



Memorandum to the Danish Public  
Accounts Committee on the European  
Court of Auditors' Annual Report and  
Statement of Assurance for the Financial  
Year 2006

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**The European Court of Auditors' Annual Report and Statement of Assurance for the Financial Year 2006**

5 December 2007

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**Translation****I. Introduction and the Court's Audit Method**

1. On 13 November 2007, the European Court of Auditors (the Court) issued its Annual Report and Statement of Assurance for the financial year 2006. In this memorandum I shall inform the Public Accounts Committee of the Court's Annual Report including the Statement of Assurance and the areas in which the Court has expressed its reservations. I shall also refer to the Court's comments on the European Commission's (the Commission) internal controls, and the Court's reference to Denmark in the Annual Report and in one of the special reports. Finally, I shall inform the Public Accounts Committee of the Court's observations on national declarations and my comments on the subject.

2. The Court's Annual Report presents the results of the Court's financial audit. The results of the Court's performance audit are published in separate special reports in the course of the year. Since publication of the previous Annual Report, the Court has issued the following eight special reports on the results of the performance audit conducted in 2007:

No.	Title
11/2006	Community Transit System
1/2007	Implementation of the Mid-term Processes on the Structural Funds 2000-2006
2/2007	Institutions' Expenditure on Buildings
3/2007	Management of the European Refugee Fund (2000-2004)
4/2007	Physical and Substitution Checks on Export Refund Consignments
5/2007	The Commission's Management of the CARDS Programme
6/2007	Effectiveness of Technical Assistance in the Context of Capacity Development
7/2007	Control, Inspection and Sanction Systems Relating to the Rules on Conservation of Community Fisheries Resources.

3. The Court's submission of the Annual Report is the first step of the European Parliament's (the Parliament) discharge procedure which is a political assessment and approval of the Commission's management of the EU funds. This year's Annual Report is the 30th issued by the Court. Since 1994, the Annual Report has also included a Statement of Assurance (Déclaration d'Assurance or DAS). The Statement of Assurance includes the Court's overall opinion concerning the EU's income and expenditure:

- Are the Commission's accounts reliable.
- The legality and regularity of underlying transactions.

4. The audit methodology applied by the Court is called DAS and in the course of 2007, this method was further developed and adapted to ensure that the core element of the DAS approach is an assurance model, based on two principal sources of evidence:

- *Systems based audit* of the supervisory and control systems applied by the Commission, Member States and Third Countries. The purpose is to examine whether the systems function as intended and prevent, detect and correct errors in relation to collection and disbursement of EU funds.
- *Substantive audit* of payments made to and by the Commission which the Court checks down to the level of the final beneficiary.

To achieve further assurance concerning the legality of collection and disbursement of EU's funds, the Court may apply two complementing sources: 1. The Annual Activity Reports and declarations on internal control which are prepared by the Commission's Directors-General. 2. An examination of the work of other auditors, e.g. the national supreme audit institutions' audits of EU funds.

## II. The Court's Statement of Assurance 2006

5. The key elements of the Court's Statement of Assurance, which is based on the audit of the EU budget for 2006, are:

- With the exception of a number of errors identified in the Commission's accounting system, the final annual accounts of the European Communities' for 2006 present fairly, in all material respects, the financial position of the Communities.
- The Court has identified significant errors in expenditure payments and the Court has reservations concerning CAP, structural measures, internal policies, and external actions.
- With the exception of the SAPARD Programme, revenue, commitments, administrative payments, and the pre-accession strategy are all free from material error. Moreover, the Court found a low level of errors within transactions related to external actions which are managed and controlled by the Commission,

Rigsrevisionen notes that the Court has now for thirteen years in a row issued a qualified Statement of Assurance, i.e. the Court has had reservations about the financial accounts.

