks which provided evidence that the TV advertisements were broadcast. Additional controls will be carried out in the future.*

## EFFECTIVENESS OF SYSTEMS

## Policy area agriculture and rural development

*Systems related to regularity of transactions*

3.27. The main control system to ensure the regularity of transactions is the Integrated Administration and Control System (IACS) <sup>(25)</sup>.

3.28. IACS consists, in each Member State, of databases of holdings, applications, agricultural parcels and where payments are still linked to the number of animals a database of animals, as well as a register of entitlements in those Member States implementing the SPS. The system provides for several eligibility controls: an administrative check of all claims, cross-checks with databases to prevent the same land/animals from being claimed twice and a minimum rate of 5 % on-farm inspections to be carried out by the paying agencies.

<sup>(25)</sup> Regulation (EC) No 73/2009 and Regulation (EC) No 796/2004.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.29. IACS covers SPS, SAPS and all area related coupled aid schemes as well as animal premia schemes. In the case of EAFRD, and especially for agri-environment and less favoured areas, verification of certain key elements such as surface and number of animals is made through IACS while other requirements are governed by specifically designed controls <sup>(26)</sup>.

3.30. The Court assessed eight IACS systems under the EAGF and eight specific control systems under the EAFRD (see paragraph 3.17).

3.31. The Court's audit covered compliance with the provisions of the relevant regulations and an assessment of the effectiveness of the systems in ensuring regularity of transactions. 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) Systems to ensure implementation and control of Cross-compliance.

3.32. While the IACS system is in principle well designed, the Court's annual IACS systems audits carried out in recent years show that the effectiveness of IACS is adversely affected by inaccurate data in the databases, incomplete cross checks or incorrect or incomplete follow up of anomalies. In respect of financial years 2006-2008 the Court examined the operation of IACS systems related to SPS or SAPS in 20 paying agencies in 17 Member States and reported the results in its Annual Reports. For one paying agency IACS was assessed to be effective, for 12 partially effective and for seven, significant weaknesses were identified which led the Court to conclude that the system was not effective.

**3.31.**

**(III)** *The Commission recalls that respect of cross-compliance criteria by farmers does not constitute an eligibility criterion and, therefore, the controls of these criteria do not pertain to the legality and the regularity of the underlying transactions. Farmers not respecting these criteria are entitled to receive payments, but are sanctioned on the basis of the severity, extent, permanence and repetition of the non-compliance found as well as negligence or intent of the beneficiary concerned.*

**3.32.-3.33.** *The Commission continues to consider that, as the Court acknowledged in previous annual reports since 2005, the IACS is generally an effective control system for limiting the risk of error or irregular expenditure, provided that it is properly applied.*

*The effectiveness and constant improvement of the IACS is confirmed by the results of the conformity audits which the Commission has carried out over the past years in all Member States but Luxembourg as well as by the low error rate indicated in the control statistics which it receives from Member States and which are verified and validated by the certification bodies. This low error rate is also in line with that of the Court itself in its 2008 Annual Report.*

<sup>(26)</sup> Commission 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 (OJ L 368, 23.12.2006, p. 74).

## THE COURT'S OBSERVATIONS

3.33. For its 2009 audit of eight paying agencies, the Court found the systems to be effective in ensuring the regularity of payments in only one agency, partially effective in four agencies, and ineffective in the remaining three (Greece, Cyprus and Malta).

3.34. Concerning the eight Rural Development supervisory and control systems audited, the Court found that three of the control systems implemented were effective and five of them were only partially effective in ensuring the regularity of payments.

3.35. The Court's principal audit findings are outlined in the following paragraphs. The results of the examination of systems are summarised in **Annex 3.2**.

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

3.36. Administrative checks must be undertaken on all applications for support and payment claims, and cover all elements that are possible and appropriate to control by administrative means<sup>(27)</sup>. The administrative checks must include cross-checks wherever possible and appropriate, inter alia with data from the IACS databases. The Court's audit verified whether the databases were complete and reliable as well as the adequacy of checks in identifying anomalies and taking corrective action. The most important systems weaknesses found are set out below.

## THE COMMISSION'S REPLIES

*The Commission found that for claim year 2008, significant deficiencies existed in the IACS in Bulgaria and Romania. As a result these two Member States established action plans in 2009 which have been closely followed by the Commission.*

*Other Member States have deficiencies of a lesser nature in their IACS which do not render their systems ineffective but, rather, perfectible and for which they have taken or are taking action.*

*All these deficiencies are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered.*

**3.34.** *The weaknesses of the rural development supervisory and control systems in Bulgaria and Romania are due to the deficiencies in the IACS, for which a reservation is included in the Directorate-General for Agriculture and Rural Development's Annual Activity Report for 2009.*

*The control system for the other Member States audited by the Commission in 2009 was found to be effective. However, there is scope for improvement for the following items:*

- Respect of general guidelines set out in the working document regarding agri-environment commitments and their verifiability, which notably provides that several control tools need to be used in combination;*
- Continued efforts are required to provide simple and clear eligibility criteria and to inform beneficiaries about their obligations in a clear and unequivocal manner;*
- Application of exhaustive administrative controls, in particular as regards agri-environmental measures;*
- Improvement of quality of control reports to permit better traceability and clear conclusions of the controls carried out.*

<sup>(27)</sup> Article 11 of Regulation (EC) No 1975/2006 and Article 24 of Regulation (EC) No 796/2004.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

EAGF

3.37. The *Land Parcel Identification System (LPIS)* is a database in which all the agricultural area (reference parcels) of the Member State is recorded. The Court found significant deficiencies of LPIS in three Member States that affect the effectiveness of administrative cross checks as illustrated hereunder:

## Examples

LPIS-GIS technology became mandatory in 2005. In Greece until and including the claim year 2008 the LPIS-GIS did not contain any graphical information (ortho-photos) showing the actual eligible area of the reference parcels recorded. LPIS-GIS was still not fully operational for carrying out the necessary cross-checks as of December 2009.

In Lithuania the Court found that the authorities failed to eliminate ineligible features of a total area of 13 700 ha from the eligible area of parcels recorded to be 100 % eligible in the LPIS.

In Cyprus new ortho-photos were taken and analysed in 2008. The analysis showed that more than 39 000 reference parcels were affected by changes of land use and as a result the area eligible to SAPS aid dropped by more than 7 000 ha (i.e. 5 % of the agricultural area). Although updated information was available, the Cypriot authorities decided to base payments for claim year 2008 on the outdated 2003 ortho-photos.

3.37. In general, the quality of the LPIS is constantly improving in the Member States, as also demonstrated by the Commission's reply to the examples referred to by the Court below. Moreover, as from claim year 2010 Member States are obliged to perform a quality assessment of the LPIS-GIS on an annual basis according to pre-determined procedures and to report on the results and the actions envisaged to, where required, improve the situation.

The Commission accepts that there were problems with the Greek IACS in claim year 2008. However the financial risk for the past is covered by the conformity clearance procedure by which, until now, some 866 million EUR has been or is being excluded from EU financing.

The LPIS-GIS became available in accordance with the action plan at 31 December 2008 and the roll out was done prior to the start of the 2009 claim period. The problem in 2009 was caused by the late digitisation of parcels by farmers and measures have been taken to rectify the situation in the meantime by the fixation of a cut off date for the digitisation.

The Commission is following up the deficiencies which have existed in the Lithuanian LPIS-GIS since 2005 through conformity clearance procedures. However, the Lithuanian authorities have meanwhile informed the Commission that corrective measures have been implemented in the LPIS-GIS in December 2009.

The Commission has been following the deficiencies in the LPIS-GIS of Cyprus since 2005. As a result of the missions carried out, Cyprus took remedial action so that as of 2009 the system is considered to be effective. This situation is followed up under the conformity clearance procedure.



## THE COURT'S OBSERVATIONS

3.38. The Court also found in two Member States (Italy, Spain) that the most recent ortho-photos available were not used for capping the eligible areas for calculating the payments.

## Examples

In Italy (Emilia Romagna) and Spain (Basque Country) the eligibility rate for poor pasture land is not based on the most recent information available (ortho-photos or on-the-spot inspection) but on what the farmer had claimed before SPS was introduced. In the cases examined, both Italian and Spanish farmers were allowed to claim the higher historical eligibility rate for poor pasture land which on the latest ortho-photos shows significantly lower eligibility rates. Differences have led to granting aid for significantly more than the actual eligible area.

3.39. The Court has observed in several Member States (Cyprus, Greece, Italy, Slovakia and Lithuania) that the *claim database* did not allow the nature and timing of modifications or corrections made to be identified. In the absence of a reliable audit trail the Court cannot assess the correct application of EU penalties.

## Examples

In Greece the bulk of administrative cross checks and of the necessary corrections of the claim data is carried out under a procedure that leaves no audit trail and does not lead to the application of penalties. In Cyprus conflicting information regarding dates and content of amendments of claims was shown on the paper claim and in the database.

## THE COMMISSION'S REPLIES

**3.38.** *It must be underlined that considerable work is required before new ortho-photos can actually be considered to be 'operational' in the system. They must be processed, digitised and the results quality checked before they can be efficiently used for cross checks. This process takes time. Nevertheless, the Commission considers it to be very useful that Member States make the ortho-photos available at an early stage to farmers for the claim process and for controllers for the on-the-spot-checks as it has been the case.*

*Member States are obliged to recover any amounts from previous years if over-declarations are detected afterwards as a result of updated ortho-photos. Where the Commission considers that a Member State is not sufficiently proactive in protecting the EU budget, it follows up the situation under the conformity clearance procedure.*

*Italy is in the process of finalising a total refresh of their LPIS. This implies that new ortho-images will cover the whole country, that the images will be renewed every third year, and that the reference parcels will be systematically assessed, including field visits where necessary. Over-declarations established following the refresh are being recovered. The Commission considers this approach to be a major step forward.*

*As regards Spain, the Court looked at imagery that had not yet been processed. This imagery was made available to farmers for their 2008 claim lodging.*

*The Commission actively follows up the measures taken to rectify past over-declarations.*

**3.39.** *For Cyprus, Greece and Slovakia, similar findings to the ones of the Court were included in the certification bodies' reports for financial year 2009 and in all three cases the paying agencies replied that measures have been initiated to remedy the problems.*

*Member States have been reminded in the Agriculture Funds Committee to ensure full audit trail in their IT applications.*



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.40. A reliable *entitlements database* is a prerequisite for correct SPS payments. Member States are also required to respect the overall national ceilings both for SPS and SAPS. The Court found a ceiling overshoot (Cyprus) although this did not affect the EU budget; and an inaccurate allocation of entitlements (Malta).

## Examples

When Malta introduced SPS in 2007 all livestock or dairy farmers were allocated special entitlements including those who held eligible hectares which is contrary to EU legislation. EU legislation exempted Malta from the requirement that the claimant has to maintain at least 50 % of the historical animal raising activity in order to receive payment for a special entitlement. Malta decided not to set any minimum livestock requirements at national level for activation of special entitlements. Hence, farmers who significantly reduced their herd after the introduction of SPS remain eligible and are paid in full for their special entitlements.

Cyprus exceeded the ceiling for EU SAPS aid by 1,44 %. The Cypriot authorities failed to apply a proportional reduction. As a result all individual payments were affected by a 1,44 % overpayment although this was financed by national rather than the EU budget.

3.41. With regard to the *correctness of payments*, the Court found substantial deficiencies in one Member State leading to cases of forest claimed as permanent pasture (Greece). Moreover, Greece continues to allow the claimed area to exceed the eligible area of the reference parcel as recorded in the LPIS by applying a tolerance margin of 5 % not foreseen in the regulation. This observation was already reported by the Court in 2005. Furthermore, the Court found cases of payments to beneficiaries being made without known anomalies having been resolved (Italy) and without cross-checking the area claimed against the eligible area recorded in LPIS (Spain). In addition, examples were found of systematic incorrect calculation of aid and inadequate application of area and late claim penalties.

## 3.40.

## Examples

*Malta has a significant intensive animal production without land. The Council decided to make a derogation for Malta as concerns the obligation of maintaining at least 50 % of the agricultural activity exercised before the transition to the SPS.*

*Cyprus is pursuing this issue as part of the review of the 2008 claims with a view to recovering the amounts concerned.*

3.41. *The Italian authorities confirm that prior to making the payments, the regional authorities carry out all administrative controls to verify the eligibility, to resolve anomalies, and to make the results available to the farmers. However, in cases where systems weaknesses which create a risk of undue payments are observed by the Commission, they are followed-up in the clearance of accounts procedure.*

*The Spanish authorities confirm that in claim year 2008, the LPIS-GIS was indeed only used for a part of the cross-checks, but that they have remedied this situation as from claim year 2009.*

## THE COURT'S OBSERVATIONS

## Examples

In Greece, areas recorded as forest in the LPIS were claimed as permanent pasture and benefited from SPS, although the ortho-photos clearly show a significant density of trees and rocks.

Furthermore, Greece was found to systematically calculate SPS incorrectly in cases where the area determined is insufficient for payment of all entitlements claimed by the farmer and where these entitlements are of different unit values. A similar problem was observed in Malta where in one case the incorrect calculation method led to an overpayment of 69 %.

In Cyprus overdeclaration penalties provided for in EU legislation were not applied in 2007 and in 2008 they were applied incorrectly.

## THE COMMISSION'S REPLIES

## Examples

*The Commission accepts that there were problems with the Greek IACS in the past, however with the new LPIS-GIS in operation the risk has been reduced from claim year 2009. The financial risk for the past is covered by the conformity clearance procedure by which, until now, some 866 million euro has been or is being excluded from EU financing.*

*The Commission shares the observations of the Court. The Greek authorities have stated they will remedy the problem. This is however, an issue with limited impact. The same can be said with regard to the Maltese case, which affects a total of 519 farmers or an area of 203 hectares.*

*The Commission is aware of the situation for 2007 and Cyprus has assessed its financial impact during the review of the 2007 claims. With regard to 2008 claim year, the Cypriot authorities confirmed that the procedure was amended.*

## EAFRD

3.42. Administrative checks concern the correctness of the declarations made by the claimant and the fulfilment of the eligibility requirements for the granting of the aid <sup>(28)</sup>. Such controls include cross-checks with data already available to the administration, for example in the IACS databases.

3.43. The audit found errors in the determination of the exchange rate used to convert to euro amounts of aid paid in national currencies (United-Kingdom, Czech Republic), and weaknesses in the calculation of aid reductions following on-the-spot checks (Germany (Bavaria)). Weaknesses were also found in the technical checks on reduction of nitrate pollution (Greece) and compliance with a specific eligibility condition such as adequacy of agricultural machinery relative to the land farmed (Bulgaria).

**3.43.** *The financial impact of these errors was already corrected in subsequent declarations of expenditure (Czech Republic, United Kingdom) or is being followed under conformity clearance procedures. Moreover, these amounts in relation to the payments executed can be assessed as negligible (far below 1 %).*

*The Court's observation regarding Germany (Bavaria) does not affect the EU budget because the reduction of the part of the aid paid from the EU budget was correctly calculated.*

*The weakness found by the Court in Bulgaria is followed up through a conformity clearance procedure.*

<sup>(28)</sup> For rural development measures under the 2007-2013 programming period, the detailed requirements for administrative checks are defined by Regulation (EC) No 1975/2006.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**(II) Control systems based on on-the-spot checks**

3.44. The Member States must, each year, carry out on-the-spot checks covering for most aid schemes at least 5 % of all beneficiaries <sup>(29)</sup>. 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 Court's audit revealed specific weaknesses in the on-the-spot checks.

3.45. In EAGF, the Court identified cases of incorrect application of measurement tolerances (Malta, Italy), inadequate quality and insufficient coverage of on-the-spot inspections (Greece).

**Example**

In Greece, the audit found that on-the-spot inspections did not always meet the legal requirement to measure at least 50 % of parcels and grassland was generally not or only visually inspected. In several cases examined by the Court, claimed parcels which according to the ortho-photos consisted of forest or bushland were not included in the sample of parcels inspected on the spot. In addition, in several inspection reports analysed by the Court the geographical coordinates reported for the parcel measured on the spot did not match with the locations of the digitised parcel in the LPIS-GIS (different locations, different uses, different shape and perimeter).

3.46. In EAFRD, the Court found weaknesses concerning precision and completeness of control reports (Germany (Bavaria), Romania), the global evaluation of the results of the controls (Bulgaria) and the respect of deadlines for reporting to the Commission on the controls carried out (Germany (Bavaria), France).

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

3.47. Cross compliance requirements consist of Statutory management requirements (SMRs) and GAEC standards (see paragraph 3.7). Whilst SMRs are specified in various EU Directives and regulations, GAEC standards are to be defined at national level.

3.45. According to the Maltese authorities corrective measures have been taken for 2008 and applied for 2009 as well. The Italian authorities confirmed that they applied the correct procedures for application of tolerances in claim year 2009.

**Example**

The Commission accepts that there were problems with the Greek IACS in the past, however with the new LPIS-GIS in operation the risk has been reduced from claim year 2009. The financial risk for the past is covered under the conformity clearance procedure by which, until now, some 866 million euro has been or is being excluded from EU financing.

3.46. The weaknesses referred to by the Court concern an ancillary control rather than a key control. As regards reporting deadlines, the information was transmitted to the Commission sufficiently in time to be taken into account in Directorate-General for Agriculture and Rural Development's Annual Activity Report for 2009.

<sup>(29)</sup> Article 12 of Regulation (EC) No 1975/2006 and Article 26 of Regulation (EC) No 796/2004.

## THE COURT'S OBSERVATIONS

3.48. The Court found shortcomings in the definition of what is required to maintain land in GAEC and the control of these conditions.

## Example

In Italy the same sheep were counted for two different farmers to meet the minimum stocking density requirement.

3.49. During its on-the-spot visits the Court observed, on the basis of the limited audit (see paragraph 3.17, third indent) cross compliance infringements in around 5 % of the payments subject to cross compliance obligations. The infringements observed related to both SMRs (groundwater pollution, registration of animals, animal welfare, improper use of plant protection products), and GAEC (encroachment of unwanted vegetation).

## Systems related to recoveries and financial corrections

## Recovery of old debts

3.50. 50 % of any undue payment which the Member States have not recovered from the beneficiaries within four years, or within 8 years in the case of legal proceedings, will be automatically charged to their national budget <sup>(30)</sup> (so called 50/50 rule) <sup>(31)</sup>. Member States are obliged to continue their recovery procedures. In 2009, the 50/50 rule was applied <sup>(32)</sup>, hence amounts not recovered dating from 2000 or 2004 were cleared (eight and four years old respectively): 31,4 million euro was charged to the Member States while 20,1 million euro was borne by the EU budget.

## THE COMMISSION'S REPLIES

3.48. *Weaknesses in the definition and control of the GAEC standards have been detected in the cross-compliance audits carried out by the Commission and are being followed up in the context of the conformity clearance procedure.*

## Example

*The Commission agrees with the Court that, in this individual case, the GAEC of minimum stocking density is not respected and the corresponding cross-compliance sanction should have been applied.*

3.49. *The findings of the Court are confirmed by the control statistics which the Commission received from Member States. These statistics show that sanctions are applied.*

3.50. *The Commission points out that the amount of 20,1 million euro was borne by the EU budget for reasons of insolvency of the debtor and, thus irrecoverable before the 4-8 year deadline had elapsed.*

<sup>(30)</sup> Regulation (EC) No 1290/2005.

<sup>(31)</sup> Undue payments which result from administrative errors committed by national Authorities are excluded from EU financing.

<sup>(32)</sup> Commission Decision 2009/367/EC (OJ L 111, 5.5.2009, p. 44).

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.51. In its Annual Activity Report 2009<sup>(33)</sup>, DG AGRI reports having achieved by the end of financial year 2009 an overall recovery rate of 42 % of the 1 266 million euro outstanding at the end of financial year 2006. According to the Commission, in the period 2007-2009 Member States recovered 121 million euro directly from beneficiaries and an additional 411 million euro was recovered from the Member States by the Commission applying the 50/50 rule. The Court observes that the 121 million euro recovered from the beneficiaries corresponded to less than 10 % of the total recoveries.

**3.51.** *Recovery procedures are often delayed by lengthy proceedings in the national courts which, according to the principle of shared management, as defined in Article 53b(2)(c) of the Financial Regulation and Article 9(1)(a)(iii) of Council Regulation (EC) No 1290/2005, are the sole responsibility of Member States. This is the reason why the new clearance mechanism for irregularity cases was introduced, as a result of which the amount outstanding towards the EU budget has been reduced by 60 %. The Commission considers this outcome to demonstrate that this new mechanism is an effective and efficient way of clearing irregularity cases and protecting the EU's financial interests and a strong incentive for Member States to accelerate recovery procedures.*

**The Commission's clearance of accounts procedures**

3.52. 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, which are then reimbursed by the Commission<sup>(34)</sup>. 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 multi-annual conformity decisions taken by the Commission.

## Financial clearance for financial year 2009

3.53. On 30 April 2010 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 3.5**. These decisions are mainly based on certificates provided by independent auditors (certification bodies). The Court's audit did not detect expenditure incorrectly cleared in the financial clearance decisions.

3.54. The Court noted shortcomings in the last three years regarding the reliability of the debtors' accounts. For financial year 2009 the Commission has initiated financial corrections in respect of 13 paying agencies in 10 Member States for 14,8 million euro, representing some 1,43 % of the 1 037 million euro that were to be recovered at the end of financial year 2009.

**3.54.** *The Commission obtained enough information on debtors for clearance and accounting purposes. The corrections of EUR 14,8 million were proposed by the Commission based on its assessment of the information provided by the certification bodies in their reports. The financial errors found are pursued through the normal clearance of accounts procedures.*

<sup>(33)</sup> DG AGRI Annual Activity Report 2009, p. 60.

<sup>(34)</sup> On a monthly basis for EAGF and a quarterly basis for EAFRD.

## THE COURT'S OBSERVATIONS

## Conformity clearance

3.55. 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>(35)</sup>.

3.56. In previous annual reports the Court has criticised the fact that the Member States administrations, and not the final beneficiaries, are charged with the financial corrections. In addition, the method provided for in the rules for calculating the conformity adjustments as applied by the Commission, involving considerable use of flat-rate corrections, means that the amounts thus recovered are not directly related to the real amount of irregular payments. The conformity clearance system continued unchanged in 2009.

## THE COMMISSION'S REPLIES

**3.56.** *What the Court criticises in the conformity clearance system is inherent to this system and was not objected to by any of the parties intervening in the adoption of Council Regulation (EC) No 1290/2005.*

*The conformity clearance is designed to exclude expenditure from EU financing which has not been effected in compliance with EU 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 EU. 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 EU. 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 (paragraph 83).*

*Finally, while the legal rules governing the conformity clearance system have remained unchanged, the Commission has taken action to improve its operation, including new guidelines on financial corrections and the proposal on the reinforcement of assurance referred to by the Court in paragraph 3.62.*

<sup>(35)</sup> Article 31 of Regulation (EC) No 1290/2005.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Validation of Member States' controls and inspection results**

3.57. The inspection results reported to the Commission by paying agencies assess the regularity of claims submitted by farmers and since 2007 have to be verified by the certification bodies. On the one hand, the certification bodies are requested to give an opinion on the quality of the on-the-spot inspections by checking a sample of at least 10 inspections for each of the following four populations: EAGF-IACS, EAGF-non IACS, EAFRD-IACS and EAFRD-non IACS. On the other hand, they are asked to verify and validate the Member States' control statistics. In his AAR 2009, the Director General of DG AGRI indicates that the verification by the certification bodies of the quality of the on-the-spot inspections was largely (around 90 %) positive for the different populations and that as regards the accuracy of control statistics the opinion of the certification bodies was positive for 70 % of the EAGF population and for only 54 % of the EAFRD population.

3.58. The Commission guidelines leave the certification bodies the choice to either accompany or to re-perform 10 on-the-spot inspection. The certification body reports analysed by the Court showed that only six re-performed inspections, while 23 accompanied inspections and the remainder do not specify their approach. The Court considers that re-performance of a previous inspection would provide a better basis for assessing the quality of inspections procedures as the presence of the certification body may influence the behaviour of the inspectors being assessed.

**3.58.** *Even though the Commission agrees that if carried out in due time, a re-performance of a previous check provides a better assessment of the quality of on-the-spot checks, it is still possible to evaluate the control environment through inspections accompanied by the certification body. In certain cases, it may not even be possible to re-perform a check in due time. These limitations are inherent in many ex-post controls performed by external auditors. In such situations, accompanied inspections are a good alternative. They also have the additional benefit of reducing the administrative burden on the farmer.*

*An analysis of the certification bodies' reports with regard to financial year 2009 shows that the certification bodies checked in total around 3 700 controls. Where the certification bodies carried out the checks required:*

- *in around 25 % of the cases, inspections were re-performed;*
- *inspections were accompanied in a further 50 % of the cases;*
- *in 5 % of cases both approaches were used (re-performance for certain populations and accompanied inspections for other populations);*
- *in an additional 20 % of the cases, the certification bodies did not distinguish explicitly between the two methods. However, it is clear from the tables in the reports that these bodies also checked the quality of inspections using at least one method.*

## THE COURT'S OBSERVATIONS

3.59. Furthermore, the certification bodies do not always provide detailed information on the results of inspections that were re-performed. The Court considers that such information would be useful for the Commission to allow it to reliably assess the quality of the work carried out by the certification bodies.

3.60. The Court notes that for a number of paying agencies the certification bodies could not confirm the reliability of the control statistics either because the reports were incomplete or were not made available.

3.61. In 2009 the Commission offered Member States the possibility of asking certification bodies to re-perform a representative sample of checks and verify that these on-the-spot checks have been appropriately followed up. If the certification body on this basis is able to confirm the accuracy of a Member State's control statistics, then the Commission will accept that the resulting error rate represents the maximum risk possible, i.e. financial corrections for the year in question can never be higher than that level. These provisions are scheduled to enter into force in 2010 for financial years 2011 onwards.

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

3.62. Environment, Maritime Affairs and Fisheries as well as Health and Consumer Protection are managed by the Commission under specific control systems. The audit examined the internal control system relating to the animal disease and eradication programmes<sup>(36)</sup> managed by DG SANCO.

#### Internal Control System relating to the animal disease eradication and monitoring programmes

3.63. In this context 30 randomly chosen payments for the animal disease eradication and monitoring programmes were tested. The audit revealed that there is neither a systematic segregation of functions nor a clear definition and distinction of the roles and duties of the initiating and verifying officers. The same is true for the veterinary and the financial officers. Moreover, key controls are not implemented on the basis of a periodically reviewed formal risk analysis.

## THE COMMISSION'S REPLIES

**3.59.** Certification bodies are required to keep, for each check made, a sufficiently detailed audit trail. However, the Commission does not require certification bodies to provide, in the report submitted to the Commission, details of all checks made (in total around 3 700 every year), but rather to provide a summary report of the work done and the overall conclusions. Certification bodies have been asked from financial year 2010 onwards to provide more detailed information in this respect.

**3.60.** Certification bodies have properly discharged themselves of their responsibilities, by either reporting and concluding on the work done, or signalling where this was not possible. This issue was clearly reported on in the Annual Activity Report 2009 of the Directorate-General for Agriculture and Rural Development and is being followed up by the Commission which has requested that the paying agencies in the affected Member States should take the necessary steps to ensure timely delivery of accurate information in future.

**3.61.** At the moment of this report, several Member States have indicated that they will be asking the certification bodies to carry out the required work or are considering whether to do so.

Moreover, the Commission notes that the re-performance would not be limited to the on-the-spot checks, but would cover the entire handling of the file, from receipt of the aid application to the calculation and execution of the final payment, including the application of any sanctions (substantive testing).

**3.63.** The duties and the roles of the officers (financial initiators and verifiers, operational initiators and verifiers) are set out in the job description. The Commission will further clarify the segregation of duties between the different officers. It can also be seen from the consecutive annual decisions related to the envisaged EU contributions towards the eradication/surveillance programmes of the diseases that legislation is evolving in function of the needs on the field and the risks (ceilings are in/decreased, eligible measures are adapted and better defined, the reporting requirements are updated and fine tuned).

<sup>(36)</sup> Budget line No 17.04.01.01.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.64. Some important control procedures are left to the discretion of the individual officers. Since internal controls are not standardised, there is a risk of non-performance of important controls. There is no standardised report of the veterinary officers about the implementation of the operational programmes and there are no standardised checklists for the controls performed. Finally, the small number of ex-post audits does not adequately contribute to providing assurance that the payments are free from material error.

**3.64.** Although the nature of the programmes is not fully comparable (eradication vis-à-vis monitoring) a maximum of standardisation is envisaged for internal control, reporting and checking. It should be recalled that the financial initiators and the veterinary officials are experienced and act under close supervision of the direct hierarchy.

*Due to a lack of human resources during 2009 and the priority that had to be given to ex-ante audits on the Emergency Fund, only a small number of ex-post audits could be carried out. Nevertheless, as the ex-post controls are organised on a two-year basis, more than 35 % of the amount paid could be ex-post checked. The Commission underlines that all the building blocks taken together provide reasonable assurance (management's assessment of the entire internal control system, audit results, follow-up of previous year's reservation and action plan for audits from previous years and assurance received from other authorising officers in cases of crossed sub-delegation).*

## RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS

3.65. The Court reviewed the Commission management representations, notably the Annual Activity Reports (AAR) and declarations by Directors-General, for Commission Directorates General AGRI, ENV, MARE and SANCO. The results of the review are summarised in **Annex 3.3**.

3.66. In his AAR the Director General for Agriculture concludes that there is no evidence of major problems that could affect the assurance of the Director General. Referring to DG AGRI's own audit results and the results of on-the-spot inspections carried out by the Member States he concludes that the residual error rate for direct aids, market intervention and rural development measures is below 2 %.

**3.66.** *The declaration of assurance and the annual activity report of the Director-General for Agriculture and Rural Development have been established in accordance with the Commission's internal guidelines and, for the reasons set out in the Commission replies to paragraphs 3.67 to 3.69, give a fair assessment of the financial management in relation to the regularity of agricultural expenditure.*

*The reservation on rural development measures under Axis 2 is based on Commission guidelines which provide for materiality to be assessed at EU level per ABB activity. With regard to the lifting of the reserve for Greece, see the Commission's reply to paragraph 3.69.*

*The Annual Activity Report 2009 of the Directorate-General for Agriculture and Rural Development mentions that the residual error rate for agricultural expenditure as a whole is below 2 %, while for the EAFRD it is slightly above.*

## THE COURT'S OBSERVATIONS

3.67. The Court does not endorse DG AGRI's approach which restricts the concept of the residual error to anomalies established during on-the-spot inspections. This approach ignores residual errors resulting from cross checks made on the basis of inaccurate databases or inadequate follow up of anomalies. The Court applies an integrated audit approach which covers for every transaction both components of the residual error. The Court's audit has shown that, for several transactions, administrative controls failed to detect errors. These weaknesses in the administrative controls are equally confirmed by the Court's IACS systems audit results. Furthermore, the Court's audit revealed that only limited assurance can be placed on the quality of on-the-spot inspections carried out by Member States.

3.68. The AAR of the Director General for Agriculture contains a reservation in respect of the expenditure under the IACS in Bulgaria and Romania. Whilst those reservations are consistent with the results of the Court's systems audit carried out in 2008, the Court reiterates its previous observation that it was premature to lift the long standing reservation in respect of IACS in Greece.

3.69. The AARs of the Director Generals for Environment and for Maritime Affairs and Fisheries contain reservations which are in line with the Court's previous findings. While the AAR of the Director General for Health and Consumers contains no reservation, the errors affecting the Food and Feed Safety activities, in addition to an insufficient audit coverage should have led to a reservation.

## CONCLUSIONS AND RECOMMENDATIONS

3.70. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2009 for Agriculture and Natural Resources were affected by material error.

## THE COMMISSION'S REPLIES

**3.67.** *Member States are required under the relevant EU rules to carry out administrative controls on all aid applications received. In principle, payments are consequently free from any errors which can be detected through such administrative controls. DG AGRI's approach of determining the residual error rate on the basis of the results of the randomly selected on-the-spot checks is therefore conceptually correct.*

*The Commission is aware that weaknesses in the administrative controls or on-the-spot checks imply the risk that the error rates in the control statistics which it receives from Member States are understated. To address this risk, DG AGRI applied a safety margin of a 25 % increase in these error rates.*

**3.68.** *The reservation for Greece was justified by the high reputational risk for the Commission which resulted from the insufficient implementation of the IACS in Greece and not by the financial risk for the EU budget resulting from the deficiencies, which has always been covered by the financial corrections imposed on Greece through the conformity clearance procedures. After Greece had completed its action plan to remedy the deficiencies by the end of 2008, this high reputational risk no longer existed and it was therefore fully justified to lift the reservation. Furthermore, the financial risk for past deficiencies is sufficiently covered under the conformity clearance procedure by which, until now, some 866 million EUR has been or is being excluded from EU financing.*

**3.69.** *Thanks to additional human resources and using extra capacity by externalising some audits, a significant part of the total amount to be paid in 2010 has been and will be audited. Ex-ante audits are performed on almost 40 % of this amount. In addition more than 35 % of the amount will be ex-post audited. This will lead to a very high coverage level.*

**3.70.** *The Commission considers that an error rate which over the recent years oscillates around 2 % confirms the overall positive assessment of previous years.*

*Moreover the risk to the EU budget is adequately covered by the conformity clearance procedure.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.71. Based on its audit work, the Court concludes that the supervisory and control systems for Agriculture and Natural Resources were generally, at most, partially effective in ensuring the regularity of payments.

3.72. As regards IACS the Court concludes that significant improvements are necessary especially in three out of the eight paying agencies audited (see paragraph 3.33).

3.73. The Court recommends that the systems weaknesses identified are resolved. In this regard, the most urgent deficiencies to be addressed for the SPS and SAPS are:

- (a) to overcome the systems weaknesses leading to errors relating to ineligible land or over-declarations of land as well as inaccurate entitlements, notably by improving the reliability and completeness of the data recorded in the LPIS (e.g. most recent ortho-photos);
- (b) to ensure that all IACS databases provide a reliable and full audit trail for all modifications made;

**3.71.-3.72.** *The Commission continues to consider that, as the Court acknowledged in previous annual reports since 2005, the IACS is generally an effective control system for limiting the risk of error or irregular expenditure, provided that it is properly applied (see also Commission reply to paragraphs 3.32 and 3.33).*

*The Commission found that for claim year 2008, significant deficiencies existed in the IACS in Bulgaria and Romania. As a result these two Member States established action plans in 2009 which have been closely followed by the Commission. Since, however, the completion of these action plans is only foreseen for 2011 and there are already some delays in the implementation of the individual actions, the Director-General of DG AGRI made a reservation for the IACS in Bulgaria and Romania in his 2009 annual activity report, based on the reputational risk for the Commission.*

*Other Member States have deficiencies of a lesser nature in their IACS which do not render their systems ineffective but, rather, perfectible and for which they have taken or are taking action to resolve their deficiencies.*

*All these deficiencies are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered.*

*Updates to the LPIS are always needed because both the technical possibilities and the reality in the field are constantly evolving. Moreover, it is now a legal obligation for the Member States to make an annual assessment of the quality of their LPIS. The result of the quality check will indicate whether a refresh is needed.*

**3.73.**

- (a) *The Commission is on a continuing basis working, together with the Member States, on actions to improve the reliability of information in the LPIS-GIS. As from claim year 2010 Member States are obliged to perform a quality assessment of the LPIS-GIS on an annual basis according to pre-determined procedures and to report on the results and the actions envisaged to, where required, improve the situation.*
- (b) *Annex I to Regulation (EC) No 885/2006, as part of the accreditation criteria, already requires that there is an audit trail. These criteria are checked by the certification bodies on an annual basis.*

## THE COURT'S OBSERVATIONS

- (c) to clarify and enforce further the rules so that EU direct aid is not paid to claimants who have neither used the land for farming nor maintained it in GAEC;

- (d) to set at EU level minimum annual maintenance requirements for grassland to be eligible for EU direct aid.

3.74. The Court also reiterates that further efforts are required in the area of Rural Development to further simplify the rules and conditions.

3.75. Furthermore, the Court considers that the Commission guidelines as regards the work to be performed by certification bodies must be reviewed concerning the nature, coverage and reporting obligations, especially as regards the work related to the validation of Member States' control and inspection statistics.

## THE COMMISSION'S REPLIES

- (c) *The issue of the farmer definition referred to by the Court has been addressed in the framework of the Health Check by giving Member States the possibility to exclude natural or legal persons from the direct payment schemes whose principal business objects do not consist of exercising an agricultural activity or whose agricultural activities are insignificant (Article 28(2) of Regulation (EC) No 73/2009).*

*Further reflections on this issue may be envisaged in the context of the post-2013 CAP, bearing in mind the need to avoid complicated rules which would result in a complex control system whose implementation would be costly and contrary to the simplification efforts of the Commission.*

- (d) *The current system provides for a common legal framework within which the Member States are responsible for defining the maintenance criteria under the GAEC. This allows for the diversity of agricultural areas and traditions in the EU to be taken into account.*

**3.74.** *For the 2007-2013 period, the Commission has already implemented simplifications in the Common Agricultural Policy, including rural development, and will continue to do so in future. However, any such further simplification will not be enough to reduce the error rate in certain areas of rural development below the Court's 2 % threshold without the risk of jeopardising policy objectives. Therefore, the Commission has proposed that for EAFRD expenditure, a tolerable risk of error level be set in the range between 2 and 5 %. An error rate around the middle of this range would be acceptable and justified. Above this level, additional action would be taken to reduce the error rate through increased controls and addressing the major causes of error.*

**3.75.** *The Commission considers the overall structure and reporting requirements of these to be appropriate, particularly as a basis for the financial clearance decision (see also paragraph 3.54). The revised guidelines for financial year 2010 were distributed in the Agriculture Funds Committee meeting of 18 June 2010. Changes were limited to the reporting modalities and did not affect the work to be carried out by the certification bodies.*

*Moreover, with regard to the work related to the control and inspection statistics, the Commission has recently put forward a system by which Member States can reinforce the overall framework for gaining reasonable assurance as to the legality and regularity of transactions at the level of final beneficiaries. To this end, certification bodies should extend their work beyond the present requirements by fully re-performing, for a given expenditure population, a representative sample of transactions which the paying agency in question has checked on-the-spot. The work would cover the entire handling of the file, from receipt of the aid application to the calculation and execution of the final payment.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

3.76. Finally, effective measures need to be taken, together with the concerned national authorities, to avoid the payment of ineligible expenditure for fisheries projects. Internal controls on payments for animal disease eradication and monitoring programmes to the Member States require a clear segregation of functions between the Commission services and the development of appropriate formal control procedures.

3.77. A follow-up of previous observations is summarised in **Annex 3.4**.

**3.76.** *For the programming period 2000-2006, the Commission took all the necessary actions to correct ineligible amounts. During the closure exercise it will be ensured that all ineligible amounts are deducted from final claim.*

*Under the EFF, the control environment has been reinforced with new provisions on the effective functioning of the systems to prevent and to correct ineligible expenditure. The Commission exercises a supervisory role, verifying the reliance which can be placed on the work of the Audit Authorities in the Member States. Under shared management, responsibility for control on the ground rests with the Member States. The control environment described above ensures that the Member States have put in place reliable and effective management and control systems to prevent and to correct ineligible expenditure.*

*Furthermore the Directorate-General for Maritime Affairs and Fisheries in cooperation with the other Structural Funds Directorates General are issuing regularly guidance notes on topics of common interest for improving the effectiveness of the management and control systems in place.*

**3.77.** *See Commission's replies in Annex 3.4.*

## ANNEX 3.1

## RESULTS OF TRANSACTION TESTING FOR AGRICULTURE AND NATURAL RESOURCES

	2009				2008	2007
	EAGF	RD	SANCO, ENV, MARE	Total		
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>						
Total transactions (of which):	148	80	13	241	204	196
Advances	0	0	0	0	0	0
Interim/Final payments	148	80	13	241	204	196
<b>RESULTS OF TESTING</b>						
<i>(in % and numbers of transactions)</i>						
Transactions not affected by error	76 % {113}	69 % {55}	54 % {7}	73 % {175}	68 %	69 %
Transactions affected by error	24 % {35}	31 % {25}	46 % {6}	27 % {66}	32 %	31 %
<b>ANALYSIS OF TRANSACTIONS AFFECTED BY ERROR</b>						
<i>(in % and numbers of transactions)</i>						
<b>Analysis by type of error</b>						
Non-quantifiable errors	31 % {11}	36 % {9}	67 % {4}	36 % {24}	32 %	36 %
Quantifiable errors	69 % {24}	64 % {16}	33 % {2}	64 % {42}	68 %	64 %
comprising:						
Eligibility	13 % {3}	13 % {2}	100 % {2}	17 % {7}	20 %	36 %
Occurrence	0 % {0}	6 % {1}	0 % {0}	2 % {1}	2 %	3 %
Accuracy	87 % {21}	81 % {13}	0 % {0}	81 % {34}	78 %	61 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>						
Most likely error rate for closures:						
< 2 %					X	
2 % to 5 %	X					X
> 5 %						

## ANNEX 3.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR AGRICULTURE AND NATURAL RESOURCES

## Assessment of selected supervisory and control systems — EAGF

Member State (Paying agency)	Scheme	IACS related 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
Lithuania	SAPS	183,5	2			
Latvia	SAPS	69,5				
Slovakia	SAPS	179,7	1, 2, 4, 5	A, B, C	a	
Cyprus	SAPS	24,6	1, 2, 3, 4, 7, 8	A, D		
Italy (AGREA)	SPS	409,0	6, 7, 9	A	b, c	
Malta	SPS	2,7	3, 4, 5, 7, 10	A		
Greece	SPS	2 077,1	2, 3, 5, 6, 7, 9, 11, 12	A, E, F, D	b, d	
Spain (Basque region)	SPS	30,0	1, 5, 6, 7, 13			

## Legend:

	Effective
	Partially effective
	Not effective

- 1 Non exclusion of ineligible features/ eligible area overstated in the LPIS
- 2 Insufficient audit trail
- 3 The claim registration procedure is not fully reliable
- 4 No update of eligible areas in the LPIS on the basis of new orthophotos and or OTS
- 5 No (retroactive) cross-checks on the basis of updated reference parcel information
- 6 Weaknesses in the determination of eligible area for permanent pasture and common pasture land
- 7 Incorrect application of penalties
- 8 The ceiling for SAPS was overshoot by around 1,44 % and no reduction coefficient was applied
- 9 SPS payments are done before solving the anomalies detected
- 10 Special entitlements were allocated contrary to EU legislation to farmers having eligible hectares at their disposal in the year of introduction of SPS
- 11 Serious delays in establishing LPIS-GIS which affects the quality of cross checks
- 12 Undue application of 5 % tolerance at the level of administrative cross checks
- 13 The administrative procedures to determine the entitlements to be surrendered to the national reserve have no legal basis
- A Measurement tolerances are applied incorrectly / not applied
- B No data available on control and inspection reports for 2008 claim year
- C No offsetting of area surpluses and area deficits found within one crop group
- D The on the spot inspections carried out by ECA showed large material differences
- E Beneficiaries claiming poor pasture areas have not been inspected
- F Quality of on the spot inspections found to be inadequate leading to unreliable results
- a Incomplete/ not sufficiently detailed inspection reports on GAEC controls
- b Insufficient national GAEC requirements for grassland and poor pasture
- c GAEC controls are done using only the remote sensing
- d Cross-compliance sanctions applied incorrectly

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

Member State (Paying agency)	Fund	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
Austria	EAFRD				
Bulgaria	EAFRD				
Czech Republic	EAFRD				
Germany (Bavaria)	EAFRD				
France	EAFRD				
Greece	EAFRD				
Romania	SAPARD			N/A	
UK (England)	EAFRD				

## Overall assessment of supervisory and control systems

Overall assessment	2009	2008	2007

## Legend:

	Effective
	Partially effective
	Not effective
N/A	Not applicable: payments audited not subject to cross-compliance



## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR AGRICULTURE AND NATURAL RESOURCES

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
<b>DG AGRI</b>	<b>with reservations</b>	<p>Serious deficiencies in the IACS in Bulgaria and Romania.</p> <p>Expenditure for rural development measures under Axis 2 (improving the environment and the countryside) of the 2007-2013 programming period.</p>	<p>The Court's systems audit conducted in the framework of the DAS 2009 confirmed that the IACS in Greece is still not effective in ensuring the regularity of payments; i.e. especially for grassland the eligibility rates recorded in the LPIS are not reliable (see paragraph 3.38), the claim database is affected by serious audit trail deficiencies (see paragraph 3.40) and the on-the-spot checks are of insufficient coverage and quality (see paragraph 3.46). Furthermore, the Commission in its 2009 Annual Activity Report states that the accreditation of the Greek paying agency has been limited to EAFRD measures as of claim year 2010. The Court considers that in these circumstances the reservation for Greece should not have been lifted.</p> <p>The reservation is based on the error rates resulting from the on-the-spot controls carried out by the Member States in 2008. These errors rates vary widely from one Member State to another. The Director-General does not explain why his reservation applies to all the transactions carried out in the European Union, and not only to the transactions carried out in the Member States where the error rate was, in 2008, particularly high. The Court, however, agrees that, in general, irregularities are more probable for transactions of Axis 2 than for transactions of other Axes.</p>	<b>B</b>
<b>DG ENV</b>	<b>with reservations</b>	Eligibility of expenditures declared by beneficiaries of grants.	The reservation is consistent with the Court's previous findings. It is noted that DG ENV calculated its 'error rate' on a non-standard basis (risk based).	
<b>DG MARE</b>	<b>with reservations</b>	<p>Management and Control Systems for identified operational programmes and measures of the FIFG (Germany, UK, Spain, France).</p> <p>Eligibility of payments made to Member States to compensate additional costs in the marketing of certain fisheries products from the Outermost Regions.</p>	Reservations are based on the DG's audit work. These were in line with the Court's own findings.	

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
DG SANCO	without reservations	N/A	DG SANCO considers that a residual error would be material if its financial impact on the financial statements would be higher than 2 % of the annual budget of DG SANCO. However, only the budget of the corresponding activity (ABB) should be taken into account, as indicated by DG BUDG. Based on the results of the ex-post control of 2009 and taking into account the recurrent character of the high level of detected errors above the materiality threshold (6 %), a reservation should have been issued for the Food and Feed Safety activity (ABB), for which the error rate was 6,9 %.	

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity.

B: The Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

C: The Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity.

## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR AGRICULTURE AND NATURAL RESOURCES

DG	Court observation	Action taken	Court analysis	Commission reply
<b>Rural development</b>				
AGRI	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 (*)).	According to the Commission France has introduced a new administrative system which from 2008 onwards makes it easier to track the loan from the bank to the final beneficiary. The certification body examined all the payments made in 2009 to banks which granted reduced interest rates. The certification body found the payments correct, but noted that the new system still did not ensure a complete traceability of all the individual loans to which a bank invoice refers. The Commission followed up the question with specific checks in France.	In 2009 it was still difficult to establish a link between a bank invoice for the amount of interest reductions granted by the bank in a given period and individual loans to final beneficiaries.	<i>The Commission considers, on the basis of its own audit, that the audit trail can indeed be followed.</i>
<b>Rural development</b>				
AGRI	Further efforts are required in the area of rural development to further simplify the rules and conditions (paragraph 5.66 (**)).	Action was taken in 2009 by the Council and the Commission. In the framework of the Council, concrete proposals for simplification of various aspects of the common agricultural policy were submitted by sixteen Member States. Certain proposals concerned the simplification of rules and controls applying to cross-compliance and were therefore relevant to rural development. The Commission services examined the proposals and envisaged to submit to the Council in 2010 appropriate amendments to the existing rules. At its meeting of 14-16 December 2009 the Council expressed satisfaction for the intention of the Commission to follow up on a number of proposals and invited the Commission to come forward with the amendments suggested and to continue working on various ongoing simplification projects.	The steps taken in 2009 show that attention was paid to the necessity of simplifying certain rules and conditions applying to rural development measures. As rural development expenditure is governed also by national rules, the Court, in accordance with the Council's recommendation on the discharge for the financial year 2008, reminds that simplification should be achieved also at national level.	<i>See Commission's reply to point 3.74.</i>

DG	Court observation	Action taken	Court analysis	Commission reply
<b>IACS</b>				
AGRI	<p><b>Greece</b></p> <p>For many years the Court raised the problem of insufficient implementation of the IACS in Greece. The LPIS in Greece is incomplete and contains errors in the referencing of parcels. Furthermore, there were deficiencies noted in administrative and on-the-spot controls.</p> <p><b>Other Member States</b></p> <p>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. (paragraph 5.32 (**)).</p>	<p>The DG AGRI Annual Activity Report up to the Year 2007 included a reservation on IACS in Greece. In 2008 the Commission decided that 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>Bulgaria and Romania have set the action plans, accepted by Commission in 2009 to address the deficiencies.</p> <p>The Commission considers that the deficiency found in UK has very limited impact on the system.</p> <p>The Commission is following up the cases reported in the framework of conformity clearance procedures.</p>	<p>The Court's systems audit conducted in the framework of the DAS 2009 confirmed that the IACS in Greece is still not effective in ensuring the regularity of payments; i.e. the LPIS/GIS in Greece is still not fully operational, the claim database is affected by unreliable audit trail, and the on-the-spot controls are of insufficient coverage and quality (paragraphs 3.37, 3.39 and 3.45 (***)).</p> <p>The DG AGRI accreditation audit of the OPEKEPE agency in 2009 revealed serious deficiencies relating to EAGF fund management (DG AGRI AAR 2009, A.1.3, p. 29).</p> <p>The results of the actions taken by the Commission and by the Member States cannot yet be assessed. The completion of the action plans is only foreseen for 2011 and there are already some delays in the implementation of individual actions. (DG AGRI AAR 2009)</p> <p>The results of the actions taken by the Commission and by the Member States cannot yet be assessed.</p> <p>For the 2008 claim year the deficiencies in LPIS were noted in Greece, Cyprus, Lithuania, Italy and Spain (paragraphs 3.37 and 3.38 (***)).</p> <p>The Court noted again weaknesses in the system managing the application of sanctions. The Court recommends that the systems weaknesses identified are resolved.</p>	<p><i>The Commission accepts that there were problems with the Greek IACS in the past, however with the new LPIS-GIS in operation the problems have been resolved for risk has been reduced from claim year 2009.</i></p> <p><i>With regard to the accreditation audit of the OPEKEPE agency in 2009 serious deficiencies revealed by DG AGRI related to EAFRD, rather than EAGF. The accreditation for OPEKEPE has consequently been limited to the EAFRD measures for which a proper control system and procedures have been put into place.</i></p> <p><i>The Commission found that for claim year 2008, significant deficiencies existed in Bulgaria and Romania. As a result these Member States established action plans in 2009 which have been closely followed by the Commission. As these action plans are foreseen for completion in 2011 and delays have already been noted by the Commission, the Director-General of DG AGRI made a reservation in his 2009 AAR on reputational grounds.</i></p> <p><i>Other Member States have problems of a lesser nature in their IACS which do not render their systems ineffective but, rather, perfectible. For these Member States, action plans have been established and the problems found in previous years have been rectified or are making sufficient progress in that direction.</i></p> <p><i>For Greece, Italy, Spain, and Portugal weaknesses in administrative controls are part of ongoing conformity procedures.</i></p>

DG	Court observation	Action taken	Court analysis	Commission reply
	<p><b>LPIS</b></p> <p>The Court found substantial deficiencies of LPIS in two Member States that seriously affect the efficiency of administrative cross-checks (BG and UK). 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. (paragraph 5.36 (**)).</p> <p>In some countries the graphical layer of the LPIS (GIS) contains outdated aerial photos (paragraphs 5.30(b) and(c) (*)).</p> <p>The Court also found in one Member State no adequate capping of payment based on orthophotos (PL).</p> <p><b>Administrative controls</b></p> <p>Weaknesses in administrative controls in the direct coupled payments have been identified in DAS 2007 audit in Greece, Italy, Spain and Portugal: wrong input of application data, payment for multiple incompatible aid schemes on the same parcel and a failure to correctly apply penalties and sanctions, leading to overpayments. (5.27(a) (*)).</p>	<p>The Commission amended the Regulation (EC) No 1122/2009 (amendment in Regulation (EC) No 146/2010) with the requirement for the MS to make an annual assessment of the quality of their LPIS and when appropriate to draw up an action plan to remedy the deficiencies identified. (DG AGRI AAR 2009, p. 48)</p> <p>The Commission is following up the cases reported in the framework of conformity clearance procedures.</p> <p>The Commission is following up the cases reported in the framework of conformity clearance procedures.</p>		
<b>SPS</b>				
AGRI	<p>The audit found systematic shortcomings in calculation of the entitlements (paragraphs 5.22 to 5.26 (*), 5.38 (**)).</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) (paragraph 5.28 (*)).</p>	<p>The Commission is following the cases reported in the framework of conformity clearance procedures.</p>	<p>The Court audits continue to reveal deficiencies in calculation of the entitlements and weaknesses in the controls (paragraphs 3.40, 3.41, 3.44, 3.45 (***)).</p>	<p><i>The Commission is following shortcomings identified in the context of the conformity clearance of accounts procedure.</i></p>

DG	Court observation	Action taken	Court analysis	Commission reply
<b>GAEC requirements</b>				
AGRI	The Court found shortcomings concerning the Member States' definition of the farmer and 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. (paragraph 5.49 (**)).	In Regulation (EC) No 73/2009 Article 28 introduced a provision — optional for the MS — to exclude from payment schemes the natural or legal persons whose agricultural activities are insignificant. On the other hand however — with regard to the land maintenance — the Commission is of the opinion that the present system provides sufficient guarantees that land is managed respecting the GAEC. (DG AGRI AAR 2009) Therefore the Commission does not plan to take any additional measures in this matter.	The Court recommends that the rules relating to GAEC and minimum maintenance should be tightened.(3.73(c), (d) (***)).	See Commission's reply to paragraph 3.73.
ENV	For environmental measures, projects financed by the main fund (LIFE projects) included ineligible expenditure (paragraph 5.49 (*)).	DG Environment established an action plan for improving the eligibility of expenditure declared by beneficiaries of grants in 2008. An additional action plan about beneficiaries' awareness raising and prevention actions is in the process of being adopted in 2010.	The impact of these action plans has still to be assessed but DG ENV has issued a reservation in respect of ineligible declared expenditure.	<i>The Court made its estimation based on the audit reports issued in 2009. As a big number of delayed reports were issued in 2009 thanks to the efforts made in reducing the backlog, this automatically increases the apparent report delay.</i>
	Important delays in concluding audits still remained. However, the situation improved in 2007 (paragraph 5.49 (*)).	DG ENV indicated that it has made efforts to shorten delays.	The average delay for audit reports has gone up from 191,6 days in 2006 to 230,5 days in 2009 (between the date of the audit mission and the date of the audit report). Evidence shows that DG ENV has not yet succeeded to correct this shortcoming.	<i>The Commission is confident that the delay will improve in 2010 as it is actually of 116,56 days for the reports issued this year.</i>
MARE	In the fisheries policy area, the lack of appropriate legal rules and poor documentation of expenditure relating to data collection for fisheries management increase the risk that irregular payments are made (paragraph 5.49 (*)).	The Commission indicated that the legal rules would be changed in 2008. The new legal basis would contain clear rules and should address the concerns of the Court.	Regulation (EC) No 1078/2008 which entered into force on 1 January 2009 describes the eligibility criteria and the documentation that has to be submitted along with the reimbursement claims. However, weaknesses were detected in the management and control systems put in place by the national authorities and ineligible expenditure was still detected in 2009 by the Commission's audits.	<i>It is correct that weaknesses were detected in the management and control system for the implementation of the national programmes for data collection and that ineligible expenditure was identified. However, all the audits were carried out on the implementation of these programmes under the previous legal framework which expired by the end of 2008. Audits pertaining to the new legal framework, including Commission Regulation (EC) No 1078/2008 are planned for next year, i.e after balance payments have been made for the first year of implementation of the new legal framework.</i>

DG	Court observation	Action taken	Court analysis	Commission reply
	Liabilities arising from particular cases of renewed bilateral fisheries agreements have not been covered in a timely manner by the commitment of the corresponding appropriations (paragraph 5.49 (*)).	The Commission considered that budgetary commitments covering the fisheries agreements can be made only after the legal basis (Council Decision and/or Regulation) has been adopted.	The Commission is in the process of implementing a policy of early initiation of the procedure for renegotiating protocols and agreements allowing the budgetary commitment to be made before the entry in force of the legal commitment.	<i>The Commission initiates the procedure for renegotiating protocols as soon as possible, well before they expire. This also depends on the willingness of the third states concerned to start the renegotiation at an early stage.</i>
	The Court found ineligible costs concerning the Financial Instrument for Fishery Guidance (FIFG) (paragraph 5.25 (**)).	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.	In 2009, the material level of ineligible costs detected by the Commission gave rise to a reservation in the AAR of DG MARE.	<i>Within the framework of the closure exercise the Commission will take all the appropriate measures to deduct from the final statement of expenditure and final payment claim all ineligible amounts whether identified by Commission audits, external audit activity or otherwise.</i>
SANCO	In the health and consumer protection area payments were made for veterinary measures in the absence of all the necessary supporting documentation (paragraph 5.49 (*)).	For new contracts, the Commission has introduced a clause stating that the producer of the vaccines has to prove that the vaccines were sent to the location as determined by the Commission.	The Commission has taken corrective action. The effectiveness of those actions will have to be assessed.	

(\*) Paragraph number in the ECA 2007 Annual Report.

(\*\*) Paragraph number in the ECA 2008 Annual Report.

(\*\*\*) Paragraph number in the ECA 2009 Annual Report.

## ANNEX 3.5

## PAYING AGENCY ACCOUNTS DISJOINED FOR 2009

(million euro)

Member State	Paying agency	Accounts disjoined <sup>(1)</sup>		
		EAGF	EAFRD	TRDI
Germany	Baden-Württemberg	428	82	
Germany	Bayern StMELF		194	
Germany	Hessen	222	16	
Germany	IBH	1	12	
Germany	Helaba	4	5	
Germany	Rheinland-Pfalz		36	
Germany	Thüringen		73	
Estonia	PRIA			3
Italy	AGEA	3 005		
Italy	Basilicata (ARBEA)	110	17	
Romania	PARDF		565	
Romania	PIAA	581		
Spain	Andalucia		85	
Spain	Asturias		36	
<b>Total</b>		<b>4 351</b>	<b>1 121</b>	<b>3</b>

<sup>(1)</sup> Accounts which the Commission considered not to be able to clear in its decisions of 30 April 2010. This due to reasons attributable to the Member States concerned which require additional inquiries.

Source: Commission Decisions 2010/257/EU, 2010/258/EU and 2010/263/EU (OJ L 112, 5.5.2010, OJ L 113, 6.5.2010).



## CHAPTER 4

**Cohesion**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	4.1-4.16
Specific characteristics of the policy group	4.2-4.14
Audit scope and approach	4.15-4.16
Regularity of transactions	4.17-4.23
Observations on systems	4.24-4.31
Systems related to the regularity of transactions	4.25-4.29
Systems related to recoveries and financial corrections	4.30-4.31
Reliability of Commission management representations	4.32-4.33
Conclusions and recommendations	4.34-4.39

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## INTRODUCTION

4.1. This Chapter presents the Court's specific assessment of Cohesion, which comprises policy areas 04 — Employment and Social Affairs and 13 — Regional Policy. Key information on the activities covered and the spending in 2009 is provided in **Table 4.1**.

**4.1.** *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 4.1 — Cohesion — Key information**

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
4	Employment and social affairs	Administrative expenditure	97	Centralised direct
		European Social Fund	8 562	Shared
		Working in Europe – Social dialogue and mobility	57	Centralised direct
		Employment, social solidarity and gender equality	113	Centralised direct
		European Globalisation Adjustment Fund	12	Shared
		Instrument for Pre-Accession Assistance	65	Decentralised
			<b>8 906</b>	
13	Regional Policy	Administrative expenditure	83	Centralised direct
		European Regional Development Fund and other regional operations	18 250	Shared
		Cohesion Fund (including ex-ISPA)	7 080	Shared
		Pre-accession operations related to structural policies	705	Decentralised
		Solidarity Fund	623	Shared
				<b>26 741</b>
Total administrative expenditure <sup>(1)</sup>			180	
Total operational expenditure <sup>(2)</sup> (consisting of):			35 467	
— prefinancing			12 386	
— interim/final payments			23 081	
<b>Total payments for the year</b>			<b>35 647</b>	
<b>Total commitments for the year</b>			<b>49 719</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in Chapter 9.

<sup>(2)</sup> 25,4 billion euro (71 %) of the operational expenditure related to the 2007-13 period and 8,4 billion euro (24 %) to the 2000-06 period of the ERDF, CF and ESF. For the 2007-13 period 11,3 billion euro (44 %) were prefinancing payments.

*Note:* Detailed information on budgetary implementation for 2009 can be obtained from Part II of the Annual Accounts of the European Communities Financial Year 2009, the EC's (DG Budget) documents 'Report on budgetary and financial management - financial year 2009' as well as from the Report on the 'Analysis of the budgetary implementation of the Structural and Cohesion Funds in 2009'.

*Note:* This Chapter also covers the Pre-accession (Special) Instrument I(S)PA, social dialogue and mobility policies and gender equality measures for both periods which are strictly speaking not part of Cohesion policy. Rural development and fisheries expenditure are reported in policy areas 5 'Agriculture and rural development', and 11 'Fisheries'.

*Source:* Annual Accounts 2009.

## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group****Policy objectives and instruments**

4.2. Cohesion policy aims at strengthening economic and social cohesion within the European Union by reducing the gap in the level of development between different regions.

4.3. The following three funds account for the vast majority of the spending:

- (a) the European Regional Development Fund (ERDF) for investments in infrastructure, the creation or preservation of jobs, local development initiatives and the activities of small and medium-sized enterprises (SMEs);
- (b) the European Social Fund (ESF) which provides financial assistance to combat unemployment, to develop human resources and to promote integration into the labour market; and
- (c) the Cohesion Fund (CF) finances investments in infrastructure in the field of environment and transport in those Member States whose gross national income per capita is below 90 % of the EU average.

4.4. Management of Cohesion spending is shared with Member States, who also co-finance the projects concerned. Cohesion spending is planned in multi-annual 'programming periods': payments are related to expenditure which has been incurred within the eligibility period<sup>(1)</sup>. As a result they may continue for some years beyond the end of the programming periods to which they relate. The 2000-2006 and 2007-2013 programming periods are relevant to this Chapter.

4.5. Expenditure takes place through a large number of multi-annual 'operational programmes' (OPs)<sup>(2)</sup> to individual Member States or regions within them. The Commission approves OPs on the basis of proposals from Member States. Member States choose the individual projects to be included in OPs. These projects are implemented by different types of promoters (private individuals, associations, private or public companies or local, regional or national bodies). At the start of the programmes the Commission makes prefinancing payments to the Member States. The promoters claim from the responsible authorities in the Member States for the eligible costs they have incurred. The Member State then requests reimbursement from the Commission through certified expenditure declarations. These are done through interim or final payment claims.

<sup>(1)</sup> For the 2000-2006 programming period the eligibility period initially ended on 31 December 2008. In the framework of the anti-crisis package it has been extended until 30 June 2009 for all Member States which made a request to the Commission.

<sup>(2)</sup> An OP sets out national, regional or sectorial priorities for delivering funds.

## THE COURT'S OBSERVATIONS

4.6. In 2009 expenditure of the ERDF, CF and ESF consisted mainly of interim and final payments (see **Table 4.1**). For the 2007-2013 programming period 14,1 billion euro of interim payments and 11,3 billion euro of pre-financing payments were made. In addition, interim and final payments for the 2000-2006 period were 8,4 billion euro.

**Supervision and control of Cohesion spending**

4.7. Member States are responsible for the implementation of the ERDF, the ESF and the CF. Responsibilities for day to day administration and the 'first level' controls which are intended to prevent or detect and correct incorrect reimbursement of project costs or other irregularities are allocated to Managing Authorities and Intermediate Bodies. Certifying Authorities carry out additional checks prior to submitting payment claims to the Commission.

4.8. For the 2007-2013 programming period, audit and control provisions have been strengthened<sup>(3)</sup>. The Member States are required to submit for acceptance to the Commission a report and an opinion for each OP. The report must explain whether management and control systems comply with the relevant regulations ('compliance assessment report'). The Audit Authority has to submit an audit strategy within nine months of the approval of the programme. In addition the Audit Authority is responsible for providing reasonable assurance on the effective functioning of the management and control systems of the programme, and as a consequence on the regularity of the expenditure certified<sup>(4)</sup>, to the Commission through annual control reports<sup>(5)</sup> and annual opinions.

4.9. Member States also bear the primary responsibility for correcting the irregular expenditure they detect, and reporting on this to the Commission. Member States must take action to recover or withdraw the undue payments made to beneficiaries of Cohesion spending.

<sup>(3)</sup> See 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).

<sup>(4)</sup> See in particular Article 62 of Regulation (EC) No 1083/2006.

<sup>(5)</sup> The 2009 annual control report (which had to be submitted by the end of 2009) covers the results of the audits carried out during the period July 2008 to June 2009. It comprises system audits performed and audit of operations covering the expenditure declared to the Commission during the period January 2007 to December 2008.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.10. The Commission supervises Member States and seeks to ensure that their management and control systems operate as required. 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 interrupts and/or suspends payments to the Member State concerned <sup>(6)</sup>. If the Member State does not recover or withdraw the irregular expenditure (i.e. replace the excluded expenditure with other eligible expenditure) or remedy the detected system failures, the Commission may apply financial corrections, reducing EU funding accordingly.

**Specific risks to regularity**

4.11. The regulatory framework of Cohesion is complex, requiring conformity with a variety of EU policies and rules, such as those relating to public procurement and State aid, as well as requirements specific to Cohesion spending.

4.12. There is a large number of authorities responsible for the implementation of Cohesion policy in Member States (national authorities, regional authorities, intermediate bodies) and an even larger number of beneficiaries and recipients of Community support. The actors involved in implementing OPs and projects at national or regional level may be either unaware of the applicable rules or unsure about their correct interpretation. This can lead them to make incorrect or unjustified declarations.

4.13. Payments from an OP to beneficiaries for expenditure incurred during the eligibility period usually continue beyond the programming period, until all projects are finalised and the programme is closed down. As the eligibility period for 2000-2006 came to an end in 2009, national authorities may have been under pressure to absorb the EU funds committed. As already stated by the Court in its 2008 Annual Report, this increases the risk that ineligible projects are reimbursed by the EU budget when expenditure which has been found to be ineligible is replaced by new expenditure ('withdrawal') without an effective ex-ante verification by the Member State before programme closure <sup>(7)</sup>.

**4.10.** Member States are primarily responsible for ensuring the regularity of expenditure declared to the Commission. The Commission performs its supervisory role through its own audit activity taking also account of other Community and national audit work and also through programmes negotiation, participation in monitoring committees, annual meetings with managing and audit authorities and by providing extensive guidance and seminars.

The Commission has strengthened its supervision through the implementation of its 2008 Action Plan (COM(2008) 97 final).

In 2009 the Commission adopted 7 suspension decisions and imposed financial corrections totalling 2,3 billion euro.

**4.11.** The Commission refers to the vast simplification exercise of the Cohesion regulatory framework initiated in 2008 and completed in 2010, involving specific requirements of the sectoral regulations.

Possible shortcomings in the implementation of the EU rules on public procurement and State aid at a national, regional or local level in applying EU law are not specifically related to the implementation of cohesion projects.

**4.12.** The 2007-2013 regulatory framework has been enhanced to ensure that beneficiaries are informed of all specific conditions for financing, implementing and reporting, and that managing authorities satisfy themselves that beneficiaries have the capacity to fulfil these conditions before approving projects.

Moreover, since the beginning of the programming period the Commission has provided regular and early training and guidance to the competent authorities in the Member States. Specific training actions were also foreseen in the Commission Action Plan adopted in February 2008 (COM(2008) 97 final) in that regard and are carried out on a regular basis.

**4.13.** The regulatory framework for both 2000-2006 and 2007-2013 periods provide that funds allocations are to be used within a period of two or three years after they are committed to avoid an automatic decommitment of funds. This ensures that expenditure is committed and paid evenly throughout the period and is not back-loaded in the last year.

The Commission is also particularly vigilant that Member States' management and control systems are effective throughout the implementation period up to closure and imposes financial corrections where necessary.

<sup>(6)</sup> Article 39(2) of Council Regulation (EC) No 1260/1999 (OJ L 161, 26.6.1999, p. 1); Articles 91 and 92 of Regulation (EC) No 1083/2006.

<sup>(7)</sup> See paragraphs 6.19 and 6.33 of the 2008 Annual Report.

## THE COURT'S OBSERVATIONS

4.14. For the 2007-2013 programming period, the Commission's acceptance of Member States' compliance assessments (which accompany the management and control systems description reports) and audit strategies constitutes the first essential element in the control framework for Cohesion policy. Unless and until it has approved the compliance assessments, the Commission does not authorise interim payments to the programme concerned. At the same time, Member States are allowed to start making payments to beneficiaries through unapproved systems while awaiting the Commission's approval to take place. The expenditure taking place during this period is at an increased risk of error.

### Audit scope and approach

4.15. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of Cohesion, the following specific points should be noted:

- a sample of 180 interim and final payments was tested. 69 % of these randomly selected payments relate to projects of the 2007-2013 programming period, and
- prefinancing payments were not included in the sample because of the very low risk associated with this type of payment.

4.16. The assessment of systems covered the management and control systems related to:

- the compliance with certain key provisions specified in the regulatory framework for 16 OPs of the 2007-2013 programming period in 13 Member States, and
- the processing and reporting of recoveries and withdrawals for four OPs and one Community Initiative of the 2000-2006 programming period in six Member States.

## THE COMMISSION'S REPLIES

*The Commission is actively following up the risk identified in the 2008 annual report of the Court, in particular in the context of the closure of the 2000-2006 programmes.*

**4.14.** *The Commission has carried out its approval procedures (of compliance assessment reports and national audit strategies) within the deadlines set. The risk identified by the Court is inherent to the regulatory length of time for the submission by Member States of compliance assessment reports and audit strategies.*

*The Commission considers that this is a limited risk because the fact that it has not approved management and control systems yet does not mean that such systems, approved at national level, do not comply with requirements and do not function effectively.*

*Mitigating controls are in place and the Structural Funds Directorates-General have taken this risk into account in their audit strategy and also drawn this risk to the attention of the audit authorities. Each audit authority has to present to the Commission conclusions from the results of audits of representative samples of operations, which cover expenditure declared each year and an annual opinion on the effective functioning of the management and control systems.*

**4.15.**

- *The Commission notes that prefinancing, which by definition bears almost no risk, represents one third of its cohesion payments in 2009 (see table 4.1).*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**REGULARITY OF TRANSACTIONS**

4.17. The results of transaction testing are summarised in **Annex 4.1**.

4.18. As in previous years, a large number of payments to projects in Cohesion was affected by errors. In 2009 this was the case for 36 %<sup>(8)</sup> of the 180 audited projects.

4.19. The most likely error rate estimated by the Court is above 5 %<sup>(9)</sup>.

4.20. A major proportion of the estimated error rate is attributable to eligibility errors, which are the most common type of quantifiable error in the audit sample. They were found in 24 payments to projects audited. The main causes of the eligibility errors were inclusion of costs which are not eligible for reimbursement and serious failures to respect public procurement rules (see the following examples).

**4.18.** *The Commission notes that there is a trend for decrease in error frequency in the last three years, from 54 % in the Court's annual report for 2007 to 36 % this year, as noted in Annex 4.1 to the Court's report.*

*The Commission also underlines that 53 % of the errors are non-quantifiable. In some cases these compliance errors would have had no impact on the reimbursement of expenditure, even if detected before certifying expenditure to the Commission.*

**4.19.** *In 2009, the Court estimates that at least 3 % of the expenditure certified to the Commission should not have been reimbursed, compared to at least 11 % for 2008. This constitutes a significant improvement compared to previous years (see point 1.26). The Commission considers that this improvement reflects the enhanced control provisions in the 2007-2013 Cohesion regulatory framework, as well as the first impact of the 2008 Commission Action Plan to strengthen its supervisory role for structural actions. The Commission is committed to actively pursue its efforts to reduce the errors even further.*

*The Commission considers that in eight ERDF cases affected by a quantifiable error the national authorities had already applied proportionate financial corrections before declaring the expenditure to the Commission. As a result, there is no negative financial impact on the EU budget (see point (d) in box below).*

**4.20.** *The Commission follows up in a rigorous manner all errors detected by the Court and ensures that appropriate corrections are made where necessary, as it did for previous years (see Annex 4.4 to the Court's report).*

*Possible shortcomings in the implementation of public procurement rules at a national, regional or local level in applying EU law are not strictly related to the implementation of cohesion projects.*

*The Commission has taken into account those errors for its risk assessment in its own audit work. It has also taken other steps, such as providing specialised training on public procurement procedures on numerous occasions and issued guidance to programme authorities.*

<sup>(8)</sup> See **Annex 4.1**. In 2008 and 2007, the corresponding figures were 43 % and 54 %, respectively.

<sup>(9)</sup> The error rates are calculated based on a representative statistical sample drawn from interim and final payments for 2009 (23 billion euro) with a 95 % confidence level as indicated in **Table 4.1**. In 2009 the Court estimates that at least 3 % of the expenditure certified by Member States to the Commission in Cohesion should not have been reimbursed. The corresponding figures in 2008 (2008 Annual Report, paragraph 6.17) and 2007 (2007 Annual Report, paragraph 6.27) were 11 %.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

## Examples of eligibility errors

- (a) Overdeclaration of staff costs: In the case of an ESF project supporting professional training courses for pupils from secondary schools, the beneficiary incorrectly charged various indirect costs (staff salaries, insurance, fuel, telephone and depreciation) to the project.
- (b) Unjustified application of negotiated procedure: In the case of a CF project the procurement of services related to the administrative preparation and technical planning for an infrastructure project was carried out by negotiated procedure. The Court's audit showed however that the conditions which have to be in place so that a negotiated procedure can be used were not fulfilled.
- (c) Direct award of contract: In the case of an ERDF project for the building of access roads and light constructions at the entrances of a national park, the beneficiary directly awarded works. In addition, this contractor also invoiced works which were not covered by the contract. Due to the absence of public procurement procedure, the Court considers that the payments related to this contract are irregular.
- (d) Unlawful use of award criteria: In the case of ten ERDF projects for the construction of roads those bidders offering a price equal or below the average were not differentiated, meaning that the competitive advantage of those offering the lowest prices was eliminated. This was detected by the programmes' internal controls and corrections were made to offset the financial impact of this illegal procedure before expenditure was declared to the Commission. Nevertheless, it resulted in contracts co-financed by ERDF being awarded to bidders who, in nine out of the 10 cases, had not submitted the offer that provided the best combination of price and quality.

4.21. The non-respect of public procurement rules alone accounts for 43 % of all quantifiable errors and makes up for approximately three quarters of the estimated error rate.

## Examples of eligibility errors

- (a) *The Commission will follow up this issue and ensure that the necessary correction is made. The Commission will continue to encourage Member States to widen the use of flat-rate indirect costs, in order to avoid such errors.*
- (b) *The Commission notes that the value of the contract was above the threshold specified in the applicable EU Directive on public procurement. The Commission agrees with the existence of error in this case. The Member State has also agreed and will apply a financial correction according to Commission guidelines.*
- (c) *The Commission notes that the value of the contract was below the threshold specified in the applicable EU Directive on public procurement. The Commission agrees with the existence of error in this case and will apply a financial correction according to Commission guidelines.*
- (d) *The Commission notes that the value of contracts were all below the thresholds of the applicable EU Directives on public procurement.*

*The Commission also notes that in the eight ERDF cases affected by a quantifiable error the national authorities had already applied proportionate financial corrections before certifying the expenditure to the Commission. As a result, there is no negative financial impact on the EU budget.*

4.21. The Commission has recently initiated a retrospective evaluation of the relevance, effectiveness and efficiency of the basis EU public procurement legislative framework. The evaluation will focus primarily on analysing the cost-effectiveness of public procurement procedures and rules. The evaluation will also include a description of Member States' implementation and administrative structure to implement public procurement policy, including EU legislation in this area. The results of the evaluation will be finalised by summer 2011.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.22. 53 % of the payments affected by error contained non-quantifiable errors and therefore are not included in the estimation of the error rate. Most of them were other compliance errors, mainly related to shortcomings in tendering and contracting procedures.

4.23. For at least 30 % of the errors found by the Court in this year's sample, sufficient information was available for the Member State authorities in charge of implementing the OPs to have detected and corrected the error prior to certifying the expenditure to the Commission.

**OBSERVATIONS ON SYSTEMS**

4.24. The results of the examination of systems are summarised in **Annex 4.2**.

**Systems related to the regularity of transactions****Member States**

4.25. The Court assessed the compliance of 16 management and control systems in 13 Member States with key provisions in the regulatory framework (see **Annex 4.2(1)**).

4.26. The Court's audit showed that for 11 of the 16 OPs audited, the verifications carried out by Managing Authorities were only partially compliant with the regulatory requirements.

*In addition, a Commission interservice task force is examining the most common public procurement issues arising in the context of implementation of cohesion projects.*

*The Commission will continue training actions to Member State authorities on the correct application of public procurement rules. Where appropriate, the Commission will continue to audit the application of the EU Directives on public procurement by carrying out its own enquiries in certain cases or by asking the Member States' audit authorities to perform such enquiries on its behalf.*

*The Commission also refers to its answer to paragraph 4.20.*

**4.23.** *The Commission considers that for most of the remaining errors detected by the Court the national authorities did not have sufficient information to detect the errors when declaring the expenditure to the Commission.*

**4.25.** *The Commission notes that according to the Court's assessment all 16 systems are fully or partially compliant with regard to the key requirements tested.*

**4.26.** *The Commission shares the Court's view that management verifications are key controls to prevent irregularities. They should be improved, particularly for some programmes, and the Commission will continue to pursue its efforts in this direction through advice, training actions and specific audits.*

## THE COURT'S OBSERVATIONS

4.27. For most OPs audited, the Court observed delays in the implementation of the approved national audit strategy. Most Audit Authorities did not undertake a sufficient number of audits of payments in time for the 2009 annual control report.

4.28. The Court also noted significant differences in the extent to which systems-related audit work had been carried out by the end of 2009. Several Member States did not perform any systems audits before expenditure was declared to the Commission <sup>(10)</sup>.

4.29. For two of the 16 OPs audited, the Audit Authorities are considered to be only partially compliant with the key regulatory requirement regarding system audits.

## Systems related to recoveries and financial corrections

### Member States

4.30. The Court assessed systems for the processing of errors detected by the various national *ex post* controls and the reporting of recoveries and withdrawals to the Commission. This was done for four OPs and one Community Initiative in six Member States <sup>(11)</sup>.

4.31. As in the previous year <sup>(12)</sup> the least satisfactory aspect in the audited systems concerns the reporting of corrections to the Commission (see **Annex 4.2(2)**). In some instances relevant information was not communicated to the Commission, in others it was not reliable or it had not been presented as foreseen in the instructions sent by the Commission. This means that in these cases the Commission does not have reliable information on recoveries and withdrawals implemented by Member States. Weaknesses in this respect were also noted by the Commission <sup>(13)</sup>.

## THE COMMISSION'S REPLIES

**4.27.-4.28.** *In accordance with the regulatory framework, audit authorities are required to carry out audits on operations only if expenditure has been declared to the Commission up to the end of the year prior to the audit year. Only two out of the 16 programmes audited by the Court had expenditure declared in 2008.*

**4.29.** *The Commission notes that according to the Court's assessment 14 out of the 16 audit authorities are fully compliant with regard to the key requirement tested.*

**4.31.** *Although the reporting of corrections by the Member States is not entirely satisfactory, in some cases the Commission considers that the data for 2009 submitted to the Commission in the first half of 2010 are of much better quality. Cumulative data are published in the Commission's final annual accounts. In the framework of its 2008 Action Plan the Commission has carried out audits of Member States' systems for withdrawals and recoveries similar to those of the Court, in 19 Member States. The remaining Member States will be audited in 2010.*

*For the 2007-2013 period, there is a standardised procedure for submission of recovery statements through the IT system SFC2007. The Commission expects that this reporting procedure will improve the quality of information in its disposal. Member States are also required to distinguish corrections deriving from their own controls and those from EU audits.*

<sup>(10)</sup> For most OPs audited the first expenditure was certified to the Commission only the second half of 2009.

<sup>(11)</sup> The Court did not assess whether the Member States were effective in detecting errors.

<sup>(12)</sup> See the 2008 Annual Report, paragraph 6.30.

<sup>(13)</sup> COM(2010) 52, point 1.6.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

4.32. The Court assessed the 2009 Annual Activity Reports and accompanying declarations of the Directorates-General for Regional Policy and for Employment, Social Affairs and Equal Opportunities.

4.33. The results of the review of Commission management representations are summarised in **Annex 4.3**.

**CONCLUSIONS AND RECOMMENDATIONS**

4.34. Based on its audit work, the Court concludes that the interim and final payments for the year ended 31 December 2009 for Cohesion were affected by material error.

4.35. At least 30 % of the errors found could and should have been detected and corrected by the Member States before certifying expenditure to the Commission (see paragraph 4.23).

4.36. For the systems audited, the Court concludes that:

- (a) for 12 out of 16 OPs audited weaknesses were noted with regard to verifications carried out by Managing Authorities and/or systems audits undertaken by Audit Authorities. Overall the supervisory and control systems for the 2007-2013 programming period were at least partially in compliance with the audited key provisions of the regulatory framework (see paragraphs 4.25 to 4.29); and

**4.33.** *The Commission welcomes the Court's assessment in Annex 4.3 and point 1.28 which represents an improvement over previous years.*

**4.34.** *The Commission notes that the error rate is this year significantly lower compared to previous years and that the frequency of errors in the Court sample continues to decrease for the third consecutive year.*

*The Commission considers that this gives a good indication on the effectiveness of the reinforced control provisions of the 2007-2013 regulatory framework, as well as the first impact of the 2008 Commission Action Plan to strengthen its supervisory role for structural actions. The Commission will continue its persistent efforts to bring the error rate down to lower levels.*

**4.35.** *The Commission follows up all cases where weaknesses were identified in the management and control systems in order to ensure that they function effectively.*

*The Commission considers that for most of the remaining errors detected by the Court the national authorities did not have sufficient information to detect the errors when declaring the expenditure to the Commission.*

**4.36.**

- (a) *The Commission notes that according to the Court's assessment all 16 systems audited are compliant or partially compliant, which is an encouraging result for the 2007-2013 programming period.*

*The Commission refers also to its replies to paragraphs 4.26 and 4.29.*

## THE COURT'S OBSERVATIONS

(b) the Member States' systems for recording and correcting errors of which they were aware for the 2000-2006 programming period were effective. Systems for reporting recoveries and withdrawals were partially effective which means that the Commission does not always receive reliable information on these financial corrections from Member States (see paragraphs 4.30 and 4.31).

4.37. The Court recommends the Commission to:

(a) encourage national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission;

(b) ensure that the substitution of ineligible with new expenditure (withdrawal) does not result in new irregular expenditure being declared by Member States; and

(c) ensure, through its supervision, an effective functioning of the national management and control systems for the 2007-2013 programming period.

4.38. With regard to public procurement rules (see paragraph 4.21), the Court encourages the Commission to monitor closely the correct application of the EU Directives on public procurement in Member States.

## THE COMMISSION'S REPLIES

(b) *The quality and completeness of data has been improving constantly due to Commission efforts under its 2008 Action Plan. The Commission will complete in 2010 its on-the-spot audits of Member States systems for recoveries and issue recommendations for further improvement of the Member States reporting.*

*For the 2007-2013 period, the legislative framework has been reinforced and provides for a standardised submission of information, which will improve the quality of information the Commission has in its disposal.*

*The Commission also refer to its reply to paragraph 4.31.*

4.37.

(a) *The Commission refers to its actions to improve management verifications and the certification of expenditure to the Commission, under its Action Plan adopted in February 2008. It reaffirms its commitment to encourage national authorities by providing advice, training and guidance and by closely following up audit findings in this regard.*

(b) *The Commission is actively following up the risk identified in the 2008 annual report of the Court, in particular in the context of the closure of the 2000-2006 programmes.*

(c) *The Commission will pursue the efforts undertaken under its 2008 Action Plan to improve the management and control systems in the Member States. It will follow up the Court's findings and will continue to verify the functioning of the Member States' management and control systems, building on the annual audit opinions issued by the audit authorities and its own audit work.*

4.38. *The Commission has recently initiated a retrospective evaluation of the relevance, effectiveness and efficiency of the basis EU public procurement legislative framework. The evaluation will focus primarily on analysing the cost-effectiveness of public procurement procedures and rules. The evaluation will also include a description of Member States' implementation and administrative structure to implement public procurement policy, including EU legislation in this area. The results of the evaluation will be finalised by summer 2011. In addition, a Commission interservice task force is examining the most common public procurement issues arising in the context of implementation of cohesion projects.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

4.39. A follow-up of previous observations is summarised in **Annex 4.4**.

*The Commission will continue training actions to Member States authorities on the correct application of public procurement rules. The Commission will, where applicable continue to audit the application of the EU directives on public procurement by carrying out its own enquiries in some cases or by asking the Member States' audit authorities to perform such enquiries on its behalf.*

**4.39.** See Commission's replies in Annex 4.4.

## ANNEX 4.1

## RESULTS OF TRANSACTION TESTING FOR COHESION

	2009				2008	2007
	ESF	ERDF	CF	Total		
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>						
Total transactions (of which):	44	118	18	<b>180</b>	170	180
Prefinancing	0	0	0	<b>0</b>	0	0
Interim/Final payments	44	118	18	<b>180</b>	170	180
<b>RESULTS OF TESTING</b>						
<i>(in % and numbers of transactions)</i>						
Transactions not affected by error	75 % {33}	60 % {71}	67 % {12}	<b>64 % {116}</b>	57 %	46 %
Transactions affected by error	25 % {11}	40 % {47}	33 % {6}	<b>36 % {64}</b>	43 %	54 %
<b>ANALYSIS OF TRANSACTIONS AFFECTED BY ERROR</b>						
<i>(in % and numbers of transactions)</i>						
<b>Analysis by type of error</b>						
Non-quantifiable errors	0 % {0}	62 % {29}	83 % {5}	<b>53 % {34}</b>	38 %	35 %
Quantifiable errors	100 % {11}	38 % {18}	17 % {1}	<b>47 % {30}</b>	62 %	65 %
<i>comprising:</i> Eligibility	64 % {7}	89 % {16}	100 % {1}	<b>80 % {24}</b>	91 %	79 %
Occurrence	0 % {0}	0 % {0}	0 % {0}	<b>0 % {0}</b>	0 %	13 %
Accuracy	36 % {4}	11 % {2}	0 % {0}	<b>20 % {6}</b>	9 %	8 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>						
Most likely error rate:						
< 2 %						
2 % to 5 %						
> 5 %	<b>X</b>				<b>X</b>	<b>X</b>

Note: The error rates are calculated based on a representative statistical sample drawn from interim and final payments 2009 (23 billion euro) with a 95 % confidence level.

## RESULTS OF EXAMINATION OF SYSTEMS FOR COHESION

## (1) 2007-2013 programming period - Systems related to regularity of transactions at the Member State level: compliance with key provisions of the regulatory framework

	Managing Authority and Intermediate body <sup>(1)</sup>	Certifying Authority <sup>(2)</sup>	Audit Authority <sup>(3)</sup>
ESF - Portugal - Azores Pro-Emprego			
ESF - Denmark - More & better jobs			
ERDF - Hungary - Economic development			
ERDF - Greece - Competitiveness and entrepreneurship			
ERDF - Germany - Sachsen-Anhalt Convergence			
ERDF - Germany - Lüneburger Heide			
ERDF - Estonia - Development of Economic Environment			
ESF - Poland - Human capital			
ESF - Portugal - Human potential			
ERDF - Sweden - Mellersta Norland			
ERDF - France - Pays de la Loire			
ESF - France - Regional competitiveness and employment			
ERDF - Lithuania - Economic growth			
CF - Hungary - Environment and Energy			
ERDF - INTERREG United Kingdom/Ireland			
ERDF - Spain - Castilla-La Mancha			

## Legend

	Compliant
	Partially compliant
	Not compliant
N/A	Not assessed





## Key requirements tested

- (<sup>1</sup>) Management verifications  
(<sup>2</sup>) Reliable and soundly based certifications  
(<sup>3</sup>) Adequate systems' audit

(2) 2000-2006 programming period - Systems related to processing and reporting of recoveries and withdrawals at the Member State level

	Recording of errors	Correction of errors	Recording of corrections	Correction reporting to Commission	Irregularity reporting to OLAF
ERDF - Greece - Road axis	Effective	Effective	Effective	Effective	Effective
ERDF - Spain - Information Society	Effective	Effective	Effective	Partially effective	Effective
ERDF - Luxembourg - Objective 2	Effective	Effective	Effective	Effective	Partially effective
'ERDF - INTERREG Germany/Czech Republic - System Germany'	Partially effective	Effective	Effective	Partially effective	Effective
'ERDF - INTERREG Germany/Czech Republic - System Czech Republic'	Effective	Effective	Effective	Partially effective	Effective
ERDF - Poland - Improvement of competitiveness	Effective	Effective	Effective	Partially effective	Effective

Legend

	Effective
	Partially effective
	Not effective
	Not applicable: does not apply or not assessed



## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR COHESION

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
REGIO	with reservations	<p>A total of 138 OPs were affected in 2009, against 99 in 2008 and 185 in 2007.</p> <p>The Directorates-General quantified the impact of these reservations at 183,7 million euro (as compared to 201 million euro in 2008 and 726 million euro in 2007).</p> <p>In the case of DG REGIO reservations were quantified at 31,4 million euro for the 2000-2006 period (0,44 % of interim and final payments) and 65,2 million euro for the 2007-2013 period (0,69 % of interim payments).</p>	<p>For Cohesion, the Court considers that the Director-general's declaration and the annual activity report are established according to the applicable Commission guidelines.</p> <p>The Court notes that DG REGIO and EMPL issued reservations with a quantifiable impact for both periods. For the policy area Cohesion, the scale of the reservations is closer to the conclusions of the Court's audit than in previous years.</p>	A
EMPL	with reservations	<p>In the case of DG EMPL reservations were quantified at 11,9 million euro for the 2000-2006 period (0,77 % of interim and final payments) and 75,2 million euro for the 2007-2013 period (1,77 % of interim payments).</p>		

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-general's declaration and the annual activity report give a fair assessment of financial management in relation to regularity.

B: The Director-general's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

C: The Director-general's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity.

## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR COHESION

Court observation	Action taken	Court analysis	Commission reply
<b>1. Statement of Assurance 2006, 2007 and 2008: Follow-up by the Commission to the Court's observations</b>			
<p>The Court's testing over the last three years has identified system weaknesses and errors in the expenditure declarations for a number of OPs and projects in the samples audited.</p> <p>All of these findings relate to the 2000-2006 programming period.</p>	<p>The Commission followed-up the audits carried out by the Court.</p> <p>Financial corrections of 191,6 million euro, 80 million euro and 0,2 million euro were implemented by the Commission as a result of the follow-up given to the Court's audits.</p>	<p>For audits carried out by the Court related to the financial year 2006, the Commission has taken corrective action in accordance with its own rules and procedures on all cases reviewed, while for 2007, two cases are still under consideration.</p> <p>For audits carried out by the Court related to the financial year 2008, the Commission's follow-up work is on-going.</p>	<p><i>The Commission welcomes the positive assessment of the Court for the follow up of its 2006, 2007 and 2008 findings and the Commission's audits of operations in 2009 applying a methodology similar to the one of the Court.</i></p> <p><i>This is the result of one of the actions under the Commission Action Plan of February 2008 to strengthen its supervisory role.</i></p>
<b>2. The Commission's actions to strengthen the Commission's supervisory role under shared management of structural actions</b>			
<p>The Court has assessed the control systems in the Member States as ineffective or partly effective and identified that the Commission's own supervision is not effective at preventing errors at Member State level.</p>	<p>In recent years, the Commission has undertaken various actions to strengthen its supervisory role, as described in the 'Action plan to strengthen the Commission's supervisory role under shared management of structural actions' (1).</p> <p>By the end of 2008, 28 out of 37 actions were reported to be completed. The remaining 9 actions were integrated in the Commission joint audit strategy for Cohesion (2).</p> <p>Moreover, in 2008, the Commission has adopted simplified eligibility rules for expenditure (such as use of national eligibility rules, lump sums, standard scales of unit costs and indirect costs on a flat rate basis) that can be applied in the 2007-2013 period.</p>	<p><b>Commission's audit of operations in 2009</b></p> <p>In 2009, the Commission's audit work aimed among others at auditing a statistically representative sample of operations in Member States (applying a methodology similar to the one used under the Court's assurance model) to assess the legality and regularity of certified expenditure declared to the Commission for the 2007-2013 programming period.</p> <p>The Court has analysed the Commission's audit approach for this examination and reviewed the working papers for a sample of audit files. The Court considers that the methodology applied by the Commission was overall appropriate.</p> <p>As indicated by the Commission, these results must however be interpreted in a careful manner in view of the specificities of the population audited.</p>	<p><i>The Commission considers in the impact report on the Commission Action Plan (COM (2010) 52 final) that the results of its audit of operations in 2009 provide a good indication that the enhanced control provisions for the 2007-2013 regulatory framework and the preventive measures taken by the Commission have started to produce results.</i></p>

Court observation	Action taken	Court analysis	Commission reply
		<p><b><i>Simplification of eligibility rules</i></b></p> <p>The possibility to simplify national eligibility rules adopted by the Commission is intended in particular to help beneficiaries in their declaration of personnel and indirect costs.</p> <p>In 2009, this possibility existed for the ESF only. By the end of 2009, 22 out of 27 Member States have implemented some form of simplification. The effectiveness of those simplifications can be assessed only in the coming years.</p>	

<sup>(1)</sup> See COM(2008) 97, approved on 19 February 2008 and the final implementation report COM(2009) 42/3.

<sup>(2)</sup> See DGs Regional Policy, Employment, Social Affairs and Equal Opportunities, Maritime Affairs and Fisheries and Agriculture and Rural Development, 'Joint Audit Strategy for Structural Actions 2009-2011', April 2009, first version C(2004) 3115 and annually updated since then.



## CHAPTER 5

**Research, Energy and Transport**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	5.1-5.17
Specific characteristics of the policy group	5.2-5.16
Policy objectives	5.2-5.5
Policy instruments	5.6-5.14
Risks to regularity of payments	5.15-5.16
Audit scope and approach	5.17
Regularity of transactions	5.18-5.22
Effectiveness of systems	5.23-5.42
Systems related to regularity of transactions	5.25-5.40
Ex-ante desk checks of cost statements	5.25-5.27
Audit certification of cost statements under FP6	5.28-5.31
Ex-ante certification of beneficiaries' costing methodologies under FP7	5.32-5.36
The Commission's ex-post audit strategy	5.37-5.40
Systems related to recoveries and financial corrections	5.41-5.42
Reliability of Commission management representations	5.43-5.44
Conclusions and recommendations	5.45-5.53
EU Joint Undertakings	5.54-5.57

## THE COURT'S OBSERVATIONS

## INTRODUCTION

5.1. This Chapter presents the Court's specific assessment of Research, Energy and Transport, which comprises policy areas 06-Energy and Transport; 08-Research; 09-Information Society and Media; and 10-Direct Research. Key information on the activities covered and the spending in 2009 is provided in **Table 5.1**.

