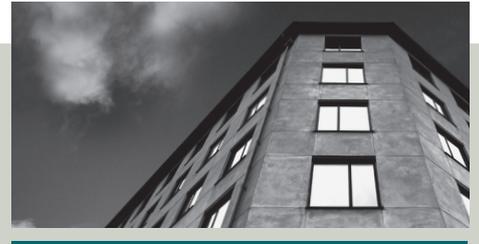




Memorandum to the Public Accounts Committee on
**the audit and approval of
the 2016 EU accounts**



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The audit and approval of the 2016 EU accounts

28 May 2018

RN 1901/18

SUMMARY

In September, in its annual report on the 2016 accounts of the European Union (the EU), the European Court of Auditors (the ECA) concluded that the consolidated accounts of the EU were correct. The ECA also concluded that there had been an important improvement in EU finances, and for the first time, the ECA issued a qualified (rather than an adverse) opinion on the regularity of the transactions underlying the 2016 accounts.

In April 2018, the European Parliament (the Parliament) approved the EU accounts for 2016 and noted with satisfaction the improvement in management reported by the ECA. Yet, the Parliament called on the European Commission (the Commission) and the Member States to strengthen transparency and accountability in management in a number of areas. The Parliament also expressed concern about the backlog of payments that the EU is committed to making - in particular within the cohesion policy frameworks.

1. In this memorandum, Rigsrevisionen informs the Danish Public Accounts Committee of the main conclusions presented in the ECA's annual report for 2016 and about the Parliament's approval of the accounts (discharge) on 18 April 2018. In the last section of the memorandum, we provide a brief account of the audit of EU funds performed by Rigsrevisionen and our cooperation with other Supreme Audit Institutions in the EU.

I. The audit and approval of the EU accounts

2. The preparation, audit and approval of the EU accounts are elements in the chain of accountability that leads to the discharge of the accounts, as illustrated in figure 1.

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

First, the Commission prepares the accounts of EU revenue and expenditure and reports on results achieved. The Commission's report addresses expenditure managed by the Commission as well as 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 the EU funds.

The second element in the chain of accountability is the audit of the EU accounts by the ECA. The results of this audit are published in the ECA's annual report, which for 2016 was published on 28 September 2017. The annual report is accompanied by a report called *EU audit in brief* in which the ECA summarises the results of its audit of the EU accounts. The national parliaments of the Member States, including the Danish Folketing, receive the annual report on the day of publication. The Danish member of the ECA – currently Bettina Jakobsen – also briefs the Public Accounts Committee by letter about the annual report.

The third element in the process is the recommendation made by the Council of the European Union (the Council) to the Parliament on discharge. The Council makes its recommendation after a debate among the representatives of the Member States that is based on the annual report of the ECA, among other things.

The fourth element includes the Parliament's political assessment and approval of the Commission's and other EU institutions' management of the EU budget – the so-called discharge. In the course of the discharge, the Parliament and Council review the ECA'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 ECA and the Court of Justice of the European Union.

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

3. The ECA's annual report for 2016 includes the results of the ECA's financial and compliance audits along with a summarised presentation of its performance audits. The ECA audits the EU revenue and expenditure. Budgetary spending in 2016 totalled approximately €136.4 billion.

4. Based on its audit findings, the ECA

- Issued a clean opinion on the reliability of the 2016 accounts of the EU.
- Stated that the revenue for 2016, taken as a whole, was legal and regular, as in previous years.
- Stated that payments for 2016 were legal and regular, but qualified its opinion on cost reimbursement payments, which make up half of the total expenditure. The ECA estimated the total level of error in payments at 3.1%.

In 2016, the EU's budgetary spending totalled €136.4 billion, or around €267 for every citizen. This spending amounts to around 2% of total spending in the EU Member States.

