RIGSREVISIONEN

Memorandum to the Public Accounts Committee on the European Court of Auditors' Annual Report for 2012

December 2013

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The European Court of Auditors' Annual Report for 2012

10 December 2013

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SUMMARY

The audit report on the EU accounts for 2012 concludes that the EU's consolidated accounts are correct but that, like previous years, the underlying payments contain too many errors.

As in previous years Rigsrevisionen has chosen to inform the Public Accounts Committee about the outcome of the audit of the European Court of Auditors (the Court) in a factual memorandum. This memorandum gives an overview of the main conclusions of the Court's 2012 annual report.

In addition to the main conclusion regarding the accounts, Rigsrevisionen has chosen to highlight two areas in the Court's annual report that we find particularly important: one concerns financial corrections and recoveries and their influence on the final assessment of the error rate of the accounts; the other concerns the European Commission's (the Commission) work on results and impact.

The memorandum concludes with a briefing to the Public Accounts Committee about Rigsrevisionen's cooperation with the Court and the other Supreme Audit Institutions (SAIs) in the EU.

I. Introduction and purpose

1. The Court audits the EU's accounts and presented its 2012 annual report to the European Parliament (the Parliament) on 5 November 2013. On the same date the annual report was submitted to the national parliaments, including the Danish Folketing. The Public Accounts Committee also received a letter from Henrik Otbo, the Danish member of the Court of Auditors, with a briefing on the annual report. The annual report is accompanied by a communication in which the Court outlines the results of its audit of the EU's 2012 accounts.

2. The Commission and the individual Member States share the management of the bulk of EU expenditure. The Commission has overall responsibility for the correct implementation of the EU budget, whereas the Member States select and check eligible projects and pay funds to the final beneficiaries. This makes Member States co-responsible for managing EU funds.

3. In its annual report the Court focuses on the management of the total EU budget. Accordingly, the Court does not provide an overall assessment of EU fund management in the individual Member States. The Member State SAIs and the Court cooperate on an ongoing basis, but the Court does not directly apply the work of the individual SAIs in its audit, nor do the SAIs directly apply the Court's work.

4. In this report, Rigsrevisionen assesses the overall management of EU funds in Denmark, i.e. Denmark's receipts from and contributions to the EU. The report was considered by the Danish Public Accounts Committee at its meeting on 13 November 2013.

II. Main conclusions in the statement of assurance and the Court's annual report

5. The Court's 2012 annual report presents the results of its financial audit and a summary of the performance audit conducted. The Court's annual report forms part of the Parliament's and the Council of the European Union's (the Council) discharge procedure, which is the political assessment and approval of the Commission's and the other EU institutions' EU budget management. The Court's audit comprises EU revenue and expenditure. In 2012 revenue amounted to EUR 139.5 billion, equal to approx. DKK 1,040 billion, and expenditure amounted to EUR 138.6 billion, equal to approx. DKK 1,033 billion.

6. Based on its audit, the Court's main conclusion on the EU accounts is as follows:

> The EU's consolidated accounts are correct, but the Court issues an adverse opinion on the legality and regularity of the payments underlying the accounts.
>
> The Court estimates the error rate at 4.8% and thus concludes that payments are affected by a material level of error.

The Court has thus issued an unqualified statement of assurance on the reliability of the accounts for six consecutive years. However, the Court has also established that overall the supervisory and control systems are only partially effective in ensuring the legality and regularity of the payments underlying the accounts. The Court estimates the error rate at 4.8%, ie, 4.8% of the total amounts paid out of the EU budget in 2012 was not paid out in accordance with the rules.

7. The Court estimates that six out of seven of the EU's expenditure areas are affected by a material level of error. The areas most affected by errors are 'Rural development, environment, fisheries and health' (7.9% error rate) and 'Regional policy, energy and transport' (6.8%). No material errors were detected for the expenditure area 'Administrative and other expenditure' (0%), nor for 'EU revenue' (0%). An outline of the Court's estimate of the various expenditure areas is provided in appendix 1. The Court estimates the overall rate of error for shared management expenditure to be 5.3% whereas the error rate for direct management expenditure by the Commission is 4.3%.

