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Contents

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IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES

COURT OF AUDITORS

In accordance with the provisions of Article 287(1) and (4) of the TFEU and Articles 148(1) and 162(1) of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 and Articles 43, 48 and 60 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund, as amended by Regulation (EU) No 567/2014

the Court of Auditors of the European Union, at its meeting of 10 September 2015, adopted its

ANNUAL REPORTS

concerning the financial year 2014.

The reports, together with the institutions' replies to the Court's observations, were transmitted to the authorities responsible for giving discharge and to the other institutions.

The Members of the Court of Auditors are:

Vítor Manuel da SILVA CALDEIRA (President), Igors LUDBORŽS, Jan KINŠT, Kersti KALJULAID, Karel PINXTEN, Henri GRETHEN, Szabolcs FAZAKAS, Louis GALEA, Ladislav BALKO, Augustyn KUBIK, Milan Martin CVIKL, Rasa BUDBERGYTĖ, Lazaros S. LAZAROU, Hans Gustaf WESSBERG, Pietro RUSSO, Ville ITÄLÄ, Kevin CARDIFF, Baudilio TOMÉ MUGURUZA, Iliana IVANOVA, George PUFAN, Neven MATES, Alex BRENNINKMEIJER, Danièle LAMARQUE, Nikolaos MILIONIS, Phil WYNN OWEN, Klaus-Heiner LEHNE, Oskar HERICS, Bettina JAKOBSEN.

ANNUAL REPORT
ON THE IMPLEMENTATION OF THE BUDGET

(2015/C 373/01)

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GENERAL INTRODUCTION

0.1. The European Court of Auditors is the institution established by the Treaty to carry out the audit of European Union (EU) finances. As the EU's external auditor we act as the independent guardian of the financial interests of the citizens of the Union and contribute to improving EU financial management. More information on our work can be found in our annual activity report which, together with our special reports on EU spending programmes and revenue and our opinions on new or amended legislation, are available on our website:

www.eca.europa.eu

0.2. This is our 38th annual report on the implementation of the EU budget and covers the 2014 financial year. A separate annual report covers the European Development Funds.

0.3. The general budget of the EU is decided annually by the Council and the European Parliament. Our annual report, together with our special reports, provides a basis for the discharge procedure, in which the European Parliament, after a recommendation from the Council, decides whether the Commission has satisfactorily carried out its responsibilities for implementing the budget. We forward our annual report to national parliaments at the same time as to the European Parliament and the Council.

0.4. The central part of our annual report is the statement of assurance on the reliability of the consolidated accounts of the EU and on the legality and regularity of transactions (referred to in the report as 'regularity of transactions'). We supplement this statement with specific assessments of each major area of EU activity.

0.5. In order to increase the usefulness of our report, the chapter structure reflects the headings of the multi-annual financial framework (MFF). This framework came into force in 2014, and is intended to determine the size and distribution of EU spending over the period until 2020. This should make it easier for readers to relate our report's findings to the relevant budgetary and accounting information.

0.6. There are no separate financial statements for individual MFF headings and therefore conclusions presented in specific assessments do not constitute audit opinions. Instead, these chapters present significant issues specific to each MFF heading.

0.7. Our report this year is organised as follows:

— chapter 1 contains the statement of assurance and a summary of the results of our audit on the reliability of accounts and on the regularity of transactions;

— chapter 2 presents our findings on budgetary and financial management;

— chapter 3 contributes to our strategic objective of improving EU public accountability and focusses on the extent to which the performance framework enables the Commission to monitor and steer progress towards Europe 2020;

— chapter 4 presents our findings on revenue;

— chapters 5 to 9 show (for MFF headings 1a, 1b, 2, 4 and 5) [1] the results of our testing of the regularity of transactions and an examination of selected systems and annual activity reports.

0.8. The Commission's replies (or replies of other EU institutions and bodies, where appropriate) to our observations are presented within the document and the description of our findings and conclusions takes into account the relevant replies of the auditee. However it is our responsibility, as external auditor, to report our audit findings, to draw conclusions from those findings, and thus to provide an independent and impartial assessment of the reliability of the accounts as well as of the regularity of transactions.

(1) We do not provide a specific assessment for spending under MFF Heading 3 (Security and citizenship) and 6 (Compensations).

CHAPTER 1

Statement of assurance and supporting information

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THE COURT'S STATEMENT OF ASSURANCE PROVIDED TO THE EUROPEAN PARLIAMENT AND THE COUNCIL — INDEPENDENT AUDITOR'S REPORT

I. We have audited:

(a) the consolidated accounts of the European Union which comprise the consolidated financial statements [1] and the aggregated reports on the implementation of the budget [2] for the financial year ended 31 December 2014, approved by the Commission on 23 July 2015; and

(b) the legality and regularity of the transactions underlying those accounts,

as required by Article 287 of the Treaty on the Functioning of the European Union (TFEU).

Management's responsibility

II. In accordance with Articles 317 to 318 of the TFEU and the Financial Regulation, the Commission is responsible for the preparation and fair presentation of the consolidated accounts of the European Union on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. The Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the European Union (Article 317 of the TFEU).

Auditor's responsibility

III. Our responsibility is to provide, on the basis of our audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the transactions underlying them. We conducted our audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the consolidated accounts of the European Union are free from material misstatement and the transactions underlying them are legal and regular.

IV. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated accounts and the legality and the regularity of the transactions underlying them. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the European Union, whether due to fraud or error. In making those risk assessments, internal control relevant to the preparation and fair presentation of the consolidated accounts and legality and regularity of underlying transactions, is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the consolidated accounts.

V. For revenue, our examination of Value Added Tax and Gross National Income-based own resources takes as its starting point the relevant macroeconomic aggregates on which these are calculated, and assesses the Commission's systems for processing these until the contributions of the Member States have been received and recorded in the consolidated accounts. For traditional own resources, we examine the accounts of the customs authorities and analyse the flow of duties until the amounts are received by the Commission and recorded in the accounts.

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(1) The consolidated financial statements comprise the balance sheet, the statement of financial performance, the cashflow statement, the statement of changes in net assets and a summary of significant accounting policies and other explanatory notes (including segment reporting).

(2) The aggregated reports on implementation of the budget comprise the aggregated reports on implementation of the budget and explanatory notes.

VI. For expenditure, we examine payment transactions when expenditure has been incurred, recorded and accepted. This examination covers all categories of payments (including those made for the purchase of assets) other than advances at the point they are made. Advance payments are examined when the recipient of funds is required to provide or provides justification for their proper use and the advance payment is cleared or becomes recoverable.

VII. We consider that the audit evidence obtained is sufficient and appropriate to provide a basis for our opinions.

Reliability of the accounts

Opinion on the reliability of the accounts

VIII. In our opinion, the consolidated accounts of the European Union for the year ended 31 December 2014 present fairly, in all material respects, the financial position of the Union as at 31 December 2014, the results of its operations, its cash flows, and the changes in net assets for the year then ended, in accordance with the Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue underlying the accounts

IX. In our opinion, revenue underlying the accounts for the year ended 31 December 2014 is legal and regular in all material respects.

Payments

Basis for adverse opinion on the legality and regularity of payments underlying the accounts

X. Expenditure recorded in 2014 under the multi-annual financial framework headings 1 to 4 ([3]), covering operational spending, is materially affected by error. Our estimated level of error for payments underlying the accounts is 4,4 %. Our conclusion is corroborated by the Commission's analysis of amounts at risk presented in the synthesis report.

Adverse opinion on the legality and regularity of payments underlying the accounts

XI. In our opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2014 are materially affected by error.

([3]) These headings are covered by chapters 5 to 8 of this annual report.

Other information

XII. The Financial Statement Discussion and Analysis is not a part of the financial statements. The information given in the Financial Statement Discussion and Analysis is consistent with the financial statements.

10 September 2015.

Vítor Manuel da SILVA CALDEIRA

President

European Court of Auditors

12, rue Alcide De Gasperi, 1615 Luxembourg, LUXEMBOURG

THE COURT'S OBSERVATIONS

INTRODUCTION

EU spending is a significant tool for achieving policy objectives

1.1. EU spending is a significant instrument for achieving policy objectives. Other significant instruments are the use of legislation and the freedom for goods, services, capital and people to move throughout the Union. On average EU spending represents 1,9 % of EU Member States' (see ***Graph 1.1***) total general government expenditure.

1.2. Our role, as laid down in the Treaty includes:

— checking whether the EU budget is used in accordance with applicable laws and regulations;

— expressing our opinion on the accounts of the EU;

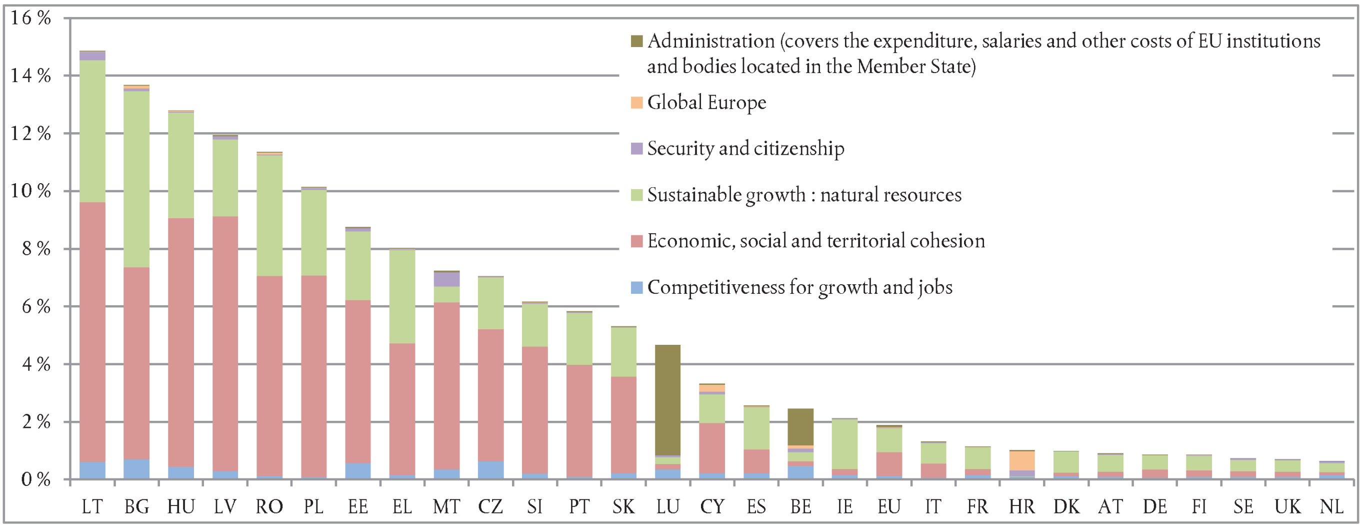
— reporting on the economy, efficiency and effectiveness ([4]) of EU spending; and

— giving opinions on proposed legislation with a financial impact.

The work we do supporting the statement of assurance fulfils the first and second of these objectives. It assists us in identifying risks affecting economy, efficiency and effectiveness. It provides an important input to our opinions on proposed financial legislation.

([4]) Defined in Article 30(2) of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union (OJ L 298, 26.10.2012, p. 1) as follows:
'The principle of economy requires that the resources used by the institution for the pursuit of its activities shall be made available in due time, in appropriate quantity and quality and at the best price.
The principle of efficiency is concerned with the best relationship between resources employed and results achieved.
The principle of effectiveness is concerned with attaining the specific objectives set and achieving the intended results.'

Graph 1.1 — 2014 EU spending in each Member State as a share of total general government expenditure



Sources:

European Union spending (European Commission accounting data, compiled by ECA).
Member States' total general government expenditure: (Eurostat — Government statistics — Government revenue, expenditure and main aggregates — Total general government expenditure 2014)
(http://ec.europa.eu/eurostat/web/government-finance-statistics/data/database). See ***Annex 1.5*** for explanation of country codes.

THE COURT'S OBSERVATIONS

1.3. This chapter of the annual report:

— sets out the background to our statement of assurance and summarises our audit approach (see ***Annex 1.1***), findings and conclusions;

— analyses the nature of the different risks involved in EU spending; and

— presents the actions taken by the Commission in response to our observations and recommendations in previous annual reports on the reliability of the accounts (see ***Annex 1.2***).

THE COURT'S OBSERVATIONS

AUDIT FINDINGS FOR THE 2014 FINANCIAL YEAR

The accounts were not affected by material misstatements

1.4. Our observations concern the consolidated accounts ([5]) (the 'accounts') of the European Union for the financial year 2014. We received them, together with the accounting officer's letter of representation, on 23 July 2015 ([6]). The accounts are accompanied by a 'Financial Statement Discussion and Analysis' ([7]). This analysis is not covered by our audit opinion. In accordance with auditing standards, we have, however, assessed its consistency with information in the accounts.

1.5. The accounts (summarised in ***Annex 1.3***) show that at 31 December 2014 total liabilities amounted to 220,7 billion euro compared to 162,7 billion euro of total assets. The economic result for 2014 amounts to a deficit of 11,3 billion euro (see also paragraphs 2.12 and 2.13).

1.6. Our audit found that the accounts were not affected by material misstatements (see also ***Annex 1.2***). Our observations on the financial and budgetary management of EU funds are made in chapter 2.

([5]) The consolidated accounts comprise:
- (a) the consolidated financial statements covering the balance sheet (presenting the assets and liabilities at the end of the year), the statement of financial performance (recognising the income and expenses of the year), the cashflow statement (disclosing how changes in the accounts affect cash and cash equivalents) and the statement of changes in net assets as well as the related notes;
- (b) the aggregated reports on the implementation of the budget covering the revenue and expenditure for the year as well as the related notes.

([6]) The provisional accounts, together with the accounting officer's letter of representation, were received on 31 March 2015, the final date for presentation allowed under the Financial Regulation (see Article 147 of Regulation (EU, Euratom) No 966/2012). The final accounts were received eight days prior to the deadline for presentation of 31 July set out in Article 148. The Commission's revised version of its accompanying Financial Statement Discussion and Analysis (FSDA) was transmitted to the Court on 1 September 2015.

([7]) See Recommended Practice Guideline 2 (RPG 2) 'Financial Statements Discussion and Analysis' of International Public Sector Accounting Standards Board (IPSASB).

THE COURT'S OBSERVATIONS

1.7. In 2014 the Commission has made several changes in the presentation of the accounts. These take account of the new MFF, and further strengthen alignment with international standards. There are notable improvements in the presentation of certain notes to the accounts ([8]).

THE COMMISSION'S REPLIES

1.7. *The Commission appreciates the Court's recognition of the improvements made. These improvements, such as the voluntary disclosures in the Financial Statement Discussion and Analysis, are made so as to remain at the forefront of public sector financial reporting by providing useful financial information for the users of the EU accounts.*

Issues affecting the accounts

1.8. The following issues affect the accounts:

(a) The Commission has made progress in terms of the presentation of Note 6 to the accounts (on 'Protection of the EU budget') as discussed in paragraph 1.13 of our 2013 annual report and point 2 of this year's follow-up table (***Annex 1.2***). The note now provides more focussed information. For cohesion, it discloses the extent to which corrections are made prior to expenditure being recorded, during implementation and at closure. The note now describes (but does not always quantify) the impact on the EU budget of the corrective measures (for example, creation of assigned revenue, withdrawals and replacements by Member States, etc) ([9]).

(b) Note 2.5.2 on pre-financings (advances to Member States) indicates that the Commission has limited information on the use of funds advanced for financial instruments under shared management (FISM) (3,8 billion euro) and other aid schemes (3,6 billion euro). This may impact their valuation at year end. The Commission may need to make significant adjustments at closure of the 2007-2013 programming period.

1.8.

(a) *Regarding Note 6, it provides a summary of the results of the Commission's corrective actions (decided and implemented) and also its preventive actions for the year 2014. More detailed information on this subject is included in the annual Commission Communication on the Protection of the EU Budget.*

([8]) Including the consolidated presentation of current and non-current assets and liabilities, and the simplified presentation of segmental information.

([9]) The Commission intends to reflect the European Court of Justice decisions of June 2015 annulling financial correction decisions for an amount of 457 million euro in Note 6 in the 2015 accounts. These decisions are already treated as adjusting post balance sheet events in note 2.10 'Provisions' (judgments of the Court of 24 June 2015 in joined cases C-549/12 P and C-54/13 P annulling two Commission Decisions amounting to 94 million euro related to ERDF programmes in Germany, and in case C-263/13 P, annulling three Commission Decisions amounting to 363 million euro for ERDF programmes in Spain). These decisions affected spending under 1994-1999 operational programmes.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Regularity of transactions: our overall audit results, although stable, show a material level of error

1.9. We examine EU revenue and spending to assess whether it is in accordance with applicable laws and regulations. We present our audit results on revenue in chapter 4 and on expenditure in chapters 5 to 9 (see ***Table 1.1***).

1.10. Revenue was free from material error (see paragraph 4.26). In expenditure, we continue to find a material level of error. The estimated level of error in expenditure (after taking account of relevant corrective actions, see paragraph 1.32 [10]) was 4,4 %, at a similar level to 2013 (4,5 % [11]) (see ***Table 1.1***). Spending on MFF heading 5 ('Administration') was free from material error (see paragraph 9.15). Expenditure for all remaining headings, covering operational spending, was affected by material error (see paragraphs 5.32 to 5.33, 6.76 to 6.77, 7.72 to 7.73 and 8.26 to 8.27).

1.10. *The Commission shares the Court's assessment of most errors reported on revenue in Chapter 4 and on expenditure in Chapters 5 to 9, and will duly follow-up the errors to protect the EU budget.*

Table 1.1 — 2014 Summary of audit results on regularity of transactions

Annual report chapter	MFF heading	Transactions subject to audit (billion euro)	Estimated level of error 2014 (%)	Confidence interval (%)		Estimated level of error 2013 (%)
				Lower error limit (LEL)	Upper error limit (UEL)	
5. Competitiveness	Heading 1a	13,0	5,6	3,1	8,1	4,0
6. Cohesion	Heading 1b	55,7	5,7	3,1	8,2	5,3
7. Natural Resources	Heading 2	57,5	3,6	2,7	4,6	4,4
8. Global Europe	Heading 4	7,4	2,7	0,9	4,4	2,1
9. Administration	Heading 5	8,8	0,5	0,1	0,9	1,1

(10) It is not appropriate to compare corrections on claims made 'at source' which did not lead to payment or which led to reduced payment with the level of final payments.

(11) The estimated level of error we reported in the 2013 annual report was 4,7 %. The comparable estimated level presented here is 0,2 percentage points lower because we updated our quantification of public procurement errors (see paragraphs 1.13 to 1.14).

Annual report chapter	MFF heading	Transactions subject to audit (billion euro)	Estimated level of error 2014 (%)	Confidence interval (%)		Estimated level of error 2013 (%)
				Lower error limit (LEL)	Upper error limit (UEL)	
Other [1]	Heading 3, 6 and other	2,1	—	—	—	—
Total		**144,5**	**4,4**	**3,3**	**5,4**	**4,5**
Revenue		**143,9**	**0**	**0**	**0**	**0**

(1) We do not provide a specific assessment or separate chapter for spending under MFF Headings 3 ('Security and citizenship') and 6 ('Compensations'), nor for other spending (special instruments outside the 2014-2020 MFF such as Emergency Aid Reserve, European Globalisation Adjustment Fund, European Union Solidarity Fund and Flexibility Instrument). Work in these areas contributes however to our overall conclusion on spending for the year 2014.

Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

1.11. Overall audit results have been relatively stable at a level significantly exceeding our benchmark for materiality over the last three years (see ***Graph 1.2***).

