2005 discharge: EC general budget, section III, Commission

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PURPOSE: to present the Council Recommendation on the discharge to be given to the Commission in respect of the implementation of the budget for the financial year 2005 (Section III - Commission).

CONTENT: the Council approved the draft recommendation on the discharge to be given to the Commission in respect of the implementation of the budget for the financial year 2005. The recommendation lays down the amounts of revenue and expenditure for 2005:

Detailed analysis of revenue and expenditure:

- revenue amounted to EUR 107 090 637 948;
- expenditure disbursed from appropriations amounted to EUR 103 548 235 840;
- cancelled payment appropriations (including earmarked revenue) carried over from 2004 amounted to EUR 1 518 600 450;
- appropriations for payments carried forward from 2005 to 2006 EUR 2 686 900 906;
- EFTA-payment appropriations carried over from 2004 EUR 91 242;
- the balance of exchange-rate differences amounted to EUR 40 924 144;
- the positive budget balance amounts to EUR 2 414 934 555.

Cancelled payment appropriations for the financial year amounted to EUR 1 911 869 884. EUR 1 286 993 986 (83%) of the EUR 1 559 765 026 in appropriations for payments carried forward from 2004 to 2005 have been used.

The observations in the report by the Court of Auditors for the financial year 2005 call for certain comments by the Council. It attaches importance to its comments being followed up and assumes that the Commission will implement all of the recommendations in full, without delay.

Statement of assurance (DAS): the Council regrets that the 12th Statement of Assurance (DAS) given by the Court remains qualified for the areas where the supervisory and control systems are not implemented in a manner which provides for adequate risk management. However, it notes with satisfaction the Court's statement that the transactions for revenue, commitments and payments for administrative expenditure and pre-accession strategy except Sapard are legal and regular, taken as a whole, and that, where properly applied, the Integrated Administration and Control System (IACS) is an effective system to limit the risk of irregular expenditure. The Council invites the Commission to present a general report on recoveries for the financial years 2000-2006, including amounts recovered by the Member States as well as the Commission and amounts of open entitlements by the end of each year. This report should be sent to the Council before the end of September 2007.

Improvement of financial management: the Council recalls the importance of continuing to improve financial management and of having controls working correctly and effectively so that for all transactions underlying the EU-accounts an unqualified DAS should be achieved as soon as possible. It emphasises the need to continue working towards the achievement of an effective integrated internal control. While respecting the different national control systems and specifities, the Council notes with interest the ongoing work under current regulations, arrangements and initiatives by Member States to improve financial management. The Council emphasises that the Commission is ultimately responsible for EU-expenditure according to the Treaty. It recalls the Council conclusions of November 2005, that the

Commission implements the budget on its own responsibility, and that the Member States, in the framework of their co-operation with the Commission under Article 274 of the EC Treaty, should continue to undertake and improve controls over funds under shared management arrangements. As agreed in its discussions on the Financial Regulation, the Council will pursue its in-depth examination of all related items.

Reliability of the accounts: the Council notes with satisfaction the Court's positive opinion concerning the reliability of the final annual and that the Court's statement that except for some observations the accounts present fairly, in all material respects, the financial position of the Communities and the results of their operations and cash flows as of 31 December 2005. The Council takes note that the Court identified errors after corrections made to the provisional accounts consisting in an overstatement of net assets by some EUR 132 million in the opening balance as at 1 January 2005 and an overstatement of net assets by some EUR 314 million affecting the closing balance as at 31 December 2005.

Accounting system: the Council congratulates the Commission for the good results of the introduction of the new accruals-based accounting system within the relatively short timeframe of three years, a change particularly demanding and comprehensive. It underlines the need for further development by the Commission of reliable, cost-effective and easily understandable indicators to be audited on an annual comparable basis by the Court. Regarding controls, the Council underlines that it is important to continue with the identification of weaknesses in the design and the operation of schemes and to introduce appropriate remedial actions in the areas of centralised, shared and joint management.

2005 expenditure: the Council comments on the following issues :

- **CAP**: the Council regrets finding that, as in previous years, CAP expenditure, viewed as a whole, was still materially affected by errors. The Council welcomes the Court's statement that the IACS, which is the main control tool for area aid, animal premiums and the new single area payment scheme and covers around 62% of CAP expenditure, is an effective system to limit the risk of irregular expenditure, if properly applied. However, it regrets the fact that controls and checks implemented under IACS are still not effectively enforced or are not yet completely reliable in some Member States. Moreover the Council shares the Court's concern that statistics for animal premiums are still less reliable than the equivalent statistics for area aid applications. As a consequence, the Council urges the Commission to ensure with the Member States that IACS is fully implemented in all EU-15 and that the weaknesses found in the EU-10 are remedied. In the area aid sector, where 40% of the applications checked by the Court contained errors, the Council urges the Commission to improve checks and to further strengthen work in the area of risk management and risk assessment.
- **Structural operations**: the Council shares the Court's observations about a number of factors that increase the inherent risks related to the legality and the regularity of expenditure for structural operations, such as the large number of programmes and projects which are implemented over several years, the large number of eligibility conditions which are sometimes open to divergent interpretations, and the variety of entities that intervene in the management process. Therefore, the Council underlines the paramount importance of the simplification of the procedures and rules, and exhorts both the Commission and the Member States to do their utmost to streamline the bureaucracy and the requirements at all level. It encourages the Commission and the Member States to pursue their efforts and take all the necessary steps to mitigate the risks through both strong and adequate controls and effective supervision. However, they both should constantly bear in mind that such controls have to be proportionate to the risks and costs involved. Moreover, the Council calls on the Commission to keep on providing updated, timely and comprehensive guidance and clarification on the rules and procedures applicable to the different programmes and projects, whether it be for the closure of the 2000-2006 programmes or for the launching of the 2007-2013

