



Memorandum to the Public Accounts  
Committee on the European Court of  
Auditors' Annual Report for 2010

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**The European Court of Auditors' Annual Report for 2010**

30 November 2011

RN SEKR03/11

**I. Introduction**

1. In this memorandum I will inform the Public Accounts Committee of the European Court of Auditors' annual report and statement of assurance regarding the annual accounts of the European Union. On 10 November 2011, the European Court of Auditors (ECA) presented its annual report and statement of assurance for the financial year 2010. On the same date the annual report was submitted to the national parliaments, including the Danish Folketing and the Folketing's European Affairs Committee. The Public Accounts Committee and Rigsrevisionen have also received a memorandum from the Danish member of ECA, Morten Levysøhn, in which he gives a briefing on the most important elements of the annual report.

2. ECA is the EU's external auditor responsible for the audit of the EU accounts and for presenting an annual report on the implementation of the EU budget and a statement of assurance regarding the EU accounts. In the EU, the European Commission ('the Commission') has overall responsibility for implementing the EU budget. Consequently, ECA's annual report focuses on the Commission's management of the EU budget and does not assess the management of EU funds in the individual Member States. The Member States' supreme audit institutions and ECA cooperate on an overall level, but ECA does not directly apply the work of the individual supreme audit institutions in its audit.

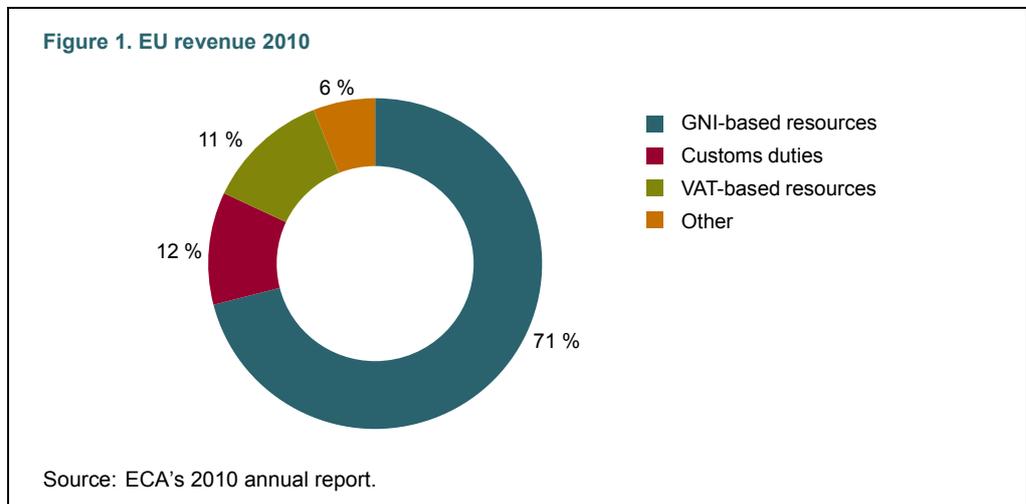
3. At its meeting on 16 November 2011, the Public Accounts Committee considered report no. 15/2010 on the audit of EU funds in Denmark in 2010. The report deals with the management of EU funds in Denmark, ie, Denmark's receipts from and contributions to the EU. In the report, Rigsrevisionen assessed the management of EU funds in Denmark.

4. In this memorandum I will inform the Public Accounts Committee of selected parts of ECA's annual report, including the statement of assurance and the main conclusions. Initially the memorandum provides an outline of EU revenue and expenditure to form the basis of my subsequent briefing on ECA's annual report and statement of assurance for 2010. To conclude the memorandum, I will inform the Public Accounts Committee about the most recent developments in the cooperation on auditing in the EU and briefly comment on the annual report and the development of the cooperation.

