RIGSREVISIONEN

Memorandum to the Public Accounts Committee on the European Court of Auditors' Annual Report for 2014

December 2015

revision

The European Court of Auditors' Annual Report for 2014

1 December 2015

RN 1902/15

SUMMARY

In this memorandum, Rigsrevisionen informs the Public Accounts Committee of the main conclusions presented in the European Court of Auditors' annual report for 2014.

In the annual report for 2014, 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.

In connection with the presentation of the annual report, the European Court of Auditors calls on the EU decision makers to develop a wholly new approach to the management of EU investment and spending in order to reduce the error rate and improve the overall performance of the EU budget.

I. Introduction

1. The European Court of Auditors (ECA) audited the EU's accounts and presented its annual report for 2014 to the European Parliament (the Parliament) on 10 November 2015. The annual report was forwarded to the national parliaments, including the Danish Folketing, on the same date. The Public Accounts Committee also received a letter from the Danish member of the ECA, Bettina Jakobsen, with a briefing on the annual report. The annual report is accompanied by a report called *Audit in Brief* in which the ECA summarises the results of its audit of the EU accounts for 2014.

2. The bulk of the EU's expenditure is under shared management by the European Commission (the Commission) and the individual Member States. The Commission has the overall responsibility for the correct implementation of the EU budget, whereas the Member States select and check eligible projects and execute payments to the final beneficiaries, which makes them co-responsible for managing the EU funds.

3. The audit conducted by the ECA is part of the chain of accountability (figure 1) that leads to the approval of the EU budget and accounts (discharge).

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

The ECA's annual report is thus one of the elements in the discharge procedure of the Council for the European Union (the Council) and the Parliament, which is a political assessment and approval of the Commission's and other EU institutions' management of the EU budget.

4. The ECA does not provide an assessment of the management of EU funds in the individual Member States in the annual report; instead its focus in on the management of the overall EU budget. The Member State Supreme Audit Institutions (SAI) and the ECA cooperate on an ongoing basis, but the ECA does not apply the work of the individual SAIs directly in their audit, nor do the SAIs use the work of the ECA, since the focus of their audit is not the same; the ECA's focus is on the Commission and the EU as such, whereas the focus of the national SAIs is on the management of EU funds in their respective countries.

5. Every year, Rigsrevisionen issues an opinion on the audit of EU funds in Denmark, i.e. the funds that Denmark has received from the EU and the contributions that Denmark has made to the EU budget. This year, Rigsrevisionen's audit opinion was issued as part of our report on the annual audit of the government accounts for 2014, which was discussed by the members of the Public Accounts Committee at their meeting on 16 September 2015.

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

The total expenditure of the EU per capita is approx. EUR 285, which is approx. 2 per cent of the total public expenditure of all Member States in 2014.

6. The annual report for 2014 presents the results of the ECA's financial audit and includes also a summarized presentation of selected performance audits conducted by the ECA. The ECA audit the revenue and expenditure of the EU, which in 2014 was EUR 143.9 billion and EUR 144.5 billion, respectively.

7. Based on the audit results, the ECA issued the following audit opinion.

*An **adverse opinion** is issued when the auditor disagrees with the information provided by the management in the accounts – or if the auditor has been unable to procure sufficient evidence of the correctness of the information included in the accounts.*

The consolidated accounts of the European Union are, in all material respects, correct and are therefore given a clean opinion by the ECA.

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 ECA estimates the total level of error to be 4.4 per cent.

With that, the ECA confirmed the reliability of the EU accounts for 2014, as it has done for every year since 2007.

However, at the same time, the ECA has once more detected high levels of error in most expenditure areas, which has led to an adverse opinion on the payments underlying the accounts. The ECA has estimated the error rate to be 4.4 per cent, meaning that 4.4 per cent of all payments executed from the EU budget in 2014 were not paid out in full compliance with the rules.

8. In the opinion of the ECA, this year's error rate is very similar to the error rates estimated for previous years. The overall error rate was thus 4.5 per cent in 2012 and 2013, and for 2014 it has been estimated to be 4.4 per cent – all well over the acceptable error rate of 2 per cent. So, any significant improvement in the administration of EU funds over the past years cannot be established.

9. Again this year, the ECA highlights the fact that the Commission and the Member States could have prevented or detected and corrected a considerable proportion of the errors, if they had made better use of the data and information available to them before they reported or approved expenditure. The control systems in the Member States were thus not sufficiently reliable in a number of areas. 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.