THE COMMISSION'S REPLIES

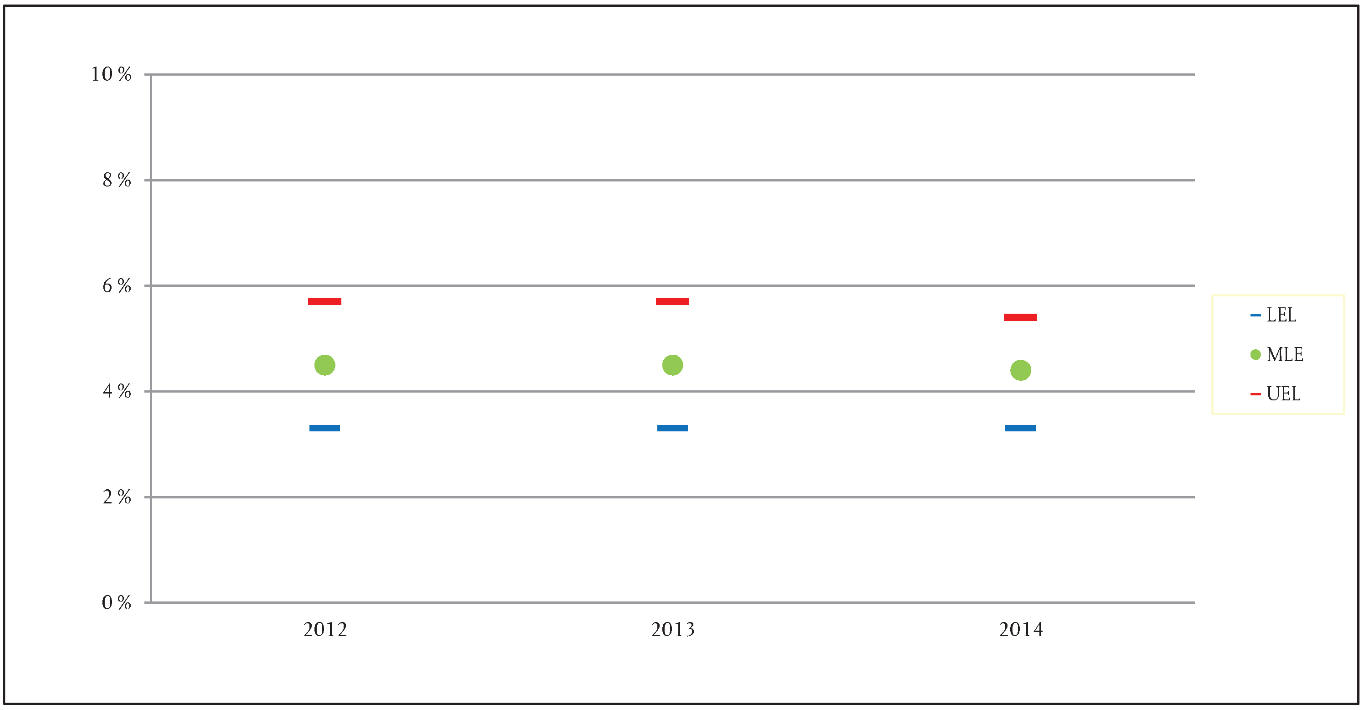
1.11. *The Commission notes that the error rate reported by the Court is an annual estimate which takes into account corrections of project expenditure detected before the announcement of the Court's audit.*

The Commission underlines that it is bound by the Financial Regulation, which stipulates, in Article 32(2)(e), that its internal control system should ensure, among other things, 'adequate management of the risks relating to the legality and regularity of the underlying transactions, taking into account the multiannual character of programmes as well as the nature of payments concerned'.

In the 2014 Synthesis Report (COM(2015)279 final), the Commission estimated the future impact of corrective mechanisms to be 2,7 billion euro, which represents 1,9 % of payments made by the EU budget.

The Commission will continue to exercise its supervisory role by implementing financial corrections and recoveries at the level that corresponds to the level of irregularities and deficiencies identified throughout the whole period and even after the closure of the programmes.

Graph 1.2 — The estimated level of error (most likely error, MLE) (2012-2014) ([1])



([1]) The estimated level of error for 2012 and 2013 has been adjusted so as to take into account the updated approach to quantifying serious public procurement errors (see paragraph 1.13).

Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

1.12. EU spending is dominated by two types of expenditure programmes involving distinct patterns of risk ([12]):

— Entitlement programmes, where payment is based on meeting certain conditions. Such programmes include student and research fellowships (chapter 5), direct aid for farmers (chapter 7), direct budget support ([13]) (chapter 8), salaries and pensions (chapter 9).

— Cost reimbursement schemes, where the EU reimburses eligible costs for eligible activities. Such schemes include research projects (chapter 5), investment schemes in regional and rural development (chapters 6 and 7), training schemes (chapter 6), and development projects (chapter 8).

([12]) Paragraphs 1.20 to 1.22 include a further analysis of these distinct risks.

([13]) Direct budget support payments contribute to a state's general budget or its budget for a specific policy or objective (see also paragraphs 8.7 and 8.8).

THE COURT'S OBSERVATIONS

We updated our audit approach …

1.13. For 2014 we updated our approach to the quantification of serious infringements of public procurement rules. This resulted in a clarification of the way in which we assess the impact of these infringements. In particular, we introduced a proportional approach to the calculation of errors related to the modification of contracts.

1.14. To ensure the comparability of results presented in this report we have adjusted the 2013 and 2012 figures in ***Table 1.1***, ***Graphs 1.2***, ***1.3***, ***1.4, 1.5*** and ***1.6*** in accordance with the updated approach. The unadjusted historical information on the estimated level of error reported in the 2009-2013 period is given in ***Annex 1.4***. The impact of the adjustment was to decrease the overall estimated level of error by 0,2 % in 2013 and by 0,3 % in 2012. This adjustment has no impact on the conclusions that we reached in either year. The level of error remains clearly material.

1.15. In 2015 we will adjust our approach to cross-compliance to the changed legal framework of the common agricultural policy. We will report on information the Commission provides on cross-compliance but will no longer include this element in our audit testing. This year we found many cross-compliance errors affecting one in four farms visited. Their contribution to our overall estimated level of error is 0,2 percentage points (2013: 0,2) ([14]) and is 0,6 percentage points for the 'Natural Resources' chapter (2013: 0,5).

THE COMMISSION'S REPLIES

1.13. *The Commission welcomes the new approach of the Court in the quantification of serious infringements of public procurement rules.*

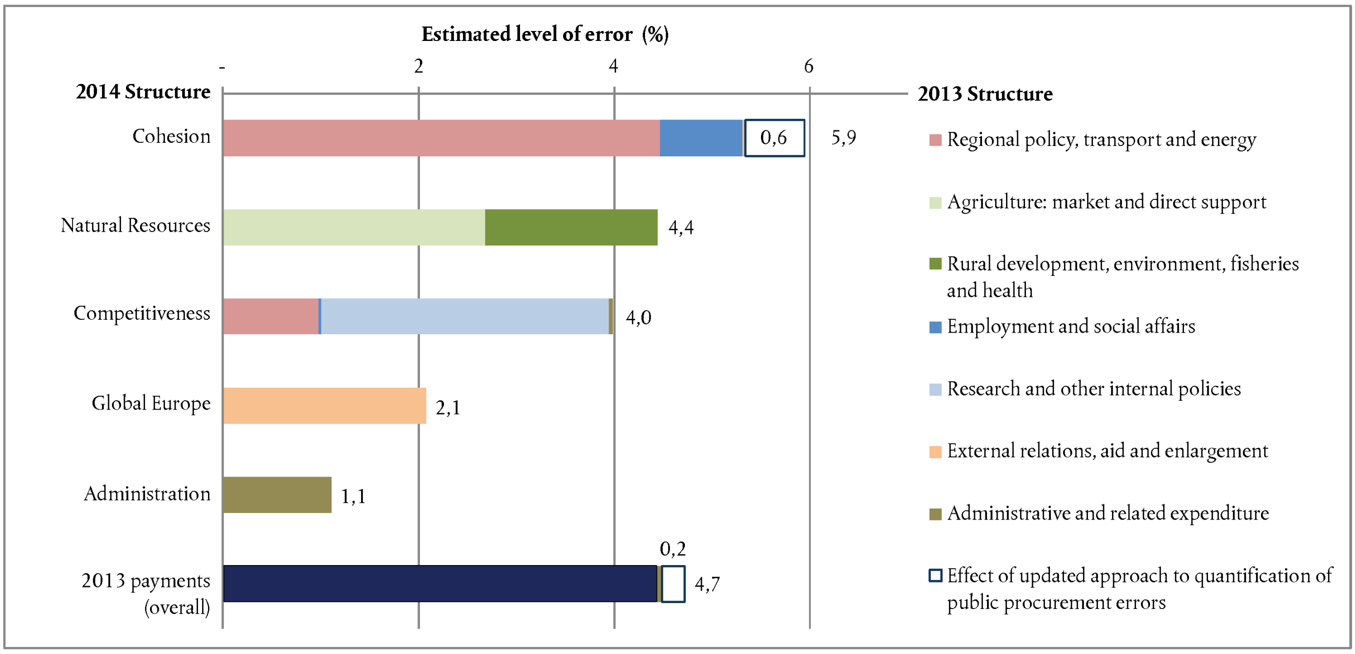
1.15. *The Commission welcomes the change in the Court's approach as of 2015. For 2014, it reiterates its view that cross compliance infringements do not affect eligibility conditions for payments (see Commission's reply to paragraph 7.7).*

([14]) See also paragraph 1.21 of the 2013 annual report.

… and the structure of our annual report

1.16. As described in the General Introduction (paragraphs 0.5 to 0.7), we have updated the structure of chapters in the annual report. In order to preserve comparability, we show below (***Graph 1.3***) how last year's audit results would have appeared under the new structure, and taking account of the updated approach to quantification of public procurement (see paragraphs 1.13 and 1.14). We used these figures in ***Table 1.1***.

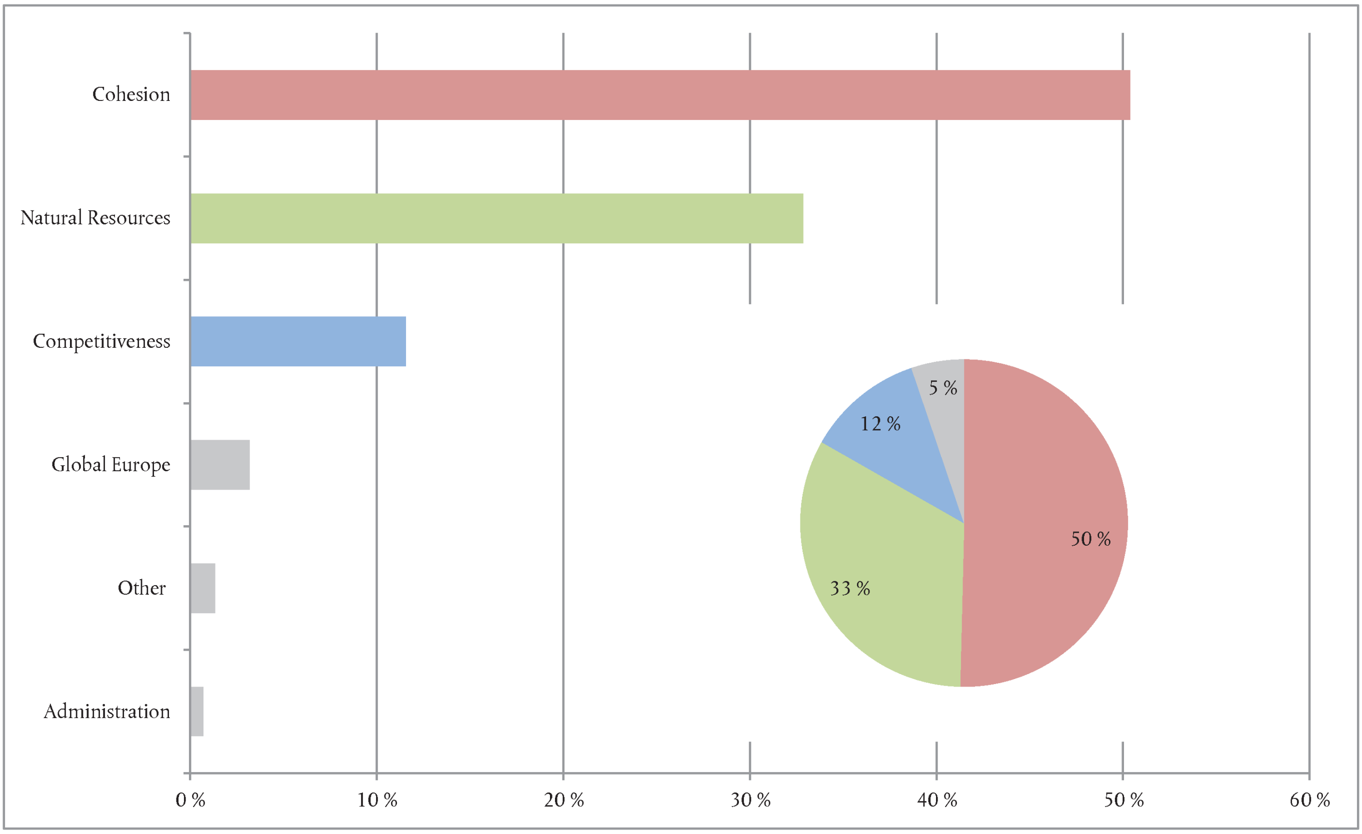
Graph 1.3 — Reclassification of 2013 audit results based on the 2014 annual report structure and taking into account the updated approach to quantification of public procurement errors



Source: European Court of Auditors, taking account of changes to the annual report structure and the updated approach to quantification of serious infringements of public procurement rules.

1.17. As shown in ***Graph 1.4***, Cohesion was the biggest contributor to our estimated level of error for 2014, followed by 'Natural Resources', 'Competitiveness' and 'Global Europe'. This distribution is in line with our findings for 2013.

Graph 1.4 — Contribution to 2014 overall estimated level of error by MFF heading



Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

1.18. Eligibility errors in cost reimbursement schemes dominate the errors detected for 2014 (see also paragraph 1.20 to 1.22, ***Graph 1.5*** and ***Graph 1.6***).

(a) For reimbursement expenditure the estimated level of error is 5,5 % (2013: 5,6 %). Typical errors in this area include:

— ineligible costs included in cost claims;

— ineligible projects, activities and beneficiaries;

— serious infringements of public procurement rules during tendering; and

— serious infringements of public procurement rules during contract implementation (i.e. modifications made to contracts and the awarding of additional works).

THE COMMISSION'S REPLIES

1.18.

(a) *The Commission has also identified similar problems during its audits. Considerable efforts have been made by the Commission during the 2007-2013 programming period to identify the root cause of problems and implement corrective actions where necessary.*

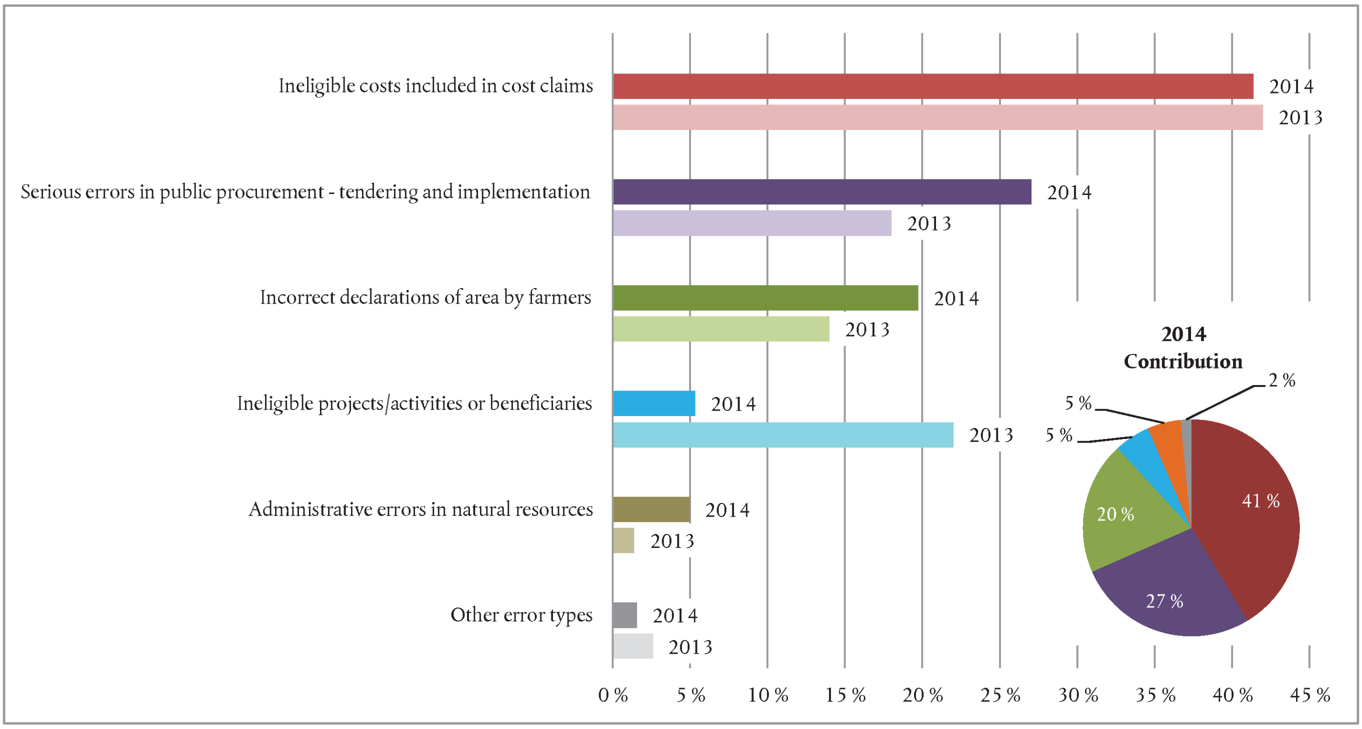
THE COURT'S OBSERVATIONS

(b) For entitlement programmes, the estimated level of error is 2,7 % (2013: 3,0 %). Typical errors in this area include:

— over-declarations by farmers of agriculture areas; and

— administrative errors affecting payments to farmers.

Graph 1.5 — Contribution to overall estimated level of error by type



Source: European Court of Auditors.

1.19. The figures for 2013 in ***Graph 1.5*** are on the same basis as for 2014, i.e. on the basis of the approach described in paragraph 1.13.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

There is a strong relationship between expenditure type and levels of error

1.20. We have analysed the relationship between expenditure type and risk of error. A feature of EU spending is the extent to which correct calculation of payments to recipients of funding depends upon information provided by the recipients themselves. This is true of the largest category of entitlement expenditure — the area-based subsidies paid to farmers. It is especially significant in the area of reimbursement activities: recipients must provide information supporting their claim to be engaged in an activity eligible for support and to have incurred costs for which they are entitled to reimbursement. This affects all management modes [15].

1.20. *The Integrated Administration and Control System (IACS) — which includes the Land Parcel Identification System (LPIS) — makes a significant contribution in preventing errors and reducing the error rate (see paragraph 7.32).*

LPIS is established and maintained by the national authorities. Payments to final beneficiaries are only possible after their claim has been cross-checked with the information available in LPIS.

As a result of LPIS, the level of errors for area-based subsidies is lower than for any of the other types of subsidies under shared management.

The Commission considers that box 1.2 and box 1.3 confirm this view.

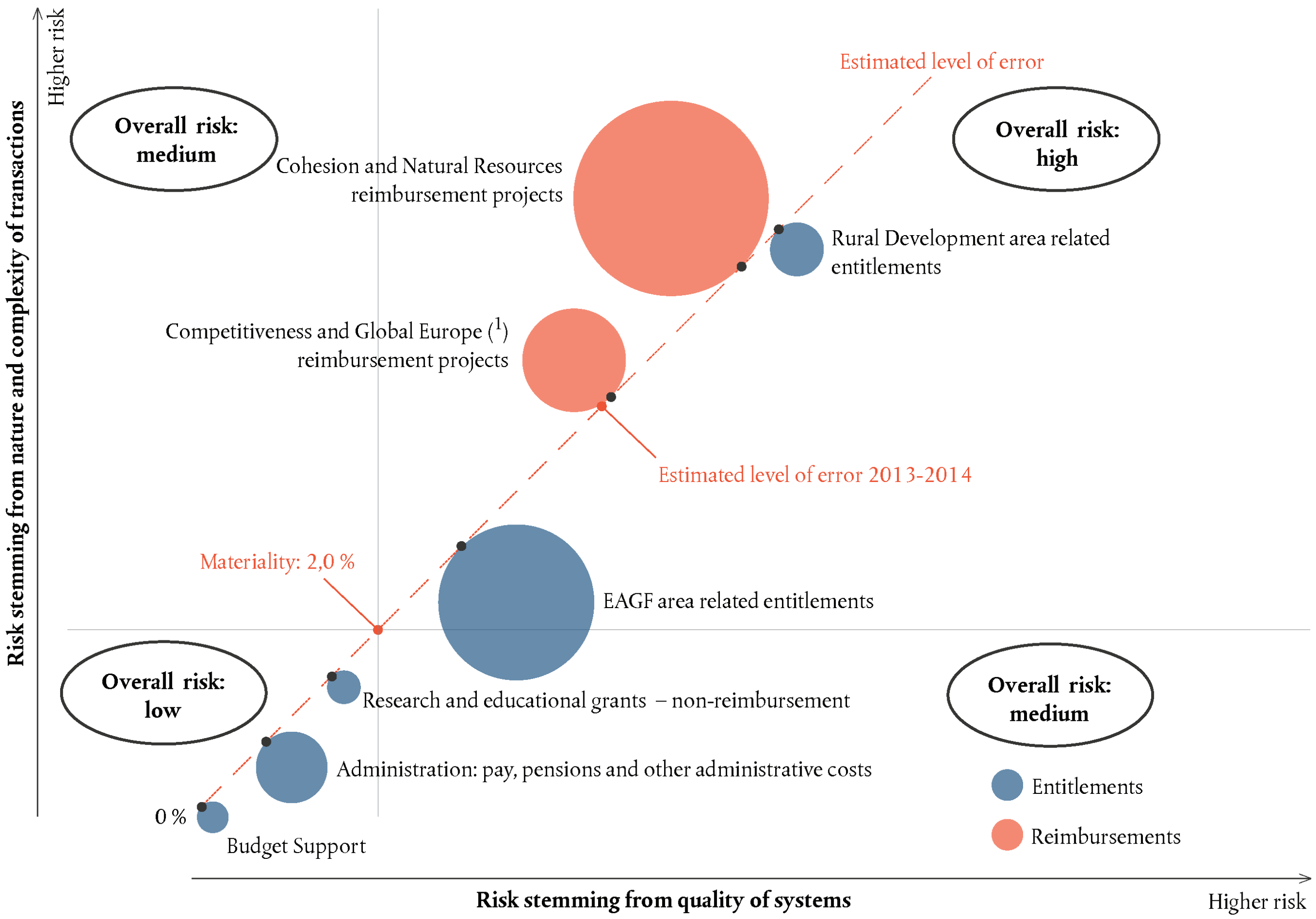
1.21. ***Graph 1.6*** is based on all audit testing of EU spending over the last two years [16], for the annual reports on the general budget and the European Development Funds. Payment streams are grouped according to their nature. The size of the circles in this graph represents their weight in overall spending; their position along the 45° line indicates relative levels of estimated errors; their colour indicates whether the expenditure is based upon entitlement or reimbursement.