**Table 5.1 — Research, Energy and Transport — Key information**

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
6	Energy and Transport	Administrative expenditure <sup>(1)</sup>	143	Centralised direct
		Inland, air and maritime transport	875	Centralised direct
		Trans-European Networks (TENs)	839	Centralised direct
		Conventional and renewable energies	67	Centralised direct
		Nuclear energy	129	Centralised direct/Centralised indirect/ Decentralised and joint
		Research related to energy and transport (FP7)	131	Centralised direct
		Completion of previous framework programmes (FP5 and FP6)	68	Centralised direct
		Security and protection of energy and transport users	1	Centralised direct
		<b>2 253</b>		
8	Research	Administrative expenditure <sup>(1)</sup>	300	Centralised direct
		FP7	2 817	Centralised direct
		ITER: Fusion	267	Centralised indirect
		Completion of previous framework programmes (FP5 and FP6)	1 388	Centralised direct
		ECSC — EIT	54	Centralised direct
			<b>4 826</b>	
9	Information Society and Media	Administrative expenditure <sup>(1)</sup>	134	Centralised direct
		FP7	698	Centralised direct
		Completion of previous framework programmes (FPs)	314	Centralised direct
		Media	105	Centralised direct
		CIP and others	124	Centralised direct
			<b>1 375</b>	

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
10	Direct research	Staff, running costs and investments	321	Centralised direct
		FP7	40	Centralised direct
		Historical liabilities resulting from nuclear activities	19	Centralised direct
		Completion of previous framework programmes (FP5 and FP6)	30	Centralised direct
			<b>410</b>	
Total administrative expenditure <sup>(1)</sup>			898	
Total FPs			5 486	
Total TENS			839	
Total Other			1 641	
Total operational expenditure (consisting of):			7 966	
— advances <sup>(2)</sup>			4 543	
— interim/final payments <sup>(3)</sup>			3 423	
<b>Total payments for the year</b>			<b>8 864</b>	
<b>Total commitments for the year</b>			<b>11 876</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in Chapter 9.

<sup>(2)</sup> Advances under the Seventh Framework Programme (2007-13) amounted to 2 101 million euro.

<sup>(3)</sup> Interim/Final payments under the Seventh Framework Programme (2007-13) and the Sixth Framework Programme (2002-06) amounted to 1 585 million euro and 1 800 million euro respectively.

Source: Annual Accounts 2009.

## THE COURT'S OBSERVATIONS

**Specific characteristics of the policy group***Policy objectives*

5.2. 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.

5.3. Research policy seeks to foster investment in research and the transition towards the knowledge-based economy in order to reinforce the competitiveness of the EU. It also aims to reinforce the scientific and technical base of the European Research Area (ERA), improve the excellence of research in Europe, and increase the openness and attractiveness of the ERA and to maximise benefits from international cooperation.

5.4. Information society and media policies aim to create an innovative, open and competitive single space for information society and media services, further leading the transition to the future networks and Internet. They seek to increase the scale and effectiveness of EU investment in Information and Communication Technologies (ICT) research and take-up, and address the current fragmentation of the Single Market for the digital economy. The policies also aspire to achieve an inclusive European information society, providing growth and jobs in a manner consistent with sustainable development and that prioritises better public services and quality of life.

5.5. 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, as well as to ensure a long-term programme of nuclear decommissioning and nuclear waste management.

*Policy instruments*

5.6. The majority of the expenditure for this policy group is implemented by the Commission under direct centralised management and, increasingly, by indirect centralised management through Agencies and Joint Undertakings. Nuclear decommissioning funds are subject to joint management with the European Bank for Reconstruction and Development (EBRD).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Research**

5.7. Around 70 % of the operational expenditure for the policy group is on research projects, under multiannual Framework Programmes (FPs), which have multiple funding schemes, supporting various thematic areas and types of projects. The Commission generally makes payments to beneficiaries without the involvement of national, regional or local authorities in the Member States.

5.8. Beneficiaries may be research institutes, universities, public administrations, companies or individuals. The beneficiaries or partners usually work as a consortium of partners across Member States, associated States or other countries, on the basis of a grant agreement with the Commission. For FP7 each project has on average six partners, although depending on the funding scheme, the number may range from 1 to 64. Partners may participate in several projects.

5.9. For FP7 up to the end of 2009, research grants ranged from about 7 500 euro for individual researchers up to 93 million euro for major collaborative projects. Although there are more than 12 000 beneficiaries, the 250 largest receive around 50 % of the total EU contribution.

5.10. From mid-2009, parts of FP7 are managed by the Research Executive Agency and the European Research Council Executive Agency. In addition, at the end of 2009, four research Joint Undertakings were in operation, with total EU contribution for the year of 288 million euro<sup>(1)</sup>. The Joint Undertakings manage funding provided by the EU and other public and private partners for specific research initiatives.

**Energy and transport**

5.11. The other main single category of expenditure in 2009 (around 11 % of the total) is for major energy and transport projects under the trans-European networks (TEN) programme. Beneficiaries are usually Member State authorities but may also be public or private companies. The projects are generally technically complex and most are transnational.

5.12. In 2009, there were 404 ongoing transport (TEN-T) projects with an average grant of 18,05 million euro and 49 ongoing energy (TEN-E) projects with an average grant of 1,53 million euro.

5.7. *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.*

*Because the current legislative and contractual environment makes the management of project complex both for the beneficiaries and the Commission, simplification measures have been taken by the Commission for the implementation of FP7.*

5.10. *Most of the expenditure is managed directly by the Commission but FP7 also allows for the implementation of the budget in indirect centralised management mode; i.e. the Commission entrusts implementing tasks to Executive Agencies, Joint Undertakings set up by the EU and 'Article 185 Initiatives', which are structures created for the execution of research programmes undertaken jointly by several Member States.*

<sup>(1)</sup> Fusion for Energy Joint Undertaking (management of the Euratom contribution to the ITER nuclear fusion facility), Innovative Medicines Joint Undertaking (improvement of the efficiency and effectiveness of drug development), Clean Sky Joint Undertaking (development of clean air transport technologies) and Artemis Joint Undertaking (development of embedded computing systems).

## THE COURT'S OBSERVATIONS

5.13. The TEN-T programme is managed by the TEN-T Executive Agency and parts of energy and transport expenditure are managed by the Executive Agency for Competitiveness and Innovation. The SESAR Joint Undertaking manages the development phase of the EU project to modernise European air traffic management, with a budget in 2009 of 157 million euro.

**Other payments**

5.14. Other payments in 2009 include advance payments by the Commission under agreements with the European Space Agency (ESA) for the implementation of the Galileo satellite navigation system, contributions to nuclear decommissioning programmes, and other specific expenditure such as payments under agreements with the European Investment Bank (EIB) for the TEN-T Loan Guarantee Fund and the FP7 Risk Sharing Finance Facility.

*Risks to regularity of payments*

5.15. For both research and transport and energy projects, the grants are paid in instalments: an advance after completion of the project selection process and upon signature of the grant agreement or financing decision, followed by interim and final payments which are intended to reimburse eligible expenditure reported by the beneficiaries in periodic cost statements. At this stage of the programming cycle, around half of the research payments are advances for FP7 projects. The remainder are interim and final payments for FP6 projects, and interim payments for FP7 projects.

5.16. For interim and final payments, the main risk is that beneficiaries may include ineligible costs in their cost statements, which may not be detected and corrected by the supervisory and control systems of the Commission before reimbursement of the declared costs. The risk is exacerbated by the complexity of the rules for calculating eligible costs, including numerous eligibility criteria, and the requirement for beneficiaries to allocate personnel and indirect costs to projects, while deducting various items considered ineligible for EU co-financing. The payment conditions for advance payments are less complex, as these payments are triggered by the signature of the grant agreement or financing decision. However, advance payments have been subject to error in previous years, although these are generally not quantifiable and have concerned procedural weaknesses such as late payments.

## THE COMMISSION'S REPLIES

**5.16.** *The Commission agrees with the Court. Indeed the complexity of the rules is a major source of errors and ineligible cost claims. The Commission's Communication on simplifying the implementation of the research framework programmes<sup>(1)</sup> proposes actions to address this risk. As these proposals will only be implemented within the next framework programme, and as it needs to address the problems caused by complex eligibility requirements for grant beneficiaries, on 26 May 2010 the Commission adopted a Communication<sup>(2)</sup> to the other Institutions proposing a level for the tolerable risk of error in this area of between 2 and 5%. The proposed level of tolerable risk of error is established taking into account the cost-effectiveness of the controls and an acceptable level of residual error that is justified in the light of these costs.*

<sup>(1)</sup> COM(2010) 187 final of 29.4.2010.

<sup>(2)</sup> COM(2010) 261 final of 26.5.2010.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Audit scope and approach**

5.17. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of Research, Energy and Transport, the following specific points should be noted:

- a sample of 150 transactions was tested, comprising 86 advances, and 64 interim and final payments,
- the assessment of systems focused on research payments and covered:
  - ex-ante desk checks of cost statements submitted by beneficiaries,
  - audit certification of cost statements by independent auditors,
  - ex-ante certification of beneficiaries' costing methodologies,
  - ex-post financial audits of projects, and
  - implementation of recoveries and financial corrections.

**REGULARITY OF TRANSACTIONS**

5.18. The results of transaction testing are summarised in **Annex 5.1**. The most likely error rate estimated by the Court lies between 2 % and 5 %.

5.19. In total, the Court found that 36 of the sample of 150 transactions were affected by error. In 23 cases, the errors concern the reimbursement of ineligible or inaccurately declared costs in interim and final payments to research projects. The principal source of error remains the reimbursement of overstated personnel and indirect costs. The following two examples illustrate this.

**Example 1: personnel costs**

The Court found that the audited beneficiary reported 17 person-months as input to the Commission, but that the amount it claimed actually equated to 42 person-months of work for the beneficiary. The Court found no evidence to link the additional amount of personnel costs charged to the project. In addition, the claim included travel costs which had not been incurred in relation to the project. The error amounted to 73 000 euro or 50 % of declared costs.

**5.19.****Example 1**

*The Commission agrees with the findings of the Court and the recovery process is ongoing.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Example 2: indirect costs**

According to the standard grant agreement, indirect costs must be actual and necessary for the project, and must be justified by the beneficiary's accounting system as incurred in direct relationship with the eligible direct costs for the project. The Court found that the accounts of the audited beneficiary did not directly link costs to specific projects. Therefore, although the accounts demonstrated that the beneficiary had incurred indirect costs for the project, it was not possible to reconcile the actual amount directly related to the project. Also taking into account identified ineligible direct costs, the Court reported an error of 62 000 euro or 10 % of total declared costs.

5.20. The Court's transaction testing sample included 13 interim payments to FP7 projects. The Court found errors, of a similar nature to those which have affected FP6 projects, in six cases.

5.21. Overall, the findings on the regularity of transactions are consistent with the results of the Commission's own 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.

5.22. For the 44 transactions other than research payments which were tested (28 advances and 16 interim and final payments), the Court found errors in six cases. These included one TEN-T project where public procurement rules had not been properly applied and another TEN-T project where costs outside the scope of the financing decision had been claimed and reimbursed.

## EFFECTIVENESS OF SYSTEMS

5.23. The results of the Court's examination of systems are summarised in **Annex 5.2**. The Court found that the systems were partially effective in ensuring the regularity of transactions.

5.24. The findings below focus mainly on the controls over research interim and final payments.

### Systems related to regularity of transactions

#### *Ex-ante desk checks of cost statements*

5.25. 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.

**5.20.** *At this stage of the programme cycle, and given the small number of FP7 interim payments included in the Court's sample, it is too early to draw conclusions on the frequency and the value of errors in FP7 by comparison with FP6.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.26. Although many errors may only be found by performing checks at the beneficiary, desk checks should permit the detection of basic deficiencies in cost statements.

5.27. The Court tested the operation of the checks for all its sample of 150 transactions. The results of the Court's testing indicate that the checks generally operate as intended, although in four cases, anomalies in cost declarations which should have been detected, such as incorrect overhead rates, were not detected by the checks.

*Audit certification of cost statements under FP6*

5.28. Under FP6, the grant agreements generally stipulate that 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.

5.29. Each project partner should provide at least one audit certificate covering the whole duration of the project. A certificate is always required when the EU contribution requested by a partner exceeds 750 000 euro for a specific reporting period.

5.30. For the 30 transactions audited at the beneficiary where a certificate had been provided<sup>(2)</sup>, the Court compared the results of its own testing with the certificate. In 13 or 43 % of cases, all of which concerned FP6, the Court found errors in cost statements which had received an unqualified opinion from the certifying auditor before submission for reimbursement.

5.31. This is in line with the findings of last year<sup>(3)</sup> and with the observations reported in Chapter 8<sup>(4)</sup>, confirming the need to improve the reliability of this control.

**5.31.** *The Commission shares the concern of the Court on the correctness of the FP6 audit certificates, which did not fully provide the additional assurance initially expected. However, the Commission maintains that this instrument made a substantial contribution to the prevention of errors, resulting in a significant decrease of the error rates in FP6 audits compared with FP5.*

<sup>(2)</sup> 27 FP6, 1 FP7, 1 Research Fund for Coal and Steel, 1 MEDIA 2007 Programme.

<sup>(3)</sup> 2008 Annual Report, paragraphs 7.21 to 7.24.

<sup>(4)</sup> Chapter 8, paragraphs 8.19 and 8.20.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Ex-ante certification of beneficiaries' costing methodologies under FP7*

5.32. As the Court observed in 2008, the Commission has sought to simplify the audit certification system under FP7 by introducing the ex-ante certification of beneficiaries' costing methodologies.

5.33. The measure is intended to apply to beneficiaries of multiple grants whose accounting systems can provide reasonable assurance that their costing methodologies conform to the provisions of the grant agreement. Beneficiaries may receive certification in respect of their methodology for calculating personnel and indirect costs, and for average personnel costs.

5.34. At the end of May 2010, only 25 beneficiaries of the potential 650 beneficiaries eligible to apply for certification had actually received ex-ante certification of their costing methodologies. Another 16 beneficiaries had their applications rejected while others had preferred not to apply, in the expectation of being refused certification.

5.35. The Commission has recognised that the acceptability criteria <sup>(5)</sup> which it laid down for receiving certification of the costing methodology are too stringent for most beneficiaries <sup>(6)</sup>. Indeed, the criteria do not correspond to common accounting practices in industry (such as the use of average personnel costs by cost centre) and in research organisations.

The Commission has taken remedial action in order to improve the quality of the audit certificates in FP7. FP7 audit certification is based on 'agreed upon procedures', which require the certifying auditor to perform pre-defined procedures and report factual findings on that basis. This approach should lead to a reduction in errors of interpretation of the eligibility rules by the auditors which occurred in FP6.

The Commission will continue assessing the reliability of audit certificates during its own financial audits.

See also reply to paragraph 5.49.

**5.32.-5.33.** The ex-ante certification of beneficiaries' costing methodologies is only compulsory for those who wish to apply average personnel costing to their cost claims. It is optional for other beneficiaries.

In addition, beneficiaries are still required to provide a certificate for the final payment covering all periods if the cumulative requested contribution exceeds 375 000 euro. In practical terms, ex-ante certification does reduce the administrative burden for beneficiaries and contributes to substantial costs savings on audit fees.

See also reply to paragraph 5.36.

**5.34.-5.35.** In its Communication on simplification, the Commission proposes to take into account any average personnel cost methodology applied as usual accounting practices of the beneficiaries, including a cost centre based approach, as long as they are based on actual personnel costs registered in the accounts and any double funding of costs under other cost categories is excluded.

The FP7 Rules for Participation authorise average personnel costs as an exception to the general rule of actual costs, providing this is the usual accounting practice of the beneficiary and that the average costs do not differ significantly from the actual costs. The criteria defined by the Commission aim to provide reasonable assurance that the application of a beneficiary's methodology will not lead to any significant deviation of the average costs reported vis-à-vis the actual costs. In the view of the Commission, these criteria represent the best possible balance between simplification and accountability concerns within the prevailing regulatory framework.

<sup>(5)</sup> Commission Decision of 23.6.2009 (C(2009) 4705).

<sup>(6)</sup> COM(2010) 187 of 24 April 2010 — Simplifying the implementation of the Research Framework Programmes.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.36. The main funding rules for FP6 — and the associated risks to the regularity of expenditure — have been carried over to FP7. The risks may have increased at this stage, as the number of audit certificates required has been significantly reduced, while the system of ex-ante certification of costing methodologies, which is supposed to largely replace the audit certificates, is not operating as intended.

**5.36.** *The intensity of audit certificate submissions under FP7 has been reduced to lower the administrative burden on participants. However, a Certificate on Financial Statements (CFS) is still required for beneficiaries who have received certification of their costing methodologies, since this only removes the obligation for a beneficiary to submit an intermediate CFS. A CFS must be submitted for the last reporting period if the cumulative requested contribution exceeds 375 000 euro. Following the intensive FP6 audit campaigns, many beneficiaries have undergone a learning effect and the Commission expects that beneficiaries are likely to apply improved project cost accounting practices as a result.*

*At the present juncture, it is not possible to conclude that the overall error rate will increase, as the risks identified may be offset by other measures.*

### *The Commission's ex-post audit strategy*

5.37. 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 or 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.

5.38. In 2009, the research DGs of the Commission (DG RTD, DG INFSO, DG TREN and DG ENTR) entered into the third year of implementation of the FP6 common ex-post audit strategy and also launched the first audits under the ex-post audit strategy for FP7. The strategies are intended to assess the regularity of research expenditure and to provide the basis for corrective and recovery action.

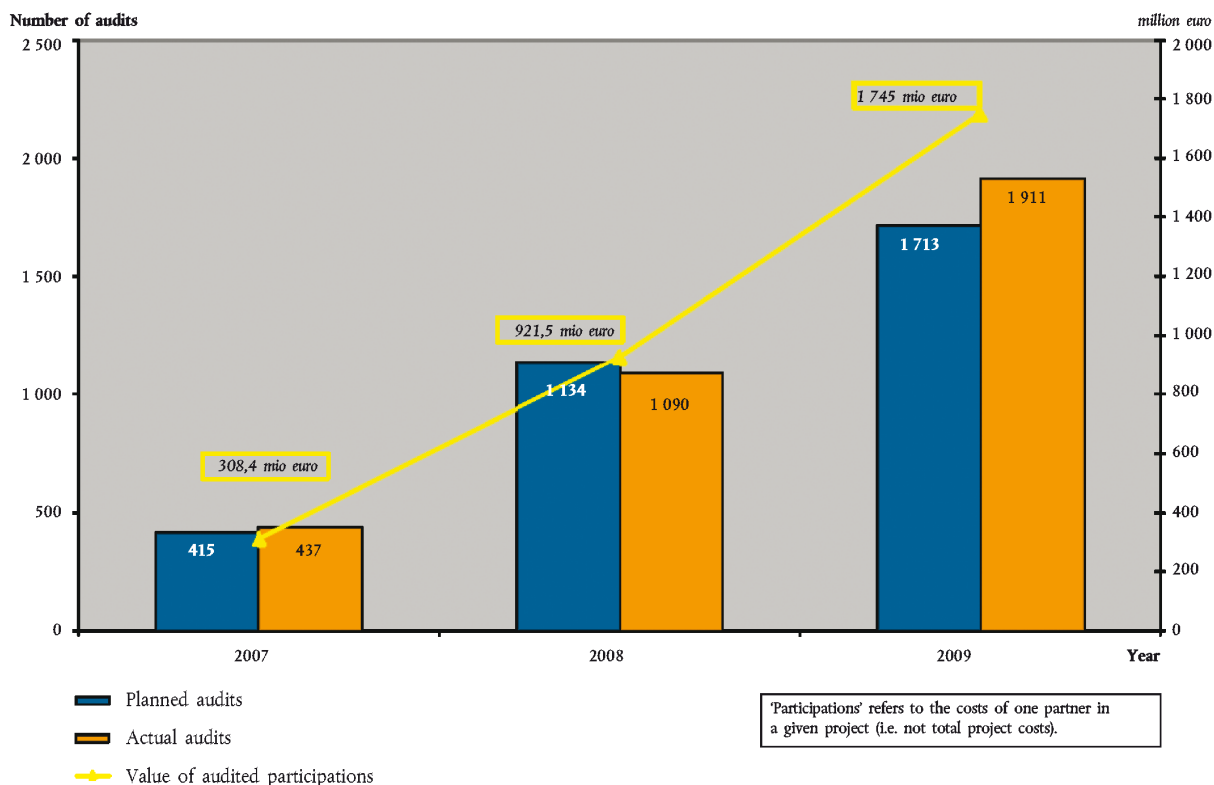
5.39. In 2009, the coverage of expenditure by ex-post audits continued to increase and the research DGs achieved the targeted number of audits for the year (**Graph 5.1**). The number of completed audits increased from 1 084 at the end of 2008 to 1 905 at the end of 2009.

5.40. The research DGs have continued their efforts to ensure a coherent approach and efficient coordination through joint working groups and committees. The introduction of new IT tools during 2009 is expected to further promote effective coordination. The integration of the Research and European Research Council Executive Agencies into the audit activities, together with the division of DG Transport and Energy into two DGs <sup>(7)</sup>, requires enhanced coordination efforts.

**5.40.** *The Commission welcomes the positive assessment of the progress made. It is fully aware of the required levels of co-ordination and is proceeding accordingly.*

<sup>(7)</sup> Since February 2010, DG TREN has been divided into DG for Mobility and Transport (DG MOVE) and DG Energy.



Graph 5.1 — Implementation of the Commission's common ex-post audit strategy <sup>(1)</sup>

<sup>(1)</sup> The previously published figures for 2007 and 2008 have been adjusted due to a change in the reporting criteria.

#### THE COURT'S OBSERVATIONS

### Systems related to recoveries and financial corrections

5.41. In 2008, the Court observed a significant backlog in the implementation of financial corrections following the ex-post audits. While the Commission considerably increased the amount of ineligible costs recovered during 2009, the outstanding recoverable amounts showed a similar increase and have almost tripled to 31,5 million euro (**Graph 5.2**).

#### THE COMMISSION'S REPLIES

5.41. Additional efforts will be undertaken in order to improve the timely implementation of audit results.

The recovery process in the framework of the implementation of the audit strategy has also been subject to simplification measures <sup>(3)</sup> in order to reduce the burden both for the Commission and the beneficiaries.

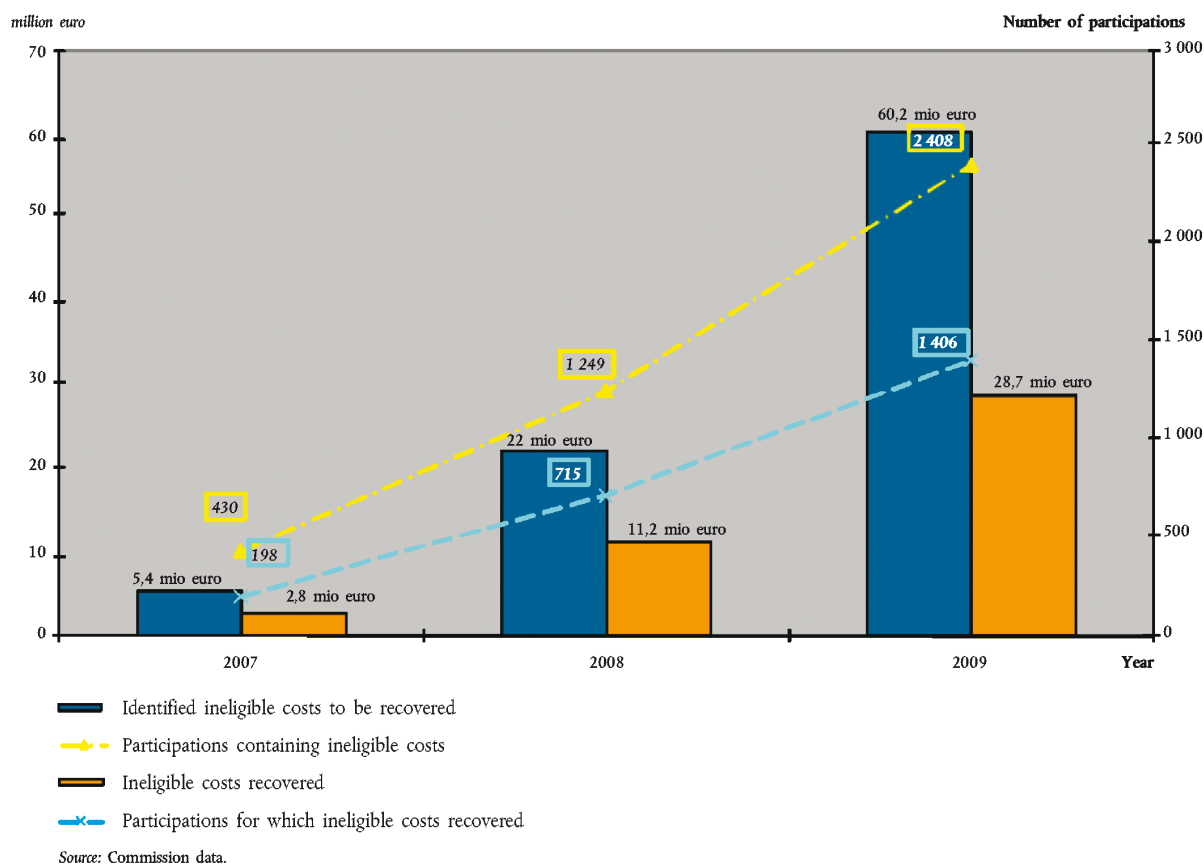
The performance of the recovery process has progressed significantly in 2009.

Most financial corrections are implemented by deducting the amount due from the next payment, which is the most cost-effective method of recovery. Since payments are usually made annually, this leads to a time lag in the recovery process.

The increased number of audits has multiplied the number of projects requiring corrections and adjustments.

<sup>(3)</sup> SEC(2009) 1720 of 15.12.2009.



Graph 5.2 — Implementation of financial corrections following audits <sup>(1)</sup>

<sup>(1)</sup> The previously published figures for 2007 and 2008 have been adjusted due to a change in the reporting criteria.

#### THE COURT'S OBSERVATIONS

5.42. The Court remarked in its 2008 Annual Report <sup>(8)</sup> that the Commission had not imposed any sanctions, 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>(9)</sup>. During 2009, the Commission took remedial action and all research DGs, with the exception of DG TREN, applied sanctions. By the end of 2009, the Commission had imposed penalties in 34 cases, amounting to 514 330 euro.

#### RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS

5.43. The Court assessed the Annual Activity Reports and accompanying declarations of the Directors-General for DG RTD, DG INFSO and DG TREN.

#### THE COMMISSION'S REPLIES

5.42. From their creation in mid-February 2010, DGs MOVE and ENER apply liquidated damages in the same way as other research DGs.

<sup>(8)</sup> Paragraph 7.39.

<sup>(9)</sup> Article 20 of Regulation (EC) No 2321/2002 of the European Parliament and of the Council (OJ L 355, 30.12.2002, p. 23).

## THE COURT'S OBSERVATIONS

5.44. The results of the review of these management representations are summarised in **Annex 5.3**. The Court found that the Directors-Generals' declarations and the annual activity reports give a fair assessment of financial management in relation to regularity.

## CONCLUSIONS AND RECOMMENDATIONS

5.45. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2009 for Research, Energy and Transport were affected by material error.

5.46. Based on its audit work, the Court concludes that the supervisory and control systems for policy group Research, Energy and Transport were partially effective in ensuring the regularity of payments.

5.47. These results are consistent with those of previous years. The main source of error in this policy group remains the reimbursement of overstated personnel and indirect costs to research projects.

5.48. In this context, the Court acknowledged in its 2008 Annual Report <sup>(10)</sup> the reduction in the level of error for this policy group over the last years, due to the reinforcement of the internal control systems and the changes aimed at simplifying the funding rules for research projects. The Court notes that this trend has continued in 2009. However, there is a risk that the positive effect of the changes may not continue under FP7, particularly due to difficulties in implementing the ex-ante certification of beneficiaries' costing methodologies (see paragraphs 5.20 and 5.36).

## THE COMMISSION'S REPLIES

5.44. *The Commission welcomes the positive assessment of the Court for all the Annual Activity Reports covered by this Chapter.*

5.45. *The Commission underlines that the Court's finding regarding the error rate is in line with the past year and that the most likely error rate for the policy areas covered in this Chapter lies between 2 and 5 %.*

*This result is in line with the Commission's own findings. On 26 May, the Commission adopted a Communication <sup>(4)</sup> proposing a tolerable risk of error level in this range (2 %-5 %). A DAS error rate around the middle of this range would, in the view of the Commission, be acceptable and justified. Beyond this level, additional action would be taken to reduce the error rate through increased controls addressing the major causes of error and taking into account the multi-annual nature of the expenditure. This rate should cover all Research Framework Programmes.*

*This level could be revised in the light of major changes in the control environment that would have an effect on the DAS error rate, in particular simplification actions taking effect in the next framework programme.*

5.48. *The Commission welcomes the positive trend noted by the Court. It underlines that the changes in audit certification requirements have been introduced to simplify and facilitate the participation of the beneficiaries.*

*Furthermore, whilst recognising the limited success of the ex-ante methodology certification, the full array of internal controls in place, including the FP7 audit strategy, will ensure the right conditions for sound financial management.*

<sup>(10)</sup> Paragraph 7.42.

<sup>(4)</sup> COM(2010) 261 final of 26.5.2010.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5.49. The Court encourages the Commission to continue its efforts to ensure rigorous application of effective control systems. In the context of the current legal framework, the Commission should:

(a) ensure that the independent auditors who have incorrectly certified cost statements are made aware of the eligibility criteria for declared costs;

(b) review the operation of the system for the certification of beneficiaries' costing methodologies;

(c) reduce the backlog in recovering undue amounts paid, imposing sanctions where necessary.

5.50. The research FPs have developed into complex funding mechanisms, for which the Commission has built up correspondingly weighty management and control systems. While proper accountability for the use of EU funds must remain the underlying principle, it is clear that there remains scope for further simplification of the research funding rules.

5.49. *The Commission's primary objective is to efficiently achieve the research policy objective, whilst ensuring sound control of the related budget implementation.*

(a) *The Commission pursues a policy of actively feeding back findings of ex-post audits to the beneficiaries in order to ensure - where necessary - improvements in the work of the auditors delivering audit certificates. To this effect every beneficiary is requested in the course of the audit procedure to inform the certifying auditor on material audit findings. The Commission observes, however, that the main cause of the Court's observations is not so much the design or concept of the audit certificate but rather the relative complexity of the rules, duly referred to by the Court under paragraph 5.16. This inherent complexity impacts the work performed by the external auditors mandated by beneficiaries to deliver audit certificates. For FP7 it is expected that with the reliance on agreed upon procedures, the degree of errors due to such misinterpretation will significantly decrease.*

(b) *The certification on the methodology (CoM) is intended only for beneficiaries of multiple grants. The eligibility criteria for the CoM were reviewed in November 2008 and published in the FP7 Guide to Financial Issues.*

*The Commission recently took action in order to reinforce the attractiveness of the ex-ante certification of beneficiaries costing methodologies. The Commission expressed its views in this respect in its Communication on simplification of 24 April 2010 as well as in its proposal for triennial revision of the Financial Regulation and its implementing rules adopted on 28 May 2010. Genuine simplification could be yielded by allowing methodologies applied as usual accounting practice as long as they are based on actual personnel costs registered in the accounts.*

(c) *The Commission will further pursue its efforts to improve the timely implementation of audit results and continue to apply its guidelines on the application of liquidated damages. Furthermore the communication on the simplification of the recovery process adopted on 15 December 2009 provides measures to improve the performance of the recovery process.*

5.50. *The Commission fully agrees and refers to the orientations developed in its recent Communications on 'Simplifying the Implementation of the Research Framework Programmes' and 'More or less controls? Striking the right balance between the administrative costs of control and the risk of error'.*

## THE COURT'S OBSERVATIONS

5.51. Therefore, the Court welcomes the Communication issued recently by the Commission <sup>(11)</sup>, putting forward further possibilities for the simplification of research funding rules and procedures, both for FP7 and for future FPs. The Commission's Communication should form the basis for discussions with all relevant stakeholders, leading to a comprehensive review of the management and control systems for EU research funding.

5.52. Simplification and clarification of rules and procedures may not only reduce the scope for error and increase assurance of the regularity of expenditure, but also facilitate the participation of researchers in the FPs and the achievement of EU research policy objectives.

5.53. A follow-up of previous observations is summarised in **Annex 5.4**.

## EU JOINT UNDERTAKINGS

5.54. Audits of the EU Joint Undertakings are the subject of Specific Annual Reports which are published separately.

5.55. The Court issued unqualified opinions on the reliability of the accounts and the regularity of the underlying transactions for the Joint Undertakings in the Research, Energy and Transport policy group in 2009 (see paragraphs 5.10 and 5.13).

5.56. While the audit opinions for the Joint Undertakings were unqualified, the Court has emphasised the need for the Joint Undertakings to build up robust and comprehensive internal control systems.

5.57. The Court has also issued Opinions on the Financial Regulations of the Fusion for Energy and SESAR Joint Undertakings <sup>(12)</sup>. The Court made several remarks in view of reinforcing the financial framework of the Joint Undertakings and ensuring consistency with the general EU Financial Regulation and the framework Financial Regulation for EU bodies. The Court also pointed out that the financial rules adopted by the Joint Undertakings do not make adequate provision as regards the powers of the Internal Audit Service of the Commission to perform audits of the Joint Undertakings.

<sup>(11)</sup> COM(2010) 187.

<sup>(12)</sup> Opinion No 4/2008 on the Financial Regulation of the European Joint Undertaking for ITER and the Development of Fusion Energy (Fusion for Energy) and Opinion No 2/2010 on the SESAR Joint Undertaking Financial Rules.

## THE COMMISSION'S REPLIES

**5.51.** *The full impact of these simplification measures will be felt mainly in the next Framework Programme. Until such proposals are implemented, the Commission needs to address the problems caused by complex eligibility rules for grant beneficiaries. On 26 May 2010 the Commission adopted a Communication proposing a tolerable risk of error in this area of between 2 and 5 % <sup>(5)</sup>. The tolerable risk level is established taking into account the cost-effectiveness of controls and an acceptable level of residual error that is justified in the light of these costs.*

**5.56.** *The Commission monitors the implementation of the action plans devised by the Joint Undertakings to fully deploy their internal control systems.*

**5.57.** *The Commission shares the Court's opinion that the IAS of the Commission should exercise the same powers over the bodies set up by the EU having a legal personality and receiving contributions from the budget pursuant to Article 185(3) of the general Financial Regulation as those which it exercises over Commission departments.*

<sup>(5)</sup> COM(2010) 261 final.

## ANNEX 5.1

## RESULTS OF TRANSACTION TESTING FOR RESEARCH, ENERGY AND TRANSPORT

	2009					2008	2007
	FP6	FP7	TEN	Other	Total		
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>							
Total transactions (of which):	35	71	16	28	<b>150</b>	150	180
Advances	0	58	9	19	<b>86</b>	82	59
Interim/Final payments	35	13	7	9	<b>64</b>	68	121
<b>RESULTS OF TESTING</b>							
<i>(in % and numbers of transactions)</i>							
Transactions not affected by error	49 % {17}	85 % {60}	81 % {13}	86 % {24}	<b>76 % {114}</b>	78 %	52 %
Transactions affected by error	51 % {18}	15 % {11}	19 % {3}	14 % {4}	<b>24 % {36}</b>	22 %	48 %
<b>ANALYSIS OF TRANSACTIONS AFFECTED BY ERROR</b>							
<i>(in % and numbers of transactions)</i>							
<b>Analysis by type of expenditure</b>							
Advances	0 % {0}	36 % {4}	0 % {0}	50 % {2}	<b>17 % {6}</b>	3 %	9 %
Interim/Final payments/Other	100 % {18}	64 % {7}	100 % {3}	50 % {2}	<b>83 % {30}</b>	97 %	91 %
<b>Analysis by type of error</b>							
Non-quantifiable errors	22 % {4}	27 % {3}	33 % {1}	25 % {1}	<b>25 % {9}</b>	27 %	29 %
Quantifiable errors	78 % {14}	73 % {8}	67 % {2}	75 % {3}	<b>75 % {27}</b>	73 %	71 %
comprising:							
Eligibility	21 % {3}	63 % {5}	0 % {0}	0 % {0}	<b>30 % {8}</b>	58 %	77 %
Occurrence	0 % {0}	0 % {0}	0 % {0}	0 % {0}	<b>0 % {0}</b>	0 %	3 %
Accuracy	79 % {11}	37 % {3}	100 % {2}	100 % {3}	<b>70 % {19}</b>	42 %	20 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>							
Most likely error rate:							
< 2 %							
2 % to 5 %	<b>X</b>					<b>X</b>	<b>X</b>
> 5 %							

## ANNEX 5.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR RESEARCH, ENERGY AND TRANSPORT

## Assessment of selected supervisory and control systems

System concerned	Desk checks before payment	Audit certification	Ex-post financial audits	Implementation of financial corrections	Overall assessment
Research Framework Programmes					

## Overall assessment of supervisory and control systems

Overall assessment	2009	2008	2007

## Legend

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

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR RESEARCH, ENERGY AND TRANSPORT

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
RTD	With a reservation	Rate of residual errors with regard to the accuracy of cost claims in the Sixth Research Framework Programme (FP6)	<p>The reservation is based on the residual error rate for FP6 cost claims, assessed by DG RTD as above 2 %. The reservation is in line with the Court's findings that the supervisory and control systems for research payments are partially effective and that the expenditure is subject to material error.</p> <p>While the amount at risk in respect of FP7 cost claims is assessed as not material in 2009 and therefore no reservation is made, DG RTD draws attention in its Annual Activity Report to the likelihood of material error affecting FP7 cost claims from 2010.</p>	A
INFSO	With a reservation	Rate of residual errors with regard to the accuracy of cost claims in the Sixth Research Framework Programme (FP6)	<p>The reservation is based on the residual error rate for FP6 cost claims, assessed by DG INFSO as above 2 %. The reservation is in line with the Court's findings that the supervisory and control systems for research payments are partially effective and that the expenditure is subject to material error.</p> <p>The amount at risk in respect of FP7 cost claims is assessed by DG INFSO as not material in 2009 and therefore no reservation is made. However, the Court has noted the potential material error in FP7 cost claims from 2010.</p>	A
TREN	With a reservation	Rate of residual errors with regard to the accuracy of cost claims in the Sixth Research Framework Programme (FP6)	<p>The reservation is based on the residual error rate for FP6 cost claims, assessed by DG TREN as above 2 %. The reservation is in line with the Court's findings that the supervisory and control systems for research payments are partially effective and that the expenditure is subject to material error.</p> <p>The amount at risk in respect of FP7 cost claims is assessed by DG TREN as not material in 2009 and therefore no reservation is made. However, the Court has noted the potential material error in FP7 cost claims from 2010.</p>	A

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity

B: The Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity

C: The Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity

## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR RESEARCH, ENERGY AND TRANSPORT

Court observation	Action taken	Court analysis	Commission reply
<b>1. Statements of Assurance 2007 and 2008: a material level of error in payments</b>			
<p>In 2007 and 2008, the Court detected substantive errors in 83 of the transactions audited. The main types of error were: overstatement of eligible personnel and indirect costs; declaration of other ineligible costs; inadequate supporting evidence to justify costs claimed; declaration of budgeted amounts rather than actual costs; and declaration of costs not attributable to the project.</p> <p>(2007 Annual Report, paragraphs 7.14 to 7.15; 2008 Annual Report, paragraphs 7.11 to 7.15)</p>	<p>In 12 cases, the Commission has concluded that no specific corrective action is necessary to remedy the errors identified by the Court.</p> <p>In 56 cases, the Commission has made financial corrections.</p> <p>In 14 cases, the Commission has initiated corrective action which remains to be completed.</p> <p>In one case, corrective action has not yet been initiated.</p>	<p>Although in five cases there have been significant delays in implementing corrective action, the Commission has generally taken appropriate measures in due time in order to follow up the Court's observations.</p>	
<b>2. Late payments by the Commission</b>			
<p>The Commission has incurred undue delays in making payments to beneficiaries, although in 2008 the Court observed that the Commission made considerable progress in reducing the delays in payments.</p> <p>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>In 2009, the Court found late payments in 10 out of 150 payments audited (i.e. 7 %).</p> <p>(2007 Annual Report, Annex 7.2; 2008 Annual Report, paragraph 7.16)</p>	<p>The Commission has improved the monitoring of delays, adapted its IT tools and streamlined procedures. Administrative management of payments has increasingly been delegated to the research Executive Agencies.</p>	<p>The Commission has maintained the improved performance which was noted in 2008. While there were significant improvements regarding payments to experts, further efforts are required to reduce payment delays for research grants, for which 30 % of payments were late in 2009.</p>	<p><i>The Commission welcomes the recognition by the Court of the progress made so far. The Commission is committed to pursuing these efforts to further improve its performance.</i></p>



## CHAPTER 6

**External aid, Development and Enlargement**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	6.1-6.17
Specific characteristics of the policy group	6.2-6.16
EuropeAid	6.3-6.7
DG RELEX	6.8-6.11
DG ELARG	6.12-6.14
DG ECHO	6.15-6.16
Audit scope and approach	6.17
Regularity of transactions	6.18-6.21
Effectiveness of systems	6.22-6.46
EuropeAid	6.23
DG RELEX	6.24-6.30
DG ELARG	6.31-6.40
DG ECHO	6.41-6.46
Reliability of Commission management representations	6.47-6.50
Conclusions and recommendations	6.51-6.55
Follow-up of Special Report No 3/2006 on the Humanitarian Aid Response to the Tsunami	6.56-6.67
Introduction	6.56-6.58
Follow-up of the recommendations	6.59-6.66
Conclusions	6.67
Follow-up of Special Report No 6/2006 on the Environmental Aspects of the Commission's Development Cooperation	6.68-6.88
Introduction	6.68-6.70
Follow-up of the recommendations	6.71-6.86
Conclusions	6.87-6.88

## THE COURT'S OBSERVATIONS

## INTRODUCTION

6.1. This chapter presents the Court's specific assessment of External Aid, Development and Enlargement, which comprises 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. Key information on the activities covered and the spending in 2009 is provided in **Table 6.1**.

**Table 6.1 — External aid, Development and Enlargement — Key information**

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
19	External relations	Administrative expenditure	415	Centralised direct
		Multilateral relations, cooperation with third countries in the areas of migration and asylum and general external relations matters	60	Centralised direct /
		Common foreign and security policy	316	Centralised indirect <sup>(1)</sup> / Joint
		European Instrument for Democracy and Human Rights (EIDHR)	123	Centralised direct
		Relations and cooperation with industrialised non-member countries	16	Centralised direct
		Crisis response and global threats to security	215	Centralised direct
		European Neighbourhood Policy and relations with Russia	1 469	Centralised direct / decentralised
		Relations with Latin America	308	Centralised direct / decentralised
		Relations with Asia, Central Asia and Middle Eastern countries	727	Centralised direct / decentralised / joint
		Policy strategy and coordination	24	Centralised direct
		<b>3 673</b>		
21	Development and relations with ACP States	Administrative expenditure	349	Centralised direct
		Food security	673	Centralised direct
		Non-State actors in development	181	Centralised direct
		Environment and sustainable management of natural resources, including energy	81	Centralised direct
		Human and social development	113	Centralised direct / joint
		Geographical cooperation with African, Caribbean and Pacific (ACP) States	256	Centralised direct / decentralised / joint
		Development cooperation actions and ad hoc programmes	30	Centralised direct
		Policy strategy and coordination	15	Centralised direct
		<b>1 698</b>		

<sup>(1)</sup> Aid provided through the European Development Funds is reported separately as it is not financed from the General Budget.

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
22	Enlargement	Administrative expenditure	91	Centralised direct
		Enlargement process and strategy	1 165	Centralised direct / indirect / Decentralised
		Post-accession financial support	43	Centralised direct / Decentralised
		Information and communication strategy	9	Centralised direct
			<b>1 308</b>	
23	Humanitarian aid	Administrative expenditure	28	Centralised direct
		Humanitarian aid	772	Centralised direct / Joint
			<b>800</b>	
Total administrative expenditure <sup>(2)</sup>			883	
Total operational expenditure (consisting of)			6 596	
— advances			4 079	
— interim/final payments			2 517	
<b>Total payments for the year</b>			<b>7 479</b>	
<b>Total commitments for the year</b>			<b>8 463</b>	

(1) 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.

(2) The audit of administrative expenditure is reported in Chapter 9.

Source: Annual Accounts 2009.

## THE COURT'S OBSERVATIONS

### Specific characteristics of the policy group

6.2. 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).

#### EuropeAid

6.3. Expenditure implemented by EuropeAid includes:

- (a) financial and technical assistance to, and economic cooperation with, countries in Asia and Latin America;
- (b) European neighbourhood policy, including the strategic partnership with Russia;
- (c) thematic programmes, including food security, non-state actors and local authorities, environment, health and education, democracy and human rights.

## THE COURT'S OBSERVATIONS

6.4. The majority of the expenditure is subject to direct centralised management by Commission services either from Commission Headquarters or at the EU Delegations <sup>(2)</sup> in the third countries concerned. Aid delivered through international organisations is subject to joint management.

6.5. Most of the payments are either advance or interim payments, while final payments represent not more than 20 % of the spending of the year.

6.6. Final payments are in general subject to greater risk to regularity than advance and interim payments. The latter are normally only required to comply with a limited number of conditions while final payments are usually conditional upon submission and validation of all expenditure actually incurred for the whole project.

6.7. Development projects are dispersed through more than 150 countries, and the implementing organisations vary greatly both in size and experience. To be eligible for EU support project are required to comply with complex rules including tendering and contract award procedures.

*DG RELEX*

6.8. Expenditure managed by DG RELEX mainly relates to actions implemented under the Common Foreign and Security Policy (CFSP), the Instrument for Stability (IfS) and the Industrialised Countries Instrument (ICI). The main objectives relate to: peace maintenance; the prevention of conflicts; the strengthening of international security and the promotion of EU interests with main industrialised and high income partners on foreign policy, economic integration and global issues.

6.9. The following management modes apply:

- (a) indirect centralised or joint management with international organisations for the Common Foreign and Security Policy;
- (b) direct centralised management for both relations and cooperation with industrialised non-member countries (Industrialised Countries Instrument) and;
- (c) direct centralised and joint management for crisis response and global threats to security (Instrument for Stability). Projects are implemented either by Headquarters or by Delegations.

## THE COMMISSION'S REPLIES

**6.8.** *Most of the actions under the IfS involve responding to situations of crisis or emerging crisis, as well as pre- and post-crisis capacity building.*

<sup>(2)</sup> After the entry into force of the EU Treaty as modified by the Lisbon Treaty the Commission Delegations became the European Union Delegations.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.10. In the case of the CFSP, the expenditure mainly relates to the operation of the European Security and Defence Policy (ESDP) through civilian missions established in various countries and territories usually subject to high political risk and instability. Similar risks apply to the Instrument for Stability.

