2010 discharge: EU general budget, Section III, Commission

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The Committee on Budgetary Control adopted the report by Christofer FJELLNER (EPP, SE) in which it recommends the European Parliament to grant the Commission discharge in respect of the implementation of the general budget of the European Union for the financial year 2010 as well as to the Directors of the Education, Audiovisual and Culture Executive Agency, the Executive Agency for Competitiveness and Innovation, the Executive Agency for Health and Consumers, the European Research Council Executive Agency, the Trans-European Transport Network Executive Agency on the implementation of their respective budgets for the financial year 2010.

The Commission also recommends that the European Parliament gives closure to the accounts of the general budget of the European Union for 2010.

- In a series of general observation, Members make a number of recommendations budget that need to be taken into account when the discharge is granted. Amongst these include the achievement of the following priority actions:
- close monitoring of the use of Financial Engineering Instruments (FEIs) by granting priority to the evaluation and the transparency of the implementation of these instruments;
- improvement and strengthening of the reliability of the accountability chain by delivering a political declaration in which it accepts its final and overall responsibility for the implementation of the budget;
- reconsidering the increased use of pre-financing as well as control and audit mechanisms;
- creation of an effective sanctioning mechanism in the area of Cohesion policy:

1. The Court of Auditors' Statement of Assurance:

- **Accounts – clean opinion**: firstly Members note that the annual accounts of the Union for the financial year 2010 present fairly in all material respects the position of the Union as of 31 December 2010, and the results of its operations and its cash flows for the then completed year. They note the emphasis of matter in relation to a change in the Commission's accounting policy with regard to financial engineering instruments (FEIs), which shows that risks of material misstatements remain, although the accounts have received an unmodified opinion since 2007.
- **Legality and regularity of payments – adverse opinion**: they regret deeply that payments remain materially affected by an error rate which is estimated to be most likely 3.7%. Members are worried about this increase because it reverses the positive trend observed in the past few years. They attribute this development mainly to the increase of the most likely error rate in the area of Cohesion, Energy and Transport, which marked a significant increase to 7.7%.

II. Horiziontal issues:

Financial Engineering Instruments (FEIs): Members recall that the Commission promotes an increased use of FEIs for the next multiannual financial framework despite the fact that the Commission itself considers FEIs to be of high risk. They understand that FEIs complement rather than replace existing grant funding and have the potential benefit of being able to be used more than once. They deplore the absence of formal reporting requirements and note that FEIs with a total commitment of approximately EUR 8.1 billion have been created and have received payments of approximately EUR 5.2 billion from 2007-2013 operational programmes. Members regret the lack of transparency which characterises the implementation

of these instruments and the uncertainty as regards the legal basis. Members invite the Commission to consider it a priority action to closely monitor the use of FEIs inter alia by:

- evaluating objectively and critically the experiences with FEIs in the Cohesion policy for the programming period 2007-2013 so far;
- providing a risk assessment considering different FEIs separately as well as taking into account the risk structure of the beneficiary of the FEIs;
- completing the process of gathering information from Member States on issues not yet fully covered, such as the exact number and size of specific funds and relevant indicators on the effectiveness, efficiency and economy of FEIs;
- reporting annually to Parliament, in the context of the discharge procedure, on the use of FEIs in Member States.

Responsibility of the Commission and its management representations: Members stress once again that **the Commission therefore has the primary responsibility in the management of the Union funds** concerned and that, as a consequence, the Commission has the obligation to take measures that are aimed at ensuring legality and regularity as well as sound financial management. For Members, it is not possible for the Commission to transfer its financial responsibility to the Member States, even in cases where a managerial weakness or irregularity has been identified at the level of a Member State.

They note the close link between the **Commission's ultimate responsibility** for implementing the budget and the significance of the discharge procedure and stress that the Commission's final responsibility regarding the implementation of the budget also covers weaknesses in Member States' management and control systems. **Financial responsibility is and shall remain indivisible**.

Members underline that the **College and the Commissioners** thereby take the final responsibility for the reliability and completeness. They consider that the Commission has made great progress as regards adequate corporate governance within the Commission. Further, they invite **the Commission to consider it a priority action to improve and strengthen the accountability chain**, inter alia by:

- providing the Committee on Budgetary Control full insight into the Member States annual summaries;
- delivering a political declaration in which it accepts its final and overall responsibility for the implementation of the budget, including the part of the budget which is implemented under shared management;
- establishing the AARs in accordance with the principle of objectivity, avoiding optimistic estimations;
- providing mandatory, complete and relevant guidance to the Directorates-General, in particular regarding the way residual error rates and residual risks;
- providing in each AAR a complete and reliable explanation of the relationship between the residual risk or the residual error rate and the Court of Auditors' error rate.