1.22. This graph incorporates both elements of professional judgement (assessment of the impact of systems and of risks related to transaction type — see ***Annex 1.1***, paragraph 1) and empirical elements (measuring estimated levels of error over a two-year period). It is intended both to respond to requests from stakeholders for more information on differing risk profiles, and to assist the Commission in taking action to deal with areas of persistently high levels of errors.

[15] Direct management (budget implemented directly by the European Commission), indirect management (budget implementation entrusted to non-EU partner countries, international organizations etc.), shared management (budget implementation shared between the Commission and Member States).

[16] Evaluated on the same approach for both years (see paragraphs 1.13 and 1.14).

Graph 1.6 — The relationship between transaction type, risk, and estimated level of error in EU transactions (2013-2014)



([1]) Reimbursement for 'Global Europe' includes multi-donor projects which in practice have many of the attributes of entitlement spending and are affected by lower levels of error.

Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

Results in different areas of spending show distinct patterns of error

1.23. 'Competitiveness' (chapter 5): the estimated level of error is 5,6 %, an increase on the equivalent results in 2013 (4,0 % ([17])). Much of the expenditure is made on a cost reimbursement basis and the errors here essentially reflect different categories of ineligible cost (notably personnel costs, other direct costs, and indirect costs).

1.24. 'Cohesion' (chapter 6): the estimated level of error is 5,7 %, an increase on the equivalent results in 2013 (5,3 % ([17])). Almost all spending in this area takes the form of cost reimbursement. The main causes of error include serious infringements of public procurement rules (around half of the estimated level of error), followed by ineligible costs in expenditure declarations (over a quarter of the estimated level of error). Non-compliance with state aid rules and ineligible projects make up the balance of errors.

1.25. 'Natural resources' (chapter 7): the estimated level of error is 3,6 %, a decrease on the equivalent results in 2013 (4,4 % ([17])). European Agriculture Guarantee Fund (EAGF) accounts for more than three quarters of expenditure in this area and is less affected by error than rural development, where we have long found high levels of error, in particular in the spending organised on the basis of cost reimbursement. Overall, overstated claims from farmers of agricultural areas or animal numbers contributed around one-third of the estimated level of error. Errors related to ineligible beneficiaries, activities or expenditure were the second highest contributor (nearly one quarter of the estimated level of error). Cross-compliance infringements (one-sixth) and administrative errors (one-sixth) form the key remaining elements.

([17]) This comparator figure takes account both of the reclassification of budget lines to ensure that chapters reflect MFF headings and of the updated approach to procurement errors. See also ***Graph 1.3***.

THE COMMISSION'S REPLIES

1.23. *See the Commission's replies to Chapter 5 of the Annual Report (paragraphs 5.6 to 5.17).*

1.24. *See the Commission's replies to Chapter 6 of the Annual Report (paragraphs 6.23 to 6.45 and 6.76).*

1.25. *The lower error rate for EAGF reflects the effectiveness of the IACS, notably the LPIS, where adequately implemented, in preventing errors from the very beginning of the process. The Commission is of the opinion that the IACS as a whole is a solid system for the management of CAP expenditure.*

See also replies in paragraphs 1.15 and 1.20, 7.15 to 7.19 and 7.25 to 7.29.

THE COURT'S OBSERVATIONS

1.26. 'Global Europe' (chapter 8): the estimated level of error is 2,7 %, an increase on the equivalent results in 2013 (2,1 % ([18])) ([19]). Ineligible costs reimbursed by the Commission account for more than half of the total. Payments made where works, services or supplies had not been delivered account for one quarter of the total. The remainder results from the absence of supporting documents (around one tenth of the estimated level of error), incorrect calculation of expenditure, and non-compliance with procurement rules.

1.27. 'Administration' (chapter 9): the estimated level of error is 0,5 %, a decrease on the equivalent results in 2013 (1,1 % ([18])). Most spending in this area is on the salaries, pensions and allowances paid by EU institutions and agencies. A small number of errors in allowances accounted for most of the error in this area, which is in total not material.

1.28. As explained in the General Introduction, we do not present a separate chapter for spending outside of MFF headings 1-2 and 4-5. The remaining spending, amounting to 2,1 billion euro (1,5 % of the spending covered by our audit) is therefore reported in this chapter ([20]). Of the total of 2,1 billion euro, 0,5 billion euro represents spending through and by ten agencies covered in our specific annual reports ([21]). The main errors identified in this area were the reimbursement of ineligible costs (see Box 1.1).

THE COMMISSION'S REPLIES

1.26. *See the Commission's replies to Chapter 8 of the Annual Report (paragraphs 8.11 to 8.15).*

1.27. *See the Commission's replies to Chapter 9 of the Annual Report (paragraphs 9.13 to 9.17).*

([18]) This comparator figure takes account both of the reclassification of budget lines to ensure that chapters reflect MFF headings and of the updated approach to procurement errors. See also ***Graph 1.3***.

([19]) Most of expenditure of 2013 'External relations, aid and enlargement' chapter remained in the equivalent chapter for MFF heading 'Global Europe', a small quantity moved to the 'Economic, social and territorial cohesion' chapter, see also ***Graph 1.3***.

([20]) See footnote 1 to ***Table 1.1***.

([21]) European Agency for the Enhancement of Judicial Cooperation, European Agency for the Management of Operational Cooperation at the External Borders, European Agency for the Operational Management of Large-Scale IT Systems in the Area of Freedom, Security and Justice, European Asylum Support Office, European Centre for Disease Prevention and Control, European Food Safety Authority, European Monitoring Centre for Drugs and Drug Addiction, European Police College, European Police Office, European Union Agency for Fundamental Rights.

THE COURT'S OBSERVATIONS

Box 1.1 — Example of errors in costs reimbursed for a project under MFF Heading 3 'Security and Citizenship'

We sampled a payment by the Commission to a beneficiary acting as the co-ordinator on a collaborative project under the Fundamental Rights and Citizenship Programme.

The beneficiary, a public body, seconded two permanent staff (civil servants) part-time to the project, and charged part of their salaries in the project cost statement. The seconded staff must represent additional costs, which can only be justified if costs effectively arise by contracting other staff to replace the civil servants in their usual activities. As the beneficiary did not assign any replacement for the civil servants, these costs are ineligible.

In total, the ineligible costs declared by the beneficiary amounted to 58 000 euro of the total costs declared of 237 000 euro.

We detected ineligible costs reimbursed by the Commission in 8 of the 25 sampled projects for MFF Heading 3.

1.29. The estimated level of error on shared management expenditure taken as a whole amounts to 4,6 % (2013: 4,9 % ([22])) and on all other forms of operational expenditure ([23]) is 4,6 % (2013: 3,7 % ([22])). The estimated level of error for administrative expenditure is 0,5 % (2013: 1,0 % ([22])).

THE COMMISSION'S REPLIES

Box 1.1 — Example of errors in costs reimbursed for a project under MFF Heading 3 'Security and Citizenship'

The Commission was well aware of the difficulties met by public bodies in respecting the eligibility rule applicable to staff costs for public bodies (contracting other staff to replace the civil servant in their usual activities). That is why, from 2011 onwards, the Commission modified the eligibility rules applicable to staff of public bodies, making use of the flexibility provided in this regard by the Implementing Rules to the Financial Regulation. Therefore, the ineligible costs found by the Court in the mentioned grant (staff costs for staff in public bodies not assigning a replacement) would be now considered eligible.

([22]) This comparator takes account of the updated approach to procurement errors. See also paragraphs 1.13 and 1.14.

([23]) Mainly expenditure covered by chapters 7 and 8, and also including parts of the expenditure covered by chapters 5 and 6. The extrapolated error for shared management expenditure is based on the examination of 687 transactions (drawn from a population of 113 billion euro), the extrapolation for other forms of operational expenditure is based on the examination of 497 transactions (drawn from a population of 23 billion euro).

THE COURT'S OBSERVATIONS

There are many forms of corrective measures with differing impact

1.30. Our examination of 'errors and corrections' seeks to throw light on the complex mechanisms for making and recording corrective action, as well as to explain the different ways these mechanisms can impact on our audit work. In some areas of spending the Commission will have new tools at its disposal when expenditure for new programming period comes on stream.

Corrective measures

1.31. We seek to take account of corrective measures applied by the Member States and the Commission where these are made prior to payment or before our examination. We also take note of corrections made after notification of our audit, but are unable to reduce the estimate of error where the audit itself stimulates corrective action ([24]). We check the application of these corrections (which include recoveries from the beneficiaries and corrections at project level) and adjust the quantification of error whenever appropriate. However the impact of corrective measures varies significantly between different areas of spending, and between the different corrective measures.

1.32. For 24 transactions sampled in 2014, the Commission and Member State authorities had applied corrective measures that directly affected the transaction concerned and were relevant for our calculations. These corrective measures reduced our estimated level of error by 1,1 percentage points (2013: 1,6 percentage points) equivalent to around 1,6 billion euro. Changes in the number of transactions affected and in the impact on our estimated level of error do not indicate that corrective action has become more or less effective: as these measures apply to a relatively small share of our sample, fluctuation from year to year is expected.

THE COMMISSION'S REPLIES

1.30. *The Commission considers that the Court's annual representative error rate should be seen in the context of corrective capacity of the Commission as presented in the different Annual Activity Reports and the Synthesis Report. The Financial Regulation requires due consideration of the risks relating to the legality and regularity of the underlying transactions, taking into account the multiannual character of control systems and the nature of payments.*

1.31. *Common reply to paragraphs 1.31 and 1.32.:*

In the 2014 Synthesis Report (COM(2015) 279 final), the Commission estimated the future impact of corrective mechanisms to be 2,7 billion euro, which represents 1,9 % of payments made by the EU budget.

For a breakdown of the figures per policy area see table 1 in the Synthesis Report.

The Commission underlines that all types of financial corrections and recoveries exclude expenditure in breach of law from reimbursement by the EU budget (see note 6 to the accounts).

([24]) See paragraphs 1.19 to 1.37 of the 2012 annual report.

THE COURT'S OBSERVATIONS

There are a wide range of corrective measures

1.33. The Commission uses the terms 'financial corrections' and 'recoveries' to cover a wide range of corrective measures, which apply both before and after it makes (or reimburses) expenditure.

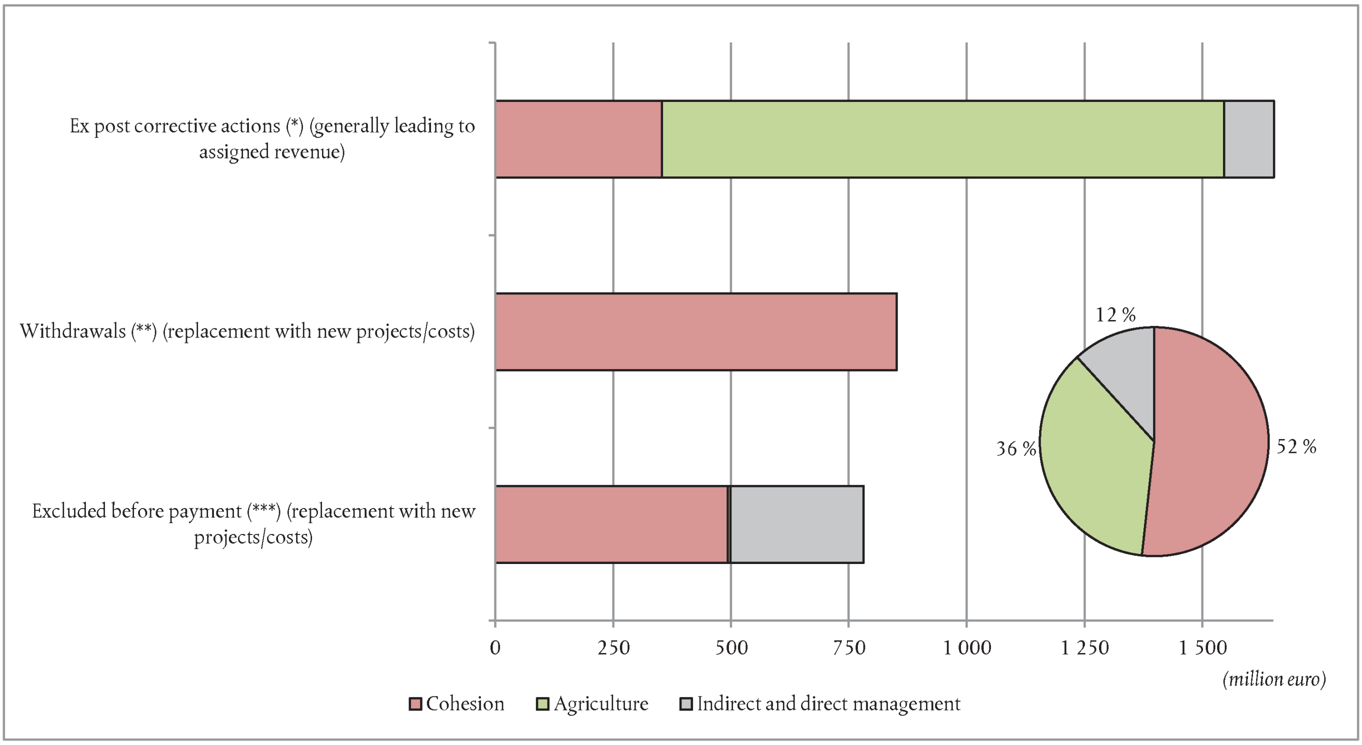
1.34. Note 6.2.2 to the accounts gives a total for implemented corrective actions in 2014 of 3 285 million euro. In ***Graph 1.7*** we show our classification of the amounts of corrections made at different stages in the spending cycle. A quarter of the total corrective actions implemented in 2014 represent corrections and recoveries 'at source' (before the Commission made the related payment) ([25]). A further quarter consists of the withdrawal and replacement of cohesion projects (either during implementation or at the closure of operational programmes).

THE COMMISSION'S REPLIES

1.33. *The Commission considers that the terms 'financial corrections' and 'recoveries' are used in accordance with the legal framework defined in the Financial Regulation and the respective sectorial legislation. More detailed information on the different preventive and corrective mechanism foreseen in the applicable legislation can be found in note 6 of the Annual Accounts of the EU and in the Communication on the Protection of the EU Budget.*

([25]) For ERDF and Cohesion Fund, corrections 'at source' reported as implemented in 2014 are 430 million euro. Of this, 75 % were already implemented in prior years.

Graph 1.7 — Classification of corrective measures implemented in 2014



(*) Commission decisions (mostly conformity decisions in agriculture), corrections at closure leading to decommitments and recoveries from beneficiaries.

(**) Reduction of reimbursed costs and introduction of new projects/costs during implementation of programmes and at closure.

(***) Corrections before payment in shared management, non eligible amounts and credit notes in direct and indirect management (recorded as "recoveries" in Note 6).

Source: Note 6 to the 2014 consolidated accounts of the EU and underlying data. For cohesion, the classification of the amounts between 'excluded before payment' and 'withdrawals' is based on an analysis of significant corrections during the period.

THE COURT'S OBSERVATIONS

1.35. The corrective action discussed in this section of the annual report also covers the work of Member State authorities and recoveries by both national authorities and the Commission.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

A significant part of the impact of corrective measures is present at the time that expenditure is accepted by the Commission

1.36. All relevant sectoral regulations in shared management lay down rules on first-level checks or reductions of amounts claimed by final beneficiaries carried out by national authorities before any expenditure is certified. National authorities also sometimes agree to reduce or eliminate some continuing costs from declarations because of errors with a long term impact (such as continuing payments under a contract affected by a public procurement error). Such adjustments can have an identifiable impact on the level of reimbursement requested for individual projects, or the subsidy paid to individual farmers, enabling the correction to reduce our estimated level of error.

1.37. In direct and indirect management, the 'recoveries' recorded by the Commission include deductions of ineligible amounts from cost claims prior to authorisation for payment. The eligibility of the amounts is established following desk reviews of available documentation, or based on the results of checks carried out (see also ***Graph 1.7***). These too allow us to reduce our estimated level of error.

1.37. *Commission services implement recoveries also 'at source' by deducting ineligible expenditure (which has been identified in previous or current cost claims) from payments made.*

Conformity decisions lead to assigned revenue that funds agricultural spending

1.38. Conformity decisions ('financial corrections' in agriculture) are often made on a flat-rate basis. In general they relate to system weaknesses rather than errors at the level of the final beneficiaries. They seldom lead to recoveries from the farmers concerned. These corrective measures are an incentive for Member States to improve their management and control systems. They contribute to the legality and regularity of the transactions at the level of the final beneficiaries if they result in continuing improvements to claims accepted by paying agencies (see Boxes 1.2 and 1.3).

1.38. *Financial corrections made by the Commission for Agriculture expenditure are meant to protect the EU budget and are imposed on Member States.*

They do not directly lead to recoveries from the farmers because the Commission does not directly pay the final beneficiaries but reimburses the payments by the Member States to the farmers. However, where such irregular payments are identifiable as a result of the conformity clearance procedure, the Commission would expect Member States to follow them up by recovery actions against the beneficiaries. Please see reply to Box 1.3.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

1.39. Paying agencies implement conformity decisions by reducing future claims for reimbursement by the Commission for payments to farmers. The Commission records the full amount paid to farmers as spending (i.e. the correction does not reduce the amount of recorded payments). Instead the accounts record the difference between payments made to farmers and the amounts reimbursed to paying agencies as assigned revenue, available to fund agricultural spending ([26]).

More than two-thirds of 'financial corrections' recorded for cohesion in 2014 represent replacement with new spending…

1.40. In cohesion, 'financial corrections' are, for more than two thirds of the recorded total, cases where authorities in the Member States withdraw expenditure declared and replace it with new expenditure. In some cases of 'withdrawal' no specific projects are identified as withdrawn. Instead the Member States declare additional projects and thus effectively receive a lower rate of co-financing. Withdrawals are only effective as a corrective measure where the replacement expenditure is itself free of material error.

1.40. *The Commission considers that all financial corrections, including those where Member States are allowed to bring in new projects and new expenditure to re-use the corrected amounts, protect the EU budget from expenditure incurred in breach of law and have an incentive effect for the Member States to recover from the beneficiaries (thus contribute to the improvement of management and control systems). Nevertheless, the deterrent effect of net financial corrections, whereby Member States cannot re-use the corrected and recovered amounts and therefore lose the funds, is certainly higher.*

([26]) For example, if an agricultural paying agency is subject to a financial correction of 5 % and makes payments to farmers of 100 million euro, it will be reimbursed 95 million euro by the Commission, but the Commission will record expenditure of 100 million euro balanced by assigned revenue of 5 million euro.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

… and net corrections are less common

1.41. Where replacement is not possible, corrections lead to a loss of EU funds for the Member State concerned [27].This may occur where Member States are unable to present sufficient eligible expenditure and where replacement is no longer possible [28] or allowed [29] and is relatively uncommon. The Commission expects that changes to legislation will make net corrections more common in the future.

1.41. *Following the example of the Agricultural area, the legislator has decided that a similar mechanism of net financial corrections should be applied to Cohesion policy for the programming period 2014-2020. This introduces an additional incentive for Member States to prevent or detect and address serious deficiencies in the management and control systems before submitting annual accounts to the Commission. If not, and serious deficiencies are still discovered by the Commission or the Court once annual accounts have been provided, the Commission must apply net correction under conditions fixed in the relevant regulations, meaning funds are lost for the Member State.*

Furthermore, the Commission considers that under shared management, all financial corrections and recoveries have a negative impact on national budgets regardless of their method of implementation. In order not to lose EU funding, the Member State must replace ineligible expenditure by additional eligible operations.

This means that the Member State bears, with its national budget, the financial consequences of the loss of EU co-financing of expenditure considered ineligible unless it recovers the amounts from individual beneficiaries.

[27] Either as reduction in payments or in the form of a cash-flow back to the EU budget. The latter results in assigned revenue (see ***Graph 2.2***).

[28] After the closure of programmes.

[29] In case of disagreement of the Member States with the Commission (see paragraph 1.25(b) of the 2012 annual report).

THE COURT'S OBSERVATIONS

The Commission and the Member States used all these forms of corrective measures in 2014

1.42. Boxes 1.2 to 1.4 illustrate differing types and impacts of corrective measures:

Box 1.2 — Example of improvement in management and control systems — Greece: Cleaning up the LPIS

The Commission took action to insist on improvement to the Land Parcel Identification System (LPIS) that is used as the basis for farm payments such as the Single Payment Scheme (SPS — the largest individual EU spending scheme). There have been several stages to this process, with the impact that 'eligible' permanent pasture on the Greek LPIS fell from 3,6 million hectares in 2012 to 1,5 million hectares in October 2014. Irregular claims for 'permanent pasture' that is not eligible for EU support has been a key factor of our estimated level of error in 'Natural Resources' over several years.

