RIGSREVISIONEN

Memorandum to the Public Accounts Committee on

the audit and approval of the 2015 EU accounts

June 2017

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SUMMARY

In this memorandum, Rigsrevisionen informs the Public Accounts Committee of the main conclusions presented in the European Court of Auditors' annual report for 2015, the special reports published by the European Court of Auditors and the European Parliament's approval (discharge) of the accounts. The last section of the memorandum sums up Rigsrevisionen's audit of EU funds in Denmark in 2016.

In its annual report, the European Court of Auditors concludes that the consolidated accounts of the European Union are correct, but continue to be affected by too many errors in the underlying payments.

The European Parliament has approved the 2015 EU accounts, but has also pointed out that the European Union is facing a crisis of confidence and has called upon the EU institutions and Member States to share responsibility for restoring confidence in the institutions of the EU.

I. The audit and approval of the EU accounts

1. The preparation, audit and approval of the EU accounts are elements in the chain of accountability that leads to the discharge of the accounts: First, the European Commission (the Commission) prepares accounts of EU revenue and expenditure and gives an account of results achieved. This account includes expenditure managed by the Commission and expenditure under shared management with the individual member states. Eighty per cent of the EU budget is under shared management. The Commission has overall responsibility for correct implementation of the EU budget, but the Member States select and check eligible projects and execute payments to the final beneficiaries. In doing so, the Member States share responsibility for the management of EU funding.

2. The second element in the chain of accountability is the audit of the EU accounts by the European Court of Auditors (the Court). The results of this audit are published in the Court's annual report, which for 2015 was published on 13 October 2016. The annual report is accompanied by a report called *EU audit in brief* in which the Court summarises the results of its audit of the EU accounts. The European Parliament (the Parliament) and the national parliaments (including the Danish Folketing) receive the annual report the same day. The Danish Public Accounts Committee has also been briefed about the annual report in a letter from the Danish member of the Court, Bettina Jakobsen.

3. The third and fourth element in the process is the Parliament's political assessment and approval of the Commission's and other EU institutions' management of the EU budget – the so-called discharge procedure. The Parliament's assessment and approval is based on a recommendation by the Council for the European Council (the Council). The Parliament's discharge is the last element in the accountability chain that leads to the final approval of the EU budget and accounts. In the course of the discharge procedure, the Parliament and Council review the Court's annual report, audit statement and special reports as well as the Commission's annual activity reports. The discharge granted by the Parliament serves two purposes. First, it represents a political assessment and approval of the Commission's management. Second, it closes the accounts and formally "discharges" the Commission of its management responsibilities. The Parliament also grants discharge to other institutions in the EU like, for instance, the Council, the Court and the Court of Justice of the European Union.

4. Figure 1 illustrates the accountability chain.

Figure 1. Chain of accountability for approval of the EU accounts

5. The Court is not providing an assessment of the management of EU funds in the individual Member States; in the annual report, its focus is on the management of the overall annual EU budget. The supreme audit institutions of the Member States and the Court cooperate on an ongoing basis, but the Court does not apply the work carried out by the individual supreme audit institutions in its audit. Nor do the supreme audit institutions use the work of the Court, since neither the focus of the audit nor the recipients of the audit results are the same. The Court has focus on the Commission and the EU as such, whereas the national supreme audit institutions have focus on the management of EU funds in their respective countries.

6. Every year, Rigsrevisionen issues an opinion on the audit of EU funds in Denmark, i.e. the funds that Denmark has received from and contributed to the EU budget. Rigsrevisionen's EU opinion on the 2015 accounts was included in the annual report on the audit of the Danish government accounts 2015 that was discussed by the members of the Public Accounts Committee at their meeting in September 2016.

II. Main conclusions of the Court's audit opinion and annual report

In 2015, the EU's budgetary spending totalled €145.2 billion, or around €285 per citizen. This spending amounts to around 1% of EU gross national income and represents approximately 2% of total public spending in the EU member states.

7. The Court's annual report for 2015 includes the results of the Court's financial and compliance audits and a summarised presentation of performance audits conducted by the Court. The Court audits the EU revenue and expenditure. In 2015, budgetary spending totalled €145.2 billion.