6.11. As with EuropeAid, most of the expenditure managed by DG RELEX is implemented on the basis of either advance or interim payments. The latter are usually conditional upon the submission of evidence that a certain level of project implementation has been achieved based on the expenditure incurred, while final payments are conditional upon submission and validation of all expenditure actually incurred for the whole project.

*DG ELARG*

6.12. DG ELARG manages expenditure linked to the enlargement strategy and process mainly under the instrument for pre-accession assistance (IPA), the Phare programme including post-accession aid, CARDS <sup>(3)</sup>, and pre-accession financial assistance for Turkey.

6.13. A significant part of the expenditure is implemented on the basis of payments made directly to the national authorities in the beneficiary countries. As a rule the first transfer of funds is made upon signature of the national programmes concerned. The release of subsequent tranches is conditional upon the approval of a declaration stating that a certain percentage of the funds previously transferred has been already committed and that expenditure incurred is eligible for EU funding.

6.14. In general, payments are made on the basis of either direct 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.

*DG ECHO*

6.15. DG ECHO is responsible for the implementation of the EU's humanitarian aid-related expenditure under Council Regulation (EC) No 1257/96 <sup>(4)</sup> which it manages from Headquarters. Approximately one half of the appropriations committed are provided to NGOs (direct centralised management) and the other half to UN or other international organisations (joint management).

<sup>(3)</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>(4)</sup> OJ L 163, 2.7.1996, p. 1.

**6.10.** *In cases where the unstable political environment creates an increased level of risk, mitigating measures are put in place such as ex-post control missions to be carried out by Headquarters or Delegations in addition to the mandatory external audits organised by the beneficiaries in the framework of their contractual requirements.*

## THE COURT'S OBSERVATIONS

6.16. The advance and interim payments represent a significant proportion of the total expenditure. Due to their nature they bear a lower risk to regularity than final payments. They are normally only required to comply with a limited number of conditions, whereas final payments are conditional upon submission and validation of all expenditure actually incurred for the whole project.

### Audit scope and approach

6.17. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of External aid, Development and Enlargement, the following specific points should be noted:

- (a) a sample of 180 items was tested comprising 83 advances, 48 interim and 49 final payments;
- (b) an assessment was made of the effectiveness of the Commission's supervisory and control systems at Headquarters as well as in Delegations, including:
  - (i) ex-ante controls;
  - (ii) monitoring and supervision;
  - (iii) external audits <sup>(5)</sup>;
  - (iv) internal audit.

### REGULARITY OF TRANSACTIONS

6.18. Of the transactions affected by errors 26 % (six out of 23) contain quantifiable errors and the remaining 74 % were non-quantifiable (17 out of 23). The most likely error estimated by the Court for the audited domain lies between 2 % and 5 % (**Annex 6.1**).

6.19. The most significant errors identified concern:

- (a) quantifiable eligibility errors (e.g. essential conditions required not met, expenditure incurred outside the eligibility period, inclusion of ineligible expenditure in the project cost claims and irregularities in the tendering and contract award procedures carried out by implementing organisations); and
- (b) non-quantifiable errors (e.g. irregularities in procurement procedures, non-compliance with the contract award criteria as set out in the financing decisions to which they relate, lack of an adequate audit trail).

## THE COMMISSION'S REPLIES

**6.17.**

- (a) *The Commission notes that significantly more final payments were included in the 2009 sample than was the case in previous years.*

**6.18.** *The Commission welcomes the increase in the 'frequency' of transactions which the Court judges to be entirely 'regular' (at 87 %) in comparison with the figures for 2008 and 2007.*

<sup>(5)</sup> Ex-post controls as far as DG RELEX is concerned.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.20. Overall most of the errors identified are non-quantifiable and were detected at the level of EU Delegations.

6.21. Some of the errors detected were in interim payments and therefore will be subject to subsequent checks in the internal control process. However, the Court found errors in some final payments which had not been detected by the Commission's controls.

## EFFECTIVENESS OF SYSTEMS

6.22. The results of the examination of systems are summarised in **Annex 6.2**. The overall assessment of supervisory and control systems is that they are partially effective.

*EuropeAid*

6.23. As presented in the Court's annual report on the 8th, 9th and 10th European Development Fund (report on the EDFs), the assessment of EuropeAid's supervisory and control systems is that they are partially effective.

*DG RELEX*

6.24. Overall DG RELEX's supervisory and control systems are assessed as partially effective.

6.25. The assessment of DG RELEX's supervisory and control systems comprised a follow up of the systems assessment made in previous years and an examination of the results of the work of internal audit.

**Ex-ante controls**

6.26. The ex-ante controls procedures in DG RELEX were reinforced in 2009 through the introduction of new procedures and checklists, although it will only be possible to assess the effectiveness of the changes in future years. The Court notes, however, that certain previously identified weaknesses have not yet been remedied (e.g. the lack of ex-ante assessment on Common Foreign and Security Policy missions as required by Article 56 of the Financial Regulation).

6.20. *EU Delegations are responsible for the vast majority of payments on the Commission's external aid portfolio. For EuropeAid, 79 % of the EU budget's ongoing portfolio (outstanding commitments) was managed by Delegations in 2009.*

6.21. *The Commission believes that detective and corrective measures prior to final payments (e.g. submission of reports, external audits, expenditure verifications and transactional checks by Commission staff) are effective. In addition, potential irregularities can still be corrected ex-post through the launching of ex-post audits and appropriate recoveries. Nevertheless, controls cannot realistically reduce the risk of financial error to zero.*

6.22. *The Commission believes that the multi-annual supervisory and control systems for the External Aid, Development and Enlargement policy group are effective and have significantly improved year on year as reflected in the increase in the proportion of entirely regular payments found by the Court in its sample.*

6.23. *The Commission welcomes the Court's observation that 'EuropeAid has set up a comprehensive control strategy' and that 'in 2009 EuropeAid continued to bring significant improvements to the design and implementation of its supervisory and control systems' (see paragraph 54 of the Annual Report 2009 on the EDFs).*

6.24. *The Commission welcomes the Court's acknowledgement of the improvements recently introduced.*

6.26. *The new proposal for the revision of the Financial Regulation includes the acknowledgement that Article 56 assessments can only be undertaken progressively due to the specific nature of these missions which are created ad hoc and ex nihilo.*

*Regarding the CFSP procurement checklists, these have been finalised and are already in use.*

## THE COURT'S OBSERVATIONS

**Monitoring and Supervision**

6.27. The Court found continued weaknesses in respect of the monitoring and supervision component of the internal control system although improvements were noticed regarding closure of old contracts where activities had already been finalised (Rapid Reaction Mechanism, RRM). At year end 16 Rapid Reaction Mechanism files had not been closed and for 20 Common Foreign and Security Policy (CFSP) contracts for which the implementation deadline had already expired (for most of them in 2008) no final report had been received.

**Ex-post controls**

6.28. As for the ex-post controls, the Director General included in his Declaration of Assurance a significant reservation regarding their effectiveness over the operational budgets for the Common Foreign and Security Policy and the Stability Instrument based on the weaknesses identified by the Court in 2008 and by internal audit (see also paragraph 6.49).

6.29. Nevertheless the Court recognises that improvements were made in the operation of the ex-post control system by comparison with 2008. An ex-post control strategy was developed and implemented and an increased number of ex-post controls were carried out. The effectiveness of the changes can only be assessed in future years.

**Internal audit**

6.30. The internal audit function is assessed as generally effective. In 2009 the IAC worked at its full capacity and undertook audits of relevant and useful topics.

**DG ELARG****Ex-ante controls**

6.31. The ex-ante controls are assessed as partially effective. A material level of error found by the Court in the tender procedures managed by the National Paying Agencies (see paragraph 6.19(a)) were not prevented or detected and corrected by the EU delegations' ex-ante control.

6.32. The Court identified a number of weaknesses in the setting up and operation of the decentralised implementation system (DIS) for Croatia and Turkey. These include:

## THE COMMISSION'S REPLIES

**6.27.** *The Commission has indeed taken measures regarding the closure of old files (both for the RRM and the CFSP) already in 2009. These efforts will be continued throughout 2010.*

**6.28.** *The Director-General of DG RELEX established an Action Plan to follow-up on the reservation issued in the AAR 2009 and to improve the quality of assurance for 2010.*

**6.29.** *The Commission welcomes the Court's acknowledgement of the improvements introduced which have continued in 2010. The measures taken this year include an improved methodology for on the spot controls, the provision of training as well as improved guidelines for the documentation of results of ex-post controls.*

**6.31.** *The Commission considers the ex-ante controls both at headquarters and in the EU Delegations to be effective. As acknowledged by the Court, the Commission further improved its internal systems and completed the set of instructions. In the Annual Report 2008, the ex-ante controls were assessed as effective.*

**6.32.** *In 2009, DG ELARG continued to ensure compliance by the national authorities in Croatia and Turkey with the conditions of the (partial) conferral of management powers. It maintained the ex-ante controls by the Delegation in order to mitigate the risks.*

*Moreover the substantive transaction testing of the Court did not reveal any significant shortcomings beyond some lack of audit trail to explain fully the decisions taken by delegations.*



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(a) a need for more specific guidance for the 'conferral of management powers' <sup>(6)</sup> procedure to clarify better the roles of the different Commission actors in the process; and

(b) the evidence of the checks carried out by the delegation and presented to the Head of Delegation for operational endorsement of requests for funds is insufficient.

6.33. Weaknesses were also found in the centralised management by the Commission, including cases of insufficient documentation and rules not properly followed.

6.34. By the end of 2009 not all the instructions for closure and clearance of the PHARE and CARDS programmes (including the use of flat rate corrections) had been completed. In the meantime, DG ELARG has reduced, but not eliminated, the backlog of final declarations for PHARE and the Transition Facility in new Member States and delays still exist (up to five years).

#### Monitoring and supervision

6.35. The monitoring and supervision is assessed as effective. Nevertheless the Court noticed that weaknesses already identified in previous years have not yet been fully remedied.

6.36. These include the need for sufficient verification of the quality of the data entered in the management information systems (CRIS, i-Perseus) as evidenced by encoding errors detected in the course of the Court's transaction testing.

6.37. Furthermore the Court noticed that in decentralised management the results of the monitoring visits of EU Delegations to beneficiaries are not always recorded in a way which allows effective analysis and follow-up.

(a) As more countries are getting ready to apply for conferral of management, DG ELARG has updated its internal guidance note of 2008 to take account of lessons learned from conferrals of management in 2008 and provided further guidance in 2009 to all actors involved in the process. A full 'Conferral of Management guidance' document is currently in preparation in time for the applications which will be received in the next couple of years.

(b) The role of the Head of Delegation endorsing a request for funds is clearly specified in internal instruction notes issued by DG ELARG. The checks to be performed according to his instructions provide the necessary basis for endorsing a specific request for funds.

6.33. The points raised by the Court relate in essence to possible improvements of the audit trail but not to material errors in applying the rules. Most of them were dealt with at the beginning of 2010 through internal instructions and clarification notes.

6.34. Since the Financial Regulation and the Implementing Rules were modified in 2003, DG ELARG has always applied a procedure for clearance of accounts as required by this amended Financial Regulation. This procedure has been regularly updated and is now replaced by a more substantial consolidated 'Policy for clearance of accounts in decentralised management – Phare and Transition Facility' adopted in June 2010, which elaborated in much more detail how flat rate corrections for system weaknesses could be applied where needed (such as for the clearance-of-account of programmes under extended decentralised management).

In 2009 alone, DG ELARG closed 375 Final Declarations, i.e. a much higher number than new programmes launched. There remain some cases for which the contradictory procedure takes time and the closure may take several years to complete.

<sup>(6)</sup> Delegation of management power by the Commission in the context of the decentralisation process.

## THE COURT'S OBSERVATIONS

**Ex-post controls**

6.38. The ex-post controls are assessed as generally effective.

6.39. In 2009, DG ELARG developed a specific strategy to introduce ex-post audits of centrally managed projects. The new strategy will only be implemented from 2010 onwards.

**Internal audit**

6.40. The internal audit function is assessed as generally effective. In 2009 the IAC worked at its full capacity and undertook audits of relevant and useful topics.

**DG ECHO****Ex-ante controls**

6.41. The ex-ante controls are assessed as generally effective.

6.42. In the Court's opinion the financial circuits in place are sufficiently well designed to detect and to correct errors made by partners. However it noted that weaknesses identified during regular audits of the partners' systems are not always addressed by them in a timely manner, nor are they always taken into account during the annual review of the partner's accreditation. This reduces the reliance that the Commission can place on the effectiveness of the partners' internal control systems to prevent errors and irregularities.

6.43. In addition the generic nature of the objectives included in the financing decisions underlying the contracts makes difficult an informed assessment of the proposals submitted. Furthermore the documentation of the assessments made does not allow an overall comparison of the proposals submitted.

## THE COMMISSION'S REPLIES

**6.38.** The Commission considers that the ex-post controls for decentralised management are fully effective. It accepts that the ex-post control function for centralised management has not yet been fully launched.

*These further ex-post audits carried out by a separate horizontal unit and addressed in this section are only intended to provide the Authorising Officer by Delegation with an additional assurance over and above the requirements of the Financial Regulation.*

**6.39.** This new strategy adds an additional layer to give further assurance without being required by the Financial Regulation.

**6.42.** The audit results are available for and used in partner assessments. The partners' accreditation also receives input gathered from the monitoring of projects undertaken and gives consideration *inter alia* to financial, legal and operational aspects of the partner. The assessment and audits often result in recommendations for the partners to improve their systems of internal control. Therefore, many audit reports have directly led to changes in the status accorded to partners' control systems. The current system of audits and partners' assessment put in place by DG ECHO has resulted in a control system that gives a balanced and effective view of the partners' internal control systems that aids the prevention of errors and irregularities.

**6.43.** Although fully sufficient for the establishment of a financing decision, the objectives as set out in funding decisions for Humanitarian Aid must be seen together with the detailed information on identified needs, the proposed strategy for and the necessary components of a convincing response which are contained in the supporting document of the decision.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Monitoring and supervision**

6.44. Overall, the monitoring and supervision systems are generally effective. However, the Court notes that the Commission does not monitor the extent to which the 'Humanitarian Procurement Centres' <sup>(7)</sup> are used by the Framework Partnership Agreements partners despite the importance of these centres for reducing the risk of errors in procurement procedures.

**External audits**

6.45. The ex-post audit activity is assessed as effective. The Court confirmed that the progress made in 2008 continued although there is still room for improvement regarding the consolidation of the follow up of audit findings in particular those giving rise to the recovery of ineligible expenditure.

**Internal audits**

6.46. The internal audit function is assessed as generally effective. In 2009 the IAC worked at its full capacity and undertook audits of relevant and useful topics.

**RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS**

6.47. The results of the review of Commission management representations are summarised in **Annex 6.3**.

6.48. The Court recognises the improvement by all the DGs in the policy group in the quality of the information provided in their annual activity reports.

*With regard to the complexity of crises situations, the multitude of needs and the availability of other donors, the detailed needs to be addressed together with the specified response is set out in the proposals submitted by DG ECHO's partners pursuant the Commission's financing decision. The Commission considers that the project selection procedures put in place by DG ECHO reflects the specificities of humanitarian aid and provide high guarantees with regard to the quality of the aid delivered by ECHO partners. Nevertheless, the Commission accepts that the documentation of the proposal evaluation can be further improved, streamlined and standardised.*

**6.44.** *The Commission welcomes the Court's overall conclusion.*

*Concerning Humanitarian Procurement Centres (HPC) the Commission welcomes the recognition of their overall usefulness.*

**6.45.** *The Commission welcomes the Court's assessment and confirms its commitment to continuing improvement of its follow-up procedure.*

**6.48.** *The Commission carried out a survey to identify the success factors which influence the quality of annual activity reports. As a response to the factors identified, a number of measures were implemented in order to improve the quality of the evidence presented in support of the assurance and the readability of the reports. The Commission therefore welcomes the Court's positive assessment of the annual activity reports and will continue working towards improving them as a source of evidence for the DAS.*

<sup>(7)</sup> Not for profit organisations specialised in the technical and commercial management of supplies and services necessary for the implementation of humanitarian actions.

## THE COURT'S OBSERVATIONS

6.49. The Court agrees with the assessments made by the directors-general for DG RELEX (one reservation related to the ex-post controls on the operational budget for CFSP and Stability Instrument) and DG ELARG and DG ECHO (no reservations).

6.50. The results of the review of the representation made by the Director-General for EuropeAid are included in the report on the EDFs. The Court considers that the Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

## CONCLUSIONS AND RECOMMENDATIONS

6.51. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2009 for the External aid, Development and Enlargement were affected by material error.

6.52. Based on its audit work, the Court concludes that the supervisory and control systems for the External aid, Development and Enlargement were generally partially effective in ensuring the regularity of payments.

6.53. The following recommendations should be considered:

- (a) DG RELEX should consolidate its ex-post control methodology and promptly address the recommendations made by the internal auditor in that respect;
- (b) DG RELEX should devote sufficient resources to the analysis and closure of the old RRM and the CFSP contracts for which the implementation deadlines have already expired;
- (c) DG ELARG should provide more specific guidance for the 'conferral of management powers' procedure to clarify better the roles of the different Commission actors in the process;

## THE COMMISSION'S REPLIES

**6.50.** *The Commission welcomes the Court's finding that the EuropeAid Annual Activity Report is 'clear and informative, in particular through its use of quantitative indicators' (see EDF report, paragraph 50). The Commission believes that the qualitative and quantitative indicators set out in the four 'assurance' building blocks of the EuropeAid Annual Activity Report do indeed provide the necessary evidence to underpin the Director-General's statement of reasonable assurance and give an accurate assessment of financial management in EuropeAid in relation to regularity.*

**6.52.** *The Commission has designed its controls to cover the full lifecycle of its multiannual projects. It believes that these supervisory and control systems for the External aid, Development and Enlargement policy group are effective and have significantly improved year on year as reflected in the increase in the proportion of entirely regular payments found by the Court in its sample. The recommendations made by the Court in past years have been implemented and many of these improvements have been recognised by the Court, resulting in significant elements of the key control systems being judged 'effective'.*

**6.53.**

- (a) *The Commission accepts the recommendation of the Court and would like to specify that it is already taking measures to address all recommendations received regarding ex-post controls in DG RELEX.*
- (b) *The Commission agrees with the Court and would highlight that considerable efforts were already undertaken in 2009 in order to clear the backlog of old projects to be closed. In fact, 75 % of all RRM contracts open at the beginning of 2009 were closed by year-end. These efforts will continue throughout 2010.*
- (c) *As more countries are getting ready to apply for 'conferral of management', DG ELARG has updated its internal guidance note of 2008 to take account of lessons learned in 2008 conferrals of management and provided further advice in 2009 to all actors involved in the process.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- (d) DG ELARG should review its internal control checklists in order to document all the checks carried out;
- (e) DG ELARG should take measures to improve the quality of the data entered in its management information systems (e.g. regular analysis and verification of the quality of the data);
- (f) DG ELARG should develop and put in place mechanisms to facilitate the analysis and follow up of the results of the monitoring missions carried out;
- (g) DG ELARG should continue to devote sufficient resources to the analysis of the outstanding final declarations submitted under PHARE and the Transition Facility in the new Member States;
- (h) DG ECHO should improve the documentation of assessments of proposals for humanitarian aid actions (e.g. the introduction of standardised evaluation reports);
- (i) DG ECHO should define and put in place a mechanism for collecting and analysing the data concerning the use of the 'Humanitarian Procurement Centres' by its partners.

6.54. Recommendations regarding EuropeAid are included in the report on the EDF.

- (d) *The Commission has already taken the necessary steps to ensure that the checks carried out by staff in the operational and the finance and contract sections are documented in more detail.*
- (e) *There are regular checks on the quality of data in CRIS, in particular ahead of extracting relevant information for the Annual Activity Report. The IT management tool where data is entered also contains embedded controls of data quality. Moreover, the Commission is putting great emphasis on training of CRIS users.*
- (g) *Closures have been a priority for DG ELARG since 2007. In 2009 alone, DG ELARG closed 375 Final Declarations.*
- (h) *The Commission is already working to further improve and harmonise the centralised documentation of its assessment of proposals. The introduction of a standardised evaluation report is one of the options considered.*
- (i) *Although the Court's suggestion is useful the current priorities and resource constraints do not allow this recommendation to be pursued in the near future.*

6.54. *In response to the Court's recommendations EuropeAid will:*

- consider possible methodologies for an indicator of the estimated financial impact of residual error;*
- assess the cost-effectiveness of its controls in the context of the review of the Tolerable Risk of Error;*
- finalise and disseminate a Financial Management Toolkit for implementing organisations;*
- continue efforts to ensure correct and timely recording of audit information;*
- strive to improve the information technology systems supporting its audit work;*
- improve the design and screening of budget support payment criteria through revised guidelines and peer review processes (Quality Support Group);*
- implement a revised public finance management monitoring and reporting framework for budget support payments.*

6.55. A follow-up of previous observations is summarised in **Annex 6.4**.

## THE COURT'S OBSERVATIONS

**FOLLOW-UP OF SPECIAL REPORT No 3/2006 ON THE HUMANITARIAN AID RESPONSE TO THE TSUNAMI****Introduction**

6.56. In 2006, the Court of Auditors published Special Report (SR) No 3/2006 concerning the Commission's humanitarian aid response to the tsunami which followed the earthquake of 26 December 2004 off the west coast of Northern Sumatra. The audit covered the emergency response and the short-term rehabilitation work of the Directorate-General for Humanitarian Aid (DG ECHO) <sup>(8)</sup>.

6.57. In SR 3/2006, the Court made a number of recommendations, which were in effect all adopted by the Council and the Parliament. The Court recommended that the Commission should:

- (a) consider the role it could play in helping affected governments to manage donor coordination more effectively to ensure that needs are met;
- (b) clarify the roles of DG ECHO and DG Environment (Civil Protection Mechanism) so as to ensure a coherent approach;
- (c) consider a longer time frame for emergency operations (e.g. nine months rather than six months) in order to provide sufficient time for implementation;
- (d) strengthen its monitoring system in order to include the following elements: written feedback to partners following monitoring visits, development of comparative cost information, better explanation of the implementing arrangements and information on what has been done where;
- (e) take into account the difficulty to access to documentation of projects implemented by United Nations (UN) agencies in the context of the Financial and Administrative Framework Agreement.

6.58. In their responses to the Court's report the Council called on the Commission to support the coordination role of the UN Office for the Coordination of the Humanitarian Affairs (OCHA), and the Parliament insisted on the importance of linking short-term humanitarian aid with longer term rehabilitation and reconstruction.

---

<sup>(8)</sup> The longer term actions of the Commission in this area have been examined by the Court of Auditors in Special Report No 6/2008 concerning European Commission Rehabilitation Aid following the Tsunami and Hurricane Mitch.



## THE COURT'S OBSERVATIONS

**Follow-up of the recommendations**

6.59. In 2007, following a European Commission proposal on the 'European Consensus on Humanitarian Aid' (Consensus), a joint statement<sup>(9)</sup> was issued in order to boost the coordination and the promotion of best practices between Member States and the Commission. In 2008, the Commission drew up an action plan attached to the Consensus.

6.60. The Commission supports the leading role of UN OCHA in coordinating the humanitarian aid response. DG ECHO is a member of the OCHA Donor Support Group (ODSG) and in the period from 2007 to 2009 the Commission signed 43 contracts in the field of cooperation with OCHA for a total value of about 30 million euros.

6.61. The Commission aims to coordinate the EU aid modalities with those of the EU Member States through the Council Working Group on Humanitarian Aid and Food Aid (COHAFA) and the Humanitarian Aid Committee (HAC). The Commission has also improved the use of the '14 point system' for recording EU humanitarian aid funding, and in 2009 DG ECHO commissioned an overview study of the humanitarian donors' coordination system at field level<sup>(10)</sup>.

6.62. Following this line, during the years 2008 and 2009, DG ECHO shared with EU Member States and the European Parliament around 250 Situation Reports (SitReps) which are drafted by the field staff and present the humanitarian situation on the ground whilst a crisis is happening in a particular country or region.

6.63. In response to the Court's recommendation, in 2009 the Commission announced the migration of the Civil Protection Monitoring and Information Centre (MIC) from DG Environment to DG ECHO, this move becoming effective from February 2010.

6.64. The Commission put the emphasis on linking relief, rehabilitation and development (LRRD) rather than the prolongation of emergency operations, which it considered would require a significant change in the conception and legislative framework of EU external action policy as a whole. In this context, the regulatory framework has been improved and the Commission has taken measures to enhance cooperation between the humanitarian and development services and other assistance actors, particularly at field level and in situations of crisis and state fragility.

<sup>(9)</sup> European Council, Joint Declaration — The European Consensus on Humanitarian Aid (OJ C 25, 30.1.2008).

<sup>(10)</sup> Spaak, M. and Otto, R., Study on the mapping of donor coordination (Humanitarian Aid) at the field level, Channel research, July 2009.

## THE COURT'S OBSERVATIONS

6.65. The Commission aimed to address weaknesses identified in the monitoring system, principally by the stricter application of its internal control procedures and also by reviewing the monitoring guidelines. A more concrete approach has been adopted for the development of a comparative cost information system. DG ECHO is working on a global system of comparable unit costs which is expected to include a critical mass of actual unit cost data. Nevertheless, 'Cost Observed for Results' (COR), as the system is known, is only expected to be in use in the Hope/e-tool information technology platform as from 2012.

6.66. The Court has scrutinized the problem of access to the documentation of projects implemented by UN agencies in its Special Report No 15/2009 <sup>(1)</sup>.

## Conclusions

6.67. The Commission has taken the recommendations of the Court and the Discharge Authorities into account, though some concrete improvements to the monitoring system are still to be finalised. More specifically:

- (a) the Commission has endeavoured to ensure that donor coordination is more effective by means of the Consensus and action plan, its support for UN OCHA and its continuous interaction with Member States. The mid-term review of the Consensus action plan, due in 2010, should systematically present how the Commission makes the most of the five comparative advantages listed in the Consensus, relating to the coordination and complementarity of the humanitarian donors;
- (b) the migration of the MIC to DG ECHO is expected to properly address the question of the coherence of approach between the two EC services;
- (c) the new financing instruments introduced in 2007, namely the Development and Cooperation Instrument and the Stability Instrument, provide the Commission with tools to tackle the LRRD challenge by applying a policy mix in States emerging from crisis;

## THE COMMISSION'S REPLIES

**6.65.** *Design of the Cost of Observed Results (COR) model will start in 2011 once it has been built into an IT tool (Hope/e-tool). Following testing and data input it is expected that use of the model can be planned to start in 2012.*

**6.66.** *The Commission has fully supported the Court's requests for obtaining necessary supporting evidence from UN organisations, and this principle is clearly stipulated in the Financial and Administrative Framework Agreement (FAFA). Where the Commission is informed by the Court of difficulties encountered in this respect, it can approach its counterparts at the UN in order to find a solution and to ensure that the Court receives the information required.*

**6.67.**

- (a) *The Commission's mid-term review of the Consensus action plan is ongoing and final results should be available by year-end 2010.*
- (b) *Integration of the MIC is already giving rise to synergies such as the availability of real-time information at the onset of natural and other disasters and closer cooperation between DG ECHO's technical experts on the ground and Member State experts dispatched for Civil Protection activities.*
- (c) *The Commission welcomes the Court's recognition of the contribution of the new instruments to the transition process. To reinforce these efforts the Commission has established an interservice group on transition in order to foster a common view, coordinated approaches and common positions on policies for 'transition situations' where humanitarian, development and stabilisation instruments are present. The aim is to improve both policy and implementation of programmes on the ground and to contribute to the international policy debate on transition situations.*

<sup>(1)</sup> Special Report No 15/2009 concerning EU assistance implemented through United Nations organisations: Decision-making and monitoring.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(d) though the development of the COR system is a rigorous and promising exercise, its performance and results can be evaluated only after the system is fully implemented.

(d) *The Commission agrees with this statement by the Court and intends to be in a position to provide first results by the end of 2011.*

## FOLLOW-UP OF SPECIAL REPORT No 6/2006 ON THE ENVIRONMENTAL ASPECTS OF THE COMMISSION'S DEVELOPMENT COOPERATION

### Introduction

6.68. In 2006, the Court published Special Report (SR) No 6/2006 on 'The Environmental Aspects of the Commission's Development Cooperation' <sup>(12)</sup>. The audit examined both environmental programmes funded by the Commission and how it mainstreamed the environment into all its development cooperation.

6.69. The Court's 15 recommendations to the Commission, welcomed by the Council and the Parliament, covered three main areas: establishing a comprehensive strategy for the environment and following up its implementation, improving the effectiveness of environmental mainstreaming, and improving the effectiveness of environment projects.

6.70. In addition, the Parliament recommended that the Commission make greater use of the recognised expertise from Member States' national aid administrations and of private companies that have an established experience as partners of these administrations in managing environmental projects in the context of national development cooperation programmes <sup>(13)</sup>.

### Follow-up of the recommendations

6.71. Following the Court's Special Report, the Commission services prioritised the drawing up of a new comprehensive environment strategy and produced a draft outline strategy by the end of 2006. However, changes in Commission priorities delayed subsequent work on the strategy so that it was only in April 2009 that elements for developing the new strategy were presented in a Commission Staff Working Paper <sup>(14)</sup>. The Council welcomed this document and in June 2009 invited the Commission to prepare an overall EU strategy document for 2011. As at March 2010, the Commission and Member States were at an early stage of developing the work programme for drawing up the new strategy.

6.71. *The delay in preparing the strategy was due to a change in priorities whereby the environment strategy was no longer to be issued as a stand-alone communication, but as an annex to a wider communication on mainstreaming all cross-cutting issues (not only environmental), scheduled to be adopted by the end of 2008. This approach was proposed with a view to reducing the number of Commission communications. However, this new approach was eventually dropped because of difficulties in putting different mainstreaming subjects together in one document and out of recognition of the need to have a more focused approach on the environment. A meeting with the Member States (and civil society) took place in September 2009 to jointly start the preparation of the new strategy.*

<sup>(12)</sup> OJ C 235, 29.9.2006, p. 1.

<sup>(13)</sup> Paragraph 233 of the Parliament's discharge resolution (OJ L 187, 15.7.2008, p. 50).

<sup>(14)</sup> 'Improving Environmental Integration in Development Cooperation'. (SEC(2009) 555, 21.4.2009).

## THE COURT'S OBSERVATIONS

6.72. In September 2006 the Commission established an operational framework for preparing its new environment strategy by setting up an interservice group led by DG Development and consisting of representatives of the relevant Directorates General. The Commission requested technical assistance to identify possible environmental integration performance indicators for use in the new environment strategy in 2006. A full assessment of the Commission's environmental integration performance was eventually made by the technical assistance for the first time in 2009 according to the indicators and methodology developed.

6.73. No specific review has been carried out by the Commission to assess its in-house capacity to implement its environment strategy. The Commission's approach to increasing capacity has been mainly through its substantial training programme and the issuing of more detailed guidance for its staff. In addition, key units at Commission headquarters have had limited staff increases, mostly in order to work on climate change in the context of development cooperation.

6.74. Staff guidance for integrating environmental issues in development aid was issued at the end of 2006 and then updated in 2009 to take better account of climate change. However, a 2009 review carried out by consultants for EuropeAid found that there was scope for further improving the integration of the environmental aspects at the project formulation stage in approximately 50 % of the projects examined.

6.75. Significant numbers of Commission staff have received training on the environmental aspects of development cooperation and the Commission has invested substantial funding for this purpose. This training has been made compulsory since 2009 for operational staff in EuropeAid although not for DG Development and DG External Relations.

6.76. The Commission has not yet carried out an overall evaluation of its environmental assistance covering both programmes and mainstreaming. A central database of all individual environment projects evaluated has also still to be put in place. While the environmental aspects of the Commission's project monitoring system have been expanded, no assessment of these monitoring reports from an environmental perspective has been made.

## THE COMMISSION'S REPLIES

**6.72.** *Key quantitative indicators in relation to the existing environmental integration strategy were put in place — as requested by the Court — and have been subject to monitoring since 2006. These indicators relate to the application of tools such as environmental profiles in the preparation of country and regional strategies, and environmental assessments in relation to programmes and projects, the amount of training offered and number of staff trained. As far as qualitative indicators to evaluate environmental integration in project formulation are concerned, these were defined and applied in a first pilot, ex-post assessment carried out in 2009.*

**6.73.** *In the context of the Commission's 'zero growth' staffing policy, and as acknowledged by the Court, EuropeAid has put the emphasis on strengthening non-specialist staff skills rather than carrying out a specific review of its in house capacity. It has been implementing this approach consistently during the reference period.*

**6.74.** *The ex-post review — which was a pilot exercise — was part of a drive towards continuous improvement at the project formulation stage.*

**6.75.** *Environmental mainstreaming training is now compulsory for all EuropeAid Headquarters operational staff and for all EuropeAid operational staff departing for delegations. This was one of the best-attended training courses during 2009 with more than 400 participants. A large programme of training seminars has been carried out since 2005, including some 50 regional seminars held in cooperation countries and a larger number delivered at Headquarters.*

**6.76.** *An evaluation of environmental mainstreaming in development cooperation is planned for 2011. A central database of individual project evaluations is currently under development and will be operational in 2011. Result-oriented monitoring (ROM) assessment reports focusing on environmental projects were carried out for Latin America in 2005 and 2009. Country-wide evaluations of EC cooperation have addressed environmental aspects as part of cross-cutting issues.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

6.77. The Commission has taken steps to improve the identification of environment-related projects but it is still not able to accurately assess the amount of environment-related expenditure. For climate-relevant projects it has introduced a system for making approximate estimates of expenditure but this has not been done for other areas, notably biodiversity and desertification.

6.78. Country Environmental Profiles (CEPs) have been prepared for nearly all Country Strategy Papers (CSPs) and annexed to them and a specific section on the environment is included in the CSP itself. Nevertheless, the quality of CEPs is variable and their influence on the overall CSP still generally limited. The guidelines for the mid-term review of CSPs, which was being carried out at the time of this follow-up exercise, aim to increase the attention given to the environment in CSPs and have placed a particular priority on including climate change issues in the revised CSPs.

6.79. The Commission has established guidance for integrating environmental issues in budget support operations. In practice, however, environmental conditionality and indicators are still rarely included in budget support programmes and in only a few cases have Strategic Environmental Assessments been carried out.

6.80. Although the Commission guidelines have established specific procedures for the environmental screening of all projects, EuropeAid has left it to Delegations to decide whether they set up environmental focal points to check these procedures. Due to staffing limitations, EuropeAid's own environmental specialists cannot review the environmental screening of all project proposals.

6.81. The Commission has also established guidelines on carrying out Environmental Impact Assessments (EIAs) during the project formulation stage as well as on follow up of the recommendations of EIAs. However, according to the 2009 EuropeAid review referred to in paragraph 6.74, the requirement for EIAs is still not always met.

6.82. For the environment thematic programme<sup>(15)</sup>, Delegations have an increased role in the evaluation of the project proposals. As regards CSP projects, the Environmental Integration Manual contains guidelines intended to ensure that local conditions are taken into account in the project's design.

*6.77. EuropeAid has improved its capacity to identify and track expenditure on environmental projects, but it remains a very complex task to calculate exact amounts allocated to environmental objectives within actions that primarily target other policy goals. Discussions with OECD/DAC are ongoing to see how qualitative data based on Rio markers can best be turned into financial data.*

*6.78. The quality of Country Environmental Profiles (CEPs) and their influence on Country Strategy Papers (CSPs) is indeed still variable but some CEPs are being updated on the basis of the environment integration guidelines and in order to better address climate change issues, while the guidelines for the mid-term review have also led to greater consideration of environment and climate change issues in the CSPs, especially in the countries covered by the Development Cooperation Instrument.*

*6.79. New Budget Support guidelines will be issued in 2011 and will include new guidance on cross-cutting issues. However, notwithstanding the inclusion of specific environmental indicators, policy dialogue on environmental issues takes place in many countries within the Joint Donor Frameworks that follow General Budget Support operations. Strategic Environmental Assessments require consideration of local context and the engagement of partner countries in order to be effective and therefore cannot be imposed.*

*6.81. EuropeAid has developed information notes and guidance documents which make references to supporting community-based natural resources management among other aspects. A number of EC programmes have promoted natural resources management initiatives at local level. The Thematic Programme for the Environment and Sustainable Management of Natural Resources, including Energy, makes specific reference to working with local communities and this was taken up in calls for proposals inviting concept notes that took into account 'securing tenure and rights of local communities, including indigenous populations' in the context of forest governance.*

<sup>(15)</sup> Environment and Sustainable Management of Natural Resources including Energy Thematic Programme (ENRTP).

## THE COURT'S OBSERVATIONS

6.83. As part of the process of simplifying the Commission's financial management, changes were made to the Financial Regulation and Practical Guide with the aim of making procurement procedures easier and faster to apply.

6.84. The need to pay attention to helping local communities find sustainable ways of using local natural resources is referred to in EuropeAid's environmental guidelines, but no specific guidance has been provided on how to do this.

6.85. No overall assessment has been made by the Commission on the effectiveness of different aid instruments in supporting the environment. EuropeAid is, however, completing a study on developing sector-wide approaches and is also addressing the possibility of creating EU Trust Funds which could be used to support the environment.

6.86. The Commission has continued to use the expertise of Member States and private companies to implement its environment programmes and has increased the possibilities for the private sector to participate in the ENRTP.

## Conclusions

6.87. The Commission has made significant progress in implementing the Court's wide-ranging recommendations. This is particularly the case in relation to building in-house capacity through providing training and guidelines to staff. Nevertheless, a 2009 EuropeAid review pointed to weaknesses in the implementation of some of the new environmental mainstreaming procedures.

6.88. There are several areas where more work has to be undertaken to fully implement the recommendations. A new comprehensive environment strategy is still being developed but needs to be ready by 2011 in order to be used in the next programming exercise. This strategy has to be supported by further work on environmental performance indicators and the overall evaluation of the effectiveness of environmental mainstreaming and programmes, including the role of different instruments. Greater attention also has to be paid to mainstreaming environmental issues into budget support programmes.

## THE COMMISSION'S REPLIES

**6.84.** EuropeAid has developed a number of information notes to promote sustainable development with emphasis on community-based approaches. In addition, the Environment Thematic Programme makes specific reference to working with local communities, and this was among other things taken up in calls for proposals inviting concept notes that took into account 'securing tenure and rights of local communities, including indigenous populations' in the context of forest governance.

**6.85.** The EC study on sector-wide approaches in environment and natural resources has now been completed in close cooperation with a number of EU development agencies and a few EC sector policy support programmes in this area are now under way. This is clearly a new development with respect to the past. The establishment of EU Trust Funds may now become possible under the proposal for a revision of the Financial Regulation and Transfer Agreements have been put in place to allow EU Member State contributions to the EC-managed Global Climate Change Alliance (GCCA). Innovative financing mechanisms for the environment also include the establishment of private-public partnerships and the blending of loans and grants.

**6.86.** The Commission has continued to make use of Member States' and private companies' expertise in implementing its environmental strategy.

**6.87.** The Commission welcomes the recognition of the significant progress made in mainstreaming environmental issues in the Commission's external aid portfolio. The ex-post review — which was a pilot exercise — was part of a drive towards continuous improvement. This process included the revision of the peer review (Quality Support Group) procedures introducing clearer indications on addressing environmental aspects in the preparation of project proposals.

**6.88.** The Commission and EU Member States are working jointly to produce a first draft environment strategy at the beginning of 2011, for adoption in the second half of 2011.

The Commission intends to carry out further work on indicators to monitor the effectiveness of a new environment strategy and to assess environmental integration in its operations. An overall evaluation of environmental mainstreaming in development cooperation is planned for 2011. If the results of the evaluation are available on time, they will be fed into the design of the new EU strategy. New Budget Support guidelines are also planned for 2011 and will include new guidance on cross-cutting issues. In carrying out this work the Commission will continue to seek close coordination and harmonisation with EU Member States, in support of the aid effectiveness agenda.

## RESULTS OF TRANSACTION TESTING FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

	2009										2008	2007
	EuropeAid		RELEX		ELARG		ECHO		Total			
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>												
Total transactions (of which):	117		11		38		14		180		180	145
Advances	57		2		13		11		83		71	46
Interim/Final payments	60		9		25		3		97		109	99
<b>RESULTS OF TESTING</b>												
<i>(in % and numbers of transactions)</i>												
Transactions not affected by error	90 %	{105}	91 %	{10}	79 %	{30}	86 %	{12}	87 %	{157}	73 %	74 %
Transactions affected by error	10 %	{12}	9 %	{1}	21 %	{8}	14 %	{2}	13 %	{23}	27 %	26 %
<b>ANALYSIS OF TRANSACTIONS AFFECTED BY ERROR</b>												
<i>(in % and numbers of transactions)</i>												
<b>Analysis by type of expenditure</b>												
Advances	33 %	{4}	0 %	{0}	0 %	{0}	0 %	{0}	17 %	{4}	19 %	19 %
Interim/Final payments	67 %	{8}	100 %	{1}	100 %	{8}	100 %	{2}	83 %	{19}	81 %	81 %
<b>Analysis by type of error</b>												
Non-quantifiable errors	67 %	{8}	100 %	{1}	88 %	{7}	50 %	{1}	74 %	{17}	60 %	73 %
Quantifiable errors	33 %	{4}	0 %	{0}	12 %	{1}	50 %	{1}	26 %	{6}	40 %	27 %
comprising:												
Eligibility	100 %	{4}	n.a.	{0}	100 %	{1}	100 %	{1}	100 %	{6}	79 %	100 %
Occurrence	0 %	{0}	n.a.	{0}	0 %	{0}	0 %	{0}	0 %	{0}	21 %	0 %
Accuracy	0 %	{0}	n.a.	{0}	0 %	{0}	0 %	{0}	0 %	{0}	0 %	0 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>												
Most likely error rate:												
< 2 %												
2 % to 5 %	X										X	X
> 5 %												

## ANNEX 6.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

## Assessment of selected supervisory and control systems

System concerned		Key internal controls (Commission)				Overall assessment
		Ex-ante controls	Monitoring and supervision	External audits	Internal Audit	
EuropeAid <sup>(1)</sup>	HQ					
	DEL				N/A	
DG RELEX				(?)		
DG ELARG				(?)		
DG ECHO						

<sup>(1)</sup> This assessment corresponds to the one published in the report on the EDFs.

<sup>(2)</sup> Ex-post controls.

## Overall assessment of supervisory and control systems

Overall assessment	2009	2008	2007

## Legend:

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

## ANNEX 6.3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

Main DGs concerned	Nature of declaration given by Director-general (*)	Reservations given	Court observations	Overall assessment of reliability
EuropeAid	without reservations	N/A	EuropeAid has set up a comprehensive control strategy and continued to bring significant improvements to the design and implementation of its supervisory and control systems. However, the Court's audit found that there remain weaknesses in certain controls and that the payments were affected by material error.	B
RELEX	with reservations	Significant weaknesses concerning inadequate mitigating controls to provide an assurance on expenditure managed by CFSP missions and important weaknesses concerning the adequacy of ex post controls to provide an additional assurance to complement other elements of the control system.	Important shortcomings identified in respect of the ex-post controls component of DG RELEX's supervisory and control systems for ensuring the regularity of the transactions still remain to be overcome.	A
ELARG	without reservations	N/A		A
ECHO	without reservations	N/A		A

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity.

B: The Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

C: The Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity.



## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

Court observation	Action taken	Court analysis
<b>External relations and development</b>		
1. <i>Monitoring of, and support to, organisations in charge of the implementation of EU-funded projects</i>		
Regarding ex-ante checks, weaknesses were noted including insufficient monitoring of, and support to, organisations in charge of the implementation of EU-funded projects.  (2008 Annual Report, paragraphs 8.22 and 8.35)	Preparation of a Financial Management Toolkit for implementing organisations.	See report on the EDFs, Annex 4, row 2.
2. <i>Budget support payments</i>		
Regarding ex-ante checks, weaknesses were noted in the case of budget support payments in the processes for verifying the fulfilment of the payment conditions.  (2008 Annual Report, paragraph 8.22)	Widespread awareness throughout the Commission's services of the need to ensure a more structured and formal approach when assessing budget support payments including the strengthening of the role of verification by finance and contracts staff in the payment approval process.	See report on the EDFs, Annex 4, row 9.
3. <i>System of external audits</i>		
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.  (2008 Annual Report, paragraphs 8.23 and 8.24)	Reforms introduced since 2007 to the audit methodology in place complemented by a substantial revision of the annual audit plan methodology.	See report on the EDFs, Annex 4, row 3.
4. <i>Risk management process</i>		
The risk management process was found to be partially effective.  (2008 Annual Report paragraph 8.23)	Continuing efforts to raise awareness of the risk management process.	The risk management process was assessed as being overall effective.



Court observation	Action taken	Court analysis
5. <i>Ex-post controls</i>		
<p>Important shortcomings were identified in respect of the ex-post controls component of the DG RELEX's supervisory and control systems for ensuring the regularity of transactions.</p> <p>(2008 Annual Report, paragraph 8.25)</p>	<p>Close monitoring of the implementation of the ex-post controls annual plans.</p>	<p>Notwithstanding the efforts and the progress made so far there are still important weaknesses to overcome.</p>
<b>Enlargement</b>		
6. <i>IAC</i>		
<p>It was noted that the multiannual programme of the IAC was not sufficiently developed.</p> <p>(2008 Annual Report, paragraph 8.27)</p>	<p>IAC in 2009 developed a multiannual programme of its activities.</p>	<p>The Court considers this observation duly addressed by DG ELARG.</p>
7. <i>Ex-post controls of centrally managed projects</i>		
<p>It was noted that DG ELARG did not have a specific strategy for the ex-post controls of centrally managed projects.</p> <p>(2008 Annual Report, paragraph 8.27)</p>	<p>During 2009 DG ELARG developed the strategy for the ex-post control of centrally managed projects.</p>	<p>The Court welcomes the initiative of DG ELARG, but the new strategy will be put in practice only in 2010 and still need to prove its effectiveness.</p>
8. <i>Potential irregularities in the management of Phare funds by two agencies in Bulgaria</i>		
<p>It was noted that fundamental weaknesses remained concerning potential irregularities in the management of Phare funds by two agencies in Bulgaria.</p> <p>(2008 Annual Report, paragraph 8.28)</p>	<p>During 2009 and following corrective actions from the Bulgarian authorities, DG ELARG lifted the suspension of payments to Bulgaria.</p>	<p>DG ELARG still need to devote a special attention to the follow-up of the implementation of the post-accession funds in Bulgaria.</p>
<b>Humanitarian aid</b>		
9. <i>IAC</i>		
<p>In 2008 the IAC did not operate yet in its full capacity due to the transferral of activities from EuropeAid's IAC.</p> <p>(2008 Annual Report, paragraph 8.29)</p>	<p>During 2009 IAC was properly staffed and implementing a full year working programme.</p>	<p>DG ECHO's IAC is functioning properly and providing assurance to DG ECHO's Director-General.</p>



## CHAPTER 7

**Education and Citizenship**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	7.1-7.8
Specific characteristics of the policy group	7.2-7.5
Audit scope and approach	7.6-7.8
Regularity of transactions	7.9-7.13
Effectiveness of systems	7.14-7.16
Reliability of Commission management representations	7.17
Conclusions and recommendations	7.18-7.21

## THE COURT'S OBSERVATIONS

## INTRODUCTION

7.1. This chapter presents the Court's specific assessment of Education and Citizenship which comprises policy areas 15 — Education and Culture, 16 — Communication; and 18 — Freedom, Security and Justice. Key information on the activities covered and the payments in 2009 is provided in **Table 7.1**.