We took account of the impact of the corrections affecting the individual payments to final beneficiaries sampled for both EAGF and European Agricultural Fund for Rural Development (EAFRD). A further impact is that the paying agency rejected many ineligible claims — removing such claims from the spending from which we drew our sample.

THE COMMISSION'S REPLIES

Box 1.2 — Example of improvement in management and control systems — Greece: Cleaning up the LPIS

Other examples of the positive impact of action plans are given by the Court in Chapter 7. Action plans are implemented every time it is considered necessary and the Commission carefully monitors their implementation and reports on the remedial actions taken in the Annual Activity Report of the Directorate General for Agriculture and Rural Development.

LPIS prevents beneficiaries from claiming land that does not exist or that does not comply with the eligibility conditions, or land that has already been claimed by another beneficiary. When correctly implemented it is a very effective tool to reduce errors. It covers 75 % of CAP expenditure. Error rates for area related payments are lower than for other measures as shown in the 2014 Annual Activity Report of the Directorate General for Agriculture and Rural Development.

THE COURT'S OBSERVATIONS

Box 1.3 — Example of corrections resulting from conformity clearance [30] procedures — Conformity Decision 47 and its impact on French farmers

In 2014 France accepted a correction of 1,1 billion euro (984 million euro for EAGF and 94 million euro for EAFRD) [31]. National authorities announced that it would have no impact on farmers and that the amount would be met by the national budget. We stated in past annual reports that such practices are not an incentive for beneficiaries to eliminate errors [32].

The main reasons for the correction were weaknesses in LPIS-GIS (695 million euro) and exceeding the entitlement ceiling leading to overpayment to farmers (141 million euro). A smaller element covered breaches of the cross compliance obligation of timely notification of animal movements (123 million euro). All of these relate to payments made from 2009 to 2013. No correction has been made for 2014, and breaches of the entitlement ceiling and ineligible areas recorded in the LPIS in France contribute 0,3 percentage points to our estimated level of error in 'Natural Resources' this year.

Box 1.4 — Example of corrections resulting in extra-spending: Romania ESF

We referred to corrective activity in Romania in both the 2012 and 2013 annual reports. In 2013 we were able to reduce our estimate of error on a number of Romanian European Social Fund (ESF) projects because national authorities had identified the impact at project level. This continued to be the case in 2014. Errors remain in some projects we examined for problems not covered by the corrections. In its 2014 annual activity report, Directorate-General for Employment, Social Affairs and Inclusion (DG EMPL) reports that it is continuing to follow up on the implementation of the agreed action plan. The financial corrections made do not necessarily mean that Romania will receive less EU funding, because Member States have the option of declaring a larger amount of spending [33].

(30) A multi annual procedure permitting the recovery of sums paid out to Member States if these payments were made in breach of EU rules or if there are weaknesses in the management and control systems of the Member State. See also paragraph 7.59.
(31) France has subsequently launched an appeal to the Court of Justice of the European Union against the decision imposing the financial correction.
(32) See paragraphs 1.26 and 1.32 of the 2012 annual report.
(33) This would effectively reduce the rate of EU co-financing.

THE COMMISSION'S REPLIES

Box 1.3 — Example of corrections resulting from conformity clearance procedures — Conformity Decision 47 and its impact on French farmers

Under shared management, Member States are responsible for ensuring that control systems are working properly. The financial correction of 1,1 billion euro will be reimbursed to the EU budget in 3 yearly instalments (2015, 2016 and 2017).

The Commission would like to underline that due to the nature of the conformity clearance procedure that applies ex-post, after the accounts of the year have been cleared, and after a contradictory phase allowing the Member State concerned to present his own arguments and calculation, it is very rare that a financial correction may be adopted already in the following year of the expenditure concerned. An on-going conformity clearance procedure will protect the EU budget for 2014.

THE COURT'S OBSERVATIONS

The Commission's reporting on corrective measures does not always quantify their varying impact …

1.43. Note 6 to the accounts largely represents voluntary disclosure of information that is not required by accounting standards. A significant part of this information is not drawn from accounting systems. The note describes but does not always quantify the varying impact of the different corrective adjustments on the EU budget.

…and further improvements would enable a better analysis

1.44. The Commission's capacity to improve the quality of spending is not simply a function of the amounts involved but of their impact. Rigorous assessment of the impact of corrective measures requires better information on the type of error corrected and the way the corrections were made ([34]). When the relevant Commission directorates-general assess the impact of their corrective measures, they make the required adjustments to figures drawn from Note 6 (see paragraph 1.55).

The Commission's synthesis report confirms the material impact of error on transactions

1.45. Each Commission directorate general produces an annual activity report. This report includes:

— an account of the achievement of the key policy objectives (discussed in chapter 3),

— a management report of the director-general to the college of commissioners,

— a declaration in which the director-general provides assurance that the report properly presents financial information and that transactions under his/her responsibility are legal and regular.

THE COMMISSION'S REPLIES

1.43. *The legislator provided the Commission with the instrument of financial corrections in order to make sure that expenditure incurred in breach of law is not financed by the EU budget. These financial corrections are primarily linked to systems weaknesses which lead to a risk of error. It is the role of the Member States but not of the Commission to identify and recover irregular amounts from beneficiaries. If this is not done, EU funds are substituted by national funds because national budgets have to carry the burden of financial corrections.*

1.44. *A number of services have duly adjusted their figures related to the protection of the EU budget included in note 6 in order to provide an estimate of the future corrections in view of their specific circumstances.*

([34]) See the 2013 annual report, paragraphs 1.13 to 1.15.

THE COURT'S OBSERVATIONS

1.46. The synthesis report summarises this information, and provides a statement that in adopting it the Commission takes overall political responsibility for its management of EU budget.

1.47. This section presents results of our analysis of annual activity reports of the directorates general, and the Commission's synthesis report (35). It focuses on consistency and appropriateness of the Commission's estimates of:

— the level of error present when the Commission reimburses costs or settles its own expenditure (the Commission refers to this as 'amount at risk'), and

— the extent to which errors are addressed by later corrections (the Commission refers to this as its 'corrective capacity' or 'estimated future corrections' (36)).

Directors-general report annually on regularity

1.48. When directors-general are unable to give assurance on a significant segment of spending, they issue a reservation (see Box 1.5). Directors-general should do so where:

— an event has occurred with serious implications for the reputation of the Commission; or

— the impact of estimated levels of error, net of financial corrections and recoveries already made, remains material.

(35) The synthesis report and annual activity reports of the Commission are available on the Commission's website: synthesis report: http://ec.europa.eu/atwork/planning-and-preparing/synthesis-report/index_en.htm, annual activity reports: http://ec.europa.eu/atwork/synthesis/aar/index_en.htm.

(36) See footnotes 10 and 13 on p. 12 of the synthesis report.

THE COURT'S OBSERVATIONS

Box 1.5 — Reservations in 2014 annual activity reports

Directors-general made a total of 20 quantified reservations in 2014 compared to 17 in 2013. This increase in the overall number of reservations is due to:

— three new reservations made by the directors-general of Directorate-General for Communications, Networks, Content and Technology (DG CONNECT) ([37]), Directorate-General for European Neighbourhood Policy and Enlargement Negotiations (DG NEAR) ([38]) ([39]) and the Head of Service for Foreign Policy Instruments (FPI) ([40]);

— one recurrent reservation having been split into two ([41]); and

— one reservation having been lifted ([42]).

The amount of expenditure covered by a reservation decreased from 2,4 in 2013 to 2,3 billion euro in 2014 ([43]).

1.49. The European Parliament's 2013 discharge resolution ([44]) called upon the Commission 'to further clarify the calculation of the amount at risk' by 'explaining the estimated impact of corrective mechanisms on this figure'.

(37) Reservation in respect of Information and Communication Technologies Policy Support Programme (ICT-PSP) of the Competitiveness and Innovation framework Programme (CIP) countries due to the residual error rate being above 2 % (2,94 %).

(38) Reservation in respect of indirect management by beneficiary countries due to the residual error rate being above 2 % (2,67 %).

(39) Issues identified in 2013 annual report gave rise to a new reputational reservation in DG NEAR (former Directorate-General for Enlargement (DG ELARG), see paragraph 7.16 of the 2013 annual report).

(40) Reservation in respect of Common Foreign and Security Policy (CFSP) spending due to the residual error rate being above 2 % (2,13 %).

(41) Directorate-General for Regional and Urban Policy (DG REGIO) split its recurrent reservation on European Regional Development Fund (ERDF)/Cohesion Fund (CF)/Instrument for Pre-accession (IPA), into two: one on ERDF/CF and one on IPA.

(42) Directorate-General for Health and Food Safety (DG SANTE) lifted its reservation related to the animal disease eradication and monitoring programmes in the food and feed policy area.

(43) See Annex 2 to the synthesis report.

(44) Report on discharge in respect of the implementation of the general budget of the European Union for the financial year 2013, Section III — Commission and executive agencies 2014/2075(DEC) (A8-0101/2015).

THE COURT'S OBSERVATIONS

1.50. Responding to the request of the discharge authority, in 2014 the Commission further developed internal guidance [45] on presenting information in annual activity reports. It requested directors-general to present an 'average detected error rate' [46]. The application of this error rate to the total payments of the year results in the calculation of the 'amount at risk' [47]. The synthesis report presents this figure alongside the estimate of future corrective capacity of ex-post Commission checks.

The Commission recognises that spending is affected by a material level of error…

1.51. In the 2014 synthesis report the Commission presents the 'amount at risk' as a range from 3,7 to 5 billion euro. This represents between 2,6 % and 3,5 % of the 2014 payments covered by the synthesis report [48]. These figures show that overall expenditure is affected by a material level of error.

… but refers to the estimated impact of future corrections

1.52. The 2014 synthesis report provides a forecast of the aggregate amount of estimated future corrections (or corrective capacity). Based upon recorded corrections over the last six years [49], the Commission estimates that it will, in the future years, 'identify and correct errors for a total of approximately 2,7 billion euro' [50].

(45) Standing Instructions for the 2014 Annual Activity Reports (SEC (2014) 553).

(46) This is the detected or estimated error rate at the time payments were made (not the residual error rate), i.e. without an adjustment for errors corrected ex post. The error rate is calculated on a weighted basis for the directorate-general as a whole.

(47) The amount at risk is the value associated with the part of the expenditure which is deemed not to be in conformity with the applicable regulatory and contractual requirements after application of controls intended to mitigate compliance risks. In case that a specific error rate is not available for some expenditure categories or control systems, the average error rate and amount at risk would be presented as a range, assuming that the error rate for the expenditure categories or control systems concerned lies between 0 % and 2 %.

(48) See Table 1 in the synthesis report.

(49) See also paragraph 1.55.

(50) See section 2.4, p. 13 of the synthesis report.

THE COMMISSION'S REPLIES

1.50. *The estimation of an 'average detected error rate' represents a new concept with a different purpose, namely to allow the Authorising Officers by Delegation to include in their 2014 Annual Activity Reports for the first time their best estimate of the overall amount at risk, for the entire budget under their responsibility. In previous years, this was done only for the part of the expenditure subject to reservations.*

1.51. *The Commission recognises that 'spending is affected by a material level of error' in every instance that the Director-General introduces a financial reservation.*

1.52. *In the 2014 Synthesis Report, the Commission states that it will continue to operate corrective controls and produces its best estimate of amounts of correction, based on past performance over a period sufficiently long to attenuate cyclical effects. This is intended to meet the Discharge request to 'explain the estimated impact of corrective mechanisms'.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

However, some accuracy and consistency issues affect the figures

Shared management directorates-general adjusted data provided by national authorities

1.53. For more than three quarters of 2014 expenditure (MFF headings 1b and 2), directorates-general base their estimates of amounts at risk on data provided by national authorities. However the Commission states in the synthesis report that 'the reliability of Member States' control reports remains a challenge' ([51]). As a result directorates-general apply significant adjustments to the error rates reported ([52]). Such adjustments are necessary, but the Commission does not present a summary of its own work (on which it bases the adjustment).

1.53. *There are accuracy problems at the level of Member States. Therefore, the Commission took steps to improve accuracy and, when necessary, adjusted the figures using reasonable, prudent criteria. As a result the quality of the estimation improved.*

Every Annual Activity Report concerned includes a) a description of the process of scrutiny and validation or adjustment of the information reported by the Member States, b) a summary table outlining the effects of the adjustment per Member State and, c) as from this year, detailed data on each operating programme or paying agency for all DGs concerned.

Most directorates-general for direct and indirect management applied the new methodology for estimating amounts at risk consistently

1.54. In direct and indirect management, most directors-general applied the new methodology. However, for the purpose of the synthesis report, the Commission increased the estimated amount at risk for DG DEVCO by around 60 million euro ([53]).

1.54. *While DG DEVCO suggested a net amount in its Annual Activity Report, it did duly also specify that 'more than half of its average corrections would be related to action intervening before payment'. Therefore, in the Synthesis Report DG DEVCO's figure has been adjusted to undo any such netting-off effect.*

([51]) See section 2.3, p. 9 of the synthesis report.

([52]) In cohesion — for ERDF/CF the average error rate has been adjusted from 1,8 % reported by audit authorities to 2,6 %, for ESF — from 1,9 % to 2,8 %. In agriculture — error rates reported by the paying agencies have been adjusted from 0,55 % to 2,54 % for direct payments and from 1,52 % to 5,09 % for rural development.

([53]) This adjustment is related to DG DEVCO. The Commission made a corresponding adjustment to the estimate of future corrective capacity.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The Commission improved the calculation of corrective capacity

1.55. DG BUDG provided directors-general with the average amount of recoveries and financial corrections for their services since 2009 on the basis of information recorded in Note 6 of the accounts (see paragraphs 1.8 and 1.44). Several directors-general adjusted these numbers to take account of consistency issues affecting the raw data. The key adjustments made were as follows:

— elimination of ex ante or 'at source' corrections which were not relevant for the correction of payments made (see ***Graph 1.7***) (Education, Audiovisual and Culture Executive Agency, Executive Agency for Small and Medium-Sized Enterprises, DG EMPL, DG MARE, DG REGIO and DG SANTE) [54];

— elimination of corrections for periods with little relevance to current programmes (e.g. DG MARE eliminated corrections related to the 1994-99 programming period, which it considered had little relevance to current programmes, DG AGRI used the average annual amount of net financial corrections and recoveries implemented over the past three years only);

— elimination of corrections related to problems falling outside their definition of risk (e.g. cross-compliance in DG AGRI).

1.55. *The Commission does not see the consistency issues mentioned by the Court. Adjustments of historic data on the protection of the EU budget included in note 6 were only made in order to provide a reasonable estimate for a related yet different subject matter, i.e. the future corrective capacity of systems, as requested by the EP resolution.*

1.56. Several DGs' estimate of future corrections exceeds the estimated amount at risk [55]. In the area of cohesion policy, the Commission states, that this is mostly due to the fact that the corrective capacity is based on six-year average, while the amount at risk refers to the estimated level of error assessed in 2014, which is lower than in previous years.

[54] The impact of these adjustments was significant: for instance for DG REGIO removal of 'ex ante' corrections reduced the estimate of corrective capacity by 153 million euro to 1,2 billion euro.

[55] For eight DGs presenting a single estimate of amount at risk, the estimated corrective capacity is higher than the estimate. Of those DGs reporting an upper and lower level estimate in four cases the estimated level of future correction exceeds the lower level estimate, and in one case exceeds the upper level estimate.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Other issues dealt with in the synthesis report

1.57. A significant innovation in the last major revision of the Financial Regulation adopted in October 2012 was the introduction of a requirement for the Commission to evaluate areas of persistently high levels of error. While according to internal instructions ([56]) this should take place after three years, in the synthesis report the Commission announces that it does not plan to undertake such reviews until it is able to determine the effects of the new management and control systems of the 2014-2020 programming period on the level of error ([57]).

We send cases of suspected fraud to OLAF

1.58. We send cases of suspected fraud identified in our audit to the European Anti-Fraud Office (OLAF) for analysis and possible investigation. We cannot comment on individual cases or on OLAF's response to these. However, during the 2014 audit:

— we assessed the legality and regularity of some 1 200 transactions;

— we found 22 instances of suspected fraud (2013: 14) which we forwarded to OLAF ([58]);

— the most frequent instances of suspected fraud concerned declaration of costs not meeting the eligibility criteria, followed by conflicts of interest and other irregularities in procurement and the artificial creation of conditions to receive subsidy.

1.58.

The Commission stresses that artificial creation of conditions is difficult to prove under the existing legal framework, as interpreted by the Court of Justice of the European Union.

See also replies and comments in Box 7.4.

([56]) P. 33 of the Standing Instructions for the 2014 Annual Activity Reports.

([57]) See section 3.1, p. 16 and 17 of the synthesis report.

([58]) In 2014 calendar year we sent 16 cases to OLAF (related to both 2013 and 2014 audit years) (in 2013: 14). Some of these cases arise from work not related to the statement of assurance.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

CONCLUSIONS

1.59. The key function of this chapter is to support the audit opinions presented in the statement of assurance.

Audit results

1.60. Our audit results show considerable consistency with those of previous years.

1.61. Our results, as set out in ***Graph 1.6***, show a strong relationship between expenditure type and levels of error. This analysis both responds to requests from stakeholders for more information on differing risk profiles, and aims to assist the Commission in taking action to deal with areas of persistently high levels of errors.

Errors and corrections

1.62. Corrective measures recorded in Note 6 to the accounts include some important instruments for excluding irregular expenditure and providing incentives for improvement of control systems. Whenever possible, relevant corrective action is taken into account in our evaluation of individual transactions and this reduced our estimated level of error for 2014.

Annual activity reports and synthesis report

1.63. In the synthesis report the Commission recognised that the overall expenditure is affected by a material level of error.

1.64. The Commission has taken steps to begin to improve its analysis of the impact of corrective action. In doing so, it has reduced, but not eliminated the risk that the impact of corrective actions is overstated or of limited relevance. There is further scope for improvement in the Commission's assessment of the impact of corrective action.

1.64. *In the 2014 Synthesis Report, the Commission states that it will continue to operate corrective controls and produces its best estimate of amounts of correction, based on past performance over a period sufficiently long to attenuate cyclical effects. This is intended to meet the Discharge request to 'explain the estimated impact of corrective mechanisms'.*

THE COURT'S OBSERVATIONS

1.65. Achieving consistency in presentation of amounts at risk and corrective capacity represents a major challenge. There are a wide variety of systems, both within the Commission and the Member States providing information on amounts at risk and corrective capacity. Achieving consistency between these systems is not an easy task. The new guidance issued by the Commission (see paragraph 1.50) led to some improvements in the presentation of its estimation of the likely level of error, but did not remove the risk that estimates of error are significantly underestimated, nor (to a lesser extent) that corrective capacity is overstated. The adjustments introduced by numerous DGs (see page 12 of the synthesis report) should provide the Commission with a basis for further improving information systems.

1.66. The Commission has not yet undertaken the analysis of areas of persistently high levels of error. We consider it important that such an analysis be undertaken before, or as part of the mid-term review of the 2014-2020 MFF.

THE COMMISSION'S REPLIES

1.65. *There are accuracy problems at the level of Member States. Therefore, the Commission took steps to improve accuracy and, when necessary, adjusted the figures using reasonable, prudent criteria. As a result the quality of the estimation improved.*

Moreover, the adjustments result from the application of quality checks by the Commission. As stated in the Synthesis Report, the Commission considered that this was the best available indication to estimate the future corrective capacity.

(See reply to paragraph 1.53).

1.66. *The Commission will carry out the review of areas of persistently high levels of error as soon as possible when sufficient data on new programmes are available.*

ANNEX 1.1

AUDIT APPROACH AND METHODOLOGY

1. Our audit approach is set out in the Financial and Compliance Audit Manual available on our website. We use an assurance model to plan our work. In our planning, we consider the risk of errors occurring (inherent risk) and the risk that errors are not prevented or detected and corrected (control risk).

Part 1 — Audit approach and methodology for the reliability of accounts

2. The consolidated accounts consist of:

A. the consolidated financial statements; and

B. the aggregated reports on the implementation of the budget.

The consolidated accounts should properly present, in all material respects:

— the financial position of the European Union at year end;

— the results of its operations and cash flows; and

— the changes in net assets for the year ended.

Our audit involves:

(a) An evaluation of the accounting control environment.

(b) Checks on the functioning of key accounting procedures and the year-end closure process.

(c) Analytical checks (consistency and reasonableness) on the main accounting data.

(d) Analyses and reconciliations of accounts and/or balances.

(e) Substantive tests of commitments, payments and specific balance sheet items based on representative samples.

(f) To the extent possible, and in accordance with international standards on auditing, the use of the work of other auditors. This is particularly the case for the audit of those borrowing and lending activities managed by the Commission for which external audit certificates are available.

Part 2 — Audit approach and methodology for the regularity of transactions

3. The audit of the regularity of the transactions underlying the accounts involves direct testing of transactions (see ***Table 1.1***). We ascertain whether they are in line with the relevant rules and regulations.

How we test transactions

4. Within each specific assessment (chapters 4 to 9), we carry out direct tests of transactions on the basis of a representative sample of transactions. Our testing provides an estimate of the extent to which the transactions in the population concerned are irregular.

