2012 discharge: EU general budget, European Commission and executive agencies

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PURPOSE: presentation of the Report of the European Court of Auditors (ECA) on the implementation of the 2012 budget (Commission).

CONTENT: the Court of Auditors published its 36th Annual Report on the implementation of the EU budget for the 2012 financial year. This report has a two-part structure:

- a first part devoted to the work of the Court relating to the reliability of the accounts and the regularity of the operations,
- a second part focusing on the audit findings regarding the revenues and expenditures of the EU (in groups of policies) and on the analysis of the expenditure of the other institutions and bodies of the European Union.

The Statement of Assurance ("DAS") regarding the reliability of the annual accounts of the EU as well as the legality and regularity of the transactions is the central element of this report.

DAS: the main conclusion of the 2012 Statement of Assurance is that **all policy groups were affected by a material level of error**: the Court considers that the consolidated accounts of the European Union **present fairly**, in all material respects, **the financial position of the Union as at 31 December 2012**. It also concluded that:

1) revenue underlying the accounts for the year ended 31 December 2012 is legal and regular in all material respects;

2) commitments underlying the accounts for the year ended 31 December 2012 are legal and regular in all material respects;

3) the supervisory and control systems examined are partially effective in ensuring the legality and regularity of payments underlying the accounts. **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 **4.8%.**

ECA key messages relating to the DAS: this year's results again show an increase in overall estimated error rates. The most likely error for payments taken as a whole has increased from 3.9% to 4.8% in 2012. The estimated error rate has increased every year since 2009, after having fallen in the three previous years:

- the most error-prone areas: **rural development, environment, fisheries and health** remains the most errorprone spending area with an estimated error rate of 7.9%, followed by regional policy, energy and transport with an estimated error rate of 6.8%;

- in general, errors concern payments made to beneficiaries or to ineligible projects or the purchase of goods, services or investments **without respecting public procurement rules**;

- the substantial gap between appropriations for commitment and payment, coupled with a **large amount of underspending at the start of the current programming period**, has caused a buildup of the

equivalent of 2 years and 3 months' worth of unused commitments (EUR 217 billion at the end of 2012). This leads to pressure on the budget for payments. To resolve that situation, the Court recommends that it is essential that the Commission plans its payment requirements for the medium and longterm;

- for many areas of the EU budget the legislative framework is complex and there is insufficient focus on performance. The proposals on agriculture and cohesion for the 2014–2020 programming period remain fundamentally inputbased (expenditure oriented) and therefore still focused on compliance with the rules rather than performance.

Other characteristics of the 2012 budget implementation: in 2012, the EU faced a number of financial management challenges in implementing its budget. These including dealing with an increasing level of final payments as the current financial framework draws to a close together with the effects of pressure on national financing. Payments from the EU budget for 2012 totalled EUR 138.6 billion. For around 80 % of the spending – agriculture and cohesion – the task of implementation is shared between the Commission and the EU's Member States. The Court states that for a significant number of transactions affected by error, the Member States authorities had sufficient information available to have **detected and corrected the error**. With the rules in force for the current period of expenditure (2007-2013), Member States are strongly encouraged to use more efficiently the financial management systems in force.

Outstanding budgetary commitments (RAL): as the EU prepares spending programmes for the 2014-20 financial framework, considerable financial commitments from previous years remain unspent - this will put added pressure on EU cash flows and may increase the risk of error over the next few years. There is an important opportunity now for the EU institutions and the Member States to use the lessons learned during the current financial framework to improve EU financial management in the next financial framework period.

Analysis of budget implementation by expenditure groups and recommendations of the Court:

- **Agriculture** (EUR 44.5 billion): a majority of expenditure in this spending area is calculated based on agricultural land surface. Many quantifiable errors are the result of inaccurate claims by beneficiaries, with the most frequent being over-declaration of land area. The Court stresses that in Spain, Austria and Portugal some land claimed and paid for as permanent pasture was in reality fully or partly covered with rocks, dense forests or bushes. This should exclude them from EU aid. The Court found infringements in **16%** of the transactions subject to **cross-compliance obligations**. The Court recommends that the Commission and Member States increase and speed up their efforts to ensure that: (i) immediate remedial action is taken where administrative and control systems and /or IACS databases are found to be deficient or out of date; (ii) payments are based on inspection results and that on-the-spot inspections are of the quality necessary to determine the eligible area in a reliable manner.
- **Rural development, environment, fisheries and health** (EUR 15 billion): the European Agricultural Fund for Rural Development (EAFRD) represents 90% of the payments. Management of the spending is shared with Member States. The reason for most errors was that the beneficiaries did not respect the eligibility requirements, in particular those concerning agri-environment commitments, specific requirements for investment projects and procurement rules. The Court stresses that a beneficiary in Poland committed to respect specific requirements relating to the maintenance of extensive permanent grassland. The main commitment was to leave every year, on a different surface area, 5 to 10% of the applicable surface uncut, for which the beneficiary would receive EUR 270 per hectare. The ECA found that the requirements were not met: the fields were either completely cut or the uncut area was the same as in previous years or in a different location to that indicated by the ornithological expert. The Court recommends in the area of rural development that: (i) Member States carry out their existing administrative checks better, by using all relevant information available to the paying agencies; (ii) the Commission ensures that all cases where the Court detected errors are followed up appropriately.