Responsibility of Member States: Members recall that the Commission implements the Union budget on its own responsibility but also in cooperation with Member States. They underline that the two policy areas prone to the highest error rates (‘Cohesion, transport and energy’ and ‘Agriculture and natural resources’) are implemented under shared management, and deplore the fact that the estimated most likely error rates amount to 7.7 % and 2.3 %, respectively.) They welcome the fact that for the first time it is possible to identify the errors and their origin: for ERDF and Cohesion Fund, three Member States (Spain, Italy and the UK) have contributed 59 % to the cumulative quantifiable errors identified during this period and for the ESF four Member States (Spain, Portugal, the UK and Germany) have contributed 68 % to the cumulative quantifiable errors. The committee recalls its repeated invitations to the Commission to present a proposal for the **introduction of mandatory national management declarations (NMDs) issued, made public and duly audited by the responsible audit authority**, as part of the Commission's

final and overall responsibility for the implementation of the Union budget. It notes that NMDs should contain full information about the use of Union funds.

It proposes that the substance of national declarations signed at directorate-general level should comply with international auditing standards and that those declarations should be used by the Court of Auditors in its audit work and based on, among other things, the declarations by authorities to which management power is delegated. Members point to the existence of significant differences in Member States' administrative performance in the field of revenue and expenditure in shared management, especially related to detecting irregularities, fraud and errors and financial follow-up in both the customs field and spending of Union funds. They note that the Commission so far monitors administrative performance in a reactive way and on case level and thus does not perform **sufficient trend analysis** to identify fields of risk. They call on the Commission to apply the method of trend analysis to identify financial risks and to take measures to improve Member States' administrative performance.

The committee notes with great concern the cases of **Bulgaria and Romania** where there are serious cases of alleged fraud and high levels of corruption. It calls on the Commission to increase pressure on the Romanian government to implement the Commission’s recommendations and to ensure that the Romanian government’s efforts to develop a consistent jurisprudence in public procurement trials are increased.

Pre-financings: noting that pre-financings are considered necessary in order for beneficiaries to start the agreed action, Members are nevertheless concerned about the influence pre-financings have had mainly in the policy areas ‘External aid, Development and Enlargement’ and ‘Research and Internal Policies’. They believe that by paying high volumes of pre-financings, **the Commission takes on an increased financial risk**, for example in cases of insolvency of beneficiaries, as well as an increased risk to legality and regularity as acceptance of the cost declared by beneficiaries is postponed to a later date. Since it is more efficient to prevent irregularities than to correct undue payment ex-post through recoveries. Members invite the Commission to make it a **priority action to reconsider the increased use of pre-financing** as well as control and audit mechanisms by adapting the level of pre-financings in the various programmes to a level that will ensure the necessary float for the beneficiary to start the project, while also safeguarding the financial interest of the Union and informing Parliament accordingly.

Outstanding budgetary commitments (RAL): Members recall that outstanding budgetary commitments are commitment appropriations made, but not used (i.e. paid) and that they derive mainly from multi-annual programmes (e.g. Cohesion) where commitments are made in the earlier years of the programming period while the corresponding payments are made gradually during the whole programming period. A high level of outstanding commitments might indicate difficulties experienced by Member States in absorbing the amounts allocated. They note that in 2010, those outstanding commitments increased by nearly 10 % to approximately **EUR 194 billion**. There is a risk that the committed funds will have to be spent quicker than usual, thereby increasing the risk of error.

Members invite the Commission to provide information on the size of outstanding commitments per Member State as well as on its cooperation with the Member States to identify and address risk areas in relation to absorption and regularity.

Budgetary contribution to decentralised agencies and joint undertakings: Members note that the Union contribution for the financial year 2010 amounted to over EUR 620 million to the decentralised Agencies and to over EUR 500 million for the Joint Undertakings. As these sums are quite considerable, they expect the Commission, in such time of financial crisis, to avoid increases in the Agencies' budgets and to **even consider reducing the Union contribution to their budgets** based on an assessment of its priorities. They also call on the Commission to provide Parliament with a detailed overview of the criteria and verification mechanisms applied to avoid conflicts of interest and 'revolving door' cases for Agencies /Joint Undertakings.

