

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 148(1) and 162(1) of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 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 4 September 2014, adopted its

ANNUAL REPORTS**concerning the financial year 2013.**

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), Igors LUDBORŽS, Jan KINŠT, Kersti KALJULAIID, Karel PINXTEN, Henri GRETHEN, Szabolcs FAZAKAS, Louis GALEA, Ladislav BALKO, Augustyn KUBIK, Milan Martin CVIKL, Rasa BUDBERGYTĖ, Lazaros S. LAZAROU, Hans Gustaf WESSBERG, Henrik OTBO, Pietro RUSSO, Ville ITÄLÄ, Kevin CARDIFF, Baudilio TOMÉ MUGURUZA, Iliana IVANOVA, George PUFAN, Neven MATES, Alex BRENNINKMEIJER, Danièle LAMARQUE, Nikolaos MILIONIS, Phil WYNN OWEN, Klaus-Heiner LEHNE, Oskar HERICS.

ANNUAL REPORT ON THE IMPLEMENTATION OF THE BUDGET

(2014/C 398/01)

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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 acts as the independent guardian of the financial interests of the citizens of the Union and contributes to improving EU financial management. 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

0.2. This is the Court's 37th annual report on the implementation of the EU budget and covers the 2013 financial year. 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 a basis for the discharge procedure, in which the European Parliament decides whether the Commission has satisfactorily carried out its responsibilities for implementing the budget. The Court forwards its annual report to national parliaments at the same time as to the European Parliament and the Council.

0.4. The central part of the annual report is the Court's statement of assurance (the 'DAS') on the reliability of the consolidated accounts of the EU 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; the material which follows reports mainly on the audit work underlying the statement of assurance.

0.5. The report is organised as follows:

- chapter 1 contains the statement of assurance and a summary of the results of the Court's audit on the reliability of accounts and on the regularity of transactions, a review of the synthesis report and annual activity reports and a summary report on budgetary and financial management. Annex 1.3 in chapter 1 provides extracts

from the 2013 consolidated accounts. More extensive 2013 financial information is presented in the published consolidated accounts and in the financial report prepared by the European Commission, both available on:

http://ec.europa.eu/budget/biblio/documents/2013/2013_en.cfm;

- 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 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 2007-2013 financial framework, which sets out the EU's broad multiannual spending plans;
- chapter 10 analyses performance and considers the EU's budgetary rules and their focus on performance and contains the Court's observations on some aspects of the Commission's reporting on performance, including its reporting to the European Parliament and the Council, the fourth evaluation report, and the annual activity reports prepared by the Commission's directors-general. The chapter also highlights some of the main themes arising from the Court's 2013 special reports on performance.

0.6. The specific assessments are mainly based on the results of the Court's testing of the regularity of transactions and on an assessment of the effectiveness of the principal supervisory and control systems governing the revenue or expenditure involved.

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

CHAPTER 1

The Statement of Assurance and supporting information

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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 consolidated accounts of the European Union which comprise the consolidated financial statements⁽¹⁾ and the aggregated reports on the implementation of the budget⁽²⁾ for the financial year ended 31 December 2013, approved by the Commission on 30 July 2014; 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 is responsible for the preparation and presentation of the consolidated accounts of the European Union on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them. 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).

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 transactions underlying them. 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. These standards require that the Court plans and performs the audit to obtain reasonable assurance as to whether the consolidated 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 selected depend 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 making those risk assessments, internal control relevant to the preparation and fair presentation of the consolidated accounts and legality and regularity of underlying transactions, is considered in order to design audit procedures that are appropriate in the circumstances but not for the purposes of expressing an opinion on the effectiveness of internal control. 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.

V. For revenue, the Court's examination of Value Added Tax and Gross National Income-based own resources takes as its starting point the relevant macroeconomic aggregates on which these are calculated, and assesses the Commission's systems for processing these until the contributions of the Member States have been received and recorded in the consolidated accounts. For traditional own resources, the Court examines the accounts of the customs authorities and analyses the flow of duties until the amounts are received by the Commission and recorded in the accounts.

⁽¹⁾ The consolidated financial statements comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets and a summary of significant accounting policies and other explanatory notes (including segment reporting).

⁽²⁾ The aggregated reports on implementation of the budget comprise the aggregated reports on implementation of the budget and explanatory notes.

VI. For expenditure, the Court examines payment transactions when expenditure has been incurred, recorded and accepted. This examination covers all categories of payments (including those made for the purchase of assets) other than advances at the point they are made. Advance payments are examined when the recipient of funds provides justification for their proper use and the Institution or body accepts the justification by clearing the advance payment, whether in the same year or later.

VII. The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its opinions.

Reliability of the accounts

Opinion on the reliability of the accounts

VIII. In the Court's opinion, the consolidated accounts of the European Union for the year ended 31 December 2013 present fairly, in all material respects, the financial position of the Union as at 31 December 2013, the results of its operations, its cash flows, and the changes in net assets for the year then ended, in accordance with the Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue underlying the accounts

IX. In the Court's opinion, revenue underlying the accounts for the year ended 31 December 2013 is legal and regular in all material respects.

Commitments

Opinion on the legality and regularity of commitments underlying the accounts

X. In the Court's opinion, commitments underlying the accounts for the year ended 31 December 2013 are legal and regular in all material respects.

Payments

Basis for adverse opinion on the legality and regularity of payments underlying the accounts

XI. All policy groups covering operational expenditure are materially affected by error. The Court's estimate for the most likely error rate for expensed payments underlying the accounts is 4,7 %. The supervisory and control systems examined were partially effective in ensuring the legality and regularity of payments underlying the accounts.

Adverse opinion on the legality and regularity of payments underlying the accounts

XII. In the Court's opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2013 are materially affected by error.

4 September 2014

Vítor Manuel da SILVA CALDEIRA

President

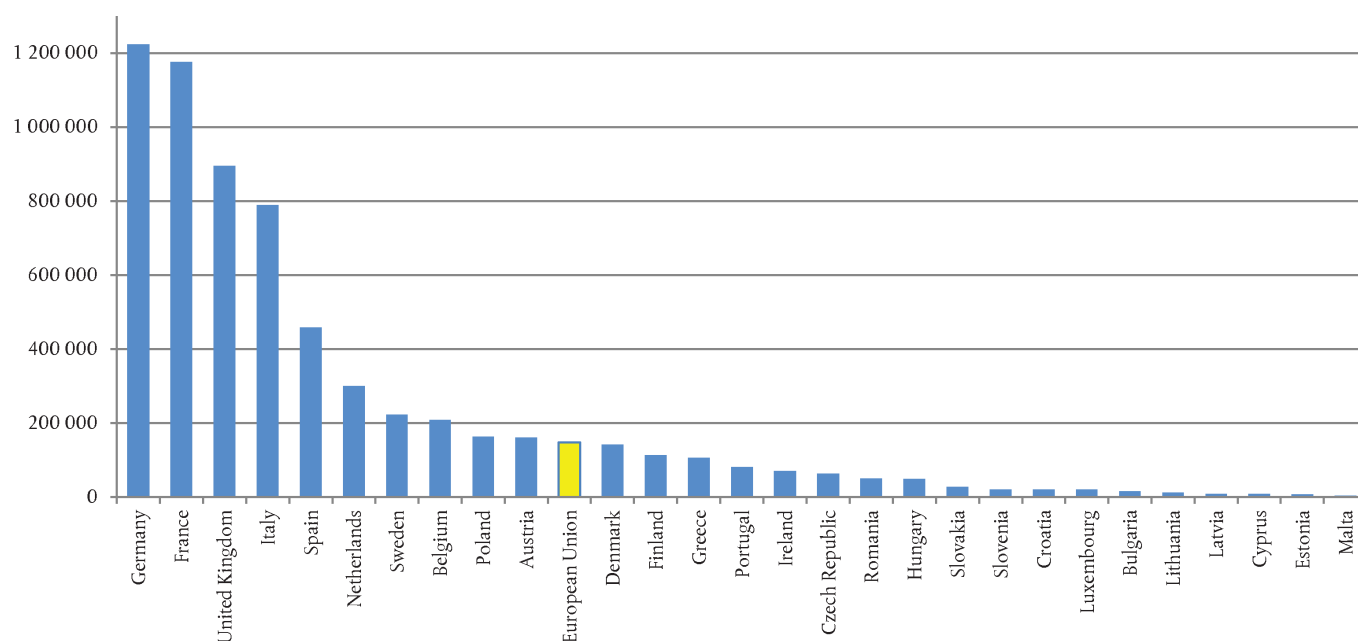
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THE COURT'S OBSERVATIONS

INTRODUCTION

1.1. The European Union (EU) budget is the instrument for financing EU policy objectives. EU spending amounts to around one per cent of EU gross national income (around 290 euro for every EU citizen in 2013). This represents approximately two per cent of total public spending of EU Member States. **Graph 1.1** compares the total implemented EU budget of 2013 with the public spending⁽³⁾ of EU Member States in 2013.

Graph 1.1 — 2013 total general government expenditure of the European Union Member States and EU spending in 2013
(in million euro)



Source: European Union: 2013 consolidated annual accounts of the European Union — result of implementation of the EU budget — Table 1.1 payments (see **Annex 1.3** — table 5).

Member States: Eurostat — Government statistics — Government revenue, expenditure and main aggregates — Total general government expenditure 2013.

(http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/database)

⁽³⁾ Defined as 'total general government expenditure': the main statistical definition used by Eurostat (European System of Accounts 1995, paragraph 8.99).

THE COURT'S OBSERVATIONS

1.2. EU spending is dominated by two types of expenditure:

- (a) entitlement programmes, where payment is based on meeting certain conditions (including direct aid for farmers (chapter 3) and direct budget support (chapter 7)); and
- (b) reimbursement schemes, where the EU reimburses eligible costs for eligible activities (including rural and regional development (chapters 4 and 5), training schemes (chapter 6), development projects (chapter 7) and research projects (chapter 8)).

1.3. The role of the European Court of Auditors includes:

- assessing whether the EU budget is used in accordance with applicable laws and regulations;
- expressing its view on whether the accounts of the European Union are reliable;
- reporting the examination of the economy, efficiency and effectiveness of EU spending; and
- providing opinions on proposed legislation with an impact on the management of resources.

The first two of these responsibilities are met through publication of the Statement of Assurance ⁽⁴⁾ (see paragraph 1.5).

1.4. This chapter of the annual report:

- sets out the background to the Court's Statement of Assurance and summarises the audit findings and conclusions which underlie this statement;
- provides information on the management of the EU budget;
- explains how the Court carries out its audit of the reliability of the accounts and the regularity of transactions (see **Annex 1.1**); and
- presents the actions taken by the Commission in response to the Court's observations and recommendations in previous annual reports on the reliability of the accounts (see **Annex 1.2**).

⁽⁴⁾ See Article 287 of the Treaty on the Functioning of the European Union (TFEU).

THE COURT'S OBSERVATIONS

1.5. The Court of Auditors provides the European Parliament and the Council with a Statement of Assurance concerning the reliability of the accounts and the regularity of the underlying transactions. The Court supplements this statement with specific assessments of each major area of EU activity. These specific assessments do not constitute audit opinions; they present significant issues specific to each policy group. The conclusion of each specific assessment is based on the overall audit evidence gathered at the level of the policy group.

1.6. 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 recorded and that the consolidated accounts (see extract in **Annex 1.3**) properly present the financial position at 31 December 2013, and the revenue, expenses, cash flows and changes in net assets for the year then ended (see paragraphs 1.9 to 1.11).

1.7. The aim of the work on the regularity of the transactions underlying the 2013 consolidated accounts is to obtain sufficient appropriate evidence to conclude on whether those transactions are in accordance with the applicable regulations or contractual provisions, and have been correctly calculated (see paragraphs 1.16 to 1.24 for an overview of the results and chapters 2 to 9 for more details).

1.8. The aim of the examination of the annual activity reports of the Commission's services and of the related synthesis report is to assess the extent to which they provide a fair assessment of the quality of financial management, and thus help form a view of the reliability of the accounts and the regularity of revenue and expenditure (see paragraphs 1.25 to 1.40 and related observations in the sections 'Examination of selected control systems' in chapters 2 to 9 ⁽⁵⁾).

⁽⁵⁾ Chapter 10 discusses the annual activity reports in relation to efficiency, effectiveness and economy of EU spending.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

AUDIT FINDINGS FOR 2013**Reliability of accounts**

1.9. The Court's observations concern the consolidated accounts of the European Union for the financial year 2013 prepared by the Commission's accounting officer, approved by the Commission in compliance with the Financial Regulation⁽⁶⁾ and received, together with the accounting officer's letter of representation, by the Court on 31 July 2014. The consolidated accounts comprise:

- (a) the consolidated financial statements covering the balance sheet (presenting the assets and liabilities at the end of the year), the statement of financial performance (recognising the income and expenses of the year), the cash flow statement (disclosing how changes in the accounts affect cash and cash equivalents) and the statement of changes in net assets as well as the related notes;
- (b) the aggregated reports on the implementation of the budget covering the revenue and expenditure for the year as well as the related notes.

1.10. As part of the audit of the 2013 financial statements, the Court used the services of an independent actuary to examine the calculation and disclosure of employee benefits covered by the Pension Scheme of European Officials. This supports the Court's overall conclusion on the 2013 consolidated accounts. However the work performed indicates a need for the Commission to improve the reliability of source data and to ensure it has the appropriate technical resources necessary for the assessment of this liability.

1.11. The Court's audit of the 2013 consolidated accounts found that these were free from material misstatements (see also **Annex 1.2**).

1.10. *The Commission takes note of the positive evaluation and will continue to improve its methods in this area.*

⁽⁶⁾ Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union (OJ L 298, 26.10.2012, p. 1) requires that the final accounts shall be sent by 31 July of the following financial year (see Article 148).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

New challenges in presenting reliable financial information

1.12. Ongoing developments in EU financial management include the growing use of net corrections and of financial instruments. This means that the Commission will face growing challenges in presenting reliable financial information. These include:

- (a) reflecting within the accounts the extended use of net financial corrections in the area of cohesion, distinguishing these from other corrective mechanisms, and providing information on the differing impact of the various corrective mechanisms in its annual communication on the protection of the EU budget ⁽⁷⁾ (see paragraph 1.13);
- (b) introducing new procedures for recording the operation of all corrective mechanisms presented in Note 6 within conventional accounting systems, and confirming the timing, origin and nature of these mechanisms with the bodies concerned (see paragraph 1.14);
- (c) completing the process of recording and measuring financial instruments and financial engineering instruments in accordance with international public sector accounting standards (as required by Article 140(11) of the Financial Regulation), in particular through reliable procedures for identifying and recording impairment;
- (d) obtaining information on cash held pending initial use (see paragraph 1.48); and

1.12. *Net financial corrections which are used in the Common Agricultural Policy since 1976 will also be applied systematically in the cohesion area for the programming period 2014-2020.*

- (a) *Amounts resulting from the extended use of net financial corrections in the area of Cohesion will be reflected in the accounts applying common accounting procedures.*

In response to a request by the European Parliament, the Commission will include a chapter on net financial corrections in its annual communication on the protection of the EU budget.

- (b) *The Commission will review the procedures in place taking into account the new reporting requirements but considers that transactions linked to the exchange of ineligible against eligible projects/expenditure by Member States have in the first place to be recorded in the national accounting systems. As regards the new regulatory framework on net financial corrections, see reply to paragraph 1.12(a).*

- (c) *The Commission has a reporting process for financial instruments in place on the basis of EU accounting rule 11 which is in line with IPSAS. It has issued guidelines for fiduciary accounts as well as detailed year-end reporting requirements in Financial and administrative framework (FAFA) agreements with EIB and EIF.*

The Commission is in the process of analysing the situation of pre-2014 financial instruments.

The Commission underlines that Article 140 of the Financial Regulation is applicable to financial instruments under direct and indirect management only. Financial engineering instruments under shared management are covered by the CPR and are accounted for as advances to Member States in accordance with EU accounting rules.

- (d) *The Commission will examine together with Member states how information could be further improved in the way the Court suggests, bearing in mind cost-benefit considerations.*

⁽⁷⁾ Report on the protection of the EU budget according to Article 150(4) of the Financial Regulation (EU, Euratom No 966/2012) to be presented to the budgetary authorities in September (2012: COM(2013) 682 final/2).

THE COURT'S OBSERVATIONS

- (e) ensuring that all Commission services clear advances only on the basis of incurred expenditure, supported by reliable information from recipients (see chapter 7, paragraph 7.25, recommendation 1).

Providing better information on corrective mechanisms

1.13. Summarised figures for financial corrections are presented in Note 6 to the EU consolidated accounts. These are further elaborated in an annual Commission communication on the protection of the EU budget. At present, neither Note 6 nor the annual Commission communication summarises the varying impact of a number of different corrective adjustments:

- (a) — rejection of expenditure declared by Member States before acceptance by the Commission; **or**
— adjustments in accepted expenditure after reimbursement by the Commission;
- (b) — adjustments at project level; **or**
— corrections at programme level only;
- (c) — corrections which reduce the spending envelope for individual Member States (net financial corrections); **or**
— agreements which allow the replacement of irregular expenditure with new declarations.

1.14. The information presented in Note 6 focusses on the Commission's supervisory role and includes figures both on annual and cumulative⁽⁸⁾ bases. However, the mechanisms summarised in the note:

- (a) involve many actors from national authorities and Commission services;
- (b) take several years to complete (in particular for cohesion spending, where around four fifth of corrections made during the years 2007 to 2013 relate to operational programmes of earlier periods, see **Graph 1.2**); and
- (c) are for cohesion largely recorded outside the accounting system of the Commission.

THE COMMISSION'S REPLIES

- (e) *The existing accounting rules and guidance already communicated to DGs clarify the correct treatment to be followed for clearings. DG ELARG will put in place a new procedure, in line with applicable rules and regulations.*

1.13. *The Commission will consider the presentation of this information, bearing in mind both the costs and benefits of this approach.*

- (c) *See reply to paragraph 1.12(a).*

1.14.

- (a) *This is the nature/set-up of the shared management system.*

- (b) *See reply to paragraph 1.18.*

- (c) *The Commission would point out that the information is partly recorded outside of the Commission's accounting system in accordance with the underlying legal basis and the fact that such transactions are transactions of the Member State, not the Commission.*

See reply to paragraph 1.12(b).

⁽⁸⁾ In Note 6 the Commission presents cumulative information covering several years. This is in contrast to other notes to consolidated accounts which focus on information relevant to the financial year and, for comparative purposes, the previous year.

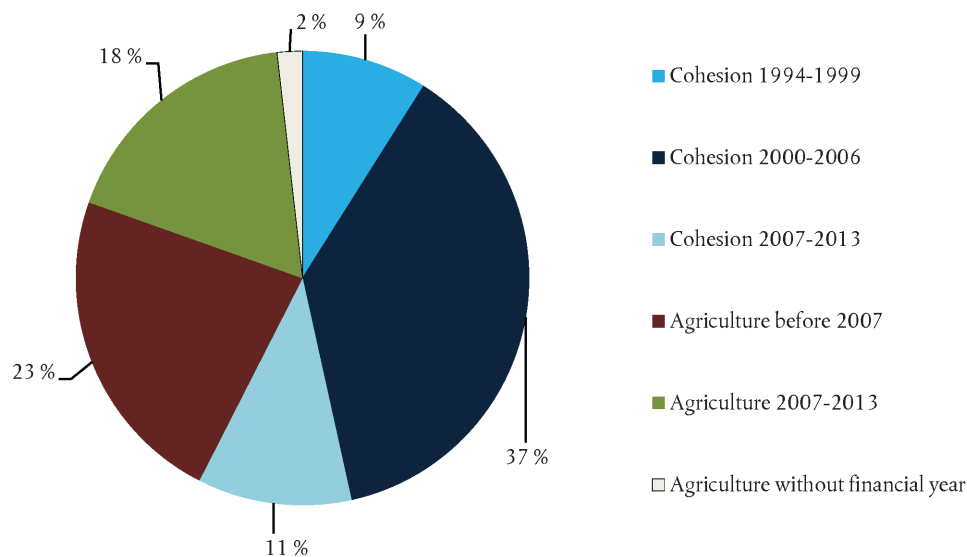
THE COURT'S OBSERVATIONS

1.15. It is therefore important that the Commission puts in place sound procedures for confirming the timing, the origin and the amount of corrective measures with the Member States that give greater assurance on the accuracy of the figures presented in the accounts and in the annual communication on the protection of the EU budget.

THE COMMISSION'S REPLIES

1.15. *The Commission will examine with the Member States how existing information systems can be further improved in the way the Court suggests.*

Graph 1.2 — Financial corrections for agriculture and cohesion reported by the Commission in the years 2007 to 2013 by period



THE COURT'S OBSERVATIONS

Overview of audit results on the regularity of transactions

1.16. The Court presents its audit results on revenue in chapter 2 and on expenditure in chapters 3 to 9 (see **Table 1.1**).

Table 1.1 — Transactions subject to audit for annual report chapters 3 to 9

(million euro)

Annual report chapters		Payments made in 2013	Transactions subject to audit in 2013
		(A)	(B)
Chapter 3	Agriculture: market and direct support	45 004	45 016
Chapter 4	Rural development, environment, fisheries and health	14 780	15 581
Chapter 5	Regional policy, transport and energy	45 084	45 477
Chapter 6	Employment and social affairs	14 017	16 200
Chapter 7	External relations, aid and enlargement	6 180	6 019
Chapter 8	Research and other internal policies	13 156	10 431
Chapter 9	Administrative and related expenditure ⁽¹⁾	10 248	10 600
Total		148 469	149 324

'Transactions subject to audit in 2013' (B) consist of 'Payments made in 2013' (A) excluding advance payments made in 2013 (16 763 million euro) and including clearings of advances in 2013 (15 842 million euro) as well as disbursements made to final recipients from FEIs (1 776 million euro).

⁽¹⁾ This chapter also covers expenditure classified in the budget as operational, where the spending is administrative by nature — such as the building and salary costs of operational DGs.

THE COURT'S OBSERVATIONS

1.17. The 2013 audit results indicate that revenue (149 504 million euro) and transactions in the policy group administrative and related expenditure (10 600 million euro) were free from material error and that the examined supervisory and control systems were effective (see **Table 1.2** and paragraphs 2.27 and 9.18). All policy groups covering operational expenditure were affected by material error (see paragraphs 3.44, 4.35, 5.61 to 5.62, 6.39 to 6.40, 7.22 to 7.23 and 8.33 to 8.34). Commitments were free from material error.

THE COMMISSION'S REPLIES

1.17. *The Commission understands that the error rate reported by the Court is an annual estimate which takes into account corrections of project expenditure or reimbursements affected by errors detected and recorded before the Court's audit.*

The Commission underlines that it is bound by the Financial Regulation which stipulates, in Article 32(e), that its internal control system should ensure, amongst other things, 'adequate management of the risks relating to the legality and regularity of the underlying transactions taking into account the multiannual character of programmes and the nature of payments'.

The Commission will continue to exercise its supervisory role, in particular by implementing financial corrections and recoveries at a level that corresponds to the level of irregularities and deficiencies identified. Due to the legal framework for protecting the Union financial interests, the complexity of the related procedures and the number of control layers involved in many areas, errors are only corrected several years after they have occurred.

In addition, the Financial Regulation (Article 80(4)) foresees the use of flat-rate or extrapolated corrections in accordance with the sector-specific rules where the unduly spent amounts cannot be precisely identified, which is a frequent scenario. The Commission has acted within its powers and in full respect of the existing regulations in order to protect the EU budget. Under the Court's audit approach, adjustments are made to the extent that a link to individual operations was established.

The Commission considers that the Court's annual representative error rate should be seen in the context of the multiannual character of EU interventions (see also paragraphs 3.7, 3.44 first indent, 4.6, 4.36 first indent, 5.20, 5.21 and 6.13).

The Commission shares the Court's assessment of the errors reported aside from the limited number of exceptions described in paragraphs 3.6 (b), 3.7, 3.13, 4.5(b), 4.7, 4.15 and 6.13.

Table 1.2 — 2013 summary of audit results on the regularity of transactions

Annual report chapter	Transactions subject to audit (million euro)	Most likely error (MLE) 2013 (%)	Confidence interval		Most likely error (MLE) 2012 (%)
			Lower error limit (LEL)	Upper error limit (UEL)	
Agriculture: market and direct support	45 016	3,6	1,7	5,5	3,8
Rural development, environment, fisheries and health	15 581	6,7	3,5	9,9	7,9
Regional policy, transport and energy	45 477	6,9	3,7	10,1	6,8
Employment and social affairs	16 200	3,1	1,5	4,7	3,2
External relations, aid and enlargement	6 019	2,6	1,2	4,0	3,3
Research and other internal policies	10 431	4,6	2,6	6,6	3,9
Administrative and related expenditure	10 600	1,0	0,0	2,3	0
Total	149 324	4,7	3,5	5,9	4,8
Revenue	149 504⁽¹⁾	0	0	0	0

⁽¹⁾ The audit involved examination at the Commission level of a sample of recovery orders covering all types of revenue (see paragraph 2.4).

THE COURT'S OBSERVATIONS

1.18. The Court concludes that, overall, payments⁽⁹⁾ were materially affected by error and that the supervisory and control systems examined were, in general, partially effective (see **Table 1.2**).

THE COMMISSION'S REPLIES

1.18. The Commission recognises that the examined systems are partially effective as reflected in the Court's estimated error rate at the level of final recipients. As a consequence of the operation of its supervisory and control systems, the Commission has implemented financial corrections, net financial corrections and recoveries in 2013 amounting to 3 334 million euro (provisional amount) which corresponds to the equivalent of 2,4 % as compared to the payments made (see table 1.1). For a breakdown of the figures per policy area see below:

- Chapter 3 — Agriculture — Market and Direct Support: 637 million euro of financial corrections and recoveries (1,4 % of the payments made),
- Chapter 4 — Rural development, Environment, Fisheries and Health: 476 million euro of financial corrections and recoveries (3,2 % of the payments made),
- Chapter 5 — Regional policy, Energy and Transport: 1 029 million euro of financial corrections and recoveries implemented (2,3 % of the payments made),
- Chapter 6 — Employment and Social Affairs: 898 million euro (6,4 % of total payments made) ,
- Chapter 7 — External relations, Aid and Enlargement: 93 million euro (1,5 % of total payments made),
- Chapter 8 — Research and Other Internal Policies: 197 million euro (1,5 % of total payments made) and
- Chapter 9 — Administrative expenditure: 3 million euro (0 % of payments made).

This does not mean that all recoveries, financial corrections and net financial corrections implemented in year T can be deducted from the errors of year T. However, it implies that when assessing whether the overall system of internal control is effective in protecting the EU budget on a multiannual basis, both error rates and recoveries/financial corrections/net financial corrections have to be taken into account (see reply to paragraph 1.17).

Analysis of audit results

1.19. This year's results show a material level of error in most parts of the budget, close to that of 2012. Overall, the estimated error rate for 2013 is 4,7 %, a decrease of 0,1 percentage points. A significant factor in 2013 has been the increased impact of corrective measures applied by the Member States and the Commission. If these corrective measures had not been applied to transactions sampled by the Court, the overall estimated level of error would have been 1,6 percentage points higher.

1.19. See replies to 1.17 and 1.18.

⁽⁹⁾ The Court examines payments when expenditure has been incurred, recorded and accepted.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

1.20. The relatively stable results have been achieved in a year in which spending on the most error prone expenditure (cohesion) increased markedly.

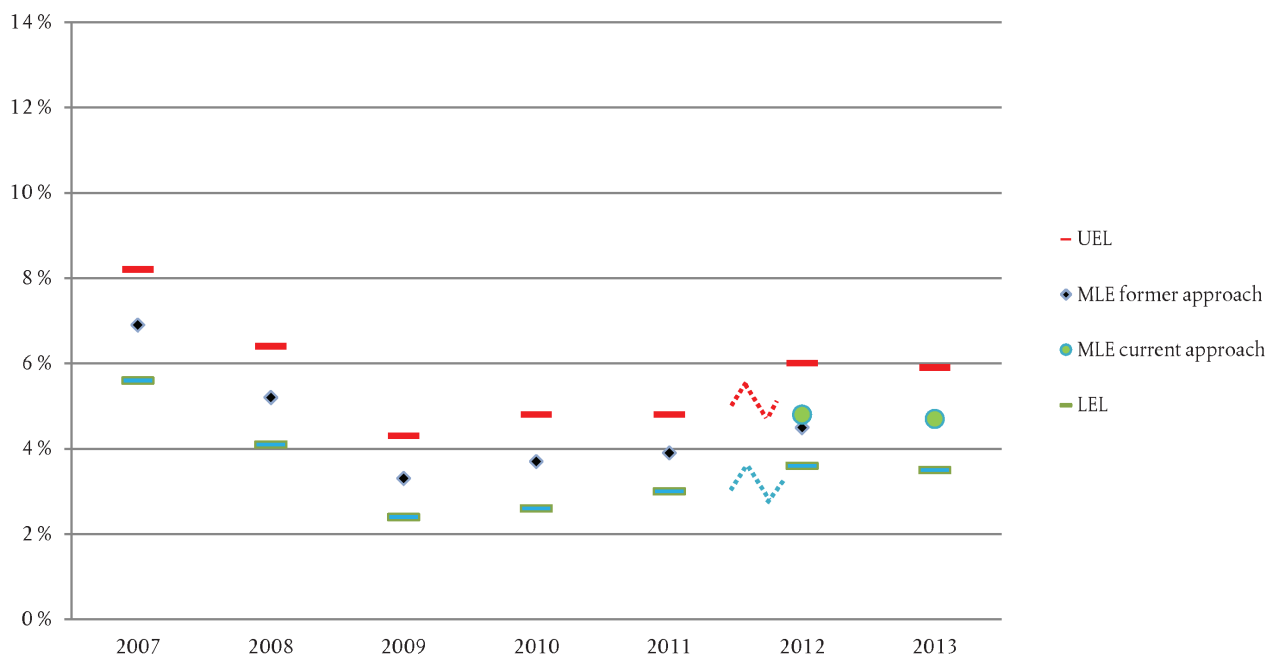
1.21. Other factors with an impact on the 2013 estimated level of error include:

- the decrease in incidence of public procurement errors (although it still accounts for one fifth of the estimated level of error, see paragraph 1.22 and **Graph 1.4**);
- for cross-compliance a high number of errors (more than a quarter of farmers visited who were subject to cross-compliance requirements failed to observe one or more of them) and a wider coverage of cross-compliance meant that they contributed 0,2 percentage points to the overall error rate (2012: 0,1 percentage points);

1.21.

The respect of cross-compliance obligations does not constitute an eligibility criterion for CAP payments and, therefore, the controls of these requirements do not pertain to the legality and regularity of the underlying transactions. See replies to paragraphs 3.6(b), 3.7, 3.13, 4.5(b), 4.7, and 4.15.

Graph 1.3 — The Court's estimate of the most likely error (2007-2013) ⁽¹⁾

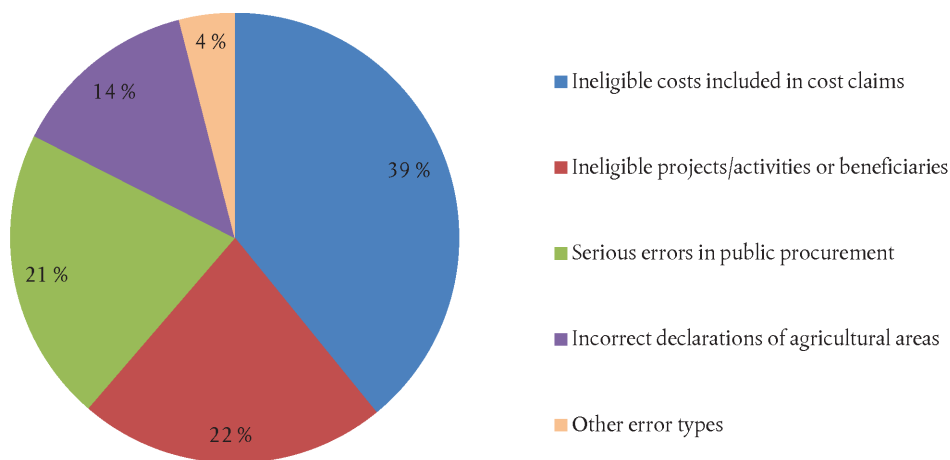


⁽¹⁾ The two points for 2012 represent the most likely error (MLE) estimated by the Court in 2012 (4,8 %, see **Table 1.2** in the Court's 2012 annual report) and an estimate of what the MLE would have been had the same findings been detected in a sample drawn on the same basis as in previous years (4,5 %, see 2012 annual report, paragraphs 1.14 and 1.15). The upper and lower error limits (UEL and LEL) for 2012 have been based on the sampling approach since that year.

THE COURT'S OBSERVATIONS

1.22. Eligibility errors in reimbursement expenditure dominate the errors detected by the Court in 2013. Ineligible costs included in cost claims contributed 1,8 percentage points (2012: 1,0), the category ineligible projects, activities and beneficiaries contributed a further 1,1 percentage points (2012: 1,1) to the total level of error and serious breaches of public procurement rules (mostly related to reimbursement expenditure but also affecting some administrative expenditure) contributed a further 1,0 percentage point (2012: 1,4). The key source of error for entitlement expenditure were incorrect declarations by farmers, which contributed 0,6 percentage points (2012: 0,8) to the overall level of error (see **Graph 1.4**).

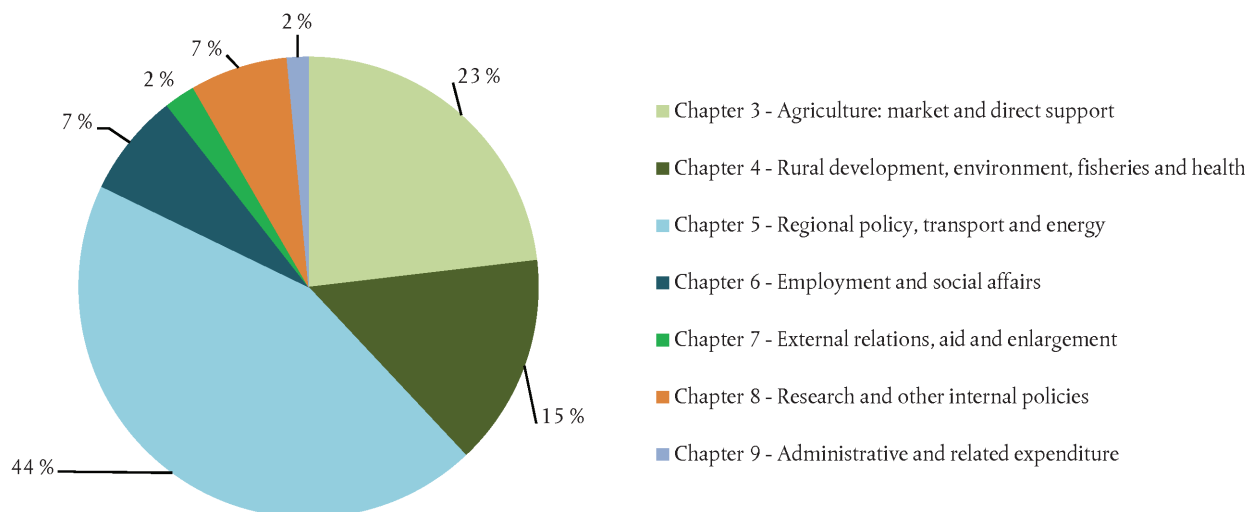
Graph 1.4 — Contribution to overall estimated error by type



1.23. A breakdown of the overall estimated error by chapter shows that 'Regional policy, transport and energy' (chapter 5) contributes around two fifths of the overall estimated error, 'Agriculture: market and direct support' (chapter 3) contributes around one quarter and 'Rural development, environment, fisheries and health' (chapter 4) contributes around one seventh (see **Graph 1.5**). There are no significant changes in this distribution compared to 2012.

THE COMMISSION'S REPLIES

1.22. *The Commission has also identified similar problems during its audits. Considerable efforts have been made by the Commission during the last period to identify the root cause of problems and implement corrective actions where necessary.*

Graph 1.5 — Contribution to overall estimated error by annual report chapter

THE COURT'S OBSERVATIONS

1.24. The Court calculates that the estimated rate of error taken as a whole on shared management expenditure amounts to 5,2 % (2012: 5,3 %) and on all other forms of operational expenditure⁽¹⁰⁾ is 3,7 % (2012: 4,3 %). The estimated rate of error for administrative expenditure is 1 % in 2013 (2012: 0 %).

⁽¹⁰⁾ Mainly expenditure covered by chapters 7 and 8, and also including parts of the expenditure covered by chapters 4, 5 and 6. The extrapolated error for shared management expenditure is based on the examination of 699 transactions (drawn from a population of 119,6 billion euro), the extrapolation for other forms of operational expenditure is based on the examination of 342 transactions (drawn from a population of 19 billion euro).

THE COURT'S OBSERVATIONS

Review of synthesis report and annual activity reports

Annual activity reports

Directors-general report annually on regularity...

1.25. The Commission requires directors-general⁽¹¹⁾ to provide declarations of assurance on the legality and regularity of underlying transactions in their annual activity reports⁽¹²⁾ (performance reporting within the framework of annual activity reports is discussed in chapter 10). When they are unable to give assurance on a significant segment of spending, they issue a reservation. Directors-general should qualify their assurance where:

- (a) an event has occurred with serious implications for the reputation of the Commission; or
- (b) the impact of estimated levels of error, net of financial corrections and recoveries already made, remains material.

1.26. In 2013 the Secretariat-General and the DG Budget updated guidance⁽¹³⁾ on drafting and presenting information in the annual activity reports and the basis for reservations. Annual activity reports now aim to present a consistent message in three layers of information: (1) a summary, (2) description of achievements, management and assessments and (3) detailed annexes. A new element in the guidance requires directors-general to identify areas of persistently high error. This guidance also responds to the requirement in the Financial Regulation that the Commission should take or propose appropriate action where the level of error is persistently high⁽¹⁴⁾.

⁽¹¹⁾ The term 'director-general' is used here to cover all persons signing declarations. The declarations have been signed by the Secretary-General of the Commission, 36 directors-general, eight directors and four heads of service and the chief operating officer of the European External Action Service.

⁽¹²⁾ The annual activity reports of Commission services are available on the Commission's website: http://ec.europa.eu/atwork/synthesis/aar/index_en.htm

⁽¹³⁾ Standing Instructions for the 2013 Annual Activity Reports (SEC/2013/SEC(2013)584).

⁽¹⁴⁾ Article 32(5) of the Financial Regulation.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

... and recorded fewer reservations as levels of payment dropped on some higher risk programmes

1.27. Directors-general made a total of 17 quantified reservations in 2013 compared to 23 in 2012 (see **Table 1.3**). The biggest factor in the reduction in the number of reservations was the drop in the level of payments under Sixth Framework Programme (FP6) and cohesion 2000-2006 operational programmes ⁽¹⁵⁾ (subject to five quantified reservations ⁽¹⁶⁾ in 2012 but none in 2013). The DGs responsible will still need to clear expenditure claims for these programmes ⁽¹⁷⁾.

1.28. In the light of observations by the Court ⁽¹⁸⁾ and the Internal Audit Service, the Director-General for Agriculture and Rural Development introduced two new reservations. The additional reservations and the adjusted quantification of continuing reservations in the annual activity report of DG Agriculture and Rural Development provide a more realistic view of the policy area compared to last year. However, the Court notes the limitations to the approach followed (paragraphs 3.39 to 3.43).

1.28. DG AGRI has taken a multilayered approach to assurance building, acknowledging that each layer of assurance taken on its own may not be sufficient. This is precisely why the Commission has integrated all available information in order to make the most solid estimate of the residual error rate and thus determine where reservations are necessary.

⁽¹⁵⁾ Operational programmes for the European Regional Development Fund (ERDF), Cohesion Fund (CF) and European Social Fund (ESF).

⁽¹⁶⁾ The directors-general for Employment, Social Affairs and Inclusion, Maritime Affairs and Fisheries and the Head of Service for Foreign Policy Instruments have not continued a reservation issued in 2012 with expenditure in 2012 of 58,5 million euro, 2,4 million euro and 25,9 million euro respectively.

⁽¹⁷⁾ The risks related to closure of operational programmes 2000-2006 are now subject to two non-quantified (reputational) reservations issued by the directors-general of DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion. Two other non-quantified reservations have been issued by directors-general of DG Climate Action (for the European Emissions Trading System) and DG Human Resources and Security (for a potential fraud in one European School).

⁽¹⁸⁾ Court's 2012 annual report, paragraphs 4.38 and 4.44 (recommendation 3).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The annual activity reports are still evolving and therefore difficult to compare between years

1.29. Changes in presentation introduced in 2013 mean that annual activity reports provide more than one estimate of 'amounts at risk' (itself a complicated concept, see paragraphs 1.31 and 1.32). The error rate on which this calculation is based lies, however, in the lower end of the range estimated by the Court. While risk rates in the key area of cohesion are reported across a range of possible outcomes⁽¹⁹⁾, the executive summary focusses upon a lower figure⁽²⁰⁾ (see chapter 3, paragraph 3.42, chapter 5, paragraphs 5.46, 5.47, 5.51, 5.52, 5.57, and chapter 6, paragraphs 6.34 to 6.38).

1.30. Two directorates-general⁽²¹⁾ were subject to a 'limited review' and three to a follow up review⁽²²⁾ carried out by the Commission's Internal Audit Service (IAS). The limited review of the residual error rate for DG Regional and Urban Policy found the system for checking and correcting Member State error rates to be relatively well planned, but that there were nevertheless significant uncertainties and weaknesses in the figures. For DG Agriculture and Rural Development the IAS found that the director-general has a more solid basis for providing assurance compared to 2012. However arrangements for collecting, processing and reporting information still need to be improved.

1.29. *The Commission has taken the steps to harmonise and simplify the structure of the Annual Activity Reports so as to improve clarity and consistency.*

The Commission considers that its estimates are broadly in line with those of the Court. Moreover, the estimate of the residual error rate for chapter 3 falls rather closer to the median than to the lower figure of the confidence interval.

1.30. *Actions already initiated by DG AGRI in 2012 continue in order to automate the collection and processing of the data and thus bring the further improvements recommended by the IAS.*

⁽¹⁹⁾ DG Regional and urban policy (DG REGIO) annual activity report page 6 'the estimated average risk rate linked to the 2013 payments for ERDF and Cohesion Fund is in the range between 2,8% and 5,3%' and DG Employment, social affairs and inclusion (DG EMPL) annual activity report page 44 'an average error rate for ESF in the range between 2,6% and 3,5%' for 2007-2013 operational programmes.

⁽²⁰⁾ Key-performance indicator 5 for DG Regional and urban policy (DG REGIO) and DG Employment, social affairs and inclusion (DG EMPL) are 1,2% and 1,1% respectively.

⁽²¹⁾ DG Regional and Urban Policy (DG REGIO) and DG Communications Networks, Content and Technology (DG CNECT).

⁽²²⁾ DG Agriculture and Rural Development (DG AGRI), DG Development and Cooperation — EuropeAid (DG DEVCO) and DG Research and Innovation (DG RTD).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The Commission now presents two measures of 'amounts at risk'

1.31. **Table 1.3** presents two 'amounts at risk taken from the annual activity reports'. The higher amount, totalling 4 179 million euro⁽²³⁾ is the amount mentioned in section 4.1 of the synthesis report (see paragraph 1.35). Presentation of this figure represents an improvement compared to 2012 (see paragraph 1.36). The lower amount (2 437 million euro) is the quantification of reservations, made by the directors-general in the annual activity reports.

1.32. The Court considers that some annual activity reports may underestimate 'amounts at risk'. Thus the Commission's assessment of different areas of spending, and identification of areas of persistently high error, may not be sufficiently robust (see paragraph 1.29).

1.31. The Commission notes that the Synthesis Report includes a definition of 'amount at risk', a table of reservations quantified and an estimation of the amount at risk for expenditure not under reservation.

Although the 'classic' approach (based on the amounts at risk from those activities that are under reservation) remained the main method to estimate the amounts at risk, the DGs under shared management nevertheless also presented in their AARs the alternative method (maximum scenario) including those areas with a relatively lower error rate and not under reservation.

1.32. In the Commission's view, its assessment of different areas of spending, and identification of areas of persistently high error, is sufficiently robust, following the implementation of measures addressing previously identified weaknesses.

⁽²³⁾ The 'amounts at risk' of annex 1 of the synthesis report (3 807 million euro) and an addition of 372 million euro for the expenditure not subject to a reservation (section 4.1 of the synthesis report).

Table 1.3 — Quantified reservations in Commission annual activity reports

(million euro)

Chapter	DG/ Service ⁽¹⁾	Reason for reservation	Total payments for relevant activities in 2013	Total amount at risk	Total payments to entities under reservation for relevant activities in 2013	Amount at risk (reservations)
3	AGRI	Weaknesses in legality and regularity of payments for interventions in agricultural markets in nine Member States.	3 193,2	237,4	670,8	198,3
		Weaknesses in legality and regularity of direct payments to farmers in six Member States.	41 658,3	973,9	18 997,5	652,2
4	AGRI	The action plans of 31 paying agencies in 19 Member States did not address all identified weaknesses in the legality and regularity of transactions.	13 151,8	673,9	9 591,5	598,8
		Weaknesses in evaluation of reasonableness of costs of investment measures in one candidate Member State.	47,6	2,6	26,0	2,6
	MARE	National audit report revealed error rates exceeding 2 % of declared expenditure (four Member States), or a non reliable or no report provided by two Member States.	566,4	10,8	91,3	7,6
	SANCO	Reservation concerning the rate of residual errors with regard to the accuracy of Member States' cost claims under the animal disease eradication and monitoring programmes in the food and feed policy area (annual programmes).	229,1	4,5	229,1	4,5

⁽¹⁾ For the full list of Commission DGs/services please see <http://publications.europa.eu/code/en/en-390600.htm>

(million euro)

Chapter	DG/ Service ⁽¹⁾	Reason for reservation	Total payments for relevant activities in 2013	Total amount at risk	Total payments to entities under reservation for relevant activities in 2013	Amount at risk (reservations)	
5	REGIO	Serious deficiencies in management and control systems for 73 operational programmes in 15 Member States for European Regional Development Fund/Cohesion Fund (2007-2013) and two programmes for the Instrument for Pre-Accession (IPA).	43 392,8	1 152,7	5 636,0	440,2	
6	EMPL	Significant deficiency of management and control systems set up for the European Social Fund (2007-2013) in 36 operational programmes in 11 Member States.	13 763,8	330,3	2 159,4	123,2	
7	DEVCO ⁽²⁾	Significant occurrence of errors in the underlying transactions (global figure for the Directorate-General).	6 730,8	225,5	225,5	225,5	
8	RTD CNECT ENTR ENER MOVE	Errors in cost claims for 7th Framework Programme (FP7) grants.	3 664,4	107,5	3 664,4	107,5	
			1 533,0	31,8	1 533,0	31,8	
			403,2	1,2	403,2	1,2	
			143,7	5,3	143,7	5,3	
			65,3	0,8	65,3	0,8	
	REA	Error in cost claims for FP7 for Space and Security.	250,8	6,3	250,8	6,3	
		Errors in cost claims for FP7 for small and medium-sized enterprises.	230,4	27,1	230,4	27,1	
	EACEA	Error in grant payment for the LLP programme (2007-2013).	124,4	3,7	124,4	3,7	
	Total quantification of reservations			129 149,0	3 795,3	50 547,6	2 436,6
		HOME	Amount at risk' for 'Solidarity' and 'Migration flows'		11,7		
Total 'amounts at risk' of annex 1 of the synthesis report			129 149,0	3 807,0	50 547,6	2 436,6	

⁽¹⁾ For the full list of Commission DGs/services please see <http://publications.europa.eu/code/en/en-390600.htm>

⁽²⁾ The amounts for the Directorate-General for Development and Cooperation — EuropeAid (DG DEVCO) include for the respective columns 2 963,0 million euro and 99,3 million euro for the European Development Funds (EDF).

Source: Annual activity reports of the directorates-general, services and executive agencies and the synthesis report.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

*The synthesis report***The synthesis report is an instrument for external and internal accountability...**

1.33. The Commission adopted the 'synthesis report' ⁽²⁴⁾ on 11 June 2014. The synthesis report was originally developed as part of internal accountability arrangements of the Commission, but it is also sent to the European Parliament and Council and made publicly available ⁽²⁵⁾ (external accountability).

1.34. As indicated in the 2012 annual report ⁽²⁶⁾ the synthesis report is not subject to audit by the Court. It is finalised in accordance with a timetable set out in the Financial Regulation, but too late for it to be a significant input to the work of the Court. The following comments relate to its observations made in the 2012 annual report and the cost-effectiveness of control procedures.

... in which the Commission recognises that spending is affected by a material level of error...

1.35. The 2013 synthesis report contains a description and overview of amounts at risk (comparable to **Table 1.3**). It notes that the financial scope of the reservations made by the directors-general increased compared with 2012. The amounts at risk (see paragraphs 1.29 to 1.32) correspond to 2,8 % ⁽²⁷⁾ of all expenditure disbursed (both from the EU budget and through the European Development Fund). The Commission thus recognises that spending is affected by a material level of error. In key areas of spending, the Commission bases this evaluation on assessments of directors-general that are lower than the level estimated by the Court. In the Court's view differences in the level of detected error are a key reason for the differing figures presented by the Court for estimated error, and the Commission for 'amounts at risk'.

1.35. *In general, the Commission complements the annual amount at risk by the multiannual residual error rate which takes into account financial corrections and recoveries.*

The Commission considers that the multiannual residual error rate gives a fair indication of the extent to which the EU budget remains affected by expenditure incurred in breach of law after the operation of supervisory and control systems.

⁽²⁴⁾ The full name of the document is the 'Synthesis report of the Commission's management achievements in 2013', shortened here to 'synthesis report'.

⁽²⁵⁾ The synthesis is published on the Commission's website: http://ec.europa.eu/atwork/pdf/synthesis_report_2013_en.pdf, together with its annex http://ec.europa.eu/atwork/pdf/synthesis_report_2013_annex_en.pdf

⁽²⁶⁾ Court's 2012 annual report, paragraph 1.45.

⁽²⁷⁾ Synthesis report, section 4.1, page 14.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

...and seeks to explain the Commission's concept of 'amounts at risk'

1.36. Alongside the synthesis report the Commission provides a one-page annex on the calculation of amounts at risk. This explains 'amounts at risk' as 'the value of the fraction of the transactions which is estimated not to be in full conformity with the applicable regulatory and contractual requirements after the application of all controls (corrective measures) intended to mitigate compliance risks'. It would be useful for external readers to be informed of the nature and financial impact of these 'corrective measures'. The Court will consider further examination of the calculation of amounts at risk in future audit work, taking account of the work of the Commission's internal audit service.

The synthesis report provides a first consideration of the cost-effectiveness of control procedures

1.37. The synthesis report considers the cost-effectiveness of control systems in section 3.4. This element responds to a new requirement, stemming from the 2012 revision of the financial regulation. While the analysis presented in the body of the report is provisional⁽²⁸⁾, and looks to further updates in methodology, the executive summary provides some firm conclusions. The Commission concludes that for direct management 'more detailed controls are costly and [...] additional controls should be performed only where the potential benefits can be shown to outweigh the costs to the Commission and the beneficiaries'. For shared management, the Commission concludes that 'Member States should make maximum use of all available instruments to prevent errors'.

1.38. The report does not contain information on costs supporting the conclusions it presents for direct management (where 'more detailed controls are costly') and for shared management (where Member States are urged to 'make maximum use of all available instruments'). The synthesis report does not discuss the challenge of programmes with persistently high level of error (see paragraph 1.26).

1.36. *The Commission will provide information on the nature and financial impact of these corrective measures in its updated communication on the protection of the EU budget.*

1.37. *In accordance with the new Financial Regulation the number and extent of controls have to be adapted to the level of risk, while taking account of cost-effectiveness. The primary purpose of assessing the cost-effectiveness of controls is to support management decision-making as regards the design of the control systems and the ensuing allocation of resources. This also applies to Member States' controls relating to EU funds. In 2013, DGs across the Commission were required to review the control strategies and systems to ensure that they are cost-effective and proportional to the risks. This may entail major structural changes in financial management processes. The Commission is committed to effectively implement the new requirements.*

⁽²⁸⁾ Synthesis report section 3.4 (page 12) includes 'that further work is required to make better use of this information to modulate control intensity and frequency according to risk. Significant gaps are apparent as regards establishing indicators for control effectiveness.'

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Overall assessment

1.39. The Court looks forward to further improvements in the synthesis report in future years. In particular the Commission should consider further clarifying the calculation of amounts at risk, and explaining the estimated impact of corrective mechanisms on this figure. Clarification of these points will assist the Commission in reaching conclusions on areas suffering from persistently high levels of error, on which more fundamental reconsideration is required (see paragraph 1.26).

1.40. Some other areas for improvement identified by the Court in 2012 remain relevant. Presentation of the synthesis report in accordance with the timetable set out in Article 66 of the Financial Regulation means that it is too late to have a significant impact on the Court's conclusions. In addition the report — while now clearer on the material impact of irregularity — does not have to and does not include an explicit declaration⁽²⁹⁾ of the kind made in other areas.

1.39. *The Commission will examine how the synthesis report can be further improved, in particular on the annual amounts at risk and the estimated impact of corrective mechanism on the multiannual residual error rates. Details can already be found in the AARs.*

The Commission intends to use this information in the context of Article 32(5) of the Financial Regulation which requires it to take or propose appropriate actions where the level of error is persistently high.

1.40. *The Commission considers that the Synthesis Report goes significantly beyond the requirements of the Financial Regulation which states in Article 66: 'No later than 15 June each year, the Commission shall send to the European Parliament and the Council a summary of the annual activity reports for the preceding year'. The Synthesis Report is the summary of the annual activity reports and is the document by which the College takes political responsibility on the basis of Article 317 of the TFEU. It contains an analysis of the reservations and their reasons and gives instructions to the services on how to address the remaining weaknesses.*

The Commission considers that the combination of the annual activity reports and the Synthesis Report fulfil the internal and external accountability objectives defined by the Court. The annual activity reports are finalised in time to be taken into account by the Court and they contain an explicit declaration of the kind comparable to other areas.

BUDGETARY AND FINANCIAL MANAGEMENT

1.41. Key features of EU budgetary and financial management in 2013 included:

- (a) a large increase in the volume of payments that the Commission was allowed to make;
- (b) overall spending levels which were close to the maximum allowed under the legal framework for the budget;
- (c) a continued increase in obligations to pay in the future;

⁽²⁹⁾ For example the management declaration required of bodies in the Member States (Article 59(5)(a) of the Financial Regulation) and the corporate governance statements required under Article 46(a) of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (OJ L 222, 14.8.1978, p. 11).

THE COURT'S OBSERVATIONS

- (d) a persistently lengthy period from initial commitment to acceptance of expenditure in several areas of spending;
- (e) a significant volume of funds charged to the budget but not disbursed to final recipients; and
- (f) delays in recording repayments as budgetary revenue.

Amending budgets significantly increased the volume of payments the Commission was allowed to make

1.42. The initial budget for 2013 fixed a limit for payments of 132,8 billion euro. Nine amending budgets were approved during the year. In particular amending budgets 2 and 8⁽³⁰⁾ added 11,2 billion euro to permitted spending for the year. In total, amending budgets and adjustments for carry-overs brought appropriations for payment in the annual budget to 145,5 billion euro⁽³¹⁾ (6,3 % higher than in 2012). The additional budget for cohesion (Heading 1b, 9,2 billion euro) was an increase of 17 % on the previous year.

Overall spending levels were close to the maximum allowed under the budgetary framework

1.43. The Multiannual Financial Framework set a maximum level for commitments which could be budgeted for 2013 of 153,3 billion euro, and a maximum level for payments of 144,6 billion euro⁽³²⁾. The final budget set a limit close to the maximum permitted under the financial framework (99,3 % of the maximum for commitments and 99,9 % of the maximum for payments). The final outturn for both commitments and payments was in turn close to the limits set in annual budget — and therefore the financial framework — with payments reaching 98,8 % of the financial framework ceiling.

⁽³⁰⁾ Amending budget No 2 (OJ L 327, 6.12.2013, p. 1) and amending budget No 8 (OJ L 49, 19.2.2014, p. 13).

⁽³¹⁾ Consolidated accounts of the EU, table 3.1 columns (7) + (8) and the amounts carried over of 1 billion euro in column (9).

⁽³²⁾ These amounts include 0,8 billion euro for commitment and 0,3 billion euro for payment appropriations on four funds which fall outside the ceiling of the Multiannual Financial Framework (Emergency Aid Reserve, European Union Solidarity Fund, Flexibility Instrument, European Globalisation Adjustment Fund).

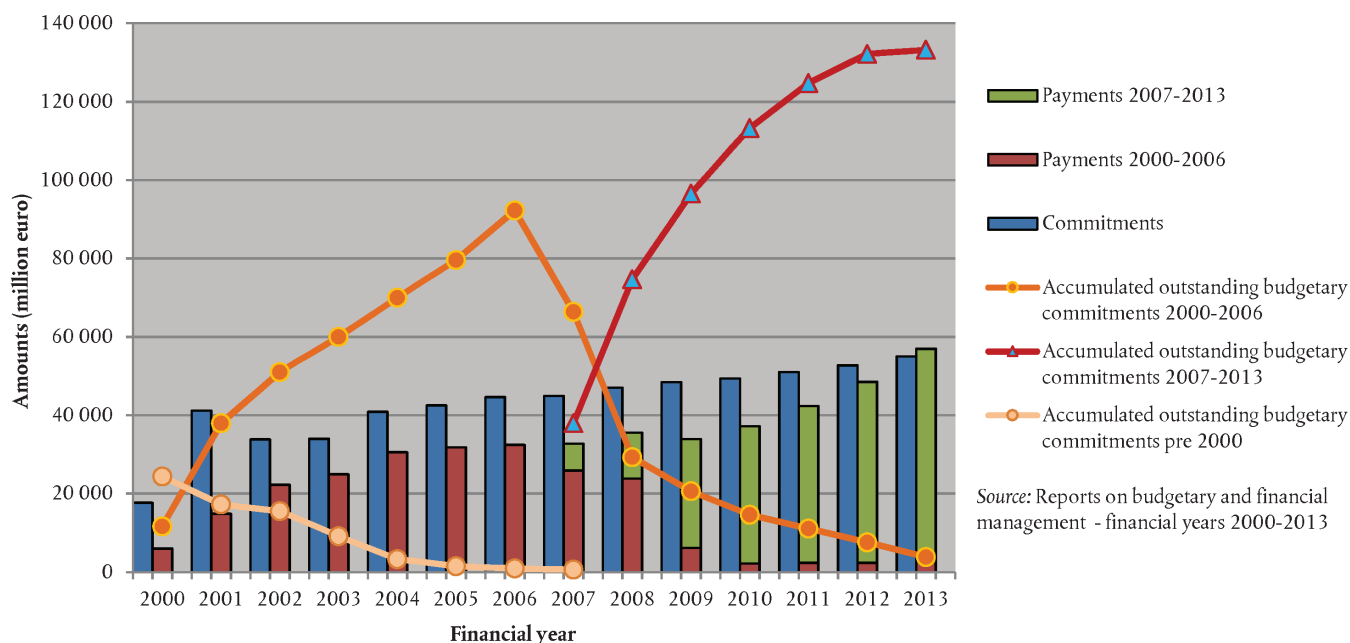
THE COURT'S OBSERVATIONS

Despite the high level of payments, obligations to make payments in the future continued to grow

1.44. The budgetary result for the year was positive as revenue (essentially own resources received from the Member States) exceeded payments by 1,0 billion euro in 2013 (as in 2012). This budgetary surplus will offset calls for own resources from Member States in 2014. However the economic result (drawn up on an accrual basis) is negative, reflecting an increase in net liabilities of 5,4 billion euro (see **Annex 1.3**, tables 1 and 6). Key factors were the increase in accrued expenses and in provisions.

1.45. Taking outstanding commitments and outstanding liabilities together, the amount to be funded from future budgets increased from 313 billion euro at 31 December 2012 to 322 billion euro at 31 December 2013. Of the 322 billion euro, 222 billion euro represent outstanding budgetary commitments and 99 billion euro⁽³³⁾ relate to balance sheet liabilities not covered by outstanding commitments. Outstanding commitments for cohesion (Heading 1b) make up 61,6 % of the total (see **Graph 1.6**).

Graph 1.6 — Evolution of accumulated outstanding commitments for cohesion



⁽³³⁾ With the notable exception of loans, most of the liabilities on the balance sheet will eventually turn into a demand for payment from the budget. Of the 143 billion euro liabilities that do not reflect borrowings, only 44 billion euro is already covered by commitments.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

A persistently lengthy period from initial commitment to acceptance of expenditure in several areas of spending

1.46. On average more than two years elapse before a commitment becomes a payment. The liquidation of a commitment by a payment does not necessarily end the process of recording expenditure. The Commission records final expenditure by clearing prefinancing. This takes place only when activities have been undertaken, reported to it, and accepted. **Table 1.4** shows the level of prefinancing disbursements on which the Commission has not yet accepted and validated final use by beneficiaries. Gross prefinancing amounted to 79,4 billion euro at the end of 2013.

1.46. *Commission services are instructed to clear prefinancing only on the basis of incurred expenditure, supported by reliable information from recipients, validated and accepted (see paragraph 1.12(e)).*

Table 1.4 — Breakdown of the Commission's outstanding budgetary commitments and pre-financing

(million euro)

Outstanding budgetary commitments ⁽¹⁾												
Heading	< 2007	2007	2008	2009	2010	2011	2012	2013	Total	Years of commitments ⁽²⁾		
1	4 097	337	859	3 760	12 112	28 399	51 867	65 263	166 694	2,3		
2	479	46	95	139	219	2 571	9 496	15 383	28 428	1,7		
3	6	16	50	144	214	398	728	1 522	3 078	1,1		
4	956	415	823	1 237	2 375	3 845	5 923	7 738	23 312	2,5		
5	0	0	0	0	0	1	3	339	343	0,0		
Total	5 538	814	1 827	5 280	14 920	35 214	68 017	90 245	221 855 ⁽⁴⁾	2,2		
Pre-financing ⁽⁵⁾												
Heading	< 2007 ⁽⁶⁾	2007	2008	2009	2010	2011	2012	2013	Total	Years of payments ⁽⁷⁾		
1	1 776	6 947	11 888	12 476	3 710	4 743	6 867	8 746	57 153	0,8		
2	805	3 826	2 723	158	93	121	205	346	8 277	0,1		
3	3	2	69	154	224	697	1 421	1 455	4 025	2,4		
4	214	128	174	591	908	1 488	2 409	3 982	9 894	1,5		
5	0	0	0	0	0	0	1	5	6	0,0		
Total (gross pre-financing)	2 798	10 903	14 854	13 379	4 935	7 049	10 903	14 534	79 355	0,6		

Note: When comparing this with the figures of 2012, account should be taken of the increase in the budget which reduces the number of years of payments given in the final column.

⁽¹⁾ Source: Annual accounts of the European Commission 2013, table 3.5.

⁽²⁾ Source: Report on budgetary and financial management — 2013 — section A.6.3.

⁽³⁾ Heading 1 — Sustainable growth is made up of Heading 1a — Competitiveness for Growth and Employment and 1b — Cohesion for Growth and Employment.

⁽⁴⁾ Outstanding budgetary commitments do not include 557 million euro from other institutions.

⁽⁵⁾ Pre-financing by other institutions and agencies amounts to 257 million euro.

⁽⁶⁾ A part of the pre-financing paid before 2007 has been allocated to the corresponding financial framework heading based on the information concerning the budget line was not available in the Commission's information system.

⁽⁷⁾ Pre-financing paid as at 31.12.2013 divided by payments made from the year's appropriations.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

1.47. **Table 1.4** shows that the longest average period from commitment to acceptance of expenditure is for Heading 4 (EU as a global player), where for a typical operation 4 years elapse between a commitment being made, and the Commission recording the final related expenditure.

A significant volume of funds charged to the budget but not disbursed to final recipients

1.48. In the latest Commission report ⁽³⁴⁾ on structural fund financial engineering instruments (FEIs) (dated September 2013), describing the situation as at the end of 2012 only 37 % of amounts paid to FEIs were paid out to final beneficiaries. The EU had contributed 8,4 billion euro to these funds as at the end of 2012. Considering the pressure on the budget for payments and the Financial Regulation which states in Article 140(7) that excessive balances should be avoided on financial instruments, the Commission should look critically at the flow of payments towards these instruments. It should also keep sums held on fiduciary accounts to the lowest level consistent with expected cash flow demands over the following year.

1.48. *The Commission is aware of the limitations of the legislative framework during the MFF 2007-2013: in line with Article 78(6) of the cohesion policy 2007-2013 general regulation (Council Regulation (EC) No 1083/2006), Member States may immediately claim from the Commission 100 % of the amounts they have paid to 2007-2013 Financial Instruments. As with all other claims, the Commission shall pay these within two months, subject to available funding (Article 87).*

The Commission underlines that it has taken actions to address excessive balances. This includes performing additional audit work and evaluations, as well as the provision of detailed guidance and support structures. Furthermore, the current legislative framework has been strengthened significantly, for both direct and indirect management, (Article 140(7) of the Financial Regulation) and shared management (Article 41 of Regulation (EU) No 1303/2013) so as to avoid the problem of parking of funds.

In particular, Article 41 states that in 2014-2020 Member States may only include payments to Financial Engineering Instruments in claims to the Commission in several percentage tranches (not exceeding 25 % and depending on effective disbursements). Experience of the previous period, as noted by the Court, has accordingly been incorporated in the new Regulation.

The Commission indicated already in the past the low execution at the beginning of the programming period in its various reports to the Parliament and Council. However the Commission does not only focus on the absorption of funds but also on the achievement of results by the co-funded investments. Therefore, it might accept a lower absorption if the quality of the investments is secured.

The Commission further notes that at the end of 2012 the average disbursement rate in FEIs was 40 %. This average reflects the fact that the majority of FEIs were established in 2009 or later. Between 2011 and 2012 the number of financial instruments increased by 60 % and the amount of the contribution of the programmes to the FEIs increased by 14 %. This confirms that still in 2012 a significant number of new FEIs were established, with an impact on the average disbursement rates (see reply to paragraph 5.35).