5. Transaction testing involves examining each transaction selected. We determine whether or not the claim or payment was made for the purposes approved by the budget and specified in relevant legislation. We examine the calculation of the amount of the claim or payment (for larger claims based on a representative selection of the items on which subsidy is based). This involves tracing the transaction down from the budgetary accounts to the level of the final recipient (e.g. a farmer, the organiser of a training course, or a development aid project promoter). We test compliance at each level. There is an error when the transaction (at any level):

— is incorrectly calculated; or

— does not meet a regulatory requirement or contractual provision.

6. For revenue, our examination of value added tax and gross national income-based own resources takes as a starting point the relevant macroeconomic aggregates on which these are calculated. We examine the Commission's control systems for processing these until the contributions of the Member States have been received and recorded in the consolidated accounts. For traditional own resources, we examine the accounts of the customs authorities and the flow of duties until the amounts are received by the Commission and recorded in the accounts.

7. For expenditure we examine payments when expenditure has been incurred, recorded and accepted ('expensed payments'). This examination covers all categories of payments (including those made for the purchase of assets). We do not examine advances at the point they are made. We examine advance payments when:

— the final recipient of EU funds (e.g. a farmer, a research institute, a company providing publicly procured works or services) provides evidence of their proper use; and

— the Commission (or other institution or body managing EU funds) accepts that final use of funds is justified by clearing the advance payment.

8. Our audit sample is designed to provide an estimate of the level of error in the audited population as a whole. We examine larger claims or payments by selecting items (e.g. invoices of a project, parcels in a claim by a farmer, see paragraph 5) to audit within individual transactions using monetary unit sampling (MUS). Thus in case of examined items being part of a project or claim by a farmer, the error rate reported for these items does not constitute an error rate for the audited project or a claim by a farmer, but contributes to the overall evaluation of EU expenditure.

9. We do not examine transactions in every Member State, beneficiary state and/or region each year. The examples provided in the annual report are for illustrative purposes and demonstrate the most typical errors found. The naming of certain Member States, beneficiary states and/or regions does not mean that the examples presented do not occur elsewhere. The illustrative examples presented in this report do not form a basis for conclusions to be drawn on the Member States, beneficiary states and/or regions concerned.

10. Our approach is not designed to gather data on the frequency of error in the population. Therefore, figures presented on frequency of error are not an indication of the frequency of error in EU-funded transactions or in individual Member States. Our sampling approach applies different weighting to different transactions. Our sampling reflects the value of the expenditure concerned and the intensity of audit work. This weighting is removed in a frequency table which therefore gives as much weight to rural development as to direct support in the area of 'Natural Resources' and to Social Fund expenditure as to regional and cohesion payments in the 'Cohesion' chapter. The relative frequency of error in samples drawn in different Member States cannot be a guide to the relative level of error in different Member States.

How we evaluate and present the results of transaction testing

11. Errors in transactions occur for a variety of reasons. They take a number of different forms depending on the nature of the breach and specific rule or contractual requirement not followed. Individual transactions may be wholly or partially affected by error. Errors detected and corrected before and independently of the checks carried out by us are excluded from the calculation and frequency of error. They demonstrate that the control systems have worked effectively. We consider whether individual errors are quantifiable or non-quantifiable. We take account of the extent to which it is possible to measure how much of the amount audited was affected by error.

12. Many errors occur in the application of public procurement laws. To respect the basic principles of competition foreseen in EU laws and regulations, significant procedures must be advertised. Bids must be evaluated according to specified criteria. Contracts may not be artificially split to avoid breaching thresholds ([1]).

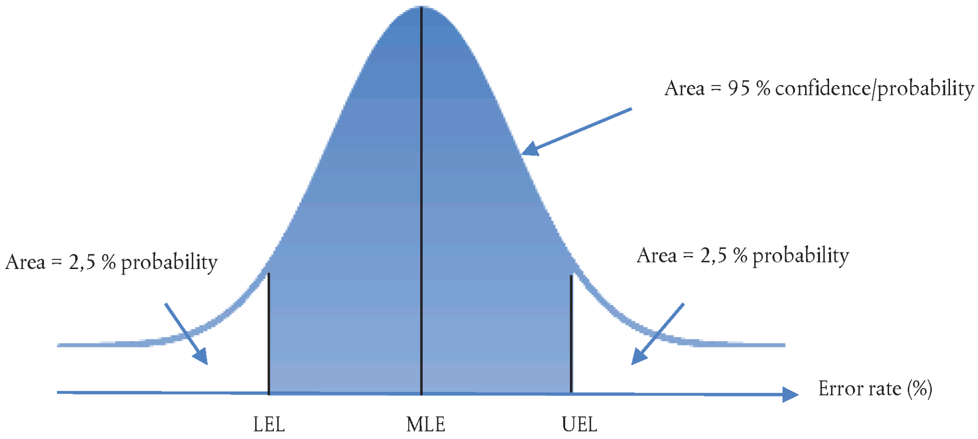
([1]) See also paragraphs 6.30 to 6.35 and special report No 10/2015 'Efforts to address problems with public procurement in EU Cohesion expenditure should be intensified'.

13. Our criteria for quantification of public procurement errors are described in the document 'Non-compliance with the rules on public procurement — types of irregularities and basis for quantification' ([2]).

14. Our quantification may differ from that used by the Commission or Member States when deciding how to respond to the misapplication of the public procurement rules.

Estimated level of error (most likely error)

15. We estimate the level of error using the most likely rate of error (MLE). We do this for each MFF heading, and for spending from the budget as whole. Only quantified errors are part of the calculation. The MLE percentage is a statistical estimate of the likely percentage of error in the population. Examples of errors are quantifiable breaches of applicable regulations, rules, and contract and grant conditions. We also estimate the lower error limit (LEL) and the upper error limit (UEL) (see illustration below).



16. The percentage of the shaded area below the curve indicates the probability that the level of error of the population is between the LEL and the UEL.

17. We plan our work on the basis of a materiality threshold of 2 %. We use the level of materiality as guidance for our opinion. We also take account of the nature, amount and context of errors when forming our opinion.

How we examine systems and report the results

18. The Commission, other EU institutions and bodies, Member States' authorities, beneficiary countries and/or regions establish systems. They use these systems to manage the risks to the budget, including the regularity of transactions. Examining systems is particularly useful for identifying recommendations for improvement.

19. Each MFF heading, including revenue, involves many individual systems. We select a sample of systems each year. We present the results with recommendations for improvement.

How we arrive at our opinions in the statement of assurance

20. All our work reported in chapters 4 to 9 forms the basis for our opinion on the regularity of transactions underlying the European Union's consolidated accounts. Our opinion is set out in the statement of assurance. In forming our opinion we consider whether error is pervasive. Our work allows us to arrive at an informed opinion as to whether errors in the population exceed or fall within the materiality limits. Our best estimate of the level of error for overall spending in 2014 is 4,4 %. We have more than 95 % confidence that the level of error for the audited population is material. The estimated level of error found in different MFF headings varies as described in chapters 4 to 9. We assessed error as pervasive — extending across the majority of spending areas.

([2]) http://www.eca.europa.eu/Lists/ECADocuments/Guideline_procurement/Quantification_of_public_procurement_errors.pdf

Suspected fraud

21. If we have reason to suspect that fraudulent activity has taken place, we report this to OLAF, the Union's antifraud office. OLAF is responsible for carrying out any resulting investigations. We report several cases per year to OLAF.

Part 3 — Link between the audit opinions for the reliability of accounts and the regularity of transactions

22. We have issued:

(a) an audit opinion on the consolidated accounts of the European Union for the financial year ended; and

(b) audit opinions on the regularity of the revenue and payments underlying those accounts.

23. Our work and our opinions follow the IFAC's International Standards on Auditing and Codes of Ethics and INTOSAI's International Standards of Supreme Audit Institutions.

24. These standards also provide for the situation where auditors issue audit opinions on the reliability of accounts and the regularity of transactions underlying those accounts, by stating that a modified opinion on the regularity of transactions does not in itself lead to a modified opinion on the reliability of accounts. The financial statements on which we express an opinion, in particular Note 6, recognise that there is a material issue in relation to breaches of the rules governing expenses charged to the EU budget. Accordingly, we have decided that the existence of a material level of error affecting regularity is not in itself a reason to modify our separate opinion on the reliability of the accounts.

ANNEX 1.2

FOLLOW-UP OF OBSERVATIONS FROM PRIOR YEARS CONCERNING THE RELIABILITY OF ACCOUNTS

Observations raised in previous years	Court's analysis of the progress made	Commission reply
1. **Pre-financing, accounts payable and cut-off procedures**	1. **Pre-financing, accounts payable and cut-off procedures**	1. **Pre-financing, accounts payable and cut-off procedures**
For pre-financings, accounts payable and related cut-off, since the 2007 financial year we have identified accounting errors with an immaterial financial impact overall but a high frequency. This underlines the need for further improvement at the level of certain directorates-general.	The Commission continued to work on improving the accuracy of its accounting data. Our examination of representative samples of pre-financings and invoices/cost claims again identified errors with an immaterial financial impact overall but a high frequency.	*The Commission recognises that improvements can always be made, however, it highlights that pre-financing and invoices have been correctly accounted for during the past 8 years.*
As regards accounting for pre-financed amounts, we found that several directorates-general continued to record estimates in the accounts even when they have an adequate basis for clearing the corresponding pre-financings. We also found that in several directorates-general the cut-off procedures should be improved, harmonised and automated.	Several directorates-general have not yet achieved a timely clearance of pre-financing or sufficiently accurate procedures for calculating the extent to which pre-financing has been used, and the split between current and non-current pre-financing.	
The Commission included financial engineering instruments for the first time in the 2010 accounts and advances from other aid schemes for the first time in the 2011 accounts. Outstanding balances in both cases are estimated on the assumption that funds are used evenly over the period of operation. The Commission should keep this assumption under review.	Outstanding balances continue to be estimated on the assumption that funds are used evenly over the period of operation taking into account, where available, information provided by the Member States for the financial instruments under shared management (FISM). For the FISM (formerly financial engineering instruments), the period of operation is based on an assumed extension from 31 December 2015 till 31 March 2017 on the basis of a new interpretation of the related closure guidelines. The limited information available on the use of the advances for the FISM and other aid schemes may impact on their year-end valuation and lead to significant adjustments at the closure of the 2007-2013 programming period. It is important that the DGs concerned verify the use of these funds.	

Observations raised in previous years	Court's analysis of the progress made	Commission reply
2. **Disclosures concerning recoveries and financial corrections ('protection of the EU budget')**	2. **Disclosures concerning recoveries and financial corrections ('protection of the EU budget')**	2. **Disclosures concerning recoveries and financial corrections ('protection of the EU budget')**
The accounting officer has refined the presentation of information on recoveries and financial corrections in Note 6 to the financial statements. This note is now more focussed and less extensive but it also contains information which is not drawn from the accounting system. This information could be better presented in the report on the protection of the EU budget according to Article 150(4) of the Financial Regulation (EU, Euratom) No 966/2012 to be presented to the budgetary authorities in September of each year.	The Commission has made further progress in the presentation of Note 6. For cohesion, Note 6 now discloses the extent to which corrections are made prior to expenditure being recorded ('at source'), during implementation and at closure.	
Neither Note 6 nor the aforementioned report on the protection of the EU budget summarises the varying impact of the different corrective adjustments.	The note now describes but does not always quantify the impact of the corrective measures on the EU budget. We found that note 6 still does not distinguish between: — adjustments at project level or corrections at programme level; and — net financial corrections and agreements which allow for replacement of irregular expenditure.	*To the extent possible and given cost-benefit considerations, the split of information referred to by the Court is now being included in the annual Communication on the Protection of the EU Budget.*
	The Commission intends to reflect the European Court of Justice decisions of June 2015 annulling financial correction decisions for an amount of 457 million euro in Note 6 in the 2015 accounts.	*The legal cases referred to by the Court relate to the programming period 1994-1999 and decisions taken between 2008 and 2010. The judgments received reflect procedural issues arising from Regulation 1083/2006. The Commission is analysing the impact.*
	The note still contains information which is not drawn from the accounting system. The Commission is currently analysing the situation with the aim of introducing new procedures in order to record these transactions within conventional accounting systems.	*As the Court recognises, the Commission is investigating possible new procedures, however, this has to take place under the constraints of the regulatory system in place and the resulting information available.*
In order to ensure the accuracy of the figures presented, the Commission should put in place procedures for confirming the timing, the origin and the amount of the corrective mechanisms with the Member States.	Procedures in place are not yet effective.	*The Commission will examine with the Member States how existing information systems can be further improved in the way the Court suggests.*

ANNEX 1.3

EXTRACTS FROM THE 2014 CONSOLIDATED ACCOUNTS (1)

Table 1 — Balance sheet (*)

(million euro)

	31.12.2014	31.12.2013
Non-current assets		
Intangible assets	282	237
Property, plant and equipment	7 937	6 104
Investments accounted for using the equity method	409	349
Financial assets	56 438	59 844
Pre-financing	18 358	38 072
Exchange receivables and non-exchange recoverables	1 198	498
	84 623	**105 104**
Current assets		
Financial assets	11 811	5 571
Pre-financing	34 237	21 367
Exchange receivables and non-exchange recoverables	14 380	13 182
Inventories	128	128
Cash and cash equivalents	17 545	9 510
	78 101	**49 758**
Total assets	**162 724**	**154 862**
Non-current liabilities		
Pension and other employee benefits	(58 616)	(46 818)
Provisions	(1 537)	(1 323)
Financial liabilities	(51 851)	(56 369)
	(112 005)	**(104 510)**
Current liabilities		
Provisions	(745)	(545)
Financial liabilities	(8 828)	(3 163)
Payables	(43 180)	(36 213)
Accrued charges and deferred income	(55 973)	(56 282)
	(108 726)	**(96 204)**
Total liabilities	**(220 730)**	**(200 714)**
Net assets	**(58 006)**	**(45 852)**
Reserves	4 435	4 073
Amounts to be called from Member States	(62 441)	(49 925)
Net assets	**(58 006)**	**(45 852)**

(*) The balance sheet is presented using the layout of the consolidated accounts of the European Union.

(1) The reader is advised to consult the full text of the consolidated accounts of the European Union for the financial year 2014 including both the consolidated financial statements and explanatory notes and the aggregated reports on the implementation of the budget and explanatory notes.

Table 2 — Statement of financial performance (*)

(million euro)

	2014	2013 (reclassified)
Revenue		
Revenue from non-exchange transactions		
GNI resources	104 688	110 194
Traditional own resources	17 137	15 467
VAT resources	17 462	14 019
Fines	2 297	2 757
Recovery of expenses	3 418	1 777
Other	5 623	4 045
Total	**150 625**	**148 259**
Revenue from exchange transactions		
Financial income	2 298	1 991
Other	1 066	1 443
Total	**3 364**	**3 434**
	153 989	**151 693**
Expenses (**)		
Implemented by Member States		
European Agricultural Guarantee Fund	(44 465)	(45 067)
European Agricultural Fund for Rural Development and other rural development instruments	(14 046)	(13 585)
European Regional Development Fund and Cohesion Fund	(43 345)	(47 767)
European Social Fund	(12 651)	(12 126)
Other	(2 307)	(1 525)
Implemented by the Commission and executive agencies	(15 311)	(12 519)
Implemented by other EU agencies and bodies	(1 025)	(656)
Implemented by third countries and international organisations	(2 770)	(2 465)
Implemented by other entities	(1 799)	(1 694)
Staff and pension costs	(9 662)	(9 058)
Changes in employee benefits actuarial assumptions	(9 170)	(2 033)
Finance costs	(2 926)	(2 383)
Share of net deficit of joint ventures and associates	(640)	(608)
Other expenses	(5 152)	(4 572)
	(165 269)	**(156 058)**
Economic result of the year	**(11 280)**	**(4 365)**

(*) The statement of financial performance is presented using the layout of the consolidated accounts of the European Union.
(**) Implemented by Member States: Shared management; implemented by the Commission and executive agencies: Direct management; implemented by other EU agencies and bodies, third countries, international organisations and other entities: Indirect management.

Table 3 — Cashflow statement (*)

(million euro)

	2014	2013
Economic result of the year	(11 280)	(4 365)
Operating activities		
Amortisation	61	48
Depreciation	408	401
(Increase)/decrease in loans	(1 298)	20
(Increase)/decrease in pre-financing	6 844	(1 695)
(Increase)/decrease in exchange receivables and non-exchange recoverables	(1 898)	923
(Increase)/decrease in inventories	—	10
Increase/(decrease) in pension and employee benefits liability	11 798	4 315
Increase/(decrease) in provisions	414	(196)
Increase/(decrease) in financial liabilities	1 146	(330)
Increase/(decrease) in payables	6 967	14 655
Increase/(decrease) in accrued charges and deferred income	(309)	(12 154)
Prior year budgetary surplus taken as non-cash revenue	(1 005)	(1 023)
Other non-cash movements	130	(50)
Investing activities		
(Increase)/decrease in intangible assets and property, plant and equipment	(2 347)	(624)
(Increase)/decrease in investments accounted for using the equity method	(60)	43
(Increase)/decrease in available for sale financial assets	(1 536)	(1 142)
Net cashflow	**8 035**	**(1 164)**
Net increase/(decrease) in cash and cash equivalents	8 035	(1 164)
Cash and cash equivalents at the beginning of the year	9 510	10 674
Cash and cash equivalents at year-end	17 545	9 510

(*) The cashflow statement is presented using the layout of the consolidated accounts of the European Union.

Table 4 — Statement of changes in net assets (*)

(million euro)

	Reserves (A)		Amounts to be called from Member States (B)		Net Assets = (A)+(B)
	Fair value reserve	Other reserves	Accumulated Surplus/ (Deficit)	Economic result of the year	
Balance as at 31.12.2012	**150**	**3 911**	**(39 148)**	**(5 329)**	**(40 416)**
Movement in Guarantee Fund reserve	—	46	(46)	—	—
Fair value movements	(51)	—	—	—	(51)
Other	—	12	(9)	—	3
Allocation of the 2012 economic result	—	5	(5 334)	5 329	—
2012 budget result credited to Member States	—	—	(1 023)	—	(1 023)
Economic result of the year	—	—	—	(4 365)	(4 365)
Balance as at 31.12.2013	**99**	**3 974**	**(45 560)**	**(4 365)**	**(45 852)**
Movement in Guarantee Fund reserve	—	247	(247)	—	—
Fair value movements	139	—	—	—	139
Other	—	(24)	16	—	(8)
Allocation of the 2013 economic result	—	(0)	(4 365)	4 365	—
2013 budget result credited to Member States	—	—	(1 005)	—	(1 005)
Economic result of the year	—	—	—	(11 280)	(11 280)
Balance as at 31.12.2014	**238**	**4 197**	**(51 161)**	**(11 280)**	**(58 006)**

(*) The statement of changes in net assets is presented using the layout of the consolidated accounts of the European Union.

Table 5 — EU budget result (*)

(million euro)

	2014	2013
Revenue for the financial year	143 940	149 504
Payments against current year's budget appropriations	(141 193)	(147 567)
Payment appropriations carried over to year N+1	(1 787)	(1 329)
Cancellation of unused payment appropriations carried over from year N-1	25	34
Evolution of assigned revenue	336	403
Exchange differences for the year	110	(42)
Budget result (**)	**1 432**	**1 002**

(*) The EU budget result is presented using the layout of the consolidated accounts of the European Union.
(**) Of which EFTA result is (3) million euro in 2014 and (4) million euro in 2013.

Table 6 — Reconciliation of economic result with budget result (*)

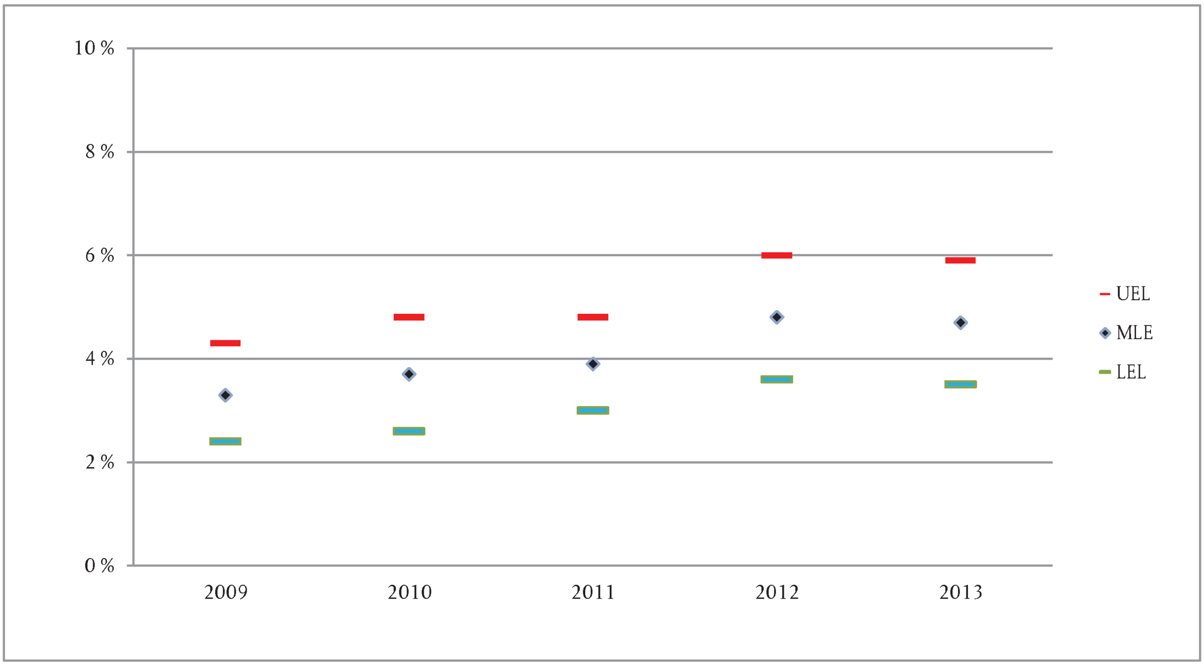
(million euro)

	2014	2013
Economic result of the year	**(11 280)**	**(4 365)**
Revenue		
Entitlements established in current year but not yet collected	(6 573)	(2 071)
Entitlements established in previous years and collected in current year	4 809	3 357
Accrued revenue (net)	(4 877)	(134)
Expenses		
Accrued expenses (net)	9 223	3 216
Expenses prior year paid in current year	(821)	(1 123)
Net-effect pre-financing	457	(902)
Payment appropriations carried over to next year	(1 979)	(1 528)
Payments made from carry-overs and cancellation of unused payment appropriations	1 858	1 538
Movement in provisions	12 164	4 136
Other	(1 719)	(1 027)
Economic result agencies and ECSC	**170**	**(93)**
Budget result of the year	**1 432**	**1 002**

(*) The reconciliation of economic result with budget result is presented using the layout of the consolidated accounts of the European Union.