Table 7.1 — Education and Citizenship — Key information

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
15	Education and Culture	Administrative expenditure	118	Centralised direct
		Lifelong learning, including multilingualism	1 154	Centralised indirect
		Developing cultural cooperation in Europe	52	Centralised indirect
		Encouraging and promoting cooperation in the field of youth and sports	144	Centralised indirect
		Fostering European Citizenship	28	Centralised indirect
			<b>1 496</b>	
16	Communication	Administrative expenditure	109	Centralised direct
		Communication and the media	35	Centralised direct
		Going Local communication	39	Centralised direct
		Analysis and communication tools	21	Centralised direct
			<b>204</b>	
18	Freedom, Justice and Security	Administrative expenditure	64	Centralised direct
		Solidarity — External borders, visa policy and free movement of people	270	Shared / Centralised direct
		Migration flows — Common immigration and asylum policies	254	Shared / Centralised direct
		Fundamental rights and citizenship	34	Centralised direct
		Security and safeguarding liberties	52	Centralised direct
		Justice in criminal and civil matters	50	Centralised direct
		Drugs prevention and information	16	Centralised direct
		Policy strategy and coordination	4	Centralised direct
			<b>744</b>	
Total administrative expenditure <sup>(1)</sup>			291	
Total operational expenditure (consisting of):			2 153	
— advances			1 881	
— interim/final payments			272	
<b>Total payments for the year</b>			<b>2 444</b>	
<b>Total commitments for the year</b>			<b>2 788</b>	

(1) The audit of administrative expenditure is reported in Chapter 9.  
Source: Annual Accounts 2009.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Specific characteristics of the policy group**

7.2. The three budget titles in this policy group 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 (EACEA), 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.

7.3. 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 education and training organisations, but also by other non profit organisations, private firms and public administrations. The final beneficiaries of mobility actions 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, mostly, shared with Member States.

7.4. The funding in this policy group mostly includes advances to traditional EU agencies and National Agencies, in addition to quarterly contributions to their operating costs. Payments to National Agencies are made after the signature of a contract or acceptance of a work programme, or in the case of most second and third pre-financings, 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 for receiving advance payments means that the risk of error is very low. The risk of error for interim and final payments is considered higher than for advance payments. Interim and final payments are based on actual costs to be reimbursed, so there is a risk that ineligible, overstated or unsubstantiated costs are included in beneficiaries' cost declarations and not detected by the managing body or the Commission.

*7.4. In the policy area Education and Culture, the Commission has set up its supervisory and control system based on a single audit approach with primary controls at the level of the National Agencies, secondary controls performed by the National Authorities and supervisory controls at Commission level.*

*In order to minimise the risk of ineligible expenditure on final payments DG EAC has extended the use of lump sums and flat rate grants in the present generation of programmes.*

*Controls have also been imposed at the level of National Agencies, notably on-the-spot checks, desk-checks and audits with minimum requirements based on risk assessment.*

<sup>(1)</sup> Having a contractual relationship with the Commission.

## THE COURT'S OBSERVATIONS

7.5. The National agencies enter into grant agreements with participating organisations<sup>(2)</sup>, and use the Commission advances they have received to make 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 three years, leading to final reports and closures between the National agency and beneficiaries. The National Agency submits to the Commission a Yearly National Agency Report that contains the financial reports for all open agreements between the Agency and the Commission. After all projects funded from the budget of a given year have been closed, the National agency submits a consolidated final report to the Commission as part of the Yearly National Agency Report concerned. The Commission closes the agreement with the Agency by approving the report, calculating the final balance and making the settlement payment or recovery.

**Audit scope and approach**

7.6. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of Education and Citizenship, the following specific points should be noted:

- (a) a sample of 120 closures of programmes and projects at Commission level was tested of which 78 related to the closure of programmes and projects for the 2000 to 2006 period;
- (b) a sample of 30 advances paid in 2009 was tested separately;
- (c) the assessment of systems was focused on systems for closures of programmes and projects made by the Commission;
- (d) the annual activity reports and accompanying declarations for DGs EAC and JLS were assessed.

## THE COMMISSION'S REPLIES

7.5. *The Yearly National Agency Reports allow the Commission to have a full overview on a yearly basis of the state of implementation of the programme and the management and controls carried out by the National Agencies.*

*The information contained in the Yearly National Agency Reports is certified each year by the National Authority of the country concerned in the framework of its Declaration of Assurance to the Commission.*

7.6.

- (a) *The benefit of the current generation of programmes 2007-2013 with simplified rules and extensive use of lump sum financing should reduce the risks linked to final payments.*

<sup>(2)</sup> Participating organisations are usually universities, schools or colleges, who manage payments to beneficiaries such as students or teachers.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

7.7. For DAS 2009 the Court has focused the audit on the underlying expenditure incurred and approved by the Commission. This audit included on-the-spot visits to final beneficiaries such as state border guards in Member States, refugee centres, cultural institutes and universities administering payments to students and teachers in order to assess the correct calculation and compliance with the relevant rules and regulations for the expenditure. The audit of a sample of transactions underpinning closures provides a fuller picture of the financial management at Commission and Member State level in this policy group than would be obtained by examining a large number of advances, for which the risk of error is very low (based on the Court's previous audits) as at the point of closure it becomes clear whether expenditure has been incurred in accordance with the conditions of the scheme concerned. As such, the audit approach differs from last year and the results are therefore not directly comparable.

7.8. Due to the multi-stage closure process, underlying expenditure at the level of final beneficiaries may only be considered for approval by the Commission several years after the initial contracts have been signed. In the sample of Commission settlements made in 2009, many underlying transactions concern projects initiated in 2004 and 2005. The projects therefore relate to the 2000-2006 programming period. For the 2007-2013 period expenditure new funding rules and control systems were introduced. The related closures will occur in later years.

## REGULARITY OF TRANSACTIONS

7.9. The results of transaction testing are summarised in **Annex 7.1**.

7.10. Advance payments account for 87 % of the total payments made in the Education and Citizenship policy group. The Court examined a random sample of 30 advances paid during 2009. The combined value of these advances was 410 million euro, equivalent to 22 % of the total expenditure by way of advances booked to the accounts. Advance payments were found to be free from material error.

7.11. The Court found the error rate for closures to be between 2 % and 5 %.

7.7. *The Commission notes that the Court's sample for the DAS 2009 consists of 120 closure payments and 30 advances, while 87 % of payment amounts for the whole policy group are advances (see Table 7.1).*

7.8. *The Commission stresses that the current management and control system relies on a stable network of National Agencies that are closely supervised both at national and EU levels. This means that the closure of financial agreements between the Agencies and the Commission is not a particular risk factor, as there is a solid system of yearly reporting, whereby the Commission monitors budget implementation by the Agencies on a yearly basis. In case of problems noted during this yearly review, the Commission can and does already intervene with the National Agency and National Authority well before the closure of the financial agreement concerned (cf. financial assessment feedback provided in the evaluation conclusions letter at the end of the yearly desk review).*

7.9. *The apparent deterioration in the proportion of the transactions affected by errors in 2009 is explained by the change in approach of the Court which focuses mainly on closures.*

7.10. *The Commission welcomes the fact that the Court found no errors in the advance payments.*

7.11. *The Commission notes that the error rate for closures slightly exceeds 2 %.*

## THE COURT'S OBSERVATIONS

7.12. The Court found that 29 of the 120 closures audited (24 %) contained quantifiable errors. The most common type of quantifiable error found was errors of eligibility; see example (c). Examples of quantifiable errors include:

(a) *Students paid for incorrect durations of student mobility periods (accuracy)*

In 7 of the 36 DG EAC Socrates II transactions audited (20 %), the majority of which were payments to universities who disburse funds for Erasmus study periods, cases were found where students were paid for longer stays than were actually completed.

(b) *Costs not supported by invoices or proof of payment (occurrence)*

For a DG JLS Daphne II <sup>(3)</sup> project, costs claimed included unsubstantiated travel and subsistence cost. The errors found represented 10 % of the declared costs.

(c) *Declaration of ineligible costs (eligibility)*

In one DG EAC Youth exchange project audited, 27 out of 48 participants were above the maximum age permitted, without any justification given. This led to ineligible travel, visa and activity costs amounting to 12 460 euro (37 % of declared costs). For other projects found to contain errors and audited under DG EAC Youth in Action, error rates ranged from 1 % to 13 %.

7.13. Furthermore, 38 transactions (32 %) contained non-quantifiable errors, some of which indicate weaknesses in systems at Commission level. For example, there were five cases of late approval by the Commission of final reports, one in DG JLS, one in EACEA and three in DG EAC, ranging from 87 days to more than two years after the deadline.

## EFFECTIVENESS OF SYSTEMS

7.14. The results of the examination of systems are summarised in **Annex 7.2** for Education and Citizenship.

## THE COMMISSION'S REPLIES

**7.12.** *The Commission will follow up the errors found by the Court, and where appropriate, funds unduly paid will be recovered.*

(a) *The Commission stresses that the findings of the Court relate to Socrates II transactions covering grants to higher education institutions for the academic years 2004/2005, 2005/2006 and 2006/2007. With the introduction of the Lifelong Learning Programme, the Commission has stepped up the guidance and support to National Agencies in order to ensure sound management of EU funds both at the level of the National Agencies and the beneficiaries and to establish a proper audit trail at all levels.*

(b) *The Commission will follow up and recover any undue payments in relation to the Daphne file.*

(c) *Under the former Youth Programme which was audited by the Court, the eligibility criteria offered a certain flexibility. The eligibility criteria have been made stricter under the current Youth in Action Programme. Because of the non-availability of a justification concerning this old file, the Commission will recover the funds concerned.*

**7.13.** *Approval times are monitored in regular reporting to senior management. The Commission acknowledges delays in closing the mentioned final reports but would like to underline that this did not impact the final beneficiaries of the programme. In order to correct this situation, a dedicated task force in each service is in charge of closing such files and programme reporting rules have been modified.*

<sup>(3)</sup> Programme to combat violence against children, young people and women.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

7.15. The Court's systems audit was focused on systems at the level of the Commission which relate to the closures it made in 2009 (based largely on the 2000–2006 rules, see paragraph 7.8). This covered whether the Commission had a sound basis for closure/final settlement through checking inter alia whether the Commission had fully assessed final reports, including financial and non financial aspects, whether the amount of payment/recovery had been correctly determined and the pre-financing correctly cleared, and whether there was adequate separation of duties.

7.16. The Court stated in its Annual Report 2008 that the design of the system for the new period — if properly applied — could provide an adequate basis for assurance in the future. However, for DG EAC the supervisory and control systems at Commission level in 2009 left undetected and uncorrected a significant number of errors in the closures made that year. For DG JLS, the Court found errors in transactions that had been performed before the corresponding payments were made. For example, for three sampled transactions for the development, implementation and support services of the Biometric Matching System (BMS) Central Unit and the BMS Backup Central Unit for the Visa Information System were booked against the incorrect commitment.

## RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS

7.17. The results of the review of Commission management representations are summarised in **Annex 7.3**.

## CONCLUSIONS AND RECOMMENDATIONS

7.18. Based on its audit work, the Court concludes that the closures for the year ended 31 December 2009 for Education and Citizenship were affected by material error.

7.15. *The Commission welcomes the fact that the Court does not report any significant findings from its systems audits, in particular as regards the Commission's assessment of final reports, determination of payments and recoveries and clearance of pre-financing as well as an adequate separation of duties. In these respects the control systems are considered by the Commission to be effective.*

7.16. *Simplified rules and extensive use of lump sum financing in the current generation of programmes (2007-2013) should reduce the risks linked to final payments in the future, see reply to paragraph 7.6(a). Currently, DG EAC is undertaking a study on the cost of controls. Pending the outcome of that study, the Commission considers that it would not be cost effective to increase its checks in view of the low error rate detected.*

*The Court's example referring to JLS concerns corrections/regularisations to balance one previous error.*

7.17. *As regards JLS, the Director-General decided not to include reservations concerning the two 'reputational risks' mentioned by the Court (CEPOL and procurement regarding the Bulgarian Schengen Facility) in the Annual Activity Report for 2009 as a thorough analysis of the particular circumstances led to the conclusion that the criteria fixed in the general guidelines for including reservations were not met. According to the Standing Instructions for the 2009 Annual Activity Reports, a reputational risk cannot give rise to a reservation (there has to be an 'event' which leads to a reservation, and the event has to meet certain criteria). In the Commission's view there was no such event in JLS in 2009.*

*Moreover, the situation was the same in the Annual Activity Report for 2008.*

7.18. *The Commission welcomes the fact that the Court found no errors in advance payments, which covered 87 % of the total operational expenditure for Education and Citizenship in 2009 (see Table 7.1).*

*The Commission notes that the error rate for closures slightly exceeds 2 %. It will follow up the errors in closure payments found by the Court, and where appropriate, funds will be recovered.*

## THE COURT'S OBSERVATIONS

7.19. Based on its audit work, the Court concludes that the supervisory and control systems for Education and Citizenship were partially effective in ensuring the regularity of closures made in 2009. As explained in paragraph 7.8, the multi-stage closure process applied by the Commission means that these closures concern underlying transactions which date back to 2004/2005 but were only approved by the Commission in 2009.

7.20. The Court recommends that the Commission continues to reinforce the checks on closures to ensure that errors are detected and corrected and prevent the reoccurrence of previously identified errors.

7.21. A follow-up of previous observations is summarised in **Annex 7.4**.

## THE COMMISSION'S REPLIES

**7.19.-7.20** *The Commission considers that the supervisory and control systems put in place for the 2007-2013 period provide for a sound framework.*

*The improvements of the systems in the area of Education and Culture made in 2009 (updated guidance for the National Authorities and reinforced on the spot audit visits) are not reflected as the Court focused on closure payments related to actions from the previous programme generation that were not covered by the current system (notably the audited actions related to the 2004/2005 and 2005/2006 academic years).*

*The Commission emphasises that its closure in 2009 of projects from 2004/2005 is normal procedure. The longest of these projects ended in 2008 and were submitted for closure by the National Agencies in the Annual Report 2008, which the Commission received in 2009.*

## ANNEX 7.1

RESULTS OF TRANSACTION TESTING FOR EDUCATION AND CITIZENSHIP <sup>(1)</sup>

	2009				2008	2007
	15 Education and Culture	16 Communication	18 Freedom, Justice and Security	Total		
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>						
Total transactions (of which):	92	13	45	150	150	150
Advances	20	1	9	30	129	95
Closures	72	12	36	120	21	55
<b>RESULTS OF TESTING</b>						
<i>(in % and numbers of transactions)</i>						
Transactions not affected by error	58 % {53}	100 % {13}	82 % {37}	69 % {103}	90 %	79 %
Transactions affected by error	42 % {39}	0 % {0}	18 % {8}	31 % {47}	10 %	21 %
<b>ANALYSIS OF TRANSACTIONS AFFECTED BY ERROR</b>						
<i>(in % and numbers of transactions)</i>						
<b>Analysis by type of expenditure</b>						
Advances	0 % {0}	0 % {0}	0 % {0}	0 % {0}	60 %	35 %
Closures	100 % {39}	0 % {0}	100 % {8}	100 % {47}	40 %	65 %
<b>Analysis by type of error</b>						
Non-quantifiable errors	33 % {13}	0 % {0}	67 % {5}	38 % {18}	73 %	68 %
Quantifiable errors	67 % {26}	0 % {0}	33 % {3}	62 % {29}	27 %	32 %
comprising:						
Eligibility	50 % {13}	0 % {0}	100 % {3}	55 % {16}	50 %	80 %
Occurrence	15 % {4}	0 % {0}	0 % {0}	14 % {4}	25 %	0 %
Accuracy	35 % {9}	0 % {0}	0 % {0}	31 % {9}	25 %	20 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>						
Most likely error rate for closures:						
< 2 %					X	
2 % to 5 %			X			X
> 5 %						

<sup>(1)</sup> As explained in 7.7, the audit approach for 2009 differs from that for 2008 and 2007 and the results for 2009 are therefore not directly comparable with the results for 2008 and 2007. Furthermore, it should be noted that for 2007 and 2008, the Court's sample consisted of interim/final payments and advances whereas for 2009 the sample consisted of closures and advances. Therefore, 'closures' in the first column should for 2007 and 2008 be read as 'interim/final payments'.

## ANNEX 7.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR EDUCATION AND CITIZENSHIP

**Assessment of selected supervisory and control systems**

System concerned	Overall assessment
DG EAC	Partially effective
DG JLS	Partially effective
DG COMM	Effective

**Overall assessment of supervisory and control systems**

Overall assessment	2009	2008	2007
	( <sup>1</sup> )	( <sup>2</sup> )	( <sup>3</sup> )

(<sup>1</sup>) Systems audited: Commission closure of payments and settlements.

(<sup>2</sup>) Systems audited: Lifelong Learning Programme management in National Authorities, National Agencies and Commission.

(<sup>3</sup>) Systems audited: Commission assessments of ex-ante declaration of assurance in Lifelong Learning Programme and European Refugee Fund II, Commission ex-ante checks on payments, Commission ex-post checks/audits.

*Legend*

	Effective
	Partially effective
	Not effective

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS

Main DGs concerned	Nature of declaration given by Director-general (*)	Reservations given	Court observations	Overall assessment of reliability
EAC	with reservation	There is a 'too high error rate in the small share of overall expenditure managed via centralised direct management, due to lack of justifying documents for cost claims, in respect of projects dating from the previous programming period.'		A
JLS	with reservations	<p>Reputational damage due to delays in the completion of the SIS II project.</p> <p>Reputational damage due to a delay in the completion of the VIS project.</p> <p>Financial risk corresponding to the residual error rate (2,15 %) in the non-audited population of grants in the programmes under ABB activity 1804 – Fundamental Rights and Citizenship.</p>	Two reputational risks listed in the 2008 AAR continued to be present in 2009 but the DG did not consider them sufficient to warrant reservations. Firstly, although measures have been taken to address deficiencies in the European Police College (CEPOL) systems, these will not take effect until 2010. Secondly, the 2009 AAR explains that weaknesses remain in procurement regarding the Bulgarian Schengen Facility.	

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity.

B: The Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

C: The Director-General's declaration and annual activity report do not give a fair assessment of financial management in relation to regularity.

## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR EDUCATION AND CITIZENSHIP

Court observation	Action taken	Court analysis	Commission reply
<b>1. Weaknesses in the systems set up in the Member States for Lifelong Learning Programme (LLP)</b>			
<p>The Court noted the following weaknesses in the systems set up in the Member States for Lifelong Learning Programme:</p> <ul style="list-style-type: none"> <li>— for the primary controls 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, no exceptions registers, or treasury policy which ensured that funds were placed on interest-bearing accounts;</li> <li>— late submission of yearly reports by the national agencies to the Commission;</li> <li>— for the secondary controls the Court's audit found approaches of varying quality used by the national authorities to obtain a basis for the <i>ex-ante</i> and <i>ex-post</i> declarations of assurance and differences in the degree of disclosure of procedures carried out by these authorities;</li> <li>— only 10 of the 40 <i>ex-post</i> declarations for 2007 were sent by the national authorities to the Commission before the 30 April 2008 deadline. The rate of compliance had not improved by March 2009. The <i>ex-post</i> declarations for 2008 were due on 30 April 2009 but only six declarations were received on time;</li> </ul>	<p>According to the AAR 2009 of DG EAC, the findings of the Court concerning the primary controls '... are followed-up individually during the assessment of the yearly declaration of assurance and checked during on-the-spot visits. The individual follow-up is completed by training seminars and permanent information and communication with the National Agencies.'</p> <p>With regard to the late submission of yearly reports by the national agencies and the yearly <i>ex-post</i> declarations sent by the National Authorities to the Commission the DG EAC's AAR 2009 states: '... the report forms and guidelines for completion were issued in December 2009, thus ensuring that both NAs (National Agencies) and NAUs (National Authorities) will have more time for completion and for the necessary supervisory checks in view of the 30/4/2010 submission deadline. Furthermore, financial report forms have been substantially simplified in order to reduce the risk of erroneous reporting and incoherencies between financial reports and reports on primary checks.'</p>	<p>The Court acknowledges the changes in the procedures, but at this stage, the impact of the actions described in the 2009 AAR cannot be ascertained.</p> <p>For 2009, nine declarations and reports (23 % of total) from National Agencies were received on time (an additional three electronic copies were received by 6 May).</p> <p>The comparison with 2008 (six declarations received on time) shows only a little progress in terms of timeliness of the declarations and reports.</p> <p>The updated guidance for the National Authorities takes into account the issues indicated in the Court's findings. However, as this guidance will only be implemented by the Member States in 2010, at this stage it is not possible to assess its impact on the secondary controls performed by the National Authorities.</p>	<p><i>DG EAC has developed a system of permanent assurance. The analysis of the yearly declarations of assurance is just one of the elements on which the Commission bases its overall assurance. In addition, monitoring visits and supervisory checks are carried out by DG EAC services and by an external auditor. This ensures that the Commission can test the results of its desk review of the yearly declarations of assurance and closely follow the potential problem cases,</i></p> <p><i>The Commission welcomes the Court's analysis that its updated guidance takes into account the Court's recommendation of the previous year.</i></p>

Court observation	Action taken	Court analysis	Commission reply
<p>— while the guidance for national agencies is well-developed, both in legislative terms 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 has been issued by the Commission clarifying the responsibilities, there is no sufficiently detailed prescriptive guidance containing specific procedures for the authorities to follow.</p> <p>(2008 Annual Report, paragraphs 9.16, 9.19 to 9.21 and 9.33)</p>	<p>According to the AAR 2009 of DG EAC: 'As a follow-up to the Court's recommendations, updated guidance for the National Authorities has been worked out and communicated at the end of 2009. On the basis of these revised guidelines, coupled with a training seminar for National Authorities on 2 March 2010, it is expected that the 2009 Declarations of Assurance will be of better and of more homogenous quality than in the past years.' (p. 35). An ECA representative attended the seminar for National Authorities mentioned in the AAR and the Court has received a copy of the new guidance.</p>		

## 2. Weaknesses in the Commission's assessment process of *ex-ante* and *ex-post* declarations for LLP

<p>The Court found that the application of procedure for both the <i>ex-ante</i> declarations for the period 2007 to 2013 and the <i>ex-post</i> declaration for 2007 provided limited assurance for the quality of the management of the expenditure. 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.</p> <p>It is recommended that the Commission engage in closer supervision of the annual <i>ex-post</i> declaration process with direct verification that the controls described are adequate and fully applied.</p>	<p>According to the AAR 2009 of DG EAC: 'In line with its Strategic Supervision Policy, DG EAC has already reinforced the on-the-spot visits that focus on the existence and implementation of management procedures and checks as described by Member States. The 2010 audit plan will continue in this perspective'.</p> <p>In 2009 DG EAC conducted five financial audits of nine decentralised action agreements 2000-2006 or 2007-2008 (against 14 financial audits in eight countries performed in 2008) and 11 system audit visits to National Authorities. It has also performed 58 monitoring visits to National Agencies (against 41 in 2008).</p>	<p>In 2009, the number of financial audits was lower than in 2008, though DG EAC performed additional systems audits in National Authorities. Monitoring visits to National Agencies increased in 2009.</p>	<p><i>The decrease in the number of financial audits in 2009 compared to 2008 is explained by the good results of similar audits in 2008, which have shown low error rates.</i></p> <p><i>These audits cannot be seen isolated from supervisory control visits and systems monitoring carried out by DG EAC services in 2009.</i></p>
--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

Court observation	Action taken	Court analysis	Commission reply
<p>Based on its assessment of both the <i>ex-ante</i> and <i>ex-post</i> declarations, the yearly reports from the national agencies and the results of its monitoring visits to the national agencies and national authorities, the Commission has established a list of qualifications to be remedied by national agencies and national authorities. A continued follow-up of qualifications, in the form of more thorough monitoring visits, and a closer supervision by the Commission of the annual <i>ex-post</i> 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.</p> <p>(2008 Annual Report, paragraphs 9.22 to 9.24, 9.25 and 9.34)</p>			
<p><b>3. Partially effective <i>ex-post</i> controls at DG EAC</b></p>			
<p>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 national agency, which does not normally receive all justifying documents, they do not cover all eligibility criteria.</p> <p>(2008 Annual Report, paragraph 9.26)</p>	<p>The LLP error rate found for 2009 amounted to 0,65 %.</p>	<p>The scope of the financial audits carried out was unchanged from 2008 to 2009 and therefore, the Court's observation on the audit limitations is maintained.</p>	<p><i>The scope of the 2009 financial audits compared to 2008 audits has been slightly changed and more emphasis has been put on auditing a sample of primary checks carried out by or on behalf of the National Agency. These audits included the review of routine checks of final reports, desk checks of supporting documents, on-the-spot checks during action and financial on-the-spot checks after receipt of the final report.</i></p>



## CHAPTER 8

**Economic and Financial Affairs**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Overview	8.1
Specific assessment in the context of the Statement of Assurance	8.2-8.34
Introduction	8.2-8.9
Specific characteristics of the policy group	8.3-8.8
Audit scope and approach	8.9
Regularity of transactions	8.10-8.12
Effectiveness of systems	8.13-8.27
Ex-ante controls	8.15-8.18
Audit certification	8.19-8.21
Ex-post controls	8.22-8.27
Reliability of Commission management representations	8.28-8.29
Conclusions and recommendations	8.30-8.34
Results of the Audit of the Guarantee Fund for External Actions	8.35-8.39
Results of the Audit of the ECSC in Liquidation	8.40-8.44

## THE COURT'S OBSERVATIONS

**OVERVIEW**

8.1. Chapter 8 consists of three parts. First it contains the specific assessment of policy group Economic and Financial Affairs in the context of the Statement of Assurance (see paragraphs 8.2 to 8.34). This is followed by the results of the recurrent audits on the Guarantee Fund for External Actions (see paragraphs 8.35 to 8.39) and the European Coal and Steel Community in Liquidation (see paragraphs 8.40 to 8.44). The chapter concludes with a follow-up of previous years' observations (see **Annex 8.4**).

**SPECIFIC ASSESSMENT IN THE CONTEXT OF THE STATEMENT OF ASSURANCE****Introduction**

8.2. 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. Key information on the activities covered and the spending in 2009 is provided in **Table 8.1**.

*Specific characteristics of the policy group*

8.3. The main programmes in this policy group, accounting for almost 83 % (or 605 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:

- (a) the Seventh and Sixth Framework Programmes for research and technological development (FP7, FP6) (222 million euro);
- (b) the funding of EU agencies <sup>(1)</sup> (116 million euro);
- (c) the Guarantee Fund for external actions (see paragraphs 8.35 to 8.39) (92 million euro); and
- (d) the Competitiveness and Innovation Framework Programme (CIP) and the Multiannual Programme for Enterprise and Entrepreneurship (MAP) (175 million euro).

<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.

Table 8.1 — Economic and financial affairs — Key information

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
1	Economic and Financial Affairs	Administrative expenditure <sup>(1)</sup>	63	Centralised direct
		Economic and monetary union	13	Centralised direct
		International economic and financial affairs	17	Centralised direct
		Financial operations and instruments	235	Centralised direct/joint management with EIF/centralised indirect via EIF
			<b>328</b>	
2	Enterprise	Administrative expenditure <sup>(1)</sup>	114	Centralised direct
		Competitiveness, industrial policy, innovation and entrepreneurship	71	Centralised direct/centralised indirect via EACI
		Internal market for goods and sectoral policies	145	Centralised direct
		Cooperation — space and security	228	Centralised direct
			<b>558</b>	
3	Competition	Administrative expenditure <sup>(1)</sup>	91	Centralised direct
		Cartels, anti-trust and liberalisation	3	Centralised direct
			<b>94</b>	
12	Internal Market	Administrative expenditure <sup>(1)</sup>	58	Centralised direct
		Policy strategy and coordination for the Directorate-General for the Internal Market	8	Centralised direct
			<b>66</b>	
20	Trade	Administrative expenditure <sup>(1)</sup>	65	Centralised direct
		Trade policy	12	Centralised direct/joint management with IO
			<b>77</b>	
Total administrative expenditure <sup>(1)</sup>			391	
Total operational expenditure (consisting of):			732	
— advances <sup>(2)</sup>			273	
— interim/final payments <sup>(3)</sup>			459	
<b>Total payments for the year</b>			<b>1 123</b>	
<b>Total commitments for the year</b>			<b>1 373</b>	

<sup>(1)</sup> The audit of administrative expenditure is reported in Chapter 9.<sup>(2)</sup> Advances under the Seventh Framework Programme (2007-2013) amounted to 100 million euro.<sup>(3)</sup> Interim/Final payments under the Seventh Framework Programme (2007-2013) and the Sixth Framework Programme (2002-2006) amounted to 9 million euro and 32 million euro respectively.

Source: Annual Accounts 2009.

## THE COURT'S OBSERVATIONS

8.4. The CIP and MAP programmes financed by the 01 — Economic and Financial Affairs policy area aim to support small and medium-sized enterprises (SMEs) through Community financial instruments operated on behalf of the Commission by the European Investment Fund (EIF) which facilitate access to finance. The payments made by the Commission to the EIF relate to the transfer of the funds to fiduciary accounts which are used by the EIF to implement the programmes. The risk of illegal or irregular payments made by the Commission is low.

8.5. The aim of the FP7 programme within the scope of this policy area is to support actions carried out in the area of space and security research whereas, FP6 supports actions which promote technological innovation, the exploitation of research results and the setting-up of technology businesses within the Community and all its regions. The aim of the CIP programme financed by the 02 — Enterprise policy is to foster actions which promote the competitiveness of enterprises and in particular SMEs, through innovation.

8.6. For the majority of the actions under the three above programmes <sup>(2)</sup>, funding is provided through a grant agreement with the Commission. The grants are paid in instalments: an advance when the grant agreement is signed, followed by interim and final payments which reimburse eligible expenditure on the basis of cost statements submitted by the beneficiaries.

8.7. The main risk to 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 <sup>(3)</sup>. The payment conditions for advance payments are less complex, as these payments are triggered by the signature of the grant agreement or financing decision. However, advance payments have been subject to error in previous years, although these are generally not quantifiable and were related to procedural weaknesses.

## THE COMMISSION'S REPLIES

**8.7.** *The Commission has put in place a control strategy and developed ex post audits in order to mitigate the risk with regard to the regularity of payments made. The corrective action taken is aimed at reducing the error rate. The Commission recovers any amount overpaid to the audited beneficiaries.*

<sup>(2)</sup> FP6, FP7 and CIP programme financed by the 02 — Enterprise policy.

<sup>(3)</sup> The interim or final payments made in 2009 under the FP6, FP7 and CIP programme financed by the 02 — Enterprise policy, amount to 142 million euro.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.8. In the framework of FP7 the Commission also entered into an agreement with the European Space Agency (ESA) <sup>(4)</sup> with the purpose of financing the Space Component of Global Monitoring for Environment and Security (GMES) 2008 to 2013. In accordance with Article 53d of the Financial Regulation, the Commission delegated budget implementation tasks to ESA. Under this agreement, 624 million euro in total are allocated to ESA, out of which an amount of 68 million euro was paid during 2009.

*Audit scope and approach*

8.9. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of Economic and Financial Affairs, the following specific points should be noted:

- a sample of 80 payments was tested, 51 of which were interim or final payments including 15 relating to the three programmes mentioned above <sup>(5)</sup> (see paragraph 8.5);
- advances were included in the sample because they are at risk of error; and
- the assessment of the effectiveness of the supervisory and control systems covered:
  - ex-ante desk checks for payments made by the Executive Agency for Competitiveness and Innovation (EACI) <sup>(6)</sup>, mainly through an examination of a sample of 30 payments;
  - audit certification of project cost statements provided by independent auditors; and
  - ex-post controls, notably those of Directorates General Enterprise and Industry and Economic and Financial Affairs.

**8.8.** *The payment made to ESA in 2009 was the first contribution from the EU budget to the jointly managed GMES programme. The Delegation Agreement was signed between the Commission and ESA under the terms of 'Joint Management', where certain implementation tasks are delegated to international organisations.*

<sup>(4)</sup> ESA is an international public sector organisation set up by an intergovernmental agreement outside the EU framework. ESA has its headquarters in Paris and specialist centres in the Netherlands, Germany, Italy and Spain.

<sup>(5)</sup> For 14 interim or final payments, the audit was carried out at the level of the final beneficiaries.

<sup>(6)</sup> EACI is entrusted by the Commission with the management of actions under the CIP programme financed by the O2 — Enterprise policy.

## THE COURT'S OBSERVATIONS

**Regularity of transactions**

8.10. The results of the transaction testing are summarised in **Annex 8.1**. The Court found that 26 % of the payments (21 out of 80)<sup>(7)</sup> were affected by 25 errors. 62 % of these payments (13 out of 21) were affected by quantifiable errors concerning the eligibility or accuracy of declared expenditure. The rest of the payments (eight out of 21) were affected by non-quantifiable errors and principally relate to breaches of either the Commission procurement procedures or other internal rules<sup>(8)</sup>. The Court found that overall the tested payments were free from material error.

8.11. Most of these errors related to actions financed by the three programmes mentioned above (see paragraph 8.5) and concern the reimbursement by the Commission of ineligible costs declared by beneficiaries in their cost statements. This result is corroborated by the findings of the Commission's ex-post controls<sup>(9)</sup>.

8.12. The causes of the errors were mostly due to ineligible personnel and indirect costs, inadequate or missing supporting evidence. The following three examples illustrate the types of projects with errors that the Court encounters in its audits at the level of the final beneficiaries.

## THE COMMISSION'S REPLIES

**8.10.** *The Commission is striving to further reduce and correct errors as far as this is possible by cost efficient means*

**8.11.** *The complexity of the rules is a major source of errors and ineligible costs claims. The Commission's Communication on simplifying the research framework programmes proposes actions to address this risk. As these proposals will only be implemented under the next framework programme, and as the Commission needs to address the problems caused by complex eligibility requirements for grant beneficiaries, it adopted on 26 May 2010 a Communication<sup>(1)</sup> to the other Institutions proposing a level for the tolerable risk of error in the research area of between 2 and 5 %. The proposed level of tolerable risk of error is established taking into account the cost-effectiveness of the controls and an acceptable level of residual error that is justified in the light of these costs.*

**8.12.** *Concerning these three cases the Commission would like to point out the following:*

<sup>(7)</sup> Seven out of these 21 concern the first contribution from the EU budget to the jointly managed GMES programme.

<sup>(8)</sup> As there is no financial impact, these are considered as non-quantifiable errors.

<sup>(9)</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 2009 Annual Activity Report of the Directorate General Enterprise and Industry.

<sup>(1)</sup> COM(2010) 261

## THE COURT'S OBSERVATIONS

## Examples of ineligible costs

(a) 6<sup>th</sup> Framework Programme

The project audited was managed by a beneficiary who was implementing five FP6 projects in total financed by two different Directorates General of the Commission. By examining the timesheets of all projects, it was noted that the beneficiary was overcharging and even double booking hours on these Community funded projects. In addition the beneficiary significantly overcharged its indirect costs. The total error detected amounted to 21 % of the declared costs (or around 146 000 euro). These serious deficiencies in the cost statements were not detected by the firm which provided the audit certificate nor were they detected during the two ex-post controls carried out by another external audit firm on behalf of the Commission.

(b) 7<sup>th</sup> Framework Programme

Since 2004, the beneficiary has participated in six projects financed under FP6 and in eight projects financed under FP7. The total Community funding received since 2006 is approximately 1 million euro. The beneficiary applied a methodology for the calculation of personnel costs which did not comply with either the FP6 or the FP7 rules. Consequently, for the one project audited the costs declared were overcharged by more than 17 % (or around 7 800 euro). This methodology was also applied to the other 13 projects.

(c) 7<sup>th</sup> Framework Programme — Joint management

ESA submits annual financial reports which show the use made of the funds received from the EU (see paragraph 8.8). The Court examined the 2008 Annual Report, which was submitted to the Commission on 19 March 2009 and amounted to 20,2 million euro of expenditure. The Court noted the inclusion of costs which should not be funded by the Community or costs which were insufficiently supported for an amount of close to 10 % of the audited sample (or approximately 1,3 million euro) and serious weaknesses in the procurement rules and procedures<sup>(10)</sup>.

## THE COMMISSION'S REPLIES

## Examples of ineligible costs

(a) *The Commission will further investigate the case and recover any amount overpaid.*

*The ex post controls carried out on behalf of the Commission did detect a number of deficiencies in the cost statements. However, their conclusion with regard to the eligibility of indirect costs differed from the Court's observations.*

*Although hours were indeed double booked on different projects, it was concluded that this was mainly due to weak project management by the beneficiary and not done intentionally.*

(b) *The error observed relates to a misinterpretation of the FP7 eligibility rules with regard to the standard productive hours. The Commission will make the necessary correction and the observation will be extrapolated to other projects managed by this beneficiary.*(c) *The payment made to ESA in 2009, which was audited by the Court, was the first contribution from the EU budget to the jointly managed GMES programme. Under the terms of the Delegation Agreement signed between the Commission and ESA, the annual transfer of funds by the Commission is independent from the amount reported in the annual financial report submitted by ESA. Possible errors found in ESA's annual financial report did not affect the legality and regularity of the payment. The Commission considers that, also taking into account costs initially not included in the financial report, the costs reported by ESA were 2 % too high. This will be corrected before making the final payment at the end of the programme.*

<sup>(10)</sup> See reservation concerning the reliability of the financial reporting by ESA in the Declaration given by the Director-General in the 2009 Annual Activity Report of the Directorate General Enterprise and Industry.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*While the Commission agrees that some procurement procedures should be further aligned with the EC rules, the particular nature of the Space procurement activities should be taken into account. The Commission considers that ESA procurement rules and procedures ensure best value for money in the specific area of Space procurement.*

### Effectiveness of systems

8.13. The Commission established various controls covering the full expenditure cycle in order to mitigate the risk of incorrect or irregular payments. The Court assessed the effectiveness of the operation of the ex-ante controls on payments, the reliability of the audit certification system and the Commission's ex-post controls of reimbursed expenditure.

8.14. The results of the examination of systems are summarised in **Annex 8.2**.

#### *Ex-ante controls*

8.15. The purpose of the ex-ante controls is to verify the regularity and the soundness of the financial management of the payments. They cover both the operational and financial aspects, notably the quality of the deliverables, compliance with the contractual requirements and the correctness of the calculation of the amount to be paid.

8.16. As for both FP6 and FP7, the interim or final payments are only based on cost statements, so the standard ex-ante controls on the declared expenditure in the cost statements only permit the detection of clerical or arithmetical errors. In order to take into consideration the inherent limited nature of such ex-ante controls, the Directorate General Enterprise and Industry has enhanced its ex-ante control strategy notably by carrying out detailed desk checks<sup>(1)</sup> and performing ex-ante audits of beneficiaries systems.

<sup>(1)</sup> By for instance requesting supporting documents such as invoices prior to the payment being made.



## THE COURT'S OBSERVATIONS

8.17. The audit of the sample of the 80 payments mentioned in paragraph 8.9 did not reveal any significant weaknesses in the operation of the ex-ante desk checks. However for policy area 02 — Enterprise, the Court noted that out of 48 payments tested 24 were affected by weaknesses in the ex-ante controls. In the case of the Research Executive Agency <sup>(12)</sup>, the ex-ante controls failed to detect five regularity errors. In the case of ESA, prior to the signing of the agreement for the funding of GMES (see paragraph 8.8), the Commission did not clearly define the eligible costs of the jointly funded activities and did not address the procurement weaknesses. In addition, the Commission did not formalize any strategy for ex-ante controls till February 2010 (see paragraph 8.26).

8.18. The Court selected an additional sample of 30 advance payments in order to assess the set up of the ex-ante system and the effectiveness of its operation in EACI concerning the management of CIP <sup>(13)</sup>. No significant weaknesses were noted. Nevertheless, the Court found that the financial manual needs to be updated and that the documentation of parts of the checks performed was insufficient.

## THE COMMISSION'S REPLIES

**8.17.** *The Commission agrees with the Court's assessment that the ex ante checks under policy area 02 — Enterprise did not reveal any significant weaknesses.*

*The Commission considers that the ex ante checks under policy area 02 — Enterprise are proportionate and effective. Minor discrepancies do not affect the effectiveness of the ex ante checks. To eliminate these minor discrepancies would not be cost efficient.*

*With regard to the Research Executive Agency, three of the five cases mentioned relate to one and the same empowerment of an agent in the payment workflow which the Court deemed incorrect. The Commission does not share the view of the Court that there are legality/regularity errors relating to the empowerment by the authorising officer of staff having acted for the financial circuit, as there is no regulatory requirement to formally appoint staff in the various functions.*

*The fact that the eligible costs of jointly funded activities are not defined in every detail is inherent to activities under Joint Management in general and to the nature of the GMES programme in particular. The programme involves a technically complex space project including the development of Sentinel satellites, which makes it difficult to separate elements that are funded via different sources in the development and procurement process.*

*The Commission considers the ex ante assessment of requirements for 'Joint Management' performed before entering into the agreement to be sufficient.*

*The preparation of the monitoring and control framework for the funding of GMES already started in 2008, but had to be adapted and completed in the light of experience with the implementation of the project. The Commission has enforced and formalised its monitoring and control activities as from 2010.*

**8.18.** *The EACI acknowledges that not all parts of the Manual of Procedures are completely updated for all the programmes. The different chapters of the Manual were subjected to review and updating in 2010.*

<sup>(12)</sup> The Research Executive Agency was set up in 2008 to manage parts of FP7 and became autonomous in June 2009.

<sup>(13)</sup> More specifically the Enterprise Europe Network (EEN) and the Intellectual Property Rights (IPR) awareness and enforcement projects.

## THE COURT'S OBSERVATIONS

*Audit certification*

8.19. The EU Financial Regulation <sup>(14)</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, especially under FP6 and FP7.

8.20. For all payments audited at beneficiary level for which a certificate had been provided, the Court compared the results of its own audit with the certificate provided. In all cases for which an unqualified opinion had been issued by the approved auditor, the Court detected errors. While in two of the cases the errors did not have a significant financial impact <sup>(15)</sup>, in the remaining four cases they did, or they concerned a cost allocation methodology incompatible with the applicable rules. This finding confirms the previous year's results and the results of Chapter 5, and indicates that this control is only partially effective in identifying errors in the declared costs.

8.21. Concerning FP6, the submission of at least one audit certificate for project costs was in principle mandatory for each beneficiary. For FP7, beneficiaries are only required to submit audit certificates when cumulative EU funding is greater than or equal to 375 000 euro. In addition the Commission has introduced the system of ex-ante certification of beneficiaries' costing methodologies. However, the number of beneficiaries which have received certification of their costing methodologies is low. Together with the significant reduction in the number of audit certificates required, this increases the risk of errors (see also paragraphs 5.28 to 5.31).

## THE COMMISSION'S REPLIES

**8.20.** *The Commission shares the concern of the Court regarding the correctness of the FP6 audit certificates, which in the event have not fully provided the additional assurance initially expected. However, the Commission maintains that this instrument made a significant contribution to the prevention of errors, resulting in a significant decrease of the error rates in FP6 audits compared with FP5.*

*The Commission has taken remedial action in order to improve the quality of the audit certificates 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. This approach should lead to a reduction in the errors of interpretation of the eligibility rules by the auditors which occurred in FP6. The Commission will continue to assess the reliability of audit certificates during its own financial audits.*

**8.21.** *The intensity of audit certificate submissions under FP7 has been reduced to lower the administrative burden on participants.*

*However, a Certificate on Financial Statements (CFS) is still required for beneficiaries who have received certification of their costing methodologies, since this only removes the obligation for a beneficiary to submit an intermediate CFS. A CFS must be submitted for the last reporting period if the cumulative requested contribution exceeds 375 000 euro. Following the intensive FP6 audit campaigns, many beneficiaries have undergone a learning effect and the Commission expects that beneficiaries are likely to apply improved project cost accounting practices as a result.*

*At the present juncture, it is not possible to conclude that the overall error rate will increase, as the risks identified may be offset by other measures.*

<sup>(14)</sup> Article 180 of the Commission Regulation (EC, Euratom) No 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 357, 31.12.2002, p. 1), as amended.

<sup>(15)</sup> For instance wrong classification of costs.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Ex-post controls*

8.22. The Directorates-General in charge of the implementation of the policy areas 01 — Economic and Financial Affairs and 02 — Enterprise have established separate ex-post control functions primarily due to the high number of payments and the complexity of the programmes managed.

8.23. Regarding policy area 01 — Economic and Financial Affairs, the Court found that the work programme for ex-post controls covering 2009 was only formalised in December 2009. In 2009 three ex-post reports were published, two of them relating to controls launched in 2006 but only finalised in 2009.

8.24. Regarding policy area 02 — Enterprise, the internal control system for its research expenditure mainly relies on its ex-post control system (i.e. financial audits at beneficiaries after reimbursement). These audits are performed either directly by the Commission's auditors or by external audit firms under the supervision of the Commission. Concerning FP6 and FP7, a specific audit strategy has been defined aiming to:

- (a) assess the regularity of financial transactions and provide input to the annual declaration of assurance (see paragraphs 8.28 and 8.29); and
- (b) provide the basis for corrective and recovery mechanisms.

8.25. The ex-post control system put in place by the Directorate General Enterprise and Industry was assessed as effective even though some further improvements are desirable concerning the ex-post controls outsourced to external audit firms. The part of the policy area 02 — Enterprise delegated to the REA and EACI was not covered by the Executive Agencies' work programmes and no ex-post controls had been carried out.

**8.23.** *The delay in formalising the work programme for 2009 is acknowledged. However, this programme was largely defined and agreed by the Internal Control Management Group (ICMG) in February 2009 and its implementation started from then. The programme for the following year was agreed by the ICMG in January 2010 and formalised in March 2010.*

*In previous years, the bulk of the ex-post control resources was dedicated to an extremely important control and, consequently, the finalisation of other controls was delayed.*

**8.25.** *The assessment of the Court relates exclusively to 2009.*

*For EACI, the volume and timing of the first interim payments based on cost claims in 2009 relating to policy area 02 — Enterprise did not justify the launch of ex post audits already in 2009.*

*The REA is implementing the common FP7 multi-annual audit strategy. In accordance with this strategy, and as further detailed in its Annual Activity Report, the volume of payments made in 2009 and falling within the scope of this strategy was too small to justify a first selection and subsequent launch of ex post audits in 2009. These 2009 payments will nevertheless be considered in the population of payments from which ex post audits will be selected in 2010.*

## THE COURT'S OBSERVATIONS

8.26. Concerning the agreement for the funding of GMES (see paragraph 8.8) which was signed in February 2008, the monitoring strategy and control framework was only finalised in February 2010. Article 6 of the agreement states that the Commission may conduct documentary and on-the-spot checks on the use made of Community funding and may carry out a full audit. As at the end of 2009, the Commission had not performed any such checks or audits and did not request any supporting documents justifying ESA's annual financial report.

8.27. The Court also noted that while the FP7 ex-post audit strategy for 2009 to 2016 was finalised in September 2009, no specific FP7 audit manual was available at the end of 2009.

### Reliability of Commission management representations

8.28. The Court assessed the annual activity reports and accompanying declarations for the five Directorates General in charge of the policy areas covered in the chapter Economic and Financial Affairs as well as the relevant parts of the annual activity reports of the two Executive Agencies<sup>(16)</sup> partly responsible for the implementation of the policy area 02 — Enterprise.

8.29. The results of the review of these management representations are summarised in **Annex 8.3**.

### Conclusions and recommendations

8.30. Based on its audit work, the Court concludes that the payments for the year ended 31 December 2009 for Economic and Financial Affairs were free from material error. However, the Court draws attention to the type and extent of the errors found in research framework expenditure, despite these errors not being material to the regularity of the policy group as a whole.