6. The Court's Statement of Assurance for 2006 is qualified within most EU expenditure areas of which the largest are CAP and structural measures. However, with respect to CAP, the Court finds that the level of error within underlying transactions has been markedly reduced since 2006. In 2006, the European Communities' overall expenditure amounted to 106.6 billion euro. Close to half of this amount went to CAP and the second largest amount on the budget went to structural measures.

**Table 1. Overview of the Court's reservations concerning the 2006 EU expenditure**

EU expenditure 2006	Billions euro	Statement of Assurance 2006
Common agricultural policy	49.8	Qualified
Structural measures	32.4	Qualified
Internal policies	9.0	Qualified
Administration	6.7	Unqualified
External actions	5.2	Predominantly qualified
Pre-accession strategy	2.3	Predominantly unqualified

Source: The Court's Annual Report for 2006.

7. Disbursements to the final beneficiaries within CAP and structural measures are implemented by the Member States' Paying Agencies on behalf of the Commission. This management form is called shared management. At present, 76 % of all EU funds are implemented by Member States under shared management. About 22 % of funds are managed by the Commission and the balance is managed by international organisations or third countries.

8. The Court has reservations within CAP and structural policies, which are both under shared management, and within internal policies and external actions, which are both under direct management by the Commission. The Court emphasises that not only the Member States are under obligation to ensure adequate controls, but the Commission should lead by example and be particularly careful in establishing its own internal control systems and make sure that they are effectively applied in the expenditure areas under direct management, i.e. internal policies and external actions.

### III. The Court's Comments on CAP Expenditure

9. Expenditure for CAP accounts for the largest part of the budget, and the Court notes a marked reduction in the estimated overall level of error in underlying transactions compared to 2005. However, the level of error remains just above the materiality threshold of 2 % which the Court considers acceptable. The Court is of the opinion that the improvement in the agricultural area may be ascribed to the integrated administrative and control system (IFKS), which covers some 70 % of total CAP expenditure. The Court finds that the system, where properly applied, is effective in reducing undue payments. According to the Court, the implementation of the Single Payment Scheme (SPS) in 2005 is another possible explanation for the improvement. Under the SPS farmers are not paid on the basis of what they produce, the land they own or the number of animals they keep. Beneficiaries are now required to maintain their land in good agricultural and environmental condition and comply with the various standards covering public, animal, and plant health, the environment and animal welfare.

10. The Court finds that measures under rural development are prone to a higher incidence of errors than other parts of CAP. The Court is of the opinion that the level of errors may be related to the often complex eligibility conditions. The Court's audit revealed more errors within agri-environmental measures, because farmers had difficulties understanding and complying with the eligibility conditions. The Court recommends that the Commission considers the relevance of the complex eligibility conditions within the agri-environmental area.

#### **IV. The Courts Comments on the Administration of Structural Policy Expenditure**

11. The objective of EU's structural policies is to reduce the developmental disparities between the regions within EU. The expenditure related to these policies accounts for the second largest part of the Community budget. The Court establishes that structural policies will continue to be major policies of the European Union. According to the Court's audit, the effectiveness of the Commission's and the Member States' control systems is unsatisfactory. There is high risk that declared costs of structural policies projects are misstated or ineligible for reimbursement. The Court is reasonably confident that in the budget year 2006 at least 12 % of the total amount reimbursed to structural policies projects should not have been reimbursed.

12. The Court recommends that the Member States seek to prevent errors from occurring by working with the project promoters at the start of each project. The Member States should also provide their staff with training and guidance on the tasks required for reviewing and assessing projects. The Court goes on to recommend that the Commission should focus its audit and supervisory efforts on the operations of the Managing Authorities in the Member States. The Court points out that the Commission should review the reporting of weaknesses and errors and identify whether the action taken is sufficient to address the immediate and future consequences of the issue.

13. As with the CAP expenditure, the Court emphasises that the audit revealed that unclear eligibility criteria or complex legal requirements may have a considerable impact on the legality and regularity of the underlying transactions.