ANNEX 1.4

THE ESTIMATED LEVEL OF ERROR (MOST LIKELY ERROR, MLE) — UNADJUSTED HISTORICAL DATA FOR 2009 TO 2013



This graph includes the unadjusted, historical estimated levels of error as published in the 2009 to 2013 annual reports, Graphs 1.1 and Tables 1.2 (see paragraph 1.14).

ANNEX 1.5

FREQUENCY OF DETECTED ERRORS IN AUDIT SAMPLING FOR THE YEAR 2014

Frequency of detected errors in audit sampling for the year 2014 by directorate-general and institution (expenditure only)

European Commission Directorate-General (DG) Other instutions and bodies (all types of management)		Total number of transactons examined	Number of transactions affected by one or more errors	Number of transactions affected by:				
				Other compliance issues and non quantifiable errors	Quantifiable errors	Quantifiable errors < 20 %	Quantifiable errors 20 %-80 %	Quantifiable errors 80 %-100 %
European Commission:								
AGRI	DG Agriculture and Rural Development	345	172	46	126	107	13	6
EMPL	DG Employment, Social Affairs and Inclusion	178	62	32	30	18	7	5
REGIO	DG Regional and Urban Policy	161	75	50	25	10	10	5
DEVCO	DG International Cooperation and Development	102	31	12	19	14	4	1
RTD	DG Research and Innovation	54	37	12	25	18	6	1
PMO	Office for the Administration and Payment of Individual Entitlements	58	7	3	4	4	0	0
ECHO	DG Humanitarian Aid and Civil Protection (ECHO)	37	6	0	6	6	0	0
NEAR	DG Neighbourhood and Enlargement Negotiations	23	4	2	2	2	0	0
CNECT	DG Communications Networks, Content and Technology	20	9	2	7	6	1	0
EAC	DG Education and Culture	20	5	0	5	4	1	0
ERCEA	European Research Council Executive Agency	14	10	7	3	3	0	0
EACEA	Education, Audiovisual and Culture Executive Agency	12	5	1	4	4	0	0
MARE	DG Maritime Affairs and Fisheries	12	4	2	2	1	1	0

European Commission Directorate-General (DG) Other instutions and bodies (all types of management)		Total number of transactons examined	Number of transactions affected by one or more errors	Number of transactions affected by:				
				Other compliance issues and non quantifiable errors	Quantifiable errors	Quantifiable errors < 20 %	Quantifiable errors 20 %-80 %	Quantifiable errors 80 %-100 %
HOME	DG Migration and Home Affairs	11	5	0	5	4	1	0
JRC	Joint Research Centre	11	2	1	1	0	0	1
REA	Research Executive Agency	9	5	2	3	2	1	0
GROW	DG Internal Market, Industry, Entrepreneurship and SMEs	8	1	0	1	1	0	0
OIB	Office for Infrastructure and Logistics in Brussels	7	3	3	0	0	0	0
ENER	DG Energy	6	3	1	2	2	0	0
MOVE	DG Mobility and Transport	6	2	0	2	1	1	0
DIGIT	DG Informatics	5	0	0	0	0	0	0
SANTE	DG Health and Food Safety	5	2	0	2	2	0	0
JUST	DG Justice and Consumers	4	1	0	1	0	1	0
FPI	Service for Foreign Policy Instruments	4	1	1	0	0	0	0
COMM	DG Communication	3	0	0	0	0	0	0
ECFIN	DG Economic and Financial Affairs	3	0	0	0	0	0	0
CLIMA	DG Climate Action	2	0	0	0	0	0	0
FISMA	DG Financial Stability, Financial Services and Capital Markets Union	2	0	0	0	0	0	0
HR	DG Human Resources and Security	2	0	0	0	0	0	0
TAXUD	DG Taxation and Customs Union	2	0	0	0	0	0	0
BUDG	DG Budget	1	0	0	0	0	0	0
ENV	DG Environment	1	1	0	1	0	1	0
ESTAT	DG Eurostat	1	0	0	0	0	0	0
Subtotal European Commission		1 129	453	177	276	209	48	19

European Commission Directorate-General (DG) Other instutions and bodies (all types of management)	Total number of transactons examined	Number of transactions affected by one or more errors	Number of transactions affected by:				
			Other compliance issues and non quantifiable errors	Quantifiable errors	Quantifiable errors < 20 %	Quantifiable errors 20 %-80 %	Quantifiable errors 80 %-100 %
Other instutions and bodies							
European Parliament	28	3	0	3	3	0	0
European External Action Service	11	5	2	3	3	0	0
Council of the European Union	7	1	0	1	1	0	0
Court of Justice of the European Union	4	0	0	0	0	0	0
European Court of Auditors	2	0	0	0	0	0	0
Other bodies	3	0	0	0	0	0	0
Subtotal other instutions and bodies	55	9	2	7	7	0	0
Total	**1 184**	**462**	**179**	**283**	**216**	**48**	**19**

Frequency of detected errors in audit sampling for the year 2014 by Member State (MFF headings 1b and 2)

Member State (shared management)		MFF heading 1b — Cohesion														MFF heading 2b — Natural Resources														Shared management MFF headings 1b Cohesion and 2 Natural Resources (total)						
		European Regional Development Fund/ Cohesion Fund (ERDF/CF)							European Social Fund (ESF)							Market and direct support							Rural development, environment, climate action and fisheries													
		Number of transactions	Number of errors	Number of transactions affected by:					Number of transactions	Number of errors	Number of transactions affected by:					Number of transactions	Number of errors	Number of transactions affected by:					Number of transactions	Number of errors	Number of transactions affected by:					Number of transactions	Number of errors	Number of transactions affected by:				
				OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %			OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %			OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %			OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %			OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
BE	Belgium	7	4	3	1	1	0	0								4	4	0	4	4	0	0								11	8	3	5	5	0	0
BG	Bulgaria								8	0	0	0	0	0	0								5	2	2	0	0	0	0	13	2	2	0	0	0	0
CZ	Czech Republic	18	8	5	3	1	1	1	14	2	1	1	1	0	0	4	2	0	2	2	0	0	5	4	2	2	1	0	1	41	16	8	8	5	1	2
DK	Denmark															8	2	0	2	2	0	0								8	2	0	2	2	0	0
DE	Germany	8	7	5	2	2	0	0	14	6	3	3	2	0	1	20	5	0	5	5	0	0	15	8	1	7	6	0	1	57	26	9	17	15	0	2
EE	Estonia															4	2	0	2	2	0	0								4	2	0	2	2	0	0
IE	Ireland															4	3	0	3	3	0	0								4	3	0	3	3	0	0
EL	Greece	13	3	2	1	0	1	0	20	4	0	4	0	1	3	12	3	0	3	1	2	0	10	3	2	1	0	1	0	55	13	4	9	1	5	3
ES	Spain	7	3	3	0	0	0	0								28	10	2	8	5	3	0	12	3	1	2	1	1	0	47	16	6	10	6	4	0
FR	France								7	2	1	1	1	0	0	35	30	0	30	30	0	0	9	6	4	2	2	0	0	51	38	5	33	33	0	0
HR	Croatia																																			
IT	Italy	8	5	4	1	0	1	0	20	10	7	3	1	2	0	16	8	1	7	6	1	0	16	12	10	2	2	0	0	60	35	22	13	9	4	0
CY	Cyprus																																			
LV	Latvia	7	1	1	0	0	0	0															5	1	1	0	0	0	0	12	2	2	0	0	0	0

Member State (shared management)		MFF heading 1b — Cohesion														MFF heading 2b — Natural Resources														Shared management MFF headings 1b Cohesion and 2 Natural Resources (total)						
		European Regional Development Fund/ Cohesion Fund (ERDF/CF)							European Social Fund (ESF)							Market and direct support							Rural development, environment, climate action and fisheries													
				Number of transactions affected by:							Number of transactions affected by:							Number of transactions affected by:							Number of transactions affected by:							Number of transactions affected by:				
		Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
LT	Lithuania	7	1	1	0	0	0	0															5	3	1	2	0	1	1	**12**	**4**	**2**	**2**	**0**	**1**	**1**
LU	Luxembourg																																			
HU	Hungary	12	6	3	3	1	2	0	7	0	0	0	0	0	0	8	3	1	2	2	0	0	5	2	0	2	1	1	0	**32**	**11**	**4**	**7**	**4**	**3**	**0**
MT	Malta	4	2	1	1	0	0	1																						**4**	**2**	**1**	**1**	**0**	**0**	**1**
NL	Netherlands								7	6	4	2	2	0	0	4	2	0	2	2	0	0	5	5	4	1	1	0	0	**16**	**13**	**8**	**5**	**5**	**0**	**0**
AT	Austria								7	5	4	1	0	1	0								10	2	0	2	2	0	0	**17**	**7**	**4**	**3**	**2**	**1**	**0**
PL	Poland	34	20	16	4	2	1	1	21	3	1	2	2	0	0	12	5	1	4	3	1	0	20	9	6	3	2	0	1	**87**	**37**	**24**	**13**	**9**	**2**	**2**
PT	Portugal	11	3	2	1	1	0	0	15	9	5	4	3	1	0	4	0	0	0	0	0	0	15	7	5	2	1	1	0	**45**	**19**	**12**	**7**	**5**	**2**	**0**
RO	Romania	7	2	0	2	0	1	1	8	4	2	2	0	1	1								5	1	1	0	0	0	0	**20**	**7**	**3**	**4**	**0**	**2**	**2**
SI	Slovenia																																			
SK	Slovakia								7	1	1	0	0	0	0	4	4	0	4	4	0	0	5	3	0	3	3	0	0	**16**	**8**	**1**	**7**	**7**	**0**	**0**
SF	Finland								7	4	1	3	2	1	0	4	1	0	1	1	0	0								**11**	**5**	**1**	**4**	**3**	**1**	**0**
SE	Sweden	7	5	1	4	2	2	0	8	4	2	2	2	0	0								5	2	2	0	0	0	0	**20**	**11**	**5**	**6**	**4**	**2**	**0**
UK	United Kingdom	7	5	3	2	0	1	1								12	9	0	9	9	0	0	21	9	1	8	4	2	2	**40**	**23**	**4**	**19**	**13**	**3**	**3**

Member State (shared management)	MFF heading 1b — Cohesion														MFF heading 2b — Natural Resources														Shared management MFF headings 1b Cohesion and 2 Natural Resources (total)						
	European Regional Development Fund/ Cohesion Fund (ERDF/CF)							European Social Fund (ESF)							Market and direct support							Rural development, environment, climate action and fisheries													
			Number of transactions affected by:							Number of transactions affected by:							Number of transactions affected by:							Number of transactions affected by:							Number of transactions affected by:				
	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %	Number of transactions	Number of errors	OCI/NQE	Quantifiable	<20 %	20 %-80 %	80 %-100 %
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(1)	(2)	(3)	(4)	(5)	(6)	(7)
cross border cooperation	*4*	*0*	*0*	*0*	*0*	*0*	*0*																						**4**	**0**	**0**	**0**	**0**	**0**	**0**
Total	***161***	***75***	***50***	***25***	***10***	***10***	***5***	***170***	***60***	***32***	***28***	***16***	***7***	***5***	***183***	***93***	***5***	***88***	***81***	***7***	***0***	***173***	***82***	***43***	***39***	***26***	***7***	***6***	**687**	**310**	**130**	**180**	**133**	**31**	**16**

(1) Total number of transactons examined

(2) Number of transactions affected by one or more errors

(3) Other compliance issues (OCI) and non quantifiable errors (NQE)

(4) Quantifiable errors

(5) Quantifiable errors <20 %

(6) Quantifiable errors 20 % — 80 %

(7) Quantifiable errors 80 % — 100 %

We take account of corrective measures and this impacts on the individual findings included in the table (see also paragraph 1.32). We do not examine transactions in every Member State, beneficiary state, and/or region each year. Where the table has no content ('blank cells') it indicates that there were no transactions examined. Our approach is not designed to gather data on the frequency of error in the population. Therefore, figures presented on frequency of error are not an indication of the frequency of error in EU funded transactions or in individual Member States. The relative frequency of error in samples drawn in different Member States cannot be a guide to the relative level of error in different Member States.

CHAPTER 2

Budgetary and financial management

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INTRODUCTION

2.1. This chapter gives an overview of key budgetary and financial management issues arising in 2014. These include overall levels of spending and the relationship with budgetary and new multiannual financial framework (MFF) ceilings (see paragraphs 2.4 to 2.9), levels of unpaid payment claims and outstanding commitments (see paragraphs 2.10 to 2.22), and levels of cash held in financial instruments (see paragraphs 2.23 to 2.26).

2.2. This was the first year of the MFF, covering the period 2014 to 2020. In practice most of the payments made in 2014 were still related to the programmes of the previous MFF. Payments in 2014 covered for example the cost of subsidies to farmers for 2013, reimbursement of claims for cohesion projects for the 2007-2013 operational programmes, and for research projects under the Seventh Framework Programme, which began in 2007.

2.3. The multiannual financial framework is a seven-year programme setting out the key parameters for the annual budget of the European Union. It is defined in a Council Regulation ([1]) with the consent of the European Parliament and fixes an overall annual ceiling on payment and commitment appropriations. The new MFF sets commitment appropriations at a maximum of 1 083 billion euro and payment appropriations at a maximum of 1 024 billion euro for the seven-year period ([2]). A new feature in this MFF is that unused amounts under the payment ceiling are automatically made available in subsequent years ([3]).

([1]) Council Regulation (EU, Euratom) No 1311/2013 (OJ L 347, 20.12.2013, p. 884).

([2]) Amounts are stated in current prices.

([3]) According to Article 5 of Regulation (EU, Euratom) No 1311/2013, the Commission must adjust upwards the payment ceiling of a year by an amount equivalent to the difference between the payments and the MFF payment ceiling of the previous year. These annual adjustments must not exceed maximum amounts of 7, 9 and 10 billion euro (in 2011 prices) in 2018, 2019 and 2020 respectively.

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The budget for payments in 2014 was the second highest ever

2.4. The EU budget is planned and reported on a cash basis and is set-up with the aim of balancing receipts and payments: the budget cannot be funded by borrowing [4] see paragraphs 2.12 to 2.13). The initial budget for payments in 2014 was the highest in the history of the EU. The final level of payments [5] was second only to 2013 and was, as in 2013, higher than the MFF ceiling (see ***Graphs 2.1*** and ***2.2***).

(4) Article 17 of the Financial Regulation — Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1).

(5) Including 350 million euro for special instruments.

Graph 2.1 — Evolution of budgets and payments 2010-2014

(billion euro)

Source: Consolidated annual accounts of the European Union — Financial years 2010-2014.

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2014 payment appropriations and payments were higher than forecast in the MFF

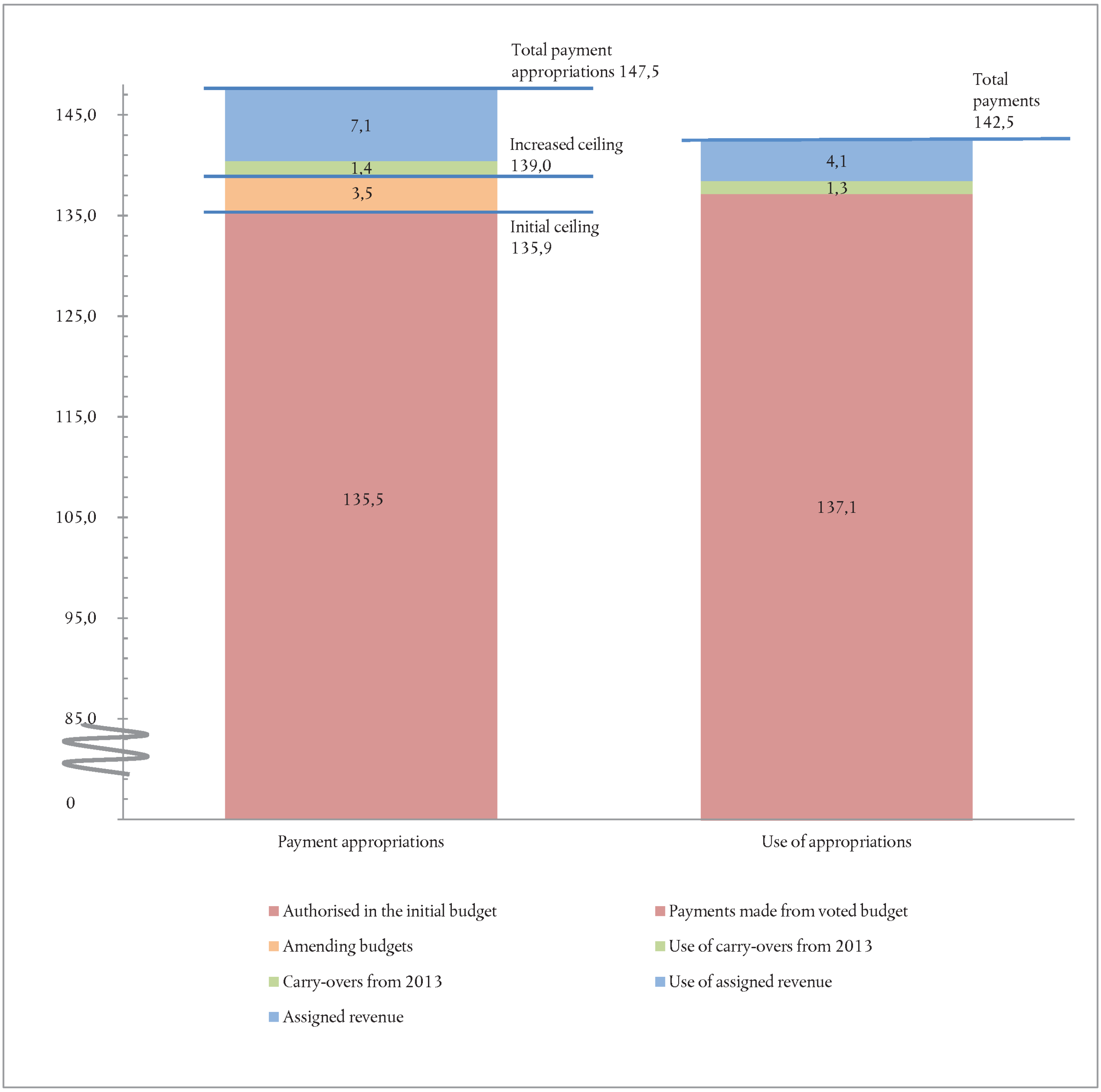
2.5. ***Graph 2.2*** gives an overview of the key figures on payment appropriations and payments made in 2014.

2.6. The MFF regulation [6] adopted in 2013 set a maximum level for payment appropriations for 2014 at 135,9 billion euro [7]. The initial budget was set just below this ceiling at 135,5 billion euro.

(6) Regulation (EU, Euratom) No 1311/2013.
(7) Including 350 million euro for special instruments.

Graph 2.2 — Payment appropriations and payments made in 2014

(billion euro)



Source: Consolidated annual accounts of the European Union — Financial year 2014, 'Aggregated reports on the implementation of the budget and explanatory notes', Tables 5.1 and 5.3.

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2.7. Parliament and Council approved seven amending budgets [8], six of them on 17 December 2014. The most significant amending budgets (No 2 and 3) responded to a Commission request for a further 3,5 billion euro in payment appropriations. Establishment of a budget at this higher level required the activation of the contingency margin ('a last-resort instrument to react to unforeseen circumstances' [9]). The Commission requested use of this in May 2014, at an early stage of the new MFF period.

2.8. Use of the contingency margin increased the payment appropriations ceiling for 2014 established in the MFF by 3,2 billion euro to 139,0 billion euro. As a consequence the payment appropriations ceiling will be reduced by 0,9 billion euro in each of the years 2018-2020. The Commission had not made a proposal for a reduction covering the balance of the contingency margin at the time this report was finalised [10].