8. The Court issued the following opinion on the EU accounts for 2015, based on its audit findings:

> The consolidated accounts of the European Union are, in all material respects, correct and are therefore given a clean opinion.
>
> The revenue underlying the accounts is legal and regular and is therefore also given a clean opinion.
>
> The payments underlying the accounts are materially affected by error, and the legality and regularity of the payments are therefore given an adverse opinion. The Court estimates the total level of error at 3.8 per cent.

The Court has thus, as it has done since 2007, confirmed the reliability of the EU accounts for 2015.

*An **adverse opinion** means that the auditors disagree with the information disclosed in the accounts by management, or that the accounts include information for whose regularity the auditors could not obtain sufficient evidence.*

However, at the same time, the Court has once more noted high levels of error in most spending areas which has led to an adverse opinion on the payments underlying the accounts. The Court has estimated the level of error at 3.8 per cent, which means that 3.8 per cent of all payments from the EU budget were not made in line with the rules.

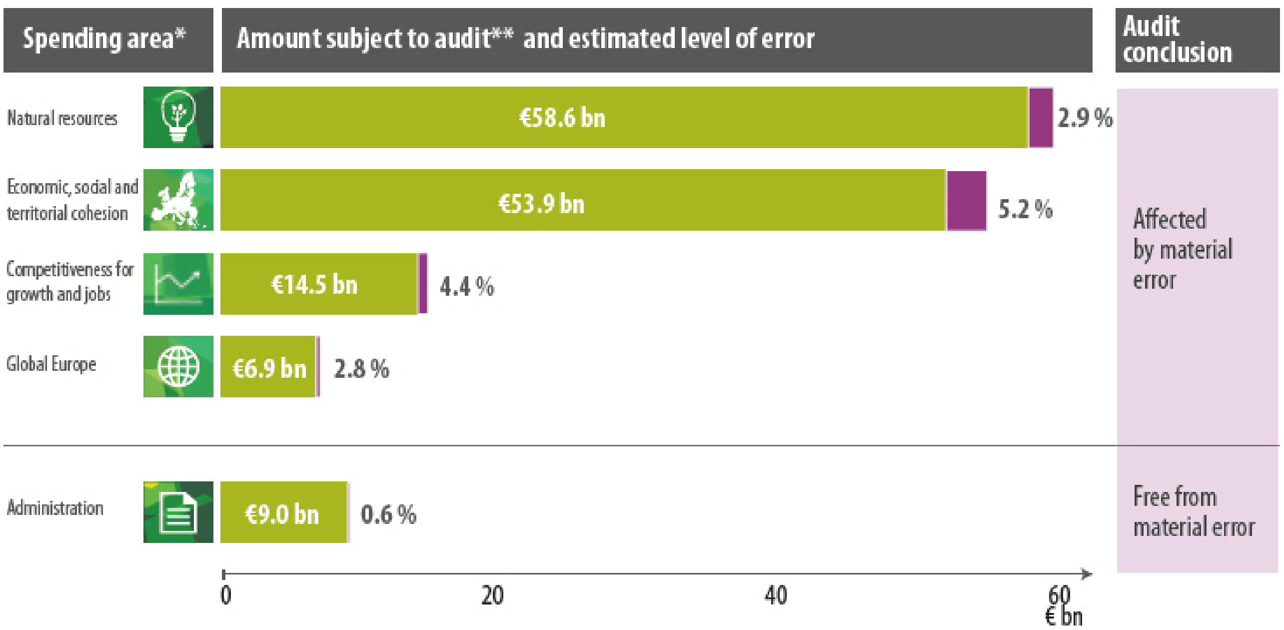
9. This year's error rate is lower than in previous years, but an error rate of 3.8 per cent is still considerably higher than the acceptable error level of 2 per cent. In 2012 and 2013, the total error rate was 4.5 per cent, and in 2014 it was 4.4 per cent.

10. Again this year, the Court highlights the fact that the Commission and Member States could have prevented, or detected and corrected a considerable number of the errors, if they had made better use of the information available to them before they reported or approved the expenditure. The control systems in the Member States were thus, in several areas, not entirely reliable. Besides, the Commission could have reduced the number of errors and recovered more irregularly spent funds, if it had applied financial corrections (suspension or repayment of EU funds) more consistently.