⁽³⁴⁾ Document reference: COCOF_13-0093-00-EN.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Delays in recording budgetary revenue

1.49. At 31 December 2013, reflows⁽³⁵⁾ from MEDA⁽³⁶⁾ loans and risk capital operations amounting to 259 million euro had accumulated and remained in a fiduciary account at the EIB and had not been treated as budgetary revenue. Initially these reflows were regularly transferred by the EIB to the Commission. However, at the request of the Commission⁽³⁷⁾, the transfer of reflows to the budget was suspended in 2008. As a result reflows after this date were not returned to the EU budget as revenue.

Need for a long-range cash flow forecast

1.50. The continued increase in sums to be funded from future budgets (see paragraph 1.45), despite the increase in payments in 2013, further supports the view expressed by the Court in its 2012 annual report. The Court continues to consider that the Commission should prepare and publish annually a long range cash flow forecast⁽³⁸⁾. This would assist stakeholders in assessing future payment requirements and budgetary priorities. It would also assist the Commission to take the decisions needed to ensure that essential payments can be met from approved annual budgets.

1.49. *Delays have occurred due to an ongoing discussion on the best way to reuse these funds. This has now been resolved via Decision No 466/2014/EU of the European Parliament and of the Council of 16 April 2014 granting an EU guarantee to the European Investment Bank against losses under financing operations supporting investment projects outside the Union (OJ L 135, 8.5.2014, p. 1), whereby:*

- 110 million EUR will be used to reinforce the ECFIN Guarantee Fund (for the EIB). The current status is that the EIB has been asked to return these funds to the Commission,
- the balance of the reflow funds (151 million euro) has already been repaid by the EIB and has been returned to the general budget.

1.50. *The Commission accepts this recommendation and will present this forecast in the Accounting Officer's report (Article 150(4) of the Financial Regulation) to the discharge authority in September 2014. Nonetheless, the Commission would point out that it already has detailed information on its long-term budgetary needs which is used in the context of its annual budgeting process and MFF monitoring.*

⁽³⁵⁾ Interest payments and repayments of loans, dividends and capital reimbursement.

⁽³⁶⁾ The principal instrument of economic and financial cooperation under the Euro-Mediterranean partnership.

⁽³⁷⁾ Based on a legislative proposal amending Regulation (EC) No 1638/2006, which was not adopted.

⁽³⁸⁾ See paragraphs 1.58 and 1.59 of the Court's 2012 annual report.

ANNEX 1.1

AUDIT APPROACH AND METHODOLOGY

1. The Court's audit approach is set out in the Financial and Compliance Audit Manual (FCAM). This manual is available on the Court's website. In order to plan audit work, and determine the extent of substantive testing, the Court uses an audit assurance model. This involves considering the risk of errors occurring in transactions (inherent risk) and the risk that the control systems do not prevent or detect and correct such errors (control risk).

PART 1 — Audit approach and methodology for the reliability of accounts

2. In order to assess whether the consolidated accounts (the consolidated financial statements and the aggregated reports on the implementation of the budget) properly present, in all material respects, the financial position of the European Union at year end, and the results of its operations and cash flows, and the changes in net assets for the year ended, the audit involves:

- (a) an evaluation of the accounting control environment;
- (b) checking 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;
- (e) substantive tests of commitments, payments and specific balance sheet items based on representative samples; and,
- (f) to the extent possible, and in accordance with international standards on auditing, the use of the work of other auditors. This is particularly the case for the audit of the borrowing and lending activities managed by the Commission, the Guarantee Fund for external actions and the BUFI fund for provisionally cashed fines for which external audit certificates are available.

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

3. The audit of the regularity of the transactions underlying the accounts involves:

- (a) direct testing of transactions (see **Tables 1.1** and **1.2**) to ascertain whether they are in line with the relevant rules and regulations; and
- (b) an examination of selected control systems. This is supplemented by evidence provided by the work of other auditors (where relevant) and an analysis of information and assurances from the Commission.

How the Court tests transactions

4. The direct testing of transactions within each specific assessment (chapters 2 to 9) is based on a representative sample of the receipts (in the case of revenue) and transactions contained within the policy group concerned⁽¹⁾. This testing provides an estimate of the extent to which the transactions in the population concerned are irregular.

5. Transaction testing involves an examination of each transaction selected, to determine whether or not the claim or payment was made for the purposes approved by the budget and specified in relevant legislation, correctly calculated and in compliance with the relevant rules and regulations. This involves tracing the transaction down from the budgetary accounts to the level of the final recipient (e.g. a farmer, organiser of training course, or development aid project promoter) and testing compliance 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.

⁽¹⁾ Additionally to this, a horizontal representative sample of commitments is drawn and tested for compliance with the relevant rules and regulations.

6. For revenue, the Court's examination of value added tax and gross national income-based own resources takes as a starting point the relevant macroeconomic aggregates on which these are calculated, and examines the Commission's control systems for processing these until the contributions of the Member States have been received and recorded in the consolidated accounts. For traditional own resources, the Court examines the accounts of the customs authorities and the flow of duties until the amounts are received by the Commission and recorded in the accounts.

7. For expenditure the Court examines payments when expenditure has been incurred, recorded and accepted ('expensed payments'). This examination covers all categories of payments (including those made for the purchase of assets) other than advances at the point they are made. Advance payments are examined when the final recipient of EU funds (e.g. a farmer, a research institute, a company providing publicly procured works or services) provides justification for their proper use and the Commission (or other institution or body managing EU funds) accepts that final use of funds is justified by clearing the advance payment.

8. The Court's audit sample is designed to provide an estimate of the level of error in the audited population as a whole. The Court does not examine transactions in every Member State, beneficiary state and/or region each year. The examples provided in the annual report are for illustrative purposes and demonstrate the most typical errors found. The naming of certain Member States, beneficiary states and/or regions does not mean that the examples presented do not occur elsewhere. The illustrative examples presented in this report do not form a basis for conclusions to be drawn on the Member States, beneficiary states and/or regions concerned ⁽²⁾.

How the Court evaluates and presents the results of transaction testing

9. **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. Individual transactions may be wholly or partially affected by error. Errors detected and corrected before and independently of the checks carried out by the Court are excluded from the calculation and frequency of error, since they demonstrate that the control systems work effectively. The Court considers whether individual errors are quantifiable or non-quantifiable, taking account of the extent to which it is possible to measure how much of the amount audited was affected by error.

10. Many errors occur in the application of public procurement laws. To respect the basic principles of competition foreseen in EU law, significant procedures must be advertised; bids must be evaluated according to specified criteria; contracts may not be artificially split to avoid breaching thresholds, etc.

11. For its audit purposes, the Court puts a value on failures to observe the requirements of procurement law. The Court:

- (a) quantifies (and where appropriate extrapolates) the impact of serious infringements of the public procurement rules ⁽³⁾ on the basis that it affects the entire value of the payment related to the contract — a 100 % quantifiable error ⁽⁴⁾;
- (b) does not quantify less serious errors, which do not affect the outcome of the tendering procedure (non-quantifiable errors) ⁽⁵⁾.

12. The quantification by the Court may differ from that used by the Commission or Member States when deciding how to respond to the misapplication of the public procurement rules.

⁽²⁾ The aim of the audit is to reach a valid conclusion on EU expenditure and revenue as a whole. In order to make a valid, statistically significant, comparison among Member States, beneficiary states and/or regions, it would be necessary to sample a much larger number of transactions in each of them than is realistically possible.

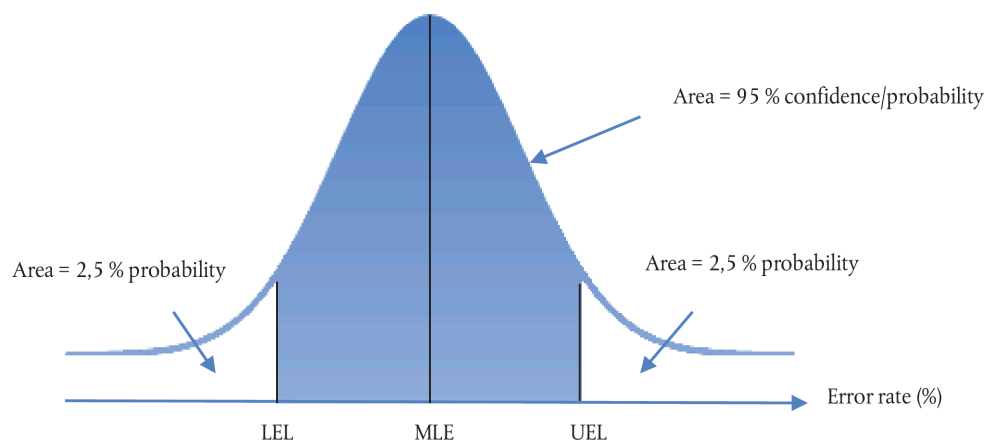
⁽³⁾ The Court regards as serious those errors which frustrate the objectives of the public procurement rules: fair competition and award of the contract to the best qualified bidder. There are essentially two award systems: the lowest offer or the most advantageous offer.

⁽⁴⁾ Examples of a quantifiable error: no or restricted competition (except where this is explicitly allowed by the legal framework) for the main or a supplementary contract; inappropriate assessment of bids with an impact on the outcome of the tender; substantial change of the contract scope; artificial splitting of contracts in order to bring projects below the threshold at which public procurement rules apply.

⁽⁵⁾ Examples of a non-quantifiable error: inappropriate assessment of bids without impact on the outcome of the tender, formal weaknesses of tender procedure or tender specification, formal aspects of the transparency requirements not respected.

Estimated rate of error (most likely error)

13. On the basis of the errors which it has quantified, the Court estimates the **most likely rate of error** (MLE) in each specific assessment, and for spending from the budget as whole. The MLE percentage is a statistical estimate of the likely percentage of error (i.e. quantifiable breaches of applicable regulations, rules, and contract and grant conditions) in the population ⁽⁶⁾. The Court also estimates the lower error limit (LEL) and the upper error limit (UEL) (see illustration below).



14. The percentage of the shaded area below the curve indicates the probability that the error rate of the population is between the LEL and the UEL.

15. In planning its audit work, the Court seeks to undertake procedures allowing it to compare the estimated rate of error in the population with a planning **materiality** of 2%. In assessing audit results, the Court is guided by this level of materiality and takes account of the nature, amount and context of errors when forming its audit opinion.

Frequency of error

16. The Court expresses the frequency by which errors occur by presenting the proportion of the sample affected by either quantifiable or non-quantifiable errors.

How the Court examines control systems and reports the results

17. Control systems are established by the Commission, other EU institutions and bodies, Member States' authorities, beneficiary countries and/or regions to manage the risks to the budget, including the regularity of transactions. Examining control systems is particularly useful for identifying recommendations for improvement.

18. Each policy group, including revenue, operates many individual systems. The Court selects a sample of systems to assess each year. The results of the supervisory and control systems assessments are presented in the form of a table in Annexes x.2 of chapters 2 to 9. Systems examined are classified as being *effective* in mitigating the risk of error in transactions, *partially effective* (when there are some weaknesses affecting operational effectiveness) or *not effective* (when weaknesses are pervasive and thereby completely undermine operating effectiveness):

⁽⁶⁾
$$MLE = \frac{1}{\sum ASI} * \sum_i \left(ASI_i * \frac{error\ amount_i}{audited\ amount_i} \right)$$
, where ASI is the average sampling interval and i is the numbering of transactions in the sample.

How the Court arrives at its opinions in the statement of assurance

19. The Court arrives at its opinion on the regularity of transactions underlying the European Union's consolidated accounts, set out in the statement of assurance, on the basis of all its audit work as reported in chapters 2 to 9 of this report and including an assessment of the pervasiveness of error. The work performed allows the Court to assess the assurance that errors in the population exceed or fall within the materiality limits. The Court's best estimate of the rate of error for overall spending in 2013 is 4,7 %. The Court has more than 95 % confidence that the rate of error for the audited population is material. The estimated error rate found in different policy areas varies as described in chapters 3 to 9. The Court assessed error as pervasive — extending across the majority of spending areas. The Court gives an overall opinion on the regularity of commitments based on an additional horizontal sample.

Fraud

20. If the Court has reason to suspect that fraudulent activity has taken place, it reports this to OLAF, the Union's antifraud office, which is responsible for carrying out any resulting investigations. The Court reports several cases per year to OLAF.

PART 3 — Link between the audit opinions for the reliability of accounts and the regularity of transactions

21. Pursuant to the provisions of Article 287 of the TFEU the Court has issued:

- (a) an audit opinion on the consolidated accounts of the European Union for the financial year ended; and
- (b) audit opinions on the regularity of the revenue, payments and commitments underlying those accounts.

22. These audit opinions and the related audits are undertaken in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions.

23. These standards also provide for the situation where auditors issue audit opinions on the reliability of accounts and the regularity of transactions underlying those accounts, by stating that a modified opinion on the regularity of transactions does not in itself lead to a modified opinion on the reliability of accounts. The financial statements on which the Court places an opinion, in particular Note 6, recognise that there is a material issue in relation to breaches of the rules governing expenses charged to the EU budget. Accordingly, the Court has decided that the existence of a material level of error affecting regularity is not in itself a reason to modify its separate opinion on the reliability of the accounts.

ANNEX 1.2

FOLLOW-UP OF OBSERVATIONS FROM PREVIOUS YEARS CONCERNING THE RELIABILITY OF ACCOUNTS

Observations raised in previous years	Court's analysis of the progress made	Commission reply
<p>1. Prefinancing, accounts payable and cut-off procedures</p> <p>For prefinancing, accounts payable and related cut-off, since the financial year 2007 the Court has identified accounting errors with an immaterial financial impact overall but a high frequency. This underlines the need for further improvement at the level of certain directorates-general.</p> <p>As regards accounting for amounts prefinanced, the Court found that several directorates-general continued to record estimates in the accounts even when they have an adequate basis for clearing the corresponding prefinancing. In some cases, delays in accounting for expenditure incurred were linked to a loss of audit trail. The Court considered that significant improvements in procedures were required in certain directorates-general.</p> <p>The Commission included financial engineering instruments for the first time in the 2010 accounts and advances from other aid schemes for the first time in the 2011 accounts. Outstanding balances in both cases are estimated on the assumption that funds are used evenly over the period of operation. The Commission should keep this assumption under review.</p>	<p>1. Prefinancing, accounts payable and cut-off procedures</p> <p>The Court found cases where estimates were recorded in the accounts (in some cases an adequate basis for clearing the corresponding prefinancing was already available). The Court also found that in several directorates-general the cut-off procedures should be improved, harmonised and automated.</p> <p>Outstanding balances continue to be estimated on the assumption that funds are used evenly over the period of operation.</p>	<p>1. Prefinancing, accounts payable and cut-off procedures</p> <p>The existing accounting rules and guidance already communicated to DGs clarify the correct treatment to be followed for clearings. The DG concerned will put in place a new procedure in line with applicable rules and regulations.</p> <p>The Commission would point out that it is normal and understood that there will always be possibilities to improve, it is a continuous process. However, the Commission also highlights that prefinancing and invoices have been correctly accounted for during the past seven years.</p> <p>Improvements are expected for the period 2014-2020 based on the legal requirements now in place.</p>
<p>2. Disclosures concerning recoveries and financial corrections</p> <p>The accounting officer has refined the presentation of information on recoveries and financial corrections in Note 6 to the financial statements. This note is now more focussed and less extensive but it also contains non-financial information which could be better presented in the report on the protection of the EU budget according to Article 150(4) of the Financial Regulation (EU, Euratom No 966/2012) to be presented to the budgetary authorities in September of each year.</p>	<p>2. Disclosures concerning recoveries and financial corrections</p> <p>The presentation of information in note 6 has further been improved but still contains information which is not drawn from the accounting system.</p> <p>New challenges in presenting reliable financial information are discussed in paragraphs 1.12 to 1.14.</p>	<p>2. Disclosures concerning recoveries and financial corrections</p> <p>The Commission will examine together with Member States how information could be further improved in the way the Court suggests, bearing in mind cost-benefit considerations.</p>

Observations raised in previous years	Court's analysis of the progress made	Commission reply
<p>3. Transfer of assets of Galileo</p> <p>In its 2010 and subsequent annual reports, the Court has drawn attention to the reservations made by the responsible director-general in his annual activity reports concerning the reliability of the European Space Agency's financial reporting.</p>	<p>3. Transfer of assets of Galileo</p> <p>The responsible director-general discontinued the reservation concerning the reliability of the financial reporting of the European Space Agency in his 2013 annual activity report.</p>	<p>3. Transfer of assets of Galileo</p>

ANNEX 1.3
EXTRACTS FROM THE 2013 CONSOLIDATED ACCOUNTS⁽¹⁾

Table 1 — Balance sheet (*)

	(million euro)	
	31.12.2013	31.12.2012
Non-current assets		
Intangible assets	237	188
Property, plant and equipment	6 104	5 978
Investments accounted for using the equity method	349	392
Financial assets	59 844	62 311
Receivables and recoverables	498	564
Pre-financing	38 072	44 505
	105 104	113 938
Current assets		
Inventories	128	138
Financial assets	5 571	1 981
Receivables and recoverables	13 182	14 039
Pre-financing	21 367	13 238
Cash and cash equivalents	9 510	10 674
	49 758	40 070
Total assets	154 862	154 008
Non-current liabilities		
Pension and other employee benefits	(46 818)	(42 503)
Provisions	(1 323)	(1 258)
Financial liabilities	(54 153)	(57 232)
Other liabilities	(2 216)	(2 527)
	(104 510)	(103 520)
Current liabilities		
Provisions	(545)	(806)
Financial liabilities	(3 065)	(15)
Payables	(92 594)	(90 083)
	(96 204)	(90 904)
Total liabilities	(200 714)	(194 424)
Net assets	(45 852)	(40 416)
Reserves	4 073	4 061
Amounts to be called from Member States (**)	(49 925)	(44 477)
Net assets	(45 852)	(40 416)

(*) The balance sheet is presented using the layout as in the consolidated accounts of the European Union.

(**) The European Parliament adopted a budget on 20 November 2013 which provides for the payment of the EU's short-term liabilities from own resources to be collected by, or called up from, the Member States in 2014. Additionally, under Article 83 of the Staff Regulations (Council Regulation 259/68 of 29 February 1968 as amended), the Member States shall jointly guarantee the liability for pensions.

⁽¹⁾ The reader is advised to consult the full text of the consolidated accounts of the European Union for the financial year 2013 including both the consolidated financial statements and explanatory notes and the aggregated reports on implementation of the budget and explanatory notes.

Table 2 — Statement of financial performance (*)

	<i>(million euro)</i>	
	2013	2012
Operating revenue		
Own resource and contributions revenue	141 241	130 919
Other operating revenue	8 414	6 826
	149 655	137 745
Operating expenses		
Administrative expenses	(9 269)	(9 320)
Operating expenses	(138 571)	(124 633)
	(147 840)	(133 953)
Surplus from operating activities	1 815	3 792
Financial revenue	2 038	2 157
Financial expenses	(2 045)	(1 942)
Movement in pension and other employee benefits liability	(5 565)	(8 846)
Share of net deficit of joint ventures and associates	(608)	(490)
Economic result of the year	(4 365)	(5 329)

(*) The statement of financial performance is presented using the layout as in the consolidated accounts of the European Union.

Table 3 — Cashflow statement (*)

	(million euro)	
	2013	2012
Economic result of the year	(4 365)	(5 329)
Operating activities		
Amortisation	48	39
Depreciation	401	405
(Increase)/decrease in loans	20	(16 062)
(Increase)/decrease in receivables and recoverables	923	(4 837)
(Increase)/decrease in prefinancing	(1 695)	(2 013)
(Increase)/decrease in inventories	10	(44)
Increase/(decrease) in provisions	(196)	299
Increase/(decrease) in financial liabilities	(29)	16 017
Increase/(decrease) in other liabilities	(311)	468
Increase/(decrease) in payables	2 511	(1 390)
Prior year budgetary surplus taken as non-cash revenue	(1 023)	(1 497)
Other non-cash movements	(50)	260
Increase/(decrease) in pension and employee benefits liability	4 315	7 668
Investing activities		
(Increase)/decrease in intangible assets and property, plant and equipment	(624)	(1 390)
(Increase)/decrease in investments accounted for using the equity method	43	(18)
(Increase)/decrease in available for sale financial assets	(1 142)	(837)
Net cashflow	(1 164)	(8 261)
Net increase/(decrease) in cash and cash equivalents	(1 164)	(8 261)
Cash and cash equivalents at the beginning of the year	10 674	18 935
Cash and cash equivalents at year-end	9 510	10 674

(*) The cashflow statement is presented using the layout as in the consolidated accounts of the European Union.

Table 4 — Statement of changes in net assets (*)

(million euro)

	Reserves (A)		Amounts to be called from Member States (B)		Net assets = (A) + (B)
	Fair value reserve	Other reserves	Accumulated surplus/(deficit)	Economic result of the year	
Balance as at 31 December 2011	(108)	3 716	(35 669)	(1 789)	(33 850)
Movement in Guarantee Fund reserve	—	168	(168)	—	0
Fair value movements	258	—	—	—	258
Other	—	21	(19)	—	2
Allocation of the 2011 economic result	—	6	(1 795)	1 789	0
2011 budget result credited to Member States	—	—	(1 497)	—	(1 497)
Economic result of the year	—	—	—	(5 329)	(5 329)
Balance as at 31 December 2012	150	3 911	(39 148)	(5 329)	(40 416)
Movement in Guarantee Fund reserve	—	46	(46)	—	0
Fair value movements	(51)	—	—	—	(51)
Other	—	12	(9)	—	3
Allocation of the 2012 economic result	—	5	(5 334)	5 329	0
2012 budget result credited to Member States	—	—	(1 023)	—	(1 023)
Economic result of the year	—	—	—	(4 365)	(4 365)
Balance as at 31 December 2013	99	3 974	(45 560)	(4 365)	(45 852)

(*) The statement of changes in net assets is presented using the layout as in the consolidated accounts of the European Union.

Table 5 — EU budget result (*)

<i>(million euro)</i>		
European Union	2013	2012
Revenue for the financial year	149 504	139 541
Payments against current year appropriations	(147 567)	(137 738)
Payment appropriations carried over to year N+1	(1 329)	(936)
Cancellation of unused payment appropriations carried over from year N-1	437	92
Exchange differences for the year	(42)	60
Budget result (**)	1 002	1 019

(*) The EU budget result is presented using the layout as in the consolidated accounts of the European Union.

(**) Of which EFTA result is (4) million euro in 2013 and (4) million euro in 2012.

Table 6 — Reconciliation of economic result with budget result (*)

<i>(million euro)</i>		
	2013	2012
Economic result of the year	(4 365)	(5 329)
Revenue		
Entitlements established in current year but not yet collected	(2 071)	(2 000)
Entitlements established in previous years and collected in current year	3 357	4 582
Accrued revenue (net)	(134)	(38)
Expenses		
Accrued expenses (net)	3 216	(1 544)
Expenses prior year paid in current year	(1 123)	(2 695)
Net-effect prefinancing	(902)	820
Payment appropriations carried over to next year	(1 528)	(4 666)
Payments made from carry-overs and cancellation of unused payment appropriations	1 538	4 768
Movement in provisions	4 136	7 805
Other	(1 028)	(670)
Economic result agencies and ECSC	(93)	(15)
Budget result of the year	1 002	1 019

(*) The reconciliation of economic result with budget result is presented using the layout as in the consolidated accounts of the European Union.

CHAPTER 2

Revenue

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THE COURT'S OBSERVATIONS

INTRODUCTION

2.1. This chapter presents the specific assessment of revenue, which comprises own resources and other revenue. Key information on revenue in 2013 is provided in **Table 2.1**.

Table 2.1 — Revenue — Key information 2013

Type of revenue	Description	Revenue 2013 (million euro)
GNI-based own resources	GNI (gross national income) -based resources from the current financial year	110 032
Traditional own resources (TOR)	Customs duties and sugar levies	15 366
VAT-based own resources	VAT (value added tax) -based resources from the current financial year	14 542
Correction of budgetary imbalances	UK correction	166
Reduction of GNI-based contribution	Granted to the Netherlands and Sweden	- 6
	TOTAL OWN RESOURCES	140 100
Contributions and refunds in connection with Union/Community agreements and programmes		3 897
Interest on late payments and fines		2 973
Revenue accruing from persons working with the Institutions and other Union bodies		1 199
Surpluses, balances and adjustments		698
Revenue accruing from the administrative operation of the Institutions		611
Miscellaneous revenue		24
Borrowing and lending operations		2
	TOTAL OTHER REVENUE	9 404
TOTAL REVENUE FOR THE YEAR		149 504

Source: 2013 consolidated accounts of the European Union.

THE COURT'S OBSERVATIONS

Specific characteristics of revenue

2.2. Most revenue comes from own resources (93,7 % of revenue)⁽¹⁾ of which there are three categories:

- The gross national income (GNI)-based own resources result from the application of a uniform rate to the Member States' GNI (110 032 million euro, 73,6 % of revenue). The calculation of the Member States' contributions is based on forecast GNI data⁽²⁾. This data is subject to revision⁽³⁾ for four years, after which it becomes time-barred⁽⁴⁾. After taking into account all other sources of revenue the GNI-based own resources are used to balance the EU budget⁽⁵⁾. The principal risks to regularity are that the underlying statistics are not compiled in compliance with Union rules or are not processed by the Commission according to these rules.
- Traditional own resources (TOR) are customs duties collected on imports and sugar production charge. They are established and collected by the Member States. Three quarters of these amounts are paid to the EU budget (15 366 million euro, 10,3 % of revenue), the remaining quarter being retained to cover collection costs. The principal risks regarding TOR are the completeness, accuracy and timeliness of the duties made available to the Union.

⁽¹⁾ 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 last amended by Regulation (EC, Euratom) No 105/2009 (OJ L 36, 5.2.2009, p. 1).

⁽²⁾ This data is agreed between the Commission and the Member States at the meeting of the Advisory Committee on Own Resources.

⁽³⁾ Revisions are taken into account for the calculation of Member States' GNI balances and adjustments of previous years which also contribute to the annual revenue budget. These revisions may be positive or negative in each Member State. For 2013, net GNI balances and adjustments amounted to 162 million euro, 0,1 % of revenue (positive adjustments amounted to 1 177 million euro, 0,8 % of revenue, and negative adjustments amounted to 1 015 million euro, 0,7 % of revenue).

⁽⁴⁾ Unless reservations are set (see paragraph 2.7).

⁽⁵⁾ Any understatement (or overstatement) of GNI for particular Member States — while not affecting the overall GNI-based own resources — has the effect of increasing (or decreasing) the contributions from the other Member States, until the GNI data is corrected.

THE COURT'S OBSERVATIONS

— The value added tax (VAT)-based own resources result from the application of a uniform rate to Member States' notionally harmonised VAT assessment bases⁽⁶⁾ (14 542 million euro, 9,7 % of revenue). The principal risks lie in the completeness and accuracy of the information provided by Member States, the accuracy of the Commission's calculations of the contributions due and the timeliness of the Member States' payments.

2.3. The principal risks in respect of other revenue include the Commission's management of fines and errors in the calculation of contributions in connection with Union/Community agreements.

Audit scope and approach

2.4. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of revenue, the following specific points should be noted:

- (a) The audit involved an examination at Commission level of a sample of 55 recovery orders⁽⁷⁾ as defined in **Annex 1.1**, paragraph 6. The sample is designed to be representative of the entire range of recovery orders within revenue.
- (b) The assessment of control systems examined:
 - (i) the Commission's systems for ensuring that Member States' GNI data is appropriate as a basis for own-resources purposes and the Commission's systems for calculating and collecting the GNI-based own resources contributions⁽⁸⁾;
 - (ii) the Commission's systems for TOR, including its monitoring of Member States' post-clearance audits;
 - (iii) the TOR accounting systems in three selected Member States (Germany, the Netherlands and Romania)⁽⁹⁾ and a review of their systems for post-clearance audits;

⁽⁶⁾ Four Member States (Germany, the Netherlands, Austria and Sweden) benefit from a reduced call rate for the period 2007-2013.

⁽⁷⁾ A recovery order is the procedure by which the authorising officer registers a Commission entitlement in order to retrieve the amount which is due.

⁽⁸⁾ The assessment took as its starting point the agreed forecast GNI data. The Court cannot provide a judgement on the quality of the data agreed upon between the Commission and the Member States.

⁽⁹⁾ The Court's audit cannot cover undeclared imports or those that have escaped customs surveillance.

THE COURT'S OBSERVATIONS

- (iv) the Commission's systems for ensuring that VAT-based own resources are correctly calculated and collected⁽¹⁰⁾;
- (v) the Commission's management of fines and penalties;
- (vi) the annual activity reports for 2013 (AAR 2013) of the Directorate-General for Budget (DG Budget) and Eurostat.

REGULARITY OF TRANSACTIONS

2.5. **Annex 2.1** contains a summary of the results of transaction testing. Out of the 55 transactions audited by the Court none was affected by error.

- The Court's audit did not find any errors in the Commission's calculation of Member States' contributions on the basis of the VAT and GNI data or their payment.
- The Court found that, overall, the recovery orders raised by the Commission reflect the TOR statements sent by the Member States.
- The Court's audit did not find any errors in the calculations or payments of other revenue transactions.

EXAMINATION OF SELECTED CONTROL SYSTEMS

2.6. **Annex 2.2** contains a summary of the results of the systems examined by the Court.

GNI-based own resources

2.7. A reservation⁽¹¹⁾ is a means by which a doubtful element in GNI data submitted by a Member State can be kept open for correction after the statutory time-limit of four years. The use of reservations is thus part of the internal control process. The Commission and Member States should endeavour to resolve doubtful elements as soon as possible.

⁽¹⁰⁾ The Court's audit took as its starting point the harmonised VAT base prepared by the Member States. It did not directly test the statistics and data provided by Member States.

⁽¹¹⁾ Reservations can be general or specific. General reservations cover all elements of the GNI compilation. Specific reservations cover discrete elements of GNI (GNP until 2001, GNI thereafter).

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2.8. At the end of 2013 there were 114 specific reservations in place (see **Table 2.2**). In the course of 2013 there were 21 specific reservations set⁽¹²⁾ and 12 lifted. There is still one specific GNP reservation outstanding relating to the period 1995 — 2001. The financial effect of GNI and GNP reservations lifted in 2013 has been calculated by the Court⁽¹³⁾ as a net reduction in contributions for the Member States concerned of 583,5 million euro⁽¹⁴⁾.

⁽¹²⁾ 19 of the 21 reservations were set following the completion of the verification cycle for Bulgaria and Romania. One was set for Austria following a dialogue visit in the framework of the Excessive Deficit Procedure and one was set for the UK based on the issues identified in the Court's special report No 11/2013 'Getting the gross national income (GNI) data right: a more structured and better-focused approach would improve the effectiveness of the Commission's verification'.

⁽¹³⁾ The financial effect of the lifting of reservations has been determined by the Court by taking into account all the changes to the GNI base due to the impact of reservations lifted in 2013 for the years which were already time-barred.

⁽¹⁴⁾ The balance of an increase of 0,4 million euro and a decrease of 583,9 million euro.

Table 2.2 — Member States' specific GNI/GNP reservations as at 31 December 2013 ⁽¹⁾

Member State	Reservations outstanding at 31.12.2012	Reservations placed in 2013	Reservations lifted in 2013	Reservations outstanding at 31.12.2013	Earliest year to which reservations apply
Belgium	3	0	0	3	2002
Bulgaria	n/a	8	0	8	2007
Czech Republic	2	0	0	2	2004
Denmark	1	0	0	1	2002
Germany	2	0	0	2	2002
Estonia	2	0	0	2	2004
Ireland	1	0	1	0	n/a
Greece	9	0	0	9	1995
Spain	3	0	0	3	2002
France	2	0	0	2	2002
Italy	3	0	0	3	2002
Cyprus	5	0	0	5	2004
Latvia	10	0	0	10	2004
Lithuania	2	0	0	2	2004
Luxembourg	2	0	1	1	2002
Hungary	10	0	0	10	2004
Malta	8	0	1	7	2004
Netherlands	4	0	4	0	n/a
Austria	1	1	1	1	2009
Poland	11	0	0	11	2004
Portugal	3	0	0	3	2002
Romania	n/a	11	0	11	2007
Slovenia	3	0	1	2	2004
Slovakia	2	0	0	2	2004
Finland	1	0	0	1	2002
Sweden	4	0	0	4	2002
United Kingdom	11	1	3	9	2002
TOTAL	105	21	12	114	

⁽¹⁾ The transversal specific reservations are not included in the table.

Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

2.9. In addition to specific GNI reservations the Commission has set specific transversal reservations. These reservations are defined by the Commission as points notified to all Member States to enable the Commission to make a comparison of the underlying compilation of data. Two new transversal reservations⁽¹⁵⁾ were set in 2013 (adding up to eight the number of open transversal reservations). For the six transversal reservations already in place, the Commission started the process of lifting them (for three this has led to lifting in some Member States⁽¹⁶⁾).

2.10. The only general reservation in place at the end of 2013 was on Greek GNI data covering the years 2008 and 2009. The reservation for the year 2008 was set in 2012 because the data for that year was based on preliminary estimates. It could not be lifted in 2013 as Greece did not provide the Commission with any new information. It had to be extended to 2009 to prevent time-barring (see paragraph 2.2, first indent) as the data for that year was still based on preliminary estimates.

2.11. The Commission is closely following the situation regarding the problems in Greece's compilation of national accounts, including carrying out regular visits. The Court welcomes the fact that the Commission is placing general reservations on the Greek GNI data and thus safeguarding the financial interests of the EU. However, the prolonged use of general reservations can lead to budgetary uncertainty.

2.12. During 2013 the area of the non-observed economy was discussed in the meetings of the GNI Committee. It was acknowledged by the Commission that the level of harmonization of the data does not meet the usual standards of European Statistics. The Court has previously drawn attention to this matter and made a specific recommendation in its special report No 11/2013.

THE COMMISSION'S REPLIES

2.9. *Transversal reservations have continued to be resolved. The process is accelerating in 2014 with a further 25 such reservations being lifted in the first quarter alone.*

2.10. *A short-term action plan for improving Greek annual national accounts is foreseen from a recently started assistance project.*

2.11. *There is only one general reservation in existence at present.*

2.12. *Exhaustiveness has been a major consideration in the GNP/GNI verification process since the early days and will continue to be so.*

Member States are not required to make separate estimates of individual elements of the non-observed economy as long as overall exhaustiveness of the GNI totals used for own resource purposes is ensured.

⁽¹⁵⁾ 'The recording of the vehicle registration tax' and 'The calculation of intermediate consumption for actual and imputed rentals in the estimation of the production of housing services', both based on the issues identified in the Court's special report No 11/2013.

⁽¹⁶⁾ Transversal reservation III (the treatment of entities with little or no physical presence) was lifted in 19 countries, transversal reservation IV (the treatment of car scrap schemes) was lifted in 17 countries and transversal reservation V (the treatment of cooperative dwellings) was lifted in 11 countries.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Traditional own resources

2.13. Customs authorities may, after releasing the goods and in order to satisfy themselves as to the accuracy of the particulars contained in the declaration, inspect the commercial documents and data relating to the import operations⁽¹⁷⁾. These checks, which include post-clearance audits⁽¹⁸⁾, are referred to as post-clearance controls. They should be based on risk analysis on the basis of criteria developed at national, Community and, where available, international level⁽¹⁹⁾.

2.14. The Court's audit found that the quality, scope and the results of the post-clearance audits varied substantially across the three Member States visited⁽²⁰⁾. The following weaknesses in the identification, selection and inspection of the importers after the clearance of goods for free circulation were identified in:

- (a) Identification and selection of importers:
- (i) There are no legally binding EU risk analysis standards for the post-clearance audits.
 - (ii) The Member States' methodologies for selecting importers to be inspected are not harmonised.
 - (iii) There is no EU-wide database of imports containing information which could be used for identification and selection of the importers for post-clearance audits⁽²¹⁾.

2.14. *The Court's findings will be followed up by the Commission. Where weaknesses have been found it will request the Member States to take remedial measures.*

- (a)
- (i) *While the exchange of risk information is a legal requirement, the risk criteria as defined in the latest version of the Customs Audit Guide (March 2014) are not legally binding. The Commission supplies the Member States with risk information in the form of Mutual Assistance notices and Risk Information Form (RIF) notices so that this information can be used by them in the formulation of their risk analysis. The Commission is examining the use of this information by the Member States in its 2014 inspections.*
 - (ii) *The new Customs Audit Guide (supported by the respective Customs programme) provides a common harmonised approach to the conduct of post-clearance audits.*
 - (iii) *The Commission manages a database of imports in Member States (Surveillance II), in which the names of importers are not provided. Surveillance III should provide more information, allowing importers to be identified, but will not be fully operational until 2018.*

⁽¹⁷⁾ Article 78 of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code (OJ L 302, 19.10.1992, p. 1).

⁽¹⁸⁾ 'Post clearance audit is a method of controlling economic operators through examination of their accounts, records and systems.' *Source:* Customs audit guide.

⁽¹⁹⁾ Article 13(2) of Community Customs Code.

⁽²⁰⁾ The most structured approach concerning the risk analysis, implementation and execution of post clearance audits was found to be in Germany compared to the Netherlands and Romania.

⁽²¹⁾ The Commission manages a database of imports in Member States for safety and security reasons, but as the names of importers are not provided the data is of no use for post-clearance audits.

THE COURT'S OBSERVATIONS

These three aspects limit the effectiveness of the identification and selection of importers for post-clearance audits. The riskiest importers may not be selected and certain importers may never be inspected. For example the importers which clear imports in several Member States with the total amount of these imports being significant, would never be selected for the inspection, if the amounts in each Member State are considered immaterial by the national customs authorities.

(b) Inspection of the importers:

- (i) Minimum EU-wide standards for post-clearance audits have not been defined by any legislative measures, leaving it up to the Member States to set up their own framework⁽²²⁾. Although the Commission has developed a non-binding customs audit guide⁽²³⁾ this was not used by the Member States visited, where the audit methodology varied. No monitoring in this area has been done by the Commission in recent years.
- (ii) When goods are cleared in a Member State (A) different to the one in which the importer is located (B), both the carrying out of post-clearance audits and any subsequent recovery procedures — to be initiated by Member State (A) — are more cumbersome as the importer falls under the jurisdiction of another Member State (B) (See example in Box 2.1). While the problem was acknowledged by the Customs Code Committee in 2000, no action on this matter has been taken.

THE COMMISSION'S REPLIES

(b)

- (i) *The Commission inspects various aspects of customs controls, including those of post-clearance audits, in its annual inspections in the Member States.*

The Commission distributed the Customs Audit Guide to all Member States' customs authorities in order to strive for a fully harmonised approach to audit for the purposes of customs controls and to promote recognised audit controls within the EU. The Commission regrets that the guide was not used in the Member States visited by the Court and will request all Member States to make effective use of the new Customs Audit Guide.

- (ii) *While good auditing practice would suggest that Member States communicate with each other, especially in a situation where a large quantity of goods were imported by a company into a Member State different from where its headquarters is situated, there is no legal obligation in EU customs law on the Member State of import to take this course of action. Nevertheless, each Member State can in accordance with Council Regulation (EC) No 515/97 use the mutual assistance tool to request the assistance from another Member State's customs authority. The new audit guide refers to this option.*

⁽²²⁾ For the application of the Articles 13 and 78 of the Community Customs Code.

⁽²³⁾ The guide is a result of collaboration between the Member States and the Commission within the Customs 2007 project group on post clearance audit systems. However, it is not obligatory for Member States to apply it.

THE COURT'S OBSERVATIONS

Box 2.1 — Low recovery results when the importer is located in a Member State different to the one where the goods are cleared for free circulation

Following a notification from OLAF, the Dutch customs identified imports declared in Rotterdam (the Netherlands) of extremely low value textiles from China.

Consequently the Dutch customs carried out inspections relating to these imports at the premises of the declarants in the Netherlands. These inspections led to recovery notifications totalling approximately 50 million euro. Most of the recovery notifications were submitted to companies with headquarters in other Member States.

A very low recovery rate was achieved: more than 45 million euro were outstanding in the B-accounts at the date of the audit and Dutch customs considered that it was unlikely to recover the outstanding debts.

In one of these cases the Dutch customs found that goods were unloaded in Hamburg (Germany) and transported to Rotterdam (the Netherlands). In Rotterdam the goods were cleared for free circulation and afterwards the goods were driven to their final destination in Poland. In this particular case, it appears that, as the transport routes used did not have any economic or logistical justification, the importers sought clearance in a different Member State in order to reduce the likelihood of being subject to controls and to complicate any potential recovery procedure.

- (iii) The Court found that two of the Member States visited (the Netherlands and Romania), when carrying out post clearance audits at an importer, did not examine those imports cleared by the same importer in another Member State. In Germany inspectors go a step further by checking whether the goods have been put under a customs procedure in another Member State and if they find discrepancies they inform other concerned Member States⁽²⁴⁾ (see Box 2.2).

THE COMMISSION'S REPLIES

Box 2.1 — Low recovery results when the importer is located in a Member State different to the one where the goods are cleared for free circulation

The Commission will follow up this matter with the Dutch customs authorities. The Commission systematically follows up Member States' recovery action of amounts above € 50 000 that have been written off from the B-account and reported to it as required by the relevant legislation. Where the non-recovery is attributable to the Member State, the Commission will request it to make the amount available.

- (iii) The Court's findings will be followed up by the Commission. Where weaknesses have been found it will request the Member States to take remedial measures.*

⁽²⁴⁾ Under the Mutual Assistance Scheme (Council Regulation (EC) No 515/97 of 13 March 1997 on mutual assistance between the administrative authorities of the Member States and cooperation between the latter and the Commission to ensure the correct application of the law on customs and agricultural matters (OJ L 82, 22.3.1997, p. 1)).

THE COURT'S OBSERVATIONS

Box 2.2 — Exchange of information relating to discrepancies detected at an importer in one Member State which also concerned other Member States

A tariff classification error was detected by German customs which also applied to imports cleared in two other Member States (France and the United Kingdom). The German customs authorities informed those Member States about these discrepancies. Despite this, by May 2014, 15 months later, no feedback on any recovery action had been provided to the German authorities by the two Member States concerned.

(iv) The level of implementation of the 2012 audit plans was low in Romania and the Netherlands.

2.15. Each Member State sends the Commission a monthly statement of established duties (the 'A accounts') and a quarterly statement of those established duties which are not included therein (the 'B accounts')⁽²⁵⁾.

2.16. The Court's audits in the three Member States identified weaknesses in the management of the B accounts. For example, the amounts deemed to be irrecoverable⁽²⁶⁾ were underestimated⁽²⁷⁾ or long delays in enforcement and follow-up procedures were detected.

2.17. In addition the Court found weaknesses in the management of the A accounts in the Netherlands as manual interventions are still necessary in order to prepare the A account statements which gives rise to risks of errors⁽²⁸⁾.

THE COMMISSION'S REPLIES

Box 2.2 — Exchange of information relating to discrepancies detected at an importer in one Member State which also concerned other Member States

The Commission follows up with the Member States all points raised in its inspections reports and those made by the Court, and where weaknesses are found it requests the Member States to take appropriate remedial measures.

2.17. *The Commission will follow up this issue with the Dutch authorities in the course of its regular follow-up of the points raised by the Court.*

⁽²⁵⁾ 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 these separate accounts.

⁽²⁶⁾ According to Article 6(4)(b) of Regulation (EC, Euratom) No 1150/2000.

⁽²⁷⁾ These cases did not affect the reliability of the overall amount as established in the separate account and the related write-down as disclosed in the consolidated accounts of the European Union.

⁽²⁸⁾ For example, the Netherlands made mistakes in their treatment of irrecoverable amounts relating to the A and B accounts for the period 1/2005 — 4/2012, which gave rise to a payment of TOR by the Dutch authorities of 12,3 million euro (after deduction of 25 % collection costs) and further interest of 6,5 million euro in 2012 and 2013 respectively.

THE COURT'S OBSERVATIONS

2.18. The Commission's inspections carried out during 2013 also found shortcomings in the management of the B accounts in most of the Member States they visited⁽²⁹⁾. Two inspections carried out in Greece identified significant problems in the management of the B accounts⁽³⁰⁾.

2.19. The Commission's inspections in Member States result in 'open points'⁽³¹⁾. These open points can have a potential financial impact or not and are closed when appropriately addressed by the Member States. At the year-end a total of 341 points were open, of which 35 had been open for longer than five years (see **Table 2.3**).

THE COMMISSION'S REPLIES

2.18. *The inspections carried out by the Commission comprise an examination of the B-account for the office(s) of the Member States visited and the findings made are in general of a one-off nature that show individual problems in the collection procedure for traditional own resources. They are rarely of a systematic nature affecting the management of that account. In an account of this nature (a collection of problem and contested cases which may give rise to different legal interpretations) there will inevitably be one-off findings. The situation of Greece is exceptional and is under special follow-up action.*

2.19. *The Commission services are constantly working with the Member States to resolve open points. While some points raised in the Commission's inspections or the Court's audits may be relatively simple and can be dealt with and closed quickly, other points raised with the Member States are more complex and may require legislative/organisational change, or the taking of legal proceedings. In these cases the points cannot be closed by the Commission services within a short period of time. Of the 341 points shown by the Court as open, 313 remain open at the end of May 2014. Of these, 27 have been open for longer than five years.*

⁽²⁹⁾ The Commission's inspections covered the issue of B accounts in 22 Member States, in 17 problems were detected.

⁽³⁰⁾ According to the Commission's report, the examination of B-account cases confirms that Greece does not respect its legal obligations under Articles 17(2) and 17(3) of Regulation (EC, Euratom) No 1150/2000.

⁽³¹⁾ A total of 29 inspection reports were issued during 2013 which led to 98 new 'open points'.

Table 2.3 — TOR open points as at 31 December 2013

Member State	Points open as at 31.12.2012	Points placed in 2013	Points lifted in 2013	Points open as at 31.12.2013	Open longer than five years	Earliest year where point was opened
Belgium	14	6	9	11	0	2009
Bulgaria	14	4	8	10	0	2009
Czech Republic	8	3	5	6	0	2012
Denmark	15	3	1	17	0	2009
Germany	28	1	12	17	9	2001
Estonia	4	0	3	1	0	2012
Ireland	10	6	6	10	0	2011
Greece	33	4	3	34	5	2002
Spain	17	4	1	20	0	2009
France	40	5	11	34	7	2003
Italy	23	3	11	15	0	2009
Cyprus	6	2	0	8	0	2011
Latvia	6	0	3	3	0	2011
Lithuania	5	0	0	5	0	2011
Luxembourg	7	1	3	5	0	2011
Hungary	12	4	9	7	0	2011
Malta	2	4	2	4	0	2013
Netherlands	29	13	6	36	4	2005
Austria	3	2	0	5	0	2009
Poland	11	2	3	10	4	2006
Portugal	16	2	3	15	5	2002
Romania	11	4	2	13	0	2011
Slovenia	5	0	5	0	0	N/A
Slovakia	4	1	4	1	0	2013
Finland	7	5	2	10	1	1998
Sweden	11	10	1	20	0	2009
United Kingdom	19	9	4	24	0	2009
TOTAL	360	98	117	341	35	

Source: European Court of Auditors.

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THE COMMISSION'S REPLIES

VAT-based own resources

2.20. At the end of the year, a total of 103 reservations⁽³²⁾ were in place (see **Table 2.4**). The Commission lifted 81 reservations in 2013 (compared to 57 in the previous year). Out of these, 21 reservations related to infringements. Eight such reservations were lifted because the Court of Justice of the European Union ruled that the Member States' legislation was in line with the VAT Directive. In the remaining 13 cases, a compensation was calculated where the infringement had an impact on the VAT own resources base.

2.21. The net financial effect of lifting of reservations in 2013 for the time-barred years has been calculated by the Court⁽³³⁾ as an increase of VAT-based own resources of 81,7 million euro⁽³⁴⁾.

2.22. There were 12 Commission-set long-outstanding reservations⁽³⁵⁾ in place at the end of 2013, one less than in the previous year. During 2013 seven reservations that had been long-outstanding at the end of 2012 were lifted. Six Commission-set reservations became 'long-outstanding' because they concern year 2004. There were also four long-outstanding reservations set by Member States at the end of 2013 (three identical to the Commission's).

2.21. *The Commission considers that this figure is not a suitable indicator for the outcome of the VAT own resources inspection programme and cannot be used as an indicator of any trend.*

2.22. *The Commission continued to cooperate with Member States during 2013 to resolve the issues underlying reservations it had set. The Commission considers that significant progress was made during 2013.*

⁽³²⁾ The characteristics of reservations are explained in paragraph 2.7.

⁽³³⁾ The financial effect of the lifting of reservations has been determined by the Court by taking into account all the changes to the VAT base due to the control activity of the Commission for the years 1995 — 2009. The year 2009 became time-barred in 2013 and changes to the VAT base of 2009 and earlier years can only be made if a reservation has been in place. The effects of capping were taken into consideration.

⁽³⁴⁾ The balance of an increase of 218,3 million euro and a decrease of 136,6 million euro.

⁽³⁵⁾ The Court defines long-outstanding reservations as dating back to a year at least 10 years previously, i.e. those in place at the end of 2013 concerning 2004 and earlier.

Table 2.4 — VAT reservations as at 31 December 2013

Member State	Reservations outstanding at 31.12.2012	Reservations placed in 2013	Reservations lifted in 2013	Reservations outstanding at 31.12.2013	Earliest year to which reservations apply
Belgium	6	0	2	4	2007
Bulgaria	7	3	3	7	2007
Czech Republic	8	0	8	0	n/a
Denmark	6	0	1	5	2005
Germany	7	0	2	5	2007
Estonia	10	0	9	1	2007
Ireland	4	0	0	4	2006
Greece	5	4	3	6	1999
Spain	3	0	1	2	2003
France	12	1	8	5	2005
Italy	12	5	5	12	1999
Cyprus	0	0	0	0	n/a
Latvia	5	0	4	1	2006
Lithuania	2	0	2	0	n/a
Luxembourg	2	3	1	4	2008
Hungary	4	0	3	1	2010
Malta	4	0	0	4	2005
Netherlands	11	4	9	6	2006
Austria	5	0	0	5	2004
Poland	10	1	5	6	2004
Portugal	5	0	5	0	n/a
Romania	4	4	0	8	2007
Slovenia	0	0	0	0	n/a
Slovakia	0	0	0	0	n/a
Finland	8	1	2	7	2001
Sweden	5	1	1	5	1995
United Kingdom	8	4	7	5	2004
TOTAL	153	31	81	103	

Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Fines and penalties

2.23. The Commission can fine companies for breach of competition law. At the end of 2013 around 97 % of fines due⁽³⁶⁾ were covered either by a provisional payment or by a guarantee. The Financial Regulation's rules of application⁽³⁷⁾ state that the Commission should enforce the recovery of amounts receivable by any available means where neither provisional payments have been made nor guarantees lodged by debtors to cover the full amounts by the due dates. Additional time for payment may be allowed, but the requirement of a guarantee may only be waived on the basis of the assessment of the accounting officer.

2.24. As a follow-up of findings reported in its 2011 and 2012 annual reports, the Court examined a sample of 14 out of 33 fines due⁽³⁸⁾ which were not covered either by a provisional payment or by a guarantee and found that in 13 cases the Commission had not used all available means to enforce the recovery. In most cases the Commission was still assessing whether to allow additional time for payment.

Other general revenue issues

2.25. The Court draws attention to the issue reported in paragraph 1.49.

Annual activity reports

2.26. The 2013 AARs of DG Budget and Eurostat provide a fair assessment of financial management in relation to the legality and regularity of underlying transactions concerning own resources and other revenue and the information provided corroborates the Court's observations and conclusions.

2.23. Most of the pending fines have a provisional character since they have been appealed and may be cancelled or reduced. The objective of the Commission is not to enforce recovery at any price because this could have irreparable consequences for the fined undertakings. Therefore the Commission seeks to obtain coverage through a negotiated payment plan covered by a financial guarantee, or in exceptional circumstances under the new rules of application without a financial guarantee.

2.24. These fines concern either cases where inability to pay requests were pending and/or cases where enforcement would have caused the immediate insolvency of the fined undertaking, with the consequence that the Commission would have lost the fine because it is not a preferential creditor under the current rules. As indicated under point 2.23 the assessment whether to allow additional time for payment requires an in-depth analysis.

⁽³⁶⁾ Approximately 8,3 billion out of 8,5 billion euro.

⁽³⁷⁾ Articles 88, 89 and 90 of Commission Delegated Regulation (EU) No 1268/2012 of 29 October 2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 on the financial rules applicable to the general budget of the Union (OJ L 362, 31.12.2012, p. 1).

⁽³⁸⁾ Representing 116 million out of a total of 225 million euro. The sample included 11 fines reported in 2012 annual report.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

2.27. For revenue:

- the Court found no errors in the transactions it tested,
- the examined systems are assessed as effective for GNI and VAT-based own resources and other revenue⁽³⁹⁾(see **Annex 2.2**),
- the examined systems are assessed as overall effective for TOR. The key internal controls in Member States visited are assessed as partially effective (see **Annex 2.2**).

Overall audit evidence indicates that revenue is not affected by a material level of error.

Recommendations

2.28. **Annex 2.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented five recommendations. Out of these recommendations, the Commission fully implemented two recommendations, while two were implemented in most respects and one was not implemented.

2.29. Following this review and the findings and conclusions for 2013, the Court recommends that the Commission:

GNI-based own resources

- **Recommendation 1:** encourage Member States to provide more clarification on the methodologies they use for the compilation of data in the area of the non-observed economy and promote harmonisation between Member States in this area;

2.29

The Commission accepts the recommendation. Exhaustiveness has been a major consideration in the GNP/GNI verification process since the early days and will continue to be so.

In the next verification cycle the Commission (Eurostat) plans to revisit and update the transversal analysis that had been done in the framework of the Commission Decision on exhaustiveness.

⁽³⁹⁾ The conclusion on system is limited to the systems selected for examination as defined in the audit scope in paragraph 2.4.

THE COURT'S OBSERVATIONS

- **Recommendation 2:** put in place and closely monitor a detailed action plan with clear milestones to address the problems in the compilation of Greece's national accounts.

Traditional own resources

- **Recommendation 3:** establish minimum risk analysis standards for the customs post-clearance audits, including building upon the information in the existing database of imports, in order to allow Member States to better target risky importers;
- **Recommendation 4:** encourage Member States to use the existing guidance, and monitor, the implementation of Member States' post-clearance audits;
- **Recommendation 5:** encourage Member States to correctly use A and B accounts and to ensure that they are demonstrably complete and correct.

THE COMMISSION'S REPLIES

The Commission accepts the recommendation and notes that its implementation is ongoing. The Commission (Eurostat) is concentrating its efforts on areas of national accounts that pose the greatest risk to GNI Own Resources, namely the reservations in place, the progress on which Eurostat closely monitors. A short-term action plan for improving Greek annual national accounts is foreseen from a recently started assistance project.

The Commission accepts the recommendation. The new version of the Customs Audit Guide (2014) sets out risk indicators for the post-clearance audit. Changes to the existing database of imports are planned, but will not be fully operational until 2018.

The Commission accepts the recommendation. Under the current legal framework the carrying out of controls is a Member State competence. In addition, the Commission will, in the course of its inspections of the customs controls carried out, encourage the Member States to use the existing guidance and where weaknesses are found in the conduct of post-clearance audits request the Member States to take remedial measures. The Commission recalls that the revised Customs Audit Guide was approved in March 2014.

The Commission accepts the recommendation. The Commission will continue to encourage Member States to correctly use A and B accounts and to ensure that they are demonstrably complete and correct.

ANNEX 2.1

RESULTS OF TRANSACTION TESTING FOR REVENUE

TOR	2013			2012	2011	2010
	VAT/GNI, corrections under budget Title 1	Other revenue	Total			
7	46	2	55	55	55	55
7	46	2	55	55	55	55
SIZE AND STRUCTURE OF THE SAMPLE						
Total transactions:						
Recovery orders						
RESULTS OF TESTING ⁽¹⁾ ⁽²⁾						
Proportion (number) of transactions tested found to be:						
Free of error	100 %	(7)	100 %	(46)	100 %	(55)
Affected by one or more errors	0 %	(0)	0 %	(0)	0 %	(0)
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS						
Most likely error rate						0,0 %

⁽¹⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

The results of testing reflect the proportionate share each segment has within the policy group.

⁽²⁾ Numbers quoted in brackets represent the actual number of transactions.

ANNEX 2.2

RESULTS OF THE EXAMINATION OF SYSTEMS FOR REVENUE

Assessment of the systems examined

System concerned	Commission checks in Member States	Commission calculation/desk checks and revenue management	Commission management of reservations	Key internal controls in Member States visited	Overall assessment
GNI	N/A (*)	Effective	Effective	N/A	Effective
VAT	Effective	Effective	Effective	N/A	Effective
TOR	Effective	Effective	N/A	Partially effective (**)	Effective
Fines and penalties	N/A	Effective	N/A	N/A	Effective

(*) In 2013 the Court published the special report No 11/2013 where it assessed the effectiveness of the Commission's verification of GNI data of the period 2002 — 2010. In 2013 no verification activities were carried out by the Commission. The next verification cycle is expected to start in 2015 with delivery of the new GNI inventories by Member States.

(**) See paragraphs 2.13 to 2.18.

ANNEX 2.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR REVENUE

Year	Court recommendation	Court's analysis of the progress made					Commission reply
		Fully implemented	Being implemented In most respects	In some respects	Not implemented	Not applicable	
2011 and 2010	<i>The Court recommended in its 2011 and 2010 annual reports that the Commission should:</i>						
	encourage Member States to strengthen customs supervision (e.g. granting of the 'super simplification' for users of local clearance procedures) in order to maximise the amount of TOR collected;		x				In the course of its annual inspections in the Member States where a specific focus has been on the controls implemented and the use of risk analysis, the Commission has encouraged the Member States to strengthen their customs controls and supervision (including cases where the super simplification has been granted in the context of local clearance) so that the collection of TOR is safeguarded.
	continue its efforts to ensure that B accounts are correctly used, that accounting systems allow A and B accounts' statements of Member States to be demonstrably complete and correct (*);		x				The Commission has continued its efforts to ensure that B accounts are correctly used and that accounting statements of Member States are demonstrably complete and correct. The fact that problems persist with the B account is related to the nature of the account itself, an account which is comprised of problem and contested cases which may give rise to different legal interpretations.

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2010	present to the GNI Committee the assessment reports on GNI data of Member States so as to be able to replace all existing general reservations with specific reservations for the period 2002 onwards;	x						
	make clear the scope of the opinion it provides in its assessment reports on Member States GNI data;	x						
	take into account an evaluation of supervisory and control systems in the National Statistical Institutes (NSI) for the compilation of national accounts.				x			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, the supervisory and control systems (SCS) are of an organisational nature and give no specific indication of the reliability of the accounts, which depends primarily on the statistical sources and methods used, even though SCS may help mitigate the risks of errors in national accounts. The Commission will pursue its efforts to develop SCS guidelines for compilation of their national accounts by Member States, taking into account the observations made by the Court.

(*) The Commission follows up the use of A and B accounts every year. However, as problems persist, the efforts need to be continued.

CHAPTER 3

Agriculture: market and direct support

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INTRODUCTION

3.1. This chapter presents the specific assessment of market and direct support for agriculture. Key information on the activities covered and the spending in 2013 is provided in **Table 3.1**.

Table 3.1 — Market and direct support for agriculture — Key information 2013

(million euro)

Policy area	Description	Payments
Agriculture expenditure financed by the EAGF	Direct aid	41 658
	Interventions in agricultural markets	3 193
	Administrative expenditure ⁽¹⁾	132
	Other	153
		45 136
	Total payments for the year	45 136
	- total administrative expenditure ⁽²⁾	132
	Total operational expenditure	45 004
	- advances ⁽³⁾	9
	+ clearings of advances ⁽³⁾	21
	Audited population, total	45 016
	Total commitments for the year	45 132

⁽¹⁾ This amount represents the total administrative expenditure for the policy area of 'Agriculture and Rural Development'.

⁽²⁾ The audit of administrative expenditure is reported in chapter 9.

⁽³⁾ In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 7).

Source: 2013 consolidated accounts of the European Union.

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Specific characteristics of the policy group

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

3.3. The EU budget finances CAP expenditure through two funds⁽²⁾: the European Agricultural Guarantee Fund EAGF, which fully finances EU market measures⁽³⁾ and direct aid, and the European Agricultural Fund for Rural Development (EAFRD), which co-finances rural development programmes together with the Member States. This chapter covers the EAGF while the EAFRD is presented in chapter 4. The main measures financed by the EAGF are:

- the *direct aid* 'Single Payment Scheme' (SPS) providing for decoupled⁽⁴⁾ income support based on 'entitlements'⁽⁵⁾ each of which is activated by one hectare of eligible land. In 2013 SPS accounted for 31 394 million euro of expenditure;
- the *direct aid* 'Single Area Payment Scheme' (SAPS), a simplified decoupled income support directed at farmers in ten of the Member States⁽⁶⁾ which joined the EU in 2004 and 2007 and which provides for the payment of uniform amounts per eligible hectare of agricultural land. In 2013 SAPS accounted for 6 681 million euro of expenditure;
- other *direct aid* schemes providing mainly coupled payments⁽⁷⁾. In 2013, those schemes accounted for 3 583 million euro of expenditure;

⁽¹⁾ Article 39 of the Treaty on the Functioning of the European Union.

⁽²⁾ 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).

⁽³⁾ With the exception of certain measures such as promotion measures and the school fruit scheme, which are co-financed.

⁽⁴⁾ Decoupled payments are granted for eligible agricultural land irrespective of whether it is used for production or not.

⁽⁵⁾ The number and value of each farmer's entitlements are calculated by the national authorities in accordance with one of the models provided for under EU legislation.

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

⁽⁷⁾ Coupled aid payments are calculated on the basis of the number of animals kept (e.g. suckler cows, sheep and goat) and/or the number of hectares cultivated with a specific crop (e.g. cotton, rice, sugar beet, etc).

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— *interventions in agricultural markets* covering for example specific support for the fruit/vegetable and wine sectors, support for school milk and fruit, food aid programmes, price support under the POSEI programme⁽⁸⁾, storage intervention and export refunds (in total accounting for 3 193 million euro of expenditure in 2013).

3.4. CAP expenditure is almost exclusively subject to shared management by the Commission and the Member States. The expenditure is channelled through some 80 paying agencies that are responsible for making payments to beneficiaries. The accounts and payment records of the paying agencies are examined by independent audit bodies (certification bodies) which submit annual certificates and reports to the Commission.

3.5. The main risks with regard to the regularity of direct payments are that area aid may be paid for ineligible land, to ineligible beneficiaries or to more than one beneficiary for the same plot of land, or that entitlements are calculated incorrectly, or animal premiums are paid for non-existent animals. In the case of interventions in agricultural markets, the main risks as regards regularity are that aid is granted to ineligible applicants or for ineligible or overstated costs or products.

Audit scope and approach

3.6. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of market and direct support for agriculture, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 180 transactions as defined in **Annex 1.1**, paragraph 7. The sample is designed to be representative of the entire range of transactions within the policy group. In 2013 the sample consisted of transactions from 17 Member States⁽⁹⁾;

3.6.

⁽⁸⁾ POSEI is a programme of options specific to the remote and insular nature of the outermost regions.

⁽⁹⁾ Czech Republic, Denmark, Germany, Ireland, Greece, Spain, France, Italy, Lithuania, Hungary, the Netherlands, Poland, Portugal, Romania, Slovakia, Finland and the United Kingdom.

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- (b) the Court focused its testing of cross-compliance on selected GAEC good agricultural and environmental condition) obligations⁽¹⁰⁾ and selected SMRs statutory management requirements⁽¹¹⁾ for which evidence could be obtained and a conclusion reached at the time of the audit visits⁽¹²⁾;
- (c) the assessment of control systems⁽¹³⁾ examined the IACS Integrated Administration and Control System in four Member States⁽¹⁴⁾, the work performed under the reinforcement of assurance procedure⁽¹⁵⁾ in Italy and the control system applicable to EU aid for producer groups in Poland;
- (d) the Commission's estimates of the residual error rate was reviewed;
- (e) the Court also reviewed DG AGRI's clearance of accounts procedure. The results of this work, which also apply to this chapter, are presented in chapter 4 (see paragraphs 4.22 to 4.27).

THE COMMISSION'S REPLIES

- (b) *See reply to paragraph 3.13.*

⁽¹⁰⁾ Avoiding the encroachment of unwanted vegetation, retention of terraces, maintenance of olive groves and respect of minimum livestock stocking rates or mowing obligations.

⁽¹¹⁾ Requirements for SMR 4 (Nitrates Directive) and 6 to 8 (concerning the identification and registration of animals).

⁽¹²⁾ Cross-compliance obligations are substantive legal requirements that must be met by all recipients of EU direct aid. They are the basic and in many cases the only conditions to be respected in order to justify payment of the full amount of direct aid, hence the Court's decision to treat cross-compliance infringements as errors.

⁽¹³⁾ Selection of the Member States and systems audited was risk-based and therefore the results cannot be taken to be representative of the EU as a whole.

⁽¹⁴⁾ Germany (Bavaria), Ireland (Department of Agriculture, Fisheries and Food (DAFF)), Italy (Agenzia per le Erogazioni in Agricoltura (AGEA)) and France (Agence de Services et de Paiement (ASP)).

⁽¹⁵⁾ See paragraph 3.30.

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THE COMMISSION'S REPLIES

REGULARITY OF TRANSACTIONS

3.7. **Annex 3.1** contains a summary of the results of transaction testing. Out of the 180 transactions audited by the Court 110 (61 %) were affected by error. On the basis of the 101 errors which it has quantified, the Court estimates the most likely error to be 3,6 % ⁽¹⁶⁾.

3.8. The quantifiable errors detected by the Court can be grouped into four main categories:

- payments for aid applications which overstated the number of eligible hectares or animals;
- payments to ineligible beneficiaries or for ineligible activities/expenditure;
- payments affected by failure to meet cross-compliance obligations ⁽¹⁷⁾;
- payments affected by administrative errors.

3.7. The Commission notes that the error rate reported by the Court is an annual estimate which takes account of recoveries and corrective measures effected prior to the Court's audits. The Commission also notes that expenditure concerned shall be subject to correction in subsequent years through net financial corrections resulting from conformity clearance procedure as well as through recoveries from beneficiaries. The Commission considers that the Court's annual representative error rate should be seen in the context of the multiannual character of net financial corrections and recoveries.