2.9. The amended budget, together with the carry-overs [11] from the previous year (1,4 billion euro) and the assigned revenue (7,1 billion euro) [12], increased the final budget for payments to 147,5 [13] billion euro (see ***Graph 2.2***). Total payments made in 2014 amounted to 142,5 billion euro [14]. Of the unused payment appropriations (5,0 billion euro), 4,8 billion euro were carried forward to 2015.

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2.7. *The mobilisation of the contingency margin was justified by the growing level of unpaid claims for the 2007-2013 cohesion policy programmes at end of 2013 amounting to EUR 23,4 billion. It was due to the combination of insufficient payment credits voted in the annual budgets in the last years of the previous MFF and the tight payment ceiling of the first year of the current MFF.*

2.8. *Acknowledging that there is no final agreement between the three institutions on this interpretation, in the context of the 2015 budget procedure they agreed a joint declaration, undertaking to 'find a rapid agreement on whether and to what extend other special instruments may be mobilised over and above the MFF ceilings for payments with a view to determining whether and to what extent the amount of EUR 350 million should be offset against the MFF margins for payments for current or future financial years.'*

2.9. *Despite the late adoption of the amending budgets in December 2014, full execution was reached at end 2014 for cohesion policy and no payment appropriations were carried over.*

(8) Three of these dealt with technical adjustments and two had a relatively minor net impact (less than 0,1 billion euro) on budgetary commitments.

(9) Introduced in Article 13 of the MFF 2014-20, Regulation (EU, Euratom) No 1311/2013.

(10) Decision (EU) 2015/435 of the European Parliament and of the Council of 17 December 2014 on the mobilisation of the Contingency Margin (OJ L 72, 14.3.2015, p. 4) states in Article 2 that 'The Commission is invited to present in a timely manner a proposal concerning the remaining amount of EUR 350 million'.

(11) Carry-overs are funds unused in a financial year which are transferred to the budget of the following year.

(12) Assigned revenue is earmarked revenue for specific activities. Assigned revenue originated principally from agriculture penalties and other recoveries (3,6 billion euro) and third parties, including EFTA and candidate countries (3,0 billion euro).

(13) This figure is higher than the final voted budget appearing in ***Graph 2.1*** because it includes carry-overs and assigned revenue.

(14) See Table 5.3 MFF: Implementation of payment appropriations (p. 126 of the accounts).

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Despite this, there was a small increase in unpaid payment claims …

2.10. Despite the level of payments continuing to be higher than the MFF ceiling and use of the 'contingency margin', unpaid payment claims rose by 1,4 billion euro to 25,8 billion euro ([15]). Although this indicates a further accumulation of submitted claims, most of these claims arrived late in the year ([16]). Of these, claims for 4,8 billion euro were interrupted at year end and claims for 10,2 billion euro were submitted too late to be processed (in the last four days of the year). As a result, for cohesion (the largest component of the total) the maximum amount that the Commission could have paid after approving other claims would have been 9,7 billion euro (if the budget had been available). The amounts that were verified as correct by the Commission and recorded as ready for payment in the Commission's accounting system before the end of the year amounted to 1,9 billion euro.

… while the level of commitments made was well within the overall limit

2.11. The budget authorised appropriations for commitments of 142,7 billion euro ([17]) for 2014. Commitments made amounted to 109,3 billion euro (76,6 % of appropriations available) reflecting the level of new programmes approved by the Commission ([18]) in the first year of the new MFF 2014-2020. As a result a very high level of appropriations for commitments is available in 2015. The MFF ceiling for commitment appropriations has been adjusted in 2015 to take account of the low level of utilisation in 2014. The ceiling has been increased by 16,5 billion euro ([19]), and an amount of 12,1 billion euro has been carried over to 2015.

2.11. *The MFF Regulation provides for a reprogramming of unused 2014 commitments in the later years. As a consequence of the late adoption of the MFF and the Legal base for cohesion policy (Common Provision Regulation (EU) No 1303/2013), this was applied to cohesion policy programmes for an amount of EUR 11,2 billion. The reprogramming was adopted on 22 April 2015 by the Council.*

The Commission will monitor programme implementation very closely, using the financial information submitted three times a year by Member States (Article 112 of the CPR).

([15]) Note 2.12 on p. 66 of the accounts.

([16]) In the 'Analysis of the budgetary implementation of the European Structural and Investment Funds in 2014' the Commission comments that 'of the EUR 23,4 billion worth of payment claims submitted during the last two months of the year, about 92 % (EUR 21,5 billion) only arrived in December and some EUR 19 billion were submitted after 15 December. As in previous years, this high concentration of payment claims at the very end of the year was triggered, to some extent, by the automatic de-commitment constraint as 2014 was the last peak year for the n +2 rule.'

([17]) This includes a net amount of 50 million euro from amending budgets Nos 3, 4 and 6.

([18]) 345 programmes were approved out of 645 programmes.

([19]) The MFF ceiling will also be increased by 4,5 billion euro in 2016 and 0,1 billion euro in 2017.

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The 2014 budget result was a surplus …

2.12. The budget result for 2014 was a surplus of 1,4 billion euro [20]. This represents the excess of amounts received from the Member States over payments made. The surplus represents an advance payment by the Member States towards the following year's budget. A budgetary surplus is normal given that payments cannot exceed receipts [21].

… while the economic result was a deficit

2.13. The economic result was a deficit of 9,6 billion euro. The main reasons for this deficit are non-cash adjustments resulting from the net impact of increases in amounts receivable and in provisions. The increase in amounts receivable arises because six Member States exercised the option to defer settlement of backdated contributions following adjustments to GNI estimates [22] (see paragraphs 4.6 to 4.13). The increase in the level of provisions is principally due to the impact of the decrease of interest rates in capital markets on the valuation of accrued pension liabilities [23]. The Commission provides a reconciliation of the economic result with the budget result on page 109 of the consolidated annual accounts of the European Union 2014 with further explanations on page 118 (see ***Table 6*** in ***Annex 1.3***).

(20) See ***Annex 1.3***, ***Table 5***, from p. 108 of the accounts.
(21) In principle a deficit can occur if receipts are lower than payments made. In practice, a deficit has not occurred since 1986.
(22) See note 2.6.1.1 on p. 59 of the accounts.
(23) See note 2.9 to the accounts.

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The reduction in outstanding commitments is forecast to be temporary

2.14. As explained in paragraph 2.2, most payments were made to cover commitments of the previous MFF 2007-2013. This contributed to reducing outstanding commitments [24] from 222,4 billion euro to 189,6 billion euro.

2.15. ***Graph 2.3*** shows the evolution of outstanding commitments for the MFF heading 1b [25] (58 % of total outstanding commitments). This shows a significant decrease in outstanding commitments, reflecting the number of operational programmes for the new period not yet approved by the Commission. The Commission used 28,0 billion euro (58 %) of the 47,5 billion euro commitment appropriations for 2014. MFF heading 1b used all the payment appropriations of 54,4 billion.

2.15. *For cohesion policy, the outstanding commitments for the period 2007-2013 have decreased by almost 40 % (EUR 52 billion) to EUR 80,6 billion in 2014, thus marking the end of an upward trend observed until end of 2013. It could have been reduced even more if the Commission's ability to honour payment claims received late in the year had not been limited by the lack of payment appropriations (see reply to paragraph 2.10).*

Moreover, the decrease of outstanding commitments in 2014 is linked to the high level of payments made EUR 51,8 billion (or 111 % of initial authorised budget) for cohesion policy in for the 2007-2013 programmes coming towards the end of their eligibility period (i.e. 31 December 2015).

(See: 'Analysis of the budgetary implementation of the European Structural and Investment Funds in 2014').

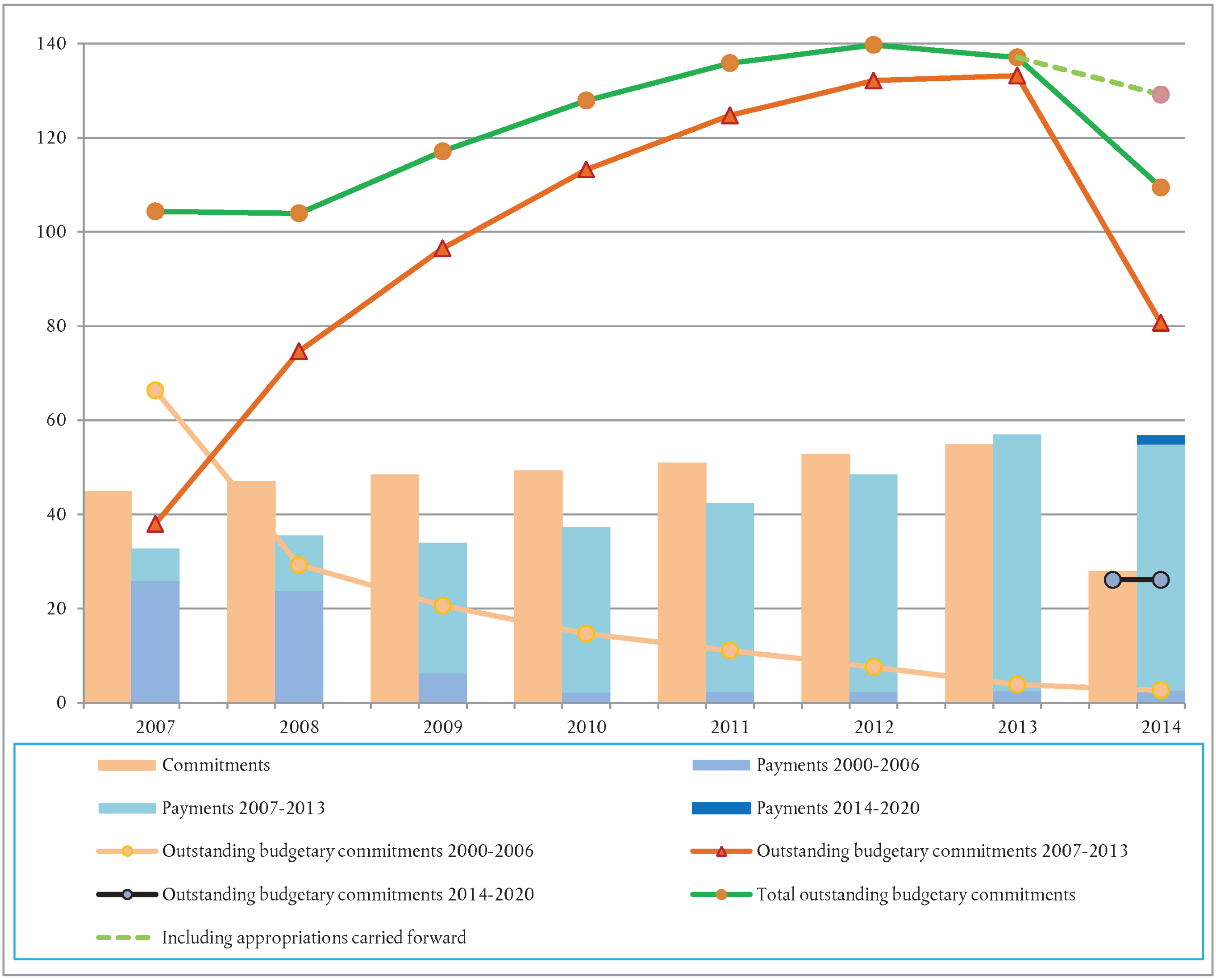
2.16. The reduction in the level of outstanding commitments is forecast to be temporary because of the requested increase in the MFF ceiling for 2015 and subsequent years (see paragraph 2.11 and ***Graph 2.3***).

[24] Commitment appropriations that have been authorised but have not yet been turned into payments.

[25] Funds in Heading 1b 'Economic, social and territorial cohesion', namely the European Social Fund, the European Regional Development Fund, the Cohesion Fund.

Graph 2.3 — Evolution of accumulated outstanding commitments in MFF heading 1b

(billion euro)



Source: Reports on budgetary and financial management — Financial years 2007-2014.

THE COURT'S OBSERVATIONS

Backlogs in the absorption of multiannual European Structural and Investment (ESI) funds are significant

2.17. By the end of 2014 payments to Member States for the multiannual ESI funds ([26]) for 2007-2013 had reached 309,5 billion euro (77 % of the total of 403,0 billion euro for all approved operational programmes) ([27]). We provide an analysis of the extent to which the Commission has made payments against commitments for each Member State in ***Graph 2.4***. The absorption rate ranges from 50 % to 92 % ([28]).

2.18. ***Graph 2.4*** also shows that five Member States ([29]) account for more than half of the unused commitments of multiannual ESI funds.

2.19. In some Member States the unclaimed EU contribution, together with required national co-financing, is equivalent to a significant share of total general government expenditure (see ***Graph 2.5***). In four Member States the accumulated share that could be claimed from EU funds is equivalent to 15 % or more of annual general government expenditure ([30]).

THE COMMISSION'S REPLIES

2.17. *The final date of eligibility is 31 December 2015. Closure documents are to be sent by 31 March 2017. Payments at national level represent higher levels as certification requires time. The regulation foresees that a share of 5 % of the total allocation is retained until closure of the programmes.*

The co-legislators decided to amend the Regulation (EC) No 1083/2006 and extend the N + 3 automatic decommitment deadline for two Member States (as is also the case for Croatia following its accession treaty). This has reduced the pressure on payments for the concerned Member States.

Finally, a Task Force for Better Implementation was set up in 2014 to help Member States optimise the use of the 2007-2013 cohesion policy envelopes. Progress of the specific actions for each Member State is being monitored.

2.18. *Common reply to paragraphs 2.18 and 2.19.*

The Commission considers that there is a relationship between the weight of the initial allocation and the extent of unused commitments.

The Commission is actively involved in helping the Member States most at risk of losing funds. It set up in 2014 the Task Force for Better Implementation in order to improve implementation in Member States which significantly lag behind the EU-28 average level of financial execution and have proportionally the highest outstanding EU contributions.

([26]) ESI funds comprise the European Social Fund (ESF), the European Regional Development Fund (ERDF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

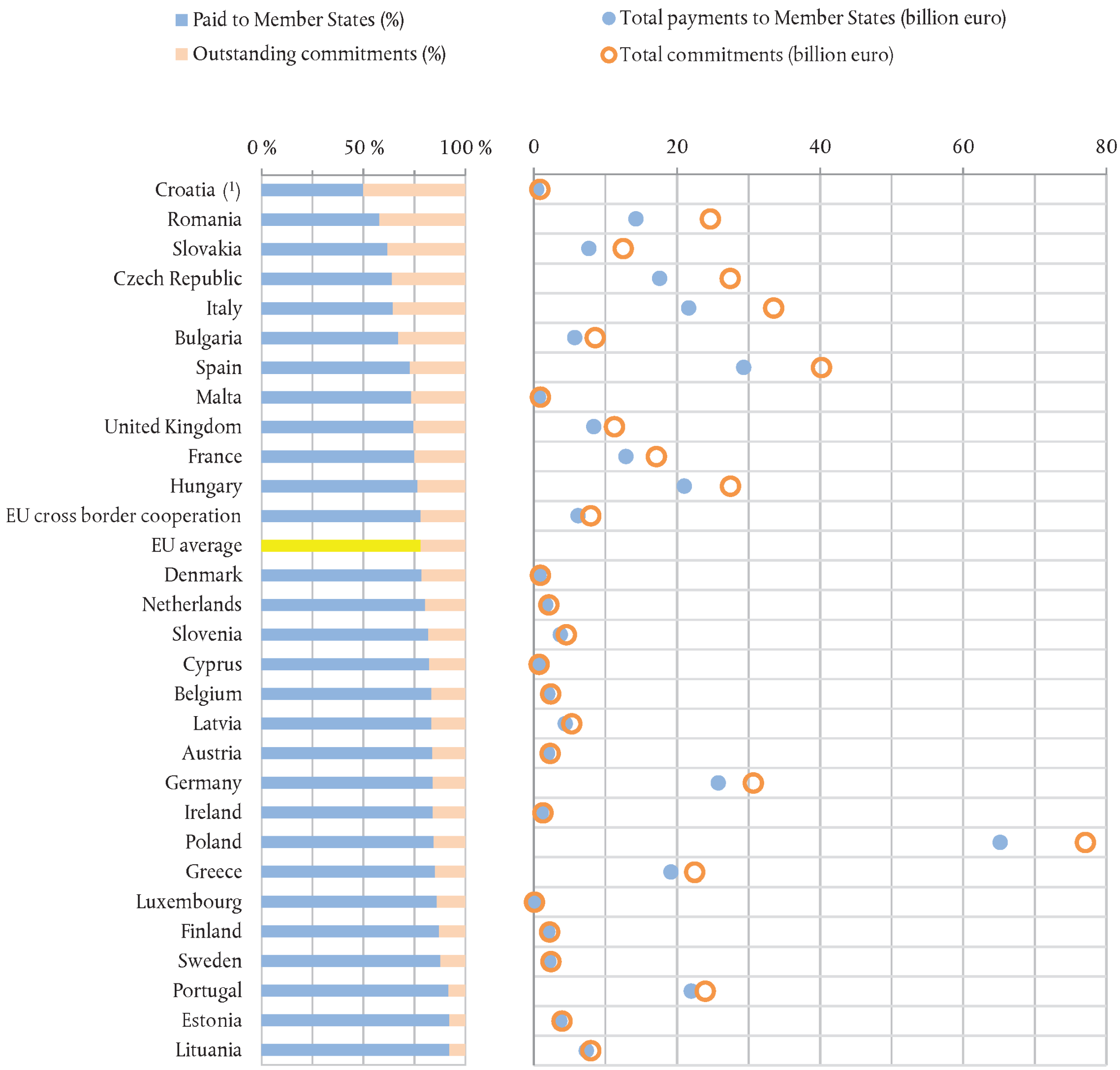
([27]) Axes 2 and 6 of the European Agricultural Fund for Rural Development (EAFRD) have been excluded from the ESI funds amounts because they are annual measures that do not affect the absorption rate of Member States.

([28]) The maximum disbursement before closure is 95 % of the total allocation.

([29]) Czech Republic, Spain, Italy, Poland and Romania account for 54,9 billion euro out of 93,5 billion euro of the unused commitments of the ESI funds.

([30]) The accumulated share that could be claimed from EU funds is composed of payments to be made by the Commission. The Member States will need to present expenditure equivalent to this amount plus national co-financing.

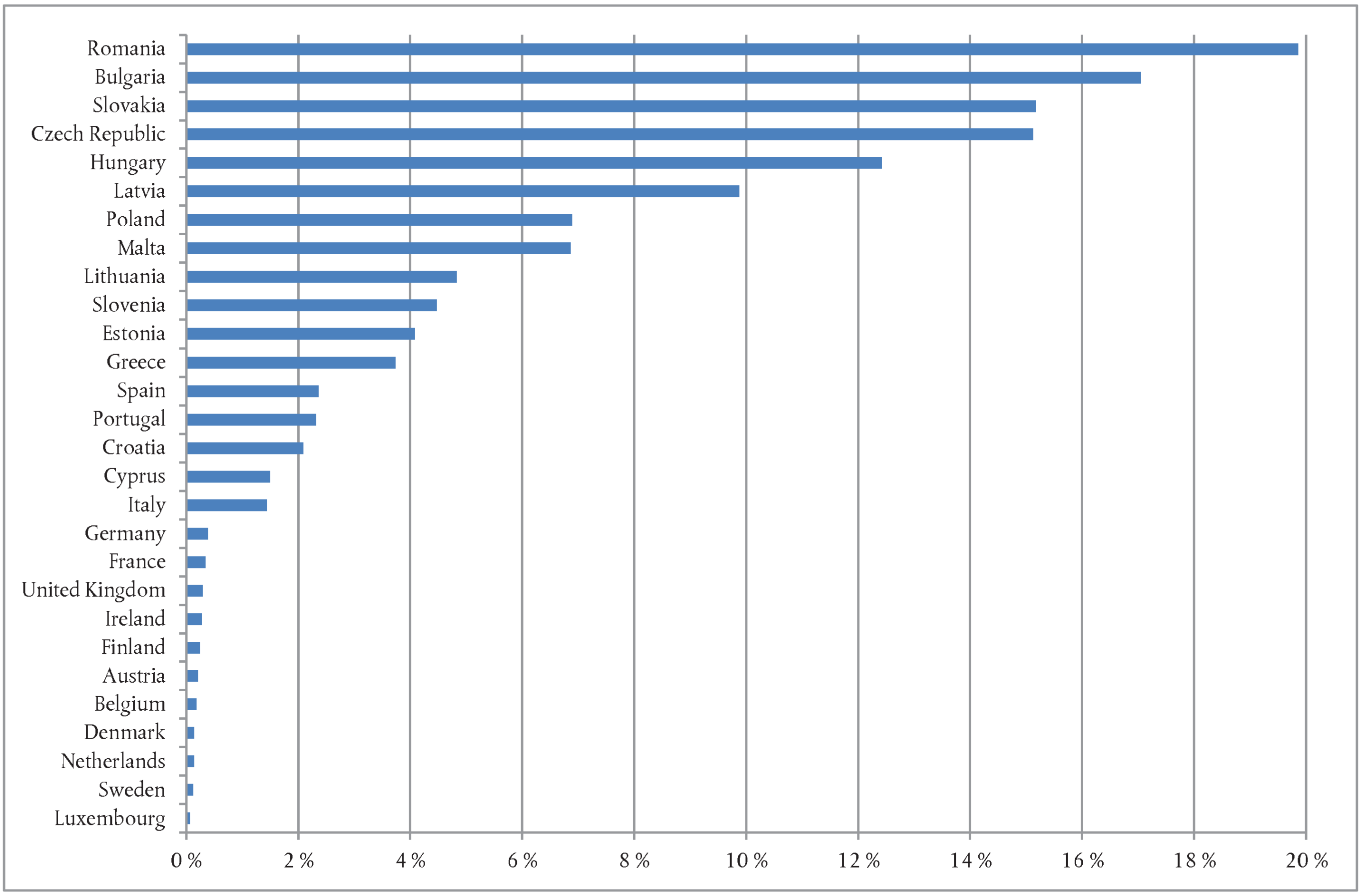
Graph 2.4 — Absorption in % and totals of 2007-13 MFF ESI funds at 31 December 2014



(1) Croatia acceded to the EU in July 2013. Absorption figures for Croatia are therefore not comparable to those of other Member States.