Union budget and the financial and budgetary crisis: in view of the continuing financial and budgetary crisis in Member States and the difficulties faced by Greece, Hungary, Ireland, Latvia, Portugal and Romania, some of these countries are receiving assistance in the form of balance of payments (BOP) facility loans (loans disbursed as at 31 December 2010 amounting to approximately EUR 12 billion). Members are concerned about the fact that the Court of Auditors did not pay sufficient attention to these new challenges in the Union in its annual report on 2010. They recall that there is no guarantee fund established to protect the budget from calls on those guarantees and therefore invite the Commission to evaluate the potential need to set up a guarantee fund to cover for potential losses similarly to the Guarantee Fund for External Actions with the aim to protect the Union budget. They are of the opinion that the more severe the financial situation in certain Member States becomes, **the more difficult it will be for those Member States to contribute to the Union budget**. They believe that this puts at risk the revenue of the Union budget stemming from 'Member States in difficulties'. They criticise the fact that the Council used Article 122 of the TFEU in 2010 for setting up the European Stability Facility (EFSF) because that Article is only applicable for natural disasters and not for economic catastrophes; is concerned that the EFSF neither contains **an element of democratic control by Parliament** nor gives the Court of Auditors any audit rights. They reiterate their invitation to the Council and Member States to ensure in the by-laws of the ESM appropriate arrangements for public external audit of legality, regularity as well as performance in line with internationally accepted auditing standards, to ensure the reliability of data and statistics, to clarify the responsibility and reporting arrangements of all actors whose liabilities will be involved in the establishment of the mechanism and to urge the Commission to report to Parliament and the Council twice a year on the risk that is incurred on the Union's budget by its guarantee to the EFSM.

Transparency: Members reiterate the vital role transparency plays in ensuring accountability for the use of public funds and recalls that it is one of the main instruments in achieving legal and regular expenditure. They also reiterate their call for **all grant payments from Union funds to be recorded in a user-friendly online database** paying due regard to data protection law. They believe that the payment of Union funds should be explicitly conditional on the acceptance by the beneficiaries that the basic details be a matter of public record. They note that in the policy area Cohesion full transparency of beneficiaries of ERDF and Cohesion Fund is not ensured. Improvements in this regard are therefore expected in the context of the next financial framework.

Statement of Assurance methodology: Members consider that the Commission, the Court of Auditors, the Parliament and other stakeholders should focus their attention and make recommendations concerning those areas in which the management needs to improve, in particular the areas of Cohesion and agriculture. They stress once again the need to closely examine pre-financings which they believe are exposed to a lower level of risk to legality and regularity than interim or final payments. They also note that the Court of Auditors applies a common methodology to quantify public procurement errors in the two policy areas Agriculture and natural resources, on the one hand, and Cohesion, Energy and Transport, on the other. They call on the Commission and the Court of Auditors to harmonise the treatment of public procurement errors in these two policy areas urgently and to report back to the Parliament's competent committee on the progress made by the end of 2012.

III. Specific issues:

Performance: Getting results from the Union budget: Members welcome the new Chapter in the Annual Report including the Court of Auditors' observations on the Commission's se-assessment of performance in its AARs. They take the view that those important findings illustrate that **Parliament cannot fully rely on the Commission's reporting on performance**. They invite the Court of Auditors to consider whether it would be possible to include the new insight on performance on the different policy groups in the related chapters of the Annual Report. The Commission is invited to improve its reporting

on performance. Members reiterate the call for the Commission to review the briefing and training given to staff regarding 'Title II: Rights and Obligations of officials' of the Staff Regulations so as to ensure that all staff are fully conversant with its terms.

Members also focus on each of its policies individually. The following is noted:

- Cohesion, energy and transport – adverse conclusion: Members are concerned about the increase of the error rate to 7.7% in the policy area 'Cohesion, energy and transport' and call on the Court of Auditors to present error rates for the European Regional Development Fund, the Cohesion Fund, the European Social Fund, energy and transport separately and not on an aggregate basis. They deplore the fact that, year after year, non-respect of public procurement rules accounts for a large proportion of the errors. They call on the Commission to pursue the ongoing reform of public procurement taking due account of these worrying results and to follow up on infringements rigorously.

Other issues concern:

- deficiencies in some audits;
- the fact that the Commission has no power to impose penalties on Member States or regions which have repeatedly failed to implement Structural Funds and the Cohesion Fund correctly;
- the error rate in Cohesion, and in particular in Regional Policy, has increased despite the increased use of interruptions;
- that financial corrections implemented by a Member State have a "virtual character" with little sanctioning effect.

The Commission is invited to consider it a priority action to support Parliament in its efforts in the ordinary legislative procedure concerning the proposal for a regulation laying down common provisions on the structural instruments to create an effective sanctioning mechanisms so that the Commission can fully assume its final and overall responsibility for the implementation of the budget. This should, inter alia, include the following elements: (i) making net reductions the rule for financial corrections imposed by the Commission and abolishing the possibility to declare retrospective projects; (ii) obliging Member States to recover ineligible expenditure from final beneficiaries as far as possible so that final beneficiaries bear the consequences of ineligible expenditure and not the national taxpayer; (iii) allowing the Commission to give Member States incentives not only to comply with the rules; (iv) ensuring that a full range of sanctions (interruptions, suspensions, financial corrections, and penalties) are available for all funds.