## THE COMMISSION'S REPLIES

**8.26.** *Under the terms of the Delegation Agreement signed between the Commission and ESA, the annual transfer of funds by the Commission is independent of the amount reported in the annual financial report submitted by ESA. The Commission had already envisaged on-the-spot controls in 2009, and these took place in 2010.*

*The preparation of the monitoring and control framework for the funding of GMES already started in 2008, but had to be adapted and supplemented in the light of experience with the implementation of the project. The Commission has recently enforced and formalised its monitoring and control activities.*

**8.27.** *The audit services of the Research family DGs have the necessary tools to implement the first FP7 audits. Standard templates have been adapted to FP7 conditions, and a similar update is scheduled as regards the FP7 Audit Manual. It should be borne in mind, however, that the auditor's main terms of reference are the prevailing rules of the grant agreements under audit, i.e. the FP7 Rules for Participation, the grant agreement provisions, and any relevant guidance.*

**8.29.** *The Commission welcomes the positive assessment of the Court for all the Annual Activity Reports covered by this chapter.*

*While DG COMP did not formalise the impact assessment, the risks associated with the recovery in question have been thoroughly assessed at management level throughout the proceedings. Furthermore, management has followed the case closely by liaising with DG BUDG and the Commission's Legal Service to decide how to recover the funds successfully.*

<sup>(16)</sup> The Research Executive Agency and the Executive Agency for Competitiveness and Innovation.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

8.31. The Court examined three supervisory and control systems for policy group Economic and Financial Affairs. While two were assessed as effective (01 — Economic and Financial Affairs and 03 — Competition, 12 — Internal Market and 20 — Trade), one related to the policy area 02 — Enterprise was assessed as only partially effective in ensuring the regularity of payments.

8.32. The Commission has taken steps to simplify the application the eligibility rules and to raise the awareness of beneficiaries. The Court recommends that the Commission should nevertheless:

- (a) encourage beneficiaries to submit their cost calculation methodology for ex-ante certification; and
- (b) raise the certifying auditors' awareness of the eligibility of expenditure with the aim to improve the reliability of the audit certificates they issue.

8.33. The Commission should further improve the quality of its ex-ante controls on the procurement procedures and interim/final payments and ensure that ex-post control functions are covered by work programmes. For joint management with ESA, the Commission should closely monitor the effective functioning of ESA's control systems and the reliability of its annual financial report covering the implementation of activities financed under the GMES delegation agreement.

8.34. A follow-up of previous observations is summarised in **Annex 8.4**.

**8.31.** See paragraph 8.17.

*The Commission considers that the ex ante checks under policy area 02 — Enterprise are proportionate and effective.*

**8.32.**

- (a) *The Commission recently took action to make the ex ante certification of beneficiaries costing methodologies more attractive. The Commission expressed its views in this respect in its Communication on simplification of 24 April 2010, as well as in its proposal for triennial revision of the Financial Regulation and its implementing rules adopted on 28 May 2010. Genuine simplification could be achieved by allowing methodologies that are applied as usual accounting practice, as long as they are based on actual personnel costs registered in the accounts.*
- (b) *The Commission pursues a policy of actively feeding back findings from ex post audits to the beneficiaries and the certifying auditors in order to ensure - where necessary - improvements at the level of the auditors issuing audit certificates. The inherent complexity of the eligibility criteria impacts on the work performed by many external auditors mandated by beneficiaries to issue audit certificates. For FP7 it is expected that, with the reliance on agreed upon procedures, the degree of errors due to such misinterpretation will decrease significantly.*

**8.33.** *The Commission will check what further action can be taken in order to reduce errors, taking cost-benefit considerations into account.*

*With regard to joint management with ESA, the Commission has enforced its monitoring and control activities as of 2010.*

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**RESULTS OF THE AUDIT OF THE GUARANTEE FUND FOR EXTERNAL ACTIONS**

8.35. The purpose of the Guarantee Fund for External Actions<sup>(17)</sup> (the Fund), which guarantees loans to third countries, is to reimburse the Community's creditors<sup>(18)</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.

8.36. At 31 December 2009, the Fund's total resources were 1 240 million euro, compared with 1 091 million euro at 31 December 2008. No guarantee calls were made on the Fund in the year under review.

8.37. The EIB and the Commission use a benchmark index to review the Fund's annual performance. The return on the Fund's portfolio in 2009 amounted to 4,6 %, compared with a benchmark return of 3,78 %.

8.38. The investment portfolio of the Guarantee Fund is managed by the EIB on behalf of the European Communities<sup>(19)</sup> whereas the investments portfolio of the ECSC i.L. is managed by a dedicated unit of DG-ECFIN. The investment objectives of both portfolios are fairly similar — e.g. risk appetite, type and quality of investments as well as investment restrictions. The financial benefits of both funds being managed by the unit of DG-ECFIN have not been assessed.

8.39. Overall, the Court considers that during 2009 the Guarantee Fund was managed in a satisfactory manner and that appropriate actions have been taken to monitor the impact of the financial crisis on the Fund's portfolio.

**8.38.** Both the EIB and the Commission have the capacity to manage the assets of the Fund in a similar way and with similar financial results. Therefore, there is no performance-related reason to propose an amendment to Article 7 of Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009 (codified version) by which the management of the assets of the Guarantee Fund for external actions has been given to the EIB.

The Commission considers that there are operational and financial risk diversification benefits deriving from the fact that funds are managed by two institutions. It is in fact a practice followed by the ministries of finance and national central banks of most Member States to outsource some of the management of their funds to third parties.

<sup>(17)</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>(18)</sup> Principally the EIB, but also Euratom external lending and EC macro financial assistance (MFA) loans to third countries.

<sup>(19)</sup> Article 6 of Regulation (EC, Euratom) No 2728/94 and the EIB receives an annual management fee for the services provided.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**RESULTS OF THE AUDIT OF THE ECSC IN LIQUIDATION**

8.40. 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>(20)</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.

8.41. At 31 December 2009, the total assets of the ECSC i.L. were 2 011 million euro, compared with 2 045 million euro at 31 December 2008. The net profit for 2009 was 13,9 million euro compared to a net loss of 14,8 million euro in 2008.

8.42. The net revenue of ECSC i.L. investments in 2009 amounted to 68 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 2009 the unused budget available for financing coal and steel research had accumulated to 238 million euro <sup>(21)</sup>.

8.43. The performance of the ECSC i.L. portfolio was 5,85 % for the year 2009 while the return of the benchmark, serving as reference rate for the ECSC i.L., was 4,41 %.

8.44. 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.

**8.42.** *The unused budget of 238 million euros includes:*

- *allocation for 2010, not yet committed (54 million euros),*
- *allocation for 2011 (61 million euros),*
- *outstanding amounts (123 million euros) related to contracts signed since 2003, in respect of which the closure of accounts is not yet completed for all partners of the project. The decommitment can be processed two months after the last closure of accounts of the contract. The average duration of a RFCS contract is three years, and most of the outstanding amount is related to contracts not yet finished or for which the final technical report has not been approved (condition for the last payment and the closure of accounts).*

*Therefore, it is only natural that the amount of 238 million euros was still unused at 31 December 2009.*

<sup>(20)</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).

<sup>(21)</sup> Including the allocations for 2011 amount to 61 million euro and for 2010 to 54 million euro.

## RESULTS OF TRANSACTION TESTING FOR ECONOMIC AND FINANCIAL AFFAIRS

	2009										2008	2007		
	Policy area 02 — Enterprise		Policy area 01 — Economic and Financial Affairs		Policy area 03 — Competition		Policy area 12 — Internal Market		Policy area 20 — Trade				Total	
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>														
Total transactions (of which):	48	27	1	0	4	<b>80</b>	80	55						
Advances	28	0	0	0	1	<b>29</b>	35	15						
Interim/Final payments	20	27	1	0	3	<b>51</b>	45	40						
<b>RESULTS OF TESTING</b>														
<i>(in % and numbers of transactions)</i>														
Transactions not affected by error	54 %	{28}	100 %	{27}	100 %	{1}	N/A	N/A	75 %	{3}	<b>74 %</b>	{59}	86 %	93 %
Transactions affected by error	46 %	{20}	0 %	{0}	0 %	{0}	N/A	N/A	25 %	{1}	<b>26 %</b>	{21}	14 %	7 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>														
Most likely error rate:														
< 2 %	<b>X</b>											<b>X</b>		
2 % to 5 %											<b>X</b>			
> 5 %														



## ANNEX 8.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR ECONOMIC AND FINANCIAL AFFAIRS

## Assessment of selected supervisory and control systems

System concerned	Ex-ante checks	Audit certification	Ex-post financial audit	Overall assessment
Policy area 01 — Economic and Financial Affairs		N/A		
Policy area 02 — Enterprise			( <sup>1</sup> )	
Policy area 03 — Competition Policy area 12 — Internal Market Policy area 20 — Trade		N/A	N/A	

(<sup>1</sup>) Effective for DG Enterprise and Industry, partially effective for EACI and not effective for ESA and REA.

## Overall assessment of supervisory and control systems

Overall assessment	2009	2008	2007

## Legend:

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

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR ECONOMIC AND FINANCIAL AFFAIRS

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
COMP	without reservations	N/A	In 2009 DG COMP issued a recovery order representing more than 70 % of its earmarked operational budget. At the end of 2009 this recovery order was still not cashed while it was due in October 2009.  Despite the fact that this item is significantly above the 2 % materiality threshold and that a reputational risk could be linked with this recovery, DG COMP did not conduct a formal impact assessment to determine if a reservation should be raised.	A
ECFIN	without reservations	N/A	The previous reservation concerning problems with the implementation of 'additionality requirements' for a financial programme was lifted. The Court reviewed the completion of the action plan and obtained evidence that the final checks concerning the effectiveness of the improved control systems were put in place.	
ENTR	with reservations	1. Reservation concerning the rate of residual error with regard to the accuracy of cost claims in the Sixth Research Framework Programme (FP6).  2. Reservation concerning the reliability of the financial reporting by the European Space Agency about the joint implementation of the space component of the Global Monitoring for Environment and Security (GMES).	The amount at risk in respect of FP7 cost claims is assessed by DG ENTR as not material in 2009 and therefore no reservation is made. However, the Court has noted the potential material error in FP7 cost claims from 2010.	A
MARKT	without reservations	N/A	—	
TRADE	without reservations	N/A	—	

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity

B: The Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity

C: The Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity

## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR ECONOMIC AND FINANCIAL AFFAIRS

Court observation	Action taken	Court analysis	Commission reply
<b>1. Regularity of underlying transactions</b>			
<p>In 2007, the Court identified regularity errors in three payments which were financed either under the fifth or the sixth Framework Programmes for research and technological development. The errors detected were principally due to: inadequate or missing supporting evidence to justify the cost claimed; the use of budgeted figures which does not comply with the contractual requirements to use actual cost; and inclusion of various ineligible costs.</p> <p>(2007 Annual Report, paragraphs 10.16 and 10.17)</p>	<p>The Commission has made financial corrections for the errors identified in the sample, either by issuing a recovery order or by adjusting payments to the beneficiaries in subsequent periods.</p>	<p>The Commission has followed up the errors identified by the Court and taken appropriate corrective action.</p>	<p><i>The Commission will continue to correct the errors identified and agreed upon.</i></p>
<b>2. Audit certification of project cost statements</b>			
<p>The EU financial rules require that cost statements above a certain threshold have to be accompanied by an audit certificate. In three projects the certifying auditor issued an unqualified opinion whereas the Court detected serious quantifiable errors.</p> <p>(2007 Annual Report, paragraphs 10.27 to 10.30)</p>	<p>For FP7 the Commission aimed to further improve the reliability of audit certificates by using 'agreed upon procedures', setting out in detail the audit work to be performed by the certifying auditors issuing the 'certificate on the financial statements' and encouraging ex-ante certification of the cost methodology.</p>	<p>These measures are unlikely to have a positive impact on the number of cost statements with errors in them in the short term because as at the end of 2009, DG ENTR has not yet executed a payment accompanied by such a certificate and the Commission had accepted the cost methodologies of only 11 beneficiaries.</p>	<p><i>FP7 establishes a threshold at the level of 375 000 EUR (EU contribution in cumulative terms per participant per project) to trigger the submission of an audit certificate. Most FP7 projects are only in their first reporting period which explains the limited number of certificates on financial statements at the end of 2009. As regards ex ante certification of the cost methodology, at the end of May 2010, the Commission had accepted the cost methodologies of 25 beneficiaries.</i></p>



## CHAPTER 9

**Administrative and other expenditure**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	9.1-9.8
Specific characteristics of the policy group	9.3-9.5
Audit scope and approach	9.6-9.8
Regularity of transactions	9.9
Compliance of systems with the financial regulation	9.10
Reliability of Commission management representations	9.11
Observations on specific Institutions	9.12-9.27
Parliament	9.13-9.16
Council	9.17
Commission	9.18-9.20
Court of Justice	9.21
Court of Auditors	9.22
European Economic and Social Committee	9.23
Committee of the Regions	9.24
European Ombudsman	9.25
European Data Protection Supervisor	9.26-9.27
Conclusions and recommendation	9.28-9.31
European Agencies and Executive Agencies	9.32-9.34
European Schools	9.35-9.37

## THE COURT'S OBSERVATIONS

## INTRODUCTION

9.1. This chapter presents the Court's specific assessment of administrative expenditure of the Institutions and bodies of the European Union. Key information on the Institutions and bodies covered, and on the spending in 2009 is provided in **Table 9.1**.

**Table 9.1 — Administrative expenditure of the institutions — Key information**

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
Sections I, II and IV-IX. For Section III, Chapter 1 of all Titles and Titles 14, 24-27 and 29	Administrative and other expenditure	European Parliament	1 466	Centralised direct
		Council	659	Centralised direct
		Commission	6 358	Centralised direct
		Court of Justice	307	Centralised direct
		Court of Auditors	123	Centralised direct
		Economic and Social Committee	117	Centralised direct
		Committee of the Regions	86	Centralised direct
		European Ombudsman	8	Centralised direct
		European Data Protection Supervisor	5	Centralised direct
Total administrative expenditure			9 129	
Total operational expenditure				
<b>Total payments for the year</b>			<b>9 129</b>	
<b>Total commitments for the year</b>			<b>9 224</b>	

Source: Annual accounts 2009.

9.2. 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.

### Specific characteristics of the policy group

9.3. Administrative expenditure mainly comprises expenditure for human resources (salaries, allowances and pensions) and expenditure for buildings, equipment, energy, communications, and information technology.

9.4. 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. This expenditure includes the following titles of the general budget: Title 14 ('taxation and customs union'), 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 2009 an amount of 200 million euro as 'Temporary and lump-sum compensation for the new Member States'.

## THE COURT'S OBSERVATIONS

9.5. The main risks in the administrative and other expenditure policy group are non-compliance with the provisions on procurement, the implementation of contracts, recruitment procedures and the calculation of salaries and allowances.

### Audit scope and approach

9.6. The Court's overall audit approach and methodology is described in **Part 2 of Annex 1.1**. For the audit of Administrative expenditure:

- a sample of 57 transactions, drawn randomly from all the administrative expenditure referred to in paragraphs 9.3 and 9.4, was tested;
- the Court assessed the compliance of the supervisory and control systems<sup>(1)</sup> applied by each Institution with the requirements of the Financial Regulation;
- the Court also reviewed the management representations of four Commission's Directorates General and Offices primarily responsible for administrative expenditure.

9.7. The Court also audited the following selected topics on the basis of specific samples:

- (a) engagement of temporary and contract agents in all Institutions,
- (b) payment of social allowances to staff in all Institutions in higher risk areas (household allowance for families without dependent children, national allowances not deducted from those of a similar nature paid by the Institutions when the spouse is deemed to receive income or benefits from outside the Institutions, national allowances deducted from those of a similar nature paid by the Institutions and not updated for more than one year),
- (c) procurement contracts in all Institutions except the European Ombudsman and the European Data Protection Supervisor,
- (d) procurement contracts awarded following a negotiated procedure due to urgency in all Institutions except the European Ombudsman and the European Data Protection Supervisor.

<sup>(1)</sup> Ex-ante and ex-post controls, internal audit function, exception reporting and internal control standards. In addition, the Court performed an in-depth assessment of supervisory and control systems in the Court of Justice, the European Ombudsman and the European Data Protection Supervisor. This assessment included the examination of an additional sample of transactions of payments relating to human resources and to other administrative expenditure.

---

THE COURT'S OBSERVATIONS

---

9.8. The Court of Auditors is audited by an independent external audit firm <sup>(2)</sup> which issued an audit report on the financial statements for the financial year from 1 January 2009 to 31 December 2009 and an assurance report concerning the regularity of the use of the Court's resources, and the control procedures in place for the financial year from 1 January 2009 to 31 December 2009 (see paragraph 9.22).

### REGULARITY OF TRANSACTIONS

9.9. The results of transaction testing are summarised in **Annex 9.1**. On the basis of the sample of 57 transactions, the audit found the payments as a whole to be free from material error.

### 9.9. REPLY OF THE COMMISSION

*The Commission welcomes the Court of Auditors' positive assessment that the administrative expenditure was free from material error.*

### COMPLIANCE OF SYSTEMS WITH THE FINANCIAL REGULATION

9.10. The results of the examination of systems are summarised in **Annex 9.2**. 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 9.6) found no material weakness.

### RELIABILITY OF COMMISSION MANAGEMENT REPRESENTATIONS

9.11. The results of the review of Commission management representations are summarised in **Annex 9.3**.

### OBSERVATIONS ON SPECIFIC INSTITUTIONS

9.12. The specific observations that follow and which are presented by Institution or body of the European Union are based on the Court's audit (a) of the supervisory and control systems applied by each Institution and (b) on the selected topics (see paragraphs 9.6 and 9.7). These findings do not call into question the assessments set out in paragraphs 9.9 and 9.10 as they are not material to administrative expenditure as a whole but are significant in the context of the individual Institution concerned.

---

<sup>(2)</sup> PricewaterhouseCoopers, Société à responsabilité limitée, Réviseur d'Entreprises.



## THE COURT'S OBSERVATIONS

**Parliament****Engagement of temporary and contractual agents**

9.13. The examination of the procedures for the engagement of other agents of the Institutions (temporary and contract staff) established that, in five cases out of 20, documents evidencing compliance with the rules related to the fulfilment of military or other obligations had not been provided.

**Payment of social allowances to staff members**

9.14. The audit found that, in 16 cases out of 30, information available to the Parliament's services, in order to ensure that allowances provided for by the Staff Regulations are paid to staff in compliance with relevant community regulations and national legislation, was not up-to-date. This situation leads to the risk of making incorrect or undue payments if the circumstances of the individual have changed. Staff should be requested to deliver at appropriate intervals documents confirming their personal situation. In addition, the Parliament should implement a system for the timely monitoring and control of these documents.

**9.13. THE REPLY OF THE EUROPEAN PARLIAMENT**

*As regards the documents to be provided as proof of fulfilment of military obligations, Parliament wishes to state the following:*

*Parliament acknowledges that, in the light of the gradual abolition of military service in the Member States, fulfilment of such obligations was not the subject of systematic checks in connection with the recruitment of temporary and contract staff until the start of the second half of 2008.*

*However, since then DG Personnel has asked applicants to provide proof of fulfilment of their military obligations. The Recruitment and Staff Transfers Unit has a database which gives details of the military obligations to be met in each Member State and systematically verifies that those obligations have been fulfilled when concluding contracts with other servants.*

*The instances of non-compliance highlighted by the Court concern temporary and contract staff recruited by Parliament for the first time prior to the introduction of these systematic checks.*

**9.14. THE REPLY OF THE EUROPEAN PARLIAMENT**

*As stipulated in Article 67(2) and Article 68 of the Staff Regulations, it is for the recipients of allowances to notify the Administration of any change in their circumstances. This arrangement, based on 'spontaneous declarations', may give rise to delays in updating individual entitlements.*

*With a view to forestalling this risk, Parliament has always taken regular steps to verify the circumstances of its staff. As from 2010, that verification has been computerised through the introduction of the 'electronic data sheet'. This 'proactive' procedure will make it possible to verify staff members' personal and administrative data at least once a year. Each staff member is required to verify his or her circumstances on a given date and to forward notification of any change, along with the requisite supporting documents, to the department concerned.*

*Sums unduly paid to officials and other servants who fail to notify the Administration of changes in their circumstances are recovered.*

## THE COURT'S OBSERVATIONS

**Organisation and functioning of political groups**

9.15. Article 12.9 of the Parliament's Internal Rules for the implementation of the budget, adopted on 27 April 2005, provides that the Internal Auditor's area of competence does not include the appropriations from Parliament's budget managed by political groups. The specific rules on the use of these appropriations<sup>(3)</sup> require that each political group establishes its own internal financial rules and implements an internal control system. The internal audit function is not mentioned. Only the rules of one out of seven political groups provide for the appointment of an internal auditor. The functional independence of political groups does not justify that regulatory provisions on the internal audit function are not applied as regards the use of funds by political groups.

9.16. The same specific rules on the use of appropriations establish provisions for the carry-over of Parliament's budget appropriations managed by political groups. They allow political groups to carry-over to the succeeding financial years unused appropriations of a given year, without having to justify this decision<sup>(4)</sup>. These specific provisions, which introduced an exception to the budgetary principle of annuality, do not find a legal basis in the Financial Regulation.

**Council****Procurement**

9.17. In two out of six procurement procedures audited, the rules set in the Financial Regulation for the publication of the outcome of the procedure in contract award notices were not respected.

**9.15. THE REPLY OF THE EUROPEAN PARLIAMENT**

*Parliament notes the Court's finding and, in response, intends to discuss the possibility of:*

- *incorporating into the rules governing the use of Item 4 0 0 0 appropriations the requirement that the financial rules adopted by the groups should include a provision laying down the remit and duties of an internal auditor, as provided for in Article 85 of the Financial Regulation,*
- *allowing the groups either to appoint an internal auditor (if their size permits) or to confer those duties on an external auditor, on the understanding that he or she is not the external auditor responsible for examining the group's accounts.*

**9.16. THE REPLY OF THE EUROPEAN PARLIAMENT**

*A distinction should be drawn between the budgetary operations conducted by the authorising officer by delegation — who commits and pays appropriations from budget Item 4 0 0 0 in full compliance with the Financial Regulation, and in particular the principle of annuality — and the management of the resources of each political group, which is governed by specific rules adopted by the Bureau on 30 June 2003. Those rules take account of the constraints imposed by the specific nature of the political groups' role and make explicit provision for the carryover procedure referred to by the Court.*

**9.17. REPLY OF THE COUNCIL**

*In conformity with Article 149.1 of the Implementing Rules, the General Secretariat of the Council informs systematically and without delay all candidates participating in a tender procedure of the outcome of the procedure as soon as the contracting authority has decided on the award of the contract.*

*In addition, the award notice mentioned in Article 118.4 of the Implementing Rules is sent by the central procurement department for publication by the Publications Office as soon as the contract is signed by the authorising officer. Unfortunately, in the two cases identified by the Court, the latter informed the central procurement department too late and the delay mentioned in Article 118.4 of the IR was not respected.*

<sup>(3)</sup> Rules adopted by the Bureau of the European Parliament on 30 June 2003, as amended by decisions of 22 March 2006 and 11 July 2007.

<sup>(4)</sup> At the end of the financial year 2008, appropriations carried over by political groups amounted to 22 million euro, i.e. 42,5 % of the annual appropriations for 2008.

## THE COURT'S OBSERVATIONS

**Commission****Payment of social allowances and benefits to staff members**

9.18. The audit of ten transactions found that, in four cases, the Office for Administration and Payment of Individual Entitlements (PMO) did not deduct, from the social allowances provided for by the Staff Regulations, the family allowances that staff is entitled to receive from national authorities. In four other cases, the amounts deducted did not reflect the latest applicable value of benefits paid by national authorities. The IT systems used to manage these payments should be further developed to ensure that the amounts of allowances paid by national authorities are updated automatically.

9.19. The audit found that, in five cases out of 15, information available to the services of the General Directorate for External Relations (DG RELEX) in order to ensure that allowances provided for by the Staff Regulations are paid to staff serving in Delegations in compliance with relevant community regulations, was not up-to-date. This situation leads to the risk of making incorrect or undue payments. Staff should be requested to deliver at appropriate intervals to the Commission's services documents proving their personal situation. In addition, DG RELEX should implement a system for the timely monitoring and control of these documents.

9.20. Article 81a of the Staff Regulation provides limitations on the amount of survivors' pensions. They are applied when the rights to a survivors' pension are initially established. The audit found that these limitations were not reviewed at regular intervals to reflect the evolution of the personal and financial situation of the beneficiary, resulting in overpayments.

*It should be noted that the in the two cases cited by the European Court of Auditors (both with a very limited number of candidates), the latter have no grounds for complaint since they were informed individually immediately of the award decision.*

**9.18. REPLY OF THE COMMISSION**

*The Office for Administration and Payments of Individual Entitlements (PMO) has already taken action to catch up delays in the control of national social allowances and will follow up the detected cases. Between mid October 2009 and end of April 2010, 348 files out of 598 files have been opened and already 243 files have been closed. Controls will continue further.*

*It is foreseen to build in the new system the possibility to update automatically national allowances, but it will not be possible to put this module into operation before the beginning of 2011. However, from that moment onwards, allowances will be corrected retroactively and recovered according to article 85 of the Staff regulations.*

**9.19. REPLY OF THE COMMISSION**

*The Commission (DG RELEX) takes note of this observation and will address this problem with the provision of timely and adequate information to officials and with regular checks. There are checks on the personal situation of staff when new staff arrives to take up their posts. Regular checks on staff who have served for some time may also be undertaken as a part of controls operated by the units responsible for the management of rights and obligations of staff in Delegations.*

*In particular, the forthcoming creation of the European External Action Service (EEAS) will require the circulation of information and the adoption where necessary of standard documents for the new service. The adaptation of the EC Staff Regulations will provide the opportunity to remind staff that, among other matters, where their personal circumstances change they have to inform the EEAS's services and they have to provide the documents proving their situation.*

*Concerning the five cases identified the Commission will duly follow-up these cases and if there is a financial impact, the necessary corrective measures shall be taken.*

**9.20. REPLY OF THE COMMISSION**

*The update of all files where this provision of the Staff Regulation is applicable began in February 2010. As soon as the backlog will have been addressed, the PMO will review the files concerned whenever there is a modification in the situation of the beneficiaries or when the criteria mentioned in Article 81a apply. The PMO will also examine if the new IT system being developed for determining the pensions could be used for an automatic update of the files.*

## THE COURT'S OBSERVATIONS

**Court of Justice** <sup>(5)</sup>**Procurement**

9.21. For the purchase of publication services, the Court of Justice did not anticipate the expiry of a framework contract, and ordered services amounting to 102 000 euro without applying competitive procurement procedures. This situation confirms the need for better preparation and coordination of procurement procedures <sup>(6)</sup>.

**9.21. REPLY OF THE COURT OF JUSTICE**

As the Court of Auditors states <sup>(1)</sup>, the Court of Justice was in 2009 the subject of an in depth assessment. The assessment related to a random sample of 54 transactions <sup>(2)</sup> covering a wide range of the activities and departments of the Court of Justice and representing a substantial part of its annual budget, with the aim of testing the effectiveness of the supervisory and control systems established by the Court of Justice.

In the current annual report, the Court of Auditors offers no overall conclusion in relation to the results of that in depth assessment.

However, the detailed conclusions sent by the Court of Auditors to the Court of Justice in March 2010 as part of the procedure prior to the drafting of the annual report are broadly positive and demonstrate that the supervisory and control systems already in place operated effectively to discover any errors and departures from the rules.

For example, in relation to expenditure relating to human resources (representing more than 70 % of the institution's budget), the Court of Auditors expressly states that 'the supervisory and control systems relating to the management and payment of remuneration and allowances are in general capable of discovering any errors or irregularities'.

As regards other administrative expenditure, the Court of Auditors has made no comment on 9 of the 10 transactions assessed, in other words, taking into account the value of each transaction in the sample, on more than 99 % of the expenditure assessed.

Lastly, as regards procurement, the detailed conclusions drawn from the assessment by the Court of Auditors explicitly referred to the series of initiatives already begun by the Court of Justice to respond to the recommendation made by the Court of Auditors in November 2009 with the objective of improving procurement procedures within the Court of Justice and providing assistance to the authorising departments in this field. Even more significantly, those conclusions stated that, following examination of whether the provisions of contract award procedures in a sample of three contracts signed in 2009 with a value of EUR 20,5 million complied with the Financial Regulation, 'no comment was called for'.

<sup>(5)</sup> See footnote 1.

<sup>(6)</sup> See also the 2008 Annual Report, paragraph 11.14 (OJ C 269, 10.11.2009).

<sup>(1)</sup> See footnote to paragraph 9.6.

<sup>(2)</sup> The assessment dealt with 41 transactions relating to the management of expenditure related to human resources and 13 transactions related to the management of other expenditure of an administrative nature (three public contract award procedures and 10 other transactions).

## THE COURT'S OBSERVATIONS

However, also in those detailed conclusions, the Court of Auditors commented on a transaction involving the sum of EUR 10 944 <sup>(3)</sup> relating to a contract for the publication of notices in the press of Member States, with a relatively modest value (EUR 102 000), an ancillary part of the principal freelance legal translation contract, which had a very substantial value (EUR 28 million). This observation alone is reproduced in the current annual report. Accordingly, the Court of Justice would like to offer the following explanation, so that the context in which this ancillary contract was authorised can be better understood.

When calls for tenders were issued for the renewal of contracts for freelance translation into all the official languages of the European Union, the Court of Justice considered that it was necessary to publish in the press of the various Member States notices designed to inform the general public of those calls for tenders. To that end, the Court placed an order with the company which it had used in the past as an intermediary between itself and the news media. However, the Court of Justice's verification department discovered that the framework contract which had previously existed with that intermediary had come to an end (a fact unknown to those departments concerned with management of the freelance translation contracts).

At that juncture, the authorising officer, who could have restricted publication of the calls for tenders to that legally required in the Official Journal, took the view that the publication of notices in the press remained of crucial importance to ensure broadly based competition (as required by Article 89(2) of the Financial Regulation) given the targeted public, namely freelance translators, it being unlikely that they would respond in large numbers to publication solely in the Official Journal.

In fact, the notices in the press were wholly successful and, as a result of strong competition, the average price of a page of translation under the new freelance translation contracts is 7,5 % less than the average price under the earlier contracts, which represents a very significant saving for the Court's budget (approximately EUR 2,4 million over four years).

It follows from the foregoing that, first, the internal control systems of the Court of Justice operated effectively in discovering that the framework contract had expired and, second, this departure from established procedures, approved in this case in the best interests of the Court's budget and in accordance with the principle of sound financial management, was identified and documented as provided for in the Court's internal control standards <sup>(4)</sup>.

<sup>(3)</sup> This transaction is part of the sample of 10 transactions with a total value of EUR 30,86 million aimed at assessing the management of administrative expenditure (other than human resources and contract award procedures tested separately).

<sup>(4)</sup> Internal control standard No 13 of the Court of Justice, according to which 'departments shall take appropriate steps to ensure that all cases in which, because of exceptional circumstances, controls are not applied or established policies and procedures are departed from are recorded in writing, justified and approved at an appropriate level before measures are adopted.' was fully complied with in the exceptional circumstances set out above.

## THE COURT'S OBSERVATIONS

*It can be added that action already taken to improve contract award procedures within the Court of Justice, in particular the enhanced management of data relating to contracts directly in the Court's computerised financial management system, will ensure that in future the situation to which this observation of the Court of Auditors relates can be avoided.*

*Lastly, it should be recalled that several recent resolutions<sup>(5)</sup> of the European Parliament draw attention to the complexity and administrative costs of the provisions of the Financial Regulation relating to public procurement for certain institutions — such as the Court of Justice — and invite the Commission to take that into account when those rules are next revised. The Court of Justice cannot but hope that those recommendations for the simplification of the Financial Regulation can be introduced as part of the revision which is currently underway.*

**Court of Auditors**

9.22. The external auditor's report<sup>(7)</sup> 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 2009, 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**

9.23. The audit did not identify any reportable weakness in respect of the topics audited.

**Committee of the Regions**

9.24. The audit did not identify any reportable weakness in respect of the topics audited.

<sup>(7)</sup> See the audit report on the financial statements referred to in paragraph 9.8.

<sup>(5)</sup> See point 17 of the decision of 23 April 2009 on the 2007 discharge of the Court of Justice [2008/2278(DEC)] and point 45 of the resolution of 18 May 2010 on the estimates of revenue and expenditure of the European Parliament for the financial year 2011 [2010/2005(BUD)].



## THE COURT'S OBSERVATIONS

**European Ombudsman** <sup>(8)</sup>**Engagement of temporary and contractual agents**

9.25. Article 12(5) of the Conditions of Employment of Other Staff of the Communities requires that each Institution shall have general provisions on the procedures for recruitment of temporary staff. Such provisions have not yet been adopted by the European Ombudsman although 47 out of 63 posts granted under the 2009 budget are temporary posts.

**European Data Protection Supervisor** <sup>(9)</sup>**Payment of social allowances to staff members**

9.26. The audit found that, in four cases out of ten, information available to the European Data Protection Supervisor's services, in order to ensure that allowances provided for by the Staff Regulations are paid to staff in compliance with relevant community regulations and national legislation, was not up-to-date. This situation leads to the risk of making incorrect or undue payments. Staff should be requested to deliver at appropriate intervals documents proving their personal situation. In this respect, the European Data Protection Supervisor should improve its system for the timely monitoring and control of these documents.

**Standards of internal control**

9.27. The European Data Protection Supervisor had not put in place a system of ex-post verification, where appropriate, as required by the Financial Regulation. In addition, the standards of internal control adopted by the European Data Protection Supervisor did not provide that exceptions to standard financial procedures are duly recorded in a central register.

**9.25. REPLY OF THE EUROPEAN OMBUDSMAN**

*The European Ombudsman has taken due note of the Court's observation and his services have been instructed to draft provisions on the procedures for recruitment of temporary staff to be adopted before the third quarter of 2010.*

**9.26. REPLY OF THE EUROPEAN DATA PROTECTION SUPERVISOR**

*At present, because of its small size, the EDPS is assisted by the PMO in handling the social allowances files. Once a year the information related to family and dependent child allowances is updated by the PMO on the basis of specific forms addressed to the staff concerned through the EDPS. These forms have been prepared by the PMO for this purpose. On the basis of the information gathered through these forms the social allowances are kept up to date.*

*In view of the Court's recommendation, the EDPS will improve the monitoring of information pertinent to the social allowances referred to by the Court.*

**9.27. REPLY OF THE EUROPEAN DATA PROTECTION SUPERVISOR**

*All the transactions carried out by the EPDS, including the reimbursement of direct payments which have been processed by other institutions on behalf of the EDPS, are already subject to an extensive ex-ante control.*

*In view of the recommendation by the Court, the EDPS will examine how to implement an ex-post verification process for the year 2011 onwards. Because of the institution's small size and the particularity of shared file handling under the various cooperation and service level agreements, further interinstitutional assistance may be necessary to enable the EDPS to fulfil this task.*

<sup>(8)</sup> See footnote 1.

<sup>(9)</sup> See footnote 1.

## THE COURT'S OBSERVATIONS

*The EDPS has decided to implement the Court's second observation on standards of internal control by creating a central list of recorded exceptions.*

**CONCLUSIONS AND RECOMMENDATION**

9.28. Based on its audit work, the Court concludes that the payments as a whole for the year ended 31 December 2009 for the Institutions' administrative expenditure were free from material error (see paragraph 9.9).

9.29. 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 9.13 to 9.27).

9.30. A follow-up of previous observations is summarised in **Annex 9.4**.

9.31. In the area of the payment of social allowances, the Court recommended to the Institutions and bodies concerned (see paragraphs 9.14, 9.19 and 9.26) that they request their staff to deliver at appropriate intervals documents confirming their personal situation and that they implement a system for the timely monitoring of these documents.

**EUROPEAN UNION AGENCIES AND EXECUTIVE AGENCIES**

9.32. Audits of the European Union's Agencies and Executive Agencies are the subject of Specific Annual Reports which are published separately in the Official Journal<sup>(10)</sup>. The Court audited 30 Agencies for the financial year 2009. Their budgets totalled 1 500,6 million euro in 2009. The principal data concerning the Agencies are set out in **Table 9.2**.

9.33. For each Agency, the Court issued a report for the financial year ended on 31 December 2009 with its opinion regarding the reliability of the accounts and the regularity of the transactions. These reports will be published separately in the *Official Journal of the European Union* by the end of the year.

9.34. With regard to the Euratom Supply Agency, the Court draws attention to the fact that in contradiction to its Statutes, the Agency had no budget for the year 2009 and consequently all the Agency's expenditure, except for the bank charges, was paid by the Commission. This situation repeated the one already observed in 2008. The Commission in consultation with all the interested parties should analyse the possible measures to remedy this situation.

**9.34. REPLY OF THE COMMISSION**

*When preparing the 2008 budget, the Commission proposed a budget for the Euratom Supply Agency (ESA). This was refused by the Budgetary Authority and so the Commission took charge of all the expenses incurred by the ESA in 2008. The Commission continued to take charge of the ESA's expenses in the 2009 and 2010 budgets and has proposed to do likewise for 2011.*

<sup>(10)</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.



Table 9.2 — European Union Agencies and Executive Agencies — Principal data

European Union Agencies and Executive Agencies	Headquarters	First year of financial autonomy	Budget <sup>(1)</sup> (million euro)		Authorised post	
			2009	2008	2009	2008
<b>Agencies</b>						
Euratom supply Agency <sup>(2)</sup>	Luxembourg	1960	—	—	—	—
European Centre for the Development of Vocational Training	Thessaloniki	1977	18,6	18,3	101	99
European Foundation for the Improvement of Living and Working Conditions	Dublin	1977	20,2	21,0	101	101
European Environment Agency	Copenhagen	1994	39,8	37,1	133	123
European Training Foundation	Turin	1994	21,8	22,4	96	96
European Monitoring Centre for Drugs and Drug Addiction	Lisbon	1995	14,7	15,1	82	82
European Medicines Agency	London	1994	194,4	182,9	530	481
Translation Centre for the Bodies of the European Union	Luxembourg	1995	62,6	59,9	233	233
Community Plant Variety Office	Angers	1995	13,2	12,5	46	43
Office for Harmonisation in the Internal Market	Alicante	1995	338,1	318,4	658	643
European Agency for Safety and Health at Work	Bilbao	1996	15,0	14,9	44	44
European Fundamental Rights Agency	Vienna	1998	17,2	15,0	61	49
European Agency for Reconstruction <sup>(3)</sup>	Thessaloniki	2000	—	235,0	—	93
European Police College	Bramshill	2006	8,8	8,7	26	22,5
Eurojust	The Hague	2002	27,6	24,8	185	175
European Aviation Safety Agency	Cologne	2003	122,0	102,0	506	452
European Maritime Safety Agency	Lisbon	2003	53,3	50,2	192	181
European Food Safety Authority	Parma	2003	71,0	66,4	355	335
European Network and Information Security Agency	Heraklion	2005	8,1	8,4	44	44
European Railway Agency	Valenciennes	2006	21,0	18,0	124	116
European Centre for Disease Prevention and Control	Stockholm	2005	49,3	40,6	170	130
European Agency for the Management of Operational Cooperation at the External Border	Warsaw	2006	88,8	71,2	119	94
European GNSS Supervisory Authority <sup>(4)</sup>	Brussels	2006	44,4	10,5	23	50
Community Fisheries Control Agency	Vigo	2007	10,1	9,5	45	47
European Chemicals Agency	Helsinki	2008	70,4	66,4	324	220
<b>Executive Agencies</b>						
Executive Agency for Competitiveness and Innovation	Brussels	2006	13,3	11,5	37	36
Education, Audiovisual and Culture Executive Agency	Brussels	2006	47,7	38,2	99	92
Executive Agency for Health and Consumers	Luxembourg	2007	64	4,4	12	9
Trans-European Transport Network Executive Agency	Brussels	2008	8,9	5,2	32	32
Research Executive Agency <sup>(5)</sup>	Brussels	2009	21,6	—	88	—
European Research Council Executive Agency	Brussels	2009	14,5	—	100	—
<b>Total</b>			<b>1 500,6</b>	<b>1 488,5</b>	<b>4 566</b>	<b>4 122,5</b>

<sup>(1)</sup> Payment appropriations.<sup>(2)</sup> See paragraph 9.34.<sup>(3)</sup> Agency closed in 2008.<sup>(4)</sup> Provisional seat.<sup>(5)</sup> Agency having acquired its financial independence in 2009.

## THE COURT'S OBSERVATIONS

**EUROPEAN SCHOOLS**

9.35. 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 <sup>(11)</sup>. The Schools' 2009 budget of 267,2 million euro was financed mainly by a Commission grant (151,9 million euro) and by contributions from the Member States (53,7 million euro) <sup>(12)</sup>. The principal data concerning the European Schools are set out in **Table 9.3**.

9.36. The Court found no material errors that might call into question the reliability of the accounts that it audited (Munich and Luxembourg I 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 regularity of the transactions underlying these accounts.

9.37. Based on the review performed nothing has come to the Court's attention that causes it to believe that the consolidated accounts are not presented fairly, in all material respects, in accordance with the relevant accounting standards, with the following exceptions arising from the unsatisfactory application of the accrual based accounting principle: (a) no provisions were made for legal cases pending against the Schools, (b) no accruals were made for salary adjustments in 2009, (c) provisions for future expenses not related to the current year were included in the balance sheet when they should only have been disclosed in the explanatory notes.

**9.37. REPLY OF THE COMMISSION**

*The application of the accrual based accounting principle is being examined in a review, currently under way, of the Financial Regulation of the European Schools. Proposals arising from the review will be submitted to the Board of Governors later this year.*

<sup>(11)</sup> The Court conducts a review of the consolidated accounts and in addition performs an annual audit of the Central Office and a cyclical audit of two out of fourteen European Schools every year.

<sup>(12)</sup> Source: European Schools, *clôtures des comptes 2009*.

Table 9.3 — European schools — Principal data

European School	Country	Budget <sup>(1)</sup> <sup>(2)</sup> (million euro)		Grant received from the Commission <sup>(2)</sup> (million euro)		School Population <sup>(3)</sup>	
		2009	2008	2009	2008	2009	2008
Office	Belgium	9,6	9,2	8,3	7,0	—	—
Luxembourg I	Luxembourg	39,8	37,4	26,0	22,8	3 468	3 437
Luxembourg II	Luxembourg	7,6	7,0	4,5	3,4	910	888
Brussels I (Uccle)	Belgium	33,1	32,1	23,1	22,7	3 112	3 057
Brussels II (Woluwé)	Belgium	32,4	31,5	22,2	21,5	3 030	2 904
Brussels III (Ixelles)	Belgium	29,7	29,1	20,8	19,8	2 811	2 649
Brussels IV	Belgium	5,4	5,5	2,7	3,4	594	438
Mol	Belgium	12,0	11,3	6,9	6,0	752	718
Varese	Italy	19,8	18,7	10,2	9,3	1 304	1 341
Karlsruhe	Germany	13,4	12,9	3,8	2,4	976	979
Munich	Germany	20,9	19,5	0,4	0,6	1 848	1 756
Frankfurt am Main	Germany	11,5	10,6	6,5	3,9	1 085	1 053
Alicante	Spain	12,5	11,9	6,8	5,2	1 020	1 029
Bergen	Netherlands	9,8	9,8	4,8	5,1	586	565
Culham	United Kingdom	9,7	11,4	4,9	5,7	835	835
<b>Total</b>		<b>267,2</b>	<b>258,0</b>	<b>151,9</b>	<b>138,9</b>	<b>22 331</b>	<b>21 649</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 2009*.

<sup>(3)</sup> Source: 2009 Annual report of the Secretary General to the Board of Governors of the European Schools.