## II. EU revenue and expenditure 2010

### EU revenue 2010

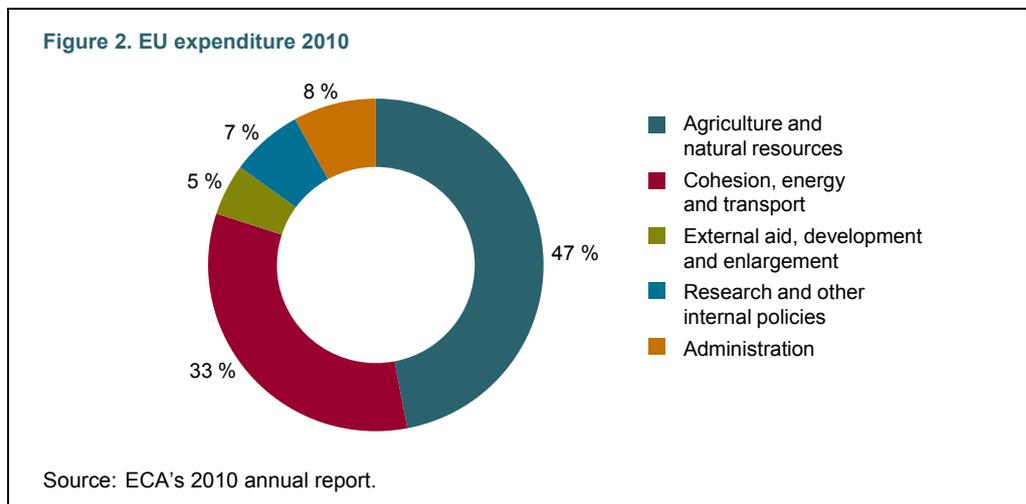
5. In 2010, EU revenue totalled EUR 127.8 billion, equal to DKK 951 billion. Revenue broken down by source is set out in Figure 1.



According to Figure 1, the bulk of the EU revenue is GNI-based resources calculated as a fixed percentage of gross national income (GNI), while the second and third largest sources of revenue are customs duties and a share of the national VAT revenue.

### EU expenditure 2010

6. In 2010, EU expenditure totalled EUR 122.2 billion, equal to DKK 904 billion. Expenditure broken down by policy area is set out in Figure 2.



According to Figure 2, just under half of EU's expenditure goes towards the policy area 'Agriculture and natural resources', representing largely common agricultural policy (CAP) expenditure and rural development aid. The second largest area is 'Cohesion, energy and transport', representing the EU's structural policies (the European Regional Development Fund, the European Social Fund, etc) and the development of the energy and transport systems in the EU.

7. The policy areas 'Agriculture and natural resources' and 'Cohesion, energy and transport' together account for approx. 80% of EU expenditure.

The Commission and individual Member States share the management of the bulk of this expenditure (shared management). The Commission has overall responsibility for the correct implementation of the budget, whereas the Member States select and check eligible projects and pay funds to the final beneficiaries.

### III. ECA's 2010 annual report and statement of assurance

#### ECA's audit approach

8. On 10 November 2011 ECA presented its annual report and statement of assurance for the financial year 2010 to the European Parliament ('the Parliament') and the Council. ECA's 2010 annual report presents the results of ECA's financial audit and a summary of the performance audit conducted.

9. ECA's annual report forms part of the Parliament's and the Council's discharge procedure, which is a political assessment and approval of the management of the EU budget by the Commission and other EU institutions. The annual report has included a statement of assurance (DAS from the French *Déclaration d'Assurance*) since 1994. The DAS includes ECA's overall opinion on:

- whether the EU accounts provide complete and accurate information, that is, information about whether the accounting procedures operate as required, whether the accounting data are complete and have been correctly recorded and whether they are appropriately presented in the annual accounts
- whether EU revenue, commitments and payment transactions on which the EU accounts are based comply with applicable rules, ie, whether the systems and controls applied to payments and administration operate as required.

10. ECA applies the so-called DAS approach, whose key element is an assurance model indicating the level of assurance that can be achieved from the following two principal sources:

- *Systems-based auditing* of the supervisory and control systems applied by the Commission, Member States and Third Countries to examine whether the systems function as intended to prevent or identify and correct errors in connection with the collection and disbursement of EU funds.
- *Substantive auditing* of payments made to and by the Commission which ECA selects through a random representative sample of transactions. Transactions to be checked are selected by ECA's special sampling method – the so-called monetary unit sampling that identifies and checks individual payments down to the level of the final beneficiary, often through on-the-spot audit visits.

In its audits, ECA supplements these sources with analyses of the Commission's management statements and may moreover include the work of other auditors.

11. ECA's statement of assurance is divided into two main parts: the reliability of the accounts and the legality and regularity of the transactions. ECA's conclusions and key elements of these two main parts are presented below.

**ECA's 2010 statement of assurance – reliability of the accounts**

12. Based on the audit of the EU's accounts, ECA concludes that:

- The 2010 annual accounts of the European Union present fairly the financial position of the Union and the results of its operations and cash flows for the financial year under review.

Accordingly, for the fourth consecutive year, ECA has issued an unqualified statement of assurance on the reliability of the accounts.