10. The ECA also emphasizes how important it is that the Commission and the Member States focus more on performance, i.e. are EU funds used effectively and for useful purposes that will produce significant, positive results for the benefit of citizens and companies in the Member States (cf section III).

11. Taking into consideration that this message has been repeated by the ECA year after year, and that the administration of the EU budget and accounts is still not showing any signs of improving, the ECA calls on the EU decision makers to develop a wholly new approach to the administration of EU investment and spending in the future in order to reduce the error rate and improve the overall performance of the EU budget (cf section IV).

Assessment of individual areas of expenditure

12. It is the ECA's assessment that four out of five EU spending areas are materially affected by error. Only the administrative expenditure of the EU institutions was, with an error rate of 0.5 per cent, not materially affected by error.

The area *cohesion* has been characterized by a high level of error for many years and with an error rate of 5.7 per cent, 2014 was no exception. Total expenditure in this area, which was EUR 55.7 billion in 2014, consists mainly of cost reimbursements from the European Regional Development Fund (ERDF), the Cohesion Fund and the European Social Fund (ESF). The area *competitiveness for growth and jobs* (EUR 13 billion), which mainly administers payments for research, innovation, education and infrastructure, also had a high error rate (5.6 per cent)

Natural resources is the largest area of expenditure (EUR 57.5 billion). It includes the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD). The total level of error estimated for this area was 3.6 per cent. The EAFRD was particularly affected with an error rate of 6.2 per cent.

Table 1 shows the results of the ECA's audit by spending area.

Table 1. Results of the ECA's audit by spending areas

Spending area[1]	EUR billion 2014	Error rate 2014	Error rate 2013[2]	Conclusion
Competitiveness	13.0	5.6 % ↑	4.0 %	**Materially affected by error**
Cohesion	55.7	5.7 % ↑	5.3 %	**Materially affected by error**
Natural resources	57.5	3.6 % ↓	4.4 %	**Materially affected by error**
A Global Europe	7.4	2.7 % ↑	2.1 %	**Materially affected by error**
Administration	8.8	0.5 % ↓	1.1 %	Not materially affected by error
Other	2.1	-	-	-
Total spending audited	**144.5**	**4.4 % ↓**	**4.5 %**	**Materially affected by error**
Revenue	143,9	0 %	0 %	Free from material error

[1] The headings of spending areas have been changed compared with 2013, but the ECA has made the adjustments necessary to allow comparison of the error rates in 2013 and 2014.

[2] The error rate for 2013 has been reduced by 0.2 per cent points, because the ECA has updated their approach for calculation of errors in 2014.

Source: Rigsrevisionen based on the ECA's annual report for 2014.

Fraud, inefficiency and waste

13. The ECA makes it very clear that the estimated error rate is not a measure of fraud, inefficiency or waste; it is an estimate of the amount of funds that should not have been paid out because they were not used in accordance with the rules. The ECA reports suspected fraud cases to the European Union's anti-fraud office (OLAF) for possible further investigation and follow-up.

During the 2014-audit, the ECA assessed 1,200 transactions and detected 22 suspected fraud cases. Most of these concerned declaration of ineligible costs. Other typical cases had to do with conflicts of interest and irregularities in connection with public procurement.

14. The ECA also notes that even if a payment has been made from the EU budget in accordance with the rules, the money may have been spent inefficiently or even wasted. Therefore, the ECA has, in a pilot exercise, expanded its sample-based audit to include also aspects of performance. In the areas *cohesion* and *natural resources,* the ECA expanded its audit beyond the legality and regularity of the projects and addressed also programme achievement and several other performance criteria for a large number of transactions.

The results of the ECA's focus on value for money in its performance audit are reported in special reports and summarised in the annual report (cf section III).

Risk of error

15. The ECA notes that the error rate for the areas under shared management by the Commission and the Member States is the same as for the areas that are managed by the Commission alone. Last year the error rate for spending under shared management was approximately 1.2 per cent higher than for spending that was directly managed by the Commission, but this difference does not exist this year. This seems to indicate that there is no relationship between mode of management and error rate