Additionally, and as already pointed out in previous years, the Commission does not agree with the Court on the qualification of infringements to cross-compliance obligations as quantifiable errors accounting for 0,5 percentage points, and considers that these should not be included in the calculation of its DAS error rates.

The Commission also notes that as reported in the 2013 Annual Activity Report of DG AGRI, the net financial corrections imposed by the Commission on Member States and recoveries from beneficiaries implemented for EAGF amounted in 2013 to 575,89 million euro (1,28 % of the total expenditure).

3.8.

⁽¹⁶⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,7 % and 5,5 % (the lower and upper error limits respectively).

⁽¹⁷⁾ See paragraph 3.12.

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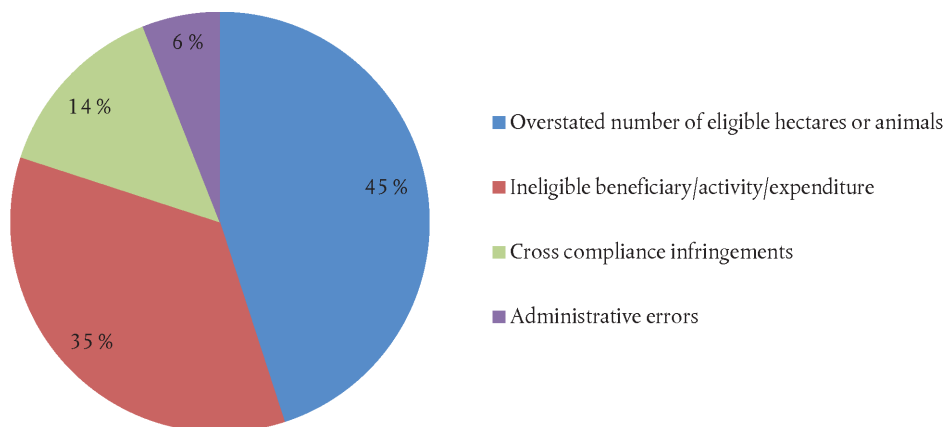
A breakdown of the estimated most likely error by type of error is provided in **Graph 3.1**. In 33 cases of quantifiable errors made by final beneficiaries, the national authorities had sufficient information (for example, from the final beneficiaries, their auditors or from the national authorities' own checks) to prevent, detect and correct the errors before declaring the expenditure to the Commission. If all this information had been used to correct errors, the most likely error estimated for this chapter would have been 1,1 percentage points lower. In addition, the Court found that for 24 cases, the error detected by the Court was made by the national authorities. These errors contributed 0,2 percentage points to the most likely error estimated.

THE COMMISSION'S REPLIES

The Commission, together with the Member States, is developing a number of remedial actions to address deficiencies identified and thereby reduce the error rate in the future. DG AGRI's Annual Activity Report (2013) specifies 11 such cases in 9 Member States in relation to market measures, and 20 cases in 6 Member States for direct payments. So far action plans have been very effective. The Commission also ensures that the financial risk to the EU budget arising from such deficiencies is always covered via net financial corrections imposed as a result of the multiannual conformity clearance procedure.

The Court highlights that the Member States could have identified, corrected and prevented a relatively important number of errors. Therefore, it can be concluded that the problems are not stemming from the system itself, but rather from shortcomings in its application by some Member States.

Graph 3.1 — Contribution by type of error to the most likely error



THE COURT'S OBSERVATIONS

3.9. Errors related to overstated eligible hectares were found in 69 transactions relating to 15 out of the 17 Member States visited. Half of these errors amount to less than 2% and thus have a small impact on the estimated level of error. The larger errors in this category related to payments for ineligible land declared as eligible permanent grassland (see Box 3.1).

Box 3.1 — Examples of payments for overstated eligible land

In Greece a parcel of land claimed as permanent grassland ⁽¹⁸⁾ benefited from SPS aid whilst in reality it was covered with dense shrubs, bushes and trees, which should have excluded it wholly or partly from EU aid. This error occurred because the Greek authorities classified such areas as eligible permanent grassland in the LPIS database ⁽¹⁹⁾.

Situations where overstated permanent grassland areas benefited from EU direct aid were also observed in Germany (Schleswig-Holstein), Ireland, France, Poland and Romania ⁽²⁰⁾.

3.10. The Court has also reported cases of incorrect assessment of the eligibility of land in LPIS databases in previous annual reports ⁽²¹⁾ and also found such cases in the context of the IACS systems audits carried out in 2013 (see paragraph 3.20).

3.11. The Court has identified three cases, where the activity, the beneficiary or the expenditure was not eligible for EU aid, two of which relate to market measures (see Box 3.2).

THE COMMISSION'S REPLIES

3.9. *The Commission will further discuss with the Court the most suitable methodology for field measurements, in particular when GPS measurements have to be superimposed on top of ortho images, for determining the eligible area, even though both elements are to different scales, and in order to ensure that Member States will get consistent guidance from the EU Institutions.*

Box 3.1 — Examples of payments for overstated eligible land

The Commission services share the view of the Court. The audits carried out by the Commission services have identified similar deficiencies. Weaknesses found are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered by net financial corrections.

3.10. *The situations reported during the previous reports of the Court were followed up through several conformity clearance procedures.*

⁽¹⁸⁾ EU legislation defines permanent pasture as land used to grow grasses or other herbaceous forage traditionally found in natural pastures.

⁽¹⁹⁾ With regard to LPIS see paragraph 3.20.

⁽²⁰⁾ In the annexes (p. 130) to its 2013 annual activity report the Commission reports about systematic weaknesses related to permanent pasture in Greece, Spain, Italy, Austria, Portugal, Sweden and United Kingdom (Scotland and Northern Ireland).

⁽²¹⁾ 2010 annual report, Annex 3.2 for Spain (Extremadura and Castilla-La Mancha); 2011 annual report, paragraph 3.20 and Annex 3.2 for Spain (Galicia), Italy (Lombardy) and Austria; 2012 annual report, Annex 3.2 for United Kingdom (England and Northern Ireland).

THE COURT'S OBSERVATIONS

Box 3.2 — Example of payments for ineligible expenditure and beneficiaries

In Italy aid for the promotion of wine⁽²²⁾ in the United States and Israel was granted to an association of five operators only four of which as actual wine producers were eligible. In addition, the approved project included expenditure representing the cost of the services of an implementing body. The Court found that EU aid was granted for this expenditure although the association had subsequently informed the Italian authorities that contrary to the approved project no implementing body was contracted.

3.12. Under all EAGF direct aid schemes, beneficiaries have an obligation to fulfil cross-compliance requirements. These requirements comprise Statutory Management Requirements (SMRs) relating to the protection of the environment, public health, animal and plant health, animal welfare; and the GAEC obligations. If farmers do not comply with these requirements their aid is reduced.

3.13. One hundred and sixty four of the claims checked by the Court were subject to these cross-compliance requirements, and 44 of the farmers concerned failed to comply with the rules. The frequency of non-compliance (25 % of claims concerned, a similar level to that reported by Member States) is relatively high, having an impact on the estimated error rate of 0,5 percentage points.

THE COMMISSION'S REPLIES

Box 3.2 — Example of payments for ineligible expenditure and beneficiaries

The Commission would like to underline that the provisions which according to the Court have not been respected by the Italian authorities are not EU requirements, but form part of Italian implementing provisions.

3.13. *The respect of cross-compliance obligations does not constitute an eligibility criterion for CAP payments and, therefore, the controls of these requirements do not pertain to the legality and regularity of the underlying transactions. Cross-compliance is a mechanism by which farmers are penalised when they do not respect a series of rules which stem in general from policies other than the CAP and apply to EU citizens independently of the CAP. Thus, the Commission considers that reductions imposed for violations of cross-compliance requirements should not be taken into account for the calculation of the error rates for the CAP.*

The error rate for cross-compliance 0,5 % has a significant impact on the overall error rate 3,6 %

In addition, since cross-compliance reductions apply only to direct payments, and not to any market measurements, the impact for direct payments is even higher.

The Commission also considers that in the new CAP legal framework, the legislator confirmed what was meant since the very beginning (also for the 2007-2013 period), namely that for all CAP support 'The imposition of an administrative penalty shall not affect the legality and regularity of the payments to which it applies' (Article 97(4) of Regulation (EU) No 1306/2013).

⁽²²⁾ EU legislation provides for co-financing of wine promotion measures carried out in non-EU countries. Italian implementing legislation restricts the aid to wine producers.

THE COURT'S OBSERVATIONS

3.14. The most frequent cross-compliance infringements observed by the Court relate to non-respect of reporting obligations with regard to animal databases (see Box 3.3).

Box 3.3 — Example of cross-compliance errors

EU cross-compliance legislation requires animal movements/births/deaths to be notified to the national animal database within 7 days. In the United Kingdom (Scotland) a farmer had not respected the notification deadline for 53 out of 104 such events.

The Court found other cases of failures to meet reporting obligations with regard to the animal databases in the Czech Republic, Denmark, Germany (Bavaria and Schleswig-Holstein), Ireland, Greece, France, Italy, Hungary, Poland, Romania and Slovakia.

3.15. The Court has also found a number of administrative errors in the way that national authorities treated applications. The most frequent error in this category relates to exceeding the ceiling for SPS entitlements in France. It affected all 26 SPS transactions audited in that Member State (see Box 3.5).

THE COMMISSION'S REPLIES

3.14. Concerning the significant problems found for the identification and registration of animals, the Commission shares the Court's observation and pays particular attention to these requirements during its cross-compliance audits.

Box 3.3 — Example of cross-compliance errors

During its 2014 audit in Scotland, the Commission observed weaknesses in the control of the respect of the notification deadlines. This will be followed up in the framework of the conformity clearance procedure.

The Commission has carried out cross-compliance audits in all Member States audited by the Court and, in many of them, has observed weaknesses in the control and sanctioning of the reporting obligations and, in general, in relation to Identification & Registration of animals. When a systemic non-compliance has been established, the Commission has always followed it up via the conformity clearance procedure.

3.15. The Commission is, as a result of its own audits, aware of the situation and is following up the deficiency under the clearance of accounts procedure for the financial years concerned. See further comments in Box 3.5.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

EXAMINATION OF SELECTED CONTROL SYSTEMS**Member States' systems related to regularity of transactions**

3.16. **Annex 3.2** contains a summary of the results ⁽²³⁾ of the systems examined by the Court ⁽²⁴⁾.

The Integrated Administration and Control System (IACS)

3.17. The IACS is the main management and control system in operation to ensure the regularity of direct aid payments. It covers more than 90 % of EAGF expenditure. The system consists of databases of farm holdings and aid applications, a Land Parcel Identification System (LPIS), animal databases and a database of entitlements in Member States that implement the SPS. The paying agencies carry out administrative cross-checks between these databases designed to ensure that payments are made for the correct amount, to the eligible beneficiary concerned for eligible land or animals. Payments are made only for the claims assessed as eligible after all the necessary administrative and on-the-spot checks are carried out 100 % administrative checks and at least 5 % on-the-spot checks ⁽²⁵⁾.

3.16. Under the shared management system it is primarily the responsibility of the paying agencies' internal control systems to reveal deficiencies. That means that the monitoring system and internal audit of the paying agency should detect in the first place if the administrative and control procedures are not effective. In general when paying agencies become aware of the deficiencies, they take actions to remedy them. The conformity clearance procedure is in place to ensure that net financial corrections can be applied against Member States for financial risk due to weak controls or for non-compliance with key controls.

3.17. Whilst recognising that there will inevitably always remain certain weaknesses and imperfections, the Commission services are however of the opinion that IACS as a whole remains a solid system for management of CAP expenditure.

⁽²³⁾ Since the audit of the reinforcement of assurance in Italy was not designed to conclude on the effectiveness of systems, its results are not presented in **Annex 3.2** but in a separate section of this chapter (paragraphs 3.30-3.35).

⁽²⁴⁾ Findings related to the IACS, except those concerning entitlements, also apply to area-related and animal-related rural development measures covered by chapter 4.

⁽²⁵⁾ Between 20 % and 25 % of these inspections are selected randomly and the rest by way of risk assessment.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

3.18. The Court assessed the following key elements of the IACS:

- (a) administrative control procedures and quality of databases;
- (b) control systems based on on-the-spot checks;
- (c) procedures to ensure recovery of undue payments.

Administrative control procedures and quality of databases

3.19. The administrative control procedures applied by paying agencies require cross-checks to be carried out wherever possible and appropriate between all IACS databases⁽²⁶⁾. The Court verified whether the databases hold complete and reliable information, all relevant cross-checks are made and corrective action is taken.

3.20. The LPIS is a database which holds a record of the entire agricultural area, broken down into reference parcels, of a Member State and the eligible areas in every reference parcel. It is based on a Geographical Information System (GIS) containing digitised and geo-referenced parcel boundaries, which are supported by orthoimages⁽²⁷⁾. The Court found cases where the eligibility of land was incorrectly recorded in the LPIS databases (see Box 3.4).

Box 3.4 — Examples of inaccuracies in LPIS databases

In Ireland the Court reviewed the orthoimages of the parcels claimed by six randomly selected beneficiaries and found for four of them that ineligible features (shrubs, buildings, access roads, etc.) that were clearly visible on the orthoimages were not excluded from the eligible area recorded in the LPIS.

In France EU aid is granted for grazable heathland ('landes et parcours'). Although these areas comprise a mixture of eligible herbaceous vegetation and ineligible bushes, shrubs, etc. the French LPIS records them as being fully eligible.

Box 3.4 — Examples of inaccuracies in LPIS databases

The Commission's audit work has already revealed the deficiencies in both Ireland and France. As a result conformity clearance procedures are ongoing for both Member States. The risk to the fund is and will be systemically covered by net financial corrections as a result of multiannual conformity clearance procedures.

⁽²⁶⁾ Articles 28 and 29 of Commission Regulation (EC) No 1122/2009 (OJ L 316, 2.12.2009, p. 65).

⁽²⁷⁾ Orthoimages are aerial photographs used to assess the eligibility of land in the LPIS.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

3.21. With regard to administrative controls on area aid schemes, the Court has found important deficiencies in two paying agencies (see Box 3.5).

Box 3.5 — Examples of deficiencies in administrative control procedures

In 2010 France allocated payment entitlements that exceeded the national ceiling under EU legislation by 4,61 %⁽²⁸⁾. However, instead of applying a 4,61 % reduction to the values of all entitlements the French authorities applied reductions of 3,92 %, 3,4 % and 3,31 % to all SPS payments in the budget years 2011 to 2013 respectively with the result that those payments were too high⁽²⁹⁾.

In Italy, in more than 10 000 cases, aid was granted for land which was declared only after expiry of the deadline set in EU legislation which excludes such land from EU aid⁽³⁰⁾.

3.21. See comments in Box 3.5.

Box 3.5 — Examples of deficiencies in administrative control procedures

The Commission is, as a result of its own audit work, aware of the situation and is following up the deficiency under the clearance of accounts procedure for the financial years concerned. The risk to the Fund will be assessed and covered by net financial corrections.

Control systems based on on-the-spot checks

3.22. The Court re-performed 82 on-the-spot measurements that had been carried out by the four paying agencies audited. Although in 21 cases⁽³¹⁾ the Court's measurements differed from those of the paying agencies, in 12 of these cases the area differences observed did not exceed 0,1 ha. The Court therefore concludes that overall the results of its re-performances were satisfactory.

⁽²⁸⁾ The ceiling overshoot occurred when a number of coupled aid schemes were decoupled and incorporated into SPS.

⁽²⁹⁾ The Court referred to this issue in its 2011 annual report (see Box 3.2) and in its 2012 annual report (see Box 3.1).

⁽³⁰⁾ See Article 23(2), last subparagraph, of Regulation (EC) No 1122/2009.

⁽³¹⁾ Six cases in Italy, eight cases in Ireland, four cases in Germany (Bavaria) and three cases in France.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Procedures to ensure recovery of undue payments

3.23. Under EU legislation⁽³²⁾, Member States should recover sums lost as a result of irregularities or negligence and initiate the process within one year of becoming aware of the loss. If the undue payments are not recovered within four years or within eight years where recovery action is taken in the national courts, the loss should be shared equally between the Member State and the EU⁽³³⁾.

3.24. In Ireland the Court observed that debts relating to claim years 2008 or earlier had been notified to the debtors after considerable delay and were not subject to any recovery or enforcement procedure for several years. Until the end of 2012 out of 6,7 million euro of debts relating to these claim years a total of 2,3 million euro was borne by the EU under the 50/50 sharing rule and another 0,7 million euro was written off and entirely borne by the EU budget.

3.25. Where sums are lost owing to administrative error, the 50/50 sharing rule does not apply and the Member State has to refund the full amount to the EU budget. The Italian authorities did not reliably record whether debts were due to irregularity or administrative error. As a result the amounts resulting from administrative errors that were reported to the Commission were unreliable, which could potentially lead to unnecessary charging to the EU budget.

3.23. *The question whether the national authorities acted negligently also derived from the relevant case-law of the European Court of Justice (ECJ). In order to discharge themselves of their obligation to rectify irregularities promptly and to be considered diligent in this matter, Member States have to:*

- *start a recovery procedure within 4 years from the moment of the first indication of an irregularity;*
- *start a recovery procedure within 1 year after the primary administrative or judicial finding;*
- *follow up on the national recovery procedure within 1 year after the last event or action which is relevant for that recovery procedure;*
- *respect the principles of equivalence and effectiveness, in order to safeguard the EU financial interests.*

3.24. *The Commission is, through its own audit work and after the review of the last Certification Body's report, aware of certain of the deficiencies in Ireland described by the Court, and a conformity clearance procedure is currently ongoing where the necessary corrective measures are being assessed. At the end of this procedure the identified total risk to the fund will be covered by net financial corrections which will be calculated on the basis of the information provided by the Certification Body.*

3.25. *The Commission is, through its own audit work, aware of certain deficiencies in the Italian debt management which are followed up in the context of a number of conformity clearance procedures. In addition, the Commission has carried out a mission to Italy in June 2014 in order to further clarify the situation on irregularities. Any risk to the fund will be covered by net financial corrections.*

⁽³²⁾ Article 32 of Regulation (EC) No 1290/2005.

⁽³³⁾ Article 32(5) of Regulation (EC) No 1290/2005.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Overall assessment of IACS

3.26. Taken as a whole, IACS plays a key role in preventing and reducing errors in claims from farmers. However, persistent weaknesses in excluding ineligible land from the LPIS and in the administrative treatment of claims contribute significantly to the level of error remaining in payments to farmers.

3.27. As regards inaccurate data on land eligibility recorded in the LPIS such errors often result from either insufficient interpretation of orthoimages or from the use of incorrect eligibility criteria by the Member State (see paragraphs 3.9 and 3.10 and Box 3.4).

3.28. As regards incorrect administrative treatment of aid applications such errors result from the incorrect implementation of EU legislation or a failure, on the part of the Member States, to remedy systems errors brought to their attention (see Box 3.5 and footnote 29).

3.29. Notwithstanding the weaknesses in the LPIS and administrative checks that were detected by the audit, the Court considers, on the basis of its audit results, that the IACS makes a significant contribution to reducing the error rates in the expenditure it covers. This is also reflected in the low rate of error attributable to expenditure managed under IACS in comparison with the high rate of error detected in the market measures as reported by the Commission in its 2013 annual activity report (see paragraphs 3.40 and 3.41).

Assessment of the reinforcement of assurance exercise

3.30. In 2010, the Commission introduced, on a voluntary basis, the 'Reinforcement of Assurance' procedure (RA). Under this procedure, which is based on Commission guidelines, an independent audit body designated by the Member State delivers an opinion on not only the proper functioning of the internal control system but also, based on a detailed review of a representative sample of transactions, the legality and regularity of expenditure declared to the EU. The sample is to be drawn randomly from the applications inspected on the spot by the paying agency.

3.26. *IACS is designed to prevent ineligible claims from being entered in the first place. The administrative cross-check of all claims, when correctly implemented, allows the detection of most of the errors that remain in claims introduced in the system. The Commission services are attentive to the accuracy of the information in the databases, as it is a key element for the correct management and control. When deficiencies are found, Member States are requested to remedy them. Furthermore, the risk for the Fund is covered under the conformity clearance procedure.*

Whilst recognising that there will inevitably always remain certain weaknesses and imperfections, the Commission services are of the opinion that IACS as a whole remains, when correctly implemented, a solid system for management of CAP expenditure.

3.27. *See reply to paragraph 3.26.*

3.28. *See reply to paragraph 3.26.*

3.29. *The Commission concurs with the Court regarding the positive contribution of the IACS on the level of error. The IACS has a preventive, detective and corrective effect on error. However, the Commission also notes that because of the diversity and targeted nature of the various market measures, it would not be possible to extend the IACS to cover them.*

THE COURT'S OBSERVATIONS

3.31. When the Member State can certify, in accordance with the methodology defined by the Commission, that the rate of errors found in the random sample checked on the spot does not exceed 2 % for at least two consecutive years, that Member State may decide to replace the physical on-the-spot checks by checks based on orthoimages⁽³⁴⁾.

3.32. Italy retroactively carried out the RA procedure in 2012 for claim years 2010, 2011 and 2012 and concluded that the residual error rates were below 2 % for the years concerned. As a result Italy decided to reduce its on-the-spot inspection rate to 1 % from claim year 2012 onwards.

3.33. The Court reviewed the work of the Italian audit body for claim year 2011 and found that the sample, which had not been drawn in accordance with the Commission guidelines, was not representative. Furthermore, the audit body did not examine the administrative treatment of the claims contrary to the procedure laid down in the EU guidelines.

3.34. Of the 133 transactions checked by the Italian audit body for claim year 2011 the Court examined a random selection of 60, and found that nine were affected by administrative errors which had not been detected. In six of the seven risk-based cases selected, the Court carried out on-the-spot measurements and found that the eligible area determined by the audit body was incorrect.

3.35. Given the errors found in the 60 transactions examined, the Court considers that the audit performed by the Italian audit body was not sufficient to justify the subsequent reduction of the on-the-spot inspection rate by the Italian authorities.

Control system applicable to EU aid for producer groups

3.36. In the Member States which acceded in 2004 or later⁽³⁵⁾, EU aid is available to producer groups for investments that are required in order for them to be subsequently recognised as a producer organisation⁽³⁶⁾. Recognition must be achieved within a maximum period of five years. A producer group can be created on the initiative of farmers who are growers of one or more products in the fruit and vegetable sector. The EU co-finances 50 % of the eligible cost of such investments.

THE COMMISSION'S REPLIES

3.31. *If the Commission finds that the legal conditions were not respected, this will be treated as a deficiency in the control system and any risk to the EU budget will be covered with a net financial correction.*

3.35. *The reduction in the physical on-the-spot checks by the Italian authorities will be followed-up during conformity audit procedures and the risk for the fund will be covered through net financial corrections.*

⁽³⁴⁾ A further condition is that the Member State in question has assessed its LPIS to be reliable.

⁽³⁵⁾ This scheme applies equally to the outermost regions of the EU and to the smaller Aegean Islands.

⁽³⁶⁾ Producer organisations are the basic operators in the fruit and vegetable regime. They provide technical assistance to their members and group their supplies. Their recognition is subject to a series of conditions, including use of environmentally sound cultivation practices including waste management and the existence of proper commercial and accounting management.

THE COURT'S OBSERVATIONS

3.37. The Court examined the control system applicable to EU aid for producer groups in Poland⁽³⁷⁾. Under the Polish rules a producer group may be recognised only if it comprises at least five members and provided that none of the members holds more than 20 % of the voting rights in the group. In order to be recognised as a producer group the applicants must submit a recognition plan⁽³⁸⁾. Furthermore, EU legislation⁽³⁹⁾ provides that concentration of supply and placing on the market of the products of its members should be the main activity of the producer group and that failure to respect this condition will lead to withdrawal of recognition.

3.38. The Court's audit revealed significant shortcomings in the control procedures applied when granting recognition to producer groups. Of the 40 cases examined by the Court, it found 9 in which the groups did not meet the eligibility criteria. In some cases the requirements regarding the minimum number of members and maximum voting rights were achieved by splitting holdings immediately prior to submission of the recognition plan or by creating separate legal entities owned by members of the group. In three cases the group's production was placed on the market not by the group but by one or two of its members or by companies owned by them. The Commission's own audits have already concluded that there are significant structural deficiencies in the approval procedures for recognition plans of producer groups in Poland. As a result, it has in its annual activity report 2013 established a reservation based on its estimate that 25 % of total expenditure under the measure is at risk.

THE COMMISSION'S REPLIES

3.38. *The objective of producer groups is to gain recognition as producer organisations within a time-frame of five years. The Commission confirms that it has also found shortcomings in its audits of producer groups. A conformity clearance procedure has been launched on 14 February 2014. The relevant findings led to a reservation in DG AGRI's 2013 AAR and to a request for remedial action with regard to checks before approval of (amendments to) recognition plans and before aid payments, and to undertake the necessary recoveries of undue payments from beneficiaries. The Polish authorities have also been requested to launch an action plan including a full review of all recognition plans. The Commission will closely monitor the action plan's implementation. Failure to implement the action plan would lead to suspension/reduction of EU payments. However, the Commission would like to stress that EU rules do not prevent the recognition of a producer group only because it has reached the minimum number of members or the maximum number of voting rights shortly before its creation. Similarly, the regulatory provisions for producer groups do not exclude outsourcing of sales to or sales by an important member in the transitional period.*

⁽³⁷⁾ The EU's total expenditure on producer groups amounted to 343 million euro in 2013 of which around 90 % was spent in Poland.

⁽³⁸⁾ The plan specifies the available assets as well as the investments and actions necessary to obtain recognition as a producer organisation at the end of the recognition period. In a number of cases such investments comprise the purchase of existing machinery from group members.

⁽³⁹⁾ Articles 28(1), 43, 116(1) and 118(1) of Commission Regulation (EC) No 1580/2007 (OJ L 350, 31.12.2007, p. 1) and Articles 41(1), 114(1) and 116(1) of Commission Implementing Regulation (EU) No 543/2011 (OJ L 157, 15.6.2011, p. 1).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Commission's estimates of the residual error rate

3.39. In its 2013 annual activity report DG AGRI assesses the residual error rate (RER), i.e. the extent to which transactions remain affected by error after the operation of the supervisory and control systems. The RERs for direct aid and market measures are first calculated separately.

3.40. For direct aid the starting point for determining the RER is the error rates reported by the Member States in their inspection statistics. However, since these statistics do not cover all components of the residual error rate and are not always reliable, DG AGRI carried out an individual assessment for each paying agency, based on all available information — including the Court's audit findings. Depending on the extent of the weaknesses found, it applied uplifts of up to 5 percentage points to the error rates reported by 42 out of 66 paying agencies managing direct aid. The RER estimated for direct aid amounts to 2,33 % of all expenditure ⁽⁴⁰⁾.

3.41. With regard to market measures the RER is not determined for every paying agency but for measures as a whole, based on all available audit information. It is estimated at 7,44 % of all expenditure.

3.39. In 2012 DG AGRI adjusted its method to estimate a more comprehensive residual error rate (RER) by taking into account all available information (its own audit reports, those of the Court and those of the certification bodies). This assessment was carried out in respect of decoupled direct aids in the AAR of 2012 and extended, as recommended by the Court (in its 2012 Annual Report), after further fine-tuning in the AAR 2013 to all CAP expenditure.

The methodology for calculating the RER will be further developed next year (AAR 2014) in the direction of a multiannual cumulative approach that will reflect the impact of the ex post net financial corrections imposed by the Commission (and recoveries from beneficiaries by Member States themselves) on the residual risk to the EU budget.

⁽⁴⁰⁾ This rate is more than three times higher than the weighted average error rate of 0,69 % calculated on the basis of the statistics reported by the Member States.

THE COURT'S OBSERVATIONS

3.42. As a result, the Commission estimated the overall residual error rate for EAGF payments for 2013 to be 2,69 %. The Court considers that the new approach which takes into account not only control data provided by the Member States but also other available audit information, represents an improvement in the calculation of the RER.

3.43. However, the Court observes that the results of this approach show that only limited assurance can be gained from the Member States' inspection statistics, the declarations of the directors of paying agencies and from the work carried out by the certification bodies. This is illustrated by the fact that the directors of all but one Spain Asturias)) of the 81 paying agencies had given unqualified statements of assurance⁽⁴¹⁾ and the certification bodies reached positive conclusions regarding the quality of on-the-spot inspections and the statistics thereon in the case of 79 of the paying agencies.

THE COMMISSION'S REPLIES

3.42. *The Commission welcomes the Court's assessment that its new methodology for calculating the RER is an improvement.*

As recommended by ECA, DG AGRI applies a new approach to estimate the residual error rates that takes into account all available information, notably audits from both DG AGRI and ECA in the last 3 years. The potential impact of the identified deficiencies on the error rate is estimated and added as a top-up to the error rate reported by the Member State concerned at the level of each paying agency, resulting in a more realistic and more precise estimate of the residual error rate. Applied to direct payments for the AAR 2012, the methodology has been further developed and, as recommended by the Court, extended to the whole CAP expenditure in the AAR 2013.

3.43. *Each layer of assurance taken on its own may not be sufficient. This is why the Commission has integrated all available information in order to make the most solid estimate of the residual error rate.*

⁽⁴¹⁾ In the framework of the assurance model used by the Commission, directors of the paying agencies submit their statements of assurance declaring that they have put in place a system which provides reasonable assurance on the legality and regularity of the underlying transactions.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

3.44. For this policy group:

- testing of transactions indicates that the most likely error present in the population is 3,6 %;

- of the five control systems examined, one was assessed as effective, two as partially effective and two as not effective.

Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

3.44.

The Commission notes that the error rate reported by the Court is an annual estimate which takes account of recoveries and corrective measures effected prior to the Court's audits. The Commission also notes that expenditure concerned shall be subject to correction in subsequent years through net financial corrections resulting from conformity clearance procedure as well as through recoveries from beneficiaries. The Commission considers that the Court's annual representative error rate should be seen in the context of the multiannual character of net financial corrections and recoveries.

Furthermore, it does not agree, with the qualification by the Court of infringements to cross-compliance obligations as quantifiable errors, and consider that these should not be included in the calculation of its DAS error rates.

As laid down in Article 287(1) TFEU the DAS covers the 'reliability of the accounts and the legality and regularity of the underlying transactions'.

Cross-compliance infringements do on the other hand affect neither the eligibility of farmers to CAP support (1st and 2nd pillar) nor the regularity of the payments. The eligibility of the expenditure does not depend on whether the farmer complied with his cross-compliance obligations and non-respect of cross-compliance obligations therefore does not entail a partial or full loss of the farmer's right to CAP support but triggers the application of reductions which are subject to specific conditions other than those on eligibility.

The Commission also considers that in the new CAP legal framework, the legislator confirmed what was meant since the very beginning also for the financing period 2007-2013, namely that for all CAP support 'The imposition of an administrative penalty shall not affect the legality and regularity of the payments to which it applies' (Article 97(4) of Regulation (EU) No 1306/2013).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

3.45. **Annex 3.3** shows the results of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented six recommendations. Out of these recommendations, three were implemented in most respects and three were implemented in some respects.

3.46. Following this review and the findings and conclusions for 2013, the Court recommends that:

- **Recommendation 1:** the Commission and Member States take the necessary measures to ensure that the IACS is used to its full potential. This comprises particular efforts in ensuring that:
 - the eligibility and size of agricultural parcels, in particular of permanent pasture, are correctly assessed and recorded by the Member States on the basis of the applicable EU criteria by way of comprehensive analysis of the most recent orthoimages (see paragraphs 3.9, 3.10 and 3.20);
 - immediate remedial action is taken by the Member States where the IACS is found to be affected by systemic errors, especially as regards incorrect administrative treatment of aid applications (see paragraph 3.15 and Box 3.5);
 - the debtors ledgers of the Member States contain full and reliable information on the amounts and nature of debts and that effective recovery/enforcement procedures are applied without any undue delay (see paragraphs 3.24 and 3.25);
- **Recommendation 2:** the Commission ensures that the reinforcement of assurance procedure is effectively applied in order to enhance the quality and comparability of the work performed by the audit bodies and that remedial action is taken in respect of the unjustified reduction by the Italian authorities of the on-the-spot inspection rate (see paragraphs 3.30 to 3.35);
- **Recommendation 3:** the Commission actively monitors the application of remedial actions with regard to the deficiencies in the control system applicable to EU aid for producer groups in Poland (see paragraphs 3.36 to 3.38).

3.46.

The Commission accepts the recommendation. The Commission underlines that it safeguards the financial interest of the EU budget via net financial corrections in the framework of the conformity clearance procedure.

In order to assist Member States in their implementation of the new rules on direct payments in the CAP reform, a new unit has been specifically created within DG AGRI.

In addition, shortcomings in Member States' management and control systems are addressed through targeted and comprehensive action plans where necessary. When the Commission services detect such problems during the course of their audits, they request the Member State to take remedial actions. Where the problem is particularly acute, the Member State is required to implement a remedial action plan which is closely followed by the services. So far such plans have been found to be very effective.

Conformity debt management enquiries are carried out by the Commission to gain such an assurance. In that context, the diligence criteria quoted in our reply to point 3.23 are strictly applied. In case of negligence by the Member State, the complete non-recovered amount is charged to the budget of the Member State concerned. Such an approach ensures equal treatment of the individual cases and between the Member States.

The Commission accepts the recommendation.

The reduction in the on-the-spot controls by the Italian authorities will be followed-up via conformity audit procedures and the risk for the fund will be covered through net financial corrections.

The Commission accepts the recommendation and is already implementing appropriate remedial measures in this regard.

ANNEX 3.1

RESULTS OF TRANSACTION TESTING FOR AGRICULTURE: MARKET AND DIRECT SUPPORT

	2013		2012	2011	2010
	IACS	Non-IACS			
SIZE AND STRUCTURE OF THE SAMPLE					
Total transactions:	164	16	180	180	146
RESULTS OF TESTING ⁽¹⁾ ⁽²⁾					
Proportion (number) of transactions tested found to be:					
Free of error	36 % (59)	69 % (11)	39 % (70)	59 % 61 %	73 %
Affected by one or more errors	64 % (105)	31 % (5)	61 % (110)	41 % 39 %	27 %
Analysis of transactions affected by error					
Analysis by type of error					
Other compliance issues and non-quantifiable errors:	7 % (7)	40 % (2)	8 % (9)	19 % 14 %	31 %
Quantifiable errors:	93 % (98)	60 % (3)	92 % (101)	81 % 86 %	69 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS					
Most likely error rate			3,6 %	3,8 %	2,9 %
Upper Error Limit (UEL)			5,5 %		n.a.
Lower Error Limit (LEL)			1,7 %		
⁽¹⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.					
⁽²⁾ Numbers quoted in brackets represent the actual number of transactions.					

ANNEX 3.2

RESULTS OF EXAMINATION OF SELECTED SYSTEMS FOR AGRICULTURE: MARKET AND DIRECT SUPPORT

Assessment of selected supervisory and control systems — EAGF

Member State (Paying agency)	Scheme	IACS related expenditure (national ceiling, Annex VIII of Regulation (EC) No 73/2009) (1 000 euro)	Administrative control procedures to ensure correct payment including quality of databases	On-the-spot inspection methodology, selection, execution, quality control and reporting of individual results	Procedures for the recovery of undue payments	Overall assessment
France	SPS	8 527 494	Not effective 1, 2, 3, 4, 5	Effective	Effective	Not effective
Ireland	SPS	1 340 869	Partially effective 1, 2	Effective	Partially effective A	Partially effective
Italy (AGEA)	SPS	4 379 985	Partially effective 1, 3, 6	Partially effective a	Partially effective B	Partially effective
Germany (Bavaria)	SPS	5 852 938	Effective	Partially effective a	Effective	Effective

1 Eligibility of land not accurately recorded in the LPIS.

2 Insufficient audit trail in IACS databases.

3 Weaknesses in the claim registration procedure.

4 Incorrect basis of payment calculation.

5 Non-respect of the ceiling for payment entitlements.

6 Non-application of penalties for parcels added to the claim after the deadline, unreliable information on obvious error corrections.

a Insufficient quality of area measurements during on-the-spot controls.

A Delays in the application of enforcement procedures.

B Incomplete information in debtor's ledger.

Member State (Paying agency)	Scheme	Expenditure budget year 2013 (1 000 euro)	Administrative and control procedures to ensure correct payment	On-the-spot inspections	Overall assessment
Poland	Aid for the preliminary recognition of producer groups in the fruit and vegetable sector	307 264	Not effective 1, 2, 3, 4	Partially effective a	Not effective

1 Weaknesses in the control of the eligibility of the beneficiary

Recognition of producer groups not meeting the legal requirements
Minimum number of members achieved by splitting existing holdings

2 Weaknesses in the checks related to the necessity of the investment

Insufficient checks/incomplete audit trail on checks carried out.
Approved increases of investments were disproportionate to increase in production

3 Weaknesses in the checks related to the reasonableness of cost

Insufficient checks/incomplete audit trail on checks carried out.
Acceptance of cost items resulting from non-arm's-length transactions between related persons

4 Other legality and regularity problems

Transport costs included in the value of marketed production (VMP)
Group production not marketed by the group
Duration of the recognition plan longer than necessary
Cost of usufruct accepted as eligible expenditure

a Weaknesses in the final check after the last year of implementation of the recognition plan

ANNEX 3.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR AGRICULTURE: MARKET AND DIRECT SUPPORT

Year	Court recommendation	Court's analysis of the progress made					Commission reply
		Fully implemented	Being implemented In most respects	In some respects	Not implemented	No longer applicable	
2011	<p>3.45. Following this review and the findings and conclusions for 2011, the Court recommends for the current programming period that the Commission and Member States take appropriate action to ensure that:</p> <p>Recommendation 1: the eligibility of permanent pasture is properly assessed, especially in cases where area are partly covered with bushes, shrubs, dense trees or rocks (see paragraphs 3.12 and 3.20);</p>			X			<p>The Commission is aware of this issue and the eligibility criteria in the context of the CAP reform towards 2020 has been clarified.</p> <p>For the current period, where the Commission finds such weaknesses, recommendations for rectification are made to the Member State and net financial corrections are imposed through conformity clearance procedures in order to protect the EU's financial interests.</p> <p>Further action in this topic is the instigation of specific remedial action plans by Member States, following the request of the Commission; this is the case in e.g. Spain and Greece:</p> <ul style="list-style-type: none"> — the mission in 2013 showed that work by Greece was not to standard. Consequently the moratorium was lifted proportionally for part of the amounts at stake (i.e. only the part linked to permanent pasture was 'revoked') and net financial corrections will be applied; — the remedial actions taken by Spain were audited mid-2013 and found not to address the situation in full. As a consequence a more hands-on approach will be adopted vis-à-vis Spain and net financial corrections will continue.

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2011	<p>Recommendation 2: paying agencies take immediate remedial action where their administrative and control systems and/or IACS databases are found to be deficient (see paragraphs 3.19 to 3.22) ⁽¹⁾;</p>		X					<p>Done. The Commission has only a supervisory role under shared management; the MSs are primarily responsible for the prevention, detection and correction of errors. Therefore, the Commission works with the Member States to ensure a continuous improvement of the reliability of information in the LPIIS-GIS. As from claim year 2010 Commission Regulation (EU) No 146/2010 introduced the requirement for Member States to perform a quality assessment of the LPIIS-GIS on an annual basis according to determined procedures and to report on the results and the actions envisaged, where required, to improve the situation [2010/AUD/0083].</p>
	<p>Recommendation 3: on-the-spot inspections are of the quality necessary to identify the eligible area in a reliable manner (see paragraph 3.23) ⁽¹⁾;</p>		X					<p>The Commission agrees with the Court and systematically recommends as part of the clearance Member States to improve the control systems and ensure a more vigorous implementation thereof. More generally the quality of on-the-spot checks is part of expert groups organised on the topics of the on-the-spot checks.</p> <p>Moreover, the Commission services have identified similar deficiencies in the quality of the on-the-spot checks, and the weaknesses found are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered.</p> <p>During DAS 2013, problems were identified by ECA during the system audits in France. To that the Commission would like to highlight that from 2013 onwards, France has ongoing action plans aiming to address the weaknesses in the LPIIS. The draft action plan has been discussed at multiple bilateral meetings before FR submitted a 'final' version of the action plan on 15 November 2013.</p> <p>In addition, France has an ongoing action plan for weaknesses in the controls of cross-compliance and non-area coupled aids. The results will be visible in 2014 or 2015.</p>

Year	Court's recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented		Not implemented	No longer applicable		Insufficient evidence
			In most respects	In some respects				
2011	<p>Recommendation 4: the design and quality of the work performed by the certification bodies provides a reliable assessment of the legality and regularity of operations in the paying agencies (see paragraphs 3.29 ff).</p>		X				<p>The Commission has put forward efforts to ensure that the design and quality of the work performed by the Certification Bodies provides a reliable assessment of the legality and regularity of operations in the paying agencies.</p> <p>The reinforcement of the work of the CB is proposed in the CAP reform, Art 9 of Regulation (EU) No 1306/2013. According to the new legal framework, this work will be performed from the 2014 claim year (financial year 2015), meaning that the results will be reported only in February 2016 for the purposes of the financial clearance of accounts.</p> <p>Detailed guidelines on the audit methodology for the CB have been prepared with the Member State and were made available on 15 January 2014. Further guidance is offered to the CBs during regular Expert Group Meetings.</p>	

Year	Court recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented		Not implemented	No longer applicable		Insufficient evidence
			In most respects	In some respects				
2010	<p>3.58. Following this review as well as the findings and conclusions for 2010, the Court recommends that the Commission takes appropriate action to ensure that:</p> <p>(a) the use of ortho-photos becomes mandatory and that the LPIS is regularly updated on the basis of new ortho-photos (see paragraph 3.31);</p> <p>(d) the quality of inspections is adequately checked and reported by the certification bodies (see paragraphs 3.46 and 3.47).</p>		X				<p>Done. The Commission has only a supervisory role under shared management; the Member States are primarily responsible for the prevention, detection and correction of errors.</p> <p>The issue of a regular update of the LPIS is taken into account in the newly introduced mandatory quality assessment of the LPIS. In the context of the reform of the CAP post-2013, where Article 70 of the Regulation (EU) No 1306/2013 makes the use of computerised geographical information system techniques, including aerial or spatial orthoimagery, compulsory, it is even more important to use up-to-date imageries as the lack of being up to date/detail in the orthoimagery renders difficult implementing eligibility checks with sufficient quality. Moreover, up-to-date orthoimagery would add considerable value to farmers and enable them more reliably to determine eligible areas and changes in vegetation and land cover.</p> <p>In the end, the general risk that outdated orthophotos could lead to irregular payments is reflected, when appropriate, in the Central Register of Risk and then in the Annual Work Programme in Directorate J).</p> <p>From the 2014 claim year (financial year 2015) the certification bodies are expected to perform a more thorough verification of the controls carried out in the PA (both administrative and on-the-spot).</p> <p>See also reply for Recommendation 4 — FY 2011.</p>	

(1) Similar recommendations were made in paragraph 3.58 (b) and (c) of the 2010 annual report.

CHAPTER 4

Rural development, environment, fisheries and health

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INTRODUCTION

4.1. This chapter presents the specific assessment of rural development, environment, fisheries and health, which comprises the rural development part of the 'Agriculture and rural development' policy area, together with the policy areas 'Environment and climate action', 'Maritime affairs and fisheries', and 'Health and consumer protection'. Key information on the activities covered and the spending in 2013 is provided in **Table 4.1**.

Table 4.1 — Rural development, environment, fisheries and health — Key information 2013

(million euro)

Policy area	Description	Payments
Rural development	Rural development	13 152
	Pre-accession measures	48
	International aspects of 'Agriculture and rural development' policy area	3
		13 203
Maritime affairs and fisheries	Operational expenditure	779
	Administrative expenditure	41
		820
Health and consumer protection	Operational expenditure	484
	Administrative expenditure	115
		599
Environment and climate action	Operational expenditure	314
	Administrative expenditure	92
		406
Total payments for the year		15 028
- total administrative expenditure ⁽¹⁾		248
Total operational expenditure		14 780
- advances ⁽²⁾ ⁽³⁾		537
+ clearings of advances ⁽²⁾		1 254
+ disbursements to final recipients from Financial Engineering Instruments		84
Audited population, total		15 581
Total commitments for the year		17 173

⁽¹⁾ The audit of administrative expenditure is reported in chapter 9. Total administrative expenditure for the policy area agriculture and rural development is included in **Table 3.1**.

⁽²⁾ In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 7).

⁽³⁾ This figure includes 13 million euro of advances paid to Financial Engineering Instruments.

Source: 2013 consolidated accounts of the European Union.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Specific characteristics of the policy group

4.2. Rural development is part of the common agricultural policy (CAP), for which the overall objectives, sources of funding and management and control of the expenditure are presented in chapter 3 (paragraphs 3.2 to 3.4). The European Agricultural Fund for Rural Development (EAFRD) co-finances at varying rates the rural development expenditure disbursed through Member States' rural development programmes⁽¹⁾. The expenditure covers 46 measures⁽²⁾ which include both area-related measures⁽³⁾ and non-area-related measures⁽⁴⁾.

4.3. Concerning the other policy areas, the Union's policy on the environment is intended to contribute to protecting and improving environmental quality, the life of its citizens, and the rational utilisation of natural resources, including at international level, with expenditure implemented on a centralised basis by DG ENV⁽⁵⁾ and by DG CLIMA⁽⁶⁾ for climate action. The common fisheries policy of the 'Maritime affairs and fisheries' policy area pursues similar overall objectives to those of the common agricultural policy (see paragraph 3.2); this policy area involves both shared management between Member States and the Commission (DG MARE)⁽⁷⁾, and direct management by DG MARE. In the 'Health and consumer protection' policy area, which is managed by DG SANCO⁽⁸⁾ on a centralised basis, the EU contributes both to human, animal and plant health protection and to consumer welfare.

4.4. The main risk to regularity for the policy group, and in particular for rural development, is that expenditure is ineligible, due to non-compliance with often complex rules and eligibility conditions.

4.2. *The Commission underlines that EAFRD expenditure includes both area-related measures (which are dealt with under the IACS for the area-related aspects) and non-area-related measures. This has an impact on the magnitude of errors for the respective measures.*

4.4. *As regards the complex rules and eligibility conditions referred to by the Court, the Commission points out that they are, to a large extent, a consequence of the ambitious objectives of the rural development policy.*

Nevertheless, for the 2014-2020 programming period, the legal framework has been simplified.

⁽¹⁾ Total 13 152 million euro, including payments for completion of programmes prior to 2006 (195 million euro).

⁽²⁾ The measures are listed under point 7a in Annex II of Commission Regulation (EC) No 1974/2006 (OJ L 368, 23.12.2006, p. 15).

⁽³⁾ Area-related measures are those where payment is linked to the number of hectares, such as agri-environment payments and compensatory payments to farmers in areas with natural handicaps.

⁽⁴⁾ Non-area-related measures are typically investment measures, such as modernisation of agricultural holdings and the setting up of basic services for the economy and rural population.

⁽⁵⁾ The Commission's Directorate-General for the Environment.

⁽⁶⁾ The Commission's Directorate-General for Climate Action.

⁽⁷⁾ The Commission's Directorate-General for Maritime Affairs and Fisheries.

⁽⁸⁾ The Commission's Directorate-General for Health and Consumers.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Audit scope and approach

4.5. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of rural development, environment, fisheries and health, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 177 transactions as defined in **Annex 1.1**, paragraph 7. The sample is designed to be representative of the entire range of transactions within the policy group. In 2013 the sample consisted of 162 transactions for rural development in 16 Member States and 1 candidate country⁽⁹⁾, and 15 transactions concerning environment, fisheries and health in 5 Member States⁽¹⁰⁾;
- (b) the Court focused its testing of cross-compliance requirements (described in paragraph 3.13) on GAEC (good agricultural and environmental condition) obligations and selected SMRs (statutory management requirements)⁽¹¹⁾ for which evidence could be obtained and a conclusion reached at the time of the audit visits⁽¹²⁾;
- (c) the assessment of control systems for rural development examined eight paying agencies⁽¹³⁾ in eight Member States⁽¹⁴⁾. In addition, the control system for cross-compliance was checked in four Member States⁽¹⁵⁾. For the other policy areas, the European Fisheries Fund (EFF) systems in Poland and DG MARE were audited;

4.5.

- (b) See reply to paragraph 4.15.

⁽⁹⁾ Bulgaria, the Czech Republic, Denmark, Germany (Brandenburg and Berlin, Mecklenburg-Vorpommern, Saxony), Greece, Spain (Andalucía), France, Italy (Calabria, Piemonte, Sardinia), Latvia, Hungary, the Netherlands, Austria, Poland, Portugal (Azores, Continental), Romania, Finland and Turkey.

⁽¹⁰⁾ The sample consisted of 8 transactions under direct management and 7 under shared management in Greece, Spain, Italy, Poland and Portugal.

⁽¹¹⁾ Requirements for SMRs 4 (Nitrates Directive) and 6 to 8 (concerning the identification and registration of animals), and obvious non-compliance with SMRs 16 and 18 (animal welfare).

⁽¹²⁾ Cross-compliance obligations are substantive legal requirements that must be met by all recipients of EU direct aid. They are the basic and in many cases the only conditions to be respected in order to justify payment of the full amount of direct aid, hence the Court's decision to treat cross-compliance infringements as errors.

⁽¹³⁾ The paying agencies and key controls were selected on the basis of a risk analysis.

⁽¹⁴⁾ Germany (North Rhine-Westphalia), Spain (Valencia), Italy (Sicily), Latvia, Malta, Poland, Romania and Slovenia.

⁽¹⁵⁾ The Czech Republic, Spain (Castilla y León), Italy (Emilia-Romagna) and Malta.

THE COURT'S OBSERVATIONS

- (d) the Commission's annual activity reports of DG AGRI⁽¹⁶⁾ (concerning rural development and DG SANCO) were reviewed;
- (e) in addition, in order to assess the basis for the Commission's clearance decisions the Court reviewed DG AGRI's clearance of accounts audit work (for EAGF — the European Agricultural Guarantee Fund — and for EAFRD).

REGULARITY OF TRANSACTIONS

4.6. **Annex 4.1** contains a summary of the results of transaction testing. Out of the 177 transactions audited by the Court 96 (54 %) were affected by error. On the basis of the 48 errors which it has quantified, the Court estimates the most likely error to be 6,7 %⁽¹⁷⁾, for which **Graph 4.1** shows the main categories.

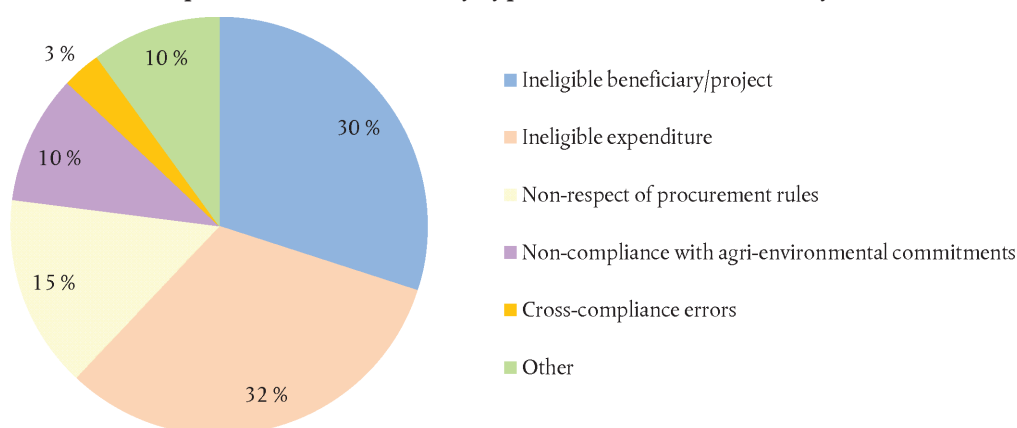
THE COMMISSION'S REPLIES

4.6. *The Commission notes that the error rate reported by the Court is an annual estimate which takes account of recoveries and corrective measures effected prior to the Court's audits. The Commission also notes that expenditure concerned shall be subject to correction in subsequent years through net financial corrections resulting from conformity clearance procedure as well as through recoveries from beneficiaries. The Commission considers that the Court's annual representative error rate should be seen in the context of the multiannual character of net financial corrections and recoveries.*

The Commission takes note of the most likely error rate estimated by the Court which is lower than that of last year. The Commission also notes that as reported in the 2013 Annual Activity Report of DG AGRI, the net financial corrections imposed on Member States by the Commission and the recoveries from beneficiaries implemented for EAFRD amounted in 2013 to 327,77 million euro (2,53 % of the total expenditure).

⁽¹⁶⁾ The Commission's Directorate-General for Agriculture and Rural Development.

⁽¹⁷⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 3,5 % and 9,9 % (the lower and upper error limits respectively).

Graph 4.1 — Contribution by type of error to the most likely error

 THE COURT'S OBSERVATIONS

Rural development

4.7. With regard to rural development expenditure, of 162 transactions sampled, 92 (57 %) were affected by error, of which 48 (52 %) were quantifiable errors.

 THE COMMISSION'S REPLIES

4.7. The frequency of errors found by the Court in rural development has decreased from 63 % in 2012 to 57 %. The error rate for rural development must also be appreciated in light of the ambitious objectives of rural development policy.

The Commission notes that 11 of the abovementioned quantified errors only concerned cross-compliance infringements. Therefore, in the Commission's view, since cross-compliance requirements affect neither the eligibility of farmers to CAP support (first and second pillar) nor the regularity of the payments, excluding these errors brings the number of transactions affected by quantifiable error down to 37 (40 %).

In his declaration of assurance for 2013 the Director General of DG AGRI has issued reservations concerning rural development expenditure for 19 Member States (31 paying agencies). The reservations were issued due to the significant occurrence of weaknesses in the underlying transactions and accompanied by a request to the Member States concerned to address the deficiencies via remedial actions.

THE COURT'S OBSERVATIONS

4.8. In 20 cases of quantifiable errors made by final beneficiaries, the national authorities had sufficient information (from the final beneficiaries, their auditors or from the national authorities' own checks) to prevent, detect and correct the errors before declaring the expenditure to the Commission. If all this information had been used to correct errors, the most likely error estimated for this chapter would have been 4,7 percentage points lower. In addition, the Court found that for three cases, the error detected by the Court was made by the national authorities. These errors contributed 0,5 percentage points to the most likely error estimated.

4.9. The audit involved examining transactions drawn from 31 different measures. Of the 162 transactions, 61 were area-related and 101 non-area-related. Errors were found in the sampled transactions in all 16 Member States visited. As in previous years, the major component (75 %) of the most likely error reported in paragraph 4.6 concerned non-area-related measures.

4.10. The reason for most quantifiable errors was non-compliance with the eligibility requirements, in particular those concerning:

- (a) agri-environment commitments;
- (b) specific requirements for investment projects, beneficiaries and expenditure;
- (c) procurement rules.

An analysis of each of these is set out in the following paragraphs.

THE COMMISSION'S REPLIES

4.8. *The Commission shares the view that the national authorities could potentially have detected many of the errors found by the Court: the CAP rules provide the Member States with all necessary instruments to mitigate most of the risks of errors. Following the reservations in 2011, 2012 and 2013 by the Director General of DG AGRI, extensive action plans have been established in collaboration with the Member States to identify the root causes of errors and appropriate remedial actions.*

For the programming period 2014-2020 all Rural Development Programmes are required to include an ex ante assessment on the verifiability and controllability of the measures, conducted jointly by the Managing Authority and the Paying Agency.

In addition, since 2013 the Commission has intensified its audits on rural development expenditure.

4.9. *During its own audits in some Member States the Commission found shortcomings similar to those detected by the Court of Auditors. Substantial net financial corrections have been imposed on the Member States concerned (or conformity clearance procedures are underway with a view to making such corrections) in order to protect the EU budget.*

Furthermore where reservations were made, Member States concerned are required to take remedial actions (see paragraph 4.8).

The lower level of errors for area-related measures confirm that, when well implemented, the Integrated Administrative and Control System (IACS) is an effective system to prevent and correct errors.

4.10. *The Commission also found similar cases in its own audits in Member States. Where appropriate, the Commission addresses recommendations for remedial action to the national authorities and excludes ineligible expenditure from EU financing.*

Most of the specific requirements referred to by the Court are not laid down in the European Union legislation, but are eligibility criteria established by the Member States in order to better achieve the objectives of the rural development policy of the Member State in question.

As regards public procurement. See reply to paragraph 4.13.

THE COURT'S OBSERVATIONS

4.11. The sample audited included 36 transactions for agri-environment payments, which concern the use of agricultural production methods compatible with protection of the environment, landscape and natural resources. The Court found that in seven cases (19%), farmers had not met all the conditions for payment. An example of such an error found by the Court is provided in Box 4.1.

Box 4.1 — Example of eligibility error: non-compliance with agri-environment commitments

A beneficiary in Italy (Sardinia) undertook not to use harmful plant protection products on artichokes. During its on-the-spot visit, the Court found that the beneficiary had used such products 12 times during the period audited.

Cases of non-compliance with agri-environment commitments were also detected in Italy (Piemonte), Hungary, the Netherlands, Poland and Romania.

4.12. Eligibility criteria and selection procedures help target the aid at certain categories of beneficiaries, thus aiming to improve the effectiveness of rural development spending. However, of the 101 transactions examined which related to investment projects, 24 (24%) did not comply with the eligibility requirements. An example of this type of error is in Box 4.2.

Box 4.2 — Example of eligibility error: ineligible beneficiary

The measure 'adding value to agricultural and forestry products' grants investment support. The aid should be targeted at enterprises under a certain size as these are considered to be better placed to add value to local products. In Portugal, beneficiaries under this measure must have fewer than 750 employees or a turnover of less than 200 million euro. Figures for controlling enterprises (e.g. majority shareholders) have to be included to fulfil this requirement.

A beneficiary audited in Portugal received 523 644 euro of EU aid to expand its olive oil production facilities. The Court found that the enterprise was owned by two large multinational companies, thus exceeding both size requirements for eligibility by more than 300 times. Consequently, the beneficiary was not eligible for aid and no payment should have been made.

Non-compliance with eligibility requirements for investment projects or for the expenditure concerned was also found in Bulgaria, Denmark, Germany (Brandenburg and Berlin), Greece, Spain (Andalucia), France, Italy (Piemonte), Latvia, the Netherlands, Austria, Poland, Portugal (Azores), Romania and Finland.

THE COMMISSION'S REPLIES

4.11. The Commission notes that the frequency of errors found by the Court in agri-environment payments has decreased from 26% in 2012 to 19% in 2013.

The Commission has audited the implementation of agri-environmental measures in all Member States in the 2007-2013 programming period. Remaining weaknesses notwithstanding, the overall quality of the implementation has improved over the period.

Box 4.1 — Example of eligibility error: non-compliance with agri-environment commitments

Regarding the Member States mentioned by the Court, the Commission also detected weaknesses and conformity clearance procedures are underway in respect to Hungary, Italy (Piemonte), the Netherlands, Poland and Romania, which will lead to net financial corrections covering the risk to the EU budget

4.12. On the basis of its own audit results the Commission has applied net financial corrections in this respect and will continue to do so as necessary. In the action plans for reducing the rural development error rate, eligibility and selection criteria are two of the areas addressed.

Box 4.2 — Example of eligibility error: ineligible beneficiary

The Commission shares the Court's appreciation of the example in Box 4.2 which it will follow up through the conformity clearance procedure. The Commission was already aware of the shortcoming identified; it has found weaknesses in the check of the eligibility criteria for small and medium enterprises during one of its own audit missions to Portugal in 2012. A net financial correction will be proposed for these shortcomings though the conformity clearance procedure

THE COURT'S OBSERVATIONS

4.13. For 24 transactions examined, the beneficiary was required to comply with public procurement rules. These rules are designed to ensure that the goods and services required are purchased on the most favourable terms, while guaranteeing equal access to public contracts and compliance with the principles of transparency and non-discrimination. The Court found that in 11 cases, one or more of these rules had been breached. Of these, 5 were reported as quantifiable errors because they represented serious infringements of procurement rules, an illustration of which is in Box 4.3.

Box 4.3 — Example of eligibility error: non-respect of procurement rules

In France, a rural municipality received EAFRD funding for a project concerning the renovation and extension of a public building, including construction works and consultancy services.

For one contract forming part of the project the municipality did not award a contract to the lowest bidder, without any documentation justifying this treatment. For the consultancy services, the beneficiary received three expressions of interest without price quotations. While the professional capacity of all three bidders was considered adequate for the project, the beneficiary negotiated the price with only one company, and concluded the contract without asking for offers from the other two bidders.

Due to the non-respect of the basic procurement principles of equal treatment and transparency, the expenditure concerned is ineligible.

The Court also found breaches of public procurement rules in Bulgaria, Germany (Brandenburg and Berlin, Saxony), Spain (Andalucia), the Netherlands, Poland, Romania and Finland.

THE COMMISSION'S REPLIES

4.13. Public procurement is a central element in the rural development action plans mentioned in paragraph 4.8.

The Commission would also like to underline that an error in public procurement does not necessarily mean fraud or misuse of EU funds. Nor does non-respect of procurement rules necessarily entail that 100 % of the expenditure concerned has been misused. Very often, the policy objectives for the individual action have indeed been met and the taxpayers' money has not been lost.

To enforce the existing rules on public procurement the Commission has adopted new guidelines for determining net financial corrections to be made to expenditure financed by the Union under shared management, for non-compliance with the rules on public procurement (Commission Decision C(2013) 9527). Pertaining to these guidelines, the non-respect of procurement rules is judged based on principle of proportionality. Regarding the examples cited by the Court in Box 4.3, the Commission services also found significant shortcomings in certain Member States. The conformity clearance procedures are underway and net financial corrections will be applied if needed.

Box 4.3 — Example of eligibility error: non-respect of procurement rules

See reply to paragraph 4.13.

See reply to paragraph 4.13.

THE COURT'S OBSERVATIONS

4.14. Weaknesses in management and control systems can affect a large number of payments, as they concern all transactions of the same type processed through the relevant system. Of the 92 errors detected by the Court, 40 % resulted from conditions affecting more than one transaction. These errors may or may not have a financial impact. An example of such an error is included in Box 4.4.

Box 4.4 — Example of error affecting more than one transaction

Farmers of pre-retirement age who cease agricultural activity in order to transfer the holding to other farmers may benefit from early retirement support under EAFRD. In Poland, the rural development programme stipulates that the amount of early retirement support should be reduced by the amount of the state pension, once a beneficiary has reached the statutory retirement age and has been subject to pension insurance for at least 25 years.

The paying agency did not have appropriate checks in place to ensure compliance with this requirement. Thus, a 63-year old beneficiary continued to receive the full amount of early retirement support without deduction of the state pension, despite fulfilling the conditions for the latter. The Court concludes that the part of the early retirement support that should have been paid from the national social security fund in the form of a state pension is ineligible for EAFRD funding. This error in Poland affects other transactions where a farmer fulfills the conditions described in the above paragraph.

Errors affecting more payments than the one examined, and with a financial impact were also found in the Netherlands, Portugal (Azores, Continental) and Finland.

THE COMMISSION'S REPLIES

Box 4.4 — Example of error affecting more than one transaction

The Commission wishes to clarify that there is no suggestion here that there was a double payment to the retiree, it is rather that the EU budget has borne costs that should have been funded from the national budget.

The Commission shares the Court's view that the national authorities should have ensured that any rights to national pensions should have been deducted from the early retirement support, regardless of the fact that the beneficiary did not claim his national pension. In the framework of the conformity clearance procedure, the Commission is following up the Court's findings vis-à-vis the national authorities with a view to protecting the financial interest of the EU and recovering any undue payments.

In the framework of the conformity clearance procedure, the Commission is following up the Court's findings of systemic error (i.e. deficiencies in the management and control systems) with a view to protecting the financial interests of the EU and recovering any undue payments through net financial corrections.

THE COURT'S OBSERVATIONS

4.15. Under certain EAFRD aid schemes⁽¹⁸⁾, beneficiaries of EU aid have a legal obligation to fulfil 'cross-compliance' conditions, as described in paragraph 3.12. While 24 (39 %) of the 61 farmers visited who were subject to cross-compliance requirements failed to observe them, the impact on the estimated error rate is relatively low (0,2 percentage points). Farmers were particularly likely to breach the rules on the identification and registration of animals.

Environment, fisheries and health

4.16. As regards environment, fisheries and health, of 15 transactions sampled, four (27 %) were affected by non-quantifiable errors.

EXAMINATION OF SELECTED CONTROL SYSTEMS**Rural development**

Member States' systems related to the regularity of transactions

4.17. **Annex 4.2** contains a summary of the results of the systems examined by the Court⁽¹⁹⁾.

THE COMMISSION'S REPLIES

4.15. *The respect of cross-compliance obligations does not constitute an eligibility criterion for CAP payments and, therefore, the controls of these requirements do not pertain to the legality and regularity of the underlying transactions. Cross-compliance is a mechanism by which farmers are penalised when they do not respect a series of rules which stem in general from policies other than the CAP and apply to EU citizens independently of the CAP. Thus, the Commission considers that reductions imposed for violations of cross-compliance requirements should not be taken into account for the calculation of the error rates for the CAP.*

The Commission also considers that in the new CAP legal framework, the legislator has explicitly confirmed this approach for all CAP support by stipulating in Article 97(4) of Regulation (EU) No 1306/2013 that 'The imposition of an administrative penalty shall not affect the legality and regularity of the payments to which it applies'.

Concerning the problems found for the identification and registration of animals, the Commission shares the Court's observation and pays particular attention to these requirements during its own cross-compliance audits.

⁽¹⁸⁾ As set out in Article 50a of Council Regulation (EC) No 1698/2005 (OJ L 277, 21.10.2005, p. 1).

⁽¹⁹⁾ For area-related rural development measures, verification of certain key elements such as eligible area is made through the Integrated Administration and Control System (IACS), described in paragraph 3.17. Other eligibility requirements are governed by specifically designed controls. As described in **Annex 3.2**, the Court assessed the IACS systems in four paying agencies and found them to be effective in one case, partially effective in two cases and not effective in one case.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

4.18. Member States' authorities are responsible for putting in place and operating in particular:

- (a) appropriate administrative and control procedures to ensure the accuracy of declarations made by the claimant and the fulfilment of eligibility requirements;
- (b) on-the-spot checks which, depending on the aid scheme, should cover at least 5% of all beneficiaries or of the expenditure ⁽²⁰⁾;
- (c) a system for ensuring that cross-compliance requirements are met.