N. B.: Variations in totals are due to the effects of rounding.

## ANNEX 9.1

## RESULTS OF TRANSACTION TESTING FOR ADMINISTRATIVE EXPENDITURE

	2009				2008	2007
	Expenses related to staff of the Institutions	Expenses related to buildings	Other expenses	Total		
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>						
Total transactions (of which):	38	7	12	57	57	56
Advances	0	1	1	2	0	0
Interim/Final payments	38	6	11	55	57	56
<b>RESULTS OF TESTING</b>						
<i>(in % and numbers of transactions)</i>						
Transactions not affected by error	97 % {37}	100 % {7}	75 % {9}	<b>93 % {53}</b>	91 %	95 %
Transactions affected by error	3 % {1}	0 % {0}	25 % {3}	<b>7 % {4}</b>	9 %	5 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>						
Most likely error rate:						
< 2 %	<b>X</b>				<b>X</b>	<b>X</b>
2 % to 5 %						
> 5 %						




## ANNEX 9.2

## RESULTS OF EXAMINATION OF SYSTEMS FOR ADMINISTRATIVE EXPENDITURE

**Overall assessment of supervisory and control systems**

Overall assessment	2009	2008	2007

*Legend*

	Compliant
	Partially compliant
	Not compliant
N/A	Not applicable: does not apply or not assessed

## ANNEX 9.3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR ADMINISTRATIVE EXPENDITURE

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
PMO	without reservations	N/A	—	A
OIB	without reservations	N/A	—	
OIL	without reservations	N/A	—	
DIGIT	without reservations	N/A	—	

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: The Director-general's declaration and the annual activity report give a fair assessment of financial management in relation to regularity

B: The Director-general's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity

C: The Director-general's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity

## FOLLOW-UP OF PREVIOUS OBSERVATIONS FOR ADMINISTRATIVE EXPENDITURE

Court observation	Action taken	Court analysis	Institution's reply
<b>1. Multiplication factor applicable to salaries</b>			
<p>2007 Annual Report, paragraphs 11.7 to 11.11, most recently Annex 11.2 of the 2008 Annual Report:</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>Parliament and the Economic 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 forward 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 shares the procedural approach of the Court of Auditors and will wait for the Court of Justice's final rulings.</i></p>
<b>2. Reimbursement of accommodation costs incurred on mission</b>			
<p>2004 and 2007 Annual Reports, most recently Annex 11.2 of the 2008 Annual 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).</p> <p>Contrary to this rule, the Parliament provided in its internal rules for the payment of a flat-rate sum of 60 % of the maximum allowable amount, to staff who do not produce any evidence of having incurred accommodation costs.</p>	<p>The Internal Rules Governing Missions and Duty Travel by Officials and Other Servants of the European Parliament were adopted by a decision of the Secretary-General on 10 December 2009. In addition to arrangements for missions, these Internal Rules lay down specific arrangements applicable to duty travel to the three places of work of the Parliament (Luxembourg, Strasbourg and Brussels) including reimbursement of costs on a lump-sum basis without production of supporting documentation. 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>Updated rules do not comply with the Staff Regulations. 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 notes the Court's position on the new rules specifically adopted in the light of previous observations, but stands by its view concerning the need for staff 'undertaking duty travel between the three working places' and 'on mission' to be treated differently. Parliament intends to take advantage of the opportunity offered by a forthcoming revision of the Staff Regulations and of its role as co-legislator in that procedure to amend certain provisions of the Staff Regulations to introduce a distinction between missions and duty travel between the three working places.</i></p>

Court observation	Action taken	Court analysis	Institution's reply
			<p>In that connection, the budgetary authority has already altered the name and the remarks against former budget Item 3 0 0 0 , 'Mission expenses'. That item is now entitled 'Expenses on staff missions and duty travel between the three working places' and the remarks clearly stipulate that the appropriations are intended to cover expenditure on duty travel by staff, seconded national experts or trainees between their place of employment and one of Parliament's three working places (Brussels, Luxembourg and Strasbourg) and on missions elsewhere, thereby creating the basis in the budget for the rules which Parliament applies to duty travel between the three working places.</p>
<p><b>3. Allowances for assistance to Members of the European Parliament (MEPs)</b></p>			
<p>2006 Annual Report, paragraphs 10.10 to 10.12, and Annex 11.2 of the 2008 Annual Report:</p> <p>In its 2006 Annual Report, 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>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'</p>	<p>The clearance of the parliamentary assistance expenses for the 2004 - 2007 financial years has been fully completed.</p> <p>In relation to the 2008 financial year, the Parliament's administration has obtained over 98 % of statements of expenditure and amounts invoiced.</p> <p>In relation to the 2009 financial year, the Parliament's administration is currently processing statements received during the past months.</p>	<p>The Court will monitor the clearance by the Parliament of the MEPs' statements of expenditure related to the financial years 2008 and 2009.</p> <p>The Parliament's administration should perform checks on original invoices that support statements of expenditure.</p>	<p>The European Parliament's replies</p> <p><i>The regularisation of parliamentary assistance expenses for the years 2008-09 (first half) is taking place in accordance with the provisions of Article 14 of the Rules governing the payment of expenses and allowances to Members (PEAM). For the year 2008, 99,79 % of the total value of payments falling into the scope of the regularisation procedure had been successfully regularised. The remaining 0,2 % is currently treated on an individual case basis and where appropriate compulsory reimbursement of amounts is considered.</i></p> <p><i>For the first half of the year 2009 <sup>(1)</sup>, the rate of successful regularisation is at this step almost 92,31 % (i.e. 94 227 604 euro out of 102 074 881 euro). The remaining 7,6 % is principally composed of documents which are currently being examined (6,28 %). Documents concerning 1,41 % of the payments falling under the regularisation procedure are still awaited.</i></p>



Court observation	Action taken	Court analysis	Institution's reply
<p>issued by paying agents and service providers. These new rules apply for periods since July 2004. The 2007 Annual Report 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><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.</i></p> <p><i>Before the end of the year, when the remaining documents will be fully examined, it is expected that the final rate of successful regularisation will approach the levels seen for other years.</i></p>
<p><b>4. Additional pension scheme for Members of the European Parliament</b></p>			
<p>2006 Annual Report, Table 10.2, and Annex 11.2 of the 2008 Annual Report:</p> <p>The Court recalls the observations made regarding this matter in its 2008 Annual Report:</p> <p>(a) 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>(b) Parliament should clarify its role in the management and supervision of the Fund's assets;</p>	<p>According to an actuarial study provided by the Parliament, the Fund would incur an actuarial deficit of 84,5 million euros as at 31 December 2009, on the basis of the new rules defined in the decisions of the Bureau in its meeting of 1 April 2009.</p>	<p>The Parliament should obtain from the Fund the establishment of an investment strategy based on the guidelines set by the Parliament.</p>	<p>The European Parliament's replies</p> <p><i>Parliament reminds that on 1 April 2009 the Bureau took important decisions aimed at defining the Parliament's position towards the Fund and at ensuring clarity in its obligations and relations with it.</i></p> <p><i>Concerning Parliament's role in the settlement of the investments strategy, Parliament has shown its willingness to suggest general guidelines to the management of the Fund but does not intend to take an active part into precise investment decisions, nor could do so as the Fund is a separate and independent entity. Guidelines have already been given by letter of the EP President to the Fund on 4 May 2009, asking to avoid exposing the Fund to risks of fluctuation in exchange rates and to adopt a prudent investments strategy.</i></p> <p><i>The combined effect of the Bureau decisions, the guidelines given and the recovery of the financial markets has allowed the Fund to reduce the actuarial deficit from 121,84 million euro (31 December 2008) to 84,56 million euro (31 December 2009).</i></p>

Court observation	Action taken	Court analysis	Institution's reply
			<p>Moreover, Parliament has had new independent actuarial studies carried out with a view to assessing the financial situation of the Pension Fund following the entry into force of the Staff Regulations and the Bureau decisions of 9 March and 1 April 2009 modifying the Additional (Voluntary) Pension Scheme. Given that Parliament has acknowledged its liability for any deficit, the amount in question has been entered on the balance sheet, as requested by the Court. The actuarial assessment will be updated annually as part of the process of drawing up the annual financial statements.</p>
<p><b>5. Completion date for the Secured European System for Automatic Messaging (SESAME)</b></p>			
<p>2008 Annual Report, paragraph 11.10:</p> <p>The target completion date for the Secured European System for Automatic Messaging (SESAME) used to prepare the Council's annual budgets was consistently overoptimistic. There were many changes to the initial project design and there was no agreement among Member States on how to treat certain kinds of sensitive information. As a result the annual budget for SESAME was overestimated each year.</p>	<p>In 2009, the 2,7 million euro budget for SESAME was again overestimated by 2,4 million euro. However, the implementation of the Low Classified Segment of SESAME has been authorized by the Member States in the Political and Security Committee in October 2009. The project can thus be launched. However, a further agreement has to be reached on the design of the High Classified Segment of the project.</p>	<p>The Council should ensure that budgetary appropriations made available for the SESAME project are in line with the state of implementation of the project.</p>	<p>The Council's replies</p> <p><i>The General Secretariat of the Council accepts the analysis of the Court of Auditors regarding the follow-up of the 2008 observation of the Court of Auditors on the SESAME project.</i></p> <p><i>In order to ensure that budgetary appropriations for the SESAME project are in line with the state of implementation of the project, the amounts foreseen in the budget 2010 and the draft budget 2011 are reduced to EUR 400 000 per year.</i></p>

Court observation	Action taken	Court analysis	Institution's reply
<b>6. Implementation of the Individual Rights Information System</b>			
<p>2008 Annual Report, paragraph 11.11:</p> <p>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. 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.</p>	<p>Following the problems encountered, the development of IRIS was stopped. Two new projects were launched: one for the management of individual entitlements and one for the management of sickness assurance. During the development of these applications, the calculation of individual rights is based on data introduced manually in the payroll calculation system.</p>	<p>The Commission should ensure that new applications will be implemented only when evidence that the results of system testing are satisfactory is obtained.</p>	<p>The Commission's replies</p> <p><i>The PMO has already started the tests of the redeveloped modules for the management of individual entitlements. The extensive test programme elaborated takes into account the lessons drawn from past experience.</i></p>
<b>7. Pension scheme for local staff at Commission Delegations</b>			
<p>2008 Annual Report, paragraph 11.13:</p> <p>Since 1996, the pension scheme for the local staff employed at Commission delegations established by the External Service Directorate of the General Directorate for External Relations 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.</p>	<p>The Commission agreed to explore how to make this scheme permanent. It also confirmed the need for the establishment of a legislative proposal and for the performance of an actuarial study.</p>	<p>The Commission should take action to adopt rules for the organisation and the management of this scheme.</p>	<p>The Commission's replies</p> <p><i>Making the current complementary scheme permanent needs a legal basis. This requires an amendment of the Conditions of Employment of Other Staff, which the Commission has included in the EEAS proposal to the Council and the Parliament.</i></p>
<p>(<sup>1</sup>) As of 26 July 2010.</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 Union. 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 Treaties <sup>(1)</sup> <sup>(2)</sup> (Articles 310 to 325 TFEU) and 106a EAEC and by the financial regulations <sup>(3)</sup>.

### 3. BUDGETARY PRINCIPLES LAID DOWN IN THE TREATIES AND THE FINANCIAL REGULATION

All items of European Union 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 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 European Union 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 1**).

### 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;
- payment appropriations make it possible to cover expenditure arising from commitments entered into during current and preceding financial years;

<sup>(1)</sup> Treaty of Rome (25 March 1957): Treaty on the functioning of the European Union (TFEU).

<sup>(2)</sup> Treaty of Rome (25 March 1957): Treaty establishing the European Atomic Energy Community (EAEC).

<sup>(3)</sup> Mainly the Financial Regulation (FINREG) of 25 June 2002 (OJ L 248, 16.9.2002, p. 1).

<sup>(4)</sup> Principal legal acts relating to own resources: Council Decision 2007/436/EC, Euratom (OJ L 163, 23.6.2007, p. 17); Council Decision 2000/597/EC, Euratom (OJ L 253, 7.10.2000, p. 42); Council Regulation (EC, Euratom) No 1150/2000 (OJ L 130, 31.5.2000, p. 1).

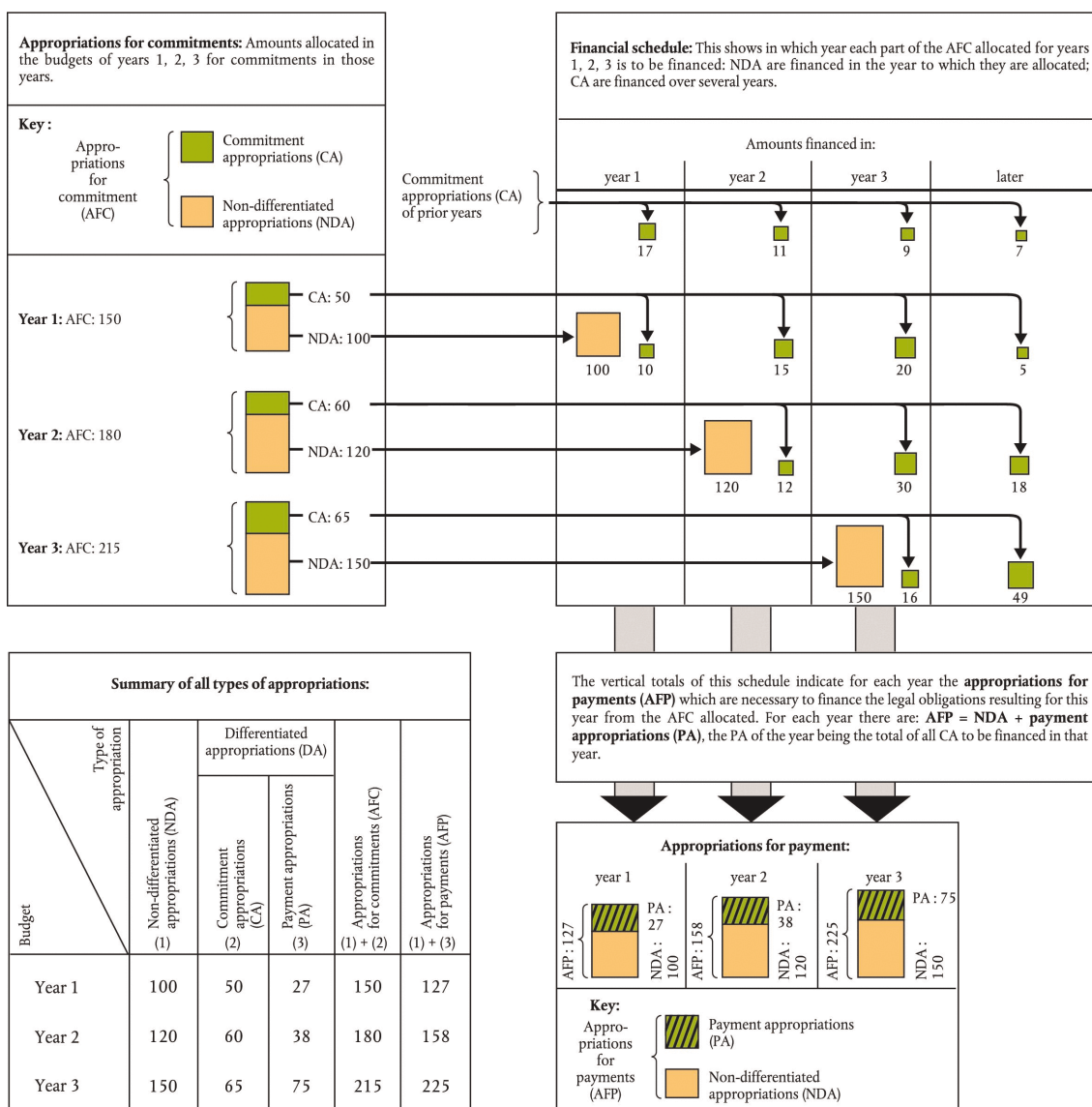
(b) non-differentiated appropriations (NDA) make it possible to ensure the commitment and payment of expenditure relating to annual activities during each financial year.

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 European Union 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 European Union (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 317 TFEU, 106a EAEC 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 Union <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 Union, 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 Union.

#### **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 285 to 287 TFEU, 106a EAEC and Articles 139 to 147 of the FINREG.

<sup>(9)</sup> See Articles 319 TFEU and 106a EAEC.

**EXPLANATORY NOTES**

## SOURCES OF FINANCIAL DATA

The financial data contained in this Annex have been drawn from the annual accounts of the European Union 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	Official Journal of the European Union
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 2009 AND BUDGETARY IMPLEMENTATION DURING THE FINANCIAL YEAR 2009**

DIA I	Budget 2009 — Estimated revenue and final appropriations for payments
DIA II	Budget 2009 — Appropriations for commitments
DIA III	Appropriations for commitments available in 2009 and utilisation thereof
DIA IV	Appropriations for payments available in 2009 and utilisation thereof
DIA V	Own resources in 2009, by Member State
DIA VI	Payments made in 2009, in each Member State

**CONSOLIDATED ACCOUNTS FOR THE FINANCIAL YEAR 2009**

DIA VII	Consolidated balance sheet
DIA VIII	Consolidated economic outturn account

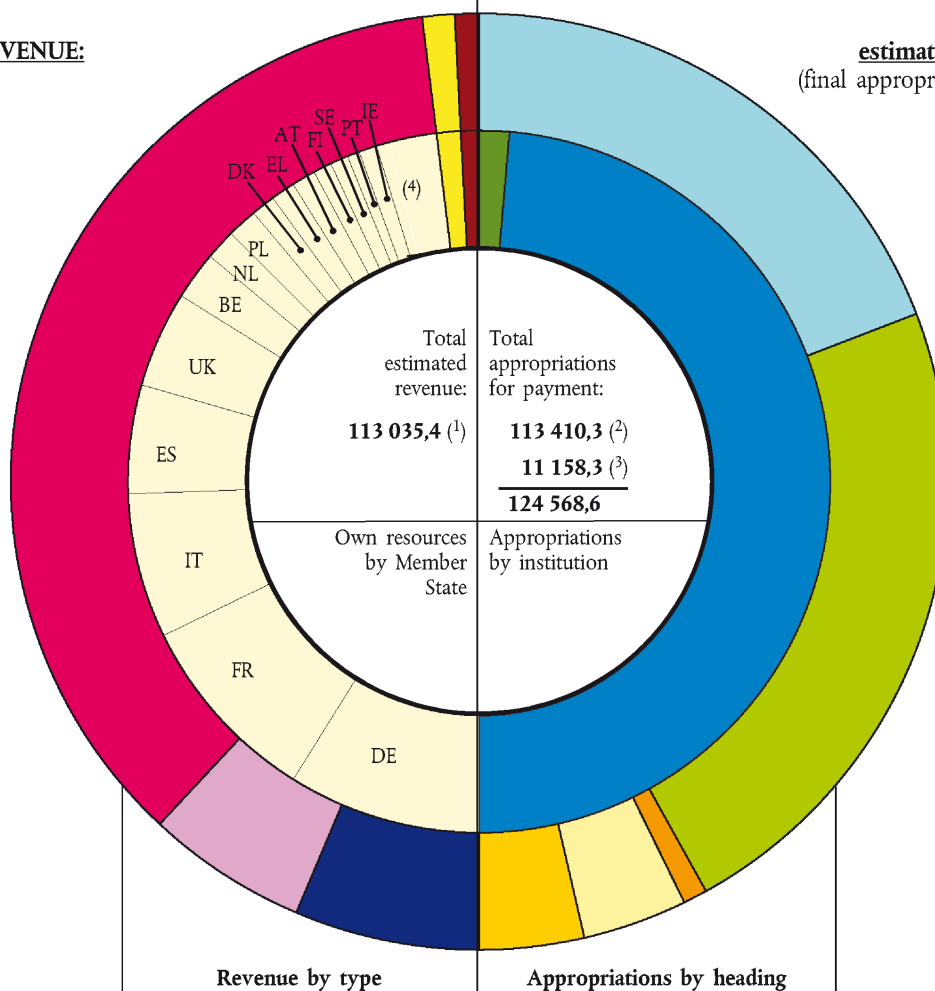
**Diagram I**  
**Budget 2009 — Estimated revenue and final appropriations for payments**

[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)]

(million euro and %)

**estimated REVENUE:**

**estimated EXPENDITURE:**  
(final appropriations for payment)



**Revenue key:**

Total own resources (by Member State)	—	(0 %)
Agricultural duties	—	(0,1 %)
'Sugar' and 'isoglucose' levies	139,4	(0,1 %)
Customs duties	14 441,1	(12,8 %)
Own resources accruing from VAT	12 714,0	(11,2 %)
GNI-based own resources	81 557,1	(72,2 %)
Other revenue	2 387,7	(2,1 %)
Surplus available from the previous year	1 796,2	(1,6 %)

**Expenditure key**

**Financial framework headings**

1. Sustainable Growth	47 520,1	(38,1 %)
2. Preserv. Manage. of Natural Resources	57 106,9	(45,8 %)
3. Citizenship, freedom, security and justice	2 174,4	(1,7 %)
4. EU as a global player	8 804,1	(7,1 %)
5. Administration	8 754,0	(7 %)
6. Compensation	209,1	(0,2 %)
Appropriations available for other institutions	3 333,9	(2,7 %)
Appropriations available to the Commission	121 234,7	(97,3 %)
of which operating appropriations	115 814,6	(93 %)

(1) After amending budgets.

(4) Revenue contribution by CZ, RO, HU, SK, SI, LU, BG, LT, LV, EE, CY, MT was grouped together.

(2) After amending budgets and transfers between budget headings.

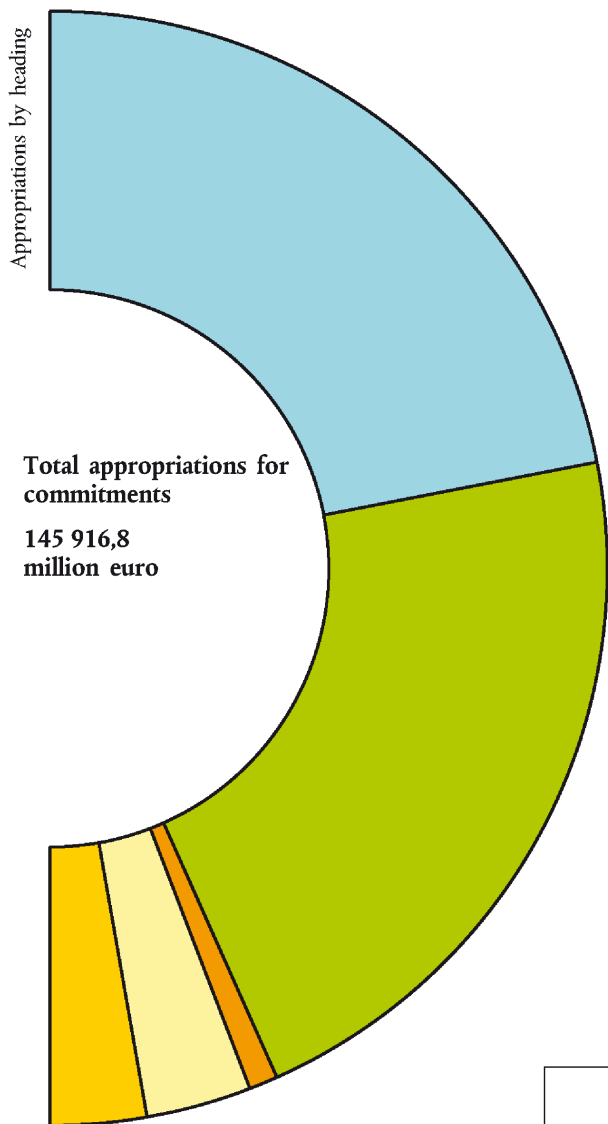
(3) Assigned revenue and appropriations carried over.



**Diagram II**  
**Budget 2009 — 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 2009 as the commitment appropriations also include amounts to be financed by budgetary revenue from subsequent years.

**Expenditure key**  
 Financial framework headings:

1. Sustainable Growth	63 923,3	(43,8 %)
2. Preserv. and Managem. of Natural Resources	62 718,4	(43 %)
3. Citizenship, freedom, security and justice	2 327,7	(1,6 %)
4. EU as a global player	8 713,5	(6 %)
5. Administration	8 024,7	(5,5 %)
6. Compensation	209,1	(0,1 %)





**Diagram III**  
**Appropriations for commitments available in 2009 and utilisation thereof**

(million euro and %)

Sections (S) and titles (T) corresponding to the 2009 budgetary nomenclature and financial framework headings	Final appropriations <sup>(1)</sup>	Utilisation of appropriations					
		Commitments entered into	Utilisation rate (%)	Carry-overs to 2010	Rate (%)	Cancellations	Rate (%)
		(a)	(b)	(b)/(a)	(c)	(c)/(a)	(d) = (a) - (b) - (c)
<b>Budgetary nomenclature</b>							
I Parliament (S. I)	1 596,1	1 467,4	91,9	26,3	1,6	102,4	6,4
II Council (S. II)	642,1	592,8	92,3	37,7	5,9	11,5	1,8
III Commission (S. III)	142 946,7	139 778,5	97,8	2 486,7	1,7	681,5	0,5
III.1 Economic and financial affairs (T.01)	444,6	439,7	98,9	1,5	0,3	3,4	0,8
III.2 Enterprise (T.02)	757,3	697,6	92,1	55,5	7,3	4,2	0,6
III.3 Competition (T.03)	94,1	91,6	97,3	1,8	2,0	0,7	0,8
III.4 Employment and social affairs (T.04)	11 255,1	11 195,6	99,5	46,0	0,4	13,4	0,1
III.5 Agriculture and rural development (T.05)	61 260,4	60 054,0	98,0	1 180,3	1,9	26,1	0,0
III.6 Energy and transport (T.06)	4 859,0	4 803,4	98,9	44,0	0,9	11,5	0,2
III.7 Environment (T.07)	487,8	459,8	94,2	18,7	3,8	9,4	1,9
III.8 Research (T.08)	5 388,0	5 083,5	94,3	301,2	5,6	3,3	0,1
III.9 Information society and media (T.09)	1 609,3	1 555,8	96,7	52,3	3,3	1,2	0,1
III.10 Direct research (T.10)	795,3	432,6	54,4	360,8	45,4	1,9	0,2
III.11 Fisheries and maritime affairs (T.11)	985,4	976,2	99,1	4,5	0,5	4,7	0,5
III.12 Internal market (T.12)	68,5	66,2	96,6	1,1	1,6	1,2	1,8
III.13 Regional policy (T.13)	38 559,9	38 523,1	99,9	22,0	0,1	14,8	0,0
III.14 Taxation and customs union (T.14)	133,6	126,2	94,5	1,6	1,2	5,8	4,3
III.15 Education and culture (T.15)	1 691,0	1 566,1	92,6	123,5	7,3	1,4	0,1
III.16 Communication (T.16)	217,4	213,7	98,3	1,4	0,6	2,3	1,0
III.17 Health and consumer protection (T.17)	695,2	675,5	97,2	11,1	1,6	8,6	1,2
III.18 Area of freedom, security and justice (T.18)	1 032,1	1 008,0	97,7	14,7	1,4	9,4	0,9
III.19 External relations (T.19)	4 167,5	4 105,3	98,5	53,8	1,3	8,4	0,2
III.20 Trade (T.20)	80,8	77,7	96,2	1,3	1,6	1,8	2,2
III.21 Development and relations with ACP States (T.21)	2 429,9	2 324,9	95,7	100,0	4,1	5,0	0,2
III.22 Enlargement (T.22)	1 131,6	1 119,9	99,0	10,3	0,9	1,4	0,1
III.23 Humanitarian aid (T.23)	915,0	913,0	99,8	1,0	0,1	0,9	0,1
III.24 Fight against fraud (T.24)	78,4	77,4	98,6	0,0	0,0	1,1	1,4
III.25 Commission's policy coordination and legal advice (T.25)	193,7	187,3	96,7	3,8	2,0	2,7	1,4
III.26 Commission's Administration (T.26)	1 092,5	1 047,9	95,9	36,5	3,3	8,1	0,7
III.27 Budget (T.27)	274,3	271,7	99,1	2,0	0,7	0,5	0,2
III.28 Audit (T.28)	10,9	10,5	96,8	0,2	1,9	0,1	1,3
III.29 Statistics (T.29)	143,4	133,0	92,7	7,1	4,9	3,3	2,3
III.30 Pensions (T.30)	1 135,9	1 117,3	98,4	—	—	18,7	1,6
III.31 Language Services (T.31)	455,8	424,0	93,0	28,5	6,2	3,4	0,7
III.40 Reserves (T.40)	503,0	—	—	—	—	503,0	100,0
IV Court of Justice (S. IV)	317,6	312,8	98,5	1,2	0,4	3,6	1,1
V Court of Auditors (S. V)	188,2	173,5	92,2	0,4	0,2	14,3	7,6
VI Economic and Social Committee (S. VI)	122,3	119,9	98,0	0,4	0,3	2,0	1,6
VII Committee of the Regions (S. VII)	88,2	86,8	98,4	0,1	0,1	1,4	1,6
VIII European Ombudsman (S. VIII)	9,0	8,3	92,0	—	—	0,7	8,0
IX European Data-protection Supervisor (S. IX)	6,7	5,4	81,4	—	—	1,2	18,6
<b>Grand total appropriations for commitments</b>	<b>145 916,8</b>	<b>142 545,4</b>	<b>97,7</b>	<b>2 552,7</b>	<b>1,7</b>	<b>818,7</b>	<b>0,6</b>
<b>Financial Framework</b>							
1 Sustainable Growth	63 923,3	62 444,5	97,7	972,1	1,5	506,7	0,8
2 Preservation and Management of Natural Resources	62 718,4	61 484,4	98,0	1 192,8	1,9	41,3	0,1
3 Citizenship, freedom, security and justice	2 327,7	2 264,1	97,3	49,9	2,1	13,7	0,6
4 EU as a global player	8 713,5	8 481,4	97,3	166,3	1,9	65,8	0,8
5 Administration	8 024,7	7 661,9	95,5	171,6	2,1	191,2	2,4
6 Compensation	209,1	209,1	100,0	—	—	—	—
<b>Grand total appropriations for commitments</b>	<b>145 916,8</b>	<b>142 545,4</b>	<b>97,7</b>	<b>2 552,7</b>	<b>1,7</b>	<b>818,7</b>	<b>0,6</b>
<b>Grand total appropriations for payments</b>	<b>124 568,6</b>	<b>118 361,0</b>	<b>95,0</b>	<b>4 519,1</b>	<b>3,6</b>	<b>1 688,5</b>	<b>1,4</b>

(<sup>1</sup>) 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.



**Diagram IV**  
**Appropriations for payments available in 2009 and utilisation thereof**

(million euro and %)

Sections (S) and titles (T) corresponding to the 2009 budgetary nomenclature and financial framework headings	Final appropriations (1)	Utilisation of appropriations					
		Payments made in 2009	Utilisation rate (%)	Carry-overs to 2010	Rate (%)	Cancellations	Rate (%)
		(a)	(b)/(a)	(c)	(c)/(a)	(d) = (a) - (b) - (c)	(d)/(a)
<b>Budgetary nomenclature</b>							
I Parliament (S. I)	1 798,8	1 466,1	81,5	211,9	11,8	120,8	6,7
II Council (S. II)	762,2	658,8	86,4	82,8	10,9	20,6	2,7
III Commission (S. III)	121 234,7	115 589,9	95,3	4 127,4	3,4	1 517,3	1,3
III.1 Economic and financial affairs (T.01)	345,2	327,4	94,8	14,1	4,1	3,7	1,1
III.2 Enterprise (T.02)	705,0	558,4	79,2	88,6	12,6	58,0	8,2
III.3 Competition (T.03)	107,0	94,5	88,3	10,1	9,4	2,4	2,3
III.4 Employment and social affairs (T.04)	9 929,4	8 906,4	89,7	754,7	7,6	268,3	2,7
III.5 Agriculture and rural development (T.05)	56 412,6	55 208,9	97,9	954,2	1,7	249,5	0,4
III.6 Energy and transport (T.06)	2 480,5	2 253,2	90,8	176,5	7,1	50,7	2,0
III.7 Environment (T.07)	408,6	356,1	87,2	30,2	7,4	22,2	5,4
III.8 Research (T.08)	5 644,1	4 825,8	85,5	788,6	14,0	29,7	0,5
III.9 Information society and media (T.09)	1 552,0	1 374,7	88,6	172,7	11,1	4,6	0,3
III.10 Direct research (T.10)	734,7	410,5	55,9	313,9	42,7	10,3	1,4
III.11 Fisheries and maritime affairs (T.11)	714,9	592,5	82,9	19,2	2,7	103,3	14,4
III.12 Internal market (T.12)	75,5	65,6	86,9	7,2	9,5	2,8	3,6
III.13 Regional policy (T.13)	26 792,8	26 739,5	99,8	14,9	0,1	38,4	0,1
III.14 Taxation and customs union (T.14)	131,5	120,4	91,5	8,6	6,5	2,5	1,9
III.15 Education and culture (T.15)	1 654,2	1 495,1	90,4	153,4	9,3	5,7	0,3
III.16 Communication (T.16)	228,6	203,9	89,2	16,4	7,2	8,3	3,6
III.17 Health and consumer protection (T.17)	632,2	526,4	83,3	35,3	5,6	70,6	11,2
III.18 Area of freedom, security and justice (T.18)	830,4	744,4	89,6	15,7	1,9	70,3	8,5
III.19 External relations (T.19)	3 804,5	3 673,4	96,6	72,5	1,9	58,7	1,5
III.20 Trade (T.20)	87,9	77,4	88,1	7,5	8,6	2,9	3,4
III.21 Development and relations with ACP States (T.21)	1 872,1	1 697,7	90,7	137,9	7,4	36,6	2,0
III.22 Enlargement (T.22)	1 436,5	1 308,4	91,1	17,9	1,2	110,2	7,7
III.23 Humanitarian aid (T.23)	858,7	799,7	93,1	46,6	5,4	12,4	1,4
III.24 Fight against fraud (T.24)	80,1	71,0	88,6	6,8	8,5	2,3	2,8
III.25 Commission's policy coordination and legal advice (T.25)	211,6	184,7	87,3	19,7	9,3	7,2	3,4
III.26 Commission's Administration (T.26)	1 225,6	1 033,7	84,3	163,6	13,4	28,2	2,3
III.27 Budget (T.27)	284,6	270,9	95,2	12,2	4,3	1,5	0,5
III.28 Audit (T.28)	11,5	10,4	90,0	0,9	7,4	0,3	2,5
III.29 Statistics (T.29)	137,8	120,3	87,3	14,7	10,6	2,9	2,1
III.30 Pensions (T.30)	1 135,9	1 117,3	98,4	—	—	18,7	1,6
III.31 Language Services (T.31)	479,5	421,5	87,9	52,8	11,0	5,1	1,1
III.40 Reserves (T.40)	229,0	—	—	—	—	229,0	100,0
IV Court of Justice (S. IV)	332,2	307,2	92,5	19,4	5,8	5,6	1,7
V Court of Auditors (S. V)	200,5	123,0	61,3	61,7	30,8	15,8	7,9
VI Economic and Social Committee (S. VI)	128,0	117,3	91,7	7,6	5,9	3,0	2,4
VII Committee of the Regions (S. VII)	95,0	85,6	90,1	6,4	6,7	3,0	3,2
VIII European Ombudsman (S. VIII)	9,6	8,1	84,6	0,7	7,6	0,8	7,9
IX European Data-protection Supervisor (S. IX)	7,6	4,9	64,2	1,1	15,0	1,6	20,7
<b>Grand total appropriations for payments</b>	<b>124 568,6</b>	<b>118 361,0</b>	<b>95,0</b>	<b>4 519,1</b>	<b>3,6</b>	<b>1 688,5</b>	<b>1,4</b>
<b>Financial Framework</b>							
1 Sustainable Growth	47 520,1	44 683,5	94,0	2 380,6	5,0	455,9	1,0
2 Preservation and Management of Natural Resources	57 106,9	55 877,3	97,8	985,7	1,7	243,9	0,4
3 Citizenship, freedom, security and justice	2 174,4	1 993,0	91,7	75,2	3,5	106,2	4,9
4 EU as a global player	8 804,1	7 982,9	90,7	220,0	2,5	601,2	6,8
5 Administration	8 754,0	7 615,3	87,0	857,5	9,8	281,3	3,2
6 Compensation	209,1	209,1	100,0	—	—	—	—
<b>Grand total appropriations for payments</b>	<b>124 568,6</b>	<b>118 361,0</b>	<b>95,0</b>	<b>4 519,1</b>	<b>3,6</b>	<b>1 688,5</b>	<b>1,4</b>

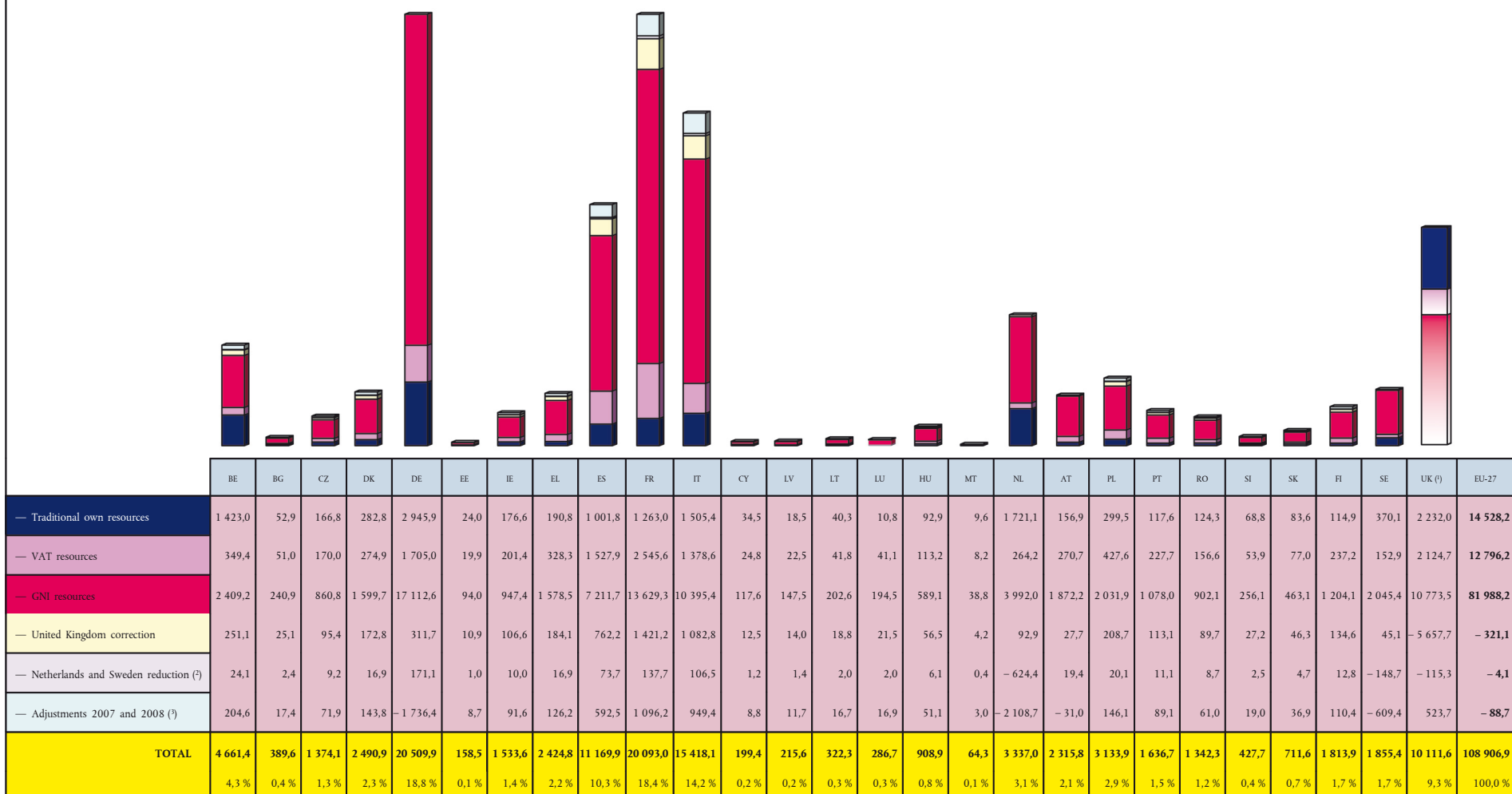
(1) Final budget appropriations after taking account of transfers between budget headings, appropriations relating to assigned revenue or similar and appropriations carried over from the previous financial year.



Diagram V  
Own resources in 2009, by Member State

## Revenue Outturn

(million euro and %)



(\*) For the United Kingdom a correction (5 657,7 million euro) is applied to the gross amount of own resources (15 769,3 million euro). The financing of this adjustment is borne by the other Member States.

(\*) For the Netherlands and Sweden a gross reduction in their annual GNI contribution is granted for the period 2007-2013. For 2009 their amounts are respectively 624,4 and 148,7 million euro.

(\*) Following the entry into force of the Council Decision 2007/436/EC, haratom on the system of the European Communities' own resources an adjustment was calculated for its implementation regarding the financial years 2007 and 2008.



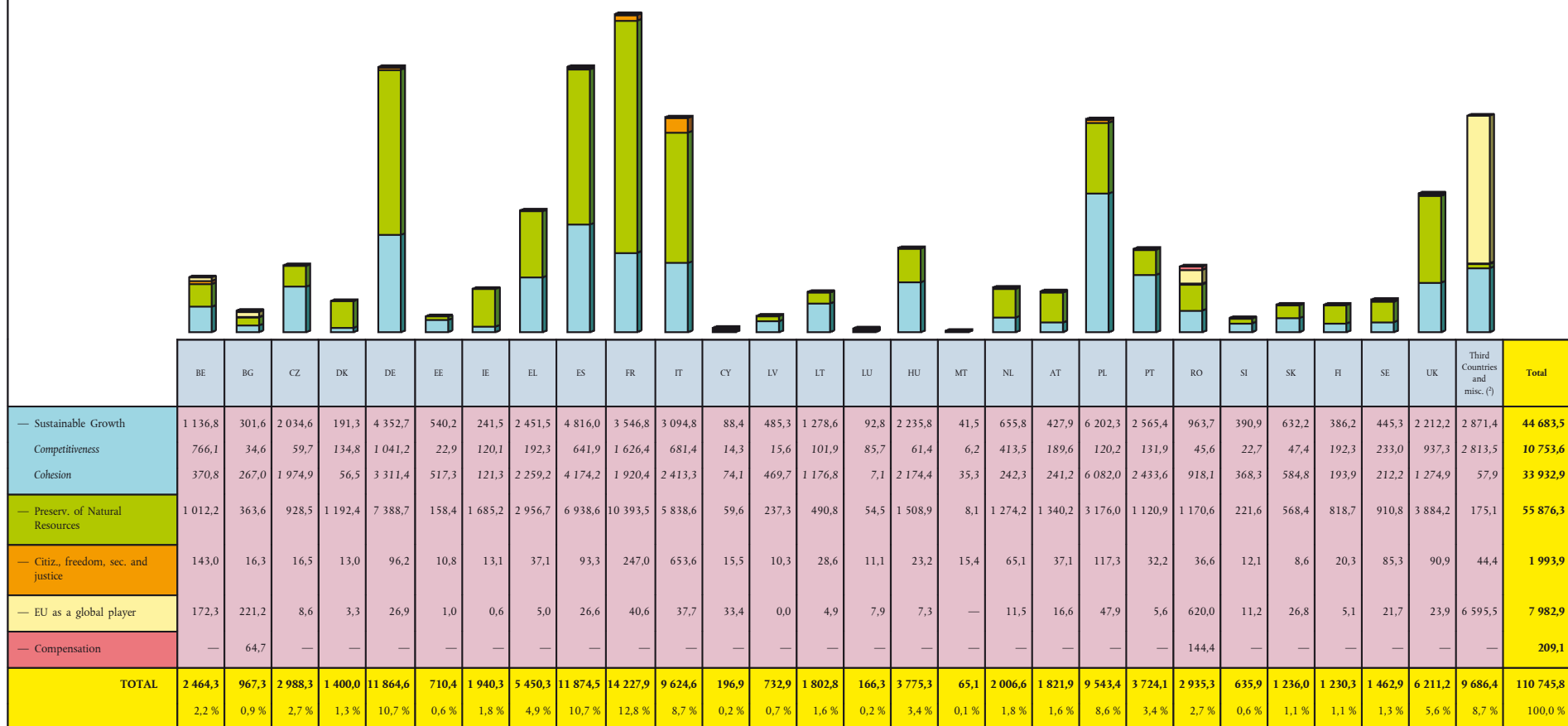
Diagram VI

Payments made in 2009, in each Member State <sup>(1)</sup>

Note: Payments made in 2009 = payments against 2009 operating appropriations plus payments against carry-overs from 2008.

## Financial framework headings

(million euro and %)

<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>		
	31.12.2009	31.12.2008
<b>Non-current assets:</b>		
Intangible assets	72	56
Property, plant and equipment	4 859	4 881
Long-term investments	2 379	2 078
Loans	10 764	3 565
Long-term pre-financing	39 750	29 023
Long-term receivables	55	45
	<b>57 879</b>	<b>39 648</b>
<b>Current assets:</b>		
Inventories	77	85
Short-term investments	1 791	1 553
Short-term pre-financing	9 077	10 262
Short-term receivables	8 663	11 920
Cash and cash equivalents	23 372	23 724
	<b>42 980</b>	<b>47 544</b>
<b>Total assets</b>	<b>100 859</b>	<b>87 192</b>
<b>Non-current liabilities:</b>		
Employee benefits	- 37 242	- 37 556
Long-term provisions	- 1 469	- 1 341
Long-term financial liabilities	- 10 559	- 3 349
Other long-term liabilities	- 2 178	- 2 226
	<b>- 51 448</b>	<b>- 44 472</b>
<b>Current liabilities:</b>		
Short-term provisions	- 213	- 348
Short-term financial liabilities	- 40	- 119
Accounts payable	- 93 884	- 89 677
	<b>- 94 137</b>	<b>- 90 144</b>
<b>Total liabilities</b>	<b>- 145 585</b>	<b>- 134 616</b>
<b>Net assets</b>	<b>- 44 726</b>	<b>- 47 424</b>
Reserves	3 323	3 115
Amounts to be called from Member States:		
<i>Employee benefits</i>	- 37 242	- 37 556
<i>Other amounts</i>	- 10 807	- 12 983
<b>Net assets</b>	<b>- 44 726</b>	<b>- 47 424</b>



<b>Diagram VIII</b>		
<b>Consolidated economic outturn account</b>		
<i>(million euro)</i>		
	31.12.2009	31.12.2008
<b>Operating revenue</b>		
Own resource and contributions revenue	110 537	112 713
Other operating revenue	7 532	9 731
	<b>118 069</b>	<b>122 444</b>
<b>Operating expenses</b>		
Administrative expenses	– 8 133	– 7 720
Operating expenses	– 104 934	– 97 214
	<b>– 113 067</b>	<b>– 104 934</b>
<b>Surplus from operating activities</b>	<b>5 002</b>	<b>17 510</b>
Financial revenue	835	698
Financial expenses	– 594	– 467
Movement in employee benefits liability	– 683	– 5 009
Share of net surplus (deficit) of associates and joint ventures	– 103	– 46
<b>Economic outturn for the year</b>	<b>4 457</b>	<b>12 686</b>

## ANNEX II

**List of Special Reports adopted by the Court of Auditors since the last Annual Report:**

- Special Report No 15/2009 — EU assistance implemented through United Nations organisations: decision-making and monitoring
- Special Report No 16/2009 — The European Commission's management of pre-accession assistance to Turkey
- Special Report No 17/2009 — Vocational training actions for women co-financed by the European Social Fund
- Special Report No 18/2009 — Effectiveness of EDF support for Regional Economic Integration in East Africa and West Africa
- Special Report No 1/2010 — Are simplified customs procedures for imports effectively controlled?
- Special Report No 2/2010 — The effectiveness of the Design Studies and Construction of New Infrastructures support schemes under the Sixth Framework Programme for Research
- Special Report No 3/2010 — Impact Assessments in the EU institutions: do they support decision-making?
- Special Report No 4/2010 — Is the design and management of the mobility scheme of the Leonardo da Vinci programme likely to lead to effective results?
- Special Report No 5/2010 — Implementation of the Leader approach for rural development
- Special Report No 6/2010 — Has the reform of the sugar market achieved its main objectives?
- Special Report No 7/2010 — Audit of the clearance of accounts procedure
- Special Report No 8/2010 — Improving transport performance on trans-European rail axes: Have EU rail infrastructure investments been effective?
- Special Report No 9/2010 — Is EU Structural Measures spending on the supply of water for domestic consumption used to best effect?

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 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: [euraud@eca.europa.eu](mailto:euraud@eca.europa.eu)**

or by filling in an electronic order form on EU-Bookshop.

**ANNUAL REPORT ON THE ACTIVITIES  
FUNDED BY THE EIGHTH, NINTH AND TENTH  
EUROPEAN DEVELOPMENT FUNDS (EDFs)**

(2010/C 303/02)



**Annual Report on the activities funded by the eighth, ninth and tenth European Development Funds (EDFs)**

## TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	1-5
Specific characteristics of the European Development Funds	2-5
Chapter I — Implementation of the eighth, ninth and tenth EDFs	6-10
Financial implementation	6-9
The Commission's annual report on the financial management of the eighth to tenth European Development Funds	10
Chapter II — Independent Statement of Assurance by the Court of Auditors on the EDFs	I-X
Independent Statement of Assurance by the Court of Auditors on the eighth, ninth and tenth European Development Funds (EDFs) for the financial year 2009	I-X
Information in support of the Statement of Assurance	11-55
Audit scope and approach	11-12
Reliability of the accounts	13-18
Regularity of transactions	19-25
Revenue	20
Commitments	21
Payments	22-25
Effectiveness of systems	26-51
Ex-ante controls	29-33
Monitoring and supervision	34-41
External audits	42-46
Internal Audit	47-48
Reliability of Commission management representations	49-51
Conclusions and recommendations	52-55

## THE COURT'S OBSERVATIONS

## INTRODUCTION

1. This Annual Report presents the Court's assessment of the European Development Funds (EDFs). Key information on the activities covered and spending in 2009 is provided in **Table 1**.

Table 1 — European Development Funds — Key information

(million euro)

Budget Title	Policy area	Description	Payments 2009	Management Mode
European Development Funds	8th EDF	Administrative expenditure	0	Centralised direct
		Operational expenditure	0	Central indirect
			20	Centralised direct
			152	Decentralised
			0	Joint management
			<b>172</b>	
	9th EDF	Administrative expenditure	4	Centralised direct
		Operational expenditure	36	Central indirect
			439	Centralised direct
			1 188	Decentralised
			177	Joint management
			<b>1 844</b>	
	10th EDF	Administrative expenditure	71	Centralised direct
		Operational expenditure	2	Central indirect
			663	Centralised direct
		110	Decentralised	
		261	Joint management	
		<b>1 107</b>		
Total administrative expenditure			75	
Total operational expenditure:			3 048	
<b>Total payments <sup>(1)</sup></b>			<b>3 123</b>	
<b>Total individual commitments <sup>(2)</sup></b>			<b>4 141</b>	
<b>Total global commitments <sup>(2)</sup></b>			<b>3 405</b>	

<sup>(1)</sup> Gross payments, excluding recoveries.

<sup>(2)</sup> The totals of individual and global commitments contain the decommitments.

Source: European Court of Auditors on the basis of data provided by AIDCO DataWarehouse.