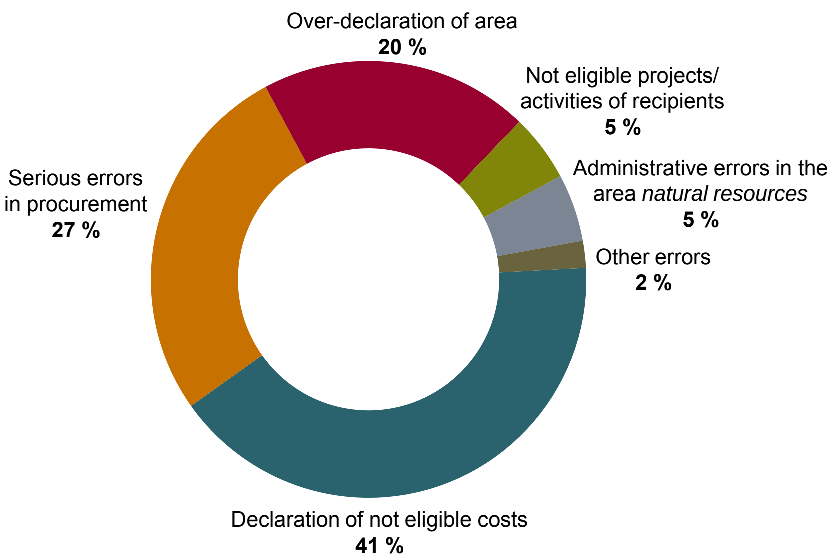
16. On the other hand, the ECA's analysis shows that the risk of error is closely related to type of payment. The ECA estimates the error rate for programmes where costs are reimbursed on the basis of information provided by the recipients themselves to be 5.5 per cent. The error rate for programmes where certain eligibility criteria must be met prior to payment (entitlement) is estimated to be 2.7 per cent. It appears that the risk of error is significantly higher for reimbursements than for entitlements.

This difference helps to explain the variances in error rates between the spending areas. The policy areas *cohesion* and *competitiveness for growth and jobs* where almost all payments are made as reimbursements have the highest error rates. *Natural resources* and *Global Europe*, where more payments are based on entitlements, have lower error rates.

Types of error

17. According to the ECA's annual report, certain types of errors appear more frequently than others. Errors relating to declaration of ineligible costs, serious procurement errors and incorrect declaration of area by farmers are most frequent. Combined, these three types of error accounted for 88 per cent of all errors in 2014. Figure 2 shows the estimated level of error for 2014 by type of error.

Figure 2. Level of error for 2014 by type of error



Source: Rigsrevisionen based on the ECA's annual report 2014.

Backlog of unused funds
18. The ECA reports that a considerable backlog of outstanding payment claims (commitments) from the European structural and investment funds has been built up in the Member States. Absorbing funds allocated from the multiannual programmes is a significant challenge to some Member States, since they need to select a sufficiently large number of relevant projects and provide the required co-funding. With only few projects to choose from, the Member States may be tempted to be less critical of the quality and relevance of the projects for fear that they will be unable to fully use the allocated funds and thus lose EU funding. This concern increases the risk of inefficiency and waste.

19. Five Member States account for more than half of the unused funds; the Check Republic, Spain, Italy, Poland and Romania are responsible for EUR 54.9 billion of the total amount of unused funds of EUR 93.5 billion. In some Member States, funds not yet claimed represent a significant portion of their governments' annual spending. In Romania, unused funds corresponded to almost 20 per cent of annual public spending in 2014 and in Bulgaria, Slovakia and the Check Republic, unused funds accounted for more than an 15 per cent of public spending.

20. It appears from the ECA's annual report that, compared with most of the other Member States, unused EU funds make up only a limited portion of total government spending in Denmark (less than 0.5 per cent in 2014).

Rigsrevisionen looked into this issue in its report on Denmark's absorption of EU funds, which was submitted to the Public Accounts Committee in August 2014.

Mention of Denmark in the annual report
21. As mentioned earlier in the memorandum, the ECA is not providing an overall assessment of the management of EU funds in the Member States. In the annual report, reference is made to specific Member States only to illustrate audit results.

Denmark is mentioned in a number of general tables where the performance of the Member States is measured against various financial criteria. Denmark is also mentioned in a summary presentation of errors detected in the Member States from which it appears that the ECA found two errors in the management of agricultural policy, during its visits in Denmark. Both errors were categorized as being relatively small and it appears from a subsequent section in the ECA' annual report that the errors concerned over-declaration of eligible agricultural area by a farmer and failure to comply with the notification deadlines for animal movements.

III. Benefits and impact of the EU budget

22. The ECA emphasizes the importance of using EU funds more effectively to resolve the challenges facing the EU. The ECA is therefore again this year focusing on the Commission's and the Member States' performance, i.e. their ability to get results from the EU budget.

