2010 discharge: EU general budget, Section III, Commission

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PURPOSE: presentation of the Court of Auditors' report on the implementation of the budget in 2010 (Section III - Commission).

CONTENT: the Court of auditors presents its 34th Annual Report on the implementation of the EU budget for the year 2010.

The report contains two parts:

1. the first part contains a summary of the results of the Court's audit on the reliability of accounts and on the regularity of transactions;

2. the second part provides detailed audit findings of EU revenue and expenditure (by groups of policy areas which correspond broadly to the headings used in the 2007-2013 Financial Framework) and an analysis of the expenditure of the other EU institutions and organs.

The central part of the annual report is the Court's statement of assurance (the 'DAS') on the reliability of the annual accounts of the EU and on the legality and regularity of transactions.

DAS: payments, basis for the Court's adverse opinion: the Court considers that overall the supervisory and control systems are **partially effective** in ensuring the legality and regularity of payments underlying the accounts. On the other hand, taken together, the **Court's best estimate of the rate of error for overall spending in 2010 is 3.7%.**

Specific observation: pre-financing: a significant component of payments made by the Commission provide funding in advance for costs which will be incurred by outside bodies at a later date. There has been a substantial increase of pre-financing in the EU budget during the last financial framework period. The Commission corrected material problems concerning the completeness of pre-financing through cut-off bookings and adjustments. **Nonetheless, the lack of current information on the EU funds actually used by the Member States reduces significantly the usefulness for management of the accounting information,** notably for the Commission in its responsibilities for implementing the budget. The increased use of pre-financing makes it urgent for the Commission to revisit the relevant accounting rule in order to provide adequate guidance on the recognition and clearing of pre-financing. This should be accompanied by improved supervision.

The legality and regularity of transactions underlying the accounts: in the Court's opinion, revenue underlying the accounts for the year ended 31 December 2010 is legal and regular in all material respects. On the other hand, the Court concludes that overall the supervisory and control systems are only partially effective in ensuring the legality and regularity of **payments** underlying the accounts.

The following policy areas: (i) agriculture and natural resources (ii) cohesion, energy and transport are **materially affected by error**. The Court's estimate for the most likely error rate for payments underlying the accounts is 3.7%. The rate of error is:

- 7.7% for policy group 'cohesion, energy and transport'

- 2.3% for the policy group 'agriculture and natural resources.'

The Court's estimate of the most likely error concerning the payments for the other policy groups remained relatively stable. Direct payments to farmers covered by the IACS (Integrated Administration and Control System) were free from material error.

Generally, the Court considers that during the planning of EU expenditure programmes, the Commission and the Member States should pay greater attention to defining SMART objectives - specific, measurable, achievable, relevant and timed - as well as to identifying and mitigating the risks which may occur during implementation.

Analysis of budgetary implementation by policy group and Court's recommendations:

- **Agriculture and natural resources**: (EUR 56.8 million) the Court states that the payments tested in this group are materially affected by error. The most likely error resulting from transaction testing estimated by the Court is 2.3%. However, direct payments (EUR 39.7 million) covered by IACS were not found to contain material error. The Court notes that Rural Development expenditure is particularly prone to error. In the EAGF, 27% of transactions sampled were affected by errors, but with regard to Rural Development expenditure, 50% were affected by errors. The type of error most often noted concerned the **over-declarations of eligible land by beneficiaries**. Furthermore, the Court found out that there are still weaknesses in paying agencies, particularly the LPIS and in the quality of on-the-spot checks by national inspectors. The Court calls upon the Commission to ensure that: (i) the use of ortho-photos becomes mandatory and that the LPIS is regularly updated on the basis of new ortho-photos; (ii) the paying agencies remedy the weaknesses identified where the control systems and IACS databases were found to be deficient; (iii) the quality of inspections is adequately checked and reported by the certification bodies.
- **Cohesion (EUR 40.6 million)**: the Court notes that payments relating to the policy group 'Cohesion, energy and transport' were materially affected by errors: 49% of the payments audited were affected by such errors, the most likely rate of error being 7.7%. With regard to payments related to 'Cohesion' Member States' authorities are encouraged to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission. The Court considers that sufficient information was available for the Member State authorities to have detected and corrected at least some of the errors (prior to certifying the expenditure to the Commission) for 58% of the transactions affected by error. In addition, the Court found projects, which were wholly ineligible in 3% of the transactions audited. One fifth of transactions were affected by breaches of public procurement rules. Serious failures to respect these rules were identified in 5% of the transactions audited. They account for 24% of all quantifiable errors and make up approximately 31% of the estimated error rate for this policy group. Moreover, the Court found other errors related to the set-up of financial engineering instruments. Accordingly, the Court recommends that the Commission: (i) continues to monitor compliance with the eligibility requirements particularly the correct application of public procurement rules; (ii) encourages national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission; (iii) carry 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; (iv) provide further guidance to audit authorities for on sampling and the scope of verifications to be undertaken for audits of projects and the reporting of audit findings.
- **External Aid, Development and Enlargement**: (EUR 6.5 million): the Court considers, that the payments for External aid, Development and Enlargement were free from material error. The most likely rate of error estimated by the Court is 1.7%. However, interim and final payments were subject to material error. An increased rate of non quantifiable errors were identified concerning errors in procurement procedures and extension of contracts by the Commission. The Court recommends: (i) DG ELARG defines in more detail the criteria for lifting ex- ante control and suspending the 'conferral of management' to decentralised countries and tests the performance of

the systems used by national authorities; (ii) the DG develop a tool to facilitate the consolidation of the visit outcomes related to legality and regularity issues; (iii) DG ELARG increases ex-post reviews of transactions for centralised management. The Commission must define a coherent methodology for the calculation of the residual error rate by the external relations directorates based on which Directors-General deliver their management representation.

- **Research and other Internal Policies (EUR 9 million):** this group of polices was also free from material error, the most likely error rate being 1.4%. However, interim and final payments for the research framework programmes (FPs) were subject to material error. The Court's testing of its sample of transactions found 39% to be affected by error. Most of these errors (88%) were noted in interim and final payments and 95% of quantifiable errors related to reimbursement of ineligible costs and incorrectly calculated costs in the field of research. For the 33 cost claims audited at beneficiary level for which a certificate had been provided, the Court compared the results of its own audit with the certificate provided. In 27 cases for which the independent auditor had issued an unqualified opinion the Court detected errors. In 14 of the cases the errors had significant financial impact. With regard to **education,** the Court notes that national agencies do not wholly implement primary controls regarding education and lifelong learning programmes. It recommends that the Commission: (i) in the area of the FPs on research, further enhance the Commission's ex-ante controls with the aim of identifying payments with a relatively high-risk profile; (ii) in the area of the LLP, continue to give emphasis to the implementation of primary controls.