Some of the commonest types of error are violation of public procurement rules, declaration of ineligible projects or costs and incorrect declaration of eligible agricultural areas.

Examples of errors identified by the Court are:

- failure to observe the public procurement requirement for assignments and awarding them directly to a supplier
- application for support for expenditure incurred before the eligibility period commenced
- support provided to agricultural areas identified as pastures are partly covered with rocks, forests or bushes
- agricultural areas for which financial support is sought are not accurately measured. This is often because the methods used to measure agricultural areas (eg, air photos) are not sufficiently accurate either.

In its annual report, the Court points out that in many cases the Member State authorities had enough information to detect and correct the errors.

8. The error rate dropped from 7.3% to 3.3% from 2006 to 2009 but is now increasing for the third consecutive year. For the financial year 2009, the Court thus estimated the error rate at 3.3%, for 2010 at 3.7%, for 2011 at 3.9% and now for 2012 at 4.8 %. The Court estimates that 0.3 percentage point of the increase from 2011 to 2012 reflects a change in the Court's sampling approach. The remaining 0.6 percentage point reflects an increase in number of errors compared with 2011.

9. In the annual report the Court identifies the areas with fewer or more errors than last year and the types of errors predominantly identified (see paragraph 7). A targeted effort by governments and the administration (in both the EU and the Member States) in the areas described by the Court in the annual report as subject to error will most likely cause the rate of error to drop. However, Rigsrevisionen is of the opinion that the Court's audit approach may make it difficult to identify the reason for the fluctuation in overall error rate from one year to the next other than the Court's identification of slightly higher or lower error numbers in its sample than the year before.

Rigsrevisionen is also of the opinion that annual report readers should be wary of considering the estimated annual error rate definitive. The internal EU expenditure controls are organised to take into account that support programmes form part of a seven-year financial framework period. This means that the expenditure incurred and the derived corrections are often only finally checked once the programmes have been completed. The Court addresses this issue in the annual report and Rigsrevisionen provides an explanation in section III. The Court's audit concerns the Commission's payments in any given year. Notably in the structural fund area these payments consist of reimbursed expenditure for Member State activities in previous years. This means first that many errors uncovered by the Court's audit are related to activities that took place in previous years but result in payments in the current financial year. Second, it means that the Court does not audit projects for which the Commission's payments have been suspended, for example, because of ineffective Member State control systems.

III. Financial corrections and recoveries

10. In its 2012 annual report, the Court includes a section on financial corrections and recoveries in which it explains how corrections and recoveries are taken into account and how they impact on the statement of assurance. Rigsrevisionen has chosen to include this theme in its memorandum because financial corrections and recoveries affect the Court's statement of assurance and the transparency of the EU's presentation of accounts. It also represents a subject-area strongly emphasised by the Commission as part of the discharge procedure for the financial years 2011 and 2012.

11. *Financial corrections* are applied in areas in which the Commission and the Member States share EU budget management and consist of excluding expenditure from Union funding if it is subsequently established that the expenditure was incurred irregularly. Exclusion means that the financing of the expenditure concerned passes from the EU budget to the national budgets, after which it is up to the national authorities to assess whether a basis exists for *recovering* the funds from the beneficiary.

12. Financial corrections result from the controls performed after EU funds have been disbursed. As an assumed element of the control system applied to the EU's multi-annual programming periods, financial corrections thus supplement the controls performed before payments are made.

In the annual report, the Court states that corrections of EUR 3.7 billion and recoveries of EUR 678 million, mainly relating to the period 2000-2006, were made in 2012.

13. In its audit, the Court takes financial corrections and recoveries into account to the extent they cause errors to be corrected individually, for example, by recoveries or detailed corrections at project level before the Court audit takes place. The error rate does not include these errors. However, the so-called flat-rate corrections, which do not remove irregular expenditure at project level, do not affect the Court's estimated error rate.