Assessment of spending areas

11. The Court estimates that four out of the five EU spending areas are affected by material error (> 2%). Only the EU institutions' spending on administration was free from material error (0.6%). Figure 2 shows the results of the Court's audit of the five spending areas.

Figure 2. The Court's audit of spending areas



*) The Court is not providing specific assessments for the spending areas *Security and citizenship, Compensations* and *Other expenditure,* but the audit of these areas contributes to the Court's overall conclusion on the EU accounts for 2015.

**) Total audited expenditure is not identical with total EU spending, because advance payments are not examined until the expenditure has been cleared.

Source: The Court's annual report for 2015 and the publication *EU audit in brief 2015*.

12. The highest levels of error were found in the spending area *Economic, social and territorial cohesion* (5.2%). Expenditure under this area totalled €53.9 billion in 2015 with the European Regional Development Fund, the Cohesion Fund and the European Social Fund accounting for most of the payments. This area has for many years been characterized by a high level of error. The area *Competitiveness for growth and jobs* was also affected by material error (4.4%). Total spending under this area was €14.5 billion, relating mainly to research, innovation, education and infrastructure.

13. The EU's largest spending area is *Natural resources* (€58.6 billion), which includes the EU common agricultural policy, fisheries policy, climate action and environmental measures. The total level of error for this area was 2.9%. Most errors were found in rural development, fisheries, climate action and environmental measures, and together the level of error for these areas was estimated at 5.2%.

BOX 1. THE LEVEL OF ERROR IS NOT A MEASURE OF FRAUD, INEFFICIENCY OR WASTE

It is an estimate of the money that should not have been paid out because it was not used in accordance with the applicable rules and regulations. Typical errors include payments for expenditure which was ineligible or for purchases without proper application of public purchasing rules.

Fraud is an act of deliberate deception to gain a benefit. The Court reports suspected fraud cases detected during the audit work to the European Union's anti-fraud office (OLAF), which investigates and follows up as necessary.

Out of 1,200 transactions assessed during the 2015 audit, the Court detected twelve instances of suspected fraud. The most frequent instances of fraud concerned conflicts of interest, declarations of costs that did not meet the eligibility criteria and the artificial creation of conditions to receive subsidy (e.g. pro forma division of a larger company to make it eligible for subsidy intended for small and medium-sized businesses).

Source: The Court's annual report for 2015.

Risk of error

14. The Court notes that for the second year in a row, the level of error in 2015 is largely the same in the spending areas that are under shared management by the Commission and Member States (4%) as for expenditure managed directly by the Commission (3.9%). Thus, management mode does not seem to have any impact on the level of error. The Court has previously indicated that the level of error was considerably higher in areas under shared management.

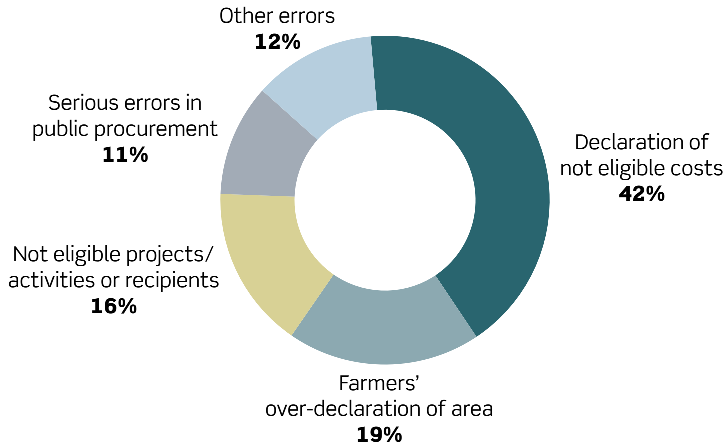
15. The Court's analysis shows that the risk of error very much depends on the type of payments made. The risk of error is considerably higher for reimbursements than for entitlements. The Court estimates the level of error at 5.2% for reimbursement schemes, where the EU reimburses eligible costs on the basis of costs declarations made by the beneficiaries. For entitlement schemes, where payments are made on meeting specific conditions, the level of error is estimated to be 1.9% by the Court.

The difference between estimated risk of error for reimbursements and entitlements, respectively, helps explain the differences in level of error under the various spending areas. The levels of error under *Cohesion* and *Competitiveness* are among the highest in the EU, and almost all payments made in these spending areas are cost reimbursements. *Natural resources* and *A global Europe* both have lower levels of error, and payments here are mainly made on meeting specific conditions of entitlement schemes.