- Agriculture and natural resources – qualified conclusion: Members recall that IACS must ensure that correct and traceable payments are made to farmers which doesn’t seem to be the case. They encourage the Commission to further reduce the duration of the conformity clearance procedure while ensuring that Member States' right of defence is preserved. They reiterate the belief that agricultural funds unduly paid have to be recovered from the final beneficiaries as much as possible to avoid the taxpayer being hit twice. These systems should be examined.

- External aid, development and enlargement – qualified conclusion: Members state that the overall most likely error estimated by the Court of Auditors is 1.7%. They regret, however, that a material level of error was found in interim and final payments. They recall that the main risks linked to budget support (risk to effectiveness of the aid as well as risks of fraud and corruption) also do not materialise in the Statement of Assurance audit. The committee invites the Commission to encourage EuropeAid to complete as soon as possible the work on a methodology to calculate the level of 'residual error' which might remain after all controls have been executed.

Members note that the Heads of Union Delegations, where they are the only EEAS staff in a delegation, may not delegate, even on a temporary basis, their powers as authorising officers for the Union

Delegation's administrative expenditure when they are absent. In addition, the UN is expected to grant intergovernmental donor organisations similar rights to access internal audit reports as are granted to UN Member States.

- Research and other internal policies – qualified conclusion: Members understand that the Commission estimates the representative error rate without prefinancings on a multi-annual basis to be 3.4% for Framework Programme 6 and the provisional representative error rate for Framework Programme 7 to be a little above 4 % on a multi-annual basis. They note that the Commission is simplifying ex ante control procedures as far as possible with a view to facilitate the processing of payments with the consequence that only administrative requirements and **arithmetical checks can be made**. They are worried that even in the case of doubt about the eligibility of cost declared, only limited ex ante checks were carried out. A balance has to be struck between facilitating payments and controlling the eligibility of cost declared.

IV. Views from specific policy perspectives: lastly, Members make a series of observations on the Commission's sectoral policies:

- **Development policies**: noting the Commission's supervisory and control systems for external aid and development were again only partially effective, Members encourage the Commission to develop a coherent methodology for the external relations' directorates to calculate the residual error rate, and to uphold the highest control standards possible. Particular efforts are needed: (i) to improve the effectiveness of Union aid to the basic education sector in Sub-Saharan Africa and South Asia; (ii) to fight the large-scale fraud cases uncovered by the Global Fund to Fight AIDS, Tuberculosis and Malaria in Mali, Mauritania, Djibouti and Zambia; (iii) to ensure the greater involvement of parliaments and consultation with civil society in partner countries when drawing up projects;
- **Employment and Social Affairs Policy**: recalling that the proper usage of funds by Member States must be ensured, Members call on the Court of Auditors to present error rates for the European Regional Development Fund and the ESF separately and not on an aggregate basis.
- **Internal Market and Consumer Protection Policy**: underlining the complexity of rules as a major source of errors in the 'Research and Other Policies' chapter, the committee asks the Commission to explore different options to improve the balance between simplification and control in order to reduce the administrative burden for SMEs.
- **Transport and Tourism Policy:** Members call on the Commission to present, on an annual basis, lists of tourism and transport infrastructure projects, co-financed by cohesion and regional funds, as is already the case for TEN-T funds, and, as a result, make information on Union co-funding easily accessible and transparent for other Institutions and the taxpayer.
- **Foreign Affairs policy**: Members considers that, above and beyond the efforts required to improve the regularity of payments, the Commission should, for all interventions, carry out systematic evaluations through the prism of cost/benefit ratio. They stress, however, that the cost/benefit ratio cannot always be considered, in itself, as a sufficient criterion for assessing the appropriateness of the Union's assistance in a third country, and foreign policy goals should include additional criteria - such as, for example, the strategic interests of the Union, the need for a Union presence on the ground, or the implementation of projects and actions fostering Union values and fundamental principles.
- **Regional Development Policy**: the committee regrets that regional policy was part of an error-prone group, among the policy areas of Union expenditure. It notes that the non-compliance with both public procurement rules and eligibility rules accounts for a high proportion of the estimated error rate (31 % and 43 %, respectively). It underlines the need for the Commission to simplify the rules in order to ensure more user-friendly procedures and not to discourage potential beneficiaries from participating in projects. Member States are asked to improve training of officials responsible for management.

- **Fisheries:** Members emphasise that there is a need for effective monitoring of Union-funded activities that provide sectoral support in the context of international agreements. Given Parliament' s legislative and budgetary role, they ask to be more closely involved in fisheries policy.