4.19. The Court's audit covered compliance with the provisions of the relevant regulations and an assessment of the effectiveness of the systems in ensuring the regularity of transactions. In order to achieve broader systems coverage and efficiency gains, the Court based its system assessments partly on audits carried out by the Commission (DG AGRI) (see further paragraph 4.23).

4.20. For the Member States' systems examined, the Court identified the following main weaknesses ⁽²¹⁾:

- deficiencies in administrative checks related to eligibility conditions and commitments, such as non-detection of ineligible VAT or risk of double financing, in seven out of eight Member States;

4.20. *The Commission is aware of weaknesses in the Member States' control system for EAFRD. In DG AGRI's 2013 AAR, almost half of the paying agencies have been placed under reservation for EAFRD expenditure with a request to take the necessary remedial action. As mentioned by the Court in paragraph 4.19, part of its own assessment of Member State systems is based on the findings of the conformity audits carried out by the Commission services.*

Whenever, in the framework of its audits, the Commission identifies weaknesses in administrative checks, it pursues them through the conformity clearance procedure to protect the EU's financial interests.

The Commission is aware of the shortcomings concerning problems related to eligibility, including procurement procedure and VAT. These issues are at the heart of the audits carried out in the Member States on investment measures. Also in the action plans set up with MS for reducing the error rates, these problems have been and are still being addressed.

For the 2014-2020 financing period, the rules concerning the eligibility for VAT for public bodies have been simplified, which should reduce the risk for errors.

⁽²⁰⁾ Articles 12 and 25 of Commission Regulation (EU) No 65/2011 (OJ L 25, 28.1.2011, p. 8).

⁽²¹⁾ **Annex 4.2** indicates the specific Member State in which the weakness was found.

THE COURT'S OBSERVATIONS

- insufficient evaluation of the reasonableness of the costs in all four Member States where this aspect was checked, by, e. g., comparison with reference costs and use of competitive bidding;

- weaknesses in the follow-up of irregularities identified by paying agencies, including the application of reductions or recoveries in four out of six Member States;

- insufficient quality of on-the-spot checks (e.g., they did not cover all commitments and obligations), in five out of eight Member States;

- deficiencies in the design and implementation of the control system for cross-compliance checks in all four Member States, such as insufficient national GAEC standards or incorrect national implementation of the Nitrates Directive.

These weaknesses were very similar to those found and reported concerning the Member States' systems which were examined in the last two years⁽²²⁾. Such weaknesses explain in large part the errors detected during transaction testing (see paragraph 4.8).

THE COMMISSION'S REPLIES

The Commission shares the view that administrative checks of the reasonableness of costs are essential for ensuring the effectiveness of the control system. The Commission has during its conformity audits also found weaknesses in the assessment of reasonableness of cost and has imposed net financial corrections in this respect to protect the EU's financial interest.

The Commission would like to note that for the next programming period, 2014–2020, simplified costs for the reimbursement of payments (flat-rate financing, standard scale of unit costs and lump sums) will be used more widely. This should contribute to a more efficient and correct use of the Funds.

Through conformity clearance procedures, the Commission follows up any systemic deficiencies identified in the framework of its audits, including those relating to the Member States' irregularity and debt management. At the end of such procedures the total risk to the EU budget is covered by net financial corrections. For the four Member States mentioned by the Court, the Commission is aware of deficiencies and conformity clearance procedures are already underway in order to protect the EU Budget.

The Commission itself has also identified shortcomings concerning the quality of on-the-spot checks. In order to protect the EU's financial interests, the Commission systematically pursues shortcomings via the conformity clearance procedure.

The Commission shares the Court's point of view on three of the Member States, as confirmed by the results of the Commission's cross-compliance audits in those paying agencies.

The fourth Member State has been included in the audit programme for 2015.

⁽²²⁾ 2012 annual report, chapter 4, paragraphs 4.21 to 4.25, and 2011 annual report, chapter 4, paragraphs 4.22 to 4.32.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

4.21. The Court found weaknesses in the checks of procurement rules, which were apparent in all three Member States where this requirement was examined. The Court examined 17 transactions involving public procurement, of which eight (47 %) were affected by errors. In three of the eight cases, ineligible expenditure was found, amounting in total to more than 4,8 million euro of EAFRD aid. An example involving ineligible expenditure not detected by a Member State's checks is given in Box 4.5.

Box 4.5 — Example of insufficient quality of a Member State's administrative checks

For one public procurement case checked in Latvia, the paying agency itself was the beneficiary of 2 million euro in EAFRD aid, which concerned its outsourced IT system.

The Court found that the contract for the IT system and subsequent IT maintenance was awarded to a company by a public procurement procedure affected by several serious errors. For instance, the paying agency unduly applied a negotiated procedure, for which the conditions were not satisfied, rather than an open or restricted procedure as required by legislation. Failure to follow the required procedures renders the expenditure ineligible for EU financing.

In the last two years, the Court has reported very similar cases concerning the procurement of IT systems and services where the paying agency itself was the beneficiary of EAFRD aid and did not respect public procurement rules⁽²³⁾. This shows that the bodies responsible for checking EU aid do not always respect the rules themselves.

Box 4.5 — Example of insufficient quality of a Member State's administrative checks

The issues mentioned by the Court will be followed up by the Commission in a conformity audit.

Regarding the examples mentioned in the Court's previous annual reports, the Commission is following up the Court's findings in the framework of the conformity clearance of accounts procedures and will apply net financial corrections where appropriate.

The Commission's systems related to the regularity of transactions

The Commission's clearance of accounts procedures

4.22. Management of most expenditure on agriculture is shared between Member States and the Commission. Aid is paid by the Member States, which is then reimbursed by the Commission (on a monthly basis for EAGF and on a quarterly basis for EAFRD). To enable it to assume final responsibility for implementation of the budget, the Commission applies two separate procedures:

⁽²³⁾ 2012 annual report, chapter 4, Box 4.6, and 2011 annual report, chapter 4, Box 4.2.

THE COURT'S OBSERVATIONS

- (a) an *annual financial clearance procedure* covering the annual accounts and internal control system of each accredited paying agency. The resulting clearance of accounts decision is based on audits carried out by independent certification bodies in the Member States, which are submitted to the Commission;
- (b) a *multiannual conformity clearance procedure*, which may lead to financial corrections for the Member State concerned if expenditure has infringed EU rules in one or several financial years. The resulting conformity decisions are based on conformity audits performed by the Commission.

4.23. The Court checked the compliance of 20 of the Commission's conformity audits with international audit standards. Most key elements were in place and compliant with the main regulatory requirements. The Court noted improvements compared to last year, e.g. concerning audit documentation, and found that the results of the Commission's EAFRD and cross-compliance audits were of sufficient quality to be used by the Court as part of its own assessments of Member State systems. However, weaknesses remain, in particular for EAGF, in relation to quality control, the systematic use of checklists, and the way evidence is evaluated and conclusions formed. Similar observations were reported by the Court in the last two years ⁽²⁴⁾.

4.24. DG AGRI reported that in 2013 its conformity audits covered 42 % of EAGF and EAFRD expenditure, the same percentage as reported for 2012. The expenditure covered by the Commission's audit is directly related to financial corrections. However, the Court could not check the accuracy of the figure reported, as the Commission could not provide the Court with sufficient information on how it was calculated.

THE COMMISSION'S REPLIES

4.23. *The Commission welcomes the Court's acknowledgment of improvements made in respect of audit procedures. In relation to weaknesses identified for the EAGF, work continues in order to improve the system.*

4.24. *The Court has made some interesting and pertinent observations on the detailed methodology for calculating the expenditure coverage of audits. The Commission will examine them with a view to aligning its coverage calculations in the context of its new multiannual audit work programme.*

⁽²⁴⁾ 2012 annual report, chapter 4, paragraph 4.27, and 2011 annual report, chapter 4, paragraph 4.41.

THE COURT'S OBSERVATIONS

4.25. The Commission's conformity audits are systems-based, and do not check the regularity of underlying transactions. Samples are selected on a judgemental or random basis, and cover expenditure relating to several budgetary years, but are not representative. As a consequence, the Commission's audit work does not enable it to calculate an annual error rate, and the financial corrections resulting from the audits are in most cases made on a flat-rate basis. Flat-rate corrections should be used where it is not possible to identify precisely the amounts unduly spent⁽²⁵⁾. Moreover, the flat-rate corrections, typically 2% or 5%, are applied regardless of how many control weaknesses were found.

THE COMMISSION'S REPLIES

4.25. *The Certification Bodies shall, from claim 2014, check a representative sample of transactions which will enable them to give an opinion on the legality and regularity and to validate an error rate. On the other hand, the aim of the conformity audit work of the Commission is to obtain assurance that the management and control systems as implemented by the MS under shared management of the CAP comply with the rules and, where those systems are found to be deficient, to protect the EU budget via net financial corrections. The Commission's conformity clearance audits do not aspire to perform a substantive testing that would enable it to calculate error rates in respect of each paying agency for which a financial correction is considered. The samples tested during missions are intended to test the system under examination. Thus they are not required to be representative.*

Net financial corrections are determined on the basis of the nature and gravity of the infringement and the financial damage caused to the EU budget. Where possible, the amount is calculated on the basis of the loss actually caused or on the basis of an extrapolation. Where this is not possible with proportionate efforts, where Member States do not avail of the opportunity to do the additional work necessary to provide a calculated assessment of the loss to the EU Budget or, where the latter is incomplete or not sufficiently precise, flat rates are used which take account of the nature and gravity of the deficiencies identified in the national management and control systems. The rules for application of financial corrections were revised in the Horizontal Regulation for the CAP legal framework 2013-2020 (Regulation (EU) No 1306/2013), which requires the precise criteria for estimating the risk to the EU. In that respect, the provisions in the Delegated Act set out more precisely the method and criteria for calculating the net financial correction in due proportion to the risk of irregular expenditures. For instance more stringent rules and higher net financial corrections will apply where there are three or more different deficiencies in a control system.

⁽²⁵⁾ Article 80(4) of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union (OJ L 298, 26.10.2012, p. 1) specifies that 'The Commission shall make financial corrections on Member States in order to exclude from Union financing expenditure incurred in breach of applicable law. The Commission shall base its financial corrections on the identification of amounts unduly spent, and the financial implications for the budget. Where such amounts cannot be identified precisely, the Commission may apply extrapolated or flat-rate corrections in accordance with the sector-specific rules.'

THE COURT'S OBSERVATIONS

4.26. In 2013, the Commission took four conformity decisions, leading to financial corrections of 1 116,8 million euro (861,9 million euro relating to EAGF, 236,2 million euro to EAFRD and 18,6 million euro to others). Flat-rate corrections formed 66 % of these financial corrections, which is very similar to the average proportion of the last five years (65 %).

4.27. Financial corrections adopted in 2013 represent around 2 % of the EU's 2013 budget for agriculture and rural development, which is higher than the average level of financial corrections applied in the period 2008-2012 (1,4 %). This is mainly explained by the reduction of the backlog of open audit files from 553 at the end of 2012 to 516 at the end of 2013. The resolution and closure of these files, which related to financial years prior to 2010, resulted in financial corrections of 881 million euro (79 % of the total) in 2013. A sizable backlog of old files still remains, in particular for EAGF and for irregularities, for which 46 files are still open relating to audits carried out between 2007 and 2009.

THE COMMISSION'S REPLIES

4.26. *Flat-rate net financial corrections are only applied where the Commission cannot, with proportionate effort, calculate more precisely the risk for the EU budget. The criteria and methodology for applying flat-rate corrections are set out transparently in a Commission working document (VI/5330/97 of 23 December 1997) in order to ensure that the risk for the EU budget is covered. See also reply to paragraph 4.25.*

4.27. *For the CAP the Commission applies always 'net' financial corrections, i.e. they are actually reimbursed by the Member States to the EU budget.*

The Commission is taking action to address the number of open audit files, and DG AGRI has recruited five qualified staff who exclusively work on eliminating the backlog.

Moreover, DG AGRI already implements a closer monitoring of the management of the procedural delays.

The Commission is, through the new legal framework of the CAP, taking action aiming at streamlining the entire conformity procedure and limiting the risk of unnecessary delays. In particular, deadlines for each step of the conformity procedure are being introduced for both Member States and the Commission in Article 34 of the draft Implementing Regulation expected to be adopted by the Commission in July 2014.

The Commission agrees that there is scope for significantly speeding up the conformity procedure. However, the conformity procedure requires certain steps to be applied in sequence as established in Regulation (EU) No 1306/2013 (a contradictory phase constituting the core part of a standard conformity clearance procedure; and a conciliation phase at the request of the Member State). For more complex cases the two phases of the conformity procedure (contradictory followed by conciliation), the respect of the Member State's right to challenge the Commission's findings and the need for the correction to be in proportion to the seriousness of the deficiency may require significant additional work.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

DG AGRI's annual activity report (AAR)

4.28. DG AGRI's AAR⁽²⁶⁾ contains reservations for rural development expenditure for 31 paying agencies in 19 Member States. The reservations were issued 'due to the significant occurrence of weaknesses in the underlying transactions'. The amount under reservation is 599 million euro, based on a residual error rate (RER)⁽²⁷⁾ of 5,19%. This is a significant increase from the previous year, when the RER was 1,62% based on Member States' control statistics⁽²⁸⁾.

4.29. The large increase in the RER for 2013 results from the Commission's revised approach compared to 2012. The Commission now takes account of its own conformity audits, as well as the Court's audits, the yearly reports of the certification bodies and any other available information in assessing the error rate for paying agencies. For 2013, out of 69 paying agencies, the Commission adjusted the error rates reported by Member States for 43 out of 48 paying agencies audited by the Commission and the Court in the last three years. However, for expenditure not covered by the Commission's or the Court's audits, no adjustments were made. This may have an impact on the RER.

4.28. In its 2012 Annual Report, the Court recommended in chapter 4 that, for future exercises, DG AGRI apply to the EAFRD the new methodology it had used for 2012 for calculating the error rate and amount at risk for decoupled direct aids (EAGF). It was as a direct result of applying this new methodology that the RER for EAFRD calculated for 2013 diverges from that under the old methodology in 2012 and previous years. As a result of the more precise estimation of the amount at risk at paying agency level, the reservations for EAFRD were dropped for half of the paying agencies.

4.29. The Commission assesses the error rates reported by the paying agencies and makes adjustments on the basis of 'all available relevant information'. All paying agencies are subject to audit by the Certification Bodies every year (even if the Commission acknowledges that the assurance to be obtained from the certification body opinions remains to be enhanced — this is done from claim year 2014). Additionally, since the audits carried out by the Commission are determined on the basis of a risk analysis, it can be considered that the paying agencies not audited in the previous three years are considered to have a lower risk. Further adjustments not based on actual and specific evidence would lead to an overestimation of the RER.

Furthermore, it is underlined that, where the Commission adjusts the error rate of a paying agency, this may result in a reservation being required and therefore also a plan of remedial action for the paying agency concerned. This would have financial and human resource implications for that paying agency without the Commission having had objective elements on which to base the adjustment.

⁽²⁶⁾ http://ec.europa.eu/atwork/synthesis/aar/index_en.htm.

⁽²⁷⁾ The residual error rate is the Commission's estimate of the error which remains after correction of the errors detected by the Member States' supervisory and control systems.

⁽²⁸⁾ Although the Commission indicated that the RER for 2012 was likely to be higher, it did not provide its own quantified estimate.

THE COURT'S OBSERVATIONS

4.30. Following DG AGRI's reservation for EAFRD in its 2011 and 2012 AARs, all Member States were invited to develop action plans aimed at reducing the error rate for this policy area. While the Court acknowledges the efforts undertaken, a review of a sample of action plans showed that their quality and scope varied significantly. A particular weakness is that the action plans do not sufficiently take into account the Commission's and Court's audit findings. An example of good practice was found in Romania, which identified 19 different actions, covering both area and non-area-related measures, and addressing weaknesses identified in audits. In contrast, in Spain an example was found where only 9 of the 17 regions contributed to the national action plan, which, moreover, mainly focused on area-related measures and not on the investment measures which the Court has found to be more error-prone.

Environment, fisheries and health

4.31. The Court examined the systems in Poland under the responsibility of the EFF audit authority, and the main elements of DG MARE's systems for managing EFF expenditure.

Member States' systems related to the regularity of transactions

4.32. **Annex 4.2** contains a summary of the results of the systems examined by the Court.

4.33. The main objective of the Court's audit was to test the key requirements applicable to the management and control system used by the audit authority in Poland to ensure the regularity of EFF funded operations. In addition, the Court reperformed the audit authority's audits on operations funded by the EFF. The main weaknesses found concern the verification of eligibility conditions.

THE COMMISSION'S REPLIES

4.30. *Once the Court in 2012 reported a high error rate for rural development, the Commission immediately took action in close collaboration with the Member States. In 2012 action plans were set up in 14 Member States and from 2013 onwards in all Member States with the aim to identify the causes of errors and define remedial actions. A considerable effort has been made by both the Member States and the Commission. This has been a learning process for all parties involved, but the Commission is of the opinion that it has been successful so far. No doubt with the benefit of hindsight some actions could have been more targeted, others could have been timed differently etc. The Commission is taking on board the Court's comments in the continued work with the Member State authorities in view of further enhancing the effort in reducing the error rates.*

The Commission is closely monitoring that the action plans address the main audit findings and shortcomings. On those specific cases where the Member State is persistently ignoring relevant issues related to an increased error rate, the Commission may activate net financial corrections or suspension/interruptions of payments.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The Commission's systems related to the regularity of transactions

4.34. The Court examined DG MARE's systems of risk assessment, audit planning and financial corrections for the EFF, focusing on Poland, to complement the audit of that Member State's systems. The audit found that a financial correction for Poland, while based on detailed calculations, had not been supported by sufficient evidence of its validation.

4.34. *The financial correction was made in respect of non-compliance with Article 25(2) of Regulation (EC) No 1198/2006. It was not made in isolation: a dedicated working group was set up in DG MARE to analyse such cases. It involved the operational units and the conservation and control units, to ensure consistency of treatment of Member States and effective dissemination of information.*

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

4.35. For this policy group,

— testing of transactions indicates that the most likely error present in the population is 6,7 %;

— of the 13 control systems examined, seven were assessed as partially effective and six as not effective.

Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

4.35.

The Commission notes that the error rate reported by the Court is an annual estimate which takes account of recoveries and corrective measures effected prior to the Court's audits. The Commission also notes that expenditure concerned shall be subject to correction in subsequent years through net financial corrections resulting from conformity clearance procedure as well as through recoveries from beneficiaries. The Commission considers that the Court's annual representative error rate should be seen in the context of the multiannual character of net financial corrections and recoveries. The Commission takes note of the most likely error rate estimated by the Court of Auditors.

However, it does not agree, in particular, with the qualification by the Court of infringements to cross-compliance obligations as quantifiable errors, and consider that these should not be included in the calculation of its DAS error rates.

See also the Commission's reply to paragraph 4.15 for a detailed explanation of its position in this regard.

The Commission notes that the results presented are similar to the results of last year.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

4.36. **Annex 4.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented 11 recommendations. Out of these recommendations, one was implemented fully, two in most respects, six in some respects and two were not implemented.

4.37. Following this review and the findings and conclusions for 2013, the Court recommends in the area of rural development that:

- **Recommendation 1:** the Member States carry out their existing administrative checks better, by using all relevant information available to the paying agencies, as this has the potential to detect and correct the majority of errors (see paragraphs 4.8 and 4.20). In particular for investment measures, administrative checks should use all available information to confirm the eligibility of the expenditure, project and beneficiary (including all ultimate shareholders) and compliance of public procurement procedures with the applicable EU and/or national rules;

- **Recommendation 2:** the Commission ensures that all cases where the Court detected errors are followed up appropriately (as identified in paragraphs 4.14, 4.20 and 4.21, as well as in paragraph 4.16 for environment);

4.36. See replies in Annex 4.3 for the 10 recommendations concerning the rural development.

The Commission accepts the recommendation and shares the view that the Member States should carry out their administrative checks better.

Paying Agencies and Member States are currently jointly carrying out ex ante assessments on the verifiability and controllability of the measures that will be part of the RDPs 2014-2020. They are obliged to accompany any identified source of errors with targeted mitigating actions.

The Implementing Act of Regulation (EU) No 1306/2013 will clarify the scope and content of the administrative, on-the-spot and ex post checks.

To better protect the EU financial interest the Commission has reinforced the rules for the interruption of payments in rural development in cases where Member States do not correctly play their role under shared management rules.

The Commission accepts the recommendation and will ensure that all systemic errors detected by the Court are followed up as appropriate.

THE COURT'S OBSERVATIONS

- **Recommendation 3:** the Member States ensure that action plans to address the high error rate in rural development are complete, by including all regions and addressing all measures, particularly investment measures, and take the Commission's and Court's audit findings into account (see paragraph 4.30);

and for the CAP as a whole that:

- **Recommendation 4:** the Commission documents how it calculates the expenditure covered by its conformity audits (see paragraph 4.24);
- **Recommendation 5:** The Commission takes steps to further reduce the backlog of open audit files, so as to enable all audits carried out prior to 2012 to be closed by the end of 2015 (see paragraph 4.27);
- **Recommendation 6:** The Commission further develops its approach to calculating the RER by ensuring that it takes into account all expenditure and paying agencies (see paragraph 4.29).

4.38. Furthermore, the Court recommends that:

- **Recommendation 7:** financial corrections to Member States concerning the European Fisheries Fund are supported by evidence of their validation (see paragraph 4.34).

THE COMMISSION'S REPLIES

The Commission accepts the recommendation. The Commission is working intensively with the Member States in order to identify and remedy the causes of errors in the implementation of the policy. This work will continue for the foreseeable future with the aim to further address identified shortcomings, including those found by the Court of Auditors.

The last follow-up process of the action plans on error rates conducted in March 2014 already asked all MS to link the action plans and mitigating actions to different audit findings communicated by the Commission or the Court of Auditors. The following follow-up exercise will be launched during autumn 2014 and will deepen in this issue. An audit progress report is being presented quarterly in order to follow up main findings.

The Commission is notably taking this issue on board in all Annual Review meetings and Monitoring Committees with the Managing Authorities, insisting in the completeness and effectiveness of the action plans.

The Commission accepts the recommendation. Information on the audit coverage, including all underlying detailed information related with the points raised by ECA was communicated to ECA in the first week of June 2014.

The Commission accepts the recommendation. For the past years this priority has been actively pursued by the Commission services and is reflected in the annual work planning.

The Commission accepts this recommendation in the sense that as from claim year 2014 the Certification Bodies will audit the legality and regularity of the transactions on the basis of a representative sample and this will provide more robust information on the level of error at paying agency level.

The Commission accepts the recommendation.

ANNEX 4.1

RESULTS OF TRANSACTION TESTING FOR RURAL DEVELOPMENT, ENVIRONMENT, FISHERIES AND HEALTH

	2013		2012	2011	2010
	Rural development	Environment, fisheries and health			
SIZE AND STRUCTURE OF THE SAMPLE					
Total transactions:	162	15	177	178	92
RESULTS OF TESTING ⁽¹⁾ ⁽²⁾					
Proportion (number) of transactions tested found to be:					
Free of error	43 % (70)	73 % (11)	46 % (81)	43 %	48 %
Affected by one or more errors	57 % (92)	27 % (4)	54 % (96)	57 %	52 %
Analysis of transactions affected by error					
Analysis by type of error					
Other compliance issues and non-quantifiable errors:	48 % (44)	100 % (4)	50 % (48)	38 %	48 %
Quantifiable errors:	52 % (48)	0 % (0)	50 % (48)	62 %	52 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS					
Most likely error rate			6,7 %	7,9 %	n.a.
Upper Error Limit (UEL)			9,9 %		
Lower Error Limit (LEL)			3,5 %		
⁽¹⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments. ⁽²⁾ Numbers quoted in brackets represent the actual number of transactions.					

ANNEX 4.2

RESULTS OF EXAMINATION OF SELECTED SYSTEMS FOR RURAL DEVELOPMENT, ENVIRONMENT, FISHERIES AND HEALTH

Assessment of selected supervisory and control systems

Table 1

Member State (Paying agency)	Rural development measures audited	Administrative checks related to eligibility conditions and commitments	Evaluation of the reasonableness of the costs	Follow-up of irregularities including the application of reductions or recoveries	Checks of procurement rules	On-the-spot checks and sample selection	Overall assessment
Germany (North Rhine-Westphalia)	Area-related (M211, M212, M213, M214, M215)	Partially effective	n/a	Partially effective	n/a	Partially effective	Partially effective
Spain (Valencia)	Area-related (M211, M212, M214)	Partially effective	n/a	Not effective	n/a	Partially effective	Partially effective
Malta	Area-related (M212, M214)	Partially effective	n/a	Not effective	n/a	Partially effective	Partially effective
Slovenia	Area-related (M211, M212, M214)	Partially effective	n/a	Effective	n/a	Effective	Partially effective
Italy (Sicily)	Non-area-related (M121, M123, M311, M511)	Partially effective	Not effective	Effective	Not effective	Effective	Not effective
Latvia	Non-area-related (M121, M123, M321, M511)	Not effective	Not effective	Not effective	Not effective	Partially effective	Not effective
Poland	Non-area-related (M321, M322)	Effective	Not effective	n/a	Partially effective	Effective	Partially effective
Romania	Non-area-related (M312)	Not effective	Not effective	n/a	n/a	Partially effective	Not effective

Member State (Paying agency)	Rural development measures audited	Administrative checks related to eligibility conditions and commitments	Evaluation of the reasonableness of the costs	Follow-up of irregularities including the application of reductions or recoveries	Checks of procurement rules	On-the-spot checks and sample selection	Overall assessment
Number of Member States with weaknesses/ Number of Member States audited		7/8	4/4	4/6	3/3	5/8	
Area-related measures audited:	M211: natural handicap payments to farmers in mountain areas; M212: payments to farmers in areas with handicaps, other than mountain areas; M213: Natura 2000 payments and payments linked to Directive 2000/60/EC; M214: agri-environmental payments; M215: animal welfare payments						
Non-area-related measures audited:	M121: farm modernisation; M123: adding value to agricultural and forestry products; M311: diversification into non-agricultural activities; M312: business creation and development; M321: basic services for the economy and rural population; M322: village renewal and development; M511: technical assistance						

Table 2

Member State (Paying agency)	Scheme	Follow-up of irregularities including the application of reductions or recoveries	Implementation of cross-compliance standards and good agricultural and environmental condition	On-the-spot checks and sample selection	Overall assessment
Czech Republic	Cross-compliance	Partially effective	Not effective	Partially effective	Not effective
Spain (Castilla y León)	Cross-compliance	Not effective	Not effective	Partially effective	Not effective
Italy (Emilia-Romagna)	Cross-compliance	Partially effective	Not effective	Not effective	Not effective
Malta	Cross-compliance	Partially effective	Partially effective	Partially effective	Partially effective
Number of Member States with weaknesses/Number of Member States audited		4/4	4/4	4/4	

Table 3

Member State	General aspects	Audit manual coverage	Audit methodology for systems audit	Review of audits on systems	Sampling methodology for audits of operations	Audit methodology for audits of operations	Review of audits of operations	Re-performance of audits on operations	Annual control report and audit opinion	Overall assessment
Poland (audit authority for the European Fisheries Fund)	Effective	Effective	Effective	Partially effective	Effective	Partially effective	Effective	Partially effective	Effective	Partially effective

ANNEX 4.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR RURAL DEVELOPMENT, ENVIRONMENT, FISHERIES AND HEALTH

Year	Court recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented In most respects	In some respects	Not implemented	No longer applicable		Insufficient evidence
2011	4.53. It should be noted that the Court's recommendation to further simplify the rules and conditions for rural development remains valid.			X				<p>The Commission is continually alert to opportunities to simplify the rules and conditions for rural development while bearing in mind that many of these conditions are additional elements added by Member States and this places them outside the Commission's sphere of influence.</p> <p>The new legislation for rural development for the 2014-2020 programming period which entered into force at the end of 2013 introduced a number of simplification elements and also required that measures set out in the programmes are verifiable and controllable. However, now that this legislation is in place, the scope of the Commission to impose further simplification measures is somewhat limited during the 2014-2020 programming period.</p> <p>The results of the new simplification elements introduced will be visible only during the upcoming implementation period.</p>

Year	Court's recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2011	<p>4.54. Following this review and the findings and conclusions for 2011, the Court recommends in the area of rural development for the current programming period that:</p> <p>Recommendation 1: the Member States carry out administrative and on-the-spot checks in a more rigorous manner so as to mitigate the risk of declaring ineligible expenditure to the EU.</p>			X				<p>The Commission agrees with the Court and systematically recommends Member States to remedy any such deficiencies in the framework of its conformity clearance procedures.</p> <p>In its 2013 AAR, DG AGRI made 62 reservations and has required that action be taken to remedy the deficiencies. Failure by paying agencies to take the necessary action can lead to suspension of payments by the Commission.</p> <p>Furthermore, the new work which will be carried out by the Certification Bodies from financial year 2015, in order to deliver an opinion on legality and regularity, will also help to identify deficiencies in the effectiveness of the Paying Agencies' checks and direct them towards the improvements necessary to ensure that checks are performed with the necessary rigour.</p> <p>In the event that ineligible expenditure is declared by the Member States, the Commission protects the EU budget by recovering undue payments via net financial corrections.</p>
	<p>Recommendation 2: the Commission and the Member States ensure that the existing rules are better enforced concerning:</p> <ul style="list-style-type: none"> — public procurement and VAT rules when public bodies are beneficiaries of the aid, — agri-environment commitments and eligibility rules for modernisation of holdings. 			X				<p>DG AGRI during its own audits has also found similar weaknesses to those identified by the Court and follows them up through the conformity clearance procedure. Where a risk to the EU budget is determined, net financial corrections are imposed. Ongoing conformity clearance procedures are pursuing deficiencies detected with regard to application of VAT and public procurement rules as well as the rural development measure referred to.</p> <p>Regarding public procurement, it is noted that new Commission-wide guidelines for determining net financial corrections to be made to expenditure financed by the Union under shared management, for non-compliance with the rules on public procurement, have been recently adopted (Commission Decision C(2013) 9527).</p>

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2011	Recommendation 3: the Commission analyses the reasons for the material error rate.		X					Between 2012 and 2013, the Commission analysed, via a working group, what were the main reasons for the error rate. The results were set out in a Commission Staff Working Document which was presented to the European Parliament and the Council in June 2013 on the assessment of root causes of errors and corrective and preventive actions in the rural development policy (SWD(2013)244 final).
	Recommendation 4: the Commission takes account of the findings identified by the Court when establishing the audit strategy of DG AGRI's clearance of accounts audits.	X						The Commission has organised several seminars with the Member States to discuss the matter and will continue to analyse the reasons for any new elements which are identified.
	Recommendation 5: the Commission extends the guidelines for the certification bodies with the requirement that these bodies include, in their audit strategy and reports, findings from previous audits by the Commission and the Court.				X			N/A. The Commission considers that this recommendation is fully implemented. This issue is addressed in the guideline to be applied by the CBs post-2013 at two steps during the audit work: (1) at planning stage, based on an initial risk analysis that should duly consider all the available information, including ECA's prior findings; these should be properly substantiated in the audit strategy (see section 3.2 in the guideline); and (2) at error evaluation stage, when the CB is expected to perform an analysis whether their results are or are not put into questions by any relevant information coming from other verification channels (among which the ECA, EC).

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented In most respects	In some respects	Not implemented	No longer applicable	Insufficient evidence	
2011	<p>Recommendation 6: regarding cross-compliance, the Member States should ensure the respect of the requirements concerning animal identification and registration and improve the spread of checks throughout the year so that all relevant requirements are properly checked.</p> <p>4.55. In the policy areas of environment, maritime affairs and fisheries, health and consumer protection, the Court recommends that the Commission improves the monitoring of fish catches under fisheries partnership agreements with countries outside the EU.</p>				X			<p>During its audits into the application of cross-compliance by the Member States, the Commission systematically verifies that the Member States ensure the respect of the requirements concerning animal identification and registration as well as the timing of the on-the-spot checks.</p>

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2010	3.58 (d) the quality of inspections is adequately checked and reported by the certification bodies.			X				The Commission considers that this recommendation is fully implemented as the framework to ensure the certification bodies report adequately on the quality of on-the-spot inspections has been implemented and the necessary detailed guidelines have been issued to the Certification Bodies. Indeed, as from the 2014 claim year (financial year 2015) the certification bodies are required to give an opinion on the legality and regularity of expenditure declared to the Commission. This requires that they check and report on the quality of inspections carried out by the paying agencies.
	3.59. In the area of rural development, the Court recommends that the Commission and the Member States remedy the weaknesses identified, notably by improving the effectiveness of the checks carried out for non-IACS measures.			X				The Commission considers that it has already made significant progress in this regard. It has carried out an extensive exercise within DG AGRI and with the Member States to identify the root causes of error and to implement actions to remedy them. This work will continue where new deficiencies are identified. Wide-ranging action plans have been in place in 2012 and 2013 and, in 2014, 31 action plans have been required for specific paying agencies where the rate of error remains high. The new work which will be carried out by the Certification Bodies from financial year 2015, in order to deliver an opinion on legality and regularity will also help to identify deficiencies in the effectiveness of the Paying Agencies' checks and thus direct them towards the improvements necessary to ensure that checks are performed to the necessary standard.
	3.60. Finally, effective measures need to be taken by the Commission and the Member States so that the issues identified in the policy areas of environment, fisheries, health and consumer protection are resolved.			X				

CHAPTER 5

Regional policy, transport and energy

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INTRODUCTION

5.1. This chapter presents the specific assessment of regional policy, transport and energy which comprises policy areas 'Regional policy', 'Mobility and transport' and 'Energy'. Key information on the activities covered and the spending in 2013 is provided in **Table 5.1**.

Table 5.1 — Regional policy, transport and energy — Key information 2013

(million euro)

Policy area	Description	Payments
Regional Policy	European Regional Development Fund and other regional operations	31 130
	Cohesion Fund	11 906
	Pre-accession operations related to structural policies	358
	Administrative expenditure	86
	Solidarity Fund	14
		43 494
Mobility and Transport	Trans-European Networks (TENs)	771
	Inland, air and maritime transport	158
	Administrative expenditure	65
	Research related to transport	65
		1 059
Energy	Conventional and renewable energies	312
	Nuclear energy	199
	Research related to energy	144
	Administrative expenditure	76
	Trans-European Networks (TENs)	27
		758
Total payments for the year		45 311
- total administrative expenditure ⁽¹⁾		227
Total operational expenditure		45 084
- advances ⁽²⁾ ⁽³⁾		2 974
+ clearings of advances ⁽²⁾		1 742
+ disbursements to final recipients from Financial Engineering Instruments		1 625
Audited population, total		45 477
Total commitments for the year		46 759

⁽¹⁾ The audit of administrative expenditure is reported in chapter 9.

⁽²⁾ In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 7).

⁽³⁾ This figure includes 1 869 million euro of advances paid to Financial Engineering Instruments.

Source: 2013 consolidated accounts of the European Union.

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5.2. Regional policy, mostly implemented through the European Regional Development Fund (ERDF) and the Cohesion Fund (CF), accounts for 96 % of spending in the policy areas covered by this chapter while the remaining 4 % concerns the transport and energy areas.

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

5.3. Regional policy aims to strengthen economic, social and territorial cohesion within the European Union by reducing development disparities between different regions, restructuring declining industrial areas and diversifying rural areas and encourage cross-border and transnational cooperation.

Mobility, transport and energy policies

5.4. Transport and energy policies aim to establish secure, sustainable and competitive transport and energy systems and services for European citizens and businesses and to develop innovative solutions that contribute to the formulation and implementation of these policies.

*Policy instruments***Regional policy**

5.5. The ERDF finances infrastructure projects, the creation or preservation of jobs, regional economic development initiatives and activities supporting small and medium enterprises. The Cohesion Fund finances investments in infrastructure in the fields of environment and transport in Member States whose gross national income per capita is below 90 % of the EU average. In addition, there is the Instrument for Pre-Accession Assistance to help candidate countries prepare for the use of EU regional policy spending, and the EU Solidarity Fund provides support in the event of natural disasters in Member States (see **Table 5.1**).

THE COURT'S OBSERVATIONS

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Management and control of spending in cohesion policy funds (ERDF/CF and ESF)

5.6. The ERDF and Cohesion Fund and the European Social Fund (ESF) all contribute to cohesion policy funding. These funds are governed by common rules, subject to exceptions in the specific regulations of each fund. Cohesion policy funds are implemented through multiannual programmes, with management shared between the Commission and the Member States. The ESF, which is the subject of chapter 6, is referred to in this chapter where issues common to all the funds are discussed.

5.7. For each programming period, on the basis of Member States' proposals, the Commission approves operational programmes (OPs) and indicative financial plans which include the EU and national contributions⁽¹⁾. Projects selected by the Member State authorities are financed through the OPs and are carried out by private individuals, associations, private or public undertakings or local, regional and national public bodies. The rules according to which costs can be reimbursed from the EU budget are set out in the regulations and/or in national eligibility rules.

5.8. For each project, beneficiaries declare the costs incurred to their national authorities. These individual declarations are aggregated into periodic expenditure declarations per OP certified by the Member State authorities and submitted to the Commission⁽²⁾. The overall amount of EU co-financing is then reimbursed from the EU budget to the Member State in accordance with the co-financing rate established at the priority level.

5.7. *The establishment of eligibility rules at national level (Article 56 of Regulation (EC) No 1083/2006) was one of the main elements of simplification introduced in the 2007-2013 programme period. It aimed at providing Member States with more flexibility in adapting eligibility rules to the specific needs of regions or programmes and to harmonise them with rules in force for other, national public schemes.*

⁽¹⁾ In total, 434 OPs had been approved by the Commission for the 2007-2013 programming period: 317 for ERDF/CF (out of which 24 OPs contain CF projects) and 117 for ESF. On 1 July 2013, Croatia became the 28th EU Member State. As a result, the total number of OPs has increased to 440 (322 ERDF/CF and 118 ESF OPs).

⁽²⁾ The extent to which costs are reimbursed is determined in accordance with the rate set for such projects by the OP, but also takes into account other criteria (such as specific ceilings in accordance with the regulations and/or state aid rules).

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Member States and regional level

5.9. Member States bear primary responsibility for preventing or detecting and correcting irregular expenditure, and report to the Commission. Responsibility for day-to-day administration lies with designated managing authorities and intermediate bodies ⁽³⁾. They must ensure that all projects are eligible for EU funding and that the costs declared comply with all conditions specified in the Regulations and/or the national rules. These verifications include on-the-spot inspections of projects on a sample basis and desk management verification before the expenditure is certified by managing authorities. Certifying authorities must ensure that adequate checks have been made and undertake additional verifications prior to declaring expenditure for reimbursement from the Commission. Taken together, these management verifications are called 'first level checks'.

5.10. In addition, for each OP (or a group of OPs), audit authorities (AAs) in the Member States carry out system audits and, on a sample basis, ex post audits of operations ⁽⁴⁾. They report on these audits to the Commission through annual control reports (ACRs), which include an annual audit opinion on the functioning of the systems and the AA's error rate estimate (see paragraphs 5.38 and 5.41) ⁽⁵⁾.

⁽³⁾ Intermediate bodies are public or private bodies acting under the responsibility of a managing authority and carrying out duties on their behalf.

⁽⁴⁾ Article 62 of Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25).

⁽⁵⁾ Further details on the role and responsibilities of AAs and their contribution to the Commission's assurance process can be found in special report No 16/2013 'Taking stock of "single audit" and the Commission's reliance on the work of national audit authorities in Cohesion', paragraphs 5 to 11.

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Commission level

5.11. The Commission (Directorate-General for Regional and Urban Policy and Directorate-General for Employment, Social Affairs and Inclusion) has to obtain assurance that the Member States have set up management and control systems which meet the requirements of the regulations, and that the systems function effectively⁽⁶⁾. If the Commission finds that a Member State has failed to correct irregular expenditure which had been certified and declared, or that there are serious failings in the management and control systems, the Commission may interrupt or suspend payments⁽⁷⁾. If the Member State does not withdraw the irregular expenditure (which may be substituted by eligible expenditure for other projects of the same OP) and/or does not remedy any detected system failures, the Commission may apply financial corrections⁽⁸⁾. Further information on the way in which the Commission has imposed interruptions/suspensions and has applied financial corrections is also provided in chapter 1, paragraphs 1.12 to 1.14.

Mobility and transport and energy

5.12. The European Union's transport policies aim to develop the internal market, increase competition and innovation, and integrate transport networks. In this area, EU policies promote mobility, sustainable development and transport security. Energy policies aim to provide citizens and business with affordable energy, competitive prices and technologically advanced energy services. They promote sustainable energy production, transport and consumption, and a secure energy supply within the EU. The Trans-European Transport Networks (TEN-T) programme and the European energy programme for recovery (EEPR) are the main financial instruments in these two areas (see **Table 5.1**).

⁽⁶⁾ Article 72 of Regulation (EC) No 1083/2006.

⁽⁷⁾ 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.

⁽⁸⁾ Article 99 of Regulation (EC) No 1083/2006.

THE COURT'S OBSERVATIONS

Management and control of mobility and transport and energy spending

5.13. The Commission (Directorate-General for Mobility and Transport and Directorate-General for Energy) implements transport and energy expenditure through two executive agencies and a joint undertaking⁽⁹⁾ and also through joint management arrangements (such as nuclear decommissioning funds or the European energy efficiency finance facility).

5.14. The Commission generally finances projects following calls for project proposals. Payments for approved projects are made directly by the Commission to beneficiaries, based on grant agreements or Commission decisions. The beneficiaries are usually Member State authorities but may also be public or private companies. EU funding is provided in instalments: an advance or a pre-financing payment upon signature of the grant agreement or financing decision, followed by interim and final payments to reimburse eligible expenditure reported by beneficiaries.

5.15. The Commission evaluates proposals against specified selection and award criteria, provides information and guidance to beneficiaries, and monitors and verifies the implementation of projects based on financial and technical progress reports submitted by beneficiaries. Grant agreements or Commission decisions may require that expenditure claims are certified by an independent auditor or a relevant national body. In addition, the Commission carries out ex-post audits in order to detect and correct errors which may not have been prevented by earlier checks.

⁽⁹⁾ The Innovation and Networks Executive Agency, INEA (the successor of the Trans-European Transport Network Executive Agency); the Executive Agency for Small and Medium Enterprises, EASME (the successor of the Executive Agency for Competitiveness and Innovation) and the SESAR Joint Undertaking (Single European Sky Air Traffic Management Research).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

*Risks to regularity***Regional policy**

5.16. For ERDF and CF expenditure the main risks relate to non-compliance with EU and/or national public procurement rules when awarding contracts and to the funding of projects which are not eligible or which do not comply with EU state aid rules⁽¹⁰⁾. A further risk is that beneficiaries declare costs which are ineligible according to the regulations and/or national eligibility rules.

5.17. In implementing the OPs, Member State authorities face competing priorities. Spending has to be subject to appropriate checks intended to ensure regularity and sound financial management. At the same time, there is an interest in absorbing the funds allocated by the EU. This may in practice militate against the consistent application of effective controls so that infringements of rules are not detected and corrected and ineligible expenditure is ultimately reimbursed from the EU budget. This may also result in the funding of projects which are too costly, not efficiently implemented or unlikely to achieve the intended results⁽¹¹⁾. This tension becomes more relevant when the end of the eligibility period approaches.

Mobility and transport and energy

5.18. For transport and energy expenditure the main risk is that ineligible costs declared by beneficiaries are not detected by the Commission before reimbursement. As under ERDF and CF, there are also risks related to non-compliance with public procurement rules.

5.16. *The Commission shares this assessment, as detailed in its Staff Working Document 'Analysis of errors in the Cohesion Policy for the years 2006-2009' (SEC(2011) 1179 of 5 October 2011). In this document, the Commission indicates the specific actions in its undertaking to mitigate these risks (in particular additional guidance and training to managing authorities on the identified risks, timely implementation of financial corrections, interruptions and suspensions procedures, and audits targeted on the most risky areas).*

⁽¹⁰⁾ Further information on the Commission's role and responsibilities in relation to state aid can be found in the special report No 15/2011, 'Do the Commission's procedures ensure effective management of state aid control?'

⁽¹¹⁾ Further information on performance issues is presented in chapter 10.

THE COURT'S OBSERVATIONS

Audit scope and approach

5.19. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of regional policy, transport and energy, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 180 transactions ⁽¹²⁾ as defined in **Annex 1.1**, paragraph 7. The sample is designed to be representative of the entire range of transactions within the policy group. In 2013, the sample consisted of transactions from 19 Member States ⁽¹³⁾;
- (b) the audit involved an examination of financial engineering instruments (FEIs) in terms of their disbursement rates (i.e. the proportion of funds used at the level of final recipients). This was done through a review of the Commission's progress reporting for 2012 and of the five FEIs within the sample of transactions audited;
- (c) the assessment of control systems examined:
 - (i) the Commission's supervisory activities of national audit authorities in Member States;
 - (ii) the annual activity reports (AARs) of the Directorate-General for Regional and Urban Policy, the Directorate-General for Mobility and Transport and the Directorate-General for Energy.

⁽¹²⁾ This sample comprises 180 transactions related to 168 regional policy projects (125 ERDF projects, 38 CF projects and 5 financial engineering instruments), 8 transport and 4 energy projects (see **Annex 5.1**). The sample was drawn from all payments, with the exception of advances which, amounted to 2,9 billion euro in 2013. Of the 168 regional policy transactions (including all financial engineering instruments) 157 relate to the 2007-2013 programming period. The financial engineering instruments examined were sampled from those funds for which disbursements to final recipients (such as loans, guarantees or equity investments) were made during 2013.

⁽¹³⁾ Belgium, Bulgaria, Czech Republic, Germany, Estonia, Greece, Spain, France, Italy, Lithuania, Luxembourg, Hungary, Austria, Poland, Portugal, Romania, Slovenia, Slovakia and Sweden.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

REGULARITY OF TRANSACTIONS

5.20. **Annex 5.1** contains a summary of the results of transaction testing. Out of the 180 transactions audited by the Court, 102 (57 %) were affected by error. On the basis of the 40 errors which it has quantified, the Court estimates the most likely error to be 6,9 %⁽¹⁴⁾.

5.21. Chapter 1 contains an assessment of the accuracy and reliability of the figures for financial corrections presented in Note 6 to the EU consolidated accounts (see paragraphs 1.12 to 1.14). The extent to which the Court takes financial corrections into account when estimating the most likely error rate is explained in Chapter 1 of the 2012 Annual Report⁽¹⁵⁾.

5.22. **Graph 5.1** presents the extent to which the different types of irregularities contributed to the Court's estimate of the most likely error for 2013.

5.20. Common reply to paragraphs 5.20 and 5.21:

The Commission notes that the most likely error reported for 2013 is in line with the error rates presented by the Court for the last four years.

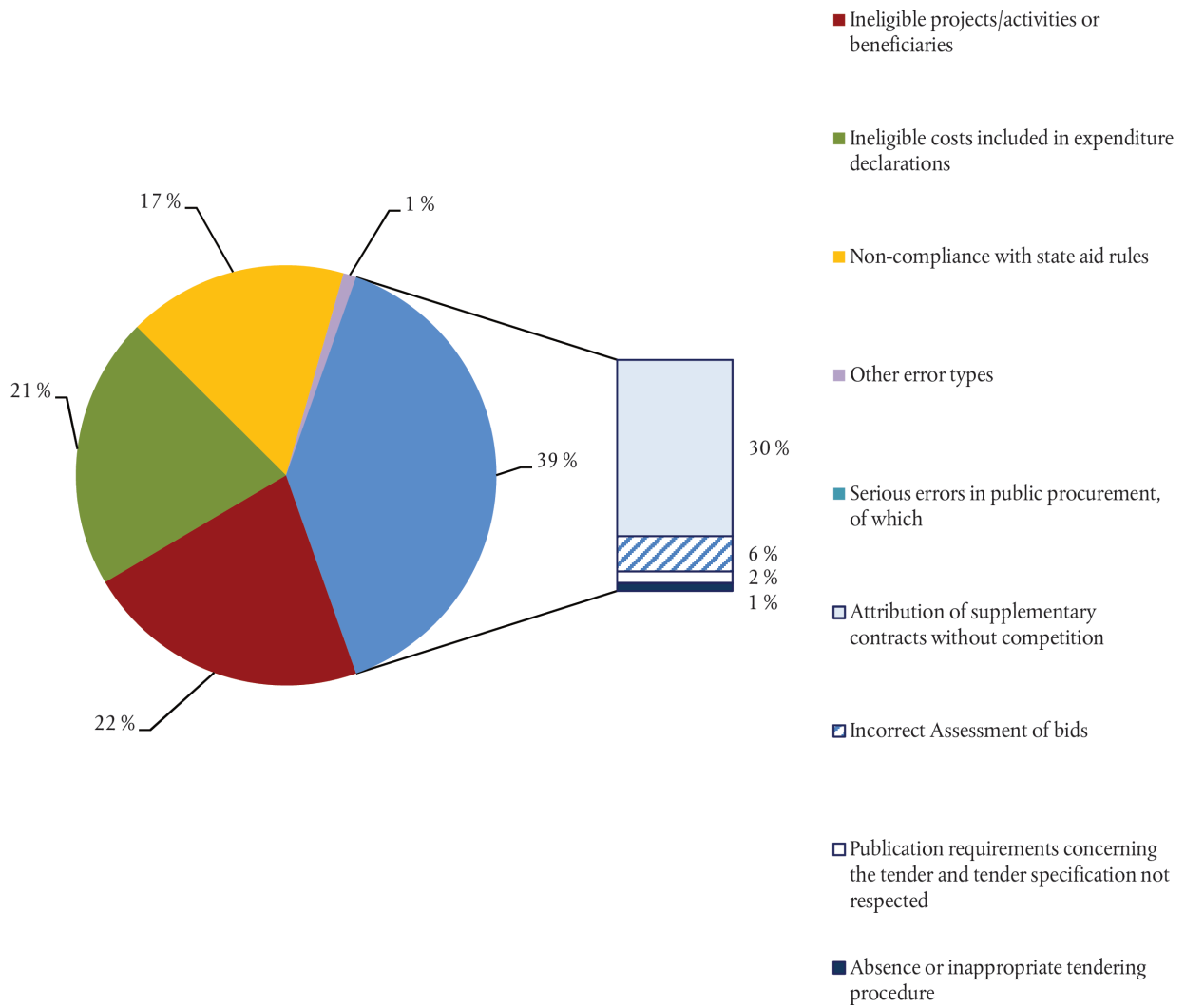
This confirms that the error rate for the 2007-2013 programming period remains stable and significantly below the rates reported for the 2000-2006 period. This development derives from the reinforced control provisions of the 2007-2013 period and the Commission's strict policy to interrupt/suspend payments when deficiencies are identified, as reported in the 2013 annual activity report of DG Regional and Urban Policy (see section 2.111 F, pp. 44-45). The Commission will continue to focus its actions on the most risky programmes/Member States and implement corrective measures when needed through a strict policy of interruptions and suspensions of payments. For the new 2014-2020 period the Commission's corrective capacity was further improved by removing, under certain conditions, the possibility for Member States to re-use funds, resulting in net financial corrections. This will be an important incentive for Member States to detect and correct irregularities before certifying annual accounts to the Commission.

In addition, the Financial Regulation (Article 80(4)) foresees the use in accordance with the cohesion policy rules (Article 99(2) of Regulation (EC) No 1083/2006) of flat rate or extrapolated corrections where the unduly spent amounts cannot be precisely identified, which is a frequent scenario. This was the case for regional policy in 2013. The Commission has acted within its powers and in full respect of the existing regulations in order to protect the EU budget. Under the Court's approach, adjustments are made to the extent that a link to individual operations was established. The Commission considers that the flat rate corrections applied covered the entirety of the programmes and operations concerned. See also Commission reply to paragraph 1.17.

⁽¹⁴⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 3,7 % and 10,1 % (the lower and upper error limits respectively).

⁽¹⁵⁾ See 2012 annual report, paragraphs 1.19 to 1.37.

Graph 5.1 — Contribution by type of error to the most likely error



THE COURT'S OBSERVATIONS

Failures to comply with public procurement rules account for more than a third of the error rate estimated by the Court for these policy areas

5.23. Public procurement rules are a key instrument for spending public money economically and effectively and for establishing an internal market within the EU.

5.24. In 2013, the Court examined 122 public procurement procedures related to contracts for works and services underlying the expenditure for the 180 transactions tested by the Court⁽¹⁶⁾. The combined estimated contract value for these public procurements amounted to approximately 4,2 billion euro⁽¹⁷⁾.

5.25. As in previous years, public procurement procedures were particularly prone to error⁽¹⁸⁾. The Court identified instances of non-compliance with EU and/or national public procurement rules for 60 of the 122 procedures examined. Around one third of these were serious failures to comply with these rules and thus classified as quantifiable errors. These errors account for 45 % of all quantifiable errors and make up approximately 39 % of the estimated error rate for this policy group (see Box 5.1).

THE COMMISSION'S REPLIES

5.23. *Common reply to paragraphs 5.23 to 5.25:*

While the Commission and the Court audit compliance with public procurement rules in the same way, the Commission applies since the 2000-2006 programming period proportionate flat-rate corrections thereby addressing the risk of damage to the EU budget and taking into account the nature and gravity of the actual irregularities.

These flat rates are applied by the Commission and by most national authorities when imposing financial corrections for infringements of public procurement rules, including when following up the errors reported by the Court.

The Commission also notes that the Discharge Authority called on the Commission and the Court to harmonise their methodologies to quantify public procurement errors (European Parliament decision of 17 April 2013 on discharge in respect of the implementation of the general budget of the European Union for the financial year 2011).

The Commission has updated in 2013 its decision on the quantification of public procurement errors in shared management, including inter alia cohesion spending and rural development (see Commission decision C(2013) 9527 final).

Based on this Commission decision, the Commission estimates that the quantification of errors for public procurement errors in 2013 would be up to 0,6 percentage point lower than calculated by the Court when using its own quantification.

⁽¹⁶⁾ For around 73 % of the 122 public procurement procedures audited by the Court the contract value was above the threshold which made them subject to EU public procurement rules as transposed into national law.

⁽¹⁷⁾ This amount represents the total expenditure for the contracts awarded, part of which has been certified under the audited expenditure declarations.

⁽¹⁸⁾ See 2010 annual report, paragraphs 4.26 to 4.27, 2011 annual report, paragraphs 5.31 to 5.33, and 2012 annual report, paragraphs 5.30 to 5.34.

THE COURT'S OBSERVATIONS

Box 5.1 — Examples of serious failures to comply with public procurement rules

- (a) *Unjustified direct award of additional works (absence of unforeseen circumstances):* In a TEN-T project in Germany, contracts for additional construction works for an airport passenger terminal (which had been directly awarded to the same contractor) were declared for co-financing. These additional works were due to deficiencies in project preparation, planning and implementation rather than to unforeseeable circumstances. In such cases the direct award is unlawful and the additional works should have been put out to tender.

Similar cases were found in other ERDF/CF and transport projects in Belgium, Czech Republic, Germany, Spain, Italy, and Sweden.

- (b) *Use of illegal award criteria in a tender procedure:* In an ERDF project related to the renovation of a public building in Spain, the formula specified in the tender dossier to determine the most economical offer unduly altered the outcome of the tender and the contract was awarded in an irregular manner.
- (c) *Change of contract scope after tender:* In an ERDF project to upgrade and refurbish the water supply network in Spain, the scope of the project was significantly modified after the tender and the award of the contract. This is in breach of EU and national public procurement rules and the declared expenditure for this contract is therefore irregular. In addition, the works actually carried out were not in line with the modified contract.

Similar cases were found in ERDF/CF projects in the Czech Republic.

THE COMMISSION'S REPLIES

Box 5.1 — Examples of serious failures to comply with public procurement rules

- (c) *For the Czech Republic the Commission underlines that it imposed a flat-rate correction of 10 % to all expenditure of this programme from 2007 until 31 August 2012 which covers the errors of the same nature reported as those identified by the Court. This correction was applied to all projects audited by the Court.*

THE COURT'S OBSERVATIONS

5.26. Other errors relating to tendering and contracting procedures occurred in a further third of the 122 public procurements audited. These errors include cases of non-compliance with information and publication requirements, incorrect application of the selection criteria and shortcomings in the tender specifications. These errors do not contribute to the error rate estimated by the Court ⁽¹⁹⁾.

For three projects audited by the Court the eligibility conditions were not met

5.27. The Court identified three projects for which the eligibility conditions set out in the Regulations and/or the national eligibility rules were not met and the errors were quantified. These projects account for 8 % of all quantifiable errors and make up approximately 22 % of the estimated error rate (see Box 5.2).

Box 5.2 — Examples of ineligible projects

- (a) *Selection of a project which realistically cannot attain its objectives:* An ERDF project in Poland consisted in the renovation of a historic building and its park for use as a training centre with accommodation facilities. This project was selected by the managing authority although the objectives of the project, as specified in the project application, could not be realistically attained. In particular, the number of trainees that would use the facilities was significantly inflated. Moreover, costs in relation to a private use of the building were declared that were outside the scope of the grant agreement.
- (b) *Beneficiary not fulfilling the selection criteria specified in the OP:* An ERDF project in Hungary consisted in the acquisition of an excavator by a beneficiary operating in the transport and construction sector. However, neither the project nor the business activity of the beneficiary can be considered to be innovative and therefore did not fulfil the criteria laid down in the OP.

THE COMMISSION'S REPLIES

5.26. *The Commission will follow-up all errors reported by the Court in accordance with Commission decision C(2013) 9527 final.*

5.27. *Common reply to paragraphs 5.27 to 5.29:*

The Commission seeks to ensure that beneficiaries and programmes managing authorities are well aware of eligibility rules. This can be through training and guidance and, for regional and urban policy, managing authorities should carry over this knowledge to all bodies in charge of managing the funds. For regional policy, when the Commission identifies complex rules at programme level, it also makes recommendations to the Member State to simplify the rules.

The Commission will continue to focus its actions on programme authorities where risks have been identified.

⁽¹⁹⁾ Further information regarding the Court's approach to the quantification of public procurement errors is set out in **Annex I.1**, paragraphs 10 to 12.

THE COURT'S OBSERVATIONS

Ineligible costs declared for almost a tenth of all projects audited by the Court

5.28. When declaring costs to the Commission, national authorities are certifying that these costs have been incurred in compliance with a number of specific provisions laid down in EU regulations, national eligibility rules, specific OP rules, calls for interest, decisions approving projects for co-financing or grant agreements.

5.29. The Court found that ineligible costs had been declared in 8 % of the transactions examined. These account for 38 % of all quantifiable errors and make up approximately 21 % of the estimated error rate for these policy areas (see Box 5.3).

Box 5.3 — Examples of ineligible costs declared

- (a) *Staff costs not substantiated:* For an Energy project in France related to the construction of an electricity interconnection between France and Spain, some staff costs could not be substantiated by the beneficiary. The underlying expenditure related to these staff costs is therefore ineligible for EU co-financing.

A similar case where ineligible salary expenditure was declared was found in an ERDF project in Italy.

- (b) *Expenditure declared for non-EU organisation:* A TEN-T project to further develop a common European airspace was carried out by organisations in several EU Member States and in one non-EU country. The requirement that only organisations from EU Member States could be beneficiaries and could therefore declare costs was disregarded by the consortium and costs from a non-EU participant were also reimbursed from the EU budget.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Infringements of State aid rules account for 17 % of the error rate

5.30. State aid is deemed incompatible in principle with the internal market since it may distort trade between Member States⁽²⁰⁾. The Commission directly enforces the EU state aid rules. Member States must notify all cases of potential state aid to the Commission (either through a scheme or case-by-case for a project), unless the project is below a 'de minimis' ceiling or is covered by the General Block Exemption Regulation (GBER)⁽²¹⁾. For all cases notified, the Directorate-General for Competition should then form a view on whether the aid is compatible with the internal market. This comprises an assessment of whether the same project would also have been undertaken without such aid.

5.31. The Court identified this year 16 projects in eight Member States that infringed the EU state aid rules. For all cases the Court has requested and obtained a preliminary assessment by the Directorate-General for Competition. This assessment and the case law of the European Court of Justice were taken into account when classifying errors. For five of these projects, the Court considers that the project should have obtained no or less public funding from the EU and/or the Member State according to the state aid rules. These quantified errors make up approximately 17 % of the estimated error rate⁽²²⁾ (see Box 5.4). The 11 other cases of non-compliance with state aid rules are not taken into account for the Court's error rate estimate.

Box 5.4 — Examples of projects infringing state aid rules

- (a) *Incentive effect not demonstrated:* In an ERDF project in Poland to establish a shared service centre for a multinational company, the information provided by the undertaking shows that the project was profitable anyway without public support and that the aid was not needed to implement the project. As a result, the project is ineligible for EU co-financing according to Article 8 of the General Block Exemption Regulation.

A similar case was found in another ERDF project in Poland.

5.31. *The Commission is the competent authority in the European Union that can decide whether an aid is incompatible with the internal market rules. When doing so, it distinguishes between breaches of formal and procedural State aid requirements and the incompatibility of an aid with the internal market rules thus not complying with substantial conditions of the State aid rules. Therefore, an aid that does not comply with formal and procedural requirements, might still comply with the material and substantive ones.*

The Commission takes note of the Court's observations and will follow-up the cases identified by the Court.

⁽²⁰⁾ Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) on state aid.

⁽²¹⁾ Commission Regulation (EC) No 800/2008 (OJ L 214, 9.8.2008, p. 3).

⁽²²⁾ In 2012, the corresponding ratio was 9 % (see 2012 annual report, paragraph 5.41).

THE COURT'S OBSERVATIONS

- (b) *Undue SME bonus for state aid*: In an ERDF project in Slovenia, aid was granted under a notified scheme for small and medium enterprises (SMEs) for research and development activities in the automotive industry. This beneficiary, however, *de facto* did not meet the criteria to qualify as an SME since it was wholly owned by large companies and carried out its research activities exclusively for them. The lower aid intensity for large undertakings should have been applied and, as a result, part of the aid is ineligible.

Similar cases were found in ERDF projects in Bulgaria and Hungary.

THE COMMISSION'S REPLIES

For a third of the transactions examined, checks at Member State level could have prevented at least some of the errors found

5.32. In 17 cases of quantifiable errors made by final beneficiaries, the national authorities had sufficient information (for example, from the final beneficiaries, their auditors or from the national authorities' own checks) to prevent, detect and correct the errors before declaring the expenditure to the Commission. If all this information had been used to correct errors, the most likely error estimated for this chapter would have been 3 percentage points lower. For 10 of these cases, the declaration was made taking account of a flat-rate correction imposed by the Commission. In addition, the Court found that for five cases, the error detected by the Court was made by the national authorities. These errors contributed 2 percentage points to the most likely error estimated.

5.32. The Commission is strictly following up these cases to ensure that the concerned systems better prevent errors before certification in the future. It agrees that sound and timely management verifications must be in place in order to prevent irregularities occurring in the first place or being included in payment claims certified to the Commission.

The Commission is carrying out since 2010 targeted audits on management verifications of high risk programmes where it has identified that deficiencies could remain undetected or not timely detected by the programme audit authority. Results of these audits by end 2013 are presented in DG Regional and Urban Policy's AAR (see page 41).

The Commission refers to the reinforced procedures in the regulatory framework for the 2014-2020 programming period, where management verifications and controls (including on-the-spot checks) will have to be carried out on time for the certification to the Commission of programme annual accounts and submission of management declarations by the managing authorities. The Commission considers that these reinforced control procedures will result in lasting reductions of the error rate.

THE COURT'S OBSERVATIONS

EXAMINATION OF FINANCIAL ENGINEERING INSTRUMENTS

5.33. Financial engineering instruments (FEIs) provide assistance to enterprises or urban projects by way of equity investments, loans or guarantees⁽²³⁾. They can be used in mainly three areas: for the support of SMEs⁽²⁴⁾, for urban development⁽²⁵⁾ and for the promotion of energy efficiency.

5.34. By the end of 2012, 940 FEIs had been set up under 175 ERDF and ESF OPs in all but two of the EU-27 Member States (Ireland and Luxembourg). Taken together, they have an endowment of around 12 558 million euro⁽²⁶⁾.

Financial Engineering Instruments continue to show low disbursement rates

5.35. In general, funds implementing FEIs receive a contribution from the OP when their legal structure is set up, and subsequently use this money to support projects. Such financial support can be provided only to projects which fall within the scope of the OP. These FEIs are designed to have a revolving character or, for certain types of guarantee funds, to achieve a high leverage effect. Any resources returned from investments or loans made, including profits, are to be used again for the purpose of the activities implemented by the FEI.

⁽²³⁾ Article 44 of Regulation (EC) No 1083/2006.

⁽²⁴⁾ This includes the Joint European Resources for Micro to Medium Enterprises (JEREMIE) programme implemented together with the European Investment Bank (EIB) and the European Investment Fund (EIF) to support additional SME financing.

⁽²⁵⁾ This includes the programme Joint European Support for Sustainable Investment in City Areas (JESSICA) which is implemented together with the EIB to make repayable investments (in the form of equity, loans or guarantees) in urban development.

⁽²⁶⁾ European Commission, 'Summary of data on the progress made in financing and implementing FEIs co-financed by Structural Funds', COCOF 13/0093-00/EN, 19 September 2013.

THE COURT'S OBSERVATIONS

5.36. The Court's examination showed that the sample of FEIs examined in 2013 continue to have low rates of disbursement (i.e. the funds used at the level of final recipients) (Box 5.5). According to the regulations, only the payments or guarantees provided to final recipients are considered eligible and unused endowments of FEIs are to be returned to the EU budget at closure ⁽²⁷⁾.

THE COMMISSION'S REPLIES

5.36. Common reply to paragraph 5.36 and Box 5.5:

The Commission reported on the low execution of FEIs by end 2012 to the Parliament and Council (see Ares(2013)3153620 of 1 October 2013). The average disbursement rate reflects the establishment of additional FEIs in 2012. The Commission will report in the second half of 2014 on the situation at the end 2013. The Commission considers that the assessment of performance should also focus on the achievement of results by the co-funded financial instruments, including the revolving and leveraging effects.