14. Flat-rate corrections come into play when irregular expenditure is due to non-compliance with public procurement rules or due to systematic irregularities, in which case it is seldom expedient or possible to correct the errors individually. Accordingly, the Commission has fixed a number of flat-rate percentages, which are used to correct the financial consequences of these errors and prevent the EU budget from co-financing irregular expenditure. The rates vary according to the seriousness of these irregularities and are fixed according to an administrative procedure between the Commission and the national authorities in accordance with sector-specific rules.

Rigsrevisionen's assessment

15. Rigsrevisionen finds that the Court's 4.8% error rate should not be considered a final determination of the extent to which the EU budget has financed irregular expenditure, because the rate does not reflect flat-rate corrections and because subsequent corrections may reduce the final error rate for a given year to a figure below that reported by the Court. The Court's own audit contributes to this inherently by identifying errors that become the subject of financial corrections later in the programme period.

16. Rigsrevisionen also finds that financial corrections and recoveries are mechanisms that contribute to ensuring that EU funds are only spent on expenditure incurred in compliance with the law. Accordingly, Rigsrevisionen finds it appropriate and justified that the Court addresses financial corrections and recoveries in the annual report.

Financial corrections are also intended to lead to improvements in the control systems concerned and avoid similar irregular expenditure in future. Although not directly addressing this issue, the Court's annual report does refer to two Court reports regarding the structural fund and agricultural areas which consider the impact of financial corrections (Special Reports Nos. 3/2012 and No. 7/2010).

17. Rigsrevisionen would like to urge the Court to include further information in future annual reports on the use and impact of financial corrections so that trends can be followed. Allowing readers to follow trends in both error rates and financial corrections could balance the Court's annual reporting.

18. Rigsrevisionen is currently examining the Danish authorities' handling of the financial correction risk and whether the Danish authorities ensure full repatriation of Denmark's share of the EU budget. A report on the examination is expected to be submitted to the Public Accounts Committee in autumn 2014.

IV. Increased focus on results and impact of EU funds

The Commission's annual reporting includes two products that are presented to the European Parliament: the Union's accounts, describing the budget implementation, and the evaluation report on the Union's finances based on the results achieved.

In addition, the individual Directorates General (DGs) prepare an annual activity report, in which the Director-General reports on the progress made in fulfilling the objectives set for the DG.

19. Rigsrevisionen believes that as much as reporting on the actual accounts is important, it is equally important to report on the impact and results achieved from public money. Because the Court does focus particularly on this field in its annual report, we have chosen to highlight this area in the memorandum.

20. Together with the Court's audit reports, the EU accounts and the Commission's evaluation report form part of the basis for the Parliament's discharge. The Parliament is of the opinion that there is still room to improve the Commission's reporting, and in last year's discharge resolution the Parliament stressed its gratification at the Court's increased focus on the results and impact achieved by the Commission.

21. In the annual report the Court gives an account of its review of the Commission's performance reporting and in this connection levels some criticism at the Commission's work on performance (ie, results and impact). The Court of Auditors has presented two recommendations to the Commission:

> 'The Commission and the legislator should ensure that there is a focus on performance in the forthcoming programming period (2014-2020). This requires that a limited number of sufficiently specific objectives with relevant indicators, expected results and impacts are laid down in the sector-specific regulations or in some other binding manner.
>
> The Commission should ensure that there is a clear link between the DGs' activities and the objectives set. When identifying these objectives each DG should take into account the relevant management mode, where applicable, and its role and responsibilities.'
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> Source: European Court of Auditors' Annual Report for 2012.

The Court finds that in its reporting the Commission should also increase focus on what the EU funds have been used for and the results thus achieved rather than place the entire emphasis on whether the EU funds have been spent and managed according to the rules, which is the current main focus. In this connection the Court explains why it is particularly important that the Commission also focuses on performance. In several expenditure areas funds are pre-allocated to individual Member States in connection with the adoption of the multi-annual financial framework, such as, for example, the 'Rural development' and 'Regional competitiveness and employment' areas. Once the funds have been pre-allocated to Member States, spending the money rather than ensuring good results and optimum impact may become a more important goal. According to the Court, this makes Commission focus on ensuring good performance particularly critical.