13. However, ECA has inserted an emphasis of matter paragraph regarding the change in the Commission's accounting policy concerning pre-financing payments. The Commission has made a correction of EUR 4.8 billion in the 2010 accounts which does not, however, have any impact on ECA's statement of assurance regarding the 2010 accounts.

ECA points out that this is not merely an accounting problem, but that the accounting practice applied limits the Commission's ability to effectively supervise and manage pre-financing payments. Over the past six years, the gross recorded value of accumulated pre-financing payments has increased from EUR 39 billion to EUR 84 billion. Consequently, ECA finds that the Commission urgently needs to reconsider this accounting rule and improve management in this area.

The Commission has also corrected the 2009 accounts in respect of which ECA also issued an unqualified statement of assurance.

**ECA's 2010 statement of assurance – legality and regularity of the underlying transactions**

14. ECA's statement of assurance regarding the legality and regularity of the transactions is divided into three main parts: revenue, commitments and payments. On the basis of the audit of the EU's accounts, ECA concludes that:

- the revenue underlying the EU's 2010 annual accounts is legal and regular in all material respects
- the commitments underlying the EU's 2010 annual accounts are legal and regular in all material respects
- the payments underlying the EU's 2010 annual accounts are materially affected by errors.

15. The reason for the adverse opinion on the legality and regularity of the payments is that generally ECA considers the supervisory and control systems to be only partially effective in ensuring the legality and regularity of payments underlying the accounts. ECA estimates the most likely aggregate error rate for the payments to be 3.7 per cent.

An error rate of 3.7 per cent thus reflects a slight increase in the error rate since the 2009 financial year when ECA estimated the error rate at 3.3 per cent. The increase is accounted for by a higher error rate in the policy area 'Cohesion, energy and transport'. Estimated error rates in the other policy areas are thus relatively unchanged.

16. Table 1 shows the distribution of the bulk of EU expenditure and revenue for 2010 and ECA's assessment of error rates and of the legality and regularity of the management of funds.

**Table 1. ECA's audit findings**

Distribution of EU expenditure and revenue in 2010	Error rate	EUR billion <sup>1)</sup>	Supervisory and control systems	Conclusion
Agriculture and natural resources	2.3%	56.0	Partially effective	Materially affected by errors
Cohesion, energy and transport	7.7%	37.6	Partially effective	
External aid, development and enlargement	1.7%	6.5	Partially effective	Overall without material errors, but interim and final payments were subject to material errors
Research and other internal policies	1.4%	9.0	Partially effective	
Administrative and other expenditure	0.4%	9.2	Effective	Without material errors
Revenue	0.0%	127.8	Effective	

<sup>1)</sup> ECA has not included pre-financing payments in this table. Accordingly, the figures are not identical to the outline of total EU expenditure in Figure 2.

Source: ECA's 2010 annual report and communication regarding the 2010 annual reports.

It appears from table 1 that four of six areas are without material errors. However, the areas 'Administrative and other expenditure' and 'Revenue' are the only two in which no material errors were identified and in which the supervisory and control systems function effectively. No material errors were detected in the areas 'Research and other internal policies' and 'External aid, development and enlargement', but ECA considers the supervisory and control systems to be only partially effective.

17. As appears from the table, 'Agriculture and natural resources' is the largest policy area in the EU. ECA characterizes the area as being materially affected by errors with an error rate of 2.3 and concludes that the supervisory and control systems are at best partially effective. The principal source of error is recipients' over-declaration of eligible land.

All Member States now apply the integrated administration and control system (IACS) to ensure correct disbursement of agricultural subsidies. ECA notes that the EUR 39.7 billion in direct payments covered by the IACS has no material errors. ECA notes a particular tendency towards errors in rural development expenditure again this year.

ECA recommends improving the controls and reporting performed by the national authorities and standardizing the aerial photos used to determine the size of agricultural parcels.

18. 'Cohesion, energy and transport' is the second-largest EU policy area. Over the years, ECA has documented very high error rates for this area. ECA estimates the error rate for 2010 to have increased to 7.7 per cent.

The sub-area 'Cohesion' accounts for more than 90 per cent of the expenditure for the policy area 'Cohesion, energy and transport'. The management of this sub-area is shared by the Commission and the Member States (shared management). ECA finds that the Member States have enough information at their disposal to enable them to correct at least some of the errors identified by ECA. Of the payments audited 3% were made to projects that were non-eligible, and these projects account for more than one-third of the total estimated error rate. In addition, ECA has identified non-compliance with the public procurement rules and declaration of non-eligible costs. However, ECA points out that the bulk of the estimated error rate is accounted for by a relatively small number of projects.