The Commission notes that a detailed analysis requires an assessment of the various situations that can occur taking particularly into account that the audited FEIs are in Bulgaria, Greece, Italy and Lithuania, Member States severely hit by the economic and financial crisis.

Box 5.5 — Low disbursement rates for FEIs

According to the Commission, the average disbursement rate for all FEIs within the EU-27 was 37 % at the end of 2012. This represents a 3 percentage points increase in comparison to 2011. This rate is still too low to expect that all funds available will be used at least once. Particular problems were noted for FEIs in 3 Member States (Bulgaria, Greece and Slovakia) where the disbursement rates are significantly below the EU average for 2012.

For four out of the five examined FEIs, the disbursement rates at the end of 2013 (between 3 % and 16 %) were still significantly below the average level of 2012. The Court also notes that Member States had the possibility to make additional contributions to FEIs from OPs until the end of 2013.

FEIs examined in Member States	2012			2013		
	Amount reported to the Commission as at 31 December 2012 in euro (*)		Disbursement rate	Amount reported by the FEIs in euro		Disbursement rate
	Amount paid to or guaranteed by the holding fund	Amount paid or guaranteed to the final recipients		Amount paid to or guaranteed by the holding fund	Amount paid or guaranteed to the final recipients	
Bulgaria	37 818 872	0	0 %	37 818 872	1 023 107	3 %
Greece	460 000 000	6 343 202	1 %	488 000 338 (**)	79 701 074	16 %
Italy	202 000 000	0	0 %	202 000 000	10 595 207,50	5 %
Italy	110 000 000	10 467 204	10 %	110 000 000	16 870 778	15 %
Lithuania	169 974 513	64 237 987	38 %	240 931 417 (**)	87 263 848	36 %

(*) Source: The annual reports submitted by Member States in accordance with article 67(2)(j) of Regulation (EC) No 1083/2006; 2013 information provided by the FEIs examined.

(**) Increase in endowments during 2013 in comparison to 2012: in Greece the increase was around 28 million euro and in Lithuania around 71 million euro.

⁽²⁷⁾ Article 78(6) of Regulation (EC) No 1083/2006.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

EXAMINATION OF SELECTED CONTROL SYSTEMS**Assessment of the Commission's supervision of audit authorities**

5.37. *Annex 5.2* contains a summary of the results of the systems examined by the Court.

Commission relies on the work of audit authorities in Member States

5.38. Audit authorities provide assurance to the Commission as to the effective functioning of the management systems and internal controls for an OP and the legality and regularity of the expenditure certified⁽²⁸⁾. This information is provided by audit authorities in their annual control reports (ACRs), audit opinions and system audit reports (see paragraph 5.10).

5.38. *The audit authorities play a central role in the assurance building process, as from the beginning of the programming period and set-up of systems.*

The regulation provides the Commission the possibility to rely on the work of an audit authority for its assurance under certain conditions (Article 73 of Regulation (EC) No 1083/2006). The Commission is closely cooperating and coordinating with them, and has started reviewing their methodologies and audit results as early as 2009. This contributed to capacity building by providing advice, guidance and recommendations to Audit Authorities through the Commission's re-performance of audit work carried out by audit authorities.

In their 2013 Annual Activity Reports, DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion, provided a detailed assessment of the accuracy and reliability of the audit information and results reported by audit authorities in their 2013 Annual Control Reports, (see section 2.111 B, pages 33 to 36 of DG Regional and Urban Policy's 2012 AAR and pages 42 to 44 of DG Employment, Social Affairs and Inclusion's 2013 AAR).

⁽²⁸⁾ Overall, the EU-28 Member States have set up 113 audit authorities for the 440 ERDF/CF and ESF OPs approved for the 2007-2013 programming period. Of these authorities 63 are in charge of both ERDF/CF and ESF OPs. For all 440 OPs taken together, 199 ACRs and audit opinions had been prepared by audit authorities by the end of December 2013.

THE COURT'S OBSERVATIONS

5.39. The Directorates-General for Regional and Urban Policy and for Employment, Social Affairs and Inclusion make use of this information when preparing their annual activity reports (AARs) and throughout the year to decide on possible interruptions and/or suspensions of payments to OPs⁽²⁹⁾. In order to assess whether they can rely on this information, the directorates-general check the error rates reported by the audit authorities for each OP (or group of OPs)⁽³⁰⁾:

- if the Commission considers the error rate to be reliable (and representative for the expenditure certified), it accepts the rate reported by the audit authority. Also the Commission may recalculate the rate for its own assessment based on additional information obtained from the audit authority;
- in the case of unreliable error rates, the Commission applies a flat error rate (between 2 % and 25 %) in line with the results of its assessment of the functioning of management and internal control systems.

5.40. The Commission also calculates a 'residual error rate' for each OP, which takes into account all financial corrections since the start of the programming period. This includes corrections already implemented at EU and/or national level, as well as pending financial corrections⁽³¹⁾.

THE COMMISSION'S REPLIES

5.39. In 2013, DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion indicated in their respective annual activity reports that around two thirds of the interruptions/suspensions of payments were based on audit results brought to the Commission's knowledge by audit authorities (see page 45 of DG Regional and Urban Policy's 2012 AAR and annex VII 2.1.1.1 of DG Employment, Social Affairs and Inclusion's 2013 AAR). The Commission underlines that interruption/pre-suspension procedures in the course of 2013 concerned 181 ERDF/Cohesion Fund programmes and almost EUR 6 billion of payment claims submitted by the Member States but not paid unless the Commission has obtained additional evidence that all necessary corrections had been made by the concerned Member States.

For ESF, as reported at page 49 of DG Employment, Social Affairs and Inclusion's AAR in 2013, the Commission sent 12 warning letters and 19 pre-suspension letters; it decided 25 interruptions of payments and suspended 11 operational programmes. In total, EUR 348,8 millions of payment claims were interrupted.

⁽²⁹⁾ In March of every year, each directorate-general prepares an annual activity report which is submitted to the European Parliament and the Council and is published. Together with this report, the Director-General must provide a statement indicating whether the budget under his or her responsibility has been implemented in a legal and regular way. This will be the case if the level of irregularities is below the Commission's own 2 % materiality threshold. Otherwise, the Director-General may issue full or partial reservations for certain areas (or programmes).

⁽³⁰⁾ The error rates reported by audit authorities for the year n are calculated on the basis of a sample of audits of operations which should be statistically representative of the expenditure certified to the Commission in the year n-1 (special report No 16/2013, paragraph 11).

⁽³¹⁾ Directorate-General for Regional and Urban Policy's annual activity report, p. 49.

THE COURT'S OBSERVATIONS

5.41. Based on these two indicators, the Commission forms its assessment of the management and control system for the OP. That assessment also takes account of the system audits submitted by audit authorities throughout the year and additional information available to the Commission. This assessment is then reported in the annual activity report of the directorate-general⁽³²⁾.

5.42. The Court considers that the Commission has put in place a system for obtaining assurance as to the legality and regularity of ERDF/CF and ESF expenditure from the work of audit authorities⁽³³⁾. The design of this system is generally in line with the 'single audit' principles set out by the Court in its Opinion No 2/2004. The Court also takes note of the Commission's close cooperation with national audit authorities and improvements in the form of a more consistent level of internal control for the ERDF/CF and ESF OPs in the 28 Member States.

Commission considers that payments from more than half of all OPs were free of a material level of error

5.43. For 2013, the Commission considers that it had assurance that 243 of the 440 OPs (representing around 55 % of the 2013 payments) were free from a material level of error: audit authorities had reported error rates below the Commission's materiality threshold of 2 %, and these rates had been validated by the Commission. For another 140 OPs (representing 34 % of the payments), validated (or re-calculated) error rates were above 2 %, but the 'residual error rate' was below 2 %⁽³⁴⁾. Compared to 2012, the number of OPs for which serious problems were identified by the Commission decreased from 61 to 57 OPs⁽³⁵⁾. These 39 ERDF/CF OPs and 18 ESF OPs for which both the validated error rate and the residual error rate were above 2 % account for 11 % of the payments in 2013. The Court acknowledges that the Commission issues reservations not exclusively based on error rates. When making its assessment, it also applies professional judgement and takes account of all other available information.

THE COMMISSION'S REPLIES

5.41. *The Commission makes reference to its extensive audit enquiry to review the work of audit authorities before deciding to formally rely on their work, including through the re-performance of audits on operations performed by the audit authorities (see respective AARs of both Directorates-General). As a result, the Directorates-General concluded that the work of respectively 40 and 81 out of the 113 audit authorities in charge of auditing around 90 % of ERDF/CF allocations and 91 % of ESF programmes can in general be relied upon.*

5.42. *The Commission considers that the Member States and the Commission have reinforced the internal control framework for the 2007-2013 programmes compared to previous programming periods. This contributes to ensuring legal and regular cohesion spending across the European Union.*

⁽³²⁾ More information can be found in special report No 16/2013 'Taking stock of "single audit" and the Commission's reliance on the work of national audit authorities in Cohesion', paragraphs 5 to 11.

⁽³³⁾ Special report No 16/2013, paragraph 80.

⁽³⁴⁾ Directorate-General for Regional and Urban Policy's 2013 annual activity report, pp. 33 to 36, and Directorate-General for Employment, Social Affairs and Inclusion's 2013 annual activity report, p. 43.

⁽³⁵⁾ Special report No 16/2013, paragraph 26 and Annex III.

THE COURT'S OBSERVATIONS

5.44. In 2013, as in previous years, the Court examined whether the Commission was effective in verifying the accuracy and reliability of the error rates reported by audit authorities. This was done for a sample of 194 OPs in 19 Member States (140 of the 322 ERDF/CF OPs and 54 of the 118 ESF OPs) on the basis of the Commission's working files⁽³⁶⁾. In addition, the Court requested and obtained additional information directly from audit authorities.

5.45. The Court's examination showed that the Commission had correctly validated (or recalculated) the error rates reported by audit authorities for 155 of the 194 OPs examined (see **Annex 5.2**).

5.46. For 39 of the 194 OPs examined (32 ERDF/CF OPs and seven ESF OPs) the Court considers however that the Commission should have validated a higher error rate (or imposed a flat rate)⁽³⁷⁾.

5.47. In four of these cases in relation to 15 ERDF and one ESF OPs, the Court considers that the Commission had not set out the reasons for not making reservations (or not making reservations with a higher financial impact) in its internal working documents and/or the 2013 AARs (see Box 5.6). For the remaining OPs, the Commission had already issued a reservation for the OP or the higher error rate recalculated by the Court remained below the Commission's 2% materiality threshold.

THE COMMISSION'S REPLIES

5.46. *When validating the error rates for the purpose of the annual activity report, the Commission took into account all information obtained until the date of its assessment.*

The Commission points out that the Court's findings do not impact the expressed audit opinions nor the number of reservations, and has only a minor impact on the quantification of reservations made.

The Commission notes that in any case the 39 programmes quoted by the Court correspond to the work of 13 audit authorities out of the total of 113 audit authorities in charge of ERDF, ESF and the CF. It also notes that the issue raised for the Spanish programmes refers to one national intermediate body that submitted expenditure for 9 regional ERDF programmes in 2013.

Concerning DG Employment, Social Affairs and Inclusion, the Commission refers to its replies to paragraphs 6.34 and 6.35.

⁽³⁶⁾ These 194 OPs account for 65% of the ERDF/CF and 75% of the ESF interim/final payments authorised in 2013 and are under the responsibility of 41 of the 113 AAs.

⁽³⁷⁾ This means that the error recalculated by the Court is at least 0,5 percentage points higher than the rate validated by the Commission and/or exceeds the Commission's materiality threshold (whereas the Commission's rate does not).

THE COURT'S OBSERVATIONS

Box 5.6 — Examples for weaknesses in the Commission's validation of error rates reported by audit authorities

For a group of four ERDF and ESF OPs in the United Kingdom, the audit authority drew a single sample of 68 operations as set out in its audit strategy. The Court found however that this sample was drawn from a preliminary population which, for three out of the four OPs, was incorrect. In addition, the audit authority estimated and submitted in its ACR individual error rates for each of the four OPs, although it should have reported a common error rate in accordance with the applicable guidance on sampling. The Commission noted these issues, but validated the incorrect individual rates estimated by the audit authority or recalculated alternative rates by grouping some OPs. The Court considers that the rates reported for all four OPs are unreliable and, in principle in the absence of additional explanations and disclosure, a flat 5 % error rate should have been applied for the group of four OPs.

For a group of four ERDF OPs in the Netherlands, the audit authority drew a single sample as set out in its audit strategy. In the ACR, however, non-representative error rates were reported for each of these four OPs. Moreover, the audit authority used an incorrect methodology to estimate these rates. Following the Commission's rejection of the initial version of the ACR, the audit authority decided to regroup three of the four OPs, for which it then recalculated an error rate below 2 % in a way which is not in line with the applicable guidance on sampling. For the remaining OP, an error rate of 6,9 % was validated and a reservation was made. This also meant that the residual error rate was understated for the three OPs concerned. In the Court's view, however, the Commission's assessment should have been made for the group of OPs as a whole. In October 2013, the Commission granted Article 73 ('single audit') status to all four OPs ⁽³⁸⁾.

THE COMMISSION'S REPLIES

Box 5.6 — Examples for weaknesses in the Commission's validation of error rates reported by audit authorities

The Article 73 status was granted to all four Dutch ERDF programmes on 30 October 2013 based on comprehensive audit work. The Commission concluded positively that there was no audit evidence putting into doubt the quality of the work of the Dutch audit authority.

⁽³⁸⁾ Article 73 of Regulation (EC) No 1083/2006 stipulates that the Commission may rely on the work carried out by a national audit authority, and reduce its own audits and checks, once it has accepted the national compliance assessment and the audit authority's audit strategy and if it has obtained reasonable assurance that the management and control systems of the OP function effectively.

THE COURT'S OBSERVATIONS

For a group of ERDF OPs in Spain, the audit authority had found that a beneficiary had not maintained the newly created workplaces for the required period (i.e. for at least two years after the grant award) as required by the grant agreement. However, the audit authority did not include this finding in its error rate calculation since the newly-created jobs had still existed when the expenditure was certified. Hence, the audit authority underestimated the error rate for the group of OPs. The Commission accepted this approach, which also meant that the 'residual error rate' (which takes account of all financial corrections made since 2007) was understated and, as a result, remained below the Commission's 2 % materiality threshold. In the Court's view, this should have also been reflected in the Commission's assessment for nine out of the 19 OPs concerned.

For four OPs in Germany-Niedersachsen, the sampling population did not reconcile with the expenditure declared to the Commission in 2012. A similar issue had already been identified by the Court for the 2012 ACR. Despite this, the Commission validated the error rate as reported by the audit authority. In the Court's view, a flat error rate of 5 % should have been applied to two ERDF OPs and of 2 % to two ESF OPs. This should have also been reflected in the Commission's assessment for two out of the four OPs concerned.

5.48. The Court also identified cases for which the Commission's approach to verifying the information reported by audit authorities differed between OPs or between the two directorates-general. Such differences hamper a harmonised assessment of the work of the audit authorities and, as a result, of the legality and regularity of cohesion spending by the two directorates-general.

Commission's desk reviews cannot properly address the risk of Member States reporting inaccurate and unreliable information

5.49. Compared to 2012, the Court considers that overall both directorates-general have strengthened their checks. In many cases the Commission requested audit authorities to provide additional information such as a reconciliation of the audited population with the expenditure declared, a recalculation of the sample size or detailed information about specific audits of operations. In addition, the two directorates-general undertook fact finding missions to 21 Member States to verify the data reported by audit authorities. This enabled the Commission to perform a more detailed analysis of annual control reports.

THE COMMISSION'S REPLIES

5.48. *The Commission considers that it has robust and harmonised systems in place to analyse the annual control reports on the two Directorates-General responsible for cohesion policy. However, annual control reports are analysed on a case-by-case basis and the final assessment depends on the professional judgements of the auditors in charge who take into account all available information to draw their opinion. As a result, slight variations might be possible and are acceptable, as long as the main conclusions do not substantially differ.*

THE COURT'S OBSERVATIONS

5.50. The Court observes however that the robustness of the Commission's assessment rests on the accuracy and reliability of information reported by Member State authorities. In particular, the Court's audits over the last three years have shown that ⁽³⁹⁾:

- some audit authorities underreport problems and that the reported error rates are not always fully reliable;
- information on financial corrections reported by Member States may not always be reliable or accurate and that the Commission's calculation method results in an understated residual error rate.

5.51. The Commission's verifications primarily consist of desk reviews and can only partly address these risks. The Court considers that the Commission's scope for validating (and, where necessary, adjusting) the reported error rates remains limited as long as audit authorities are not systematically requested to provide the Commission with more specific information on their audits of operations for its verification of the annual control reports. In addition, according to international auditing standards, the Commission's monitoring of audit authorities during the year should include re-performances for some of the audits of operations carried out by them ⁽⁴⁰⁾.

Review of the Commission's annual activity reports

5.52. The Court assessed the 2013 annual activity reports (AARs) and accompanying declarations of the Directorates-General for Regional and Urban Policy, for Mobility and Transport, and for Energy. In particular, with regard to the regularity of payments authorised during 2013, the Court:

- (a) checked the consistency and accuracy of the Commission's calculation of the amounts at risk;
- (b) assessed the reservations made for 2013.

THE COMMISSION'S REPLIES

5.50. *The Commission refers to its reply to paragraph 5.41. The Directorates-General's audit work included an exhaustive on-the-spot audit enquiry, including re-performance of system audits and audits of operations at the level of individual beneficiaries.*

- *The Commission has conducted specific risk-based on-the-spot audit in order to ensure that the corrections reported for 68 OPs over the last three years are effectively implemented and, in case of doubts or insufficient evidence, deducts the amounts concerned from the cumulative financial corrections taken into account for the purposes of the calculation of the residual error rate.*

5.51. *The Commission has a thorough verification process in place, including on-the-spot fact-finding missions, in order to ensure the accuracy and reliability of the error rates reported by audit authorities. It alternatively uses flat rates when it considers error rates as unreliable. The Commission's assessment is to be seen in the wider context of its review of the work of audit authorities, which includes an extensive re-performance work (see Commission replies to paragraphs 5.41 and 5.54). The Commission also carries risk-oriented audits to verify the accuracy of reported financial corrections (see reply to paragraph 5.50).*

⁽³⁹⁾ Special report No 16/2013, paragraph 83.

⁽⁴⁰⁾ 2012 annual report, paragraph 5.52 (first indent), and special report No 16/2013, paragraph 83 and recommendations 1 and 4.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Directorate-General for Regional and Urban Policy

5.53. In its 2013 AAR, the Directorate-General for Regional and Urban Policy estimated that between 2,8 % and 5,3 % of the interim and final payments for ERDF/CF OPs of the 2007-2013 programming period authorised during the year were at risk of error. This estimate is based on error rates reported by audit authorities in relation to 2012 expenditure and validated by the Commission in March 2014 (see paragraphs 5.38 to 5.42).

5.54. The Commission's estimate is above the 2 % materiality threshold set by the Commission. The Court recalls that the annual error rates reported by the Commission are not directly comparable to those estimated by the Court ⁽⁴¹⁾.

5.55. Overall, the Commission's calculation of the amounts at risk is consistent with the available information and accurate. In addition to the issues raised in paragraphs 5.49 to 5.51, the Court notes the following two aspects (see Box 5.7).

Box 5.7 — Remarks on the Commission's estimate of the amounts at risk

The Court's recalculation (2,9 %) basically confirms the Commission's estimate of the lower error rate (2,8 % of the interim and final payments for ERDF/CF OPs of the 2007-2013 programming period).

The Commission has modified its methodology for estimating the range of error in 2013 ⁽⁴²⁾. Based on the approach applied in previous years, the higher error estimate for this year would have been 6,9 % instead of 5,3 % as disclosed in the 2013 AAR.

5.54. Common Commission reply to paragraphs 5.54 and 5.55:

The Commission agrees that the Court's error rate and Commission's one are not directly comparable. However, the objective of this process is essentially the same, i.e. assessment of the risk to the EU budget in a particular year.

The Commission takes into account all these differences in its assessment, in particular timing, differences in quantification of public procurement errors and the impact of flat rate corrections it imposes to programmes (see Commission reply to paragraph 11 of the mentioned Court's special report 16/2013).

Except for the differences noted above, the Commission considers that for the 2013 annual report, as it was the case for the last three years in a row for DG Employment, Social Affairs and Inclusion and two years in a row for DG Regional and Urban Policy before this annual report, the result of the Commission's assessment is in line with the error rates calculated by the Court.

Box 5.7 — Remarks on the Commission's estimate of the amounts at risk

The Commission takes note of the Court's assessment.

DG Regional and Urban Policy modified its methodology for estimating the higher error estimate in order to make better use of all available information reported by audit authorities, when considered reliable.

⁽⁴¹⁾ Special report 16/2013, paragraph 11.

⁽⁴²⁾ Directorate-General for Regional and Urban Policy's annual activity report, p. 53, footnote 73.

THE COURT'S OBSERVATIONS

5.56. When assessing whether reservations need to be made for OPs (or groups of OPs), the Directorate-General for Regional and Urban Policy also considers the OP's 'residual error rate' (see paragraphs 5.40 and 5.41).

5.57. For the 322 ERDF/CF OPs of the 2007-2013 programming period as a whole, the Commission estimates this 'residual error rate' to be 1,2 % of the payments made from the EU budget. The number of OPs subject to reservation by the Directorate-General for Regional and Urban Policy decreased from 85 OPs in 2012 to 73 OPs⁽⁴³⁾. Meanwhile, the estimated financial impact of these reservations increased from 308 million euro in 2012 to 423 million euro in 2013⁽⁴⁴⁾.

5.58. The Court notes, however, that the Commission has only limited information as to whether the systems put in place by Member States for imposing financial corrections are effective and whether the information reported by certifying authorities by the end of March 2013 is accurate, complete and reliable⁽⁴⁵⁾. This assessment is corroborated by the Commission's internal audit service which considers that very limited assurance can be placed on the financial corrections reported by Member States due to the way in which they are reported to the Commission, but also because audit authorities only perform limited checks on them. This carries the risk that the Commission underestimates the 'residual error rate' and, as a result, that the Commission's assessment of the individual OPs and the financial impact of the reservations in the AAR is not sufficiently robust.

THE COMMISSION'S REPLIES

5.56. *The Commission underlines that the use of a 'cumulative residual risk' is, as noted by the Court, an additional criterion to possibly make additional reservations in the annual activity report, following the system assessment and consideration of the validated error rate (see the common annex 4 'Materiality criteria' of the AARs of DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion).*

5.58. *The Commission refers to its reply to paragraph 5.50, second indent. Its actions to verify the accuracy of the data provided by the Member States. DG Regional and Urban Policy also decided to increase its audit coverage of data on withdrawals and recoveries reported by Member States, and to use all available audit results from audit authorities, in order to increase its assurance on reported data used for the calculation of the cumulative residual risk.*

⁽⁴³⁾ The Directorate-General for Regional and Urban Policy has also issued reservations for 35 ERDF/CF OPs for which the validated error rates and/or the 'residual error rate' was below the Commission's 2 % materiality threshold (see paragraph 5.43).

⁽⁴⁴⁾ These figures include fully and partially quantified reservations for OPs for which interim and/or final payments were authorised during the year (61 in 2012 and 55 in 2013) and for OPs for which no such payments were made (24 in 2012 and 19 in 2013).

⁽⁴⁵⁾ Special report 16/2013, paragraphs 35 to 40.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Directorate-General for Mobility and Transport and Directorate-General for Energy

5.59. The Directorate-General for Mobility and Transport and the Directorate-General for Energy:

- made reservations covering 1,4 % (in relation to mobility and transport policies) and 16,4 % (in relation to energy policies) of the total payments authorised during the year⁽⁴⁶⁾;
- estimated that approximately 4,1 % of payments made during 2013 in relation to the Seventh Framework Programme for research and technological development were affected by errors;
- calculated the impact of their reservations to be 0,1 % (in relation to mobility and transport policies) and 0,8 % (in relation to energy policies) of the payments made in 2013 on the basis of the respective residual error rates for these areas.

5.60. In 2013, as in previous years, the Court found several errors in relation to non-compliance with EU and national public procurement rules for the TEN-T and the EEPR projects examined (see **Annex 5.1**). However, as in previous years, no reservation in this respect has been issued by the Directorate-General for Mobility and Transport for the TEN-T programme. The Court also considers that the Directorate-General for Energy should not have lifted its reservation, issued for the first time in 2012 for EEPR, in relation to public procurement.

5.60. *The Commission considers that the Directorate-General for Mobility and Transport has followed the standing instructions for 2013 AARs and that there were no reasons for a reservation for the TEN-T programme. The multi-annual residual error rate for finalised ex post controls for the 2007-2013 TEN-T programme was below the materiality threshold of 2 %. Furthermore, throughout 2013, the Agency continued to reinforce its ex-ante and ex-post controls, particularly in the field of public procurement.*

The Directorate-General for Energy decided to lift the reservation issued in its 2012 AAR since:

- *the higher number of ex-post controls in the EEPR programme resulted in a calculated 2013 residual error rate below the 2 % quantitative materiality threshold.*
- *in addition, further corrective measures have been taken as of 2013 to minimise the risk, in particular in relation to public procurement.*

⁽⁴⁶⁾ This includes payments made by the Innovation and Networks Executive Agency (INEA, formerly known as TEN-TEA) and by the Executive Agency for Small and Medium enterprises (EASME, formerly known as EACI).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

5.61. For this policy group:

- testing of transaction indicates that the most likely error present in the population is 6,9 %;

- the examined systems are assessed as partially effective ⁽⁴⁷⁾.

5.61.

The Commission notes that the most likely error reported for 2013 is in line with the error rates presented by the Court for the last four years.

This confirms that the error rate for the 2007-2013 programming period remains stable and significantly below the rates reported for the 2000-2006 period. This development derives from the reinforced control provisions of the 2007-2013 period and the Commission's strict policy to interrupt/suspend payments when deficiencies are identified, as reported in the 2013 annual activity report of DG Regional and Urban Policy (see section 2.111 F, pp. 44-45). The Commission will continue to focus its actions on the most risky programmes/Member States and implement corrective measures when needed through a strict policy of interruptions and suspensions of payments. For the 2014-2020 period the Commission's corrective capacity was further improved by removing, under certain conditions, the possibility for Member States to re-use funds, resulting in net financial corrections. This will be an important incentive for Member States to detect and correct irregularities before certifying annual accounts to the Commission.

In addition, the Financial Regulation (Article 80(4)) foresees the use in accordance with the cohesion policy rules (Article 99(2) of Regulation (EC) No 1083/2006) of flat rate or extrapolated corrections where the unduly spent amounts cannot be precisely identified, which is a frequent scenario. This was the case for regional policy in 2013. The Commission has acted within its powers and in full respect of the existing regulations in order to protect the EU budget. Under the Court's approach, adjustments are made to the extent that a link to individual operations was established. The Commission considers that the flat rate corrections applied covered the entirety of the programmes and operations concerned.

See also the Commission's reply to paragraph 1.17.

⁽⁴⁷⁾ The conclusion on systems is limited to the systems selected for examination as defined in the audit scope in paragraph 5.19(c)(i).

THE COURT'S OBSERVATIONS

5.62. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

Recommendations

5.63. **Annex 6.2** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports as part of chapter 6.

5.64. Following this review and the findings and conclusions for 2013, the Court recommends that the Commission should:

- **Recommendation 1:** require from the Member States in their management declarations (according to Article 59(5) (a) of the Financial Regulation ⁽⁴⁸⁾) an explicit confirmation regarding the effectiveness of the first level checks performed by the managing and certifying authorities;

THE COMMISSION'S REPLIES

5.62. *The Commission has taken specific actions in order to mitigate the risks identified, which include in particular preventive and corrective measures such as guidance, training, simplification in addition to targeted, risk-based on-the-spot audits and a strict policy on interruptions/suspensions of payments and financial corrections.*

5.64.

The Commission accepts this recommendation.

The Common provisions Regulation for the 2014-2020 period requires the programme managing authorities to submit management declaration confirming information contained in the accounts and that the control system in place gives the necessary guarantees concerning the legality and regularity of the operations and declared expenditure through the implementation of the necessary management verifications as foreseen in Article 125 of the Regulation. This declaration will be accompanied by a report containing a summary of all control and audit results carried out up to certification of the accounts, an analysis of the nature and extent of errors and system weaknesses identified, as well as of corrective actions taken or planned. The Commission is preparing guidelines for managing authorities on the drafting of the management declarations and annual summary.

⁽⁴⁸⁾ Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1).

THE COURT'S OBSERVATIONS

- **Recommendation 2:** carry out an assessment of the 'first level checks' performed during the 2007-2013 programming period in accordance with Article 32(5) of the Financial Regulation. Taking account of the weaknesses identified, the Commission should analyse the costs and benefits of possible corrective measures and take (or propose) appropriate action (such as the simplification of the applicable provisions, improvements in the control systems and re-design of the programme or delivery system);
- **Recommendation 3:** analyse the underlying reasons for the high number of cases of non-compliance with EU state aid rules;

THE COMMISSION'S REPLIES

The Commission accepts part of this recommendation and refers to the design of the delivery system for 2014-2020 programming period since it is not feasible to re-design the system still for 2007-2013.

The key elements of the 2014-2020 reform are related to ensuring better spending and better programme governance to ensure a more error-safe environment. This will include increased result orientation and performance, ex ante conditionalities to be fulfilled at the start of implementation for each programme, simplification, particularly for beneficiaries and harmonised and simplified eligibility rules.

The Common Provisions Regulation for the 2014-2020 programming period also contains reinforced control provisions and requirements compared to the 2007-2013 period that will improve the Member States' accountability so as to better address errors and ensure legality and regularity of co-financed expenditure each year before certifying the programme accounts to the Commission.

As regards the assessment of the first-level checks for 2007-2013 the Commission considers it is already carrying out such assessment since 2010 through targeted audits on high risk programmes in the frame of its audit enquiry 'Bridging the assurance gap'. Results of these risk-based audits by end 2013 were submitted to the European Parliament in the context of the 2012 Discharge and are presented in the AAR of DG Regional and Urban Policy (see page 41 and Annex 8).

The Commission accepts this recommendation and, on the basis of the assessment of reported cases, will develop an action plan in order to pro-actively raise awareness and improve administrative capacity in national authorities so as to consequently reduce the number of errors linked to non-compliance with state aid rules.

The Commission will also ensure that managing authorities pay due attention to the applicable rules, and notes that the 2012 COCOF note on clarification of the need to notify aid for infrastructure investments and the new GBER regulation to enter into force on 1st July 2014 will contribute to clarifying the rules.

THE COURT'S OBSERVATIONS

- **Recommendation 4:** analyse the reasons for the persistent delays in disbursement of EU funds through FELs and take corrective measures accordingly;

- **Recommendation 5:** confirm in the annual activity report (AAR) of the Directorate-General for Regional and Urban Policy that the Commission's calculation of the 'residual error rate' is based on accurate, complete and reliable information on financial corrections. In order to do so, the Commission should request audit authorities to certify the accuracy of the data on financial corrections reported by certifying authorities for each OP whenever it deems such action necessary;

- **Recommendation 6:** consistently disclose in its annual activity report (AAR) the reasons for not making reservations (or making reservations with a lower financial impact) in those cases where this is due to exceptions to applicable Commission guidance or approved audit strategies.

THE COMMISSION'S REPLIES

The Commission accepts this recommendation and will continue to analyse the data and report on an annual basis.

The Commission will encourage programme authorities in the monitoring committee to examine and discuss the state of implementation of FELs, including the reasons for delays and possible corrective measures to be taken.

The Commission accepts this recommendation and agrees to disclose in the annual activity reports instances where it considers that due to insufficient assurance on the reported information on withdrawals and recoveries it did not take this information into account in the calculation of the cumulative residual risk.

The Commission will also continue to take account of the Member States' audit results in this area, and will request additional controls from audit authorities where necessary.

In addition, the Commission will increase the coverage of its audits on recoveries and withdrawals in the forthcoming years in order to obtain additional direct assurance on the accuracy of reported data..

The Commission accepts the recommendation and agrees to disclose further details in annex to the annual activity reports for those individual cases where, based on its assessment of the specific situations, it takes a reasoned decision not to make reservations or not to include the issue in the quantification of the reservation

ANNEX 5.1

RESULTS OF TRANSACTION TESTING FOR REGIONAL POLICY, TRANSPORT AND ENERGY

	2013					2012	2011	2010
	ERDF	CF	FEI	Transport	Energy			
SIZE AND STRUCTURE OF THE SAMPLE								
Total transactions:	125	38	5	8	4	180	180	177
RESULTS OF TESTING ⁽¹⁾ ⁽²⁾								
Proportion (number) of transactions tested found to be:								
Free of error	45 % (56)	45 % (17)	20 % (1)	38 % (3)	25 % (1)	43 % (78)	51 %	41 %
Affected by one or more errors	55 % (69)	55 % (21)	80 % (4)	62 % (5)	75 % (3)	57 % (102)	49 %	59 %
Analysis of transactions affected by error								
Analysis by type of errors								
Other compliance issues and non-quantifiable errors:	58 % (40)	81 % (17)	75 % (3)	20 % (1)	33 % (1)	61 % (62)	53 %	64 %
Quantifiable errors:	42 % (29)	19 % (4)	25 % (1)	80 % (4)	67 % (2)	39 % (40)	47 %	36 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS								
Most likely error rate						6,9 %	6,8 %	6,0 %
Upper Error Limit (UEL)						10,1 %		
Lower Error Limit (LEL)						3,7 %		

⁽¹⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

⁽²⁾ Numbers quoted in brackets represent the actual number of transactions.

ANNEX 5.2

RESULTS OF EXAMINATION OF SELECTED CONTROL SYSTEMS FOR COHESION
(REGIONAL AND URBAN POLICY AND EMPLOYMENT, SOCIAL AFFAIRS AND INCLUSION)

Assessment of Commission's verification of error rates reported by audit authorities

The Court found ...	ERDF/CF OPs examined	ESF OPs examined	TOTAL
<i>... no issues with the Commission's checks</i>	108 (77 %)	47 (87 %)	155 (80 %)
<i>... significant issues with the Commission's checks; but without any impact on the number of reservations reported in the AARs (or their quantification)</i>	17 (12 %)	6 (11 %)	23 (12 %)
<i>... significant issues with the Commission's checks, and reasons for not making additional reservations (or quantifying reservations differently) have not been fully disclosed in the AARs</i>	15 (11 %)	1 (2 %)	16 (8 %)
TOTAL number of OPs examined	140 (100 %)	54 (100 %)	194 (100 %)

CHAPTER 6

Employment and social affairs

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 THE COURT'S OBSERVATIONS

INTRODUCTION

6.1. This chapter presents the specific assessment of the policy area Employment and social affairs. Key information on the activities covered and the spending in 2013 is provided in **Table 6.1**.

Table 6.1 — Employment and social affairs — Key information 2013

		<i>(million euro)</i>
Policy area	Description	Payments
Employment and social affairs	European Social Fund	13 763
	Employment, social solidarity and gender equality	97
	Administrative expenditure	90
	Instrument for Pre-Accession Assistance	65
	Working in Europe — Social dialogue and mobility	50
	European Globalisation Adjustment Fund	42
		14 107
Total payments for the year		14 107
- total administrative expenditure ⁽¹⁾		90
Total operational expenditure		14 017
- advances ⁽²⁾ ⁽³⁾		220
+ clearings of advances ⁽²⁾		2 336
+ disbursements to final recipients from Financial Engineering Instruments		67
Audited population, total		16 200
Total commitments for the year		12 131

⁽¹⁾ The audit of administrative expenditure is reported in chapter 9.

⁽²⁾ In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 7).

⁽³⁾ This figure includes 70 million euro of advances paid to Financial Engineering Instruments.

Source: 2013 consolidated accounts of the European Union.

THE COURT'S OBSERVATIONS

6.2. The 'Employment and social affairs' policy area is largely financed through the European Social Fund (ESF), which is one of the cohesion policy funds together with the European Regional Development Fund (ERDF) and the Cohesion Fund (CF) and is governed by the same rules. Additional provisions for the ESF are set out in a specific regulation⁽¹⁾. For issues common to all three Funds, reference is made in this chapter to chapter 5.

Specific characteristics of the policy area*Policy objectives*

6.3. The 'Employment and social affairs' policy area forms part of the EU cohesion policy, which aims to reinforce economic, social and territorial cohesion within the EU by reducing the gap in the level of development between regions. Specifically, the main objectives of EU employment and social policy are to fight unemployment, to develop human resources and to promote integration in the labour market.

Policy instruments

6.4. The ESF is the main tool for the implementation of employment and social policy, accounting for around 98 % of the policy area spending in 2013. The ESF invests in human capital through training to improve access to employment, including helping people from disadvantaged groups to get jobs and other employment measures (e.g. subsidising salary and/or social security costs for formerly unemployed persons).

⁽¹⁾ Regulation (EC) No 1081/2006 of the European Parliament and of the Council of 5 July 2006 on the European social fund and repealing Regulation (EC) No 1784/1999 (OJ L 210, 31.7.2006, p. 12).

THE COURT'S OBSERVATIONS

6.5. Other spending in this area takes the form of subsidies and grants to organisations implementing and coordinating social and employment actions. This includes funding EU agencies⁽²⁾, the European Globalisation Adjustment Fund (EGF)⁽³⁾, the Instrument for Pre-Accession Assistance (IPA)⁽⁴⁾ and contributions to financial instruments such as the European Progress Microfinance Facility⁽⁵⁾.

Management and control of spending

6.6. The Commission and the Member States share the management of the implementation of ESF and EGF expenditure. The ESF is governed by the management and control systems for cohesion spending as a whole, as described in chapter 5 (see paragraphs 5.6 to 5.11). For the EGF, the EU budgetary authority (Council and European Parliament) decides on the appropriations. The Commission then reviews the applications for funding submitted by Member States and approves the payments.

6.7. The IPA is implemented through decentralised management. Under decentralised management, the Commission confers the management of certain actions (e.g. tendering, contracting and payments) on the beneficiary country, while retaining overall final responsibility for general budget execution⁽⁶⁾.

6.8. Other social and employment expenditure is largely managed directly by the Directorate-General of Employment, Social Affairs and Inclusion at the Commission (DG EMPL).

⁽²⁾ The European Institute for Gender Equality, the European Foundation for the Improvement of Living and Working Conditions, and the European Agency for Safety and Health at Work.

⁽³⁾ The EGF supports workers in the EU made redundant as a result of major structural changes in world trade patterns and of the financial and economic crisis.

⁽⁴⁾ Only payments for the human resources development component of the IPA are included under the 'Employment and social affairs' policy budgetary area. Amongst other things, the IPA supports candidate countries in preparing for the implementation and management of the ESF.

⁽⁵⁾ The European Progress Microfinance Facility, launched in 2010, increases the availability of microcredit — loans below 25 000 euro — for setting up or developing a small business.

⁽⁶⁾ In accordance with Article 53c of Council Regulation (EC, Euratom) No 1605/2002 (OJ L 248, 16.9.2002, p. 1).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Risks to regularity

6.9. The main risks for this policy area are related to the intangible nature of the investments in human capital (such as training courses), the diversity of the co-financed activities and the involvement of multiple, often small-scale, partners in the implementation of projects. These factors increase the risks of non-compliance with EU and/or national eligibility rules and legislation resulting in ineligible costs being accepted or calculation errors affecting the accuracy of claims, which are then not detected by the systems in place. Claims may also be accepted for courses that did not take place or were attended by fewer participants than declared.

6.10. In addition, Member States' authorities face competing priorities. Spending has to be subject to appropriate checks intended to ensure regularity and sound financial management. At the same time, there is an interest in absorbing the funds allocated by the EU. This may in practice militate against the consistent application of effective controls so that infringement of rules are not detected and corrected and ineligible expenditure is ultimately reimbursed from the EU budget. This may also result in the funding of projects which are too costly, not efficiently implemented or unlikely to achieve the intended results⁽⁷⁾. This risk increases as the end of the eligibility period approaches.

6.11. Although the implementation of projects through the award of public procurement contracts is less frequent for ESF (especially above EU thresholds), the risk of non-compliance with public procurement rules is still relevant within this policy area.

6.9. *The Commission has taken specific actions in order to mitigate the risks identified, which include preventive and corrective measures such as guidance, training, simplification and a strict policy on interruptions and suspensions of payments, when necessary. The Commission is in particular actively promoting the use of simplified cost options by the Member States and addressing identified cases of 'gold plating' involving unnecessary complex eligibility rules set out by some Member States. The Commission also insists on the importance of first level checks. In this respect, DG Employment, Social Affairs and Inclusion has carried out a risk based thematic audit on the management verifications and has shared the audit conclusions and recommendations with the ESF Managing Authorities.*

6.10. *Member States approve projects on a rolling basis as foreseen in the priority axis of multiannual Operational Programmes. The concerned monitoring committees are required to ensure that projects with EU added value are selected and approved and the spending is subject to multiple checks from national and EU authorities.*

⁽⁷⁾ Further information on performance issues is presented in chapter 10.

THE COURT'S OBSERVATIONS

Audit scope and approach

6.12. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of employment and social affairs, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 182 transactions⁽⁸⁾ as defined in **Annex 1.1**, paragraph 7. The sample is designed to be representative of the entire range of transactions within the policy area. In 2013 the sample consisted of 24 interim or final payments (or clearings) to ESF Operational Programmes (OPs) in 13 Member States⁽⁹⁾, three EU agencies and other projects or actions managed directly by the Commission;
- (b) the assessment of control systems examined:
 - (i) the Commission's supervisory activities of audit authorities (AAs). In particular, the audit work assessed the effectiveness of the Commission's checks (DG EMPL) on the accuracy and reliability of the information and conclusions of annual control reports (ACRs) and audit opinions prepared by the AAs;
 - (ii) the annual activity report (AAR) of DG EMPL.

⁽⁸⁾ For the ESF and IPA, the Court's sample contained 175 ESF projects of which 161 relate to the 2007-2013 programming period and 14 to the 2000-2006 period. The remaining 7 projects concerned EGF and other employment and social measures. The sample was drawn from all payments and clearings, except for advances which amounted to 220 million euro in 2013.

⁽⁹⁾ Bulgaria, Czech Republic, Germany, Greece, Spain, France, Italy, Latvia, Hungary, Poland, Portugal, Romania and the United Kingdom.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

REGULARITY OF TRANSACTIONS

6.13. **Annex 6.1** contains a summary of the results of transaction testing. Out of the 182 transactions audited by the Court 50 (27 %) were affected by error. On the basis of the 30 errors which it has quantified, the Court estimates the most likely error to be 3,1 % ⁽¹⁰⁾.

6.13. Common reply of the Commission to paragraphs 6.13 and 6.14.

The Commission disagrees with the inclusion of an error with a significant impact despite the fact that no evidence is available to conclude that the concerned project implemented by a beneficiary currently under preliminary investigation on which no judgement has been made yet by the judicial authorities, was affected by any irregularities and despite the fact that the allegations, which concern potential overcharging of expenditure would in any case not apply to the operation audited by the Court since it was implemented through standard unit costs (see paragraph 6.16) approved by the Managing Authority. Should the allegations be finally confirmed, the Commission will apply the necessary financial corrections.

The Commission notes a decrease in the frequency of errors detected by the Court in the policy area of Employment and Social Affairs in 2013 27 % as compared to 35 % in 2012 and 40 % in 2011.

The Commission understands that the error rate reported by the Court is an annual estimate which takes into account corrections of project expenditure or reimbursements affected by errors detected and recorded before the Court's audit. The Commission underlines that it is bound by the Financial Regulation which stipulates, in Article 32(2)(e), that its internal control system should ensure, amongst other things, 'adequate management of the risks relating to the legality and regularity of the underlying transactions taking into account the multiannual character of programmes and the nature of payments'. The Commission will continue to exercise its supervisory role, in particular by implementing financial corrections and recoveries at a level that corresponds to the level of irregularities and deficiencies identified.

The Commission further notes that given the multiannual character of the management and control systems under Cohesion policy, errors made in 2013 may also be corrected in subsequent years even after the closure of the programmes. To illustrate this, in 2013 financial corrections concerning the ESF 2000-2006 and 2007-2013 programming periods amounted to 689 Mio euro, which includes the corrections that the Court has already taken into account in determining its error rate. Furthermore, financial corrections amounting to 153 Mio euro for the 1994-1999 programming period were also implemented in 2013. Total recoveries amounted to 56 Mio euro in 2013.

⁽¹⁰⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,5 % and 4,7 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

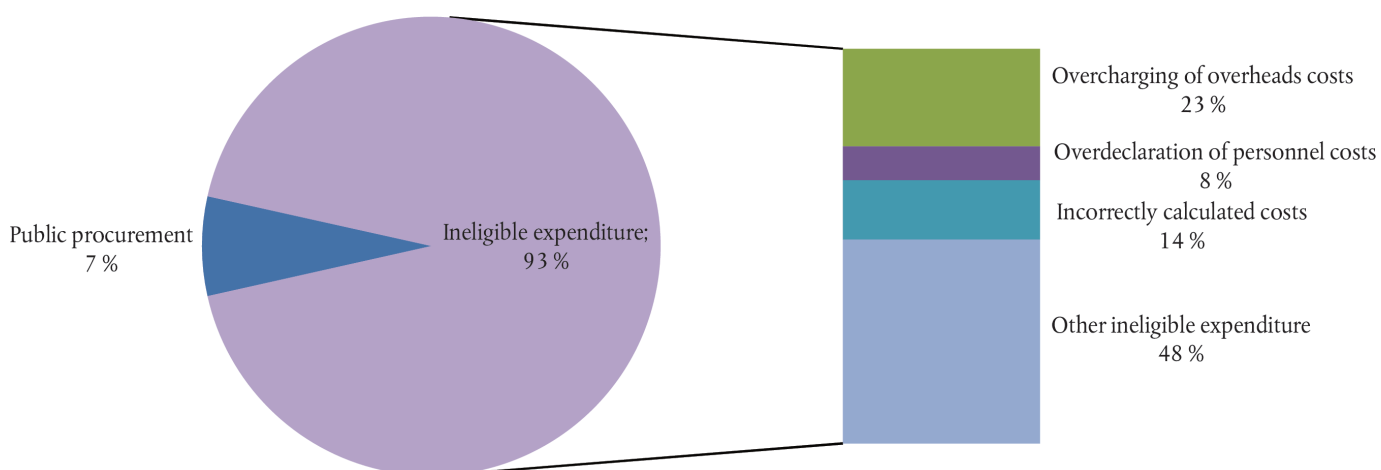
THE COMMISSION'S REPLIES

6.14. Chapter 1 contains an assessment of the accuracy and reliability of the figures related to financial corrections presented in Note 6 to the EU consolidated accounts (see paragraphs 1.12 to 1.14). The extent to which the Court takes financial corrections into account when estimating the most likely error rate was explained in Chapter 1 of the 2012 Annual Report ⁽¹⁾.

6.15. Most of the errors found in this policy area concerned ineligible expenditure and failures to comply with public procurement rules. **Graph 6.1** presents the extent to which the different types of irregularities contributed to the Court's estimate of the most likely error for 2013.

6.15. *The Commission will follow up all errors reported by the Court and will apply financial corrections where appropriate and legally possible. The Commission notes that in some cases national or regional rules applied to ESF funded expenditure are more demanding than those foreseen in the national legislation for similar expenditure nationally funded. Therefore, these additional requirements can be seen as an instance of gold plating, self-imposing unnecessary administrative burden and complexity to ESF funded expenditure, as described in the recently published Commission report ⁽¹⁾.*

Graph 6.1 — Contribution by type of error to the most likely error



⁽¹⁾ See 2012 annual report, paragraphs 1.19 to 1.37.

⁽¹⁾ <http://www.europarl.europa.eu/document/activities/cont/201311/20131115ATT74496/20131115ATT74496EN.pdf>

THE COURT'S OBSERVATIONS

6.16. In 2013, the Court sampled 31 transactions, relating to 14 of the 24 payments to OPs, which included simplified cost options (SCOs) in their cost declarations. The Court detected no error related to the specific use of SCOs. This indicates that projects using SCOs are less likely to be prone to error than the ones using actual costs.

Ineligible expenditure

6.17. The Court detected the reimbursement of ineligible costs and incorrectly calculated costs in 28 transactions, 15 % of the 182 transactions audited. 26 of these transactions related to ESF projects. Such errors account for 93 % of all quantifiable errors and make up approximately 93 % of the estimated error rate for this policy area.

6.18. As in previous years, this is the main source of errors. In particular, most of the errors were due to:

- (a) Overcharging of overhead costs.
- (b) Overdeclaration of personnel costs.
- (c) Costs calculated incorrectly.
- (d) Other ineligible costs.

THE COMMISSION'S REPLIES

6.16. *The Commission has actively worked since the introduction of the simplified cost options to progressively extend their use and considers that these efforts have already led to positive results. The Commission continues to actively promote the use of simplified cost options in the 2014-2020 programming period in order to both reduce the administrative burden on the beneficiaries and to further reduce the risk of error.*

6.17. *The Commission will follow all cases identified by the Court and will ensure that corrective measures take place.*

THE COURT'S OBSERVATIONS

6.19. Box 6.1 presents illustrative examples of errors within this category.

Box 6.1 — Examples of ineligible expenditure

- (a) *Overcharging of overhead costs:* According to EU and/or national eligibility rules overhead costs should be allocated pro rata to the operation, according to a duly justified, fair and equitable method. In the Czech Republic the overhead costs of a beneficiary which carried out a training project were allocated to the ESF project by using an incorrect cost driver resulting in overcharging overhead costs.

Similar findings were identified in other ESF projects in Spain and Romania.

- (b) *Overdeclaration of personnel costs:* In a private school in Portugal, the full salary of the school director was charged to the ESF project without taking into account his other non-ESF tasks and the ceiling established for the co-financing of salaries by the ESF. Subsequent to the audit, this error has been corrected by the Portuguese authorities in March 2014.

Similar findings were also identified in a project managed directly by the Commission and other ESF projects in Germany, Spain, Italy, Poland, and the United Kingdom.

- (c) *Incorrectly calculated costs:* A project in Germany declared amounts invoiced by the beneficiary's subsidiary for rent, catering, publication material etc., without evidence of actual costs and the link to performed activities. The national authorities did not address this issue even though they were aware of the situation.

Similar findings were also identified in other ESF projects in Poland and Portugal.

- (d) *Other ineligible costs:* In an ESF project in Spain the employers' social security contribution is reduced when maintaining the employment following a maternity leave. One of the conditions to benefit from this support is the need to be up to date with tax obligations. In one case, the beneficiary did not comply with this obligation for six out of nine months resulting in ineligible expenditure.

Similar cases of other ineligible costs were also identified in another ESF project in Poland.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Breaches of public procurement rules

6.20. The proportion of transactions with public procurement procedures is lower for employment and social affairs than for regional policy, transport and energy. Of the 182 sampled transactions, 53 involved the application of EU and/or national public procurement rules. The Court found breaches of these public procurement rules in 11 of them (21 %). Serious failures which led to quantifiable errors were identified in 2 of these cases. They account for 7 % of all quantifiable errors and make up approximately 7 % of the estimated error rate for this policy area (See Box 6.2).

6.21. For seven transactions audited in three Member States⁽¹²⁾, the national authorities had identified serious cases of non-compliance with public procurement rules and imposed specific financial corrections at project level⁽¹³⁾. Those errors have not been taken into account in the calculation of the error rate, since the corrective measures were taken before the notification of the Court's audit.

6.20. *While the Commission and the Court audit compliance with public procurement rules in the same way, the Commission applies since the 2000-2006 programming period proportionate flat-rate corrections thereby addressing the risk of damage to the EU budget and taking into account the nature and gravity of the actual irregularities.*

These flat rates are applied by the Commission and by most national authorities when imposing financial corrections for infringements of public procurement rules, including when following up the errors reported by the Court.

The Commission also notes that the Discharge Authority called on the Commission and the Court to harmonise their methodologies to quantify public procurement errors (European Parliament decision of 17 April 2013 on discharge in respect of the implementation of the general budget of the European Union for the financial year 2011).

The Commission has updated in 2013 its decision on the quantification of public procurement errors in shared management, including inter alia cohesion spending and rural development (see Commission decision C(2013) 9527 final).

Based on this Commission decision, the Commission estimates that the quantification of errors for public procurement errors in 2013 would be up to 0,1 percentage point lower than calculated by the Court when using its own quantification.

⁽¹²⁾ Czech Republic, Poland and Romania.

⁽¹³⁾ in accordance with European Commission's COCOF note 07/0037/03.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Box 6.2 — Examples of breaches in public procurement rules

- (a) *Non respect of principle of equal treatment:* In an ESF project in France, the principle of equal treatment was not respected during the evaluation process for a public procurement above EU thresholds. Furthermore, the service contract was inappropriately subdivided in lots. Only one bidder for each geographical section was received, de-facto limiting competition. In the Court's view, these issues should have led to the cancellation of the procedure.
- (b) *Contracting of services outside the scope of the framework agreement:* In Hungary a beneficiary procured services for software development by using an existing framework agreement resulting from a public procurement procedure carried out by the Hungarian central purchasing body. This specific call for tenders explicitly stated that software development was not subject to the framework agreement and it could only be purchased through an individual public procurement procedure.

Numerous failures to observe procedural requirements

6.22. The Court found several failures by managing authorities and beneficiaries to observe procedural requirements in the management and implementation of ESF projects. In 24 cases, the failures are considered by the Court as serious issues of non-compliance. Box 6.3 gives examples of the main categories of non-quantifiable errors. These errors do not contribute to the estimation of the error rate.

6.22. *The Commission will follow up all errors reported by the Court and ensure that corrective measures take place.*

Box 6.3 — Examples of failures to observe procedural requirements

- (a) *Late payments to beneficiaries:* In France the national authorities transferred the ESF funds to the regional bodies, when acting as beneficiaries, with serious delays which is not in compliance with the rules. In two cases, the payment delay was longer than five months.
- (b) *Contract award notice sent late or not sent at all:* according to EU public procurement rules contracting authorities must send a notice of the results of the award procedure no later than 48 days after the award of the contract. The Court found three cases in the United Kingdom where this rule was not observed.

Similar findings were also identified in an ESF project in France.

THE COURT'S OBSERVATIONS

- (c) *Non verification of compliance with state aid rules:* An ESF project in the United Kingdom was providing free training courses for employers' workforces. Although the amounts granted are likely to be 'de minimis', national authorities and the project sponsor should have verified the compliance of the measure with state aid rules.

THE COMMISSION'S REPLIES

Excessive costs claimed that did not lead to errors

6.23. The Court identified seven cases in four Member States⁽¹⁴⁾ where costs charged to the EU budget were excessive but where the regulations were insufficiently clear to conclude that expenditure is irregular. Although these cases may represent an inefficient use of EU funds, these cases are not taken into account in the calculation of the error rate (see examples in Box 6.4).

Box 6.4 — Examples of excessive costs claimed

- (a) *Excessive salaries:* In Romania cases were found where individuals were paid, while working on ESF funded projects, a salary up to five times higher than the normal salary received when working for nationally funded projects. This practice was allowed by national eligibility rules that established ceilings for salaries in EU projects that are well above the average salary conditions in the country.
- (b) *Inflated costs:* In Portugal the beneficiary of an ESF project claimed rental costs on the basis of a sub-letting contract, which doubled the rent as compared to a previous contract signed for the same office space three weeks earlier. In the Court's view, the additional equipment and furniture made available does not justify the level of the price increase. The Court could not quantify this observation due to the lack of access to information on the acquisition costs of the furniture by the renter, who was not the final beneficiary.

6.23. See Commission reply to Box 6.4 (a).

Box 6.4 — Examples of excessive costs claimed

- (a) *The salary situation in ESF funded projects in Romania was one issue identified by DG Employment, Social Affairs and Inclusion in an audit conducted in 2012. A flat rate financial correction of 25 % has been applied to this OP. As a result the Managing Authority concerned commissioned a study on the cost structure and the wage bill to serve as a basis for establishing maximum wage levels to be applied in future projects. The Commission has provided further recommendations to the Managing Authority concerning the parameters to be used for the determination of wage ceilings to be applied to ESF funded projects since the current ones are still considered too high.*

⁽¹⁴⁾ France, Poland, Portugal, Romania.

THE COURT'S OBSERVATIONS

- (c) *Accumulation of additional pre-financing:* In France national authorities request from the Commission the maximum co-financing rate per priority axis⁽¹⁵⁾, although beneficiaries are paid lower levels of co-financing⁽¹⁶⁾. For the priority axis audited, the difference accumulated to date amounts to 32 million euro, which represents 'de facto' a supplementary advance payment to France without a specific derogation⁽¹⁷⁾. If the accumulated amounts are not allocated to any beneficiary at the end of the programming period, the funds would have to be returned to the EU budget at closure.

THE COMMISSION'S REPLIES

- (c) *Discrepancies between the payments from the Union to the priority and the effective Funds contribution to the operations co-financed under that priority could occur. This is a consequence of the flexibility that the managing authorities have in applying different co-financing rates to individual operations as stated in Article 53(4) of the General Regulation.*

In accordance with the closure guidelines adopted by the Commission on 20 March 2013, the beneficiaries should receive at closure an amount of public contribution (national Funds and ESF) at least equal to the ESF amount reimbursed by the Commission to the Member State.

Insufficient reliability of management verifications

6.24. In 13 cases of quantifiable errors made by final beneficiaries, the national authorities had sufficient information (for example, from the final beneficiaries, their auditors or from the national authorities' own checks) to prevent, detect and correct the errors before declaring the expenditure to the Commission. If all this information had been used to correct errors, the most likely error estimated for this chapter would have been 1,3 percentage points lower. In addition, the Court found that for 3 cases, the error detected by the Court was made by the national authorities. These errors contributed 0,1 percentage points to the most likely error estimated.

6.25. In 2013, DG EMPL carried out a thematic audit on eight OPs of six Member States⁽¹⁸⁾ sampled on a risk basis. This audit concluded that first level checks are not reliable as they 'were carried out on a merely formal basis thus allegedly respecting the requirements of the regulations [...]. As a result, costs were certified to the Commission which had no added value or no link to the project'⁽¹⁹⁾. In addition breaches in public procurement procedures were often not identified by the management verifications, although checks were carried out by the managing authority or its intermediate body at the premises of the beneficiaries.

6.24. *The Commission has developed new guidance in order to further strengthen the reliability of management verifications in the 2014-2020 programming period. This guidance, which draws on the lessons learned from the previous programming period, has been presented to Member States and will be issued in the second half of 2014.*

6.25. *Further to the extensive work on management verifications done in the regular audits conducted by DG Employment, Social Affairs and Inclusion, the risk based thematic audit referred to by the Court focused on specific operational programmes in order to identify and address the root causes of the insufficient reliability of the management verifications. The results of this thematic audit have been presented by the Commission to Managing and Audit Authorities in 2014 and have been used in developing the guidance referred to in paragraph 6.24.*

⁽¹⁵⁾ As foreseen in Article 77 of Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25).

⁽¹⁶⁾ This is not in line with Article 80 of Regulation (EC) No 1083/2006.

⁽¹⁷⁾ As required by Article 78(2) of Regulation (EC) No 1083/2006.

⁽¹⁸⁾ Denmark, Germany, Ireland, Estonia, Slovakia and Spain.

⁽¹⁹⁾ See Overview report on the results of the thematic audit on management verifications conducted by Member States <http://www.europarl.europa.eu/document/activities/cont/201311/20131115ATT74498/20131115ATT74498EN.pdf>

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Errors found in closed OPs

6.26. The Court's sample included 14 transactions with final payments for the closure of two 2000-2006 OPs. In two programmes, the Court identified quantifiable errors in five transactions. For four of these transactions, the national authorities had sufficient information to prevent, detect and correct the errors before declaring the expenditure to the Commission. However, neither the Member State nor the Commission detected these errors in the checks carried out at closure⁽²⁰⁾. One of the OPs was closed without financial corrections. The other was subject to a 5 % correction affecting some of the projects sampled. These project specific corrections were taken into account by the Court in its assessment, significantly reducing the error rates reported by the Court. Even after taking account of these corrections, these cases account for 26 % of the estimated error rate for this policy area.

6.27. This corroborates again the observation made in the 2011 and 2012 annual reports⁽²¹⁾ that ineligible expenditure remains after the closure process unless the Commission carries out an ex-post audit and subsequently takes corrective actions.

6.26. *Common Commission reply to paragraphs 6.26 and 6.27.*

Concerning the 2000-2006 programming period, the Commission aims to ensure that the error rate at closure will not exceed 2 % for each operational programme. To this end, besides the significant number of audits conducted during the 2000-2006 programming period, DG Employment, Social Affairs and Inclusion has performed between 2011 and 2013 14 risk based closure audits covering 21 2000-2006 OP's, which represent 8.8 % of the total number of OPs and 25,6 % of the total amount of expenditure.

Based on this extensive audit work, and in order to protect the EU budget, significant financial corrections have been implemented at closure. As disclosed in DG's Employment, Social Affairs and Inclusion 2013 AAR (page 121), as of the end of 2013, 233 OPs have been closed for the 2000-2006 programming period. The Commission has implemented cumulative financial corrections for the 2000-2006 programming period amounting to 1,7 billion euro, of which 452 million in 2013, when final payments and clearings for the 2000-2006 programming period amounted to 3,3 billion euro. The Commission will follow up the specific errors identified by the Court and notes that it can make further financial corrections until three years after the formal closure of a programme when residual errors are detected.

While acknowledging the above risks, the Commission emphasizes that by nature it is almost unavoidable that individual instances of ineligible expenditure at project level remain after the closure process, since this process aims to reach the assurance that the overall remaining error rate is below the materiality threshold of 2 %. Moreover, by applying flat rate financial corrections at closure the Commission effectively protects the EU budget without necessarily correcting each case of ineligible expenditure at project level.

⁽²⁰⁾ Germany (Thüringen) and Spain.

⁽²¹⁾ See the 2012 annual report, paragraphs 6.26 and 6.27, and the 2011 annual report, paragraphs 5.52 to 5.64.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

EXAMINATION OF SELECTED CONTROL SYSTEMS

6.28. **Annex 5.2** contains a summary of the results of the systems examined by the Court.

6.29. For the 2007-2013 programming period, 113 audit authorities have been set up in all Member States for the 322 ERDF/CF and the 118 ESF OPs⁽²²⁾. Every year the AAs submit to the Commission an ACR and an audit opinion providing information on the regularity of EU expenditure. In 2013, a total of 199 ACRs and audit opinions were prepared of which 104 dealt with ESF OPs. 63 of these AAs cover at the same time and within the same ACR OPs of different funds (ERDF/CF and/or ESF).

Assessment of the Commission's supervision of AAs

6.30. The results of the Court's review of the Commission's supervision of AAs are shown in chapter 5 (see paragraphs 5.37 to 5.51).

6.31. With regard to the ESF, DG EMPL assessed the error rate reported by the AAs as fully reliable for 65 (56 %) of the 117 ESF OPs⁽²³⁾. This means that the error rates were not recalculated and the subsequent unqualified and qualified audit opinions were not changed. The Commission adjusted or considered unreliable the error rate reported for the remaining 52 of 117 OPs in 2013 (31 of 117 OPs in 2012). The major increase compared to last year is mainly due to OPs with reliable but recalculated error rates (from 18 in 2012 to 41 in 2013) rather than to OPs with unreliable or no error rates. Furthermore for 12 out of 41 OPs the result of the recalculation was marginal (+/- 0,1 %). The Court acknowledges that the Commission issues reservations not exclusively based on error rates. When making its assessment, it also applies professional judgement and takes account of all other available information.

6.29. *The audit authorities play a central role in the assurance building process, as from the beginning of the programming period and set-up of systems.*

The regulation provides the Commission the possibility to rely on the work of an audit authority for its assurance under certain conditions (Article 73 of Regulation (EC) No 1083/2006). The Commission is closely cooperating and coordinating with them, and has started reviewing their methodologies and audit results as early as 2009. This contributed to capacity building by providing advice, guidance and recommendations to audit authorities through the Commission's reperformance of audit work carried out by audit authorities.

In its 2013 Annual Activity Report (see pages 42 to 44), DG Employment, Social Affairs and Inclusion provided a detailed assessment of the accuracy and reliability of the audit information and results reported by audit authorities in their 2013 Annual Control Reports.

⁽²²⁾ These figures include the audit authorities set up after the accession of Croatia (one for ERDF/CF and one for ESF).

⁽²³⁾ The Croatian audit authority did not have to send an ACR in 2013.

THE COURT'S OBSERVATIONS

6.32. Examples of the weaknesses identified by the Court were:

- (a) In one case the Commission validated a flat error rate of 10 % although major deficiencies were identified at the audit authority. Based on the data provided by the audit authority, the Court estimated the error rate at around 25 % and considers that the Commission should have used a flat rate of 25 % (instead of 10 %).
- (b) In one case the sampling population was incorrect. In addition, the audit authority estimated and submitted in its ACR individual error rates for two ESF OPs, although it should have reported a common error rate because a common sample was drawn with other two OPs. The Commission noted these issues, but validated the individual rates estimated by the audit authority. The Court considers that, in principle, in the absence of additional explanations and disclosure, a flat 5 % error rate should have been applied for the group of four OPs (see Box 5.6).
- (c) In one case, the audit authority considered an error as anomalous⁽²⁴⁾ that was accepted by the Commission, although in the Court's view the nature of the error would not justify such classification. Anomalous errors are not projected to the whole population and thus the error rate is underestimated.

Review of DG EMPL annual activity report (AAR)

6.33. The Court assessed the 2013 AAR and accompanying declaration of the Director-General of DG Employment, Social Affairs and Inclusion. In particular, with regard to the regularity of payments authorised in 2013, the Court:

- (a) assessed the reservations made in the AAR;
- (b) checked the consistency and accuracy of the Commission's calculation of the 'amounts at risk'.

THE COMMISSION'S REPLIES

6.32.