14. The Court recommends that the Commission actively encourages and facilitates the use of the simplifications provided for in the new structural funds regulations, as these simplifications will reduce the likelihood of errors and reduce the administrative burden on the project promoters.

#### **V. The Court's Comments on the Commission's Internal Control System**

15. The European Commission has overall responsibility for implementing the EU budget and is required to ensure that effective internal control systems are in place. In addition to the responsibility for the funds managed directly by the Commission, i.e. disbursements concerning internal policies and external actions, the Commission is also ultimately responsible for the part of the budget which is under shared management, e.g. the 76 % of the EU budget which the Member States disburse to beneficiaries on behalf of the Commission. The Directors-General issue annual activity reports and declarations assessing the effectiveness of internal supervisory and control systems.

16. The Court states that the quality of the Commission's activity reports has improved. However, the Court points out that the Commission's reports on CAP and structural policies do not sufficiently reflect the weaknesses identified in the Member States' control systems and the subsequent high level of error in transactions managed by the Member States.

17. The Court recommends that the Commission continues its efforts to reinforce the Directors-General's supervisory and control systems. The Court emphasises that the Commission should seek to ensure that assessments in the annual activity reports and declarations are consistent and rigorous and include appropriate legality and regularity indicators.

## VI. The Court's Mention of Denmark

18. In connection with the audit of the annual accounts for 2006, the Court has visited Denmark six times in relation with four different audits. Rigsrevisionen participated in all six visits.

Audit Objects	Visiting Period
Single Payment Scheme (agricultural)	7-9 June 2006 4-8 September 2006
Fisheries funds (structural measures)	25-28 April 2006 11-20 September 2006
DAS-2006 (audit in preparation for the Statement of Assurance)	16-20 October 2006
Customs	23-27 October 2006

The Court's visits to Denmark did not give rise to comments in the Annual Report.

19. However, the Court does mention Denmark in the Annual Report in connection with the implementation of the Single Payment Scheme in the agricultural sector. The Court notes that the new regulations have created new beneficiaries, among these golf/leisure clubs and city councils in Denmark, United Kingdom, Germany and Sweden. The Court makes it clear that the new beneficiaries are not violating any rules, but that the eligibility conditions in the agricultural area have been changed. According to the new rules, land owners are under obligation to maintain their land in good agricultural and environmental condition, but they are not required to exercise any agricultural activity on the land.

20. For the information of the Public Accounts Committee, I have elaborated on the Court's criticism of Denmark in report no. 4/2007 on physical checks and substitution checks, triggering export refunds. The report presents the results of the Court's audit of the export refunds in 11 Member States, including Denmark. In the report, the Court mentions that in 2007 the Commission decided to demand repayment of part of the export refund which Denmark had received in 2000 – 2002. The Commission's claim was based on the errors in the Danish control systems which the Commission identified on its audit visits to Denmark in 2001 and 2002. The Danish authorities did not consider the errors as grave as the Commission, and therefore corresponded and met with the Commission on several occasions. The Commission's original claim was for DKK 99,572,642, but on 18 April 2007, it decided to reduce the amount to DKK 49,264,009. According to appropriation bill no. 7 11/10 2007, the Minister of Taxation has kept the Finance Committee confidentially updated on developments, but secrecy has now been suspended. The errors, which lead to the Commission's claim for repayment, were corrected on January 1, 2003.

## VII. The Court's Comments on National Declarations

21. In the Annual Report, the Court notes that a number of Member States have volunteered to issue national declarations and a few supreme audit institutions have decided to issue audit reports on the management of EU funds. Initiatives have been taken on national administrative level and by national supreme audit institutions. At this point of time, only the Dutch government has issued a national declaration on the management of EU funds (Report on the Dutch EU Member State Declaration, 2006). The Dutch declaration is audited by the Dutch supreme audit institution. Likewise, Rigsrevisionen is the only supreme audit institution which has issued a declaration on the audit of EU funds. The Court notes that the national declarations are used essentially for the accountability of national parliaments. The Court also notes that the declarations may prove of relevance to the Commission within its overall responsibilities for managing the budget, notably through its supervisory role.