23. The long-term objectives of the EU are defined in the Europe 2020 strategy for employment and growth that covers the years 2010 to 2020. The strategy is based on five headline targets, seven flagship initiatives and 11 thematic objectives. The ECA notes that the different layers of the strategy are not serving the purpose of transforming the ambitions of the Europe 2020 strategy into operational objectives – with targets and indicators – that can be used by the relevant authorities in the EU and the Members States, who will be responsible for the implementation of the strategy.

24. This weakness in the setup of the strategy is reinforced by the fact that the strategy is not aligned with the EU's seven-year budgetary cycle – the multiannual financial framework (MFF). The first half of the Europe 2020 strategy therefore took place under the MFF 2007-2013, which was designed for a different strategy, and monitoring and reporting of the strategy was first aligned under the recent MFF covering the period 2014-2020. Thus the EU budget has not in the period 2010 to 2014 been geared to underpin the overall strategic priorities of the EU.

25. The ECA also critisizes that only some of the objectives defined in the Europe 2020 strategy have been translated into operational targets by the Member States in the partnership agreements and programmes that include the most important national performance targets set for the EU funds. It follows that the EU objectives that are guiding the activities of the individual Member States only support the overall strategy to a limited extent.

26. The new budget cycle MFF 2014-2020 includes a performance reserve of 6 per cent, which means that the last 6 per cent of the allocation to the Member State in question is only released if the Member State has achieved its pre-defined targets. However, the ECA notes that the performance reserve arrangement has certain weaknesses, including the following:

- It does not provide sufficient incentive for the Member States to achieve the targets.
- The performance of the Member States is not reviewed till 2019, which prevents ongoing monitoring and reporting on their performance.
- A poor performance in terms of results achieved does not mean that the Member States lose their performance reserve – it can be re-allocated to other priorities that have reached their targets.
- If targets are not met, the Commission's possibilities of applying sanctions – e.g. financial corrections – are limited and cannot be based on result indicators.

27. Generally, the ECA is critical of the both the Commission's and the Member States' inadequate focus on achieving results with the EU funds. The ECA criticizes both the overall strategic setup, the translation of objectives into operational targets in the Commission and Member States and the Commission's limited possibilities of monitoring performance and apply sanctions if targets are not met.

IV. A new approach to the management of EU investment and spending

28. When the President of the ECA, Vitor Caldeira, presented the annual report of the ECA on 10 November 2015, he called on the decision-makers of the EU to develop a wholly new approach to the management of EU investment and spending.

The ECA recommends that

- the EU decision-makers (the Commission, the Parliament and the Council) should align the budget better with the long-term strategic priorities of the EU and at the same time ensure that the budget is more responsive in a crisis;
- the legislators (the Parliament and the Council) should ensure that spending schemes are clear about the results to be achieved and the level of risk that it is acceptable to take;
- the financial managers (the Commission and national authorities) ensure that the money is used in compliance with the rules and achieves the intended results.

29. According to the ECA, the EU is far from achieving this target and it will take time to change the current approach to management. The first half of the Europe 2020 strategy has been implemented, which means that the overall strategic priorities have already been defined, and the programmes under the multiannual framework for 2014-2020 have been launched. Still, the ECA calls on the EU decision-makers EU to reconsider the EU's spending and programme setup as part of the mid-term review of the multiannual framework.

V. Comments by Rigsrevisionen

30. Rigsrevisionen finds it positive that the ECA for the 8th consecutive year has issued a clean opinion on the annual accounts of the EU. However, the high level of error is of concern, as is the fact that the ECA has given an adverse opinion on the legality and regularity of the payments.

31. Rigsrevisionen agrees with the ECA that a new approach is needed to address the persistent problems with the management of accounts and the weaknesses in the ability to achieve results with the EU funds. A priority should be to ensure that the funds of the EU are used to achieve the most important political goals set by the EU decision-makers and to strengthen the entire process, starting with the definition of the overall strategy, across the operational targets set in the Member States and ending with the monitoring and reporting on performance in the individual Member States.

32. Rigsrevisionen is also of the opinion that the Commission and the Member States should continue their work to simplify the eligibility rules and programmes in order to reduce the risk of error, ease the burden of administration on the recipients and the authorities, and facilitate better utilisation of the EU funds.

33. At the same time, Rigsrevisionen still holds the view that the management of EU funds on all levels in the EU institutions and in the Member States should focus more on the relevance and effect of the programmes. For the past few years, Rigsrevisionen has examined the results and effect of EU investments in Denmark and we shall continue to focus on this issue also in the years ahead.

Lone Strøm