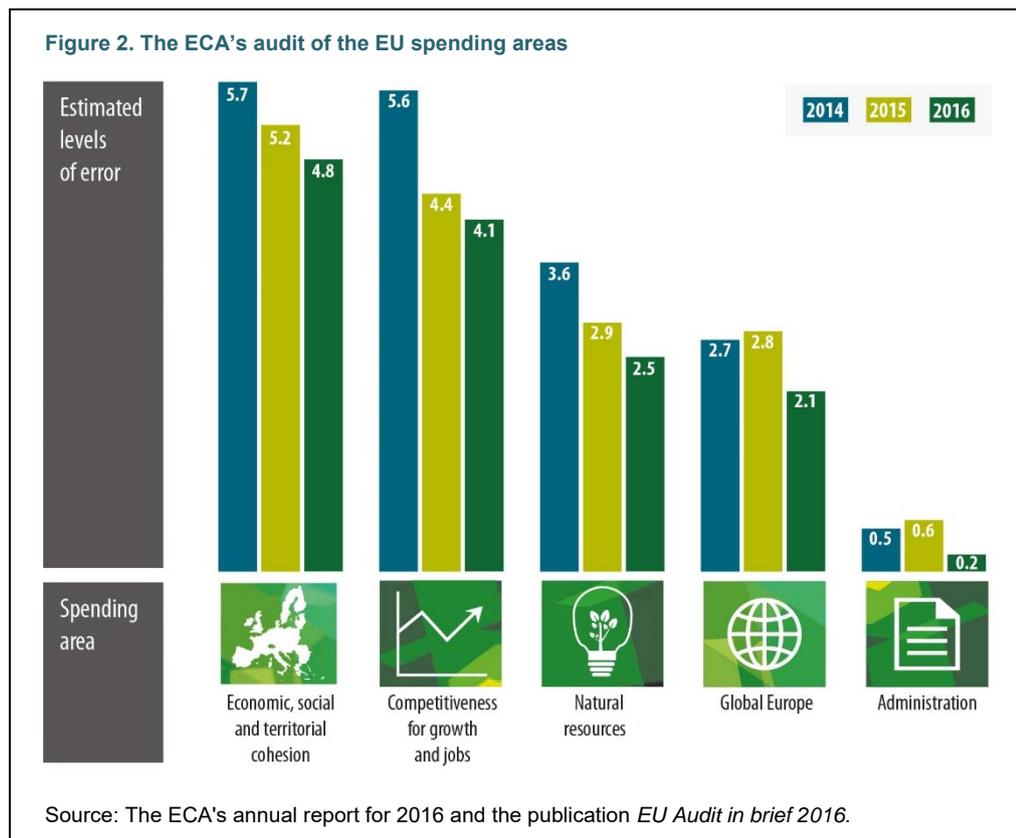
Thus, the ECA issued a clean opinion on the reliability of the EU accounts for 2016, as it has done since 2007.

For the first time since 1994, the ECA issued a qualified (rather than an adverse) opinion on the regularity of the transactions underlying the 2016 accounts. The ECA considers this an important improvement in the management of EU finances. A significant part of the 2016 expenditure audited was not affected by a material level of error, and the development in the estimated level of error in payments made from the EU budget has been positive over the past three years, decreasing from 4.4% in 2014, to 3.8% in 2015 and 3.1% in 2016.

5. However, the ECA emphasized that the backlog of payments that the EU has committed to making from future budgets is larger than ever before and is expected to increase further in the years leading up to 2020. The ECA recommended that clearing the backlog and preventing a new one from forming should be priorities when planning the Multiannual Financial Framework for the period starting in 2020.

III. Assessment of spending areas

6. Although the overall level of error has come down, four in five of the EU's spending areas were also in 2016 affected by a level of error that was above the 2% materiality threshold. Only administration costs of the EU institutions were not materially affected by error (0.2%). Figure 2 shows the results of the ECA's audit of the five spending areas.



The figure shows that the level of error has decreased in all five spending areas in the course of the past three years – and particularly the level of error for *Competitiveness for growth and jobs* has improved significantly. However, the figure also shows that the ECA still detects many errors.

A **clean opinion** means that the accounts, in all material aspects, give a true and fair view.

A **qualified opinion** means that the auditor has detected significant errors and misstatement in the accounts.

An **adverse opinion** means that the auditor disagrees with the information provided by the management or that the auditor was unable to obtain sufficient evidence to confirm the correctness of the information provided.

In 2016, the highest level of error was found in the policy area *Economic, social and territorial cohesion* (4.8%). Total expenditure was €35.7 billion and payments were mainly implemented through the European Regional Development Fund and the Cohesion Fund. For many years, the area has been characterised by a high level of error. *Competitiveness for growth and jobs* was also affected by a high level of error (4.1%). Total expenditure was €15.2 billion, mostly for research, innovation, education, job creation and infrastructure.