- (a) *The Commission concluded that a reliable error rate could not be calculated on the basis of the elements available. It therefore decided to provisionally apply a flat rate of 10 %, in accordance with the Commission Decision C(2011)7321 of 19 October 2011 — Guidelines on the principles, criteria and indicative scales to be applied in respect of financial corrections 2007-2013.*

⁽²⁴⁾ The COCOF Guidance note 08/0021/03 on sampling methods for audit authorities defines in its section 4.3 an anomalous error as 'an error that is demonstrably not representative of the population... A statistical sample is representative for the population and therefore anomalous errors should only be accepted in very exceptional, well-motivated circumstances. The frequent recourse to this concept without a due justification may undermine the reliability of the audit opinion.'

THE COURT'S OBSERVATIONS

6.34. In its 2013 AAR, the Directorate-General for Employment, Social Affairs and Inclusion estimated that between 2,6 % and 3,5 % of the interim and final payments for ESF OPs of the 2007-2013 programming period authorised during the year were at risk of error. This estimate is based on error rates reported by audit authorities in relation to 2012 expenditure and validated by the Commission in March 2014 (see paragraphs 6.30 and 6.31). Around 41 % of payments were made to OPs where the Commission's final assessment in the 2013 AAR was that they were affected by material errors (more than or equal to 2 %).

6.35. The Commission's estimate is above the 2 % materiality threshold set by the Commission. The Court recalls that the annual error rates reported by the Commission are not directly comparable to those estimated by the Court.

6.36. DG EMPL's AAR contains a reservation relating to payments made for the 2007-2013 programming period for an amount at risk of 123,2 million euro in 2013. This reservation covers 36 of 118 ESF OP's (compared to 27 out of 117 OPs in 2012).

6.37. The Court considers that for one OP the Commission should have disclosed the reasons for not making a reservation (see example in Box 5.6 and paragraph 6.32(b)).

6.38. Chapter 10 includes the findings of the Court's examination of DG EMPL's reporting on policy achievements (see paragraphs 10.32 to 10.39).

THE COMMISSION'S REPLIES

6.34. According to the Commission's standing instructions for the 2013 AAR a reservation is required only if the cumulative financial risk is above 2 %, which was not the case for the large majority of the OPs referred to by the Court, since the necessary financial corrections have been implemented. As mentioned in DG's Employment, Social Affairs and Inclusion 2013 AAR out of the 41 % payments to OPs referred to by the Court 30 percentage points referred to OPs with an error rate between 2 and 5 % and only 11 percentage points of the payments were made to OPs with an error rate above 5 %. This clearly reflects the strict interruptions and suspensions policy systematically implemented by DG Employment, Social Affairs and Inclusion, which has resulted in 25 interruptions, 12 warning letters and 11 suspension decisions adopted in 2013.

6.35. The Commission agrees that the Court's error rate and Commission's one are not directly comparable. However, the objective of this process is essentially the same, i.e. assessment of the risk to the EU budget in a particular year.

The Commission takes into account all these differences in its assessment, in particular timing, differences in quantification of public procurement and other errors and the impact of flat rate corrections it imposes to programmes (see Commission reply to paragraph 11 of the Court's Special Report 16/2013).

Except for the differences noted above, the Commission considers that for the 2013 annual report, as it was the case for the last three years in a row for DG Employment before this annual report, the result of the Commission's assessment is in line with the error rates calculated by the Court.

6.38. See the Commissions replies to paragraphs 10.32 to 10.39.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONCLUSIONS AND RECOMMENDATIONS**The conclusion for 2013**

6.39. For the 'Employment and social affairs' policy area,

- (a) testing of transactions indicates that the most likely error present in the population is 3,1 %; and

- (b) the examined control systems are assessed as partially effective ⁽²⁵⁾.

6.40. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

6.39.

- (a) Common Commission reply to paragraphs 6.39(a) and (b).

The Commission shares the Court's assessment with the exception of one error (see Commission reply to paragraph 6.13).

The Commission has a thorough process to verify the reliability of the error rates reported by the audit authorities which are revised where appropriate. The fact that the error rates reported in the AAR of DG Employment, Social Affairs and Inclusion are in line with the error rate established by the Court corroborates the reliability of the auditing and reporting systems.

The Commission understands that the error rate reported by the Court is an annual estimate which takes into account corrections of project expenditure or reimbursements affected by errors detected and recorded before the Court's audit. The Commission underlines that it is bound by the Financial Regulation which stipulates, in Article 32(2)(e), that its internal control system should ensure, amongst other things, 'adequate management of the risks relating to the legality and regularity of the underlying transactions taking into account the multiannual character of programmes and the nature of payments'. The Commission will continue to exercise its supervisory role, in particular by implementing financial corrections and recoveries at a level that corresponds to the level of irregularities and deficiencies identified.

The Commission further notes that given the multiannual character of the management and control systems under Cohesion policy, errors made in 2013 may also be corrected in subsequent years even after the closure of the programmes.

The Commission will follow all cases identified by the Court and will ensure that corrective measures take place.

⁽²⁵⁾ See **Annex I.1**, paragraphs 17 and 18.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

6.41. **Annex 6.2** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented 15 recommendations for cohesion, transport and energy. Out of these recommendations, the Commission fully implemented six recommendations, while four were implemented in most respects. The remaining five recommendations have different levels of implementation depending on the DG involved.

6.42. Following this review and the findings and conclusions for 2013, the Court recommends that the Commission:

- **Recommendation 1:** should follow-up with the Member States the weaknesses identified in the DG EMPL's risk-based thematic audit of management verifications. This would require strengthening the checks related to compliance with public procurement rules and other relevant sources of errors (costs not linked to the project or with no added value);
- **Recommendation 2:** confirms in its AARs that it has carried out appropriate checks to ensure that the 'residual error rate' is based on accurate, complete and reliable information on financial corrections. In order to do so, the Commission should request audit authorities to certify the accuracy of the data on financial corrections reported by certifying authorities for each OP, whenever it deems such an action necessary;

6.42. *The Commission has taken specific actions in order to mitigate the risks identified, which include in particular preventive and corrective measures such as guidance, training, simplification and a strict policy on interruptions and suspensions of payments and financial corrections.*

The Commission accepts this recommendation and agrees on the importance of the 'first level' checks conducted by the Member States and shares the view that these should be further strengthened. Therefore, it has given guidelines to Member States on the way Managing Authorities should define and implement their management verifications. Furthermore, a comprehensive guidance note on management verifications for the 2014-2020 programming period, drawing on the lessons learned in the 2007-2013 programming period and the Court's findings, has been drafted and will be issued in the second half of 2014.

The Commission accepts this recommendation and agrees to disclose in the annual activity reports instances where it considers that due to insufficient assurance on the reported information on withdrawals and recoveries it did not take this information into account in the calculation of the cumulative residual risk.

The Commission will also continue to take account of the Member States' audit results in this area, and will envisage requesting additional controls from audit authorities where necessary.

In addition, the Commission will increase the coverage of its audits on recoveries and withdrawals in the forthcoming years in order to obtain additional assurance on the accuracy of reported data.

THE COURT'S OBSERVATIONS

- **Recommendation 3:** should ensure that the application of Article 78 and 130 of the CPR for the 2014-2020 programming period will be applied in a manner that precludes the accumulation of pre-financing in addition to the initial pre-financing payment (see example Box 6.4).

- **Recommendation 4:** should ensure that the Member State authorities in charge of managing structural funds address the issue of charging personnel costs at higher rates for EU projects compared to those financed by national funds;

- **Recommendation 5:** ensures, when approving the OPs for the new programming period, that Member States have considered all simplification possibilities allowed by the 2014-2020 European Structural and Investment Funds regulations;

- **Recommendation 6:** consistently discloses in its annual activity report (AAR) the reasons for not making reservations (or making reservations with a lower financial impact) in those cases where this is due to exceptions to applicable Commission guidance or approved audit strategies.

THE COMMISSION'S REPLIES

The Commission does not accept this recommendation.

While the Commission agrees with the Court that the flexibility in allocating Funds to operations at a rate lower or higher than the co-financing rate fixed for the priority axis that has been granted to the Member States by the 2007-2013 and 2014-2020 regulations may lead to differences between the contribution from the Funds paid by the Commission to the Member and the amount of ESF reimbursed by Member State at project level, it considers that this cannot be assimilated to pre-financing.

In line with the CPR for the 2014-2020 programming period and for each payment claim received and at closure, the Commission ensures that the ESF paid to the Member State at priority axis level is not higher than the public eligible contribution indicated in the payment application for the priority (Article 130(2) of Regulation (EU) No 1303/2013). In addition, Article 132(1) stipulates that the managing authorities shall ensure that beneficiaries receive the total amount of eligible public expenditure in full and no later than 90 days from the date of submission of the payment claim by the beneficiary. Finally, the Member State shall ensure that by closure of the operational programme, the amount of public expenditure paid to beneficiaries is at least equal to the contribution from the Funds paid by the Commission to the Member State (Article 129 of Regulation (EU) No 1303/2013).

The Commission accepts this recommendation, but believes that these issues need to be addressed on a case-by-case basis. This point has already been raised in several audit reports issued by the Commission (DG Employment, Social Affairs and Inclusion). For certain Member States, where the problem was considered to be of a systemic nature, action plans have been requested addressing specifically this phenomenon.

The Commission accepts this recommendation and is already implementing it. Regarding simplification for the 2014-2020 programming period, the Commission has taken the necessary actions to ensure that Member States implement the relevant measures as foreseen by the European Structural and Investment Funds regulations in their Operational Programmes. The necessary support is given to the Member States to ensure that all possibilities for simplification are considered through training, guidance on simplified cost options and Technical Working Groups which encourage an active exchange of best practices. Such possibilities for implementing simplification measures are also reflected in the adoption of Partnership Agreements whereby the Member States are required to demonstrate the necessary actions to achieve a reduction in the administrative burden as well as their administrative capacity. A guidance note on simplification is also being prepared in order to assist Member States to fully leverage the significantly strengthened simplification opportunities in the new programming period.

The Commission accepts the recommendation and agrees to disclose further details in annex to the annual activity reports for those individual cases where based on its assessment of the specific situations it takes a reasoned decision not to make reservations or not to include the issue in the quantification of the reservation.

ANNEX 6.1

RESULTS OF TRANSACTION TESTING FOR EMPLOYMENT AND SOCIAL AFFAIRS

	2013			2012	2011	2010
	ESF + IPA	Other social matters	Total			
SIZE AND STRUCTURE OF THE SAMPLE						
Total transactions:	175	7	182	180	180	66
RESULTS OF TESTING ⁽¹⁾ ⁽²⁾						
Proportion (number) of transactions tested found to be:						
Free of error	73 %	71 %	73 %	65 %	60 %	73 %
Affected by one or more errors	(127)	(5)	(132)	(50)	(40)	(27)
Analysis of transactions affected by error						
Analysis by type of errors						
Other compliance issues and non-quantifiable errors:	42 %	0 %	40 %	51 %	58 %	39 %
Quantifiable errors:	(20)	—	(20)	(2)	(42)	(61)
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS						
Most likely error rate	3,1 %			3,2 %	2,2 %	N/A
Upper Error Limit (UEL)	4,7 %					
Lower Error Limit (LEL)	1,5 %					

⁽¹⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

⁽²⁾ Numbers quoted in brackets represent the actual number of transactions.

ANNEX 6.2

FOLLOW UP OF PREVIOUS RECOMMENDATIONS FOR COHESION, TRANSPORT AND ENERGY

E = DG Employment, Social Affairs and Inclusion; R = DGs Regional and Urban Policy, Mobility and Transport and Energy; X = Common assessment for all DGs

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	N/A under the current framework	Insufficient evidence	
			in most respects	in some respects				
2011	<p>Recommendation 1 (recommendation 1 and 3 of 2010): strictly requires compliance with the eligibility requirements for EU funding and, on the basis of its experience gained during the 2007-2013 programming period, carries out an assessment of the use of national eligibility rules in view of identifying possible areas for further simplification and to eliminate potential sources of errors for the period after 2013;</p> <p>Recommendation 2 of chapter 6 and recommendation 3 of chapter 5: reminds Member States of their responsibility to provide for procedures which ensure the correctness and regularity of expenditure declared and addresses the weaknesses in 'first level checks' by managing authorities and intermediate bodies through further guidance and training measures;</p> <p>Chapter 6, recommendation 3 (recommendation 2 of 2010): encourages national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission (2008). Whenever significant deficiencies in the functioning of the management and control systems are identified, the Commission should interrupt or suspend payments until remedial corrective action has been taken by the Member State and make financial corrections if necessary;</p> <p>Recommendation 4 (recommendation 5 of 2010): provides further guidance to AAs for the current programming period, in particular on sampling and the scope of verifications to be undertaken for audits of projects and quality control; encourages AAs to carry out specific system audits concerning 'first level checks' done by managing authorities and intermediate bodies.</p>		E ⁽¹⁾	R ⁽¹⁾				
		E	R ⁽²⁾					
		X						
			X ⁽²⁾					

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	N/A under the current framework	Insufficient evidence	
			in most respects	in some respects				
2011	Chapter 6, recommendation 5 : rigorously verifies the accuracy and completeness of information disclosed by AAs in their ACRs and audit opinions. The Commission's verification should take full account of the information available on system audits and audits of operations undertaken by the AAs;	E ⁽⁴⁾						
	Chapter 6, recommendation 6 : encourages the use by Member States of the simplified cost options permitted in the regulations in order to reduce the scope for error.	E						
	Chapter 5, recommendation 1 : makes sanction systems more effective by increasing the impact of financial corrections and by reducing the possibility of replacing the ineligible expenditure with other expenditure, as proposed by the Commission in the area of cohesion for the next programming period. There should be a presumption that any irregularity detected subsequent to presentation of the annual accounts will lead to a net financial correction.	R						
	Chapter 5, recommendation 5 : in order to make the procedure for closing multiannual programmes in the area of cohesion more efficient: <ul style="list-style-type: none"> — reminds the Member States to ensure that the final declarations submitted for the 2007-2013 programmes are reliable, — examines the specific weaknesses identified by the Court in the winding-up declarations for closures of 2000-2006 programmes, — considers whether these problems have also occurred for other OPs, and apply financial corrections where necessary, — ensures that ongoing closure audits adequately address the issues raised by the Court. 	R R R R						

Year	Court recommendation	Court's analysis of the progress made					Commission reply	
		Fully implemented	Being implemented		Not implemented	N/A under the current framework		Insufficient evidence
			in most respects	in some respects				
2010	<p>The recommendations issued in the context of the 2010 annual report, that are substantially similar those issued in 2011, have been analysed in conjunction.</p> <p>Recommendation 4: propose an amendment to the Structural Funds Regulations for the current programming period, in order to require Member States to report on the financial implementation of FEIs. The implementation of the funds should also be checked by the Commission on a regular basis;</p> <p>Recommendation 6: propose to align the reporting periods of the annual control reports with the financial year of the EU budget in the Structural Funds Regulations for the period after 2013 and to harmonise the approaches, so that the AAs' audit opinions can be aggregated for each fund at the national and EU levels.</p>	X						

(1) There was no systematic assessment of national eligibility rules in view of simplification. In respect of DG EMPL, the action by the Commission has essentially focused on promoting the use of simplified cost options across Member States.

(2) See chapter 5, recommendations 1 and 2.

(3) Despite the new guidance to audit authorities issued during the year 2013, the Court still found some particular weaknesses in the guidance issued by the Commission to the audit authorities, namely the treatment of financial engineering instruments and the use of monetary unit sampling. In addition, the recommendation to have the AAs carrying out specific system audits concerning 'first level checks' done by managing authorities and intermediate bodies could not be evidenced.

(4) The Court found a limited number of cases where the Commission's supervision of the work of the audit authorities could be improved (paragraph 6.32).

(5) The Court notes the adoption of Regulation (EU) No 1303/2013 of the European Parliament and of the Council, including the partial alignment of the reporting periods with the financial year of the EU budget in Structural Funds. However, in respect of the approaches of audit authorities, some inconsistencies were still detected (paragraphs 5.48 and 6.32).

CHAPTER 7

External relations, aid and enlargement

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THE COURT'S OBSERVATIONS

INTRODUCTION

7.1. This chapter presents the specific assessment of external relations, aid and enlargement, which comprises policy areas: 'External relations', 'Development and relations with African, Caribbean and Pacific (ACP) States' ⁽¹⁾, 'Enlargement' and 'Humanitarian aid'. Key information on the activities covered and the spending in 2013 is provided in **Table 7.1**.

Table 7.1 — External relations, aid and enlargement — Key information 2013

(million euro)

Policy area	Description	Payments
External relations	European neighbourhood policy and relations with Russia	1 423
	Relations with Asia, Central Asia and Middle Eastern countries	623
	Common foreign and security policy	312
	Relations with Latin America	298
	Crisis response and global threats to security	264
	Administrative expenditure	157
	European Instrument for Democracy and Human Rights (EIDHR)	136
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	3 295	
Development and relations with ACP states	Administrative expenditure	349
	Geographical cooperation with African, Caribbean and Pacific (ACP) States	295
	Non-State actors in development	212
	Food security	203
	Environment and sustainable management of natural resources, including energy	134
	Human and social development	108
	Development cooperation actions and ad hoc programmes	30
	Policy strategy and coordination	14
	1 345	

⁽¹⁾ Aid provided through the European Development Funds is reported separately as it is not financed from the general budget.

(million euro)

Policy area	Description	Payments
Humanitarian aid	Humanitarian aid	1 197
	Administrative expenditure	36
	Civil Protection Financial Instrument	16
		1 249
Enlargement	Enlargement process and strategy	833
	Administrative expenditure	87
		920
Total payments for the year		6 809
- total administrative expenditure ⁽¹⁾		629
Total operational expenditure		6 180
- advances ⁽²⁾		4 181
+ clearings of advances ⁽²⁾		4 020
Audited population, total		6 019
Total commitments for the year		9 173

⁽¹⁾ The audit of administrative expenditure is reported in chapter 9.

⁽²⁾ In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 7).

Source: 2013 consolidated accounts of the European Union.

THE COURT'S OBSERVATIONS

Specific characteristics of the policy group

7.2. The EU's external action is guided by the principles set out in Article 21 of the Treaty on European Union. In the field of **development cooperation**, the EU's primary objective is the reduction and, in the long term, the eradication of poverty ⁽²⁾. The objective of **enlargement** is to assist candidate and potential candidate countries to respect the values of human dignity, freedom, democracy, equality, the rule of law and human rights ⁽³⁾. **Humanitarian aid** is intended to provide ad hoc assistance and relief and protection for people in third countries who are victims of natural or man-made disasters ⁽⁴⁾.

7.3. Funding is provided through the following programmes and instruments:

- (a) geographical programmes, covering neighbourhood, enlargement and developing countries (3 526 million euro);
- (b) thematic programmes dealing with food security, non-state actors and local authorities, the environment, health and education, democracy and human rights (846 million euro);
- (c) foreign policy action under the Common Foreign and Security Policy, the Instrument for Stability, Election Observation Missions and the Industrialised Countries Instrument (595 million euro); and,
- (d) humanitarian aid and the Civil Protection Financial Instrument (1 213 million euro).

7.4. The external relations and development cooperation budget was implemented by the Directorate-General for Development and Cooperation — EuropeAid and also by the Service for Foreign Policy Instruments — FPI. The enlargement budget was implemented by the Directorate-General for Enlargement — DG ELARG, and the humanitarian aid budget by the Directorate-General for Humanitarian Aid and Civil Protection — DG ECHO.

⁽²⁾ Article 208 of the Treaty on the Functioning of the European Union.

⁽³⁾ Article 49 of the Treaty on European Union.

⁽⁴⁾ Article 214 of the Treaty on the Functioning of the European Union.

THE COURT'S OBSERVATIONS

Risks to regularity

7.5. The expenditure covered in this chapter is made under a wide range of cooperation instruments and delivery methods, applied in more than 150 countries. Rules and procedures are often complex, including those for tendering and the award of contracts. The Court has assessed risk as inherently high.

7.6. In two areas — budget support ⁽⁵⁾ and EU contributions to multi-donor projects carried out by international organisations ⁽⁶⁾ such as the United Nations (UN) — the nature of the instruments and payment conditions limit the extent to which transactions are prone to errors.

7.7. Budget support contributes to a state's general budget or its budget for a specific policy or objective. The Court examines whether the Commission has complied with the specific conditions for making budget support payments to the partner country concerned and has verified that general eligibility conditions (such as progress in public sector financial management) have been complied with.

7.8. However, the Commission has considerable flexibility in deciding whether these general conditions have been met. The Court's audit of regularity cannot go beyond the stage at which aid is paid to the partner country. The funds transferred are then merged with the recipient country's budget resources. Any weaknesses in its financial management will not generate errors in the Court's audit of regularity.

⁽⁵⁾ Budget support payments made from the general budget in 2013 amounted to 805 million euro.

⁽⁶⁾ The payments made to international organisations from the general budget in 2013 amounted to 1,5 billion euro.

THE COURT'S OBSERVATIONS

7.9. The Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of eligible expenditure. Under the so-called 'notional approach' the Commission assumes that underlying transactions are regular as long as the pooled amount includes sufficient eligible expenditure to cover the EU contribution. Should other donors follow the same approach and apply the same eligibility criteria for their contribution, there is a risk that overall spending does not meet the combined conditionality requirements of the Commission and the other donors.

THE COMMISSION'S REPLIES

7.9. *The Commission believes that the internal control measures put in place, together with those of the international organisations, limit this theoretical risk to a level which is indeed acceptable.*

The Commission is not aware of any specific problems with the 'notional approach' (which has been developed to allow the Commission to participate in multi-donor actions including trust funds). This approach guarantees that the legal requirements applicable to EU funding in external actions are met (by ensuring that the amount contributed by other donors is sufficient to pay for any activities which are ineligible under EU rules) while spending EU funds in the most efficient way (through donor coordination), in accordance with the principle of sound financial management.

The Commission limits this risk by assessing the accounting, audit, internal control, procurement, ex post publication of information and protection of personal data procedures of the partner international organisations in advance of any joint working, the presence of its staff in the field (and participation in steering groups) and the rigorous overall financial reporting required of the international organisation. In addition, during the implementation of external actions programmes, systems are regularly reviewed through the performance of verification missions undertaken by external auditors.

The audits carried out by the Commission have not to date evidenced any 'specific risks' of this nature, nor is the Commission aware of any other donor with 'the same eligibility criteria'.

THE COURT'S OBSERVATIONS

Audit scope and approach

7.10. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of external relations, aid and enlargement, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 172 transactions as defined in **Annex 1.1**, paragraph 7. The sample is designed to be representative of the entire range of transactions within the policy group. In 2013, the sample consisted of 60 transactions approved by Commission headquarters and 112 approved by EU delegations⁽⁷⁾;
- (b) where errors were detected, the relevant control systems were analysed to identify the specific system weaknesses involved;
- (c) the assessment of control systems examined EuropeAid's ex-ante checks, monitoring and supervision, and internal audit;
- (d) the Court reviewed a selection of framework contracts launched by the Commission's services;
- (e) the Court reviewed the annual activity reports of FPI and EuropeAid; and
- (f) it examined whether the Commission had followed the recommendations made in its 2010 and 2011 annual reports (see **Annex 7.3**).

REGULARITY OF TRANSACTIONS

7.11. **Annex 7.1** contains a summary of the results of transaction testing. Out of the 172 transactions audited by the Court, 50 (29 %) were affected by error. On the basis of the 30 errors it has quantified, the Court estimates the most likely error to be 2,6 %⁽⁸⁾.

⁽⁷⁾ In Bosnia and Herzegovina, Cambodia, Moldova, Palestine, Peru, Tunisia and Turkey, which the auditors visited; Afghanistan, Bangladesh and Iraq were examined through desk review.

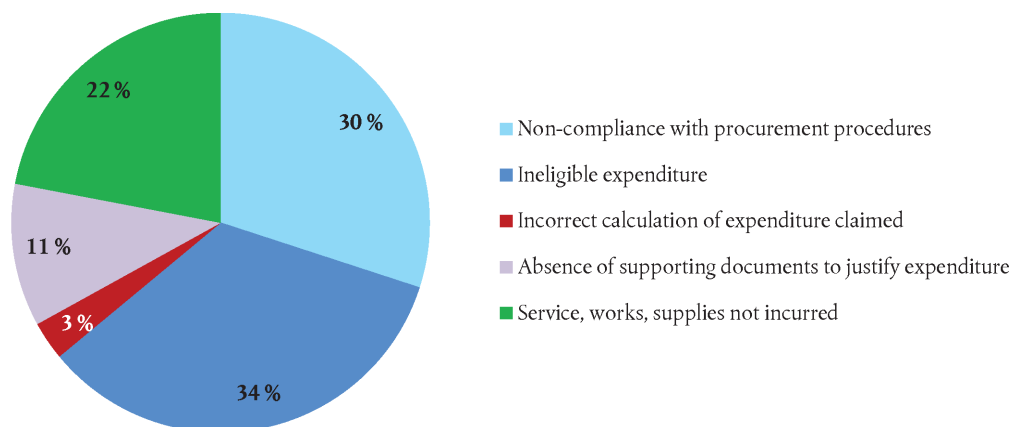
⁽⁸⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,2 % and 4,0 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

7.12. 30 out of 172 payments and clearings were affected by quantifiable errors. Of these, 20 were found in final payments and clearings. All these quantifiable errors occurred in transactions which had in principle been subject to the Commission's checks; none had been prevented or detected. In two transactions, the Court found errors that had not been detected by the auditors appointed by the beneficiaries.

7.13. **Graph 7.1** provides an overview on the nature of the errors and their contribution to the overall estimated error by type for the policy group.

Graph 7.1 — Contribution by type of error to the most likely error



7.14. The category of error, *ineligible expenditure* (14 transactions), comprises expenditure related to activities not covered by the contract or incurred outside the eligibility period, ineligible taxes and indirect costs wrongly charged as direct costs. In another three cases, the Commission incorrectly accepted (and cleared) expenditure for service, works and supplies not incurred at the moment the Commission accepted it. Examples of errors are provided below (see example in Box 7.1).

THE COMMISSION'S REPLIES

7.12. Common reply to paragraphs 7.12 to 7.15.

The Commission's checks are designed in such a way that the detection and correction of errors, through ex post audits — after final payments — is still possible. An extensive programme of ex post audits is planned and implemented by the external aid DGs on an annual basis, based on a formal risk assessment process.

THE COURT'S OBSERVATIONS

Box 7.1 — Examples of quantifiable errors

Ineligible expenditure

DG ECHO

The Commission signed a grant agreement with a German NGO for an amount of 750 000 euro for carrying out a humanitarian aid project related to health care for vulnerable people in Niger during 2011/2012. The NGO charged 12 800 euro social security charges and taxes to the project, which the Commission should not have reimbursed because the costs did not relate to the EU-financed project.

Expenditure not incurred

EuropeAid — Moldova

The Commission signed a contribution agreement with the United Nations development programme for an amount of 10,6 million euro of which 9,5 million euro were financed by the EU in order to foster economic and social development in Moldova.

In 2013, the Commission incorrectly accepted expenditure amounting to 1,8 million euro concerning contracts signed by the organisation but for which no expenditure had been incurred.

THE COMMISSION'S REPLIES

Box 7.1 — Examples of quantifiable errors

The Commission underlines the fact that ex ante controls performed before each payment have to be considered within the context of the overall control system. The supervisory and control systems in place could have still detected the errors through the implementation of ex post controls, given that the action audited by the Court was not audited after the final steps of the Commission control chain.

Nonetheless, the Commission reminded the Partner of its contractual duties, and particularly of the need to further improve its internal control systems.

7.15. Four out of the 30 quantifiable errors related to irregular procurement or contracting procedures either carried out by the Commission itself (one case) or by the beneficiaries of the grants (three cases) (see example in Box 7.2).

Box 7.2 — Irregular contracting procedure

EuropeAid — Tunisia

The Commission signed a service contract amounting to 98 000 euro with a French legal expert for carrying out advisory services in Tunisia. The contract was actually an extension to an existing service contract. The extension was in breach of the Financial Regulation and was therefore irregular.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

7.16. For nine transactions related to the national programme for pre-accession, the Commission, at its own initiative, validated (i.e. cleared⁽⁹⁾) expenditure of 150 million euro in total in the absence of supporting documentation, which would have enabled it to confirm that the expenses had actually been incurred, that they were accurately reflected in the amounts accepted and that they were eligible. The cleared amounts were based on the Commission's own estimates rather than on incurred, paid and accepted costs which correspond to actual costs proven by supporting documents. On top of the nine sampled transactions, the Court found other transactions affected by the same systemic error. Following the audit of the Court, the Commission acknowledged the clearance error identified by the former and proceeded with the accounting corrections for the transactions concerned. The Commission also agreed to amend its clearance procedure accordingly.

7.17. 20 transactions out of 172 were affected by 30 non-quantifiable errors relating to non-compliance with legal or contractual obligations.

7.18. The 20 budget support transactions examined were free from regulatory error. One of the transactions concerned the payment of 15 million euro made by the Commission in November 2013 corresponding to the first fixed tranche of budget support of 35 million euro to 'Support the implementation of the national environmental policy of Ukraine'. This payment was authorised by the Commission on the basis that both general and specific conditions were satisfied. Concretely, this means that, for two of the general conditions, the Commission concluded that the Government of Ukraine was ensuring the macroeconomic stability of the country as well as the reliability and the transparency of public finance management (even though some key performance indicators scored very low). This example illustrates the risks as described in paragraphs 7.7 and 7.8.

EXAMINATION OF SELECTED CONTROL SYSTEMS

EuropeAid

7.19. **Annex 7.2** contains a summary of the results of the EuropeAid systems examined by the Court. The detailed results of the assessment of EuropeAid systems including the residual error rate study carried out by EuropeAid are presented in the Court's annual report on the 8th, 9th and 10th European Development Funds, paragraphs 33-45.

7.16. *The Commission agrees that its procedures were not followed on these clearings which were made solely for internal accounting and management purposes and are separate from the formal procedures for the acceptance of declared expenditure. The Commission accepts that this accounting approach must be changed and has already reversed the clearings in question. DG ELARG will put in place a new clearing procedure. The delivery of pre-accession assistance includes strict verification and monitoring of systems and procedures prior to any pre-financing being paid. Each programme runs for a number of years and it is only at the end of the implementation of each programme that it is possible to assess the real costs incurred and the success of the project itself.*

7.18. *The Commission is pleased to note that Budget Support transactions are free from errors.*

⁽⁹⁾ Clearing of pre-financings should take place on the basis of verifiable information from recipients, in accordance with the procedure set out in the Financial Regulation and its rules of application.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

DG Enlargement

7.20. In his declaration of assurance for the year 2013, the Director-General for Enlargement declared he had reasonable assurance that the control procedures put in place provided the necessary guarantees concerning the legality and regularity of the underlying transactions and that the information provided in the report was reliable, complete and correct. However, as described in paragraphs 7.16, the Court found that expenditure recorded by DG ELARG was based on their own estimates rather than on incurred, paid and accepted costs which corresponded to actual costs proven by supporting documents. Since the amount at risk is 150 million euro, the Director-General should have made a reservation.

Framework contracts

7.21. The Court has carried out a review of framework contracts tendered by the three DGs and one service (FPI) related to the policy group. The review did not identify errors or system weaknesses.

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

7.22. For this policy group:

- (a) testing of transactions indicates that the most likely error present in the population is 2,6 %,
- (b) a systemic error in clearing expenditure by DG ELARG representing 150 million euro; and
- (c) the examined systems at EuropeAid are assessed as partially effective ⁽¹⁰⁾.

7.23. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

7.20. See Commission's replies to paragraph 7.16.

The Commission considers that the Director General for Enlargement was not required to make a reservation. The transactions concerned had all been reversed before the establishment of the final accounts.

7.22.

- (c) *The Commission notes that the error rate for transactions managed by EuropeAid is lower than for 2012.*

⁽¹⁰⁾ The conclusion on systems is limited to the systems selected for examination as defined in the audit scope in paragraph 7.10.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

7.24. **Annex 7.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented 11 recommendations. Out of these recommendations, the Commission fully implemented eight recommendations, while two were implemented in most respects and one was implemented in some respects.

7.25. Following this review and the findings and conclusions for 2013, the Court recommends that:

- **Recommendation 1:** the Commission, and particularly DG ELARG, ensure that instructions to staff state that clearings should be made only on the basis of incurred expenditure and not be based on their own estimates;
- **Recommendation 2:** FPI accredit all CFSP missions in accordance with the 'six-pillar assessment' ⁽¹¹⁾.

The Commission accepts the recommendation and highlights that the existing accounting rules and guidance already communicated to DGs clarify the correct treatment to be followed for clearings. DG ELARG will put in place a new clearing procedure. Cost recognition will continue to be based on the clearance of accounts procedure.

The Commission accepts this recommendation. The improvements have been noted by the auditors as specified in Annex 7.3. FPI undertook to aim for the progressive compliance of the missions, starting with the biggest. That objective is still being implemented but FPI considers that the risks due to non-compliance have been mitigated. The 4 largest missions which are either compliant or due to be compliant in the very near future constitute over 80 % of the CFSP budget managed by the missions. There is also a question of cost effectiveness in making missions compliant when many may have a limited life-span. The new CFSP missions by definition cannot be compliant from day one as they need time to establish their systems. Where missions are not compliant, FPI does not delegate full financial management but maintains mitigating controls. This is now fully recognised by the Financial Regulation (Article 60(2)).

⁽¹¹⁾ See **Annex 7.3**.

ANNEX 7.1

RESULTS OF TRANSACTION TESTING FOR EXTERNAL RELATIONS, AID AND ENLARGEMENT

	2013				2012	2011	2010
	EuropeAid ⁽³⁾	FPI	ELARG	ECHO			
SIZE AND STRUCTURE OF THE SAMPLE							
Total transactions:	115	9	18	30	174	120	90
RESULTS OF TESTING⁽¹⁾ ⁽²⁾							
Proportion (number) of transactions tested found to be:							
Free of error	77 % (88)	78 % (7)	50 % (9)	60 % (18)	77 % (122)	59 %	62 %
Affected by one or more errors	23 % (27)	22 % (2)	50 % (9)	40 % (12)	23 % (50)	41 %	38 %
Analysis of transactions affected by error							
Analysis by type of error							
Other compliance issues and non-quantifiable errors:	22 % (6)	100 % (2)	100 % (9)	25 % (3)	40 % (20)	55 %	47 %
Quantifiable errors:	78 % (21)	0 % (0)	0 % (0)	75 % (9)	60 % (30)	45 %	53 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS							
Most likely error rate					2,6 %	3,3 %	N/A
Upper Error Limit (UEL)					4,0 %		
Lower Error Limit (LEL)					1,2 %		
⁽¹⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments. ⁽²⁾ Numbers quoted in brackets represent the actual number of transactions. ⁽³⁾ Includes two transactions from the Education, Audiovisual and Culture Executive Agency.							

ANNEX 7.2

RESULTS OF THE EXAMINATION OF SELECTED SYSTEMS FOR EXTERNAL RELATIONS, AID AND ENLARGEMENT

Assessment of the system examined

System concerned	Ex-ante controls	Monitoring and supervision	Internal audit	Overall assessment
EuropeAid	Partially effective	Partially effective	Partially effective	Partially effective

ANNEX 7.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR EXTERNAL RELATIONS, AID AND ENLARGEMENT

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	N/A under the current framework	Insufficient evidence	
			In most respects	In some respects				
2011	Recommendation 1: EuropeAid, DG ECHO and FPI improve the supervision of grant contracts, making better use of on-the-spot visits to prevent and detect ineligible expenditure declared and/or increase the coverage of the audits contracted by the Commission.	X						
	Recommendation 2.1: FPI should ensure that the Internal Audit Capability becomes operational.	X						
	Recommendation 2.2: FPI should make explicit the criteria used for the risk assessments when selecting contracts to be audited under IIS and CFSP.	X						
	Recommendation 2.3: FPI should ensure that all CFSP missions are accredited in accordance with the 'six-pillar assessments'.			X				See Commission's reply to Recommendation 2.
	Recommendation 2.4: FPI should accelerate the closure of old CFSP contracts. (2011 follow up/update of a 2009 recommendation)	X						

CHAPTER 8

Research and other internal policies

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THE COURT'S OBSERVATIONS

INTRODUCTION

8.1. This chapter presents the specific assessment of research and other internal policies, which comprises policy areas 'Research', 'Education and culture', 'Communications networks, content and technology', 'Enterprise', 'Home Affairs', 'Direct research', 'Economic and financial affairs', 'Communication', 'Justice', 'Internal market', 'Trade' and 'Competition'. It also reports on the Court's recurrent audit of the Guarantee Fund for external actions. Key information on the activities covered and the spending in 2013 is provided in **Graph 8.1**.

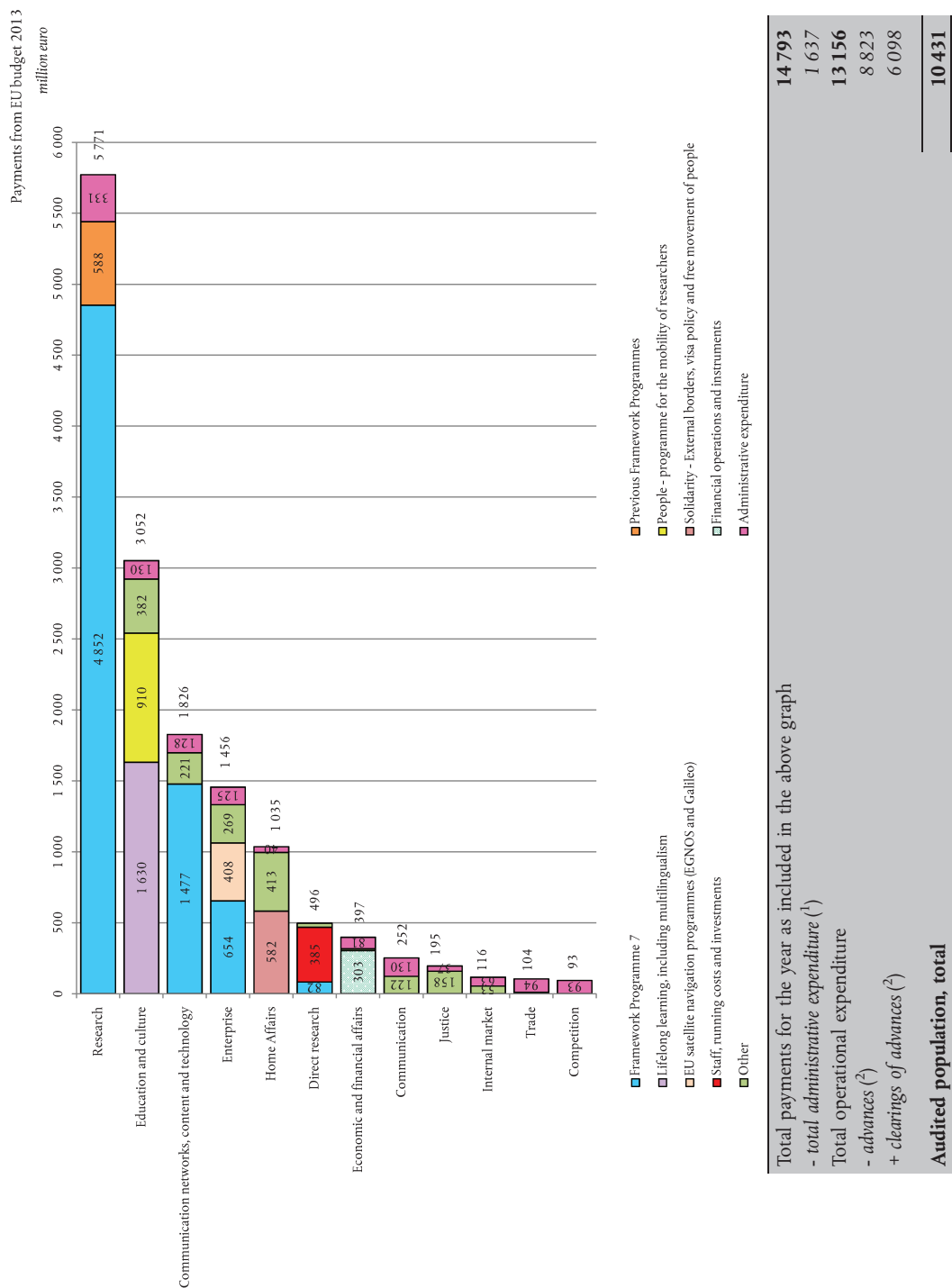
Specific characteristics of the policy group

8.2. The spending covers a wide range of policy objectives, such as research and innovation, education, security, migration and measures to combat the effects of the financial crisis.

8.3. Almost 90 % of the spending takes the form of grants to beneficiaries participating in projects. Other spending includes, for example, support to financial instruments managed by the European Investment Bank and contributions to programmes managed by the Member States, such as the External Borders Fund.

8.4. Apart from pre-financing payments, which are paid upon signature of a grant agreement or financing decision, the payment of EU funds reimburses costs declared by beneficiaries in programme or project cost statements. The principal risk to regularity is that beneficiaries include ineligible or unsubstantiated costs in their cost statements, which are neither detected nor corrected by the Commission or Member State control systems.

Graph 8.1 — Research and other internal policies — Key information 2013



⁽¹⁾ The audit of administrative expenditure is reported in chapter 9.

⁽²⁾ In line with the harmonised definition of underlying transactions (for details see **Annex 1.1**, paragraph 7).

Source: 2013 consolidated accounts of the European Union.

THE COURT'S OBSERVATIONS

Audit scope and approach

8.5. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall audit approach and methodology. For the audit of research and other internal policies, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 150 transactions as defined in **Annex 1.1**, paragraph 7. The sample is designed to be representative of the entire range of transactions within the policy group. In 2013 the sample consisted of 89 transactions related to research (86 for the Seventh Framework Programme (FP7) and three for the Sixth Framework Programme (FP6)), 25 transactions for the Lifelong Learning (LLP) and Youth in Action (YiA) Programmes and 36 transactions for other programmes;
- (b) the assessment of control systems examined the Seventh Framework Programme (FP7) which has three main control elements:
 - certification of beneficiaries' project cost statements by independent auditors before submission of the statements to the Commission;
 - checks of the submitted cost statements and project progress reports by the Commission before authorisation of payments;
 - audits by the Commission of a sample of beneficiaries and recovery of any reimbursed ineligible amounts detected by the audits;
- (c) the Court reviewed the 2013 annual activity reports of the Directorate-General for Research and Innovation (DG RTD), the Directorate-General Communications Networks, Content and Technology (DG CONNECT), the Directorate-General Education and Culture (DG EAC) and the Education, Audiovisual and Culture Executive Agency (EACEA).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

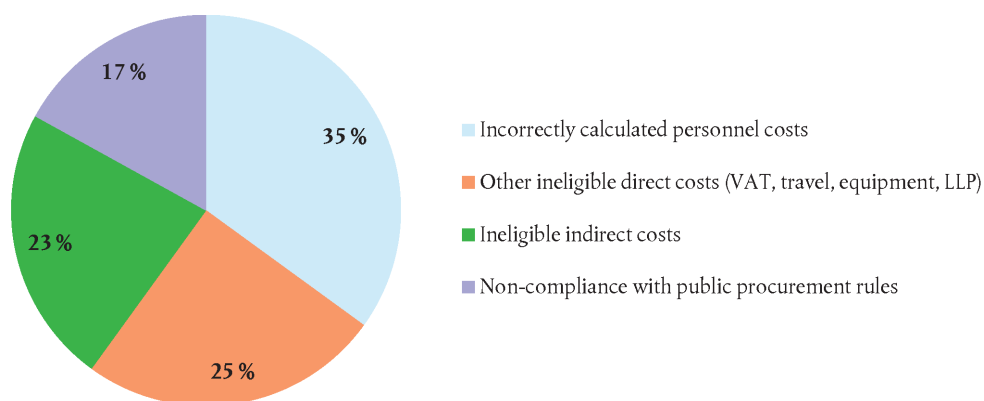
REGULARITY OF TRANSACTIONS

8.6. **Annex 8.1** contains a summary of the results of transaction testing. Out of the 150 transactions audited by the Court 76 (51 %) were affected by error. On the basis of the 54 errors which it has quantified, the Court estimates the most likely error to be 4,6 % ⁽¹⁾.

8.7. The most common types of error are incorrectly calculated personnel costs; other ineligible direct costs such as unsubstantiated costs for travel or equipment; and indirect costs which are based on erroneous overhead rates or include ineligible cost categories not linked to the project. In addition, failures by beneficiaries to comply with public procurement rules, not previously an important source of error in this policy group, contributed significantly to the error rate in 2013 (see **Graph 8.2**).

8.6. *The Commission considers that the error rate identified by the Court is one indicator of the effectiveness of the implementation of EU expenditure. It is also important to consider the results of its multiannual control strategy. On this basis its services calculate a residual error rate, which takes account of recoveries, corrections and the effects of all their controls and audits over the period of implementation of the programme. The calculated residual error at the end of 2013 was around 3 % for the research family, 0,95 % for LLP and YiA programmes managed through National Agencies, and below 2 % for the Home Affairs and Justice area.*

Graph 8.2 — Contribution by type of error to the most likely error



Source: European Court of Auditors.

⁽¹⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 2,6 % and 6,6 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Research spending affected by the same type and range of errors as before

8.8. For research spending, the Court found a similar type and range of errors as for previous years. The Commission finds these types of error with comparable range and frequency in its own audits.

8.9. In most cases, errors arise because beneficiaries incorrectly calculate the amount of eligible costs chargeable to the project or declare costs which are not in relation to the project or cannot be substantiated. Personnel costs are frequently overstated because beneficiaries declare budgeted rather than actual costs or because hourly charge-out rates are incorrect or costs are charged for time which has not been spent on the project. For other direct costs, beneficiaries committing errors often calculate eligible costs incorrectly (for example, overstating depreciation costs of equipment used on the project) or declare indirect taxes as eligible costs. Indirect costs are often overstated because beneficiaries include charges not related to research activity, such as costs of marketing or distribution costs (see example in Box 8.1).

Box 8.1 — Errors in costs declared for a European research funding (FP7) project

A beneficiary involved in an FP7 project declared costs of 185 500 euro, leading to reimbursement by the Commission of the EU contribution of 98 000 euro. The Court detected several errors in the declared costs, including:

- an incorrect method of calculation of personnel costs based on estimated figures;
- declaration of ineligible value added tax in travel costs;
- charging of indirect costs not linked to the project.

The ineligible costs declared by the beneficiary amounted to some 36 000 euro.

The Court detected cases of ineligible declared costs in more than a third of the sampled FP7 projects.

8.10. The last FP7 grant agreements were signed in 2013. The management and audit of these projects by the Commission will continue until at least 2017, in parallel with the start-up of the next research programme Horizon 2020.

8.9. *The Commission recognises the type and range of errors identified by the Court.*

Box 8.1 — Errors in costs declared for a European research funding (FP7) project

The Commission would like to underline that the type of errors reported by the Court could only have been detected by an in-depth ex post financial audit and not ex ante.

The rules for Horizon 2020, the new framework programme, should avoid most of these types of error as estimated average personnel costs will be allowed (where this is the usual practice of the beneficiary), VAT will be an eligible cost if it is not recoverable and a flat rate of indirect costs will avoid the identified type of error.

THE COURT'S OBSERVATIONS

8.11. The simpler rules for Horizon 2020, such as the wider acceptance of beneficiaries' usual accounting practices and flat rate reimbursement of indirect costs, are intended to reduce complexity for beneficiaries and decrease the error rate. However, any effect on the error rate will only become apparent at the end of 2016, after the first round of significant interim payments will have been made.

8.12. In 2013, the Commission further reduced the time it takes to pay research grants. However, the Court found 14 cases where project coordinators delayed transferring the funds to other project partners. Although in some cases there were understandable reasons for the delay, such as doubt about the actual expenditure of the partner, unnecessary delays adversely affect beneficiaries relying heavily on EU funding to fund their research, such as small and medium sized enterprises (SMEs).

Increase in errors in the education and culture policy area

8.13. In 2013, around half (12 out of 22) of the sampled LLP transactions were for education and training projects other than Erasmus student exchanges. These projects are typically implemented by small entities, such as non-governmental organisations, schools and SMEs. These beneficiaries have limited administrative capacity. They are often new to the programme and less familiar with the rules and procedures, in particular the requirement to maintain separate project accounting records and retain all supporting documents for their costs incurred on the project. As a result, errors are more frequent (see example in Box 8.2).

Box 8.2 — Errors in costs declared for a LLP project

A beneficiary involved in a LLP training project declared more than 260 000 euro of personnel costs in its cost statement, leading to reimbursement by the Commission of the EU contribution of some 190 000 euro. The Court detected several errors in the declared costs:

- calculation of staff costs using incorrect hourly rates;
- declaration of subcontracting costs as personnel costs;
- declaration of costs incurred before the start of the project eligibility period.

For this project, the Court examined costs amounting to some 114 000 euro and identified ineligible costs amounting to some 48 000 euro.

The Court detected cases of ineligible declared costs in more than a quarter of the sampled LLP projects.

THE COMMISSION'S REPLIES

8.12. *The distribution of funds is a matter subject to the provisions of the consortium agreement concluded by the beneficiaries and to which the Commission is not a party. The Commission considers it best that the transfer of funds between consortium members is managed within the consortium. When a case of delayed distribution of funds is detected, the Commission's standard practice is to follow up with the project coordinator on the reasons of this delay.*

In addition, the Commission has reminded coordinators of their obligation to promptly transfer funds.

Box 8.2 — Errors in costs declared for a LLP project

The Commission recognises the errors detected by the Court and will recover the amount unduly paid.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Non-compliance with rules on public procurement contributes significantly to the error rate in 2013

8.14. Transactions for research and other internal policies are generally not subject to public procurement. Only eight out of 150 sampled transactions involved the application of EU or national public procurement rules.

8.15. The Court found quantified errors in two of the eight cases. In one case of a contract for the provision of training services for a YiA project, the contracting authority in the Member State incorrectly applied the contract award criteria, resulting in the award of the contract to the wrong company. In the other case, a contract for the organisation of workshops for a research project, the beneficiary awarded the contract directly to a company, although national procurement rules required the use of a tender procedure (see **Annex 1.1**, paragraphs 10 and 11).

Ineligible costs can limit EU added value

8.16. Aside from a lack of assurance on the regularity of spending, the reimbursement of ineligible costs is likely to hinder the successful implementation of policy objectives. Box 8.3 provides an example of how ineligible costs can limit the EU added value of projects.

Box 8.3 — Ineligible costs can limit the EU added value of projects

The External Borders Fund (EBF) is the main EU financial instrument in support of external borders management, which aims to ensure efficient and effective controls at the EU's external borders. The EBF co-finances programmes and projects managed by the Member States.

The Court examined a project in Spain which consisted of the purchase of four helicopters to be used for external border surveillance and control. The responsible authority in the Member State claimed that external border surveillance activities would account for 75 % of the use of the helicopters.

8.15. *In the second case mentioned, for the costs of workshops organised by a university (EUR 24 000), the university failed to comply with national rules that required a full public tendering procedure for all amounts above EUR 10 000. This makes the payments for the workshop ineligible, despite the added value of the workshop (and its acceptable cost). This underlines the difficulty for the Commission to ensure the eligibility of all costs, especially when national (or even regional) authorities create additional rules that exceed the research framework programme requirements and are not necessarily appropriate to research funding.*

Box 8.3 — Ineligible costs can limit the EU added value of projects

THE COURT'S OBSERVATIONS

The Court checked the use of the helicopters based on information provided by the responsible authority. The information contained errors and inconsistencies, making the data unreliable as a source for verifying the use of the helicopters for EBF-eligible activities. On the basis of the information provided, the Court estimates that the helicopters were used for external border surveillance and control activities at most for 25,5 % of their total activities. The maximum amount eligible for EBF co-financing would therefore be 8,3 million euro rather than the declared amount of 24,3 million euro.

High amounts of ineligible costs resulting from purchased equipment not being used for the purposes of the co-financed project can limit the EU added value of the EBF and demonstrate a lack of adequate monitoring by the Member State responsible authority. Issues in relation to the effectiveness and added value of the EBF are identified in the Court's special report No 15/2014 on the EBF ⁽²⁾.

THE COMMISSION'S REPLIES

This finding relates to the issue of mixed use with other internal security tasks for the same equipment. The Commission will follow up on this finding by reopening the closure of the 2009 EBF Spanish annual programme.

EXAMINATION OF SELECTED CONTROL SYSTEMS

8.17. **Annex 8.2** contains a summary of the results of the system examined by the Court.

Certification of cost statements does not eliminate all errors

8.18. FP7 beneficiaries must provide audit certificates with their cost statements if the EU contribution to their project exceeds 375 000 euro. The independent auditor is required to certify that the declared costs meet the eligibility criteria and to report any exceptions.

8.19. For those cost statements examined by the Court for which a certificate had been provided (32 out of the 89 sampled European research funding (FP7) transactions), the Court compared the results of its own examination with the conclusion of the independent auditor. In 9 cases where the independent auditor had certified that the declared costs met the eligibility criteria, the Court found a significant level of error in the cost statements.

⁽²⁾ <http://eca.europa.eu>

THE COURT'S OBSERVATIONS

8.20. Certification of cost statements helps to reduce the level of error for the FPs as a whole. Although the Commission has undertaken a communication campaign to remind independent auditors of the eligibility rules, the quality of the work underlying audit certificates does not eliminate all errors.

Checks before authorisation of payments affected by weaknesses

8.21. The Commission has reduced checks before payment to a minimum, in order to expedite payments and to provide a reasonable balance between trust and control.

8.22. Before the Commission makes payments, project officers check the progress reports submitted by beneficiaries. Financial officers check the corresponding cost statements and audit certificates. In some cases, in-depth checks may be carried out, including verification of individual cost items based on further documentation requested from the beneficiary.

8.23. The Court identified two specific issues:

- in one case, the Commission accepted for reimbursement personnel and indirect costs that were incorrectly based on budgeted rates, despite the fact that this error had been identified by the independent auditor in the certificate on the cost statement. A similar issue concerning the checks was found by the internal audit unit of the Directorate-General (DG CONNECT);
- the further issue concerned inconsistent checks by the Commission. If a beneficiary does not have data on actual costs available at the time it draws up its cost statement, it may declare estimated costs. Any necessary adjustment to the costs can be made in the cost statement for the subsequent reporting period. In the case of cost statements submitted for the final reporting period of a project, the Commission does not always check if any further adjustments may be required before it makes the final payment.

8.24. In special report No 2/2013⁽³⁾ on FP7, the Court pointed out that the Commission does not always apply uniform procedures, which can reduce efficient implementation of the programme and increase the administrative burden for beneficiaries. Reports issued in 2013 by the internal audit units of DG RTD and DG CONNECT also refer to these risks.

THE COMMISSION'S REPLIES

8.23.

The rules for Horizon 2020 have been adapted so that the use of budgeted rates for personnel costs will be eligible, if they are based on the beneficiaries' normal practices. Indirect costs will be based on a flat-rate reimbursement, so avoiding this type of error.

An appropriate follow-up of the general obligation to adjust the estimated costs has proved to be difficult under FP7. For that reason Horizon 2020 accepts the use of estimated figures for average personnel costs if this is the usual practice of the beneficiary in order to eliminate this risk of error.

8.24. *The Commission recognises this issue and is investing heavily in ensuring uniform treatment for Horizon 2020, especially through the creation of the Common Support Centre, which brings together legal advice, business processes, IT and audit in a single directorate supporting all the services of the Commission managing research.*

⁽³⁾ http://www.eca.europa.eu/Lists/ECADocuments/SR13_02/SR13_02_EN.PDF

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Audits of beneficiaries affected by delays in some directorates-general

8.25. The Commission's audits of beneficiaries provide essential input to the annual declarations of assurance of directors-general concerning the regularity of transactions and form the basis for the recovery from beneficiaries of any funds which have reimbursed ineligible costs.

8.26. The research DGs and executive agencies have set up a joint strategy for the audit of FP7 expenditure, including a common representative audit sample designed to estimate the overall level of error in European research funding (FP7), complemented by risk-based audits.

8.27. By the end of 2013, the amount of expenditure audited by the research directorates-general and agencies reached 1,4 billion euro or 7 % of total FP7 funding. The number of audits closed was 2 195, marginally lower than the number of 2 236 planned in the audit strategy. This shortfall of 1,8 % in the number of closed audits masks variations in performance by the DGs and agencies. For example, DG RTD closed 977 audits (3,2 % more than the 947 planned), whereas the DG CONNECT closed 435 audits (8,4 % fewer than the 475 planned) and the European Research Council Executive Agency closed 192 audits (18,3 % fewer than the 235 planned).

8.28. Where errors are detected by a Commission audit, funds paid in reimbursement of ineligible costs must be recovered from the beneficiary, either through a recovery order or by offsetting against a future payment.

8.29. By the end of 2013, the amounts recovered had reached 29,6 million euro, although the outstanding recoverable amounts had also increased from 12 million euro at the end of 2012 to almost 17 million euro. The Court found that the time taken to make recoveries varies considerably both between directorates-general and between directorates within directorates-general.

8.27. The audit strategy is a multiannual, Commission-wide strategy, in which yearly fluctuations can be expected, both in the total number of audits and between services without seriously affecting the overall efficiency of the ex post audit function. Any backlog in a given year will be compensated in later years, in line with the multiannual character of the audit strategy.

In particular for ERCEA the audit campaigns started a little later than had been assumed in the audit strategy. However, the trend shows a reduction of the gap.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

8.30. The Court also reviewed the progress made by the Commission in making recoveries for the quantified errors identified by the Court in 2012. Amounts had been recovered for the majority of those errors in other internal policies. For research, 7 out of the 35 cases reviewed had not yet been fully processed. By the end of 2013, the Commission had recovered 0,4 million euro based on the errors detected by the Court of 3,6 million euro.

Review of selected Commission annual activity reports

8.31. The Court reviewed the annual activity reports of DG RTD, DG CONNECT, DG EAC and the EACEA. The Court found that the reports provide a fair assessment of financial management in relation to the regularity of underlying transactions, and the information provided corroborates the Court's findings and conclusions in most respects.

8.32. In general, if the residual error is above 2 % for an area of spending at the end of a reporting year, a reservation should be raised. However, the Director-General of DG CONNECT did not raise a reservation on spending for the Information and Communication Technologies Policy Support Programme⁽⁴⁾, although the residual error rate at the end of 2013 was 2,77 %. When applying this residual error rate to the payments of 122,9 million euro in 2013 for this programme, the amount at risk is 3,4 million euro.

8.32. *The AAR provided full transparency, giving an indication for the residual error rate, the amount at risk and the materiality. The carefully considered decision not to issue a reservation on the CIP ICT PSP payments is based on the fact that the error rate could not be used for extrapolation and drawing sound conclusions given the limited sample (14 closed audits). DG CONNECT will pursue its efforts to fully implement the non-research audit strategy and closely monitor the resulting figures. In the new programming period, this programme strand of the CIP has been integrated into Horizon 2020.*

⁽⁴⁾ A sub-programme within the Competitiveness and Innovation Framework Programme.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

8.33. For this policy group,

— testing of transactions indicates that the most likely error present in the population is 4,6 %; and

— the examined system for FP7 is assessed as partially effective: the Court identified weaknesses in audit certificates (paragraph 8.17) and in checks before authorisation of payments (paragraphs 8.21 to 8.22), as well as delays in recovery of reimbursed ineligible costs (paragraphs 8.27 and 8.30).

8.34. Overall audit evidence indicates that accepted expenditure is affected by a material level of error.

Recommendations

8.35. **Annex 8.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented seven recommendations. The Commission fully implemented three recommendations, while four were implemented in most respects.

8.33.

The Commission considers that the error rate identified by the Court is one indicator of the effectiveness of the implementation of EU expenditure. It is also important to consider the results of its multiannual control strategy. On this basis its services calculate a residual error rate, which takes account of recoveries, correction and the effects of all their controls and audits. The calculated residual error at the end of 2013 was around 3 % for the research family, 0,95 % for the LLP and YiA programmes managed through the National Agencies, and below 2 % for the Home Affairs and Justice area.

THE COURT'S OBSERVATIONS

8.36. Following this review and the findings and conclusions for 2013, the Court recommends that the Commission:

- **Recommendation 1:** extend and intensify its communication campaign to raise awareness among beneficiaries and independent auditors about the eligibility rules for research spending under FP7;
- **Recommendation 2:** across the policy group, make its control activities more risk-driven, focusing checks on high-risk beneficiaries (for example entities with less experience of European funding) and reducing the burden of checks on less risky beneficiaries;
- **Recommendation 3:** for the new 2014-2020 programmes for research and other internal policies, provide timely, consistent and clear guidance to beneficiaries and managing authorities in respect of the revised eligibility and control requirements.

THE COMMISSION'S REPLIES

8.36.

The Commission accepts this recommendation. The Communication campaign has so far reached over 3 100 people attending 24 events. The Commission will continue these efforts in the context of providing guidance for Horizon 2020 (see recommendation 3).

The Commission accepts this recommendation. In the research area, awareness-raising activities alert Commission staff to the particular risks of different types of beneficiary. This relates both to the payment stage, where there can still be an effect on FP7, and the contracting stage, where any effect will be on Horizon 2020. For Horizon 2020, this type of information will be built more systematically into the information systems used by the Commission. It is expected that 83 % of ex post audits for the period 2012-2016 will be selected using different risk factors, helping to meet the recommendation of the Court.

For other internal policies, the recommendation will be further analysed in the light of the new programme environment to arrive at a cost-effective solution.

The Commission accepts this recommendation and recognises its obligation to provide timely and effective guidance to beneficiaries. For the 2014-2020 programmes guidance has already been offered at a much earlier stage than for any earlier programme.

For research, a set of guidance documents is already available in the Participant Portal website (http://ec.europa.eu/research/participants/portal/desktop/en/funding/reference_docs.html).

Among these documents, the Horizon 2020 Annotated Grant Agreement (AGA) explains in detail, and with a large number of practical examples, all the provisions of the Grant Agreements. Special attention has been paid to those parts of the Grant Agreement which are significantly different from FP7, such as the new provisions for personnel costs.

For education and culture, the Commission has developed comprehensive guidance for the National Agencies for the management of the project lifecycle and the implementation of internal control standards, including in particular the selection, execution and recording of checks on beneficiaries under the Erasmus+ programme.

Further targeted guidance will be developed as necessary.

THE COURT'S OBSERVATIONS

RESULTS OF THE AUDIT OF THE GUARANTEE FUND FOR EXTERNAL ACTIONS FOR 2013

8.37. The purpose of the Guarantee Fund for External Actions, which guarantees EU loans to non-Member States, is to reimburse the EU's creditors in the event of a beneficiary's defaulting on a loan and avoid direct calls on the EU budget. On the basis of an agreement between the Commission and the European Investment Bank (EIB), the administrative management of the Fund is carried out by the Directorate-General for Economic and Financial Affairs (DG ECFIN), while the EIB is responsible for the financial management of the Fund.

8.38. The Court's audit focused on compliance with the agreement between the Commission and the European Investment Bank for the financial management of the Fund and on the monitoring procedures carried out by the Commission.

8.39. The Court found that, in 2013, the financial management of the Fund was in compliance with the agreement between the Commission and the European Investment Bank, and that the Commission had carried out adequate monitoring procedures.

8.40. The European Investment Bank and the Commission use a benchmark index to review the Fund's annual performance. The return on the Fund's portfolio in 2013 amounted to 0,7914 %, representing a performance of 34 basis points below the benchmark.

ANNEX 8.2

RESULTS OF EXAMINATION OF SELECTED SYSTEMS FOR RESEARCH AND OTHER INTERNAL POLICIES

Assessment of the system examined

System	Certification of cost statements	Checking of cost statements before payment authorisation	Audits and recoveries	Overall assessment
Research Framework Programme (FP7)	Partially effective	Partially effective	N/A ⁽¹⁾	Partially effective

⁽¹⁾ Audits and recoveries provide assurance on a multiannual basis rather than for a single financial year.

ANNEX 8.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR RESEARCH AND OTHER INTERNAL POLICIES

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully imple- mented	Being implemented		Not imple- mented	Not applic- able	Insufficient evidence	
			In most respects	In some respects				
2011	<p>The Court recommends that the Commission should:</p> <ul style="list-style-type: none"> — in the area of the research FPs; <p>Recommendation 1: intensify its efforts to address the errors found in interim and final payments;</p> <p>Recommendation 2: enhance its initiatives to make beneficiaries and independent auditors aware of the errors detected during the Court's and the Commission's ex-post audits;</p> <p>Recommendation 3: ensure that the external audit firms conducting audits on its behalf align their procedures with the Commission's guidelines and standard practice and in particular enhance the quality of their audit documentation.</p> <p>Recommendation 4: The Commission should:</p> <ul style="list-style-type: none"> — in the area of the other internal policies: introduce as soon as possible an ex-post audit strategy for the ICT-PSP programme, drawing on the lessons learnt by DG INFSO's risk-based ex-post audit strategy for framework programmes projects. 		X					
		X						
			X					
		X						

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented In most respects	Being implemented In some respects	Not implemented	Not applicable	Insufficient evidence	
2010	<p>The Court recommends that the Commission should:</p> <ul style="list-style-type: none"> — in the area of the research FPs: <p>Recommendation 1:</p> <ul style="list-style-type: none"> (i) draw on the lessons learnt from the good practice of DG INFSO's risk-based ex post auditing method to further enhance the Commission's ex ante controls with the aim of identifying payments with a relatively high-risk profile, and <p>Recommendation 2:</p> <ul style="list-style-type: none"> (ii) with the aim to further increase the reliability of the audit certificates, intensify its actions to raise the independent auditors' awareness of the eligibility of expenditure rules, notably by actively informing the auditors about instances of failure to identify ineligible costs. (paragraph 6.51). <p>Recommendation 3:</p> <p>The Commission should:</p> <ul style="list-style-type: none"> — in the area of the LLP, continue to give emphasis to the implementation of primary controls. In particular attention should be given to ensuring that national agencies check at least the minimum number of files required by the Commission and that all checks are properly documented. (paragraph 6.51). 		X					
			X					
			X					

CHAPTER 9

Administrative and related expenditure

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THE COURT'S OBSERVATIONS

INTRODUCTION

9.1. This chapter presents the specific assessment of the administrative and related expenditure of the institutions and bodies of the European Union⁽¹⁾. Key information on the institutions and bodies covered, and the spending in 2013 is provided in **Table 9.1**.