22. The Court refers to its opinion of July 2007 on national declarations and supreme audit institutions' audit of EU funds. In its opinion, the Court sets out the conditions which declarations should conform to if they are to be useful to the Court. Among the conditions mentioned are: that the supreme audit institutions follow the requirements of international auditing standards and that the scope and timing of national audit activities are appropriate. The Court also states that the approach applied in national declarations and audit reports is quite the opposite of the Court's approach, according to which conclusions are drawn for each individual budget area and not for individual Member States. Finally, the Court states that national declarations and national audits could stimulate improved management and control of EU funds in Member States.

23. The Parliament first brought up the issue of national declarations and audit statements in connection with the 2005 discharge procedure. Since then, the Parliament has called upon the national finance ministers and national supreme audit institutions to play a more active role in the financial management of the EU funds. The Parliament also called upon the national supreme audit institutions to submit annual audit statements on the management of EU funds in 2006. In April 2007, the Parliament welcomed Rigsrevisionen's declaration on the management of EU funds under shared management and the Netherlands, United Kingdom and Sweden's initiatives to adopt national declarations on the management of Community funding.

24. Again this year, Rigsrevisionen has submitted a statement on the audit of EU funds in Denmark, cf. report no. 16/06 on the audit of the state accounts for 2006, which was on the agenda of the Public Accounts Committee meeting on 28 November 2007. The Parliament urges the Member States to involve themselves in the management of Community funding and the audit statement represents Rigsrevisionen's contribution to this development. An English version of the audit statement will also this year be forwarded to the Court and Commission. I agree with the Court that the national declarations may contribute to improve management and control of Community funding. However, I hope that the work performed by national supreme audit institutions in the EU area may be applied by the Court in other connections also, as the Court's audit methodology does allow for examination of other auditors' work. I have noted that the Parliament in connection with the 2005 discharge procedure pointed out that the Court did not mention the cooperation with the national supreme audit institutions in its Annual Report, and the Parliament called upon the Court to submit information on this subject. However, this year's Annual Report from the Court does not either include information on the work performed by national supreme audit institutions.

25. In my opinion, the national declarations and the work performed by the supreme audit institutions in the EU area provide an opportunity to cooperate across the EU. Cooperation across national boundaries is always a challenge due to differences in mandates, etc., but I do hope that the Court will in future utilise this opportunity to the advantage of both the Court and the supreme audit institutions.

### **VIII. Conclusion**

26. With this memorandum I have informed the Danish Public Accounts Committee of the Court's Annual Report and Statement of Assurance. It is the opinion of the Court that EU's annual accounts for 2006 are true and fair with the exception of a number of errors identified in the Commission's accounting system. With regard to the management of EU expenditure, the Court has identified significant errors. The Court's statement of assurance is therefore qualified within large parts of the agricultural policy, the structural policy, internal control and external actions. However, the Court notes that the level of error in disbursements has been significantly reduced since 2006.

27. Denmark is only mentioned in connection with the Court's comments on the implementation of the SPS in the agricultural area. The Court notes that eligibility conditions do not include requirements to exercise any agricultural activity on the land, and therefore new

beneficiaries have been created, i.e. golf/ leisure clubs and city councils in Denmark and other countries.

I also mention the Court's report no. 4/2007, from which it appears that the Commission in 2007 made a final decision to claim repayment of export refunds in the amount of DKK 49,264,009 which Denmark had received in 2000 – 2002.

28. Finally, I have informed the Danish Public Accounts Committee of my view on the Court's reluctance to use the supreme audit institutions' audit findings in the EU area.

29. I shall inform the Danish Public Accounts Committee when the European Parliament has concluded the discharge procedure with its political assessment of the 2006 annual accounts.

Henrik Otbo