The largest spending area in the EU is *Natural resources* (€57.9 billion) which includes the EU common agricultural policy, fisheries policy and environmental measures. The overall level of error for this policy area was 2.5%. In its annual report, the ECA highlighted that direct support (area support) and market support, accounting for approximately two thirds of the expenditure, with a level of error of 1.7%, was below the materiality threshold of 2%. The level of error for rural development, the environment, climate action and fisheries, accounting for the last quarter of the expenditure in this area, was 4.9%, which is, however, a small improvement over last year.

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 that was ineligible or for purchases without proper application of public purchasing rules.

Source: The ECA's annual report for 2016 and the publication *EU audit in brief 2016*.

Backlog of payment commitments higher than ever before

7. In its annual report, the ECA highlighted that the backlog of payments that the EU has committed to making in the years to come increased from €217.7 billion in 2015 to approximately €238.8 billion in 2016. In comparison, the EU's total expenditure was €136.4 billion in 2016. The cause of the increase is the fact that the EU made fewer payments than planned in 2016, whereas future obligations were largely as planned. In particular, payments made from programmes under shared management in the Multiannual Financial Framework for the period 2014 to 2020 in the policy areas *Cohesion* and *Rural development* were delayed and contributed to the backlog. Outstanding commitments are expected to increase further in the years leading up to 2020, at which point the new financial framework, which the Member States are currently negotiating, enters into force.

8. The ECA considers it a priority to clear the backlog and prevent a new one from forming when planning the Multiannual Financial Framework for the period starting in 2020. According to the ECA, there is a risk that the EU's spending ceilings may be exhausted in the coming years, leaving less room for flexibility in the EU budget to respond to unforeseen events.

9. Absorbing all funds committed is a considerable challenge to a number of Member States, as they need to select a sufficiently large number of relevant projects and provide the required national co-financing. For some Member States, outstanding payments make up a significant proportion of their general government expenditure; in 2016, funding from the EU's ESI funds corresponded to more than 20% of total government expenditure in Lithuania, Bulgaria, Latvia and Romania, and more than 15% of government expenditure in Hungary, Poland, Croatia, Estonia and Slovakia. In Denmark, outstanding expenditure from the ESI funds constituted less than 1% of total government expenditure in 2016. Rigsrevisionen addressed this issue in its report from August 2014 on Denmark's absorption of EU funds.

The ESI funds manage more than one third of the expenditure on the EU budget and include:

- *The European Regional Development Fund*
- *The European Social Fund*
- *The Cohesion Fund*
- *The European Agricultural Fund for Rural Development*
- *The European Maritime and Fisheries Fund.*

Mention of Denmark in the ECA's annual report

10. The ECA is not providing an overall assessment of the management of EU funds in Denmark, or in any of the other Member States, but has focus on the management of the total EU budget. Member States are referred to in the annual report only to illustrate audit results. Denmark was referred to specifically only once in the annual report for 2016, namely in connection with errors detected in payments made from programmes under *Rural development*. Denmark was also mentioned in four footnotes and a number of general tables and figures providing data on all the Members States.

IV. Main conclusions and comments from the Parliament's discharge decision

11. On 18 April 2018, the Parliament decided to grant discharge to the Commission and thereby approve the EU accounts for 2016. The Parliament made its decision based on a recommendation by the Council of 20 February 2018. The Parliament also granted discharge to the other EU institutions, agencies, etc., but for the eighth consecutive year, the Parliament also decided to postpone the discharge to the Council and the European Council due to a long-standing disagreement concerning supply of data from the Council to the Parliament. For instance, the Parliament insists that the budgets of the European Council and the Council should be separated in order to increase transparency and the accountability of the financial management of the institutions. The Parliament also decided to postpone the discharge to the European Asylum Support Office, which is currently under investigation by the European Anti-Fraud Office in connection with a number of irregularities.

12. The Parliament welcomed the information that the ECA had issued a clean opinion on the EU accounts for 2016 and expressed satisfaction with the assessment that the revenue and commitments underlying the accounts, taken as a whole, were legal and regular. The Parliament also welcomed the information that the level of error had improved in recent years; that the ECA in 2016, for the first time in 23 years, issued a qualified (rather than an adverse) opinion on expenditure and that the ECA had noted significant improvement in the management of the EU's finances.