operations. It urges the Commission and the Member States to reinforce their co-operation to ensure the effective application of the control mechanisms, in particular for the 2007-2013 period, in compliance with the new legislative framework adopted.

- **Internal policies including research**: the Council regrets that once again, in an area of direct management by the Commission, the Court's audit revealed weaknesses in the supervisory and control system, which led to a material incidence of errors in three quarters of the transactions audited at final beneficiary level. The Council shares the Court's concern about the high material level of errors detected in the transactions audited. It urges the Commission to take appropriate measures to remedy the weaknesses identified by the Court, in particular those concerning the double charging of costs, the lack of supporting evidence for working time charged, the unjustified allocation of indirect costs to the action, the non-compliance with eligibility criteria. The Council stresses the need to develop a clear strategy on the coordination of key control procedures, as well as to enforce more reliable action plans designed to exclude over-declaration of costs. The Council, in particular, urges the Commission to increase the number of on-the-spot audits, to develop a harmonised methodology for reporting and selection of ex-post audits and to implement a common IT system for the Seventh and subsequent Framework Programmes.
- **External actions**: the Council welcomes the fact that the Court's audit revealed only a few errors in the transactions at the level of the Commission and its delegations, but regrets that at the level of the implementing organisations the Court detected a material incidence of errors. The Council notes that the Court again identified the highest risk areas to be the contracting procedures, the eligibility of expenditure at project level and an insufficient supporting documentation. It notes with satisfaction that the Court's audit of the supervisory and control systems of DG ECHO revealed that most elements function well although some of them still need to be improved. It also welcomes the fact that EuropeAid improved its supervisory and control systems. However, it encourages the Commission to continue to improve the functioning in practise, internal audits and management reporting of the supervisory and control systems of its delegations and EuropeAid. The Council regrets that the Court's assessment of external audits at the level of organisations implementing projects funded by EuropeAid remained. However, it notes with satisfaction that the Court gave a good assessment of the quality of these audits. The Council invites the Commission to further develop EuropeAid's risk assessment by making reference to the findings of auditors at project level, and by making a separation between the different types of implementing organisations and the funding method. It invites EuropeAid to improve the terms of reference of its external audits to cover all known risk areas including the verification of the compliance with the Commission's requirements regarding contracting procedures and the eligibility of expenditures. It agrees with the Court that the Commission should include information on all audits of projects in the Common Relex Information System (CRIS) and to better link this information to the project management information. The Council invites the Commission's EuropeAid headquarters to review the financial information provided by the delegations, supported through headquarters' audits, in order to ensure its completeness and consistency.
- **Pre-accession strategy**: the Council welcomes the fact that the Court's audit revealed that for the Phare and Turkey programmes the transactions tested were, like in the previous year, not affected by material errors. Nevertheless, in respect of the Phare programme, it notes the recurring problem of different interpretations regarding the eligibility of VAT expenditure under parallel cofinancing which is caused by the absence of a legal basis specifying this and invites the Commission to clarify this issue in the relevant implementing rules. At the same time, the Council regrets that the Sapard transactions audited were, unlike in the previous year, affected by significant errors in the Court's view, and invites both the Commission and the countries concerned to take due account of the errors identified. The Council notes with satisfaction that the Commission Delegations' ex-ante controls of the Phare and Turkey programmes and ISPA projects continue to be an effective key control to ensure the legality and regularity of the underlying transactions which compensates for existing important weaknesses in the supervisory and control systems at the national level. It notes the improvement of the control of national co-financing agreements under Phare but points out the recurring problem of insufficient action at the Commission level to remedy the issue of late

submissions of final declarations by the national authorities. The Council acknowledges the Court's conclusion that the Sapard supervisory and control systems included the key concepts but their functioning showed some weaknesses. Therefore, it invites both the Commission and the national authorities to pursue efforts towards removing the remaining weaknesses.

- **Administrative expenditure**: the Council welcomes the fact the Court's audit did not reveal any material errors affecting the legality and regularity of the administrative expenditure as a whole. However, the Council notes that some Institutions had not fully implemented all their Internal Control Standards and encourages them to do so without delay (for more details on the Court’s audit on the Community institutions, please refer to the corresponding discharge procedures).