- **Regional policy, energy and transport** (EUR 40.7 billion): the audit covered regional policy, which is mostly financed through the European Regional Development Fund (ERDF) and the Cohesion Fund (CF). The Court found serious failures to respect public procurement rules. Such errors accounted for 52 % of the error rate estimated by the ECA. The combined estimated contract value for the 247 audited public procurements amounted to EUR 6.3 billion. Amongst the examples given, the Court highlights the case of the construction of a high-speed railway line in France, two civil engineering contracts were **directly awarded** to the same company that had previously provided similar services. Such a direct award is not in line with the applicable procurement rules and the contract should have been put out to tender. The Court recommends that the Commission: (i) carries out an assessment of the use of national eligibility rules with a view to identifying possible areas for further simplification and eliminating unnecessarily complex rules ('gold-plating'); (ii) specifies clear rules and provides robust guidance on how to assess the eligibility of projects and calculate the co-financing for revenue generating projects under the 2014-20 programming period.
- **Employment and social affairs** (EUR 13.4 billion): the European Social Fund (ESF) is the main tool for the implementation of employment and social policy. Management of the spending is shared with Member States. The majority of errors detected – 74 % of the estimated error rate – concerned the reimbursement of ineligible costs, projects, beneficiaries or participants. Support was given to Spanish companies hiring unemployed persons. A condition for participants was that the employers had to maintain the newly employed staff for a minimum period of three or, in some cases, up to five years. This condition was not respected for 12 persons. The Court recommends that the Commission: (i) carries out an assessment of the use of national eligibility rules in order to identify possible areas for further simplification and eliminating unnecessarily complex rules; and (ii) promotes the extensive use of lump-sum and flat-rate payments in order to reduce the risk of error in cost declarations and the administrative burden on beneficiaries.
- **External relations, aid and enlargement** (EUR 6.6 billion): development projects are dispersed throughout more than 150 countries, and the implementing organisations vary greatly both in size and experience. To be eligible for EU support, projects, are required to comply with conditions set out in specific financing agreements as well as other rules covering, for example, tendering and contract award procedures. Spending is implemented directly by Commission directoratesgeneral, either from their headquarters in Brussels or by EU delegations in recipient countries, or jointly with international organisations. A majority of errors involve ineligible expenditure incurred at final beneficiary level, such as: expenditure incurred outside the eligibility period; inclusion of ineligible expenditure (e.g. VAT, staff costs and unjustified overheads) charged in the project cost claims and expenditure without adequate supporting documents. The Court recommends that the Commission: (i) ensures timely clearance of expenditure; (ii) promotes better document management by implementing partners and beneficiaries; (iii) improves the management of contract-awarding procedures by setting out clear selection criteria and documenting the evaluation process better; (iv) takes effective steps in order to enhance the quality of expenditure checks carried out by external auditors.
- **Research and other internal policies** (EUR 10.7 billion): the main source of error remains the inclusion of ineligible costs in research FPs project cost statements, and the use of incorrect methodologies by FP beneficiaries for the calculation of personnel and indirect costs. The Court detected several errors in the costs which a beneficiary involved in a research project declared to the Commission: incorrectly calculated personnel costs based on budgeted rather than actual figures, unsubstantiated travel costs, and indirect costs based on incorrectly calculated hourly overhead rates and including ineligible cost categories not linked to the project. The Court recommends that the Commission: (i) further intensifies its efforts to address the errors found, in particular by reminding beneficiaries and independent auditors of the eligibility rules and the requirement for beneficiaries to substantiate all declared costs; (ii) reminds research FP project coordinators of their responsibility to distribute the funds received to the other project partners without undue delay.
- **Administrative and other expenditure** (EUR 10 billion): spending on human resources (salaries, allowances and pensions), account for 60 % of the spending area; expenditure on buildings,

equipment, energy, communications and information technology accounts for the remainder. The Court states that no significant errors were found here.

Recommendations of the Court of Auditors: for each of these areas of expenditure, the Court made a series of recommendations aimed at improving EU financial management. This improvement is essential given the pressure on the public finances of the Union and the Member States. Expenditure, therefore, must be carried out in a way that is still **more efficient and better targeted**.

Overall, the Court invites the Commission to review the regulation applicable to EU expenditure and recommends it to simplify the legislative framework in this respect.