13. The Parliament regretted that the level of error in a number of policy areas was still very high and mentioned specifically *Rural development* (4.9%), *Cohesion* (4.8%) and *Competitiveness for growth and jobs* (4.1%).

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

Improving transparency

15. The Parliament stressed the importance of further strengthening the democratic legitimacy of the EU institutions by improving transparency and accountability. The Parliament highlighted a number of issues that the Commission and Member States might address in this respect:

- Stronger coordination between the EU's policy objectives, the multiannual financial frameworks, the legislative period of the Parliament and the mandate of the Commission in order to align policy objectives, budgets and political mandates.
- The EU's annual budget should be organised in compliance with the political priorities of the EU and the concept of performance-based budgeting should be implemented. Furthermore, the Commission should simplify its performance reporting by reducing the number of objectives and indicators and strengthening the comparability of expenditure and performance.

- The Commission should instruct all its directorates-general to publish their proposals for country specific recommendations on fiscal policy as part of the EU's coordination of the economic and fiscal policies of the Member States (the European semester).
- The Commission should improve the transparency of refugee and migration policy financing by merging the various budget items under one headline.
- The transparency of research and rural development policies should be improved with the aim of identifying and correcting the causes of particularly high and persistent error rates in these policy areas.
- Establishment of an independent EU body in order to help whistleblowers disclose information on possible irregularities, protect their confidentiality and offer the required support and advice.

The backlog of payments is of concern

16. In the discharge decision, the Parliament expressed concern about the significant backlog of payments that the ECA had also highlighted in its annual report (see items 7 to 9). The Parliament called on the Commission to speed up delivery of the programmes and related payments, particularly in the cohesion policy area. According to the Parliament, outstanding commitments of approximately €238.8 billion, corresponding almost to total payments made over three years from the EU funds, increase the risk that unforeseen expenditure incurred in the years leading up to 2020, when the current multiannual financial framework ends, cannot be financed from the EU budget.

17. The Parliament was also concerned that the Member States that are experiencing difficulties identifying a sufficient number of high quality projects (see item 9) will instead select projects based on an assessment of quantity rather than quality. Therefore, the Parliament called on the Commission and the ECA to prioritise sustainable and appropriate projects (projects that provide value for money).

18. Lastly, the Parliament called on the Commission to assist more actively the Member States that find it difficult to absorb available funding, and use the available resources for technical assistance.

V. Rigsrevisionen's audit of EU funds and cooperation with other EU SAIs and the ECA

19. Every year, Rigsrevisionen issues an opinion on the audit of EU funds in Denmark, that is, the funds that Denmark receives from the EU and the contributions that Denmark makes to the EU budget. In 2017, Rigsrevisionen's EU opinion was included in the report on the audit of the Danish government accounts for 2016 that the Public Accounts Committee discussed at its meeting in August 2017.

20. In 2017, Rigsrevisionen submitted yet another report with an EU perspective to the Committee. In its report no 7, Rigsrevisionen examined how the Danish Customs and Tax Administration checks and guides the citizens' and businesses' clearance of customs on goods imported from countries outside the EU. Denmark is a member of the EU Customs Union and tariff rates on imports are set by the EU. Customs duties make up a large proportion of the EU's own resources.

21. Rigsrevisionen cooperates with the SAIs of the other Member States and with the ECA under the auspices of the EU Contact Committee. The EU Contact Committee provides a forum for knowledge sharing, and the SAIs meet here once a year to exchange experiences on EU topics of common interest. A number of working groups and task forces have been set up under the umbrella of the Contact Committee, and Rigsrevisionen participates in two task forces: one that monitors the development of common EU accounting standards (EPSAS) and one that monitors how the Bank Union affects SAIs' access to audit banking supervision in the Member States and the ECA's access to audit the European Central Bank banking supervision. Rigsrevisionen also participates in the SAIs' network for EU contact persons and at the latest meeting on 10 and 11 May 2018, we shared knowledge and experience with the other SAIs on the EU Data Protection Directive that became effect on 25 May 2018.

22. 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. Our annual opinion on the audit of EU funds will be included in the report on the audit of the government accounts for 2017, which will be submitted to the Public Accounts Committee for its meeting in August 2018 – well in advance of the Committee's visit to Brussels and Luxembourg on 21 and 22 November 2018.

Lone Strøm