

# 2005 discharge: EC general budget, section III, Commission

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**PURPOSE:** to present the Court of Auditors report on the implementation of the 2005 general budget of the European Union (Section III- Commission).

**CONTENT:** this document, covering the 2005 financial year, comprises the Court's 29th annual report on the implementation of the general budget of the European Union.

Overall, the European Court of Auditors reports considerable progress by the Commission in introducing its new accounting system, but found **weak internal controls** for **the majority of EU expenditure**, both within Member States and at the Commission, and a high incidence of errors in the underlying transactions.

**DAS:** the Court has issued a statement of assurance for the past 12 years and the outcome is always the same : there is a need to improve the financial management of the Union's expenditure.

The Court has been providing a Statement of Assurance for twelve years now and the message remains more or less the same, that there should be an improvement in the management of the accounts. This situation should be tackled with a combination of measures:

- the rules governing expenditure should be simplified wherever possible. In particular, rules and requirements that do not contribute to meeting the objectives of the expenditure should be avoided;
- there should be an evaluation of the risk inherent in the transactions and modes of management, to be taken into account when establishing, implementing and controlling the schemes. A zero error rate is unlikely to be achieved in practice, and to aim to achieve it would be too costly. Therefore, an appropriate balance between the cost of controls and the benefit they bring should be sought;
- there should be a logical chain of effective internal controls based on common principles and standards, with the results accessible to all participants.

Lastly, an effective system of sanctions should be applied in all areas of the budget.

The introduction of **accruals based accounting** by the Commission has advanced well. The Court concludes that the 2005 consolidated accounts of the EU general budget (total payments made EUR 104.8 billion) present fairly, in all material respects, the financial position of the European Communities as at 31.12.2005 and the results of the year, but qualifies this opinion mainly due to misstatements in the balance sheets and inconsistent application of cut-off procedures.

- **Legality and regularity of the underlying transactions**, the Court only provides an unqualified opinion on EU revenue, commitments, administrative expenditure and pre-accession strategy, excluding Sapard. As for 2004, the Court's audit shows that, where properly applied, the Integrated Administration and Control System (IACS) is effective in limiting irregular agricultural expenditure. For most of the payment budget - agriculture, structural measures, internal policies and external action - the Court is again not in the position to provide an unqualified opinion on the legality and regularity of transactions due to continuing high levels of error. The situation is caused by deficiencies in internal control, in particular in Member States for shared management

expenditure, but also within expenditure directly managed by the Commission, such as internal policies. The Court found evidence of internal control checks being incompletely or inadequately carried out in many areas of the budget, both within Member States and at the Commission.

- **Reliability of the accounts:** in the Court's opinion, the 'Final annual accounts of the European Communities' were drawn up in accordance with the provisions of the Financial Regulation of 25 June 2002 and accounting rules adopted by the Commission's Accounting Officer. They present fairly, in all material respects the financial position of the Communities as of 31 December 2005, and the results of their operations and cash flows for the year then ended.

**Revenue:** in the case of revenue the scope of the Court's audit work was limited. Firstly, VAT and GNI own resources are based on macroeconomic statistics for which the underlying data cannot be audited directly by the Court, and secondly, the audits of traditional own resources cannot cover the imports that have not been subject to custom supervision.

**Expenditure:** the Court states that in most areas, payments were always affected by errors (e.g. CAP, structural actions, internal policies and external policies).

- **Agriculture:** the payments are still materially affected by errors, for the area taken as a whole. However, as for 2004, the Court finds the Integrated Administration and Control System (IACS) - which covers 56% of agricultural expenditure overall - to be an effective system where properly applied. In practice this means the EU15, except, again, for Greece, where the Court found no significant improvements in the application of these key procedures. In the new Member States these systems are not yet fully effective, with the risk that over-declarations may go undetected. The Court concludes that agricultural spending (EUR 48.5 billion) is still materially affected by errors - such as farmers over claiming or not meeting their obligations - for the area taken as a whole. In the new Member States, IACS is not yet fully effective, with the risk that overdeclarations might go undetected. Within the 44% of agricultural expenditure not covered by IACS - such as olive oil, rural development and export refunds - the risk of irregularities remains high and checks weak.
- **Structural measures** (EUR 32.8 billion): the Court's message remains the same as in previous years: weak control systems - including insufficient day-to-day management checks by Member State authorities - lead to overpayments or ineligible expenditure, because errors in claims by beneficiaries are not prevented or corrected. The Court's audit of the 1994-1999 programme closures by the Commission in 2005 revealed a material level of error despite the closure checks made. The Commission also closed some programmes without a sound basis, while closure of others has been unduly delayed. Procedures for reporting recoveries and making financial corrections are not working correctly.
- **Internal policies** (EUR 8 billion) are directly managed by the Commission. Despite the material incidence of errors found by the Court in payments to beneficiaries - including double charging of costs, overstatements of average costs and non-compliance with eligibility criteria - the number of ex-post checks by the Commission is nearly 50% less than in 2004. The recovery procedures in case of infringements are increasingly slow and sanctions mechanisms largely inadequate.
- **External action** (EUR 5 billion) is also an area directly managed by the Commission. The Court found expenditure at Commission and delegation level to be mostly legal and regular, but detected a material level of error at project implementing organisations, including ineligible expenditure and non-compliance with contractual procedures. These organisations had weak systems and lacked a comprehensive approach to supervision, control and audit.
- **Pre-accession strategy** (EUR 3 billion): the Court concludes that the expenditure is legal and regular, except for Sapard where the transactions audited by the Court were affected by significant errors. The Commission needs to improve the monitoring of national systems.

**Conclusions:** in its 2005 Annual Report, the European Court of Auditors reports considerable progress by the Commission in introducing its new accounting system, but found weak internal controls for the majority of EU expenditure, both within Member States and at the Commission, and a high incidence of errors in the underlying transactions.

The Court has over the years repeatedly pointed out the need for improved control systems, often interpreted as increasing the number of checks. However, a decisive step forward would be to improve the quality and reliability of the current systems so that the checks are carried out competently and diligently at all levels of administration.

Regarding external audit, the Court remains committed to continuing its close cooperation with the **national audit bodies** of the European Union. In practice, this involves practical support to the Court's on-the-spot audits, exchange of professional information and knowledge, joint development of practical and technical support material as well as joint audits.

Over the next few years there are a number of major challenges facing the management of the EU budget, including the start of a new financial perspective period with changes in spending schemes; the completion and closure of the current spending programmes; the introduction of the single farm payment system and the need to consolidate the 2004 enlargement while welcoming two new Member States. The Court believes that it will be necessary to ensure effective management and thus adequate controls is a great challenge, particularly for a European Union that is expanding and make significant steps in improving its own organisation and accountability. The introduction of accruals-based accounting is a considerable achievement.