22. In a report from its Budgetary Control Committee (17 September 2013), the Parliament criticises the Commission's evaluation report, which the Parliament believes can be improved in several respects. The Parliament finds it gratifying that the Treaty now obliges the Commission to prepare an annual evaluation report, the third edition of which is now available. However, the Parliament does not yet consider the evaluation report to entirely fulfil its role, ie, the report summarises the results achieved by individual DGs rather than focuses on the Commission's work on the overall policy objectives such as, for example, the Europe 2020 strategy. In the annual report, the Court agrees in this point of view.

23. The activity reports of the DGs represent another area in which the Court believes the Commission's work on performance can be improved. The Court finds it problematic that the objectives included in the management plans and activity reports of the individual DGs have often been taken directly from legal texts or high level policy documents. These objectives are worded in terms so general that their management relevance for the individual DGs is potentially negligible. In addition, Member States are co-responsible for EU funds creating results and impact in areas of shared management and for reporting correctly about this to the Commission.

Consequently, the activities of a single DG will therefore often be insufficient to fulfil the overall objective, or it may be impossible to fulfil the objective within the time frame covered by the activity reports. This means the DGs can disclaim responsibility for unachieved objectives, explaining this by stating that target achievement depends on factors beyond their control. In this way, management by objectives can lose its practical relevance. Both the Court and the Parliament point out to the Commission that the activity reports of the individual DGs should focus on the results accomplished by each DG.

24. In previous years the Court highlighted the weaknesses of the Commission's and the DGs' work on performance, but highlights this area particularly this year because the next multi-annual financial framework (MFF) runs from 2014 to 2020. In connection with the forthcoming MFF, the Court urges the Commission to re-think its reporting and accountability systems so they focus on both compliance and performance. In addition to making the objectives relevant for managing the activities, the Court also stresses that the Commission should make a point of ensuring that the performance data it generates itself or obtains from Member States or third parties are reliable and timely.

Rigsrevisionen's assessment

25. Rigsrevisionen has chosen to highlight performance in this year's memorandum on the Court's annual report because the Public Accounts Committee previously had this subject on its agenda, most recently in connection with its inspection trip to Luxembourg and Brussels in autumn 2013. We also expect the work on the results and impact of EU funds to become a theme at the Public Accounts Committee's dialogue meeting with the Folketing's Finance Committee and European Affairs Committee in January 2014. In light of this, Rigsrevisionen finds it relevant to clarify the issues associated with the concept of performance.

26. Rigsrevisionen finds the Court's conclusion that the Commission must focus more on performance particularly important. The considerations of transparency and citizen interest make it crucial to shift focus from whether the money is spent and spent according to the rules to what the money is spent on and the results generated by the money.

For the same reason, in Rigsrevisionen's most recent report on the audit of EU funding in Denmark in 2012, we did indeed focus on the impact management of EU funds and recommended how Danish authorities can improve the impact management of EU funding.

27. Rigsrevisionen agrees with the Court that focusing on this area is particularly important right now because the next multi-annual financial framework starts in 2014. Rigsrevisionen calls on politicians and the administration to focus on this area during the period 2014 to 2020 to obtain optimum results from the Union funds. In Rigsrevisionen's opinion the current and previous multi-annual financial framework periods have tended to focus on spending EU funds rather than ensuring that the funds were reasonably and prudently spent and produced good results. Rigsrevisionen therefore welcomes extra focus on this in the framework period 2014-2020.

V. Developing cooperation on the audit of EU funds

28. In the EU Contact Committee Rigsrevisionen cooperates with the SAIs of the other Member States about the audit of EU funding. In this context the SAIs discuss common issues and exchange knowledge and experience in networks, working groups and through joint audits. In recent years the financial and economic crisis and developments in the financial and economic field in the EU have been the primary focus for this cooperation.

EPSAS (European Public Sector Accounting Standards)

29. Rigsrevisionen previously informed the Public Accounts Committee about the Commission's ambition to create a single set of public sector accounting standards in the EU, named EPSAS. The work has not yet been completed and no final decisions in the area taken, but the points below summarise events since the last briefing.