ECA recommends improving the control of this sub-area to ensure compliance with public procurement and public subsidy rules. It should also be assessed whether certain rules could be simplified. In addition, ECA urges national authorities to improve the certification of expenditure for payment before submitting such expenditure to the Commission for payment.

19. Denmark is mentioned in ECA's 2010 annual report in key tables on EU revenue and expenditure and in a table according to which Denmark had nine VAT reservations at 31 December 2010, an increase of four over 2009. Other than that, Denmark is not mentioned specifically in the annual report. ECA's conclusions focus on the accounts of the European Union as a whole and on the Commission's administration. Consequently, ECA's general conclusions may well encompass management in Denmark even if this is not mentioned specifically.

#### **ECA's performance audits**

20. In 2010 ECA added a new chapter to its annual report presenting its observations on the self-assessment of performance by the Commission's Directors-General. In addition, the chapter summarizes the main results of the performance audits conducted by ECA. However, ECA's performance audits are still primarily reported in special reports issued on an on-going basis. ECA issued 14 special reports in 2010.

Overall, ECA recommends improving performance management. Objectives, indicators and targets should focus not only on effectiveness but also on economy and efficiency. In addition, ECA recommends that target achievements be analysed more closely and that interim milestones for multiyear targets are increasingly defined to enable closer follow-up on target achievement. ECA also points out that in its audit observations it urges the managers responsible to improve internal control systems and performance monitoring.

#### **IV. Developing cooperation on EU audits**

##### **Impact of the crisis on the supreme audit institutions and ECA**

21. At the annual Contact Committee meeting between the supreme audit institutions in the EU and ECA in October, the financial and debt crisis in the EU was on the agenda. The main purpose of the meeting was to discuss the impact of the crisis on the audits of the supreme audit institutions and ECA, including the various EU crisis initiatives, notably the closer finance policy coordination during the so-called 'European Semester' and the European Stability Mechanism (ESM), the new permanent crisis fund.

22. The crisis has once more accentuated the mutual dependency of Member State economies. The Contact Committee therefore decided to intensify cooperation between the supreme audit institutions, in part through better sharing of the knowledge and experience gained from auditing government crisis initiatives, eg, growth initiatives and bail-outs for financial institutions, and by conducting more parallel and coordinated audits.

23. The Contact Committee meeting also discussed whether an 'audit deficit' exists in the crisis management initiatives taken by the EU. The treaty on the establishment of the ESM, which is expected to dispose of an effective loan capital of EUR 500 billion from 1 July 2013, does not include a requirement for public auditing of its activities.

24. Consequently, the Contact Committee adopted a statement on behalf of all EU supreme audit institutions and ECA, urging EU institutions and Member State governments and parliaments to ensure appropriate public auditing of new EU crisis initiatives, including the ESM, and urging supreme audit institutions to increase cooperation and knowledge sharing in this field.

25. The statement by the Contact Committee elaborates further on another separate statement adopted by the supreme audit institutions of the eurozone, recommending that the ESM legislation include provisions on public auditing, including performance auditing. The Contact Committee also agreed on a resolution that refers to and acknowledges this statement. Box 1 outlines the statements adopted and the resolution.

**BOX 1. STATEMENTS AND DECISION TO ENSURE PUBLIC AUDITING OF NEW EU CRISIS INITIATIVES**

- *Statement* adopted by the eurozone supreme audit institutions, recommending that the ESM legislation includes provisions on public auditing, including performance auditing.
- *Statement* adopted by the Contact Committee to ensure appropriate public auditing of new EU crisis initiatives, including ESM, and urging the supreme audit institutions to cooperate more closely and increase knowledge sharing.
- *Resolution* adopted by the Contact Committee referring to and acknowledging the statement by the eurozone supreme audit institutions.

After the meeting, the President of ECA forwarded the Contact Committee's statement and resolution to the European Parliament, the Council, the Commission and Member State parliaments and governments, including the Speaker of the Danish Folketing and the Danish Prime Minister.

26. The eurozone supreme audit institutions have subsequently agreed on a concrete proposed change of the Treaty establishing the ESM. According to the proposed change, the accounts of the ESM must be audited by independent external auditors, and an audit board to consist of auditors from minimum three supreme audit institutions or ECA must be set up. The audit board must monitor the ESM's internal and external auditors and conduct its own audits of ESM activities, including compliance audits, performance audits and risk-management audits. At its meeting on 8 November 2011 the finance ministers of the Economic and Financial Affairs Council (ECOFIN) discussed a provisional draft treaty.