Table 9.1 — Administrative and related expenditure — Key information 2013

(million euro)

Policy area	Description	Payments
Administrative and other expenditure	Commission	6 544
	European Parliament	1 770
	European External Action Service	735
	Council	496
	Court of Justice	342
	Court of Auditors	132
	European Economic and Social Committee	125
	Committee of the Regions	87
	European Ombudsman	10
	European Data Protection Supervisor	7
Total payments for the year		10 248
- advances ⁽¹⁾		19
+ clearings of advances ⁽¹⁾		371
Audited population, total		10 600
Total commitments for the year		10 505

⁽¹⁾ In line with harmonised definition of underlying transactions (for details see **Annex I.I.** paragraph 7).

Source: 2013 consolidated accounts of the European Union.

⁽¹⁾ This includes expenditure classified in the general budget as operational but that is directed mostly at the functioning of the Commission's administration rather than at policy delivery.

THE COURT'S OBSERVATIONS

9.2. The Court reports separately on the European Union (EU) agencies and other bodies and on the European Schools ⁽²⁾. The Court's mandate does not cover the financial audit of the European Central Bank.

Specific characteristics of the policy group

9.3. Administrative and related expenditure comprises expenditure on human resources (salaries, allowances and pensions), accounting for 60 % of the total, and expenditure on buildings, equipment, energy, communications, and information technology.

9.4. The main risks regarding administrative and related expenditure are non-compliance with the procedures for procurement, the implementation of contracts, recruitment and the calculation of salaries and allowances.

Audit scope and approach

9.5. **Annex 1.1, part 2**, of chapter 1 describes the Court's overall approach and methodology. For the audit of administrative and related expenditure, the following specific points should be noted:

- (a) the audit involved an examination of a sample of 153 payment transactions as defined in **Annex 1.1**, paragraph 7. The sample is designed to be representative of the entire range of transactions within the policy group. In 2013 the sample consisted of 95 payments of salaries, pensions and related allowances, 17 payments in respect of contracts related to buildings and 41 payments connected with other expenditure;
- (b) the assessment of control systems examined the supervisory and control systems applied by each institution and body in order to comply with the Financial Regulation ⁽³⁾;

⁽²⁾ The Court's specific annual reports on agencies and other bodies are published in the Official Journal. The Court's specific annual report on the European Schools is submitted to the Board of Governors of the European Schools, and a copy is sent to the European Parliament, the Council and the Commission.

⁽³⁾ Ex ante and ex post controls, internal audit function, reporting of exceptions and internal control standards.

THE COURT'S OBSERVATIONS

- (c) the assessment of control systems also examined the procedures for recruiting temporary and contract staff and the procurement procedures at the Commission and the Court of Justice ⁽⁴⁾;
- (d) the annual activity reports of four of the Commission's directorates-general and offices ⁽⁵⁾ primarily responsible for administrative expenditure and of all the other institutions and bodies were reviewed;
- (e) the audit included an examination of the pension liability of the EU institutions ⁽⁶⁾. The results of this examination are reported in paragraph 1.10.

9.6. The Court of Auditors is audited by an external audit firm ⁽⁷⁾ which delivered an audit report on the financial statements for the financial year from 1 January 2013 to 31 December 2013 and an assurance report concerning the regularity of the use of the Court's resources, and the control procedures in place in 2013 (see paragraph 9.17).

REGULARITY OF TRANSACTIONS

9.7. **Annex 9.1** contains a summary of the results of transaction testing. Out of the 153 transactions audited by the Court, 15 (10 %) were affected by error. On the basis of the nine errors which it has quantified, the Court estimates the most likely error to be 1,0 % ⁽⁸⁾.

EXAMINATION OF SELECTED CONTROLS SYSTEMS

9.8. **Annex 9.2** contains a summary of the results of the systems examined by the Court.

⁽⁴⁾ Based on the rotational approach taken since 2012, the systems audit covers two institutions or bodies every year, with a sample of transactions being taken for each institution or body and system.

⁽⁵⁾ Directorate-General for Human Resources and Security, Office for the Administration and Payment of Individual Entitlements, Office for Infrastructure and Logistics in Brussels and Directorate-General for Informatics.

⁽⁶⁾ This pension liability results from an actuarial calculation performed by Eurostat, which is advised by an external consultant.

⁽⁷⁾ PricewaterhouseCoopers, Société à responsabilité limitée, Réviseur d'Entreprises.

⁽⁸⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 0,0 % and 2,3 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

OBSERVATIONS ON SPECIFIC INSTITUTIONS AND BODIES

9.9. The specific observations that follow are presented by EU institution or body and do not affect the overall assessments set out in paragraphs 9.7 and 9.8. Whilst they are not material to administrative and related expenditure as a whole, they are significant in the context of the individual institution or body concerned.

Commission

9.10. Of the four payments examined, which were made by the Joint Research Centre (JRC) for the provision of services, two cases were affected by error because the supporting documents did not confirm that all the services had been provided in accordance with the contract.

9.11. The Court examined 66 payments made by the Office for the Administration and Payment of Individual Entitlements (PMO) and found that three transactions concerning salaries and pensions and two reimbursements of travel costs were affected by error. In addition, weaknesses were detected in 11 cases in the management of family allowances as a result of both the absence of updated information on staff members' personal situation and errors in the calculation of allowances. These weaknesses were similar in nature to those detected by the Court in previous years.

9.12. The assessment of control systems based on the examination of 15 recruitment procedures and 19 procurement procedures did not reveal any serious weakness.

THE COMMISSION'S REPLY

9.10. *The Commission takes note of both findings and will ensure that all supporting documents are in place to confirm that services are provided in accordance with the contracts.*

THE COMMISSION'S REPLY

9.11. *See the Commission's reply to recommendation 1.*

THE COURT'S OBSERVATIONS

European External Action Service (EEAS)

9.13. The audit examined 11 payments made by the EEAS. Four of these were payments of salaries to staff, one of which was affected by error. In the same payment, weaknesses were also noted in the management of family allowances, which is performed on behalf of the EEAS by the PMO on the basis of a service level agreement.

9.14. The contract for the procurement of security services in the Delegation in Kenya (for which the payments made in 2013 amounted to 865 000 euro) was irregularly extended for more than two years. This extension resulted from problems detected by the Headquarters in the procurement procedure launched by the Delegation to timely conclude a new contract for similar services to be provided in the future.

9.15. One payment relating to a contract for IT services was affected by error because the supporting documents did not confirm that all the services had been provided in accordance with the awarded framework contract. In addition, the Court found that the negotiated procedure for the conclusion of this contract was poorly documented.

REPLY OF THE EUROPEAN EXTERNAL ACTION SERVICE

9.13. *Between 2012 and 2013, the EEAS has on various occasions reminded staff of their obligation to declare allowances from other sources. Furthermore, over the last year the PMO has enlarged the number of countries on which the module for allowances perceived from other sources is run; for 2014 this exercise is scheduled to include also Austria — the country of origin of the staff member whose salary payment has been checked, according to the information provided by PMO.*

At the moment of its creation the EEAS transferred the activity and resources (6,5 posts) for the calculation and liquidation of emoluments to PMO. Untaken leave is encoded in the IT application Sysper2 by the EEAS. After the encoding, payment by PMO follows automatically without interaction from the EEAS and in accordance with the programming of the NAP (Nouvelle Application Paie) managed by PMO. Sysper2 data is exported into NAP and the NAP calculates the tax rate. We are therefore in contact with PMO to adapt the NAP program accordingly.

REPLY OF THE EUROPEAN EXTERNAL ACTION SERVICE

9.14. *As highlighted in the 'negative opinion' by the EEAS HQ for both tenders, the committees set up at the delegation level made mistakes mainly in the opening and in the evaluations of the requests to participate. A direct consequence of this is that the ongoing contract had to be extended beyond its initial duration. This procurement procedure, as well as the renewal of a number of other security contracts, has now been taken on board by the task force created at HQ for security contracts in delegations. The new contract should be awarded by the end of 2014.*

REPLY OF THE EUROPEAN EXTERNAL ACTION SERVICE

9.15. *During the lifetime of the project, new telecommunication technologies have been made available by the contractor to improve the quality of existing services making part of the awarded framework contract. The prices of these service improvements have been included in the relevant Service Order Forms, documents which are integral part of the specific contract concluded under the awarded framework contract.*

THE COURT'S OBSERVATIONS

**European Parliament, European Council and Council,
Court of Justice and other institutions and bodies**

9.16. No serious weaknesses were detected in the 15 recruitment procedures and 15 procurement procedures examined at the Court of Justice as part of the assessment of control systems. The audit did not identify any serious weaknesses in respect of the topics audited for the European Parliament, the European Council and Council, the European Economic and Social Committee, the Committee of the Regions, the European Ombudsman or the European Data Protection Supervisor.

Court of Auditors

9.17. The external auditor's report ⁽⁹⁾ states the opinion that 'the financial statements give a true and fair view of the financial position of the European Court of Auditors as of 31 December 2013, of its financial performance and its cash flows for the year then ended'.

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

- 9.18. For this policy group,
- testing of transactions indicates that the most likely error present in the population is 1,0 %;
 - the examined systems are assessed as effective ⁽¹⁰⁾.

Overall, audit evidence indicates that accepted expenditure is not affected by a material level of error.

REPLY OF THE EUROPEAN PARLIAMENT

9.16. *Parliament has taken note of the Court's observations.*

REPLY OF THE EDPS

9.16. *The EDPS takes good note of the results of the Court's analysis and will continue to improve its system for timely monitoring and control.*

⁽⁹⁾ See the external auditor's report on the financial statements referred to in paragraph 9.6.

⁽¹⁰⁾ The conclusion on systems is limited to the systems selected for examination as defined in the audit scope in paragraph 9.5.

THE COURT'S OBSERVATIONS

Recommendations

9.19. **Annex 9.3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented 12 recommendations. Out of these recommendations, four were not reviewed this year given the Court's rotational approach. The institutions and bodies concerned implemented five recommendations in most respects and three were implemented in some respects.

9.20. Following this review and the findings and conclusions for 2013, the Court recommends that:

- **Recommendation 1:** the Commission and the EEAS should take further steps to ensure that staff provide documents confirming their personal situation on a regular basis, as well as to improve systems for the timely processing of those documents that have an impact on the calculation of family allowances (see paragraphs 9.11 and 9.13);

9.20.

THE COMMISSION'S REPLY

This recommendation has been reiterated and commented in the 2013 observations:

Measures have been taken to correct the detected errors.

The automatic update of the amounts of allowances of like nature has been implemented and is fully operational. The automatic update already covers more than 90 % of the population. Further extensions are being developed. Additional checks are performed in the framework of existing procedures (entry into/end of service).

In 2013, a module allowing the declaration of allowances of like nature was implemented. Another module permitting the declaration of changes in the spouse's professional activity was launched at the end of June 2014.

REPLY OF THE EUROPEAN EXTERNAL ACTION SERVICE

The EEAS has reminded staff of their obligation to duly provide updated information about their personal situation and, in particular, to declare allowances from other sources.

In 2012 and 2013, the EEAS has written to all staff who have declared revenue from other sources in a personal e-mail reminding them of their duty to update their declaration.

In addition a reminder to all EEAS staff has been sent in the administrative 'weekly flash' and published on the EEAS website.

THE COURT'S OBSERVATIONS

- **Recommendation 2:** the EEAS should improve the design, coordination and conduct of procurement procedures by means of its Headquarters providing increased support and guidance to the Delegations (see paragraphs 9.14 and 9.15).

REPLY OF THE EUROPEAN EXTERNAL ACTION SERVICE

In line with the Financial Regulations, procurement in HQ and Delegations above EUR 60 000 requires open tender procedures and is subject to verification prior to the publication of a contract notice or the signature of a contract. The verification of the procedures and the tender documents is done by a dedicated division in HQ. This division also provides support to contracting authorities during all phases of tendering procedures.

Templates and good practice are shared among the operational services, in particular delegations, to improve their quality and diminish the risks of the contracting authorities.

Thanks to this new set-up a substantial improvement of the quality of the tenders prepared by the operational divisions and the Delegations since 2012 has been noticed.

Special attention is given to security service contracts as these are the contracts most frequently tendered worldwide by the delegations.

At the end of 2013, a task force composed of members of the Ex-ante Control division and of the Field security division has been created in order to streamline security-related procurement operations and assure the respect of deadlines.

ANNEX 9.1

RESULTS OF TRANSACTION TESTING FOR ADMINISTRATIVE AND RELATED EXPENDITURE

	2013			2012	2011	2010
	Staff-related expenditure	Buildings-related expenditure	Other expenditure			
SIZE AND STRUCTURE OF THE SAMPLE						
Total transactions:	95	17	41	153	56	58
RESULTS OF TESTING ⁽¹⁾ ⁽²⁾						
Proportion (number) of transactions tested found to be:						
Free of error	94 % (89)	82 % (14)	85 % (35)	90 % (138)	93 %	93 %
Affected by one or more errors	6 % (6)	18 % (3)	15 % (6)	10 % (15)	7 %	7 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS						
Most likely error rate				1,0 %	0,0 %	0,4 %
Upper Error Limit (UEL)				2,3 %		
Lower Error Limit (LEL)				0,0 %		
⁽¹⁾	To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments. The results of testing reflect the proportionate share of each segment within the policy group.					
⁽²⁾	Numbers quoted in brackets represent the actual number of transactions.					

ANNEX 9.2

RESULTS OF THE EXAMINATION OF SYSTEMS FOR ADMINISTRATIVE AND RELATED EXPENDITURE

Assessment of the systems examined

System concerned	Commission	Court of Justice	Other institutions and bodies	Overall assessment
Key controls defined in the Financial Regulation and internal control standards	Effective	Effective	Effective	Effective
Recruitment of temporary and contract staff	Effective	Effective	Not assessed	Effective
Procurement	Effective	Effective	Not assessed	Effective

ANNEX 9.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR ADMINISTRATIVE AND RELATED EXPENDITURE

Year	Court Recommendation	Court's analysis of the progress made						Institution reply
		Fully implemented	Being implemented		Not implemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2011	<p>Recommendation 1 (European Parliament): <i>Updating of the personal situation and of allowances received by staff</i> The European Parliament should take steps to ensure that staff deliver at appropriate intervals documents confirming their personal situation and implement a system for the timely monitoring of these documents (see the 2011 annual report, paragraph 9.12).</p>		The audit did not identify any serious weaknesses on the management of family allowances (see paragraph 9.16).					Parliament has taken note of the Court's observations.
	<p>Recommendation 2 (Commission): <i>Updating of the personal situation and of allowances received by staff</i> The Commission should take steps to ensure that staff deliver at appropriate intervals documents confirming their personal situation and implement a system for the timely monitoring of these documents (see the 2011 annual report, paragraph 9.19).</p>			Weaknesses persisted in the management of family allowances (see paragraph 9.11).				In 2013, a module allowing the declaration of allowances of like nature was implemented. Another module permitting each staff member to declare the change of the spouse's professional activity was launched at the end of June 2014. Entitlement to the household allowance are now only given on condition of submitting a declaration of the spouse's income. Concerning entitlement to allowances for dependent children over the age of 18, it should also be possible in the coming months to automatically cut when no annual education declaration is introduced.

Year	Court Recommendation	Court's analysis of the progress made						Institution reply
		Fully implemented	Being implemented		Not implemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2011	<p>Recommendation 3 (European External Action Service): <i>Updating of the personal situation and of allowances received by staff</i></p> <p>The European External Action Service should take steps to ensure that staff deliver at appropriate intervals documents confirming their personal situation and implement a system for the timely monitoring of these documents (see the 2011 annual report, paragraph 9.25).</p>		Weaknesses persisted in the management of family allowances (see paragraph 9.1.3).				<p>The EEAS has reminded staff of their obligation to duly provide updated information about their personal situation and, in particular, to declare allowances from other sources.</p> <p>In 2012 and 2013, the EEAS has written to all staff who have declared revenue from other sources in a personal e-mail reminding them of their duty to update their declaration.</p> <p>In addition a reminder to all EEAS staff has been sent in the administrative 'weekly flash' and published on the EEAS website.</p>	
	<p>Recommendation 4 (European Parliament): <i>Recruitment of temporary and contract staff</i></p> <p>The European Parliament should take steps to ensure that the provisions of the relevant regulations are applied when concluding, extending or modifying employment contracts with non-permanent staff (see the 2011 annual report, paragraph 9.13). It should also ensure that appropriate documentation is established to justify the recruitment decisions made (see the 2010 annual report, paragraph 7.15).</p>		In 2012 the audit did not find any errors or weaknesses in the examination of 15 recruitment procedures (see the 2012 annual report, paragraph 9.11).				Parliament has taken note of the Court's observations.	

Year	Court Recommendation	Court's analysis of the progress made						Institution reply
		Fully implemented	Being implemented		Not implemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2011	<p>Recommendation 5 (European Economic and Social Committee): <i>Recruitment of temporary and contract staff</i> The European Economic and Social Committee should take steps to ensure that the provisions of the relevant regulations are applied when concluding, extending or modifying employment contracts with non-permanent staff (see the 2011 annual report, paragraphs 9.23 and 9.24).</p> <p>Recommendation 6 (European External Action Service): <i>Recruitment of temporary and contract staff</i> The European External Action Service should take steps to ensure that the provisions of the relevant regulations are applied when concluding, extending or modifying employment contracts with non-permanent staff (see the 2011 annual report, paragraph 9.26).</p> <p>Recommendation 7 (European Parliament): <i>Procurement</i> The European Parliament should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2011 annual report, paragraphs 9.15 to 9.17).</p>				X			<p>During the transitional period when a large number of diplomats from Member States were recruited as temporary agents, some contracts may have been signed only some time after the staff members had taken up their duties. Such cases remained exceptional. All persons were recruited according to standard and regular procedures. The EEAS has taken the necessary steps to ensure that such cases do not reoccur.</p> <p>Parliament has taken note of the Court's observations.</p>

Year	Court Recommendation	Court's analysis of the progress made					Institution reply
		Fully implemented	Being implemented	Not implemented	Not applicable (*)	Insufficient evidence	
		In most respects	In some respects				
2011	<p>Recommendation 8 (European Council and Council): <i>Procurement</i> The Council should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2011 annual report, paragraph 9.18).</p> <p>Recommendation 9 (Commission): <i>Procurement</i> The Commission should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2011 annual report, paragraphs 9.20 and 9.21).</p>	In 2012 the Court did not find any serious errors or weaknesses in the examination of 15 procurement procedures (see the 2012 annual report, paragraph 9.14).				O/S	
		The audit did not reveal any serious weakness in the procurement procedures (see paragraph 9.12).					The services concerned have implemented since mid-2011 several simplification measures in the area of procurement with a view to enhancing the quality of tender files. Compliance with the Financial Regulation is ensured whilst applying common sense, hereby fostering the participation of more tenderers.

Year	Court Recommendation	Court's analysis of the progress made					Institution reply
		Fully implemented	Being implemented		Not implemented	Not applicable (*)	
		In most respects	In some respects				
2011	<p>Recommendation 10 (European External Action Service): <i>Procurement</i> The European External Action Service should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2011 annual report, paragraph 9.28).</p>		<p>The audit revealed weaknesses in the procurement procedures (see paragraphs 9.14 and 9.15).</p>				<p>In line with the Financial Regulations, procurement in HQ and Delegations above EUR 60 000 requires open tender procedures and is subject to verification prior to the publication of a contract notice or the signature of a contract. The verification of the procedures and the tender documents is done by a dedicated division in HQ. This division also provides support to contracting authorities during all phases of tendering procedures.</p> <p>Templates and good practice are shared among the operational services, in particular delegations, to improve their quality and diminish the risks of the contracting authorities.</p> <p>Thanks to this new set-up a substantial improvement of the quality of the tenders prepared by the operational divisions and the Delegations since 2012 has been noticed.</p> <p>Special attention is given to security service contracts as these are the contracts most frequently tendered worldwide by the delegations.</p> <p>At the end of 2013, a task force composed of members of the Ex-ante Control division and of the Field security division has been created in order to streamline security-related procurement operations and assure the respect of deadlines.</p>

Year	Court Recommendation	Court's analysis of the progress made						Institution reply
		Fully im- plemented	Being implemented		Not imple- mented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2010	<p>Recommendation 11 (European Economic and Social Committee): <i>Procurement</i> The European Economic and Social Committee should ensure that authorising officers have appropriate checks and better guidance at their disposal so as to improve the design, coordination and performance of procurement procedures (see the 2010 annual report, paragraph 7.27).</p> <p>Recommendation 12 (Committee of the Regions): <i>Procurement</i> The Committee of the Regions should ensure that authorising officers have appropriate checks and better guidance at their disposal so as to improve the design, coordination and performance of procurement procedures (see the 2010 annual report, paragraphs 7.29 and 7.30).</p>				X			
					X			

(*) Under the approach for rotating the in-depth examination of control systems among the institutions and bodies, the follow-up of these recommendations will be performed in future years.

CHAPTER 10

Getting results from the EU budget

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THE COURT'S OBSERVATIONS

INTRODUCTION

10.1. This chapter focuses on performance. Performance in the European Union (EU) is assessed on the basis of the sound financial management principles (economy, efficiency and effectiveness) ⁽¹⁾, and covers:

- (a) inputs — financial, human, material, organisational or regulatory means needed for the implementation of the programme;
- (b) outputs — the deliverables of the programme;
- (c) results — the immediate effects of the programme on direct addressees or recipients;
- (d) impacts — long-term changes in society that are, at least partly, attributable to the EU's action.

10.2. The chapter is divided into three parts. The first part considers the EU's budgetary rules and their intended focus on performance. The second part presents the Court's observations on some aspects of the Commission's reporting on performance, including its reporting to the European Parliament and the Council, the fourth evaluation report ⁽²⁾, and the annual activity reports (AARs) prepared by the Commission's directors-general. The third part highlights some of the main themes arising from the Court's 2013 special reports ⁽³⁾ on performance, and the Court's follow-up of how its recommendations are implemented.

PART 1 — FOCUS ON PERFORMANCE

10.3. This part of the chapter analyses the extent to which there was a focus on performance — in addition to spending the money in compliance with the rules — in the 2007-2013 programming period; and it considers the changes made for the 2014-2020 programming period.

⁽¹⁾ Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, Article 27; repealed by Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1), Article 30 (entry into force on 1 January 2013).

⁽²⁾ Article 318 of the Treaty on the Functioning of the European Union (TFEU) provides for a report from the Commission to the European Parliament and the Council on the evaluation of the Union's finances based on the results achieved.

⁽³⁾ The Court's special reports cover the EU budget, as well as the European Development Funds.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

2007-2013 programming period

10.4. For large parts of the EU budget — particularly those where shared management operates — the maximum level of expenditure under the multiannual financial framework (MFF) headings is broken into yearly allocations per Member State. The Commission considers such allocations necessary for programming and for ex ante quantification of targets. However, the Court has noted that it is a challenge to obtain good qualitative results from schemes where absorption of funds by Member States is an implicit objective and, in practice, often the main objective⁽⁴⁾.

10.5. This challenge was also noted in the Court's special report on the effectiveness of the environment component of the LIFE⁽⁵⁾ programme — 'the environmental backbone of the EU'. The Court concluded that the indicative national allocations hampered the selection of best projects because projects were selected not only on their merit but also based on their Member State of origin. The national allocations meant that the competition for the best projects to attract funding took place at the national level, within Member States, rather than across Europe. As a consequence, some of the projects receiving funding were rated lower during the selection process than other projects which did not receive funding⁽⁶⁾.

10.4. *The Budgetary Authority considered that the yearly allocations per Member State were an important instrument to reach an agreement on the MFF. As a consequence, the allocations were adopted in the legal bases.*

However, the absorption of the funds is not an implicit objective, but a precondition to achieve results.

10.5. *In the framework of direct management, the Commission has proposed in the new LIFE Regulation, the elimination of indicative national allocations. They will be progressively phased out in the next programming period.*

⁽⁴⁾ Court's 2012 annual report, paragraph 10.4. See also Court's opinion No 7/2011 on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF) covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006 (OJ C 47, 17.2.2012), paragraph 4 (<http://eca.europa.eu>).

⁽⁵⁾ *L'Instrument Financier pour l'Environnement*. The LIFE programme is not subject to shared management, but is managed directly by the Commission.

⁽⁶⁾ Special report No 15/2013 'Has the environment component of the LIFE programme been effective?', paragraphs 17 to 21 (<http://eca.europa.eu>).

THE COURT'S OBSERVATIONS

10.6. The general focus on spending, at the expense of achieving results, was exemplified in a number of special reports published in 2013 in the field of rural development. The audit of the Commission's Common Monitoring and Evaluation Framework found that the Member States and Commission focused on financial implementation — spending the budget — rather than on achieving results⁽⁷⁾. The audits of support to the food-processing industry and measures for diversifying the rural economy both provided examples where Member States had spent money on projects which, according to their own selection systems, were likely to make only poor contributions to the EU's aims⁽⁸⁾.

10.7. Another way in which the 2007-2013 legislative framework tended to focus primarily on spending in line with the rules was the use of financial corrections and recoveries. The 2012 annual report reported on the actions available to the Commission when the spending of EU funds under shared management does not comply with the rules. Depending on the circumstances, the use of financial corrections and recoveries may result in a loss of funding for either the Member State or the final beneficiary⁽⁹⁾.

10.8. In cohesion, when Member States agree that expenditure does not comply with the rules, they are generally able to replace ineligible projects. The extent of replacement expenditure is notified to the Commission by Member States each year. However, the Commission does not analyse this replaced expenditure, nor has it assessed the potential effect on overall policy performance.

10.9. These aspects of the legislative framework — financial corrections and recoveries, and replacement projects — are triggered by problems of compliance. There is no equivalent process in place if projects or programmes have not delivered the impacts and results expected of them.

THE COMMISSION'S REPLIES

10.6. *In its supervisory role, the Commission has insisted throughout the programming period 2007-2013 on the need for greater selectivity and targeting in the implementation of the Rural Development Programmes.*

As regards the Common Monitoring and Evaluation Framework in the area of Rural Development, all available data and information, e.g. financial, monitoring data, evaluation findings, are taken into account in annual meetings with the Member States, to assess the progress in the implementation of the programmes and any need for adjustments in their strategy and financial allocations.

10.8-10.9. *Under the 2007-2013 legal framework applicable in the context of shared management, Member States only have to provide information on the amount of irregular expenditure replaced (Article 20 (2) of Regulation (EC) No 1828/2006). They do not provide information that would allow linking the replaced amounts to specific projects producing outputs and results, as there is no legal requirement for that.*

⁽⁷⁾ Special report No 12/2013 'Can the Commission and Member States show that the EU budget allocated to the rural development policy is well spent?', paragraphs 58 to 75 and 81 (<http://eca.europa.eu>).

⁽⁸⁾ Special report No 1/2013, 'Has the EU support to the food-processing industry been effective and efficient in adding value to agricultural products?', paragraph 38; special report No 6/2013, 'Have the Member States and the Commission achieved value for money with the measures for diversifying the rural economy?', paragraphs 31 and 87 (<http://eca.europa.eu>).

⁽⁹⁾ Full details are in the Court's 2012 annual report, paragraphs 1.20 to 1.35.

THE COURT'S OBSERVATIONS

10.10. Based on its audit work, the Court has found that the selection of projects under shared management — a Member State matter — has focused first on the need to spend the EU money available, secondly on the need to comply with the rules and only thirdly — and to a limited extent — on their expected performance⁽¹⁰⁾. As replacement projects are selected in the same way as the projects being replaced, the same pattern of priority applies. In the Court's view, compliance and performance should be given equal weight throughout the project cycle.

2014-2020 programming period

10.11. In its response to the Court's 2012 annual report, the Commission stated that the new programming period, for 2014-2020, would have more focus on performance, highlighting five specific aspects⁽¹¹⁾:

- (a) a renewed approach to evaluation, as set out in the Common Provision Regulation⁽¹²⁾. It is too early to assess the operation of the new arrangements;
- (b) macroeconomic conditionalities, linking disbursement of EU funds to Member State compliance with economic governance requirements as established through the European Semester⁽¹³⁾. Where Member States do not comply, the Commission may suspend payments pending the revision of Partnership Agreements (see Box 10.1) or relevant programmes⁽¹⁴⁾;

THE COMMISSION'S REPLIES

10.10. *The Commission notes that the performance criteria are built into the process of selecting each project to be funded.*

Through the application of weighted selection criteria Member States should be able to identify the projects that could best contribute to the achievement of results.

⁽¹⁰⁾ Similar conclusions were reached by the Commission's Internal Audit Service in its audit of the performance measurement systems of the Directorate-General (DG) for Regional Policy (REGIO) and DG Employment, Social Affairs and Inclusion (EMPL), both reported in December 2013.

⁽¹¹⁾ Commission's reply to 2012 annual report, paragraph 10.3. The revised requirements apply to the 'European Structural and Investment (ESI) Funds', i.e. the ERDF, ESF, CF, EAFRD and EMFF. They are set out in Regulation (EU) No 1303/2013 of the European Parliament and of the Council (OJ L 347, 20.12.2013, p. 320), sometimes referred to as the Common Provision Regulation, or CPR.

⁽¹²⁾ Regulation (EU) No 1303/2013, Articles 54-57 and 114.

⁽¹³⁾ Regulation (EU) No 1303/2013, Article 23.

⁽¹⁴⁾ In the previous programming period, 2007-2013, the legislation allowed for the suspension of Cohesion Fund commitments only in the context of non-compliance with the excessive deficit procedure. Such a suspension occurred in one case, in Hungary. However, this suspension never entered into force since Hungary submitted a revised convergence programme before the suspension took effect.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Box 10.1 — Partnership Agreements

At the heart of the revised framework governing disbursement from the European Structural and Investment (ESI) funds are Partnership Agreements between each Member State and the Commission. These Agreements set out how the Member State intends to use the available EU funding to achieve its objectives, with more detail — on targets and milestones, for example — in the lower level operational programmes⁽¹⁵⁾.

- (c) a reinforced intervention logic, linking EU and Member State objectives. When planning operational programmes, Member States are required to focus on the desired result before considering how to achieve it;
- (d) ex ante conditionalities, intended to ensure that the right frameworks are in place for the effective use of ESI funds, such as the existence of relevant strategies/plans⁽¹⁶⁾. Member States are required to demonstrate in Partnership Agreements and operational programmes compliance with relevant ex ante conditionalities, or have plans to do so by the end of 2016. Where they fail to do this, the Commission may suspend payments;
- (e) a performance reserve, discussed below.

10.12. The **performance reserve** is the main incentive for Member States to continue to focus on performance once the programmes have started⁽¹⁷⁾. The planned operation of the performance reserve is explained in Box 10.2.

Box 10.2 — The performance reserve

Regulation (EU) No 1303/2013, Articles 20 to 22, set out how the performance reserve will operate. The main features are:

- At the start of the programming period, in the Partnership Agreements and operational programmes, the Commission and each Member State agree on which specific priorities within programmes will form the basis for the allocation of a performance reserve of 6 %.

10.12. *The performance reserve is one of the main incentives for Member States to focus on performance. Having clear indicators in programmes and transparent reporting against them is also an important part of accountability and will incentivise a focus on performance.*

⁽¹⁵⁾ Regulation (EU) No 1303/2013, Articles 15 to 17.

⁽¹⁶⁾ Regulation (EU) No 1303/2013, Article 19.

⁽¹⁷⁾ In addition, in 2014-2020 for the first time there is a requirement that data is published, that annual implementation reports contain citizens' summaries and that evaluation reports are published. This is intended to facilitate public debate on outputs and results achieved.

THE COURT'S OBSERVATIONS

- In 2019, the Commission, together with the Member States, will review the achievement of programme milestones for the chosen priorities, based on the annual implementation reports submitted by Member States in that year.
- Where performance is deemed satisfactory, the Commission will release the performance reserve of 6 %. Where it is not, the Member States will propose the reallocation of the reserve to other priorities.
- Where there is evidence that there has been a 'serious failure' to meet milestones, in certain circumstances the Commission may suspend payment of the performance reserve.

10.13. For the 2007-2013 period⁽¹⁸⁾ (and not for the EAFRD), the option of using a performance reserve was delegated to Member States⁽¹⁹⁾. However, only two Member States, Poland and Italy, chose to make use of this possibility, in both cases with little or no genuine focus on performance.

10.14. Making the performance reserve work more effectively than previously will depend on the success of the Commission in, for example:

- (a) Negotiating suitable targets and milestones at the start of the programming period. These targets need to be pitched at the right level — sufficiently demanding that their achievement is not a formality, while remaining realistically within the reach of the Member State.
- (b) Obtaining accurate, reliable and timely data from Member States to determine whether the targets have been met.

⁽¹⁸⁾ A performance reserve — governed by different processes — was also in place for the Structural Funds in the 2000-2006 programming period. However, the Court concluded in an audit of these and related arrangements (special report No 1/2007, paragraph III) that the performance reserve did not add a performance focus but 'was used primarily to maximise spending rather than to concentrate spending on areas which were shown to be particularly effective. The Commission emphasised the importance of absorption'.

⁽¹⁹⁾ Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999 (OJ L 210, 31.7.2006, p. 25), Article 50.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

10.15. However, milestones applied in the performance reserve will include financial indicators, output indicators and, only where appropriate, result indicators⁽²⁰⁾. The Court's special reports have generally not revealed significant problems with outputs; difficulties tend to occur at the level of results/impacts. In practice, the performance reserve will make only limited use of result indicators as the Commission does not plan to use result indicators for any areas other than the ESF, on the grounds that EU-funded programmes by themselves do not have sufficient influence over the achievement of results, and that there can be a considerable lead time between the spending of money and the achievement of results. The Regulation also specifies that result indicators cannot be taken into account when deciding on whether to suspend performance reserve payments or to issue financial corrections. The inclusion of financial indicators as a basis for performance reserve payments risks a reversion to the focus on absorption rather than performance.

10.16. The new arrangements are welcome and the establishment of a performance reserve may encourage an increased focus on results. However, the impact is likely to be marginal as there are still no real financial incentives or sanctions in the 2014-2020 framework relating to the results achieved with EU funding.

PART 2 — THE COMMISSION'S REPORTING ON PERFORMANCE

10.17. This part of the chapter covers three elements: the framework for reporting on the Commission's performance; the fourth evaluation report; and performance reporting at the level of Commission directorates-general.

10.16. *Publication of performance data from the Annual Implementation Reports as well as the evaluation requirements (obligation for at least one impact evaluation for every priority) are intended to prompt policy debate and real accountability.*

In addition, as foreseen in the 2014-2020 regulatory framework (Article 22(6) and (7) of Regulation (EU) No 1303/2013), the Commission will be able to sanction Member States in case of serious underachievement, as a result of the performance review (Article 22(6) of Regulation (EU) No 1303/2013) and at closure (Article 22(7)).

⁽²⁰⁾ Regulation (EU) No 1303/2013, Annex II, paragraph 2.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Reporting by the Commission to the European Parliament and Council

10.18. The Commission produces a wide range of publications, on different topics and for different audiences. Legally, it is required to report annually on the performance of its obligation to implement the budget ⁽²¹⁾ in three separate documents ⁽²²⁾:

- (a) the 'report on budgetary and financial management', including a description of the objectives achieved for the year, in accordance with the principles of sound financial management ⁽²³⁾;
- (b) the 'synthesis report', representing a summary of the annual activity reports which, amongst other things, report on policy achievements ⁽²⁴⁾; and
- (c) the 'evaluation report' on the Union's finances based on results achieved ⁽²⁵⁾.

10.18. *Under the current practice, the three reports serve different purposes and are complementary to each other. The Synthesis report has a focus on the Commission's management achievements, the Article 318 evaluation report focuses on the results achieved by the spending programmes and the report on Budgetary and Financial Management reports on the budgetary aspects and budgetary management.*

⁽²¹⁾ Article 317 TFEU.

⁽²²⁾ In addition, TFEU Article 249(2) requires the Commission to publish annually 'a general report on the activities of the Union'. This report is aimed at the general reader, describing at a high level the activities of the Commission, other EU bodies and Member States. It does not constitute an analysis of the Commission's implementation of the budget.

⁽²³⁾ Article 142 of the Financial Regulation (EU, Euratom) No 966/2012 and Commission Delegated Regulation (EU) No 1268/2012 of 29 October 2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (OJ L 362, 31.12.2012, p. 1), Article 227.

⁽²⁴⁾ Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002, Article 66(9).

⁽²⁵⁾ Article 318 TFEU.

THE COURT'S OBSERVATIONS

10.19. In practice, the report on budgetary and financial management and the synthesis report contain no or little performance information. While the synthesis report for 2013 sets out some general information on the Commission framework for performance management, it did not attempt to provide any details on what the EU budget had achieved in that year.

10.20. All three reports are, according to the legislation, addressed to the European Parliament and the Council⁽²⁶⁾. From the point of view of timing, the Commission aims to publish the evaluation report and the synthesis report in June of year n+1, while the Financial Regulation specifies that the report on budgetary and financial management should be prepared earlier, by 31 March of year n+1. The evaluation report is specifically intended to be used in the discharge process, but otherwise the legislation does not make clear the particular purpose of each report. Taking these three reports together there are, as a consequence, overlaps arising from the legislation as well as gaps and inconsistencies.

THE COMMISSION'S REPLIES

10.19. As regards the report on budgetary and financial management (RBFM), there is indeed a reference in the RAP that the report should describe the objectives achieved. However, whilst the Court assumes that this relates to policy objectives, the Commission believes that this relates to objectives in the field of budget management. Article 227 of the RAP states that 'the report should describe the objectives achieved for the year, in accordance with the principle of sound financial management'. The RBFM, in accordance with Article 142(2) of the FR, sets out in detail, in both tables and text, the rates of implementation achieved, and explains how the tools of budgetary management, such as transfers and amending budgets, have been used to achieve maximum implementation, and ensure sufficient appropriations for priorities. In this way, it addresses the elements set out in the FR (Article 142(2)) and RAP (Article 227), also taking into account that Article 227 of the Rules of Application states that the report on budgetary and financial management shall be separate from the reports on implementation of the budget.

As regards the Synthesis report, the Commission points out that, in addition to the reference to the Commission framework for performance management, different aspects of performance, as indicated in the reply to paragraph 10.58, are covered.

10.20. The Commission is of the opinion that this reporting practice, in which all of these reports have a distinct role and purpose, is in conformity with the legal and operational provisions at various levels (the TFEU, the Financial Regulation and internal Commission standing instructions).

The Commission has taken account of earlier guidance provided by the different discharge reports from the EP and the Council and the Court's annual reports. This guidance, for example, indicated in which direction to develop the Article 318 report. The Commission therefore is of the opinion that, in compliance with the guidance already received, no further overhaul of reporting practice is desirable.

⁽²⁶⁾ The report on budgetary and financial management is also addressed to the Court of Auditors.

THE COURT'S OBSERVATIONS

10.21. The Commission has repeatedly stressed that EU added value is a key test to justify spending financed by the EU budget⁽²⁷⁾. The importance of this concept has been confirmed by the European Parliament and the Council. However, none of the three main reports published in 2013 provided a comprehensive overview of results in terms of EU added value. This is a significant gap in the reporting.

10.22. The presentation of information in the three reports is inconsistent, which does not facilitate comparison between them. The report on budgetary and financial management and the evaluation report present information according to the headings of the multiannual financial framework (MFF), whereas the relevant part of the synthesis report is structured around categories used in the EU budget ('budget titles'). It is not readily possible to reconcile these two different structures and how one corresponds to the other. It is therefore virtually impossible for readers to use these reports as complementary sources of information.

Review of the evaluation report published in June 2014

10.23. The Commission published its fourth evaluation report in June 2014⁽²⁸⁾. The Treaty requires that the Commission produce such a report, and that the report is part of the evidence on which the Parliament gives discharge each year to the Commission in respect of the budget⁽²⁹⁾.

THE COMMISSION'S REPLIES

10.21. *When proposing the new spending programmes, the Commission made a major effort to predict the EU added value of each programme. Where the co-legislators shared this view, they adopted the proposed spending programmes. The Commission will manage these programmes and will report on EU added value, which is one of the aspects that ex post evaluations will assess. These evaluations are publicly available and the Article 318 report includes information on EU added value.*

10.22. *As regards the different structure of the reports, the Commission points out that the discharge authority has asked the Commission to structure the Article 318 evaluation report around MFF headings. The report on budgetary and financial management is structured that way. The Synthesis report of the Commission's management achievements is structured according the budget titles, which reflects how the Commission is organised and managed.*

Given their different purposes, it is inevitable that the information covers different aspects.

⁽²⁷⁾ See also the Commission's replies to paragraphs 10.31 to 10.32 and Box 10.2 of the Court's 2011 annual report.

⁽²⁸⁾ Report from the Commission to the European Parliament and the Council on the evaluation of the Union's finances based on the results achieved (COM(2014) 383 final of 26.6.2014).

⁽²⁹⁾ Articles 318 and 319 of TFEU.

THE COURT'S OBSERVATIONS

10.24. Compared to the previous evaluation reports, the fourth report represents an improvement in so far as it tries to establish a link between the main financial programmes presented by MFF heading and the available performance information relevant to the Europe 2020 strategy. However as stated in the evaluation report itself 'it is not possible to single out what has been the exact contribution of each of the financial programmes in achieving Europe 2020 targets'. The Court shares this assessment and considers that the evaluation report should bring together all the information available on the progress towards Europe 2020 targets in order to provide the reader with a clearer overview of the achievements made⁽³⁰⁾.

THE COMMISSION'S REPLIES

10.24. *The Commission welcomes that the Court of Auditors considers that the fourth report represents an improvement compared with previous evaluation reports regarding the link between the main financial programmes and the available performance information relevant to the Europe 2020 strategy. As the Commission has already stated, the Europe 2020 Strategy had not been adopted when the 2007-2013 MFF was adopted and the monitoring, evaluation and reporting arrangements put in place. This largely explains why it has not been possible to single out the contribution of each financial programme to the targets set in that strategy. Under the new 2014-2020 MFF the Europe 2020 targets for smart, sustainable and inclusive growth have become an integral part of the intervention logic of the major spending programmes and funds. This should facilitate the identification of the contribution of spending programmes to the Union's main objectives and feed into future editions of the Article 318 Evaluation Report. The Commission will consider whether any adjustment to the structure of the Article 318 Report would be appropriate in the light of the way this reporting develops over coming years, while also taking due account of the existence of other more comprehensive reporting on Europe 2020, such as through the European Semester.*

⁽³⁰⁾ Eurostat publishes monthly the eight key Europe 2020 indicators (for details see http://epp.eurostat.ec.europa.eu/portal/page/portal/europe_2020_indicators/headline_indicators). In March, the Commission published 'Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth' (COM(2014) 130). This report is however not an annual exercise.

THE COURT'S OBSERVATIONS

10.25. In many important areas, the information and data provided in the evaluation report concern the actions taken and outputs delivered rather than the results achieved. Indeed, as the Court has already pointed out, it will be some years before the Commission is able to report in a meaningful way on the real achievements of the spending programmes for 2007-2013. For the 2014-2020 programming period, a new performance management and reporting framework is in place⁽³¹⁾. Based on this framework, the Commission expects that, as of the financial years 2017-2018, the evaluation report will be able to include initial conclusions on programme performance and information as to whether programmes are on track or require adjustment.

THE COMMISSION'S REPLIES

10.25. *The Commission considers that the necessary monitoring, evaluation and reporting arrangements, according to the legal frameworks of the different programmes, need to have been operating for some time before information on results can be expected to support reporting on the achievements of the spending programmes. In addition, sufficient time has to have elapsed in the implementation of the financial programmes before the actions financed produce their effects and the evaluation of results and impacts can start. For the 2007-2013 programmes, the final and ex post evaluations will still be based on the monitoring, evaluation and reporting arrangements fixed for those programmes. The Commission will seek to bring out as much performance information as possible. For the 2014-2020 programmes, there is a far stronger focus on performance reporting and it is expected that the interim evaluations, scheduled for 2017-2018, will as the Court states include initial conclusions on programme performance and information as to whether the programmes are on track or require adjustment.*

⁽³¹⁾ As described in the Commission Staff Working Document 'Overview of the Monitoring, Reporting and Evaluation Frameworks for the MFF 2014-2020 Programmes' (SWD(2014) 200 final of 26.6.2014) that accompanied the evaluation report (COM(2014) 383 final of 26.6.2014).

THE COURT'S OBSERVATIONS

10.26. The evaluation report is accompanied by a stock-taking of the action plan for the development of the Article 318 evaluation report⁽³²⁾. The Court will continue to monitor progress in this area.

Performance planning and reporting at directorate-general level

10.27. This section of the chapter makes first some general observations on performance planning and reporting at DG level. It then presents the findings of the Court's detailed examination of the performance elements in the plans and reports of three specific DGs, as it has done for the last three years' annual reports⁽³³⁾.

General

10.28. An important source of information for the three main reports discussed in paragraphs 10.18 to 10.22 is the annual activity reports prepared by each DG⁽³⁴⁾ and published by 31 March of year n+1. AARs represent the end of a process which begins with DGs' activity statements and management plans; this process is set out in more detail in Box 10.3.

⁽³²⁾ Commission Staff Working Document 'Stock-taking on the Action Plan for the Development of the Article 318 Evaluation Report' (SWD(2014) 201 final of 26.6.2014).

⁽³³⁾ Court's 2010 annual report, chapter 8: DGs Agriculture and Rural Development (AGRI), REGIO and Research, Innovation and Science (RTD); Court's 2011 annual report, chapter 10: DGs AGRI, Development and Cooperation — EuropeAid, REGIO; and Court's 2012 annual report, chapter 10: DGs Competition (COMP), Maritime Affairs and Fisheries (MARE) and Mobility and Transport (MOVE).

⁽³⁴⁾ References to directorates and directors-general should be taken to include services and heads of service as appropriate.

THE COURT'S OBSERVATIONS

Box 10.3 — Activity statements and management plans

Activity statements (from 2014 onwards, to be known as programme statements with different structure and content) are drafted for external use, as part of the budget process, to justify the amounts requested by the Commission. The statements provide detailed information not only on resources, objectives and indicators, but also on the anticipated results and the value added at EU level.

A significant part of the statements is duplicated six months later, when the DGs prepare their management plans (MPs). The MP is a key component of the Commission's strategic planning and programming cycle. It is intended to provide a coherent tool by which all services can plan their activities.

Based on the MPs, directors-general report to the Commission in their AARs on the performance of their duties, giving account of the activities of the DG and the achievement of key policy objectives. AARs are the main instrument of management accountability within the Commission and constitute the basis on which the Commission takes responsibility for the management of resources and the achievement of objectives. They are published on the Commission's website and contain four parts, of which the first, 'policy achievements', relates to performance. The other three parts cover management of resources, assessment of the effectiveness of the internal control systems and management assurance.

10.29. The AAR includes a declaration of assurance, in which the director-general provides assurance that, among other things, 'the information contained in the report presents a true and fair view' and that 'the resources assigned to the activities described in the report have been used for their intended purpose and in accordance with the principles of sound financial management' ⁽³⁵⁾. If deemed necessary, the declaration may be qualified with a reservation. Despite the specific reference to sound financial management in the financial regulation, in practice, the Commission restricts this declaration of assurance to parts 2 to 4 of the report, which deal mainly with issues of regularity and internal control (see also Box 10.4).

⁽³⁵⁾ Article 66(9)(a) and (b) of the Financial Regulation.

THE COURT'S OBSERVATIONS

Box 10.4 — The Commission's responsibilities with respect to sound financial management

Under the Treaty, the Commission is required to implement the budget with regard to the principles of sound financial management⁽³⁶⁾. The Financial Regulation defines sound financial management as comprising 'the principles of economy, efficiency and effectiveness' (Article 30); effectiveness is further defined as 'the attainment of specific objectives set and the attainment of the intended results'. The Court's interpretation — which it applies consistently — is that this definition covers whether the EU's policy objectives are being achieved. In excluding policy achievements from the AAR declarations, the Commission is therefore applying a narrower definition of 'sound financial management'. The consequence is that the Commission does not assume responsibility for policy achievements.

THE COMMISSION'S REPLIES

Box 10.4 — The Commission's responsibilities with respect to sound financial management

The Commission reiterates what it stated in its latest Synthesis report. Each annual activity report includes a signed declaration of assurance in which the Director-General or head of service provides assurance concerning the true and fair view given by the report and concerning the legality and regularity and the sound financial management of all financial transactions under his/her responsibility, as well as for the non-omission of significant information. If deemed necessary, the declaration contains reservations related to defined areas of revenue and expenditure. To ensure that declarations of assurance in the AARs remain fully in line with its financial responsibility for implementing the EU budget, the Commission confirms that they should focus on management and financial matters in accordance with the audit requirements of the Commission concerning the efficiency, effectiveness and transparency of its administration of EU finances.

By adopting the Synthesis report, the Commission takes overall responsibility for the management of the EU budget. This is a distinct issue from the Commission's actions taken and clear commitment, as described in the recent Synthesis report, to further strengthen its reporting on policy achievements in the same Annual Activity reports as well as in the Evaluation report as required by the Treaty. These policy achievements are the result of a collective action and responsibility with the co-legislators which contribute to the design of the programmes and adopt them, as well as Member States which often play a major role in the implementation of the programmes. Furthermore, many other factors in the economy and society, far beyond the control of the Directors-General, influence the overall performance of the programmes.

The Commission intends to continue its current practice for reporting through the Synthesis Report and the Article 318 Evaluation Report, which is fully in line with the legal provisions.

⁽³⁶⁾ Article 317 of the Treaty on the Functioning of the European Union.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

10.30. Following this practice, the director-general is not required to provide any assurance about the reporting of policy achievements in part 1 of the AAR. As a result, the assurance declaration covers only those limited aspects of performance which occur in the other parts of the report. None of the 17 quantified reservations made in all the 2013 AARs were for performance reasons⁽³⁷⁾. In the Court's review of part 1 of a sample of AARs in its annual reports for 2010 to 2013, only two reservations included some limited elements relating to performance⁽³⁸⁾.

10.31. The Court notes that EU added value is given due prominence in the activity statements — when resources are being sought — but much less so in the AARs when what has been achieved with these resources is described. Of the 12 AARs covered by the Court's review for 2010 to 2013, only three (the 2010 and 2011 AAR of DG REGIO and, to a limited extent, the 2013 AAR of Directorate-General for Health and Consumers (DG SANCO)) reported specifically on EU added value. In this respect the activity statements provide a more complete picture than the AARs.

Performance planning and reporting in three selected DGs

10.32. The Court reviewed the 2013 activity statements, MPs and AARs (part 1)⁽³⁹⁾ of the Directorate-General for Employment, Social Affairs and Inclusion (DG EMPL), the Directorate-General for Health and Consumers (DG SANCO) and the Office for Infrastructure and Logistics in Luxembourg (OIL). In particular, the Court assessed whether the AARs provide useful information on the DGs' annual contribution to policy achievements. The review was based on requirements set out in the Financial Regulation, the Commission's internal control standards and the MP and AAR instructions issued by the Commission's Secretariat-General (SG) and the Directorate-General for Budget (DG BUDG).

10.30. *Please refer to the reply to Box 10.4.*

⁽³⁷⁾ See paragraph 1.31 and Table 1.3 of the Court's 2013 annual report.

⁽³⁸⁾ DG REGIO made both reservations; one in 2011 and one in 2010.

⁽³⁹⁾ See paragraph 10.29.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

DGs' objectives not fit for management purposes

10.33. According to the Commission's 2013 MP instructions, DGs should establish general objectives with impact indicators (long-term) and specific objectives with result indicators (short-/medium-term). The directors-general were required to report in part 1 of their AARs on the results achieved and on the extent to which the results had the impact intended.

10.34. In line with its observations made in previous years in relation to other DGs, the Court's audit found that for DG EMPL and DG SANCO many of the objectives (general and specific) used in the MPs and AARs were taken directly from policy or legislative documents and were thus at too high a level to be useful as management instruments (see Box 10.5).

10.34. Objectives, as defined for the new period, allow for an integrated presentation of the DGs' *raison d'être*, key priorities and operational means (financial, legislative and policy responsibilities).

The standing instructions for management plans require that the general objectives be aligned with the Commission's political objectives by further elaborating them in the management plans. The rationale for this approach is given by the need to ensure that the Commission services follow up on the delivery of the political objectives and of the main policy priorities of the Commission. Where possible, specific objectives with result and output indicators are also defined and those contribute to the delivery of the political objectives and of the main policy priorities of the Commission.

THE COURT'S OBSERVATIONS

Box 10.5 — Examples of 'specific objectives' not fit for management purposes

DG SANCO: For the specific objective 'To foster good health in an ageing Europe', DG SANCO's influence is not measurable.

DG EMPL: This DG has as a specific objective to 'promote geographic and professional mobility (including the coordination of social security systems) of workers in Europe in order to overcome obstacles to free movement and to contribute to the establishment of a real labour market at European level'. It is difficult to determine the specific contribution of DG EMPL to the achievement of this objective.

10.35. According to the Financial Regulation, DGs' objectives should be SMART — specific, measurable, achievable, relevant and timed⁽⁴⁰⁾. However, 11 of the 15 objectives examined⁽⁴¹⁾ do not fulfil all the SMART criteria. While the objectives examined were relevant to the policy area in which the DGs operate, they are set at such a high level that it is not clear how they could be achieved. In many cases the indicators accompanying the objective do not exhaustively measure all aspects at the appropriate level. A similar conclusion was reached in December 2013 by the Internal Audit Service for DG EMPL which reported that objectives were not always clearly defined.

10.36. As a horizontal service of the Commission, OIL is not a policy or spending DG. It provides internal support for other DGs; its main objectives are administrative. As a consequence, in planning its activities in the MP and reporting on them in AARs, OIL understandably does not present general objectives and impact indicators, but only includes specific objectives with result indicators.

THE COMMISSION'S REPLIES

Box 10.5 — Examples of 'specific objectives' not fit for management purposes

The causality between DG SANCO's activities and 'to foster good health in an ageing Europe' is indeed complex, at times indirect and not quantifiable. The Commission is developing a monitoring framework to assess progress with indicators such as quality of life, sustainability of health systems and innovation and ultimately on the healthy life year target by 2020.

DG 'Employment, Social Affairs and Inclusion' will consider improving the presentation of its overall logic of intervention for the next MPs so as to better emphasise the wealth of activities contributing towards such an objective.

10.35. *The Commission always considers SMART criteria when formulating objectives. When assessing the compliance with the SMART criteria, the information in the management plan should be analysed in its entirety. The Commission underlines that performance reporting should focus on the real needs of stakeholders and should be sufficiently flexible to reflect the different nature of activities of the Commission's services.*

⁽⁴⁰⁾ Financial Regulation, Article 38(3)(e)

⁽⁴¹⁾ Five for each of DG EMPL, DG SANCO, OIL.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Difficulties remain with indicators for monitoring performance

10.37. The choice of indicators should be based on considerations such as relevance, measurability, and the availability of timely and reliable performance data. As far as is possible, indicators should meet the 'RACER' criteria⁽⁴²⁾. Indicators which measure outcomes over which DGs have limited influence should be complemented by other indicators measuring directly the DGs' activities.

10.38. The two DGs and OIL have at least one performance indicator per objective to help management monitor, evaluate and report on achievements. An examination of 15 indicators (five for each organisation) showed that only two of the indicators adequately fulfilled all the RACER criteria⁽⁴³⁾. In addition, the Court identified a number of shortcomings (see Box 10.6).

Box 10.6 — Examples of problems with indicators

(a) *Indicators which were outside the DG's ability to influence*

DG SANCO: 'Rate of influenza vaccination among EU citizens aged 65+': While this indicator was set by the Council, implementation is entirely the responsibility of the Member States. Consequently, achieving the target falls outside SANCO's scope of influence.

(b) *Indicators which lacked relevant information*

DG EMPL: The specific objective 'Increase access to employment and participation in the labour market' is measured by two result indicators: 'Number of citizens benefiting from ESF support in the form of training, employment or guidance' and 'ESF as a % of Active Labour Market Policies in the EU'. The indicators track ESF participation and ESF budget allocation but neither provides information about the purpose of the objective: to increase (access to) employment.

10.38. *The Commission significantly reviewed its indicators for the period 2014-2020 and considers that the indicators presented generally provide useful information on progress towards attaining the Commission's overall policy objectives as well as for monitoring performance.*

Box 10.6 — Examples of problems with indicators

(a) *Vaccination against seasonal influenza is a specific public health measure that lies solely within the remit of Member States. DG SANCO is aware that it has no direct influence on the progress of this indicator.*

However, the Council set an objective for vaccination coverage at EU level which can only be monitored by the Commission. Therefore, DG SANCO continues to monitor national measures to reach targets and, as such, contributes to achieving the set targets.

(b) *The Commission considers that the indicators concerned are useful, but acknowledges that these could be more specific and this was addressed for the period 2014-2020.*

⁽⁴²⁾ Relevant, accepted, credible, easy and robust: Commission's internal control standard on objectives and performance indicators (ICS 5).

⁽⁴³⁾ A similar conclusion was reached in December 2013 by the Internal Audit Service for DG EMPL which reported that indicators did not always meet the RACER criteria.

THE COURT'S OBSERVATIONS

(c) Indicators for which reliability was questionable

DG SANCO: 'Share of population worried to suffer an adverse event while receiving healthcare': To collect data, the indicator relies on citizen surveys (Eurobarometers). The first such survey was carried out in 2009, which became the baseline. The next survey is scheduled for 2014. The indicator measures citizen perception. This can be very useful circumstantial evidence, but it needs to be complemented with a more direct form of feedback (e.g. the actual number of adverse events). Because of its subjective nature, this indicator might not reliably indicate whether patient safety has improved or not.

(d) Indicators presented as result indicators but were instead output-oriented

OIL: Some indicators though defined as result indicators represent in fact output indicators. The MP 2013 includes as result indicators: 'daily average meals sold', 'number of fitness centre users' or 'number of environmental communications made'. These are not result indicators. They represent the number of products/services delivered (outputs) and not the immediate effects of the actions/activities on the target population

(e) Indicators where key information for the target is missing

DG EMPL: For the result indicator 'Number of Managing Authorities (MA) and Intermediate Bodies (IB) participating in learning networks', the target is that an MA or IB from each Member State participates in at least one relevant transnational learning network. The AAR does not provide participation rates for each Member State.

THE COMMISSION'S REPLIES

(c) The Eurobarometer survey is not designed to serve as a stand-alone indicator. It is analysed together with a number of other indicators such as the structured indicator on the implementation of the relevant Council Recommendation in the Member States, accompanied by a proxy outcome indicator exploring the impact of the measures taken on the citizens' perception of how probable patient safety incidents are.

(d) OIL reports on the achievement of every specific objective assigned to the Office, mainly through qualitative elements presented in a text format.

In order to reflect accurately the actual achievements whilst connecting the latter with underlying processes and earmarked resources, output indicators turn out in most cases to be meaningful and as such, have been agreed by the Management Board of OIL. For the sake of clarity, comparability over time and data availability, indicators selected for the Annual Activity Report cannot be limited solely to impact or result indicators.

In this respect, the indicators highlighted by the Court of Auditors, though perfectible, are generally complemented by result-targeted indicators (balanced books for catering services, awareness on environmental issues evidenced through the extended EMAS scope).

(e) The Commission considers that the indicator presented is very useful and relevant, but it nevertheless agrees that information on the attainment of the target for this particular indicator was very difficult to obtain taking into account the collaboration of 28 Member States and hundreds of MA and IB. DG 'Employment, Social Affairs and Inclusion' will strive to do better in the future.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Insufficient cooperation between DGs

10.39. According to the AAR instructions, DGs in related policy areas or managing similar programmes are expected to cooperate during the preparation of the draft AAR. Lack of cooperation might lead to inconsistencies in reporting between the DGs (see Box 10.7).

Box 10.7 — Examples of insufficient coordination between DGs

DG EMPL and DG SANCO: DG SANCO uses the indicator on the 'Number of healthy life years (HLY) at birth' as an impact indicator under the general objective 'To protect and improve human health'. Although it tracks the same data as DG EMPL's impact indicator 'Disability-free life expectancy', the two indicators have different targets and milestones without any apparent reason for this discrepancy.

10.39. *The Commission recalls that during the preparation of AARs, there has always been close coordination and collaboration between DGs in related policy areas.*

Box 10.7 — Examples of insufficient coordination between DGs

The indicator HLY is a European Core Health Indicator (ECHI) and is as such used in different contexts. To avoid discrepancies, the underlying methodology is coordinated closely between DGs SANCO, 'Employment, Social Affairs and Inclusion', and ESTAT. There is and always has been a good cooperation between DGs 'Employment, Social Affairs and Inclusion' and SANCO on health indicators, e.g. through the European Health Interview Survey where the two DGs have held coordination meetings on the data that should be collected.

However, DG-specific targets may be required to capture some specific aspects of a given DG's work.

THE COURT'S OBSERVATIONS

PART 3 — RESULTS OF THE COURT'S AUDIT ON PERFORMANCE

10.40. This part of the chapter comprises two sections: the first draws out some of the main lessons from the Court's 2013 special reports; and the second follows up the extent to which the Court's special report recommendations — from eight special reports from 2007-2010 — are implemented.

The Court's 2013 special reports

10.41. The Court's special reports examine whether the principles of sound financial management (paragraph 10.1) are applied to European Union spending. The Court chooses its topics for special reports — specific budgetary areas or management themes — to have maximum impact, based on a range of criteria, such as the level of income or spending involved (materiality), the risks to sound financial management and the degree of stakeholder interest. In 2013, the Court adopted⁽⁴⁴⁾ 19 special reports, as listed in **Annex 10.1**.

10.42. Each special report in itself constitutes an important contribution towards holding auditees accountable for their management of EU money, and towards helping them to make improvements in the future. These special reports in total cover the full range of the management lifecycle, from conception to evaluation. In previous years' annual reports, the Court has drawn out a limited number of themes, judged to be of particular relevance, from across the range of that year's special reports. In the 2011 annual report, these themes were needs analysis, design, and EU added value; in the 2012 annual report they were objectives and indicators, data on performance, and the sustainability of EU-funded projects.

10.43. In this annual report, the Court chooses to highlight two issues identified in its 2013 special reports which are of particular significance to the Commission and the legislator in terms of obtaining maximum impact from the next generation of spending programmes: EU added value, and the closely-associated concept of deadweight.

EU added value

10.44. EU added value is of increasing importance in terms of securing the best possible performance from limited EU funds (see also paragraph 10.21). Of the 19 special reports adopted in 2013, seven addressed the issues of EU added value and/or deadweight.

⁽⁴⁴⁾ Adopted means approved for publication.

THE COURT'S OBSERVATIONS

10.45. EU added value is 'the value resulting from an EU intervention which is additional to the value that would have been otherwise created by Member State action alone'⁽⁴⁵⁾. Securing EU added value is fundamental to the achievement of sound financial management⁽⁴⁶⁾.

10.46. The Court's audits found that genuine EU added value was often difficult to identify, particularly in the context of shared management where most of the budget is spent. The risk is that EU funding is used as a substitute for national funds, thereby releasing national resources for use elsewhere. This option may be attractive for Member States whose national budgets are under pressure.

10.47. An example is provided by the Court's special report on the LIFE programme, referred to earlier in paragraph 10.5. The Court found that the use of national allocations and the national, rather than EU-wide, competition for project funding had the effect of reducing the EU added value of the programme⁽⁴⁷⁾.

10.48. Another example is the Court's special report on the European Globalisation Adjustment Fund, in which the Court concluded that one third of the funding from this source compensated workers affected by mass redundancies with no EU added value. This was the proportion of funding related to income support measures which would have been paid by Member States anyway. However, the report did note that when the Fund was used to co-finance services not ordinarily existing in the Member States, such as training for redundant workers, it did deliver EU added value⁽⁴⁸⁾.

THE COMMISSION'S REPLIES

10.45. *The Commission underlines that the concept of EU added value may be used in many different contexts, such as in academic reflections on the EU budget, for defining goals and/or criteria for project selection in specific EU programmes, in provisions of the Financial Regulation and in evaluation of existing programmes but it also considers that the added value of a political project goes beyond simply referring to quantitative data.*

The Commission also points out that the principle of sound financial management is set out in Article 30 of the Financial Regulation and that the achievement of sound financial management should be measured against these principles.

10.46. *The Commission refers to its replies to paragraphs 10.48 and 10.52, where it considers that the measures taken did provide for EU added value.*

The Commission assessed EU added value when presenting proposals relating to the new spending programmes. Where the co-legislators shared this view, they adopted the proposed spending programmes. The Commission will manage these programmes and will report on EU added value, which is one of the aspects that ex post evaluations will assess. These evaluations are publicly available and the Article 318 report also includes information on EU added value.

10.47. *Please see reply to paragraph 10.5.*

10.48. *The Commission draws attention to the conclusions of the mid-term evaluation report related to EU added value. This report concludes that the EGF has delivered 'significant added value' and 'independent experts concluded that hardly any results would have been achieved without EGF support'.*

The Commission observes that support provided by the EGF should be considered as financing a 'package' of interrelated measures, which as a whole contributes to the success of the funded operations. Indeed, the EGF provides support to workers through various forms of assistance, including allowances to ensure that workers have sufficient income for the duration of the activation measures, and are hence in a position to benefit from the various supported actions such as training.

⁽⁴⁵⁾ For a fuller definition of EU added value, see Box 10.2 of the Court's 2011 annual report.

⁽⁴⁶⁾ Court of Auditors opinion No 7/2011, paragraph 9 (<http://eca.europa.eu>).

⁽⁴⁷⁾ Special report No 15/2013, paragraphs 4, 20 to 21 and 63 (<http://eca.europa.eu>).

⁽⁴⁸⁾ Special report No 7/2013, 'Has the European Global Adjustment Fund delivered EU added value in reintegrating redundant workers?', paragraphs 77 and 78 (<http://eca.europa.eu>).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Deadweight

10.49. A linked concept, negatively affecting EU added value, is that of deadweight: when applied to EU grants, this refers to the extent to which a beneficiary would have undertaken the project even in the absence of the EU support. The presence of deadweight would thus reduce or even rule out EU added value.

10.50. Deadweight, by its nature, is not easy to identify. However, the absence of sound needs analysis often indicates that there is a risk of deadweight. On some occasions the Court's audits noted projects which were authorised — or even completed — before the EU funding had been approved; this indicates the presence of deadweight.