30. Although no final decision has been made, in early 2014 the Commission is expected to propose the introduction of harmonised public sector accounting standards in the EU. The Commission expects to start preparing the standards in early 2015, after which they will be implemented in stages. The goal is to implement a full set of standards in the EU by 2020.

31. The EPSAS, the new accounting standards, will be drafted on the basis of the IPSAS (International Public Sector Accounting Standards). On the basis of the findings of a major survey, the Commission believes the IPSAS must be adapted to European conditions. The IPSAS are based on international accounting standards for private companies and their approach to the presentation of accounts thus differs from that of the state, where the primary purpose of the accounts is to check whether appropriations are met. The IPSAS assume accrual-based accounting principles in all areas, which is problematic for a number of significant state revenue and expenditure areas, which are accounted for according to cash-based principles, such as, for example, tax revenue and statutory transfers.

The desire to introduce harmonised European accounting standards derives from the fact that Member States currently apply widely different principles to the presentation of their accounts. This makes it difficult for the Commission to compare individual Member States' accounts with the statistical computations prepared for assessing excessive public deficits – the so-called Excessive Deficit Procedure (EDP), which is a part of the Stability and Growth Pact. The Commission applies these computations to monitor developments in Member State budgets and public debt and to check compliance with the convergence criteria.

32. Rigsrevisionen follows the work on the EPSAS through the EU Contact Committee and the State Accounting Board and will keep the Public Accounts Committee regularly updated on developments in the area.

Audit of crisis initiatives

33. The EU Contact Committee focuses keenly on securing adequate auditing of the initiatives taken as a result of the financial crisis. The purpose is to contribute to ensuring that EU and Member State funding become subject to adequate administration and auditing and to ensure transparency in the management of national and EU funding. Within the framework of the EU Contact Committee the national SAIs work together with the Court to create a mechanism that can improve monitoring of the accounting and auditing area in the EU and ensure that the SAIs contribute where relevant.

34. A particular focus area at present is the creation of the Banking Union. In connection with establishing a single supervisory mechanism in the EU, the heads of the EU SAIs believe it is important to ensure that the banks in the EU are subject to adequate supervision and that the supervisory mechanism and related measures are transparent and subject to adequate public auditing. In this connection the Danish Auditor General made a presentation at the most recent EU Contact Committee meeting in October 2013 on Rigsrevisionen's three reports relating to the financial crisis: report 14/2008 on the Danish Financial Supervisory Authority's activities in relation to Roskilde Bank A/S, report no. 1/2011 on the issue of an individual government guarantee to Amagerbanken A/S and report no. 12/2011 on the Financial Stability Company.

Lone Strøm

APPENDIX 1

Results of the Court's audit

The distribution of the bulk of EU expenditure and revenue in 2011	EUR billion 2012	Error rate 2011	Error rate 2012	Assessment of the supervisory and control systems	Conclusion
Agriculture: market and direct support	44.5	2.9%	3.8%	**Partially effective**	**Affected by a material level of error**
Regional policy, energy and transport	40.7	6.0%	6.8%	**Partially effective**	**Affected by a material level of error**
Rural development, environment, fisheries and health	15.0	7.7%	7.9%	**Partially effective**	**Affected by a material level of error**
Employment and social affairs	13.4	2.2%	3.2%	**Partially effective**	**Affected by a material level of error**
Research and other internal policies	10.7	3.0%	3.9%	**Partially effective**	**Affected by a material level of error**
External relations, aid and enlargement	6.6	1.1%	3.3%	**Partially effective**	**Affected by a material level of error**
Administrative and other expenditure	10.0	0.1%	0%	Effective	Free from material error
Total audited expenditure	**140.9**	**3.9%**	**4.8%**	**Partially effective**	**Affected by a material level of error**
Revenue	130.0	0.8%	0%	Effective	Free from material error

Note: The supervisory and control systems are considered effective, if the error rate is below 2%.

Source: European Court of Auditors' 2012 Annual Report and its communication on the 2012 annual reports.