27. The Contact Committee meeting also decided to launch an investigation into whether other audit deficits exist in the Member States and in connection with the new EU crisis initiatives.

28. I informed the Contact Committee meeting about the work on the financial crisis carried out by Rigsrevisionen which to date has resulted in report no. 14/2008 about the Danish Financial Supervisory Authority's activities in relation to Roskilde Bank A/S and report no. 1/2011 on the issue of an individual government guarantee to Amagerbanken A/S.

I believe it is crucial for the European Union's supreme audit institutions to help their countries and the Union emerge from the crisis. I therefore called for enhanced cooperation and exchange of experience on the audit of the crisis initiatives taken in the EU and the Member States and accordingly, I fully supported the Contact Committee's statement concerning intensified cooperation. Because ECA holds a central position in the EU's institutional framework, as well as having vast knowledge and an extensive network within the EU, I find it natural for ECA to assume a leading role in this context.

### **Cooperation between supreme audit institutions, Eurostat and national statistical institutions**

29. Moreover, at the Contact Committee meeting, the Director-General of Eurostat, the statistical office of the European Union, advocated the need to enhance the quality and reliability of national statistics – exemplified by Greece whose statistics on the general government budget deficit and debt appeared to be misleading. In this connection Eurostat called for cooperation in order to strengthen the work of both the supreme audit institutions and Eurostat.

30. At the Contact Committee meeting it was decided to set up a task force chaired by Rigsrevisionen and the Polish supreme audit institution to explore the possibilities for cooperation between the supreme audit institutions, Eurostat and the national statistical offices.

31. I have therefore initiated discussions with Statistics Denmark, the Danish national statistical institution, about potential areas of cooperation and whether it can contribute to the work of the task force. I look forward to this cooperation which will hopefully benefit Rigsrevisionen, Statistics Denmark, Eurostat and the other supreme audit institutions of the European Union.

### **Rigsrevisionen's seminar on EU audits**

32. On 2-3 February 2012, Rigsrevisionen will be hosting a seminar on EU audits. The seminar is targeted at auditors experienced in EU audits from all supreme audit institutions in the EU and ECA. The main part of the seminar will be devoted to a workshop at which ideas and experience on risk assessment and audit strategies for auditing CAP funds can be exchanged. The seminar will also focus on the most recent developments in EU fund management and regulation and on the EU declarations and opinions issued in Great Britain, Sweden, the Netherlands and Denmark.

## **V. Conclusion**

33. I have noted that for the fourth year running, ECA has issued an unqualified statement of assurance on the reliability of the accounts. ECA finds that the management of the overall EU budget has generally improved again this year. I have also noted that ECA points out that in general the control systems are significantly more effective.

34. However, I have also noted that certain policy areas are still by ECA considered materially affected by errors and that the overall error rate has increased slightly, which is primarily accounted for by an increase in the area 'Cohesion, energy and transport'. ECA considers the error rate in this area and in 'Agriculture and natural resources' to be above the acceptable level also this year. Overall, I have ascertained that ECA has given adverse opinions on several significant policy areas for the 17th consecutive year.

35. In the policy area 'Agriculture and natural resources' ECA concludes that the principal source of error is overstatement of eligible land. Rigsrevisionen has addressed the Danish authorities' area control in its most recent report no. 5/2010 on the audit of EU funds in Denmark in 2010 and inserted an emphasis of matter section in its opinion.

36. In my opinion, ECA's annual report is developing in a positive direction; this year ECA presented its observations on performance in an extra chapter to the annual report, which allows a more comprehensive assessment of financial performance and management of EU funds.

37. It is my opinion that if ECA chose to apply the extensive audit work performed by several supreme audit institutions in the Member States, it would consolidate ECA's audits. The supreme audit institutions have comprehensive knowledge of the organisation and practice of national administrations which ECA could profit by in its audits.

38. The financial and debt crisis has led to a wealth of initiatives in the EU, notably closer finance policy coordination between Member States and the establishment of various crisis management mechanisms, including the ESM, for the eurozone in particular. EU's supreme audit institutions and ECA follow this development closely.

I am convinced that the supreme audit institutions of the European Union and ECA can make an important contribution to help their countries and the Union emerge from the crisis. To reinforce this contribution the supreme audit institutions and ECA have decided to intensify cooperation and knowledge-sharing.

I will keep the Public Accounts Committee informed of the outcome of the Parliament's discharge procedure in a memorandum which I expect to issue in the course of spring 2012.

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Henrik Otbo