Types of error

16. According to the Court's annual report, certain types of errors appear more frequently than others; errors relating to declaration of ineligible costs (42% of all errors), farmers' incorrect declaration of eligible area (19%) and declaration of ineligible projects/activities or beneficiaries (15%). Combined, these three types of error accounted for 77% of all errors in 2015. The level of errors in the category of serious public procurement errors was in 2015 considerably lower than in 2014 (11% against 27%). Figure 3 shows the estimated level of error for 2015 by type of error.

Figure 3. Level of error in 2015 by type of error



Source: The Court's annual report for 2015.

Backlog of unused funds

17. The Court reports a significant backlog of outstanding payment claims (commitments) from the European Structural and Investment Funds. By the end of 2015, 10% of the €446.2 billion allocated for the period 2007 to 2013 had not been claimed. Using all funds committed is a challenge to some Member States, as they need to select a sufficiently large number of relevant projects and provide the required national co-financing. As in 2014, the Czech Republic, Spain, Italy, Poland and Romania account for more than half of the unused funds.

Mention of Denmark in the Court's annual report

18. The Court is not providing an overall assessment of the management of EU funds in Denmark or the other Member States. Reference to Member States in the report serves only to illustrate audit results. Denmark is mentioned in two footnotes and in two tables presenting general data on all the Member States.

III. Special reports

19. In addition to the annual report on the EU accounts, the Court also publishes a number of special reports on performance audit and compliance audits of specific budgetary issues or management topics. The Court published 36 special reports in 2016.

20. The audit topics of the special reports are selected based on risk of irregularities or poor management, public interest and potential for improvement. In 2016, the Court's special reports were particularly focused on topics concerning the EU's strategic objectives concerning growth and added value, and the EU's response to global challenges, including energy and climate, the Single Market and migration. Audit topics addressed in the special reports in 2016 included: food waste, Roma integration, the Baltic Sea and public procurement by EU institutions. The special reports are published on the Court's website: www.eca.europa.eu.

21. The Court has also conducted a survey on the Commission's and Member States' awareness of the recommendations made in the special reports and the extent to which these are followed up. The Court concludes that the Commission generally follows up on the Court's recommendations. The Court also concludes that many of the findings published in the special reports require action by either just the relevant Member State or by the Commission and the Member State in concert, since most EU expenditure is under shared management. The Court's recommendations reach the Member States through various channels, but the extent to which the Member States follow up on the Court's recommendations varies considerably.

IV. Main conclusions of the Parliament's discharge decision

22. On 27 April 2017, the Parliament decided to grant discharge to the Commission and thus approved the EU accounts for 2015. The Parliament granted discharge upon a recommendation by the Council of 21 February 2017. However, again this year, the Parliament decided to postpone granting discharge to the Council and the European Council due to a long-standing disagreement concerning supply of data from the Council to the Parliament.

23. The Parliament notes that the Court has issued a clean opinion on the EU accounts for 2015 and is pleased that the Court confirmed the legality and regularity of the revenue and commitments underlying the accounts.

24. The Parliament regrets that the Court, based on findings indicating that payments are materially affected by error, has issued an adverse opinion on the legality and regularity of payments underlying the accounts. The estimated level of error for these payments is 3.8%. The Parliament regrets that payments continue to be materially affected by error and that the Court has again, for the 22nd consecutive year, been unable to issue a positive statement of assurance on the legality and regularity of the payments.

25. The Parliament emphasises that the EU is facing a crisis of confidence with citizens being increasingly sceptical of the EU institutions and calls on the individual EU institutions to accept their own share of responsibility for this development. In response to the crisis of trust, the Parliament suggests that

- The Parliament should be particularly rigorous when scrutinising the EU accounts;
- The EU institutions and Member States should do more to inform the citizens of the positive results of EU policy;
- The EU institutions should prioritise issues of particular concern to the citizens;
- The Member States should sincerely cooperate with the Commission to ensure financial sound management of EU funds.

26. The Parliament's discharge decision is supplemented with a number of comments and recommendations to the Commission and Member States on the management of EU funds. This memorandum provides only a summary of the comments that Rigsrevisionen considers to be of particular interest to the members of the Public Accounts Committee.