10.51. For example, in its audit of EU support to the food-processing industry, the Court concluded that the likelihood of deadweight was high as a consequence of Member States' systematic failure to direct funding to projects for which there was a demonstrable need for public support⁽⁴⁹⁾. Also in the field of agriculture, the Court found that the risk of deadweight was high in the measures used by Member States to diversify the rural economy, with only one Member State requiring beneficiaries to demonstrate the need for the grant; in one case, EU support was provided after a project had already been completed⁽⁵⁰⁾.

10.51. *The Commission agrees with the Court that improvements in better targeting the support are needed at the level of Member States.*

When the investment support is well targeted (using among others eligibility and selection criteria, differentiation in aid rates) and based on clearly identified gaps/needs, the risk of deadweight and displacement is minimised. The targeting of investment support (Article 43 of Regulation (EC) No 1974/2006) was introduced in the programming period 2007-2013 exactly to limit deadweight and displacement effects coming out of earlier evaluations.

The legal framework for the new programming period requires that specific needs linked with specific conditions at regional or sub-regional level are taken into account and concretely addressed through adequately designed combinations of measures or thematic sub-programmes.

Furthermore, the new legal framework requires that appropriate targets are set for each of the focus areas of the Union priorities, on the basis of common result indicators, and that the selected measures in relation to the Union priorities are based on sound intervention logic supported by an ex ante evaluation.

⁽⁴⁹⁾ Special report No 1/2013, 'Has the EU support to the food-processing industry been effective and efficient in adding value to agricultural products?', paragraph 86 (<http://eca.europa.eu>).

⁽⁵⁰⁾ Special report No 6/2013, 'Have the Member States and the Commission achieved value for money with the measures for diversifying the rural economy?', paragraphs 54-57 and 93 (<http://eca.europa.eu>).

THE COURT'S OBSERVATIONS

10.52. Further examples of deadweight were found in the Court's examination of the Marco Polo programme, designed to shift freight traffic off the road. Although there was evidence that the EU support benefited projects in terms of when they were able to start, the scale of the service provided or a quicker return on investment, the audit also found serious indications of deadweight: for example, 13 of the 16 beneficiaries audited confirmed that they would have started and run the project without the EU subsidy⁽⁵¹⁾. Similarly the Court concluded that the Commission had not sufficiently demonstrated that the EU support under the Risk Sharing Finance Facility (a financial instrument designed to improve access to debt financing for research) leads to investments above the level that beneficiaries would undertake in its absence⁽⁵²⁾.

Follow-up of special report recommendations

10.53. According to international auditing standards, the follow-up of audit reports is the final stage in the performance audit cycle of planning, execution and follow-up⁽⁵³⁾. Following up the Court's performance audit reports is a necessary element in the cycle of accountability and helps encourage the effective implementation of report recommendations by the Commission.

THE COMMISSION'S REPLIES

10.52. For the reasons stated by the Court (i.e. earlier start of projects, increase of the scale of services and earlier return on investment), the Commission considers that the Marco Polo programme has clearly an EU added value for the audited projects.

What is more, the deadweight phenomenon is difficult to quantify since there may be a number of other factors which should be taken into consideration e.g. sustainability issue (a question whether projects would have been sustainable without the subsidy), multiplication factor (bigger projects generating much more modal shift), increased credibility and visibility of the beneficiaries (EU project brand), benefits resulting from collaboration between partners (transfer of know-how, best practices).

Regarding the RSFF, the Commission considers that this instrument has proven its worth, particularly in challenging economic times. The RSFF interim evaluation has also demonstrated the added value of the instrument, stating:

'The RSFF helped many European research-intensive firms to maintain RDI activities in a period of major financial stress, it has helped some of the most innovative firms in Europe to restructure their financial positions at a time banks and other financial institutions were reducing access to finance for high risk investments ...' (RSFF Interim Evaluation Report of August 2010, page 18).

Furthermore, the second interim evaluation (June 2013) refers that 'the key economic value of RSFF is the anti-cyclical nature that provides promoters with a long-term financial stability to perform RDI even in times of crisis'.

⁽⁵¹⁾ Special report No 3/2013, 'Have the Marco Polo programmes been effective in shifting traffic off the road?', paragraphs 32 and 33 (<http://eca.europa.eu>).

⁽⁵²⁾ Special report No 2/2013, 'Has the Commission ensured efficient implementation of the seventh framework programme for research?', paragraph 104 (<http://eca.europa.eu>).

⁽⁵³⁾ International Auditing Standards of Supreme Audit Institutions, ISSAI 3000 and 3100.

THE COURT'S OBSERVATIONS

10.54. The Court reviewed the Commission's follow-up of a sample of 59 audit recommendations from eight special reports adopted in the period 2007-2010. Of the 56 that could be verified⁽⁵⁴⁾, the Court concluded that the Commission implemented 79 % of the recommendations, either fully or in most respects. A further 12 % of recommendations had been implemented in some respects while 9 % had been initially rejected and consequently not implemented⁽⁵⁵⁾.

10.55. In last year's follow-up exercise, the Court recommended that the Commission refine its IT tool for monitoring the status of audit recommendations and discharge requests. The IT tool should allow a more accurate recording of the status of recommendations which have only been partially implemented. Following the Court's recommendation, the Commission has proposed improvements which should make it possible to record partially implemented recommendations in the IT tool later in 2014.

CONCLUSION AND RECOMMENDATIONS

Conclusion

10.56. When spending EU funds in the 2007-2013 programming period, the focus was on absorption (the need to spend money) and compliance rather than good performance. New arrangements are in place for the 2014-2020 period and the Court will follow the impact of these in future performance audits. While the new arrangements are welcome, and the establishment of a performance reserve may encourage an increased focus on results, the impact is, however, likely to be marginal as there are still no real financial incentives or sanctions in the 2014-2020 framework relating to the results achieved with EU funding (paragraphs 10.3 to 10.16).

THE COMMISSION'S REPLIES

10.55. *The Commission assessed the possibility to further develop the RAD application in order to improve the information provided to management. The development of the additional recommendation status 'Partially implemented' has been asked to the system provider within the Commission.*

10.56. *Publication of performance data from the Annual Implementation Reports as well as the evaluations requirements (obligation for at least one impact evaluation for every priority) will prompt policy debate and real accountability.*

In addition, as foreseen in the 2014-2020 regulatory framework (Article 22(6 and 7) of Regulation (EU) No 1303/2013), the Commission will be able to sanction Member States in case of serious underachievement, as a result of the performance review (Article 22(6) of Regulation (EU) No 1303/2013) and at closure (Article 22(7)).

⁽⁵⁴⁾ The follow-up actions pertaining to three of the selected recommendations could not be verified, as the necessary evidence was only available at the level of Member States, which was outside the scope of the review.

⁽⁵⁵⁾ The five recommendations that were rejected all concerned special report No 7/2010, on the clearance of accounts procedure, and concerned detailed aspects of the relevant procedure. However, for two of those five recommendations, some remedial actions have been initiated by the Commission in the context of the preparation of the horizontal regulation for the common agricultural policy 2014-2020.

THE COURT'S OBSERVATIONS

10.57. In the Court's view, the lack of focus on performance points to a more fundamental problem. The principle of shared management relies on trust: that Member States — who part-fund projects — manage EU funds as carefully as they do their own resources. Based on its audit work, the Court has found that the selection of projects has focused first on the need to spend the EU money available ('use it or lose it'), secondly on the need to comply with the rules, and only thirdly — and to a limited extent — on their expected performance. Compliance and performance should be given equal weight throughout the project cycle. This tension between the desire for a focus on results and the political imperatives faced by Member States is a fundamental flaw in the design of much of the EU budget.

THE COMMISSION'S REPLIES

10.57. *The Commission notes that the performance criteria are built into the process of selecting each project to be funded.*

Through the application of weighted selection criteria Member States should be able to identify the projects that could better contribute to the achievement of results.

The Commission would like to underline that, in addition to the Union funding, there always needs to be national co-financing (either public or private). Therefore the 'trust: that Member States — who part-fund projects — manage EU funds as carefully as they do their own resources', is justified as any 'bad' spending of the Union contribution, will automatically affect and spill over to the spending of the national contribution. Maximum co-financing rates are established by the CPR (Article 120), but these rates may be modulated (Article 121). Whilst in less developed regions the national co-financing can be limited to 15 %, for more developed regions it will be at least 50 %. In these cases there is thus a high risk for the national contribution in case the programme is 'not carefully managed' and focuses on spending rather than on delivering results. In addition, ex ante conditionalities should ensure that the right framework conditions for spending are in place. Therefore, even if there would be a focus on spending (which also affects the national contribution), the ex ante conditionality requires that Member States have a strategic policy framework in place which is in line with the commitments taken at EU level so as to ensure the effective and efficient achievement of the objectives of the programme and thus results.

THE COURT'S OBSERVATIONS

10.58. Reporting to the European Parliament and Council on performance takes place in a framework that has evolved over many years and is not adapted to the performance culture that the Commission is seeking to create. The Commission is legally required to report annually on its performance in three main reports to the European Parliament and Council. However, only the evaluation report focuses on performance. The report on budgetary and financial management and the synthesis report contain no or little performance information. In the Court's view, the Commission's practice of focusing its reporting of performance in the evaluation report is sensible, as the other two reports have different purposes (paragraphs 10.18 to 10.20).

10.59. In addition, the Court found examples of gaps in coverage: the reports do not address EU added value. The Court concludes that sound financial management is not reported in a useful way in any of these three reports (paragraphs 10.18 to 10.22).

THE COMMISSION'S REPLIES

10.58. Reporting to the European Parliament and Council is developing along with the performance culture that the Commission is implementing, which takes account of the views of the European Parliament and Court of Auditors. As already stated, with the adoption of the 2014-2020 MFF, the framework of reporting to the European Parliament and Council has been adapted, with an increased focus on programme performance. As indicated in the Synthesis report, the Commission has taken already the necessary actions to improve the reporting on performance by strengthening the performance framework of the programmes under the 2014-2020 Multiannual Financial Framework (MFF) and by incorporating this performance framework into the Commission's Strategic planning, programming and reporting on achievements. It will take time for these changes to feed through into results. As regards the reports mentioned by the Court, different aspects of performance, complementary to each other, are covered by the three reports, which concern the implementation details of financial and budgetary management, the synthesis of the Commission's management achievements and the overall performance of the EU financial programmes. A clear distinction needs to be maintained between these different, but related, aspects. The Commission welcomes the Court of Auditors' indication that the current practice of reporting is sensible, that the three reports have different purposes and that reporting on the performance of financial programmes is best done in the evaluation report.

10.59. The Commission considers that there are no gaps in coverage. As indicated in its replies to paragraph 10.46, the Commission assessed EU added value when presenting proposals relating to the new spending programmes. The Commission includes information on EU added value as part of the reporting on evaluations done in the context of the Article 318 report. Moreover, the Commission does not agree with the Court's interpretation that the principle of sound financial management implies reporting on EU added value. Furthermore, none of the three reports are required or designed individually to cover all three elements thereby providing a full account for all purposes of sound financial management. They have their specific purposes (see reply to paragraph 10.58).

THE COURT'S OBSERVATIONS

10.60. Compared to the previous evaluation reports, the fourth report represents an improvement in so far as it tries to establish a link between the main financial programmes presented by MFF heading and the available performance information relevant to the Europe 2020 strategy. However, in many important areas, the information and data provided in the evaluation report is not yet fit for the intended purpose in the discharge procedure. The Court notes the Commission's expectation that it will be some years before the new performance framework will be able to provide meaningful performance information on annual policy achievements. The Court will continue to monitor progress in this area (paragraphs 10.23 to 10.26).

10.61. Directors-general report to the Commission in their AARs on the performance of their duties, on the activities of the DG and on policy achievements. The AARs include a declaration of assurance by the directors-general that, amongst other things, the resources assigned to the activities described in the report have been used in accordance with their intended purpose and the principles of sound financial management. However, in practice, the assurance provided in the AARs specifically excludes performance issues. Assurance, and any associated reservations, is limited to issues of regularity and internal control (see paragraphs 10.28 to 10.30 and Box 10.4).

THE COMMISSION'S REPLIES

10.60. *The Commission considers that, within the monitoring and evaluation arrangements applicable to the 2007-2013 programmes, the latest evaluation report provides a valuable contribution to the work of the discharge authority for the year in question. In many aspects the structure and content of this year's report reflect the guidance given by the discharge authority. For example, the report separates the information on progress in achieving programme objectives from information on operational aspects of performance, such as Commission action to implement and manage the financial programmes. A distinction is made between the EU's internal policies and its external policies. The report also goes as far as has been found possible in providing available performance information on how the financial programmes have contributed to the Europe 2020 Strategy. However, it has to be recalled that, despite the fact that 2013 was the last year of the 2007-2013 programming period, it is still too early to fully measure the programmes' results and impacts as the final and ex post evaluations of the financial programmes are scheduled for the next four years (2014-2017). Nor were the monitoring, evaluation and reporting arrangements applied for the 2007-2013 programmes focused on reporting on the performance of the programmes. The performance information for the 2014-2020 programmes will gradually start to become available according to the reporting and evaluation arrangements set out in the legal acts adopted by the co-legislators and will feed into the Article 318 Report.*

10.61. *As stated in the reply to Box 10.4, the Commission will continue to apply the same practice for reporting which is in line with the legal provisions. As indicated in the Synthesis report, the declaration of assurance focuses on management and financial matters, fully in line with the financial responsibility of the Commission for implementing the EU budget. By adopting the Synthesis report, the Commission takes overall responsibility for management of the EU budget. This is a distinct issue from the Commission's clear commitment to further strengthen its reporting on policy achievements in the same Annual Activity reports as well as in the Evaluation report as required by the Treaty. These policy achievements are the result of a collective action and responsibility with the co-legislators and Member States which play a major role in the implementation of the programmes. Furthermore, many other factors in the economy and society, far beyond the control of the Directors-General, influence the overall performance of the programmes.*

THE COURT'S OBSERVATIONS

10.62. The review of this year's AARs showed that, as with previous years, DGs' objectives are not fit for management purposes; that a number of weaknesses persist with the selection of indicators, meaning that their suitability for monitoring performance is limited; and that DGs do not cooperate sufficiently in formulating their objectives and indicators (see paragraphs 10.32 to 10.39).

10.63. The Court's audits of performance continue to fulfil their twin aims in terms of accountability and improvement. Its 2013 reports, amongst many other topics, reported on cases where EU added value — fundamental to the achievement of sound financial management — had not been secured, or was reduced. A particular example of this, found in a number of cases, was the presence of deadweight — where beneficiaries would have continued with the activity even without the EU funding (paragraphs 10.40 to 10.53).

Recommendations

10.64. **Annex 10.2** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented nine recommendations. Out of these recommendations, two were not applicable because it was too early for the Court to assess progress. The Commission implemented seven recommendations in some respects.

10.65. Following this review and the findings and conclusions for 2013, the Court recommends that:

- **Recommendation 1:** the Commission should, on the next occasion that the Financial Regulation is reviewed, rationalise its reporting framework for performance;

THE COMMISSION'S REPLIES

10.62. As indicated in the 2013 Synthesis report, the structure of the 2013 annual activity reports was revised significantly. A lot of effort was put into improving the performance indicators and the reporting on performance as well as the reporting on economy and efficiency in the AARs.

Moreover, much effort has been devoted in the revised instructions to ensure that the reports include only what is relevant and to improve clarity and consistency across DGs. In addition, there will be a closer alignment of management plans with annual activity reports as regards reporting on objectives and indicators.

10.63. The Commission refers to its replies to paragraphs 10.48 and 10.52, where it considers that the measures taken did provide for EU added value. Moreover, as indicated in its reply to paragraph 10.45, the Commission does not share the Court's suggested principles underlying the concept of EU added value as indicated in its 2011 Annual report.

The Commission accepts the recommendation. The Commission is ready to adapt the Financial Regulation in order to align it with its current practice in reporting on performance. Under the current practice, the three reports referred to by the Court in paragraph 10.18, serve different purposes and are complementary to each other. The Synthesis report has a focus on the Commission's management achievements, the Article 318 evaluation report focuses on the results achieved by the spending programmes and the report on Budgetary and Financial Management reports on the budgetary aspects and budgetary management. The Commission is of the opinion that this reporting practice, in which all of these reports have a distinct role and purpose, is in conformity with the legal and operational provisions at various levels (the TFEU, the Financial Regulation and internal Commission standing instructions).

THE COURT'S OBSERVATIONS

- **Recommendation 2:** the Commission should ensure that the evaluation report presents a summary account that brings together all the information available on the progress towards Europe 2020 targets in order to provide the reader with a clear overview of the achievements made;

- **Recommendation 3:** the Commission should further develop its performance managing and reporting system so that it allows the Commission to take responsibility for sound financial management as well as the EU budget's contribution to policy achievements in the annual declarations of assurance by the directors-general.

THE COMMISSION'S REPLIES

The Commission accepts this recommendation. The Commission will focus on ensuring that the Article 318 report presents a summary account bringing together information on progress towards Europe 2020 targets with a view to providing a clear overview of achievements made. The Commission will consider whether any adjustment to the structure of the Article 318 report would be appropriate in the light of the way this reporting develops over coming years, while taking due account of the existence of other more comprehensive reporting on Europe 2020, such as through the European Semester.

The Commission does not accept this recommendation.

The Commission is committed to ensuring sound and high quality management and reporting on the EU budget, taking full account of all suggestions for the further developments of it. As indicated in the Synthesis report, the Commission has taken already the necessary actions to improve the reporting on performance by strengthening the performance framework of the programmes under the 2014-2020 Multiannual Financial Framework (MFF) and by incorporating this performance framework into the Commission's Strategic planning, programming and reporting on achievements.

However, a distinction needs to be made between the direct responsibility of the Directors General, on the one hand, for the management of the financial programmes and the implementation of the budget and, on the other hand, the policy achievements such as the impact of the financial programmes. The latter is also the responsibility of the co-legislators who contribute to the design of the programmes and adopt them, as well as of the Member States that often play a major role in the implementation of the programmes. Furthermore, many other factors in the economy and society, far beyond the control of the Directors General, influence the overall performance of the programmes.

The Commission therefore considers that the scope of the declaration of assurance provided by Directors General should continue to focus on management and financial matters, fully in line with the financial responsibility of the Commission and audit requirements for the implementation and administration of the EU budget. By adopting the Synthesis report, the Commission takes overall responsibility for management of the EU budget.

ANNEX 10.1

SPECIAL REPORTS ADOPTED BY THE COURT OF AUDITORS IN 2013

- No 1/2013 'Has the EU support to the food-processing industry been effective and efficient in adding value to agricultural products?'
- No 2/2013 'Has the Commission ensured efficient implementation of the seventh framework programme for research?'
- No 3/2013 'Have the Marco Polo programmes been effective in shifting traffic off the road?'
- No 4/2013 'EU cooperation with Egypt in the field of governance'
- No 5/2013 'Are cohesion policy funds well spent on roads?'
- No 6/2013 'Have the Member States and the Commission achieved value for money with the measures for diversifying the rural economy?'
- No 7/2013 'Has the European Globalisation Adjustment Fund delivered EU added value in reintegrating redundant workers?'
- No 8/2013 'Support for the improvement of the economic value of forests from the European Agricultural Fund for Rural Development'
- No 9/2013 'EU support for governance in the Democratic Republic of Congo'
- No 10/2013 'Common Agricultural Policy: is the specific support provided under Article 68 of Council Regulation (EC) No 73/2009 well designed and implemented?'
- No 11/2013 'Getting the Gross National Income (GNI) data right: a more structured and better-focused approach would improve the effectiveness of the Commission's verification'
- No 12/2013 'Can the Commission and Member States show that the EU budget allocated to the rural development policy is well spent?'
- No 13/2013 'EU development assistance to Central Asia'
- No 14/2013 'European Union direct financial support to the Palestinian Authority'
- No 15/2013 'Has the environment component of the LIFE programme been effective?'
- No 16/2013 'Taking stock of "single audit" and the Commission's reliance on the work of national audit authorities in cohesion'
- No 17/2013 'EU climate finance in the context of external aid'
- No 18/2013 'The reliability of the results of the Member States' checks of the agricultural expenditure'
- No 19/2013 '2012 report on the follow-up of the European Court of Auditors' special reports'.

ANNEX 10.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR GETTING RESULTS FROM THE EU BUDGET

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented In most respects	In some respects	Not implemented	Not applicable (*)	Insufficient evidence	
2011	<p>Recommendation 1: The Commission should, in the design of new spending programmes, seek to focus its activities on the results and impacts it wants to achieve. If results and impacts cannot be readily measured, the Commission should put in place indicators and milestones, based on 'SMART' objectives that would demonstrate that its activities support its desired goals.</p> <p>Recommendation 2: The Commission should work with Member States with a view to improving the quality and timeliness of the data submitted. In particular, it should draw on any lessons to be learned from the steps being taken in the CSF funds to provide Member States with incentives to supply high-quality performance data.</p>			X				<p>All spending programmes under the new MFF include a renewed performance framework including objectives, indicators and monitoring, evaluation and reporting arrangements that allow measurement and reporting on performance.</p> <p>In parallel, the Commission has developed its internal management tools — the Management Plans and Annual Activity Reports of the Directorates General — to include more reporting on the performance of the financial programmes.</p> <p>It is important to remember that the co-legislators were closely involved in the setting of the programme objectives and performance indicators.</p>

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented In most respects	Being implemented In some respects	Not implemented	Not applicable (*)	Insufficient evidence	
2011	Recommendation 3: For the next programming period, 2014-2020, the Commission should demonstrate and report how it secures EU added value.					X		As indicated in its replies to paragraph 10.46, the Commission paid great attention to EU added value in the design of the new spending programmes. It will report on EU added value, which is one of the aspects that ex post evaluations will assess. These evaluations are publicly available and the Article 318 report also summarises information on EU added value
2010	<p>Recommendation 1: Increased focus should be put on performance in the DG annual activity reports, in particular by analysing differences between planned targets and achievements as well as by reporting on the economy and efficiency of EU funding (see paragraph 8.53).</p> <p>Recommendation 2: The Commission services should define appropriate interim milestones for multiannual targets, so that progress can be assessed adequately (see paragraph 8.54).</p> <p>Recommendation 3: The Commission and the Member States within the context of their respective responsibilities under shared management should agree on consistent performance indicators and ensure the reliability of information on planned targets and achieved results (see paragraph 8.56).</p>			X				Please refer to the reply to recommendation 1 for 2011.

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented In most respects	Being implemented In some respects	Not implemented	Not applicable (*)	Insufficient evidence	
2010	<p>Recommendation 4: During the planning of EU expenditure programmes, the Commission and the Member States should pay greater attention to defining SMART objectives, as well as to identifying and mitigating the risks which may occur during implementation (see paragraph 8.57).</p> <p>Recommendation 5: Accountability of the management should also be understood to include reporting on results with a correspondence between achievements expected in the management plan and achievements reported in the annual activity report (see paragraph 8.58).</p> <p>Recommendation 6: The Commission, together with the Member States where appropriate in the context of shared management, should design and operate monitoring and control systems to produce complete and accurate information on results (see paragraph 8.58).</p>			X		X		<p>Please refer to the reply to recommendation 1 for 2011.</p> <p>Please refer to the reply to recommendation 3 of the current report on the year 2013.</p>

(*) These recommendations relate to the new programming period 2014-2020, making it difficult to assess the Commission's progress.

**ANNUAL REPORT ON THE ACTIVITIES
FUNDED BY THE 8TH, 9TH AND 10TH
EUROPEAN DEVELOPMENT FUNDS (EDFs)**

(2014/C 398/02)

Annual report on the activities funded by the 8th, 9th and 10th European Development Funds (EDFs)

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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 the spending in 2013 is provided in **Table 1**.

Table 1 — European Development Funds — Key information 2013

(million euro)

Budget title	Policy area	Description	Payments 2013	
European Development Funds	8th EDF	Operational expenditure	<i>Projects</i>	20
			<i>Budget support</i>	0
		Administrative expenditure		0
				20
	9th EDF	Operational expenditure	<i>Projects</i>	256
			<i>Budget support</i>	1
		Administrative expenditure		2
				259
	10th EDF	Operational expenditure	<i>Projects</i>	1 961
			<i>Budget Support</i>	717
		Administrative expenditure		94
				2 772
Total operational expenditure (Projects)			2 237	
Total operational expenditure (Budget support)			718	
Total administrative expenditure			96	
Total payments			3 051	
- <i>advances</i>			- 1 753	
+ <i>clearings of advances</i>			1 314	
Audited population			2 612	
Total individual commitments ⁽¹⁾			3 350	
Total global commitments ⁽¹⁾			3 923	

⁽¹⁾ Global commitments relate to financing decisions. Individual commitments relate to individual contracts.

Source: 2013 accounts of the 8th, 9th and 10th EDFs.

THE COURT'S OBSERVATIONS

Specific characteristics of the European Development Funds

2. The EDFs are 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). The partnership agreement signed in Cotonou on 23 June 2000 for a period of 20 years ('the Cotonou Agreement') is the current framework for the European Union's relations with ACP States and OCTs. Its main focus is on reducing and eventually eradicating poverty.

3. The EDFs are funded by the Member States, governed by their own financial regulations and managed, by the European Commission, outside the framework of the EU general budget. The European Investment Bank (EIB) manages the investment facility, which is not covered by the Court's Statement of Assurance or the European Parliament's discharge procedure ⁽¹⁾ ⁽²⁾.

4. The EDFs are managed almost entirely by the Commission's Directorate-General for Development and Cooperation (EuropeAid), which also manages a wide range of expenditure from the EU budget ⁽³⁾ ⁽⁴⁾.

5. EDF interventions are implemented through projects and budget support ⁽⁵⁾ under three main arrangements. In 2013, 42 % of payments were made under centralised management, 32 % under decentralised management and 26 % under joint management ⁽⁶⁾.

⁽¹⁾ See Articles 118, 125 and 134 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund (OJ L 78, 19.3.2008, p. 1) and the Court's opinion No 9/2007 on the proposal for this Regulation (OJ C 23, 28.1.2008, p. 3).

⁽²⁾ In 2012 a tripartite agreement between the EIB, the Commission and the Court (Article 134 of Regulation (EC) No 215/2008) set out rules for the audit of these operations by the Court.

⁽³⁾ The Directorate-General for Humanitarian Aid and Civil Protection (DG ECHO) manages 1,7 % of expenditure from the EDFs.

⁽⁴⁾ See chapter 7 "External relations, aid and enlargement" of the Court's 2013 annual report on the implementation of the EU budget.

⁽⁵⁾ Budget support involves the transfer of funds by the Commission to the national treasury of the partner country. It provides additional budgetary resources to support a national development strategy.

⁽⁶⁾ Under centralised management, aid is implemented directly by the Commission's services (headquarters or delegations) or indirectly through national bodies (e.g. a development agency of an EU Member State). Under decentralised management, implementation is delegated to a third country. Under joint management, implementation is delegated to an international organisation.

THE COURT'S OBSERVATIONS

Risks to regularity

6. The expenditure covered in this report is made under a wide range of delivery methods, put into action in 79 countries. Rules and procedures are often complex, including those for tendering and the award of contracts. The Court has assessed the risk as inherently high.

7. In two areas — budget support ⁽⁷⁾ and EU contributions to multi-donor projects carried out by international organisations ⁽⁸⁾ such as the United Nations (UN) — the nature of the instruments and of the payment conditions limit the extent to which transactions are prone to errors.

8. Budget support contributes to a state's general budget or its budget for a specific policy or objective. The Court examines whether the Commission has respected the specific conditions for making budget support payments to the partner country concerned and has verified that general eligibility conditions (such as progress in public sector financial management) have been complied with.

9. However the Commission has considerable flexibility in deciding whether these general conditions have been met. The Court's audit of regularity cannot go beyond the stage at which aid is paid to a partner country. The funds transferred are then merged with the recipient country's budget resources. Any weaknesses in its financial management will not generate errors in the Court's audit of regularity.

⁽⁷⁾ Gross budget support payments made from the EDFs in 2013 amounted to 718 million euro.

⁽⁸⁾ Gross payments from the EDFs in 2013 to multi-donor projects carried out by international organisations amounted to 458 million euro.

THE COURT'S OBSERVATIONS

10. The Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of eligible expenditure. Under the so-called 'notional approach' the Commission assumes that underlying transactions are regular as long as the pooled amount includes sufficient eligible expenditure to cover the EU contribution. Should other donors follow the same approach and apply the same eligibility criteria for their contribution, there is a risk that overall spending does not meet the combined conditionality requirements of the Commission and the other donors.

THE COMMISSION'S REPLIES

10. *The Commission believes that the internal control measures put in place, together with those of the international organisations, limit this theoretical risk to a level which is indeed acceptable. The Commission is not aware of any specific problems with the 'notional approach' (which has been developed to allow the Commission to participate in multi-donor actions including trust funds). This approach guarantees that the legal requirements applicable to EU funding in external actions are met (by ensuring that the amount contributed by other donors is sufficient to pay for any activities which are ineligible under EU rules) while spending EU funds in the most efficient way (through donor coordination), in accordance with the principle of sound financial management.*

The Commission limits this risk by assessing the accounting, audit, internal control, procurement, ex post publication of information and protection of personal data procedures of the partner international organisations in advance of any joint working, the presence of its staff in the field (and participation in steering groups) and the rigorous overall financial reporting required of the international organisation. In addition, during the implementation of external actions programmes, systems are regularly reviewed through the performance of verification missions undertaken by external auditors.

The audits carried out by the Commission have not to date evidenced any 'specific risks' of this nature, nor is the Commission aware of any other donor with 'the same eligibility criteria'.

THE COURT'S OBSERVATIONS

CHAPTER I — IMPLEMENTATION OF THE 8TH, 9TH AND 10TH EDFs**Financial implementation**

11. EDF agreements are usually concluded for a commitment period of around five years, but payments can be made over a longer period. In 2013, payments were made from the 8th, 9th and 10th EDFs. The 8th EDF (1995-2000) amounts to 12 840 million euro and the 9th EDF (2000-2007) to 13 800 million euro.

12. The 10th EDF (2008-2013) totals 22 682 million euro. Of this amount, 21 967 million euro are allocated to ACP countries and 285 million euro to OCTs. These sums include, respectively, 1 500 million euro and 30 million euro for the investment facility managed by the EIB for the ACP and OCT countries. Finally, 430 million euro are earmarked for the Commission's expenditure on programming and implementing the EDF.

13. In 2013, the total contributions from the Member States amounted to 3 200 million euro, of which 2 950 million euro for actions managed by the Commission.

14. **Table 2** shows the use, during 2013 and cumulatively, of EDF resources. As the funds of the 10th EDF shall no longer be committed beyond 31 December 2013⁽⁹⁾, the Commission managed to achieve higher results than planned in terms of commitments: global and individual commitments were respectively 29 % and 31 % above the initial forecast. As a consequence, payments were 7 % more than initially forecast and outstanding commitments increased by 8 % compared to 2012.

⁽⁹⁾ Article 1(5) of the Internal Agreement between the Representatives of Governments of the Member States, meeting within the Council, on the financing of Community aid under the multiannual financial framework for the period 2008 to 2013 in accordance with the ACP-EC Partnership Agreement and on the allocation of financial assistance for the Overseas Countries and Territories to which Part Four of the EC Treaty applies (OJ L 247, 9.9.2006, p. 32).

Table 2 — Use of EDF resources at 31 December 2013

	Situation at end of 2012		Budgetary implementation during the financial year 2013 (net) ⁽⁶⁾				Situation at end of 2013				
	Total amount	Implement. rate (%) ⁽²⁾	8th EDF ⁽³⁾	9th EDF ⁽³⁾	10th EDF	Total amount	8th EDF	9th EDF	10th EDF	Total amount	Implement. rate (%) ⁽²⁾
A — RESOURCES ⁽¹⁾											
B — USE											
1. Global commitments ⁽⁴⁾	43 991	89,9 %	- 98	- 72	4 093	3 923	10 478	16 084	21 351	47 914	97,7 %
2. Individual commitments ⁽⁵⁾	38 059	77,8 %	- 11	- 96	3 457	3 350	10 437	15 408	15 565	41 410	84,5 %
3. Payments	32 417	66,3 %	18	230	2 715	2 963	10 363	14 795	10 222	35 380	72,2 %
C — Outstanding commitments (B1 - B3)	11 574	23,7 %					115	1 289	11 129	12 534	25,6 %
D — Available balance (A - B1)	4 929	10,1 %					3	30	1 082	1 114	2,3 %

⁽¹⁾ Include initial allocations to the 8th, 9th and 10th EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.

⁽²⁾ As a percentage of resources.

⁽³⁾ Negative amounts correspond to decommitments.

⁽⁴⁾ Global commitments relate to financing decisions.

⁽⁵⁾ Individual commitments relate to individual contracts.

⁽⁶⁾ Net commitments after decommitments. Net payments after recoveries.

Source: Court of Auditors, based on the EDF reports on financial implementation and financial statements at 31 December 2013.

THE COURT'S OBSERVATIONS

The Commission's annual report on the financial management of the 8th to 10th EDFs

15. The Financial Regulation applicable to the 10th EDF requires the Commission to report each year on the financial management of the EDFs ⁽¹⁰⁾. In the Court's opinion, this report accurately presents relevant financial information.

⁽¹⁰⁾ Articles 118, 124 and 156 of Regulation (EC) No 215/2008.

CHAPTER II — THE COURT'S STATEMENT OF ASSURANCE ON THE EDFs**The Court's Statement of Assurance on the 8th, 9th and 10th EDFs 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) and Article 141 of the Financial Regulation applicable to the 10th EDF, which also applies to previous EDFs, the Court has audited:

- (a) the annual accounts of the 8th, 9th and 10th European Development Funds which comprise the balance sheet, the economic outturn account, the statement of cash flow, the statement of changes in net assets and the table of items payable to the European Development Funds and the report on financial implementation for the financial year ended 31 December 2013 approved by the Commission on 17 July 2014; and
- (b) the legality and regularity of the transactions underlying those accounts within the legal framework of the EDFs in respect of the part of the EDF resources for whose financial management the Commission is responsible⁽¹¹⁾.

Management's responsibility

II — In accordance with Articles 310 to 325 of the TFEU and the Financial Regulations applicable to the 8th, 9th and 10th EDFs, management is responsible for the preparation and presentation of the annual accounts of the EDFs on the basis of internationally accepted accounting standards for the public sector⁽¹²⁾ and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them. The Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the EDFs (Article 317 of the TFEU).

Auditor's responsibility

III — The Court's responsibility is to provide, on the basis of its audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require that the Court plans and performs the audit to obtain reasonable assurance as to whether the annual accounts of the EDFs 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 accounts and the legality and the regularity of the transactions underlying them. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the 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, internal control relevant to the preparation and fair presentation of the accounts, and supervisory and control systems implemented to ensure legality and regularity of underlying transactions, are considered in order to design audit procedures that are appropriate in the circumstances but not for the purposes of expressing an opinion on the effectiveness of internal control. 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 accounts.

V — The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its opinions.

⁽¹¹⁾ 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.

⁽¹²⁾ The accounting rules and methods adopted by the EDF accounting officer are drawn up on the basis of International Public Sector Accounting Standards (IPSAS) or by default, International Financial Reporting Standards (IFRS) as respectively issued by the International Federation of Accountants and the International Accounting Standards Board.

Reliability of the accounts

Opinion on the reliability of accounts

VI — In the Court's opinion, the annual accounts of the 8th, 9th and 10th EDFs for the year ended 31 December 2013 present fairly, in all material respects, the financial position as at 31 December 2013, the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the EDF Financial Regulation and with internationally accepted accounting standards for the public sector.

Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue underlying the accounts

VII — In the Court's opinion, revenue underlying the accounts for the year ended 31 December 2013 is legal and regular in all material respects.

Commitments

Opinion on the legality and regularity of commitments underlying the accounts

VIII — In the Court's opinion, commitments underlying the accounts for the year ended 31 December 2013 are legal and regular in all material respects.

Payments

Basis for adverse opinion on the legality and regularity of payments underlying the accounts

IX — The Court concludes that the supervisory and control systems are partially effective in ensuring the legality and regularity of payments underlying the accounts. The Court's estimate for the most likely error rate for expenditure transactions from the 8th, 9th and 10th EDFs is 3,4%.

Adverse opinion on the legality and regularity of payments underlying the accounts

X — In the Court's opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2013 are materially affected by error.

4 September 2014

Vítor 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*

16. **Annex 1.1** of chapter 1 of the 2013 annual report of the Court of Auditors on the implementation of the budget describes the Court's overall approach and methodology. For the audit of the EDFs, the following specific points should be noted.

17. The Court's observations regarding the reliability of the EDF accounts concern the financial statements⁽¹³⁾ and the report on the financial implementation of the 8th, 9th and 10th EDFs⁽¹⁴⁾ approved by the Commission in compliance with the EDF Financial Regulation⁽¹⁵⁾ and received, together with the accounting officer's letter of representation, by the Court on 17 July 2014. The audit involved the testing of amounts and disclosures and the assessment of the accounting principles used, significant estimates made by the management and the overall presentation of the accounts.

18. The audit of the regularity of transactions involved:

- (a) an examination of all contributions from Member States and a sample of other types of revenue transactions;
- (b) an examination of a sample of 30 commitments⁽¹⁶⁾;
- (c) an examination of a sample of 165 transactions⁽¹⁷⁾. The sample is designed to be representative of the entire range of payments within the EDFs. It consisted of 93 payments approved by 10 EU delegations⁽¹⁸⁾ and 72 payments approved by the Commission headquarters⁽¹⁹⁾;

⁽¹³⁾ See Article 122 of Regulation (EC) No 215/2008: the financial statements comprise the balance sheet, the statement of economic outturn, the statement of cash flow, the statement of changes in net assets and the table of items payable to the EDFs.

⁽¹⁴⁾ See Article 123 of Regulation (EC) No 215/2008: the reports on financial implementation include tables of appropriations, commitments and payments.

⁽¹⁵⁾ See Article 125 of Regulation (EC) No 215/2008.

⁽¹⁶⁾ Global financial commitments and the corresponding legal commitments (financing agreements) following the adoption of a financing decision by the Commission.

⁽¹⁷⁾ As defined in **Annex 1.1**, paragraph 7, of the 2013 annual report of the Court of Auditors on the implementation of the budget.

⁽¹⁸⁾ African Union, Cameroon, DR Congo, Ivory Coast, Kenya, Lesotho, Mozambique, Nigeria, Rwanda and Zimbabwe.

⁽¹⁹⁾ EuropeAid: 34 project and 35 budget support payments; DG ECHO: three project payments on humanitarian aid.

THE COURT'S OBSERVATIONS

- (d) where errors were detected, the relevant control systems were analysed to identify the specific system weaknesses involved;
- (e) an assessment of control systems examined at EuropeAid and EU delegations, covering:
 - (i) ex ante checks by Commission staff, external auditors or supervisors before payments are made;
 - (ii) monitoring and supervision, notably the follow-up of external audits, verification missions, monitoring visits, and EuropeAid's 2012 and 2013 residual error rate (RER) studies; and
 - (iii) internal audit;
- (f) a review of the annual activity report (AAR) by the Director-General of EuropeAid; and
- (g) a follow-up of previous Court recommendations.

19. As indicated in paragraph 4, EuropeAid implements most of the external assistance instruments financed from the general budget and the EDFs. The Court's observations concerning both the effectiveness of supervisory and control systems and the reliability of the AAR and the Director-General's declaration for 2013 refer to EuropeAid's entire area of responsibility.

Reliability of accounts

20. The economic outturn account includes as revenue interest on pre-financing (5,7 million euro) in respect of pre-financing payments to beneficiaries of more than 250 000 euro. For pre-financing payments over 750 000 euro, the Commission is required to recover interest on an annual basis⁽²⁰⁾. The Court found some improvement compared with 2012 as the number and value of recoveries increased⁽²¹⁾. However, authorising officers by sub-delegation still do not comply systematically with this rule and the amount of interest revenue disclosed in the accounts is partly based on estimates. Furthermore, the interest earned on pre-financing between 250 000 and 750 000 euro is still not recognised as financial revenue in the financial statements because the Commission has not yet completed the development of the CRIS system.

⁽²⁰⁾ Article 8(3) of Regulation (EC) No 215/2008.

⁽²¹⁾ 24 recoveries totalling 4,7 million euro in 2013, compared to 13 recoveries totalling 1,3 million euro in 2012.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

*Regularity of transactions***Revenue**

21. The Court's audit of revenue transactions found them to be free from material error.

Commitments

22. The Court's audit of commitments found them to be free from material error.

Payments

23. **Annex 1** contains a summary of the results of payment transaction testing. Out of the 165 payment transactions audited by the Court, 45 (27 %) were affected by error. On the basis of the 32 errors which it has quantified, the Court estimates the most likely error to be 3,4 % ⁽²²⁾ ⁽²³⁾.

23. *The Commission does not share the Court's analysis of two procurement errors with a significant impact on the Court's estimated error rate. See also the Commission reply to paragraph 26(b).*

Projects

24. Of the 130 payment transactions audited by the Court, 42 (32 %) were affected by error, of which 30 (71 %) were quantifiable errors. Of the 30 payment transactions affected by quantifiable errors, 17 were final transactions authorised after all ex ante checks had been performed.

⁽²²⁾ The Court calculates its estimate of error from a representative sample. The figure quoted is the best estimate. The Court has 95 % confidence that the rate of error in the population lies between 1,4 % and 5,4 % (the lower and upper error limits respectively).

⁽²³⁾ As regards the two errors contested by the Commission, in one case the very detailed technical specifications set in the tender notice were not justified by the intended use of the vehicles and excluded de facto a number of potential tenderers which creates an obstacle to competitive tendering. In the other case, there was no valid justification for splitting the procurement into three local open tenders instead of using an international open tender. These errors point to weaknesses in the checks performed by the EU delegations, which had given their prior approval to these procurement procedures.

THE COURT'S OBSERVATIONS

25. As was the case in 2012 ⁽²⁴⁾, errors were more frequently found in transactions relating to programme estimates, grants and contribution agreements between the Commission and international organisations than in other forms of support. Of the 72 transactions of this type audited, 32 (44 %) were affected by error.

26. The main types of quantifiable errors detected by the Court in payment transactions related to projects concerned:

- (a) absence of supporting documents to justify that eligible activity occurred (12 transactions);
- (b) non-compliance by the beneficiary with procurement rules (eight transactions) ⁽²⁵⁾;
- (c) ineligible expenditure such as expenditure relating to activities not covered by the contract (five transactions), ineligible VAT (three transactions), expenditure incurred outside the implementation period (two transactions) or non-compliant with the rule of origin (one transaction);

THE COMMISSION'S REPLIES

26.

- (b) *The Commission does not share the Court's analysis of one quantifiable error. The Commission considers that the technical specifications as defined by the contracting authority, in accordance with its broad discretionary power, a principle acknowledged by the Court of Justice, were not disproportionate and did not distort competition. This principle provides legal certainty for the contracting authorities without which any future procurement procedure could be compromised.*

For another error linked to tender, the Commission considers that it reflects a very strict interpretation of rules.

⁽²⁴⁾ Paragraph 26 of the Court's 2012 annual report.

⁽²⁵⁾ As regards the two errors contested by the Commission, in one case the very detailed technical specifications set in the tender notice were not justified by the intended use of the vehicles and excluded de facto a number of potential tenderers which creates an obstacle to competitive tendering. In the other case, there was no valid justification for splitting the procurement into three local open tenders instead of using an international open tender. These errors point to weaknesses in the checks performed by the EU delegations, which had given their prior approval to these procurement procedures.

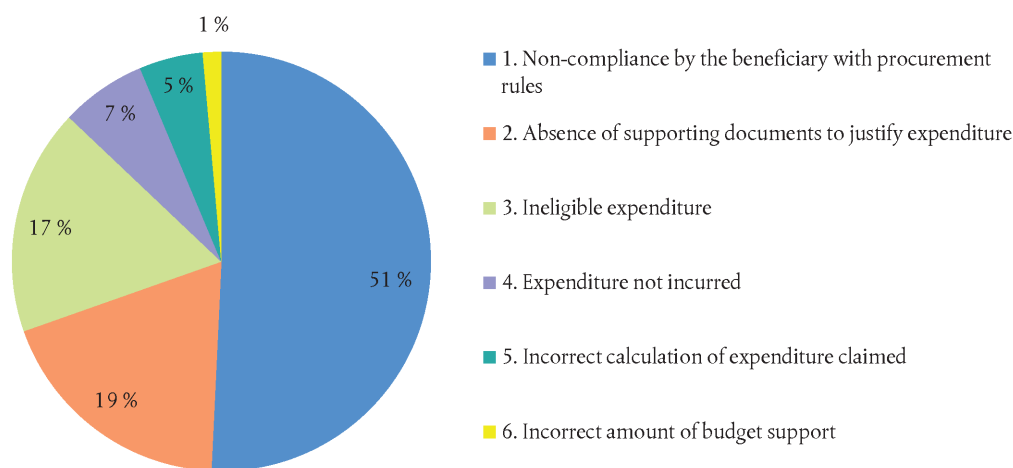
THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

- (d) expenditure not incurred by beneficiaries (seven transactions);
- (e) incorrect calculation of expenditure claimed (five transactions).

27. **Graph 1** provides an overview of the contribution of the different types of errors to the overall estimated error. Errors relating to non-compliance with procurement procedures by beneficiaries and the absence of supporting documents account for 70 % of the most likely error.

Graph 1 — Contribution by type of error to the most likely error



Box 1 — Examples of quantifiable errors in project transactions

Absence of supporting documents to justify expenditure

The Court examined the final clearance of expenditure incurred under the 'Support to peacebuilding and transition activities' programme implemented by an international organisation in sub-Saharan Africa. The Court tested 25 expenditure items. For four items, relating to staff salaries and travel costs amounting to 18 200 euro the essential supporting documents to justify the expenditure (e.g. employment contract, salary slip, proof of payment for staff salaries, invoice, boarding passes, proof of payment for travel costs) were not provided to the Court.

Box 1 — Examples of quantifiable errors in project transactions

Failure by the beneficiary to comply with procurement procedures

The Court examined the final clearance of expenditure incurred under the 'Assistance to Micro and Small Enterprises' programme in Africa and found an error in the procurement of IT equipment to a business information centre amounting to 23 398 euro. According to the tender notice, the contract award criterion was the lowest price. The evaluation report did not correctly reflect the financial offers made by the bidders. As a result, the bid offering the lowest price was not awarded the contract.

The error was not detected by the Commission's framework auditor performing a financial audit of this programme.

Ineligible expenditure and expenditure not incurred by the beneficiary

The Court examined the final clearance of expenditure incurred under the 'All ACP Agricultural Commodities Programme' implemented by an international organisation. The expenditure of 254 000 USD claimed by an implementing partner included 17 675 USD of overhead costs which were not allowed for in the contract and were therefore ineligible.

In addition, there was a difference of 3 862 USD between the amount paid by the international organisation to the implementing partner as advance payments and the expenditure actually incurred.

The error points to a weakness in the checks by the international organisation on compliance with contractual provisions and the use of advance payments.

Ineligible expenditure and expenditure not incurred by the beneficiary

The Commission has reminded the organisation about the applicable rules and obligations. The ineligibilities detected by the Court will allow the Commission to recalculate the amount of the EU contribution. In the future, enhanced verification missions will be carried out for the programmes managed by this organisation.

28. Non-quantifiable errors concerned shortcomings in the procurement procedures followed (six transactions), insufficient supporting documents to justify the correctness of the amount paid (three transactions) and insufficient information to enable the Court to quantify the error relating to the eligibility of expenditure (three transactions).

Budget support

29. For the 35 budget support transactions tested, three (9 %) were affected by errors, of which two (67 %) were quantifiable errors.

30. The quantifiable errors detected by the Court in budget support transactions concerned the incorrect application of the scoring method for determining whether or not recipients had met the conditions for a performance-based variable tranche (one transaction) and an incorrect exchange rate used to convert a budget support disbursement to local currency (one transaction).

29. *The Commission notes that the number of budget support-related errors has decreased by 82 % from 2011 to 2013.*

31. The Court also identified one non-quantifiable error. The Commission had not required the recipient to provide evidence that the correct exchange rate was used to convert the disbursement to local currency.

Box 2 — Example of a quantifiable error in a budget support transaction

Incorrect application of the scoring method for a performance-based variable tranche

The Court examined a performance-based variable tranche of 4 181 250 euro under the 'Programme d'appui au plan de développement territorial' in Mayotte. According to the financing agreement, the Commission should assess the progress made in respect of budget credibility separately for each selected budget chapter. Instead, the Commission made an overall assessment based on the total amount of the budget chapters, which meant that positive and negative variations on individual budget chapters cancelled each other out when added up. The failure to comply with the scoring method set out in the financing agreement resulted in an overpayment of 222 861 euro (5,33 %).

Box 2 — Example of a quantifiable error in a budget support transaction

Incorrect application of the scoring method for a performance-based variable tranche

The Commission corrected this for the subsequent disbursement and established a recovery order.

Examination of selected control systems

32. **Annex 2** contains a summary of the results of EuropeAid's systems examined by the Court.

Ex ante checks

33. Given the high-risk environment (see paragraph 6), EuropeAid relies mainly on ex ante checks (checks by Commission staff, external supervisors or external auditors before project payments are made) in order to prevent or detect and correct irregular payments. As in previous years, the frequency of errors found by the Court, including some affecting final claims which had been subject to external audits and expenditure verifications, point to weaknesses in these ex ante checks.

THE COURT'S OBSERVATIONS

34. In May 2013, EuropeAid adopted an action plan to address weaknesses identified in the implementation of EuropeAid's control system⁽²⁶⁾. The action plan addresses a number of recommendations made by the Court in its previous annual reports, as well as the issues identified by the 2012 and 2013 EuropeAid RER studies. It includes awareness-raising, training and provision of guidance on the main types of error and how to avoid them. It also sets out actions aimed at improving the quality of external audits⁽²⁷⁾, which are a key component of EuropeAid's supervisory and control systems, and at reinforcing cooperation with international organisations as regards control of regularity (see paragraph 39).

Monitoring and supervision

35. As indicated in the Court's previous annual reports⁽²⁸⁾, there are shortcomings in EuropeAid's management information system on the results and the follow-up of external audits, expenditure verifications and monitoring visits. These make it difficult for the Director-General to hold heads of unit or heads of EU delegations accountable for the timely follow-up and correction of the system weaknesses and errors identified. EuropeAid is developing new functions in the audit module of its CRIS information system to improve the follow-up of audit reports.

36. EuropeAid is also developing a tool to help EU delegations to screen their portfolio of projects more effectively and prioritise visits to those in particular need of monitoring based on risk assessments.

⁽²⁶⁾ See EuropeAid's 2013 annual activity report, pp. 188-190 and 195-196.

⁽²⁷⁾ Contract templates have been revised so that the Commission can have an influence on the choice of external auditors. Quality grids are to be designed to assess the reliability of audit reports and to provide guidance in case of non-compliance. Risk-based audit planning methodology is to be made compulsory.

⁽²⁸⁾ Paragraph 42 of the Court's 2010 annual report, paragraph 43 of the Court's 2011 annual report and paragraph 35 of the Court's 2012 annual report.

THE COURT'S OBSERVATIONS

2013 RER study

37. EuropeAid carried out its second RER study to measure the level of error which has evaded all management checks to prevent, detect and correct errors. The study consisted of an examination of a representative sample of transactions relating to contracts closed between September 2012 and August 2013 in order to estimate the most likely error in the population of closed contracts.

38. The results of the 2013 RER study are presented in the AAR⁽²⁹⁾. The study estimates the RER at 3,35 %, i.e. above the 2 % materiality level set by the Commission. The main types of errors identified by the study are:

- (a) absence of satisfactory documentation demonstrating eligibility provided by beneficiary organisations (51,63 % of the RER);
- (b) errors which were estimated because insufficient evidence was available to check the regularity of transactions (17,82 % of the RER);
- (c) non-compliance with public procurement procedures (12,45 % of the RER);
- (d) unrecovered and uncorrected amounts (8,71 % of the RER);
- (e) other types of errors (9,39 %).

39. Transactions implemented by international organisations account for a fifth of all transactions sampled but they account for 29,18 % of the residual error rate.

40. As indicated by the Court in its 2012 annual report⁽³⁰⁾, the design of the RER methodology is overall appropriate. For this second study, refinements were made in the calculation of error rates on individual transactions and the treatment of transactions for which no information was readily available.

⁽²⁹⁾ Pp. 140-142.

⁽³⁰⁾ Paragraph 39.

THE COURT'S OBSERVATIONS

41. The AAR indicates ⁽³¹⁾ that the RER methodology 'results in an accurate assessment of the volume of errors not detected by the overall control system' and that 'the result of the overall error evaluation was then expressed as an actual level of error with a 95 % confidence level'. This is not a fully accurate presentation of the RER study results:

- (a) the RER methodology reflects valid cost-effectiveness considerations, notably as regards the degree of reliance placed upon previous audit or verification reports and the extent of substantive testing performed. This involves a limitation of scope which should be disclosed to allow for a correct understanding of the RER study results;
- (b) on the basis of the 2013 RER study, 3,35 % is indeed the estimated most likely error rate, but the 95 % confidence level means that the error rate lies between lower and upper error limits, which are however not disclosed.

Internal audit

42. In its 2011 annual report ⁽³²⁾, the Court indicated that the Commission reorganisation that took place in 2011 had a major impact on the activity of the Internal Audit Capability (IAC) ⁽³³⁾. In its reply to the Court's 2011 annual report, the Commission committed itself to assessing the capacity of the IAC and would consider strengthening it if necessary ⁽³⁴⁾. This has not been done and there was no significant improvement in the functioning of the IAC in 2013.

⁽³¹⁾ Page 141.

⁽³²⁾ Paragraph 50 of the Court's 2011 annual report.

⁽³³⁾ The IAC is a unit of a Commission directorate-general. It is managed by a Head of Unit who reports directly to the Director-General. Its task is to provide independent assurance on the effectiveness of the internal control system with a view to improving the directorate-general's operations.

⁽³⁴⁾ Commission's reply to paragraph 59(e) of the Court's 2011 annual report.

THE COMMISSION'S REPLIES

41.

- (a) *In order to promote an efficient and cost effective study, the RER methodology foresees reliance on previous control work, including: financial and technical audits, the DAS, verifications, evaluations and technical supervisors' reports.*

This aspect of the RER methodology is founded on the presumption that RER procedures will not produce benefits exceeding those already provided by comprehensive, diligent previous control work. Previous control work typically will have been performed with greater intensity and higher cost than RER procedures.

- (b) *The disclosure of the upper and lower error limits in the 2013 AAR has not been explicitly foreseen by the instructions given by the Central Commission Services.*

42. *The Commission has initiated some actions to improve the capacity of the IAC.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Review of annual activity report

43. In his declaration of assurance, the Director-General makes a reservation concerning the legality and regularity of transactions, since the amount considered at risk (228,55 million euro) represents more than 2% of payments made by EuropeAid in 2013. However, the Director-General also states that the control procedures in place give the necessary guarantees concerning the legality and regularity of the underlying transactions. The Court considers that this is not a logical conclusion because controls systems are not effective when they fail to prevent, detect and correct material error.

44. The reservation relates to the legality and regularity of the whole expenditure managed by EuropeAid. A reservation is appropriate when control weaknesses relate to defined areas of revenue or expenditure⁽³⁵⁾, but not when they affect the operation of the control system as a whole and the financial impact exceeds the materiality threshold for the whole budget under the Director-General's responsibility. However, the Commission's standing instructions for 2013 AARs do not clearly address such a situation.

43. Given the risk environment DG DEVCO operates in, and the fact that the residual error is not a consequence of the design of the control system, but rather of weaknesses in its implementation, it is still reasonable to conclude that the control procedures in place give the necessary guarantees concerning legality and regularity of the underlying transactions.

CONCLUSION AND RECOMMENDATIONS**The conclusion for 2013**

45. Based on its audit work, the Court concludes that the EDFs' accounts for the financial year ending 31 December 2013 present fairly, in all material respects, the financial position of the EDFs as of 31 December 2013, and the results of their operations and cash flows for the year then ended, in accordance with the provisions of the EDF Financial Regulation and the accounting rules adopted by the accounting officer.

46. The Court concludes that, for the financial year ending 31 December 2013:

- (a) the revenue of the EDFs was free from material error;
- (b) the commitments entered into by the EDFs were free from material error;
- (c) EDF payment transactions were affected by material error (see paragraphs 23 to 31).

⁽³⁵⁾ See article 66(9) of Regulation (EU, Euratom) No 966/2012 of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1), and article 38 of Regulation (EC) No 215/2008.

THE COURT'S OBSERVATIONS

47. The examined systems of EuropeAid are assessed as partially effective (see paragraphs 19 and 32 to 38)⁽³⁶⁾. However, in May 2013 EuropeAid adopted an action plan to address the main weaknesses identified.

Recommendations

48. **Annex 3** shows the result of the Court's review of progress in addressing recommendations made in previous annual reports. In the 2010 and 2011 annual reports, the Court presented 14 recommendations. Out of these recommendations, EuropeAid fully implemented three recommendations, while four were implemented in most respects, five were implemented in some respects and two were not implemented.

49. As regards the recommendations not implemented, EuropeAid has not made compulsory the guidelines on risk analysis for the preparation of annual audit plans and has not assessed the IAC's capacity to perform its task effectively.

50. As regards the recommendations implemented in some respects only, EuropeAid is taking action:

- (a) EuropeAid participated in a working group headed by DG Budget to review the cost-effectiveness of its overall control architecture. In the 2013 AAR, for the first time, it provided data on estimated control costs and benefits. While this shows that EuropeAid paid due attention to the need to monitor the efficiency of its supervisory and control systems, the Court found some weaknesses as regards the quantification of benefits, which affect the reliability of cost/benefit ratios.
- (b) EuropeAid is developing tools and guidance for EU delegations to better prioritise their monitoring visits to projects and assess the quality of audit reports.
- (c) EuropeAid is developing new functions in the audit module of its CRIS information system to improve the follow-up of audit reports (see paragraph 35).

THE COMMISSION'S REPLIES

47. *The Commission agrees that, while the design of the control system is broadly consistent and sound, progress still has to be made on the implementation of the control mechanisms. The Action Plan is already progressing in this direction.*

49. *The Commission has initiated some actions to improve the capacity of the IAC.*

50.

- (a) *Guidance on possible approaches to calculate or estimate benefits and costs of the most common internal control systems in the Commission has been proposed, in combination with the related Internal Control Templates.*

Each DG is expected to apply the approaches for estimating the benefits and costs of its concerned internal control strategies for the corresponding expenditure — including its best estimate of both the quantifiable and the non-quantifiable benefits of the controls.

In line with the commitments made in the synthesis report, DG Budget shall continue to develop further guidance, identifying a limited number of cost-effectiveness indicators which could be used across the Commission, and define more precisely the methodology to be used to calculate them.

⁽³⁶⁾ The conclusion on systems is limited to the systems selected for examination as defined in the audit scope in paragraph 18(e).

THE COURT'S OBSERVATIONS

51. Following this review and the findings and conclusions for 2013, the Court recommends that EuropeAid:

- **Recommendation 1:** ensures that all authorising officers by sub-delegation recover interest generated by pre-financing over 750 000 euro annually;
- **Recommendation 2:** by the end of 2014, completes the development of the CRIS system to allow interest on pre-financing of between 250 000 and 750 000 euro to be recognised as financial revenue;
- **Recommendation 3:** revises the quantification of benefits of controls implemented;
- **Recommendation 4:** reports in the AAR on progress in the implementation of the action plan to address weaknesses in the control system; and
- **Recommendation 5:** discloses in the AAR the scope of the RER study and the estimated lower and upper error limits.

THE COMMISSION'S REPLIES

51.

The Commission accepts this recommendation. The actions taken by the Commission have already produced good results. The Commission will intensify these actions in 2014.

The Commission accepts this recommendation. Due to the implementation of the new Financial Regulation and the related ABAC release, it was not possible to implement that feature as planned. The finalization is now scheduled for the last quarter of 2014.

The Commission accepts this recommendation and will continue to improve the quantification of benefits of controls in line with the guidelines provided by the Commission Central Services.

The Commission accepts this recommendation.

The Commission agrees with this recommendation and will further discuss with the Court how to implement it. The definition of the RER and calculation of an amount at risk will remain based on the Most Likely Error (MLE).

ANNEX 1

RESULTS OF TRANSACTION TESTING FOR THE EUROPEAN DEVELOPMENT FUNDS

	2013			2012	2011	2010
	Projects	Budget support	Total			
SIZE AND STRUCTURE OF THE SAMPLE						
Total transactions:	130	35	165	167	163	165
RESULTS OF TESTING ⁽¹⁾ ⁽²⁾						
Proportion (number) of transactions tested found to be:						
Free of error	68 % (88)	91 % (32)	73 % (120)	74 %	67 %	73 %
Affected by one or more errors	32 % (42)	9 % (3)	27 % (45)	26 %	33 %	27 %
Analysis of transactions affected by error						
Analysis by type of error						
Other compliance issues and non-quantifiable errors:	29 % (12)	33 % (1)	29 % (13)	32 %	46 %	49 %
Quantifiable errors:	71 % (30)	67 % (2)	71 % (32)	68 %	54 %	51 %
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS						
Most likely error rate			3,4 %	3,0 %	5,1 %	3,4 %
Upper Error Limit (UEL)			5,4 %			
Lower Error Limit (LEL)			1,4 %			

⁽¹⁾ To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

⁽²⁾ Numbers quoted in brackets represent the actual number of transactions.

ANNEX 2

*RESULTS OF EXAMINATION OF SELECTED SYSTEMS FOR THE EUROPEAN DEVELOPMENT FUNDS AND
DEVELOPMENT AID UNDER THE EU BUDGET***Assessment of the systems examined**

System concerned	Ex ante controls	Monitoring and supervision	Internal audits	Overall assessment
EuropeAid	Partially effective	Partially effective	Partially effective	Partially effective

ANNEX 3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR THE EUROPEAN DEVELOPMENT FUNDS

Year	Court recommendation	Court's analysis of the progress made					Commission reply	
		Fully imple- mented	Being imple- mented		Not imple- mented	Not applicable		Insufficient evidence
			In most respects	In some respects				
2011	<p>Recommendation 1: EuropeAid should improve the management of contract awarding procedures, by setting out clear selection criteria and better documenting the evaluation process (2011 annual report, paragraph 59(a)).</p> <p>Recommendation 2: EuropeAid should introduce documented risk-based planning and systematic follow-up for verification visits and on-the-spot monitoring visits (2011 annual report, paragraph 59(b)).</p>		X	X			<p>The Commission is striving to improve planning for project visits, based on the risks attached to the projects. The Commission services are working on a portfolio management tool to help Delegations better screen their portfolio of projects and give priority to visits to projects in particular need of monitoring.</p> <p>Given the current resource constraints — that will probably increase in the future — the Commission needs to keep in mind cost-effectiveness aspects.</p> <p>One should also keep in mind possible security constraints; in some of the recipient countries on-the-spot checks may put the designated staff at risk, or be very difficult to carry out.</p> <p>In its reply to the original recommendation, the Commission stated that it would 'consider making EuropeAid's audit planning risk analysis methodology compulsory for the 2013 period onwards.'</p> <p>Accordingly, internal consideration has provided positive results and risk analysis will be made compulsory in the Audit Plans from 2015 onwards.</p>	

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2011	Recommendation 3: EuropeAid should render compulsory the guidelines on risk analysis for the preparation of annual audit plans by delegations and EuropeAid's headquarters (2011 annual report, paragraph 59(c)).			X				
	Recommendation 4: EuropeAid should review the design of KPIs to ensure that they are unambiguous and easy to interpret (2011 annual report, paragraph 59(d)).	X						
	Recommendation 5: EuropeAid should assess the IAC's capacity to perform its task effectively (2011 annual report, paragraph 59(e)).			X				The Commission has initiated some actions to improve the capacity of the IAC.
2010	Recommendation 1: EuropeAid should develop a key indicator for the estimated financial impact of residual errors after all ex ante and ex post controls have been implemented (2010 annual report, paragraph 62(a)).	X						
	Recommendation 2: EuropeAid should assess the cost-effectiveness of the various controls, notably of the transactions ex post control systems (2010 annual report, paragraph 62(b)).					X		Since EuropeAid, in its AAR for 2013, has assessed the cost-effectiveness of its controls on the basis of the guidance provided by the Commission Central Services, EuropeAid considers that this recommendation has been implemented
	Recommendation 3: EuropeAid should strengthen the effectiveness of project monitoring, including on-the-spot visits, on the basis of multiannual monitoring and evaluation plans (2010 annual report, paragraph 62(c)).					X		

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2010	Recommendation 4: EuropeAid should review the reliability of certificates from external supervisors, audits and expenditure verifications (2010 annual report, paragraph 63(a)).			X				Even if this recommendation was accepted by the Commission, further reflection led to the conclusion that it was not the role of the Commission to provide such verifications of reliability. The action plan for correcting the weaknesses in the implementation of the internal control system includes measures aimed at enhancing the quality and effectiveness of external audits and expenditure checks. The contract templates have been revised so that the Commission could have an influence on the choice of external auditors. The verification reports' weaknesses have already been analysed and quality grids are due to be produced by the end of 2014 in order to make it possible to assess their reliability and provide guidance in case of non-compliance.
	Recommendation 5: EuropeAid should introduce management information systems which allow the Director-General and the Heads of Delegation to better monitor the follow-up of results from on-the-spot visits, external audits and expenditure verifications (2010 annual report, paragraph 63(b)).			X				As indicated by the Court in paragraph 50, work is ongoing.
	Recommendation 6: EuropeAid should link the CRIS Audit and CRIS Recovery Orders information systems (2010 annual report, paragraph 63(c)).	X						
	Recommendation 7: EuropeAid should continue its efforts to ensure that data are recorded in an accurate, comprehensive and timely manner in the CRIS information system (2010 annual report, paragraph 63(d)).		X					

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented In most respects	In some respects	Not implemented	Not applicable	Insufficient evidence	
2010	<p>Recommendation 8: EuropeAid should ensure that Delegations consistently apply the new format and scheme for Delegations' annual reporting on reforms of public finance management systems in recipient countries so as to provide a structured and formalised demonstration of public finance management progress (2010 annual report, paragraph 64(a)).</p> <p>Recommendation 9: EuropeAid should promote through policy dialogue the setting of clear assessment frameworks in recipient countries' reform programmes on public finance management (2010 annual report, paragraph 64(b)).</p>	X						

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