## THE COURT'S OBSERVATIONS

**Specific characteristics of the European Development Funds**

2. The European Development Fund (EDF) is the main instrument for providing European Union aid for development cooperation to the African, Caribbean and Pacific (ACP) States and Overseas Countries and Territories (OCTs). It was created in 1957 under the Treaty of Rome.

3. The EDFs are funded by the Member States, governed by its own financial regulation and managed by a specific committee. The European Commission is responsible for the financial implementation of operations funded with resources of the EDFs. Within the Commission, almost all the EDF programmes are managed by the EuropeAid Cooperation Office (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>(1)</sup>. A small proportion of the EDF projects <sup>(2)</sup> relates to humanitarian aid and is managed by the Directorate-General for Humanitarian Aid (DG ECHO). The European Investment bank (EIB) manages the Investment Facility. The Investment Facility is not covered by the Court's Statement of Assurance or the European Parliament's discharge procedure <sup>(3)</sup> <sup>(4)</sup>.

4. The EDFs are managed under three main arrangements (**Table 1**): centralised, joint and decentralised management <sup>(5)</sup>. Under centralised management (40 % of payments in 2009), the Commission implements the aid activities directly; this relates mainly to budget support. Under joint management (14 % of payments in 2009), international organisations are responsible for implementing Community funded actions, provided that the accounting, audit, control and procurement procedures of the organisations offer guarantees equivalent to internationally accepted standards. EuropeAid's main partners are the United Nations' agencies and the World Bank. Under decentralised management (46 % of payments in 2009), the Commission entrusts the management of certain tasks to the authorities of the beneficiary countries. The principle of EDF decentralised management as regards the payment process is illustrated in **Diagram 1**.

<sup>(1)</sup> See Chapter 6 of the 2009 Annual Report of the Court of Auditors on the implementation of the budget.

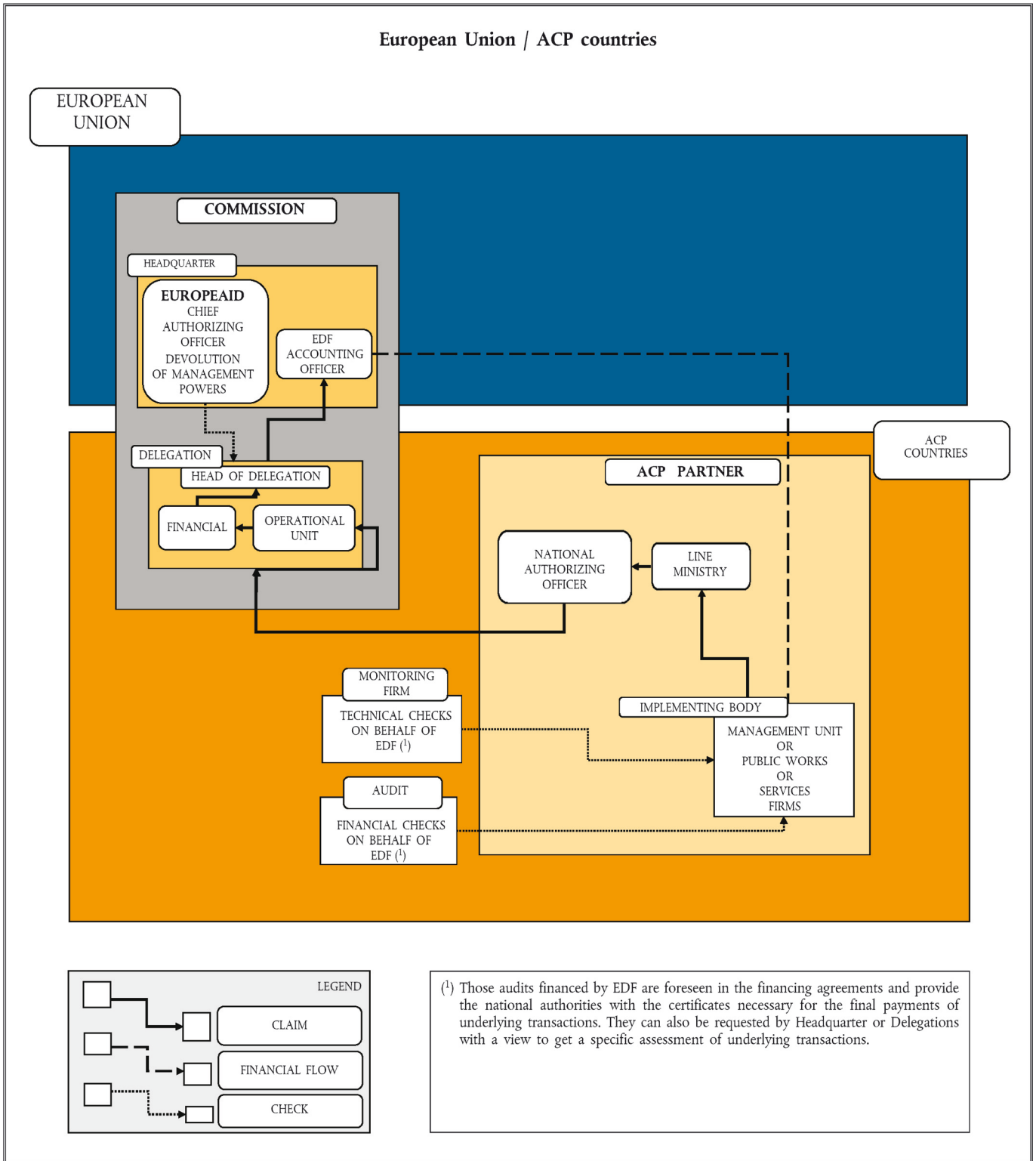
<sup>(2)</sup> Representing 0,9 % of 2009 payments.

<sup>(3)</sup> See Articles 118, 125 and 134 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the tenth European Development Fund (OJ L 78, 19.3.2008, p. 1). 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>(4)</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>(5)</sup> Articles 21 to 29 of the Financial Regulation applicable to the tenth EDF.

Diagram 1 — Principle of Decentralised management as regards the payment process



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

5. EDF interventions are implemented in and by countries in which internal control systems are generally weak. The lack of capacity of most National Authorising Officers in beneficiary countries and weaknesses in the establishment and application of financial procedures and controls of implementing organisations and supervisors constitute a high risk for the regularity of transactions. The remoteness of many project sites and the existence of conflicts in certain regions also increase the difficulty to perform verifications.

5. *The EDF is designed to help countries which are, by definition, in difficulty, and development aid policies must ensure that national authorities are in charge of development strategies. The National Authorising Officer plays a key part in this process. In order to ensure compliance with the applicable procedures and rules, a training programme specifically designed for staff in the offices of National Authorising Officers has been run for a number of years.*

## CHAPTER I — IMPLEMENTATION OF THE EIGHTH, NINTH AND TENTH EDFs

### Financial implementation

6. In 2009, the eighth, ninth and tenth EDFs were implemented simultaneously. Each EDF agreement is usually concluded for a period of around five years, whereby the programming cycles generally follow the partnership agreement/convention cycles. Although funds for each EDF are committed over a period of five years, payments can be made over a longer period.

6. *Although each EDF covers a period of around five years, the implementation of projects and programmes and the related payments may cover a longer period which is nevertheless limited by the regulations.*

7. Total contributions from the Member States amounted to 3 296 million euro received in 2009. Contributions are still being called up from the ninth EDF.

8. The tenth EDF covers the period from 2008 to 2013. It provides for Community aid worth 22 682 million euro and entered into force on 1 July 2008. Of this amount, 21 966 million euro are allocated to the ACP countries and 286 million euro to the OCTs. These amounts include 1 500 million euro and 30 million euro for the Investment Facility managed by the EIB for the ACP and OCT countries respectively. Finally, 430 million euro are earmarked for the Commission's expenditure for programming and implementation of the EDF.

## THE COURT'S OBSERVATIONS

9. **Table 2** shows the cumulative use of EDF resources managed by the Commission and their financial implementation. In 2009, the financial implementation forecasts set by the Commission for global commitments, and individual commitments were exceeded, reaching 3 406 million euro for global commitments and a record level of 4 140 million euro for individual commitments. Net payments amounted to 3 069 million euro which represented 92 % of the initial forecast. This shortfall is explained by the below forecast payments in countries subject to the consultation procedure laid down in article 96 of the Cotonou Agreement or other dialogue measures <sup>(6)</sup>, countries that had not yet ratified the Cotonou Agreement <sup>(7)</sup> and countries where budget support payments were not made due to that no confirmation had been provided as to the fulfilment of general or specific conditions <sup>(8)</sup>. Outstanding payments increased by 3 %, which is reasonable, given the gap between the level of global commitments and the net payments reached during the year. At the same time, old and dormant outstanding payments increased by 23 %, which is explained by the high level of global commitments made in 2007 so as to use up the remaining resources of the ninth EDF, but which did not lead to the same level of individual commitments.

## THE COMMISSION'S REPLIES

9. *The exceptional performance in relation to global and individual commitments testifies to the success of the policy adopted by the Commission to speed up programme implementation.*

*The increase in outstanding payments in 2009 is explained by the particularly high level of commitments in 2007 and by the EDF project cycle, which lasts on average three years, with the biggest payments generally being made in the first year and at the end of the final year.*

<sup>(6)</sup> Madagascar, Mauritania, Niger and Guinea Conakry.

<sup>(7)</sup> Sudan and Equatorial Guinea.

<sup>(8)</sup> Malawi, Haiti, Democratic Republic of Congo and Ethiopia.

Table 2 — Cumulative use of EDF resources at 31 December 2009

(million euro)

	Situation at end of 2008		Budgetary implementation during the financial year 2009				Situation at end of 2009				
	Global amount	Implementation rate <sup>(2)</sup>	8th EDF <sup>(3)</sup>	9th EDF <sup>(3)</sup>	10th EDF	Global amount	8th EDF	9th EDF	10th EDF	Global amount	Implementation rate <sup>(2)</sup>
<b>A — RESOURCES <sup>(1)</sup></b>	<b>48 677,7</b>		0,8	1,0	66,6	<b>68,4</b>	10 786,7	16 632,8	21 326,7	<b>48 746,1</b>	
<b>B — USE</b>											
<b>1. Financial commitments</b>	<b>32 185,3</b>	<b>66,1 %</b>	- 41,7	- 53,8	3 501,0	<b>3 405,5</b>	10 744,4	16 579,0	8 267,4	<b>35 590,7</b>	<b>73,0 %</b>
<b>2. Individual legal commitments</b>	<b>24 880,8</b>	<b>51,1 %</b>	- 41,8	997,4	3 184,1	<b>4 139,7</b>	10 499,1	15 206,8	3 314,5	<b>29 020,5</b>	<b>59,5 %</b>
<b>3. Payments <sup>(4)</sup></b>	<b>20 031,1</b>	<b>41,2 %</b>	152,1	1 805,8	1 111,4	<b>3 069,3</b>	10 082,4	11 816,9	1 201,1	<b>23 100,4</b>	<b>47,4 %</b>
<b>C — Outstanding payments (B1-B3)</b>	<b>12 154,1</b>	<b>25,0 %</b>					662,1	4 762,1	7 066,3	<b>12 490,3</b>	<b>25,6 %</b>
<b>D — Available balance (A-B1)</b>	<b>16 492,5</b>	<b>33,9 %</b>					42,3	53,8	13 059,3	<b>13 155,4</b>	<b>27,0 %</b>

<sup>(1)</sup> Initial allocations to the 8th, 9th and 10th EDFs, co-financing, interest, sundry resources, transfers from previous EDFs and migration adjustments.

<sup>(2)</sup> As a percentage of resources.

<sup>(3)</sup> Negative amounts correspond to decommitments.

<sup>(4)</sup> Net payments after recoveries.

Source: Court of Auditors, based on the EDF Reports on financial implementation and Financial statements at 31 December 2009.

---

THE COURT'S OBSERVATIONS

---

**The Commission's annual report on the financial management of the eighth to tenth European Development Funds**

10. 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), as well as of the financial situation and the events that had a significant influence on the activities carried out in 2009.

---

<sup>(9)</sup> Articles 118 and 124.

## CHAPTER II — INDEPENDENT STATEMENT OF ASSURANCE BY THE COURT OF AUDITORS ON THE EDFs

### Independent Statement of Assurance by the Court of Auditors on the eighth, ninth and tenth European Development Funds (EDFs) for the financial year 2009

I — Pursuant to the provisions of Article 287 of the Treaty on the functioning of the European Union and Article 141 of the Financial Regulation applicable to the tenth EDF, which also applies to previous EDFs, the Court has audited:

- (a) the 'Final annual accounts for the financial year 2009 of the 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 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 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.

<sup>(11)</sup> Pursuant to Articles 2, 3, 4, 125(4) and 134 of the Financial Regulation applicable to the tenth EDF this Statement of Assurance does not extend to the part of the 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 2009 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 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**

VI — In the Court's opinion, the final annual accounts of the eighth, ninth and tenth EDFs present fairly, in all material respects, the financial position of the EDFs as of 31 December 2009, 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.

VII — Without qualifying the opinion expressed in paragraph VI, the Court draws attention to an understatement of the amount of guarantees received in respect of prefinancing and to an overstatement of the amount of retention guarantees disclosed in the notes to the financial statements.

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

VIII — In the Court's opinion the revenue, commitments and payments underlying the accounts of the eighth, ninth and tenth European Development Funds for the year ended 31 December 2009, in all material respects are legal and regular.

IX — Without calling into question the opinion expressed in paragraph VIII, the Court draws attention to the high frequency of non-quantifiable errors affecting commitments and payments albeit not included in the estimation of total error.



X — The Court concludes that the Commission's supervisory and control systems are partially effective in preventing or detecting and correcting errors.

9 September 2010

Vitor Manuel da SILVA CALDEIRA

*President*

European Court of Auditors  
12, rue Alcide De Gasperi, 1615 Luxembourg, LUXEMBOURG

## THE COURT'S OBSERVATIONS

**INFORMATION IN SUPPORT OF THE STATEMENT OF ASSURANCE****Audit scope and approach**

11. The observations regarding the reliability of the accounts of the EDFs, set out in paragraphs VI and VII 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 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.

12. The Court's overall audit approach and methodology regarding the regularity of transactions underlying the accounts is described in Part 2 of Annex 1.1 to Chapter 1 of the 2009 Annual Report of the Court of Auditors on the implementation of the budget. The observations regarding the regularity of transactions of the EDFs, set out in paragraphs VIII to X of the Statement of Assurance, are based on the following components:

- (a) substantive testing of a representative statistical sample of 220 items, corresponding to 50 financial and individual commitments and 170 interim and final payments made by EuropeAid's central services and the Delegations. Where necessary, implementing organisations and final beneficiaries were visited on the spot in order to verify the 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 Delegations; this covered the following elements:
  - (i) ex-ante controls of contracts and payments by the authorising officers, including the National Authorising Officers,
  - (ii) monitoring and supervision,
  - (iii) external audits,
  - (iv) internal audit;
- (c) a follow-up of previous observations is summarised in **Annex 4**.

<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.'

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Reliability of the accounts**

13. The Court concludes that the accounts of the EDFs for the financial year ending 31 December 2009 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.

14. The 2009 annual accounts of the EDFs are the first set of accounts prepared using the new accrual based accounting system ABAC FED (the same system used for the General Budget of the European Union). It was implemented in February 2009 after the migration process from the previous cash-based accounting system (OLAS) had been successfully ended. The new system supports accrual based reporting better, for example, by reducing the number of manual adjustments needed to obtain accrual based accounts at year-end. The ABAC-FED has thus strengthened the accounting environment.

15. EuropeAid's ex-post controls identified an increased frequency of encoding errors<sup>(16)</sup>. While the Court's audit of the financial statements did not reveal material error due to such errors, these remain a source of concern as they may affect the accuracy of data used for the preparation of the annual accounts, in particular with respect to the cut-off exercise at year-end.

16. As announced in its reply to the 2008 Annual Report of the Court of Auditors on the EDFs<sup>(17)</sup>, the Commission has refined its method of estimating the provision for invoices to be received. The Court's audit confirmed the correct application of this method and found the amount of the accrued charges disclosed in the financial statements to be free from material error.

17. Note 2.2 to the financial statements regarding the ongoing amount of guarantees received in respect of pre-financing includes an amount of 413,6 million euro as at the end of 2009. The Court concludes that this amount was understated by 82,3 million euro, or 19,9 %.

15. *In some cases migration to the new IT system for project management may have caused confusion in the encoding of dates. EuropeAid has organised a large number of training courses in Delegations and at headquarters to improve use of this system.*

*At the end of 2009 EuropeAid's central services also set up a department to monitor the quality of information encoded in CRIS, which should further improve the reliability of the data used to prepare the annual accounts.*

*As the Court points out, this had no material impact on the annual accounts.*

17. *The Commission accepts this observation and the Authorising Officer has recorded the necessary corrections in 2010.*

*The Commission notes that the Court found a single error of 3.5 million euro identified in a sample of 39 contracts which was extrapolated.*

<sup>(16)</sup> E.g.: contract type, contract start and end dates.

<sup>(17)</sup> Paragraph 15 (O) C 269, 10.11.2009).

## THE COURT'S OBSERVATIONS

18. The amount of retention guarantees disclosed in note 5.1 to the financial statements was 186,2 million euro as at the end of 2009. The Court concludes that this amount was overstated by 58,4 million euro, or 31,4 %.

### Regularity of transactions

19. The results of the transaction testing are summarised in **Annex I**.

#### Revenue

20. The Court's audit of revenue transactions did not find material error.

#### Commitments

21. The Court's audit of commitments did not find material error but a significant frequency of non-quantifiable errors. The errors detected concerned compliance with tendering rules, legal deadlines for the signature of contracts and provisions regarding mandatory guarantees. As regards budget support commitments, the Court found that, in the context of the Commission's dynamic interpretation<sup>(18)</sup>, EuropeAid demonstrated in a formalised and structured manner compliance with the Cotonou Agreement requirements.

#### Payments

22. The Court's audit of payments did not find material error<sup>(19)</sup>. However, it detected some errors which are analysed in paragraphs 23 to 25.

#### Project payments

23. The main types of quantifiable errors detected on project payments were the following:

- (a) accuracy: calculation errors;
- (b) occurrence: absence of invoices or other supporting documents for services rendered or goods supplied;
- (c) eligibility: expenditure incurred outside the implementation period or related to items not foreseen in the contract, undue payment of VAT or non-application of mandatory penalties.

## THE COMMISSION'S REPLIES

**18.** *The Commission accepts the observation, but notes that the Court found a single error identified in a sample of 39 contracts which was extrapolated.*

**21.** *The Commission would stress that no payment was made without the coverage of financial guarantees. The Commission welcomes the finding that budget support eligibility was demonstrated in a formalised and structured manner.*

<sup>(18)</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>(19)</sup> The Court sets the materiality threshold at 2 %.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

24. The non-quantifiable errors concerned mainly non-compliance with applicable rules on bank guarantees, which may have a financial impact in the event of the insolvency of the contractor, and incorrect calculations of the reimbursement of advances from contractors.

**Budget support payments**

25. The Court's audit found budget support payments to be affected by a high frequency of non-quantifiable errors due to lack of formalised and structured demonstration of the compliance with payment conditions. The main explanation was that the Delegations' public finance management assessment reports did not explain the criteria against which progress had to be assessed (i.e. the steps that had to be taken and the results achieved during the period concerned), the progress made and the reasons why the reform programme may not have been implemented according to the recipient Government's plan. However, such errors mainly affected payments made under ninth EDF financing agreements (which did not provide a clear assessment framework) and additional budget support payments made under the Vulnerability (V) FLEX facility and Envelope B (emergency aid) to compensate for the social and economic impact of the global financial crisis and soaring food prices. Except in one case, payments made under the tenth EDF financing agreements were not affected by such errors (see paragraph 32).

**Effectiveness of systems**

26. The results of the systems examination are summarised in **Annex 2**.

27. As stated in paragraph 3, EuropeAid's mission is to implement most of the external assistance instruments<sup>(20)</sup> financed from the General Budget of the European Union and the EDFs. Therefore, unless otherwise specified, the Court's observations concerning both the effectiveness of supervisory and control systems and the reliability of the Director-General's annual activity report and declaration refer to all of EuropeAid's area of responsibility.

28. Overall, the Court assessed EuropeAid's supervisory and control systems as partially effective.

24. The Commission would point out that all the errors in calculating the reimbursement of advances were rectified before the end of the contract.

25. The Commission welcomes the observation that a substantial improvement in the demonstration of eligibility can be discerned under 10th EDF owing to clearer assessment frameworks that are now routinely used.

*In order to underpin this improvement and eliminate such errors, the Commission acknowledges the need to further reinforce the structured approach to demonstrating progress in public financial management. The Commission has therefore developed a revised framework for monitoring and reporting progress in public financial management which focuses on results achieved against initial baseline expectations. This revised format was finalised in June 2010 and country reports using this revised approach will be the basis on which eligibility will be assessed for disbursements for the remainder of 2010 and beyond. Against this background, the Commission expects to be able to demonstrate continued improvement in the level of non-quantifiable errors related to this issue in future DAS exercises.*

*For the emergency instruments referred to (Vulnerability (V) FLEX facility and Envelope B) the Commission maintained a rigorous approach to assessing eligibility as evidenced by a number of such programmes where disbursements were not made.*

28. EuropeAid has designed its controls to cover the full lifecycle of its multiannual projects. It believes that these supervisory and control systems are effective and have significantly improved year on year as reflected in the increase in the proportion of entirely regular payments found by the Court in its sample. The recommendations made by the Court in past years have been implemented and many of these improvements have been recognised by the Court, resulting in significant elements of the key control systems being judged 'effective'.

<sup>(20)</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.

## THE COURT'S OBSERVATIONS

*Ex-ante controls***EuropeAid's central services**

29. The Court assessed ex-ante controls by authorising officers in EuropeAid's central services as effective.

**Delegations**

30. The Court assessed ex-ante controls by authorising officers in the Delegations as partially effective at detecting and correcting errors.

31. In respect of project payments, weaknesses were found in the checks performed on the eligibility of expenditure, the calculation of the amounts claimed and the availability of the required supporting documents.

32. With regard to budget support, the Court's audit confirmed the improvement noted in its 2008 Annual Report on the EDFs <sup>(21)</sup>. Tenth EDF financing agreements provide clearer frameworks for the assessment of general eligibility conditions. In respect of the public finance management eligibility criterion, financing agreements refer to assessment schemes agreed between Governments, the Commission and other donors. These include Performance Assessment Frameworks which are to be used in the context of joint annual budget support reviews. The application of such frameworks for establishing priority objectives, timetables and the sources of information to be used facilitates formalised and structured progress assessments and thus promotes the transparency of disbursement decisions. However, specific conditions related to the performance-based disbursements of variable tranches are often not sufficiently clear in respect of target values for indicators, verification sources and calculation methods; this may affect the transparency of disbursement decisions.

33. Another improvement noted in 2009 was the Commission's introduction of new guidance on budget support to fragile states, which requires certain very basic elements to be in place as regards public finance management systems before budget support can be granted. The Commission also established a modified financial circuit which sets out a more logical sequence for the financial and operational checks in the payment approval process.

## THE COMMISSION'S REPLIES

**30.** *The Commission provides continuous training for staff at headquarters and in the Delegations under an extensive training programme tailored to the needs of external aid management.*

**32.** *The Commission welcomes the Court's recognition of a sustained improvement in the clarity of the assessment frameworks for the general eligibility conditions.*

*The Commission recognises the importance of similar clarity for specific conditions and performance-based disbursements. Where appropriate, the Commission is seeking to formally address the specific observations made by the Court in this regard by means of revisions to the respective Financing Agreements. At the same time, this issue is receiving closer attention during EuropeAid's peer review process (Quality Support Group) for the consideration of new programmes.*

**33.** *The Commission welcomes the acknowledgement by the Court of these two important contributions to ensuring budget support is delivered in a more structured and formalised way.*

<sup>(21)</sup> Paragraph 46.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Monitoring and supervision***Delegations**

34. The Court assessed the monitoring and supervision by Delegations as partially effective.

35. As in previous years, the Court found that the lack of capacity of most National Authorising Officers (NAO) in beneficiary countries resulted in poorly documented and ineffective checks. The Delegations frequently provide technical assistance to strengthen this capacity, but often with limited results, either because the National Authorizing Officers do not perform their tasks adequately or because of resource constraints or high staff turnover rates.

36. The Court's audit also detected shortcomings in the financial procedures and controls instituted by implementing organisations and supervisors:

- (a) weak controls of the eligibility of expenditure, inadequate filing and safeguard of supporting documents, weak accounting controls that do not ensure that the expenditure is correctly recorded and reported or do not prevent arithmetical errors from occurring;
- (b) for certain works contracts, inadequate supervisor controls of contractors' invoices.

37. In general, Delegations were aware of these weaknesses and had placed limited reliance on these controls, for example by re-performing certain checks, requiring mandatory and risk based audits or expenditure verifications before the financial closure of projects, or commissioning technical audits of ongoing works contracts. However, the Delegations are subject to resource constraints which often limit their capacity to perform certain activities, such as project monitoring on-site, training and supporting project management.

**EuropeAid's central services**

38. The Court assessed monitoring and supervision by EuropeAid's central services as effective.

35. *In addition to the support and technical assistance provided by Delegations to National Authorising Officers, EuropeAid runs a large number of training courses each year for staff in the offices of National Authorising Officers and specialised ministries. Extensive information on procedures is also available on EuropeAid's website.*

36. *The Commission notes that the control tools and procedures established in recent years are bearing fruit. Nevertheless, it promises to continue its efforts to train staff and disseminate information on management and control tools.*

- (a) *The Commission expects that the Financial Management toolkit for the beneficiaries to be made available towards the end of 2010. The main purpose of the Financial Management toolkit is to provide basic practical guidance in an easy-to-use format to help beneficiaries to comply with the financial management rules in EC financed external aid actions.*

37. *Delegations conduct a large number of additional checks to offset the weaknesses of National Authorising Departments.*



## THE COURT'S OBSERVATIONS

39. Audits mandated under the framework contract agreement provide valuable information on the weaknesses affecting projects' control systems and on the level and nature of potentially ineligible expenditure. EuropeAid's central services analyse these results annually and follow up recurrent findings with the implementing organisations; these include missing or inadequate documentation and the use of incorrect procurement procedures. In particular, EuropeAid's central services are in the process of developing a financial management toolkit, which aims to address the causes of errors by increasing the knowledge and understanding of financial management rules by these implementing organisations. In 2009 EuropeAid's central services carried out 14 verification missions. In addition, the geographical Directorates performed their own visits to the Delegations at their own initiative. All these resulted in useful training and support as well as relevant recommendations for improving internal control in the Delegations examined.

40. EuropeAid's central services' analysis of the Delegations' bi-annual External Aid Management Reports indicates that high turnover and difficulties in finding staff with the appropriate expertise, especially for fragile countries, were the most common hindrances to effective aid implementation. The vacancy rates in Delegations have been included in EuropeAid's risk register as a critical risk for 2010.

41. EuropeAid's central services monitor compliance issues via transactional ex-post controls. They decided in 2009 to expand the scope of these controls to cover compliance with financing agreements and contract procedures with effect from 2010. In addition, EuropeAid intends to carry out an overall review of its approach in 2010 to explore ways to further improve the relevance and effectiveness of such controls as regards the examination of the regularity of the underlying transactions and the quality of ex-ante controls performed by authorising officers.

*External audits*

42. The Court assessed the external audits as effective with regard to EuropeAid's central services, and partially effective in respect of the Delegations.

43. The Court's audit found that the management of external audits improved significantly in 2009. The annual audit plans were prepared on the basis of structured risk assessments performed in accordance with EuropeAid's guidelines. Audits were performed in a timely manner, and the implementation rate of the consolidated annual audit plan improved as compared with previous years.

## THE COMMISSION'S REPLIES

39. *The Commission is pleased that the Court appreciates the measures taken by EuropeAid in following up audits and carrying out monitoring missions.*

40. *In the zero growth environment for Commission posts until 2013, EuropeAid is addressing staffing matters in Delegation with an active human resources policy within the limits of its competences. The issue of vacancies mainly concerns contract agents; it is not the high turnover as such but rather a matter of finding staff with the appropriate expertise. Their selection, previously managed by HQ, has now been delegated to Heads of Delegation to shorten this lengthy process. Simultaneously, EuropeAid continues to request regular new reserve lists with an adequate number of candidates to allow recruitments for all profiles and for every category of country.*



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

44. The new terms of reference, adopted in October 2007, were used appropriately, thus promoting a more standardised audit approach. In the cases examined by the Court, audit conclusions had been acted upon, in particular as regards the financial correction of ineligible amounts through recoveries or deduction from subsequent or final payments. However, the full effect of the improved terms of reference was not yet visible in 2009 since many final audit reports were still based on the previous terms of reference, which were less precise, in particular as regards the wording of the audit opinion.

45. There remain several areas where improvement is necessary. Staff constraints in Delegations limit their capacity to launch risk-based audits, the priority being given to compulsory audits. They also have a negative impact on the length of the audit clearance process, which involves a risk that ineligible expenditure may become irrecoverable.

46. CRIS Audit has increased EuropeAid's capacity to monitor audit activities, as well as collate, analyse and act upon audit findings and recommendations. However, as in previous years<sup>(22)</sup>, and despite reminders from EuropeAid's central services and updated guidelines, not all Delegations record data in a timely and complete manner; this affects the reliability of the aggregate data used as management information, such as the nature of audit opinions and rates of ineligible expenditure. Furthermore, CRIS Audit does not always provide accurate data on the cost of audits, nor is it designed to provide information as regards financial corrections performed as the result of audits. As a result, EuropeAid does not yet make full use of the potential of this tool, in particular to ensure that its audit strategy is cost-effective.

### Internal Audit

47. The Court assessed internal audit as partially effective.

44. More than 95 % of the 2009 audit reports by the framework contractors were presented in the 'post 1 October 2007' format as opposed to about 40 % in 2008. (see AAR footnote 38 in section 3.1.2.1.2.)

45. While it is true that staffing constraints can have a negative impact on the length of the audit clearance process, the vast majority of audit reports must be received before the Commission makes final payment and therefore the risk that funds become irrecoverable is extremely limited.

In 2009 EuropeAid continued its efforts in the audit field and ran six EDF training courses covering 15 Delegations which were attended by 180 Delegation staff members and 220 outside staff (staff from the offices of Authorising Officers, ministries, project managers, NGOs and audit firms).

46. Delegations are regularly reminded of the need for timely updating of CRIS Audit records, including during audit seminars and training. Since February 2010, whenever a contract is signed for an audit (CRIS Contract), the date of signature is automatically transferred to CRIS Audit. Also, the new results screen is more complete and easier to fill in, and an audit cannot be closed if this field is not completed. This includes the audit opinion and the amount of ineligible expenditure. Information on recovery orders issued as the result of audits, is included in CRIS Recovery Order module. Some improvements could be considered with a view to consolidation, but would require further IT developments. Information is available on the amount of final ineligible expenditure detected and corrected at the time of final payment. In 2009 this represented 0.7 % by value of invoiced amounts.

47. The Commission considers that AIDCO's internal audit, despite the disruption of its operational capacity in 2009, was effective during that year. Despite the post of Head of the IAC Unit being vacant between 1 July and 15 November the unit finalised 9 follow-up audits (in relation to the 8 planned). As for new audits, out of the four planned for 2009, one final audit report and two draft audit reports (equivalent to 85 % of a final audit report according to IAS' methodology) were submitted in 2009.

<sup>(22)</sup> Paragraph 39 of the 2008 Annual Report on the EDFs.

## THE COURT'S OBSERVATIONS

48. The Internal Audit Capability (IAC) operated in compliance with its objective to provide the Director-General with assurance as to the effectiveness and efficiency of risk management, control and internal governance processes. However, its operational capacity was significantly disrupted due to staff shortages beyond its control, including the absence of the Head of Unit for most of the year. For these reasons the IAC was not fully able to implement its 2009 work plan. In its report on the second follow-up audit on the validation of the self-assessment of EuropeAid's IAC, the Internal Audit Service (IAS) mentioned again the significant amount of time needed for EuropeAid's management to follow up the IAC's recommendations.

*Reliability of Commission management representations*

49. The results of the review of the Commission's management representation are summarised in **Annex 3**.

50. The annual activity report gives a fair picture of the implementation and results of the various supervisory and control systems in place. It is clear and informative, in particular through its use of quantitative indicators. It states that, given the design and the results of its multiannual control architecture, EuropeAid does not believe that the residual error rate on its portfolio merits a reservation in the Director-General's declaration of assurance<sup>(23)</sup>. However, it does not provide evidence to support this assertion. In the absence of a key indicator for the estimated financial impact of residual error after all ex-ante and ex-post controls have been implemented<sup>(24)</sup>, EuropeAid is not in a position to demonstrate that the financial impact of shortcomings and errors remains below the materiality criteria set.

51. With respect to the financial year 2009, EuropeAid's Director-General declared that he obtained reasonable assurance that existing control procedures gave the necessary guarantees concerning the regularity of transactions. The Court's audit does not corroborate this assertion. It found that EuropeAid's systems were partially effective and that payments were overall affected by material error; whilst payments made from the EDFs were free from material error, payments made by EuropeAid from the General Budget of the Community for External Relations and Development were affected by material error<sup>(25)</sup>. The Court considers that the Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity.

## THE COMMISSION'S REPLIES

50. The Commission believes that the qualitative and quantitative indicators set out in the four 'assurance' building blocks of the Annual Activity Report do indeed provide the evidence to underpin the Director General's statement of reasonable assurance. Nevertheless, EuropeAid recognises that further work could be done to develop specific indicators in relation to the multiannual control framework, and work started in 2010 on consideration of possible methodologies for the estimated financial impact of residual error.

<sup>(23)</sup> Page 56.

<sup>(24)</sup> See paragraphs 29 and 54 of the 2008 Annual Report of the Court of Auditors on the EDFs.

<sup>(25)</sup> See Chapter 6 of the 2009 Annual Report of the Court of Auditors on the implementation of the budget.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Conclusions and recommendations**

52. Based on its audit work, the Court concludes that the accounts of the EDFs for the financial year ending 31 December 2009 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 observations in paragraphs 17 and 18 concerning the amounts of guarantees.

53. Based on its audit work, the Court concludes that for the financial year ending 31 December 2009:

- (a) the revenue of the EDFs was free from material error;
- (b) the commitments of the EDFs were free from material error but affected by a significant frequency of non-quantifiable errors; and
- (c) the payments of the EDFs were free from material error. However, they were affected by frequent non-quantifiable errors.

54. As was already noted in the 2008 Annual Report of the Court of Auditors on the EDFs <sup>(26)</sup>, EuropeAid has set up a comprehensive control strategy. In 2009, EuropeAid continued to bring significant improvements to the design and implementation of its supervisory and control systems but weaknesses remain in certain areas. Based on its audit work, the Court concludes that EuropeAid's supervisory and control systems were partially effective in ensuring the regularity of payments. The following recommendations should be considered in this context:

- (a) EuropeAid should, in the context of its planned review of its overall control strategy, develop a key indicator for the estimated financial impact of residual errors after all ex-ante and ex-post controls have been implemented, based for example on an examination of a representative statistical sample of closed projects;
- (b) EuropeAid should, in the context of this review, assess the cost-effectiveness of the various controls, notably of the transactional ex-post control system;

54. EuropeAid has designed its controls to cover the full lifecycle of its multiannual projects. It believes that these supervisory and control systems are effective and have significantly improved year on year as reflected in the increase in the proportion of entirely regular payments found by the Court in its sample. The recommendations made by the Court in past years have been implemented and many of these improvements have been recognised by the Court, resulting in significant elements of the key control systems being judged 'effective'.

- (a) The Commission started work on the consideration of possible methodologies for the development of a key indicator for the estimated financial impact of residual errors in 2010, as set out in the Commission replies to the 2008 Annual Report.
- (b) The Commission started work on the review of its control strategy in early 2010, as set out in the Commission replies to the 2008 Annual Report. The Commission will produce a Communication on the Tolerable Risk of Error in the field of external aid in 2010.

<sup>(26)</sup> Paragraph 55.

## THE COURT'S OBSERVATIONS

- (c) EuropeAid should finalise and disseminate the financial management toolkit targeting the high inherent risk of errors at the level of implementing organisations, contractors and beneficiaries to ensure adequate knowledge of financial management and eligibility rules;
- (d) EuropeAid should continue its efforts to ensure that the Delegations record data in CRIS Audit in a comprehensive and timely manner;
- (e) the design of CRIS Audit should be modified to provide information on the amounts of final ineligible expenditure and financial corrections done after the audit clearance process with the auditee has been completed.

55. As regards budget support, the Court recommends that:

- (a) EuropeAid should ensure that the specific conditions for performance-based variable tranches clearly specify the indicators, targets, calculation methods and verification sources;
- (b) EuropeAid should ensure that Delegations' reports provide a structured and formalised demonstration of public finance management progress by clearly setting the criteria against which progress was to be assessed (i.e. the results that the recipient Government had to achieve during the period concerned), the progress made and the reasons why the reform programme may have not been implemented according to plan.

## THE COMMISSION'S REPLIES

- (c) *The Financial Management toolkit will be finalised in 2010 and due consideration will be given to the issues raised by the Court.*
- (d) *EuropeAid will continue its efforts to ensure that information is encoded in CRIS Audit accurately and in good time.*
- (e) *The amount of ineligible expenditure must be introduced in CRIS Audit before closing an audit record (mandatory field since February 2010). Information on recovery orders issued as a result of audits, is included in CRIS Recovery Order module. Some improvements could be considered with a view to consolidation but this would require further IT developments. Information is available on the amount of final ineligible expenditure detected and corrected at the time of final payment. In 2009 this represented 0,7 % by value of invoiced amounts.*

55.

- (a) *The Commission recognises the importance of greater rigour in defining performance targets, calculation methods and verification sources. This issue is receiving greater attention during EuropeAid's peer review process (Quality Support Group) for the consideration of new programmes.*
- (b) *The Commission has developed a revised framework for monitoring and reporting on progress in public financial management which focuses on results achieved against initial baseline expectations. This revised format was finalised in June 2010 and country reports using this revised approach will be the basis on which eligibility will be assessed for disbursements for the remainder of 2010 and beyond.*

## ANNEX 1

## RESULTS OF TRANSACTION TESTING FOR THE EUROPEAN DEVELOPMENT FUNDS

	2009						2008	2007
	Projects		Budget Support		Total			
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>								
Total of commitments:	40		10		50		45	60
Total of transactions (of which):	150		20		170		170	148
Advances	0		0		0		40	0
Interim/Final payments	150		20		170		130	148
<b>RESULTS OF TESTING</b>								
<i>(in % and numbers of transactions)</i>								
Transactions not affected by error	80 %	{120}	65 %	{13}	78 %	{133}	76 %	63 %
Transactions affected by error	20 %	{30}	35 %	{7}	22 %	{37}	24 %	37 %
<b>ANALYSIS OF TRANSACTIONS AFFECTED BY ERROR</b>								
<i>(in % and numbers of transactions)</i>								
<b>Analysis by type of error</b>								
Non-quantifiable errors	57 %	{17}	100 %	{7}	65 %	{24}	61 %	49 %
Quantifiable errors	43 %	{13}	0 %	{0}	35 %	{13}	39 %	51 %
<i>comprising:</i> Eligibility	23 %	{3}	0 %	{0}	23 %	{3}	44 %	68 %
Occurrence	23 %	{3}	0 %	{0}	23 %	{3}	38 %	21 %
Accuracy	54 %	{7}	0 %	{0}	54 %	{7}	19 %	11 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>								
Most likely error rate:								
< 2 %	X							
2 % to 5 %							X	X
> 5 %								

## ANNEX 2

RESULTS OF EXAMINATION OF SYSTEMS FOR EUROPEAN DEVELOPMENT FUNDS AND DEVELOPMENT AID  
UNDER THE GENERAL BUDGET

## Assessment of selected supervisory and control systems

System concerned	Ex-ante controls	Monitoring and supervision	External audits	Internal audits	Overall assessment
Central services EuropeAid					
Delegations				N/A	

## Overall assessment of supervisory and control systems

Overall assessment	2009	2008	2007

## Legend

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

## ANNEX 3

## RESULTS OF REVIEW OF COMMISSION MANAGEMENT REPRESENTATIONS FOR THE EUROPEAN DEVELOPMENT FUNDS AND DEVELOPMENT AID UNDER THE GENERAL BUDGET

Main DGs concerned	Nature of declaration given by Director-General (*)	Reservations given	Court observations	Overall assessment of reliability
AIDCO	without reservations	N/A	EuropeAid has set up a comprehensive control strategy and continued to bring significant improvements to the design and implementation of its supervisory and control systems. However, the Court's audit found that there remain weaknesses in certain controls and that the payments were affected by material error.	B

(\*) By reference to the Declaration of Assurance of Director-General, he/she has reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of transactions.

A: the Director-General's declaration and the annual activity report give a fair assessment of financial management in relation to regularity

B: the Director-General's declaration and annual activity report give a partially fair assessment of financial management in relation to regularity

C: the Director-General's declaration and the annual activity report do not give a fair assessment of financial management in relation to regularity

## FOLLOW-UP OF KEY STATEMENT OF ASSURANCE OBSERVATIONS

	Court observation	Court analysis	Court recommendations	Commission reply
1.	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. (2008 Annual Report, paragraph 54)	The 2009 Annual Activity Report presents fairly the implementation and results of supervisory and control systems in place. It is clear and informative, notably through the use of quantitative indicators. However, it does not provide a clear demonstration that the results of the various controls contribute to the Director-General's reasonable assurance that the financial impact from deficiencies and errors remains below the materiality criteria set.	EuropeAid should, in the context of its planned review of its overall control strategy, develop a key indicator on the estimated financial impact of residual errors after all ex-ante and ex-post controls have been implemented.	<i>The Commission started work on the consideration of possible methodologies for the development of a key indicator for the estimated financial impact of residual errors in 2010, as set out in the Commission replies to the 2008 Annual Report.</i>
2.	Ex-ante checks should be improved by focusing on key risks. (2008 Annual Report, paragraph 55(a))	There remain weaknesses in the verifications carried out in respect of the eligibility of expenditure, the calculation of the amounts claimed and the availability of the required supporting documents.	EuropeAid should finalise and disseminate the financial management toolkit targeting the high inherent risk of errors at the level of implementing organisations, contractors and beneficiaries to ensure adequate knowledge of financial management and eligibility rules.	<i>The Financial Management toolkit will be finalised in 2010 and due consideration will be given to the issues raised by the Court.</i>
3.	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. (2008 Annual Report, paragraph 55(b))	The annual audit plans were prepared on the basis of structured risk assessment performed as provided for by EuropeAid's guidelines. Staff constraints in Delegations limit their capacity to launch risk-based audits, the priority being given to compulsory audits. They also negatively impact on the delays for the audit clearance process, which involves a risk that ineligible expenditure may become irrecoverable.	Satisfactory action has been undertaken as regards the Annual Audit planning process.	<i>The Commission agrees that substantial improvements have been achieved in the audit planning process.</i>
4.	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. (2008 Annual Report, paragraph 55(c))	EuropeAid's central services, including the geographical Directorates, monitor regularly the implementation over time. Where necessary, deviations are investigated and corrective actions are undertaken.	Satisfactory action has been taken.	<i>The Commission agrees that substantial improvements have been achieved in the monitoring of the implementation of audit plans.</i>



	Court observation	Court analysis	Court recommendations	Commission reply
5.	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. (2008 Annual Report, paragraph 55(d))	CRIS Audit does not always provide accurate data on the cost of audits nor provides any information as regards financial corrections done as a result of audits.	The design of CRIS Audit should be modified to provide information on the amounts of final ineligible expenditure and financial corrections done after the audit clearance process with the auditee was completed.	<i>Following improvements introduced in CRIS Audit in February 2010, the amount of ineligible expenditure must be indicated before closing an audit record. As to recovery orders issued as the result of audits, this information is included in CRIS Recovery Order module.</i>
6.	EuropeAid should ensure that the Delegations record data in CRIS Audit in a comprehensive and timely manner. (2008 Annual Report, paragraph 55(e))	Despite reminders from EuropeAid's central services and updated guidelines, all Delegations do not record data in a timely and complete manner. This affects the reliability of aggregate data used as management information, such as the nature of audit opinions and rates of ineligible expenditure.	EuropeAid should continue its efforts to ensure that the Delegations record data in CRIS Audit in a comprehensive and timely manner.	<i>EuropeAid continues its efforts to ensure correct and timely encoding of data in CRIS Audit.</i>
7.	In the light of the results of the approach adopted by Directorate C 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. (2008 Annual Report, paragraph 55(f))	EuropeAid expanded the scope of these controls in 2009 to cover compliance with financing agreements and contract procedures. EuropeAid intends to carry out in 2010 an overall review of its approach to explore ways to further improve the relevance and effectiveness of such controls as regards the examination of the regularity of the underlying transactions and the quality of ex-ante controls performed by authorising officers.	EuropeAid should, in the context of the review, assess the cost-effectiveness of the various controls, notably of the transactional ex-post control system, and examine the relevance and feasibility of an annual audit of a representative statistical sample of closed projects.	<i>The Commission started work on the review of its control strategy (including a possible indicator for the residual error rate based on an audit of a representative statistical sample of closed projects) in early 2010, as set out in the Commission replies to the 2008 Annual Report. The Commission will produce a Communication on the Tolerable Risk of Error in the field of external aid in 2010.</i>
8.	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. (2008 Annual Report, paragraph 56(a))	Tenth EDF financing agreements provide clearer frameworks for the assessment of general conditions on eligibility. In respect of the public finance management related criterion, financing agreements refer to assessment schemes agreed between Governments, Commission and also other donors, such as the Performance Assessment Frameworks (PAF) to be used in the context of joint annual budget support reviews. The application of such frameworks defining priority objectives, timetables and the sources of information to be used facilitates formalised and structured progress assessments and thus promotes the transparency of disbursement decisions.	Satisfactory action has been taken.	<i>The Commission agrees that substantial improvements have been achieved in the decision making framework for budget support eligibility, and for disbursement conditions.</i>

	<b>Court observation</b>	<b>Court analysis</b>	<b>Court recommendations</b>	<b>Commission reply</b>
9.	EuropeAid should ensure that all future financing agreements provide a comprehensive and clear basis for the assessment of compliance with payment conditions. (2008 Annual Report, paragraph 56(b))	Specific conditions related to performance based disbursements of variable tranches are often not sufficiently clear in respect of target values for indicators, verification sources and calculation methods; this may affect the transparency of disbursement decisions.	EuropeAid should ensure that specific conditions for performance-based variable tranche define clearly the indicators, targets, calculation methods and verification sources.	<i>The Commission recognises the importance of greater rigour in defining performance targets, calculation methods and verification sources. This issue is receiving greater attention during EuropeAid's peer review process (Quality Support Group) for the consideration of new programmes.</i>



## 2010 SUBSCRIPTION PRICES (excluding VAT, including normal transport charges)

EU Official Journal, L + C series, paper edition only	22 official EU languages	EUR 1 100 per year
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 770 per year
EU Official Journal, L + C series, monthly CD-ROM (cumulative)	22 official EU languages	EUR 400 per year
Supplement to the Official Journal (S series), tendering procedures for public contracts, CD-ROM, two editions per week	multilingual: 23 official EU languages	EUR 300 per year
EU Official Journal, C series — recruitment competitions	Language(s) according to competition(s)	EUR 50 per year

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*.

CD-Rom formats will be replaced by DVD formats during 2010.

## Sales and subscriptions

Subscriptions to various priced periodicals, such as the subscription to the *Official Journal of the European Union*, 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>**