Strategy, priorities and budget
27. The Parliament notes that the EU's long-term strategy – Europe 2020 – has not been aligned with the five-year mandates of the Parliament and Commission, nor with the EU's seven-year budget period (Multi-annual Financial Framework). The Parliament is of the opinion that this lack of alignment weakens management and has an adverse impact on the implementation of the strategies and priorities set out by the EU institutions. It also makes it difficult for the Commission to follow up on achievement of the Europe 2020 strategic objectives and other priorities.

Therefore, the Parliament calls for better alignment of the EU budget and the EU's overall strategies as implemented in the respective spending areas.

28. Building on this, the Parliament is concerned that climate-related spending of the EU budget was only 17.3% in 2015 and only 17.6% on average for the period 2014-2016. The EU has agreed on a 20% target of spending on climate-related actions, and the Parliament therefore calls attention to the fact that further efforts should be made to ensure that the EU meets the goal set at the UN Climate Change Conference in Paris in 2015.

29. Like the Court (item 17), the Parliament is also concerned about the significant backlog in the use of structural funds. The Parliament stresses that this backlog may potentially undermine the effectiveness of the European Structural and Investment Funds, because unclaimed payments, together with required national co-financing, account for 15% of total government expenditure in some Member States.

The Parliament calls on the Commission to use all available instruments to provide technical assistance and guidance to the Member States that are struggling to use appropriated funds. In that respect, the Parliament calls on the Commission and Member States to simplify administrative rules and procedures in order to facilitate access to the EU funds and ensure their effective use.

Shadow budgets
30. The Parliament points out that numerous financial mechanisms that support EU policies are not directly financed by the EU budget or recorded in the EU balance sheet, which has an adverse impact on transparency and democratic accountability. The financial mechanisms in question include the European Financial Stability Facility, the European Stability Mechanism, the European Investment Fund and the European Investment Bank. Significant funds are managed through these financial instruments that mainly provide loans, guarantees and various equity and risk-sharing instruments.

The Parliament does not believe there is enough information available for an assessment of what these instruments have achieved, and emphasises that a comprehensive evaluation of their performance and efficiency should be carried out. Overall, the Parliament urges the Commission to propose measures to make implementation of the EU budget clearer, simpler, more coherent and better equipped to ensure sufficient transparency, accountability, performance and public understanding of how EU policies are funded.

V. Rigsrevisionen’s audit of EU funds in Denmark

31. Four of the reports submitted by Rigsrevisionen to the Public Accounts Committee in 2016 addressed topics relating to the EU.

32. The report on the audit of the Danish government accounts for 2015 includes Rigsrevisionen’s opinion on the audit of EU funds in Denmark in 2015. The audit confirmed the correctness of the accounts and the legality and regularity of the underlying transactions. Three issues were emphasised in the report: inadequate control of grants for *Dansk Miljøteknologi* (Danish association of environmental technology businesses), irregularities in *Videncenter for Svineproduktion* (Danish pig research center) and the risk that inadequate control turns Denmark into an entry point for illegal import of goods. All three issues have been addressed and resolved by the Danish authorities concerned and were closed when the Public Accounts Committee discussed Rigsrevisionen’s follow-up memorandum to the report on the audit of the government accounts in January 2017.

33. Rigsrevisionen notes in the report on procurement under the Ministry of Culture that not all procurement transactions are executed by the institutions in compliance with relevant EU regulations. The government’s compliance with the EU directives was also addressed in the report on the Danish government’s tendering of IT operations and maintenance, and Rigsrevisionen notes that also in this area, several contracts are not tendered as prescribed in the regulations.

34. In the report on energy savings in the public sector, Rigsrevisionen examined whether the government meets the requirements of the EU directive concerning energy efficiency, which, with effect from 2014, induced the Danish government to commit to reducing energy consumption by 14% by 2020 compared with the level in 2006. Achievement of this target will ensure compliance with the target set in the EU directive. Rigsrevisionen concludes in the report that there is considerable risk that the government will not achieve the 14% target.

35. Rigsrevisionen will continue to keep the Public Accounts Committee updated on developments in the management and audit of EU funds, and we will retain our focus on how EU funds are managed in Denmark.

Lone Strøm