Source: European Court of Auditors calculation based on Commission accounting data.

Graph 2.5 — Outstanding commitments of ESI funds at 31 December 2014 as a percentage of 2014 general government expenditure



Source: European Court of Auditors based on information from the Commission.

THE COURT'S OBSERVATIONS

The Commission has presented a payment plan intended to 'bring the EU budget back on a sustainable track'

2.20. Over the years 2007 to 2013 EU institutions and bodies made commitments of 994 billion euro and payments of 888 billion euro ([31]). Outstanding commitments increased from 132 billion euro at the beginning of 2007 to 222 billion euro at the end of 2013. Cancelled commitments amounted to 16 billion euro over the period, a level of decommitment of 1,6 %.

([31]) Assigned revenue contributed commitments of 24 billion euro to the total commitments of 994 billion euro and payments of 24 billion euro to the total payments of 888 billion euro.

THE COURT'S OBSERVATIONS

2.21. In March 2015 the Commission presented to the Parliament and the Council a payment plan to 'bring the EU budget back on a sustainable track' ([32]). The plan presents short-term measures to reduce the level of unpaid bills. The Commission envisaged the following mitigating measures for an improved management of payment appropriations:

— speeding up the recovery of undue amounts,

— limiting idle amounts on fiduciary accounts,

— reducing pre-financing percentages,

— making use of maximum payment deadlines,

— postponing calls for proposals/tenders and related contracting.

2.22. In previous annual reports ([33]) we have supported action on the first two of these measures which, together with the other measures, build upon normal features of financial management. While the measures proposed by the Commission seek to improve shorter term cash flow management, dealing with the high level of outstanding commitments requires a longer term perspective. We continue to consider that the Commission should prepare and publish annually a long range forecast covering budgetary ceilings, payment needs, capacity constraints and potential decommitments ([34]). This would assist stakeholders significantly in assessing future payment requirements and budgetary priorities.

THE COMMISSION'S REPLIES

2.21. *Short-term measures to reduce the backlog of unpaid bills are described in the 'payment plan'. It presents an estimate of the likely backlog of unpaid claims end of 2015 (EUR 20 billion) and calls for sufficient payment credits in the 2016 budget in order to reduce the backlog to a minimum level. The Commission's draft budget 2016, adopted on 27 May 2015 includes the corresponding level of credits. The final adoption of these credits is the decisive mitigating action against the outstanding commitments, as presented in the analysis on the 'payment plan'.*

The Commission is following closely the programme implementation and will inform the budget authority when problems are identified.

2.22. *The payment plan addresses the payments backlog, which will be settled by end 2016.*

See reply to recommendation 4.

([32]) 'Financial statement discussion and analysis', presented together with the accounts, p. 25. The payment plan can be found at: http://www.europarl.europa.eu/meetdocs/2014_2019/documents/budg/dv/2015_elements_payment_plan_/2015_elements_payment_plan_en.pdf

([33]) For instance in the 2013 annual report, paragraphs 1.48 and 1.49.

([34]) See the 2013 annual report, paragraph 1.50.

THE COURT'S OBSERVATIONS

Unutilised amounts in financial instruments under shared management remain high …

2.23. In the latest available report on financial instruments under shared management which describes the situation as at the end of 2013 ([35]) contributions to the instruments increased rapidly by 1,7 billion euro from 12,6 to 14,3 billion euro. The amount paid out to final recipients increased by 2,0 billion euro from 4,7 to 6,7 billion euro and this translates to 47 % paid out from the total contributions paid in, which represents limited progress compared to the 37 % paid out at the end of 2012 ([36]).

… as does cash held in financial instruments under indirect management

2.24. Cash and cash equivalents belonging to financial instruments are managed by fiduciaries on behalf of the Commission for the purpose of implementing specific programmes funded from the EU budget. They totalled 1,3 billion euro at the end of 2014 (2013: 1,4 billion euro).

([35]) The latest available figures relate to the end of 2013, appearing in Commission report 'Summary of data on the progress made in financing and implementing financial engineering instruments reported by the managing authorities in accordance with Article 67(2)(j) of Council Regulation (EC) No 1083/2006' dated September 2014.

([36]) See paragraphs 6.49 and 6.50 and the 2013 annual report, paragraph 1.48.

THE COMMISSION'S REPLIES

2.23. *The overall disbursement rate by the end of 2013 was at 47 %, compared to 37 % end 2012 and the Commission expects a similar progress for 2014. Actions to speed up disbursement rates of financial instruments to final recipients include follow-up actions through monitoring committees, on-the-spot visits, promotional campaigns and in certain cases re-programming (in cases where it is clear that the funds originally dedicated to financial instruments cannot be disbursed to final recipients due, for example, to changes in market conditions). In addition, the Commission has through the modification of the Closure Guidelines clarified the flexibility allowed under the General Regulation in relation to support from Financial Engineering Instruments to final recipients.*

See also reply to recommendation 5.

2.24. *Many financial instruments need a certain minimum reserve for their functioning. In particular, a considerable part of cash and cash equivalents (EUR 730 million) is held by guarantee instruments which, by their very nature, need to maintain cash and short-term deposits so as to perform their function.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

2.25. The principal reason for the net decrease of 0,1 billion euro in sums held in fiduciary accounts is that the Commission has now taken action to clear reflows ([37]) from MEDA ([38]) loans and risk capital operations. At 31 December 2013 259 million euro had accumulated and remained in a fiduciary account at the EIB ([39]). During 2014 110 million euro was transferred to the Guarantee Fund for External Actions ([40]). The remaining 149 million euro was returned to the general budget of the Union.

2.26. The impact of clearance of the MEDA reflows is partly offset by the transfer of more than 200 million euro to fiduciary accounts set up for financial instruments under the new MFF. These transfers are recorded as payments in the 2014 budget.

CONCLUSIONS AND RECOMMENDATIONS

The conclusions for 2014

2.27. Payments in 2014, as in 2013, remained above the level of the MFF ceiling. Initial payment appropriations were increased by 3,5 billion euro by amending budgets. Establishment of the budget at this level required the activation of the 'contingency margin' shortly after the new MFF began (see paragraphs 2.4 to 2.9).

2.27. *See the Commission's replies to paragraphs 2.4 to 2.9.*

2.28. Outstanding budgetary commitments on expenditure of a multiannual nature remain at a very high level. Most of these outstanding commitments are related to the previous MFF (see paragraph 2.14).

2.29. Unused commitments of ESI funds are very high for some Member States (see paragraphs 2.17 to 2.19).

2.29. *See the Commission's replies to paragraphs 2.17 to 2.19.*

([37]) Interest payments and repayments of loans, dividends and capital reimbursement.

([38]) The principal instrument of economic and financial cooperation under the Euro-Mediterranean partnership.

([39]) See the 2013 annual report, paragraph 1.49.

([40]) Decision No 466/2014/EU of the European Parliament and of the Council of 16 April 2014 granting an EU guarantee to the European Investment Bank against losses under financing operations supporting investment projects outside the Union (OJ L 135, 8.5.2014, p. 1).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

2.30. We recommend that:

— **Recommendation 1:** the Commission take action to reduce the level of outstanding commitments. In addition to the short term measures proposed in March 2015, a longer term perspective is required (see paragraphs 2.14 to 2.16);

— **Recommendation 2:** the Commission consider in its budgetary and financial management the capacity constraints in certain Member States in order to avoid the underutilisation of funds and to increase the absorption rates especially in the area of ESI funds (see paragraph 2.19);

2.30.

The Commission accepts the recommendation and it is taking the requested action.

It is important to differentiate between the outstanding commitments (RAL) stemming from the time-lag between commitments and payments for multiannual programmes (the 'normal' RAL) and the RAL resulting from the 'abnormal backlog' created by the shortage of payment appropriations which has arisen in recent years. The payment plan agreed with the European Parliament and Council fully addresses such an abnormal backlog, which is expected to be phased out by end 2016. This will not eliminate normal outstanding commitments, as new commitments will continue to be made, with a view to payment in subsequent years, as is normal in multiannual programming.

The Commission considers that the 'payment plan' includes a long term perspective to reduce payment backlogs and abnormal outstanding commitments (see reply to paragraph 2.21).

The Commission accepts this recommendation. It has already taken the following actions:

— *the temporary 10 % top-up of the co-financing rate for programme countries,*

— *a specific support for the authorities of the Member States concerned,*

— *revision of the Closure Guidelines to ensure the proper use of the flexibility arrangements available to Member States (see reply to paragraph 2.23).*

Setting up, in November 2014, of an internal Task Force for Better Implementation, responsible for assessing the situation in eight Member States, identifying the bottlenecks hampering successful implementation, defining and monitoring the implementation of concrete action plans to address these potential risks of de-commitments.

In addition DG Regional and Urban Policy established in 2013 a Competence Centre 'Administrative Capacity Building', responsible for defining and implementing targeted actions addressing administrative bottlenecks and weaknesses hindering effective and efficient use of ESI Funds in MS and regions.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
— **Recommendation 3:** the Commission consider measures leading to a reduction in the outstanding commitments, faster closure of the 2007-2013 programmes, a reduction of cash held by fiduciaries and the compilation of payment plans and forecasts in those areas where the outstanding commitments exceed a multiple of the respective annual appropriations (see paragraphs 2.20 and 2.21);	*The Commission accepts this recommendation.* *The Commission faces constraints in achieving a faster closure for the 2007-2013 period.* *The Commission considers that the most important measure for the reduction of outstanding commitments for the 2007-2013 period is the approval of the requested credits in the 2016 draft budget in order to phase out the abnormal backlog of unpaid claims in 2016.*
— **Recommendation 4:** the Commission establish a long-term cash-flow forecast to better match payment needs and funds available (see paragraph 2.22);	*The Commission accepts this recommendation and is taking the recommended action by analysing how a long range cash flow forecast can best be prepared and disclosed.*
— **Recommendation 5:** the Commission reinforce efforts to reduce excessive cash balances in financial instruments (see paragraphs 2.23 to 2.26).	*The Commission accepts this recommendation and is taking the recommended action. At closure, credits available in financial instruments and not used at least for a first round of investments/guaranties will be lost for the concerned Member State.* *For the 2014-2020 period, clearer and more flexible rules have been established providing for a better targeting of the instruments* (ex ante *assessment) and payment in tranches. Moreover, a number of initiatives are set up to further facilitate the implementation of the instruments, such as off-the-shelf instruments and the technical assistance platform 'FI-compass', providing general advice, training and mutual exchange of experience for managing authorities.* *(See reply to paragraph 2.23 and recommendation 2.)*

CHAPTER 3

Getting results from the EU budget

TABLE OF CONTENTS

THE COURT'S OBSERVATIONS

INTRODUCTION

3.1. The theme of this chapter is performance (see Box 3.1). This year we have chosen to focus on the European Union's (EU) long term strategy, Europe 2020. Of the chapter's four parts, the first thus considers the Commission's monitoring and reporting on Europe 2020, and the second part examines how the Europe 2020 strategy feeds through into partnership agreements and funding programmes agreed between the Commission and Member States. The final two parts deal with subjects we have also examined in previous years. The third part presents our observations on the annual activity reports (AARs) prepared by the Commission's directors-general. Finally, the fourth part highlights some of the main themes arising from our 2014 special reports ([1]) on performance.

Box 3.1 — Performance in the EU
Performance in the EU is assessed on the basis of the sound financial management principles (economy, efficiency and effectiveness) ([2]), and covers: (a) inputs — financial, human, material, organisational or regulatory means needed for the implementation of the programme; (b) outputs — the deliverables of the programme; (c) results — the immediate effects of the programme on direct addressees or recipients; (d) impacts — long-term changes in society that are, at least partly, attributable to the EU's action.

THE COMMISSION'S REPLIES

3.1. *The MFF 2014-2020 budget is one of the EU levers contributing to the achievement of Europe 2020 objectives. However, national governments play a primary role in delivering the objectives of the EU strategy. The EU budget on its own represents only approximately 2 % of overall public spending in the EU and 1 % of EU Gross National Income. Therefore the cumulative national budgets and actions are the key factor to deliver the objectives of the EU strategy.*

The Commission is committed to report on the contribution of the EU budget to the achievement of Europe 2020 objectives. However, this is a challenging task, in particular isolating the effect of the EU budget from that of national budgets and external factors. This requires a combination of information and evidence coming from monitoring, modelling and evaluation.

In addition, the objectives of the funding programmes and implementing modalities of the new MFF were shaped by the co-legislator. These programmes are implemented largely by the Member States through shared management.

([1]) Our special reports cover the EU budget and the European Development Funds (http://eca.europa.eu).

([2]) Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities, Article 27; repealed by Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1), Article 30 (entry into force on 1 January 2013).

THE COURT'S OBSERVATIONS

3.2. Last year's annual report included a separate section analysing the Commission's follow-up of a sample of recommendations from special reports [3]. There is no equivalent in this year's chapter. Instead, we will publish a separate special report focusing on the issue of how the recommendations in special reports are followed up.

PART 1 — THE EUROPE 2020 STRATEGY AND MONITORING AND REPORTING BY THE COMMISSION

3.3. Europe 2020 is the EU's ten-year jobs and growth strategy. It was launched in 2010 to create the conditions for smart, sustainable and inclusive growth, and is the successor to the Lisbon strategy, which ran from 2000 to 2010. Europe 2020 includes five 'headline targets', to be met by the EU as a whole by the end of the strategy period.

3.4. Responsibility for delivering the Europe 2020 strategy is shared between the EU and its 28 Member States. Thus the five headline targets have an associated national target in each Member State, reflecting the different circumstances of each.

3.5. While Europe 2020 is central to many of the activities of the EU, its aims are not exactly the same as those of the EU. The EU has a number of objectives additional to those set out in Europe 2020, such as those relating to its activities outside its geographical borders. In 2014, a substantial part of the EU budget was associated with Europe 2020. However, since it is a strategy for the Member States individually as well as the EU, much of the responsibility for achieving Europe 2020's objectives lies with, and needs to be financed outside the EU budget by, the Member States.

THE COMMISSION'S REPLIES

3.5. *The Union's objectives are defined in the treaties and have to be pursued and respected (e.g. the common agricultural policy). Within this framework, the EU budget is allocated to the various activities and aligned as much as possible with the changing headline EU priorities (i.e. Lisbon strategy, Europe 2020 strategy). With the new MFF, Heads of State and Government have decided that all EU policies, instruments and legal acts, as well as financial instruments, should be mobilised to pursue the strategy's objectives. This has led it to propose a budget with a strong pan-European logic, designed to drive the Europe 2020 growth strategy.*

In accordance with the Commission assessment, for 2014, around 58 % of the EU budget was allocated to Europe 2020. A new approach has also been designed to ensure an effective use of the European structural and investment funds, notably through a strong alignment with the priorities of the Europe 2020 strategy, the recourse to conditionality, the promotion of concentration and prioritisation of resources and the introduction of performance incentives.

(3) The 2013 annual report, paragraphs 10.53 to 10.55.

THE COURT'S OBSERVATIONS

3.6. This part of the chapter considers the relationship of the strategy to the EU's budgetary cycle, the links between the strategy and the lower-level objectives, and the Commission's monitoring and reporting of the EU budget's contribution to Europe 2020. Thus we did not examine the Member States' contributions towards Europe 2020, nor the Commission's other responsibilities, such as its legislative role, its role in policymaking or in the European Semester ([4]). Consequently this chapter does not examine the policy achievements to date of Europe 2020.

The period covered by the Europe 2020 strategy is not aligned with the EU's budgetary cycle

3.7. The EU's budgetary cycle is known as the multiannual financial framework (MFF) ([5]), and runs in seven-year blocks. The MFF sets the maximum amount that can be spent by the EU budget each year for broad policy areas. For the Europe 2020 strategy, the relevant MFF periods are 2007-2013, and 2014-2020. The allocation of funds to MFF headings and to Member States takes place during these MFF negotiations. The MFF leads to a number of changes in the legislative framework governing the use of EU funds, including monitoring and reporting requirements.

3.8. The MFF periods have never been in line with the EU's strategy periods (2000-2010 and 2010-2020). This made it more difficult for the Commission to monitor and report on the contribution of the EU budget to the EU's overall strategy for the 2007-2013 MFF period.

3.9. Thus in its reply to our 2013 annual report, the Commission explained that 'the Europe 2020 strategy had not been adopted when the 2007-2013 MFF was adopted and the monitoring, evaluation and reporting arrangements put in place. This largely explains why it has not been possible to single out the contribution of each financial programme to the targets set in that strategy' ([6]).

THE COMMISSION'S REPLIES

3.8. *The 2007-2013 MFF period may not have fully coincided with the period covered by the Europe 2020 strategy. This, however, does not imply a lack of alignment with the overall strategy. Moreover, the 2014-2020 MFF period falls entirely within and has the same end date as the current Europe 2020 strategy period.*

The 2014-2020 MFF has been designed with a view to concentrate on delivering on the Europe 2020 strategy.

(4) The Europe 2020 strategy is also implemented and monitored as part of the European Semester, the EU's annual cycle of economic and budgetary coordination with Member States.

(5) Based on the 7-year MFF, there is an annual budget for the EU.

(6) The Commission's reply to the 2013 annual report, paragraph 10.24.

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3.10. It is not easy to change the framework for monitoring and reporting in the midst of an MFF period. Not only would it have been necessary to make changes to the governing legislation but, where shared management applies, each Member State would also have had to alter its own procedures. The monitoring and reporting framework underlying the MFF was brought into line with Europe 2020 with the 2014-2020 MFF. This new MFF, as recommended by evaluations of the Lisbon strategy, aligned the headings of the EU budget to reflect the growth priorities of the Europe 2020 strategy.

3.11. Payments made under the 2007-2013 MFF will continue beyond 2015. As a consequence, the first half of the 10-year Europe 2020 strategy period is taking place under an MFF designed for a different strategy. Summary reporting on the implementation of the European Structural and Investment Funds ([7]) (the ESI funds) — the main 2014-2020 funds used to deliver the Europe 2020 strategy — will start in 2016 ([8]); and strategic reports informing the debate on the contribution of the ESI funds to Europe 2020 are expected in 2017 and 2019 ([9]).

3.12. Against this background, the next two sections of this part of the chapter consider two key building blocks for effective monitoring and reporting on Europe 2020: translating high-level political aspirations into operational objectives for the EU budget, and whether the Commission was able to address the inherent difficulties in monitoring and reporting.

THE COMMISSION'S REPLIES

3.10. *The Commission is monitoring and reporting on the contribution of the EU budget to the EU's overall objectives and to the Europe 2020 strategy in particular.*

([7]) The ESI funds comprise the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF).

([8]) Except for the Youth Employment Initiative reporting for which started in April 2015.

([9]) Regulation (EU) No 1303/2013, of the European Parliament and of the Council (OJ L 347, 20.12.2013, p. 320), Article 53.

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Europe 2020 priorities, headline targets and flagship initiatives as well as thematic objectives do not serve as operational objectives

3.13. Europe 2020 is a high-level political strategy. As we have noted previously, high-level general objectives may not be sufficiently focused to be useful at lower operational levels ([10]). Operational objectives — with indicators, targets and milestones as necessary — need to be established for management purposes. These operational objectives need to be linked to the Europe 2020 strategy.

Three priorities, five headline targets, seven flagship initiatives

3.14. A number of targets, initiatives and objectives are associated with Europe 2020, as illustrated in Box 3.2. This and the following sections therefore examine whether the relationship between these different elements is coherent: whether the high-level objectives given expression in the Europe 2020 strategy are translated into operational elements which allow managers to monitor and report on the contribution made by the EU budget to the strategy.

THE COMMISSION'S REPLIES

3.13. *From the beginning, the strategy has relied on a close partnership with Member States, which are key for its success. To this aim, EU-level Europe 2020 targets are broken down into national ones. Far from being an EU-level, top-down strategy, Europe 2020 is based on the involvement of all relevant actors at European, national, regional and local level.*

The political aspirations of Europe 2020 are made concrete by the definition of targets and have inspired the architecture of the EU budget. They have been translated into the legal basis of the programmes financed from the EU budget.

3.14. *See Commission reply to paragraph 3.1.*

([10]) See the 2012 annual report, paragraph 10.10.

Box 3.2 — Europe 2020 priorities — smart, sustainable and inclusive growth (paragraph 3.15)		
Europe 2020 headline targets (paragraphs 3.16 and 3.17)	*Europe 2020 flagship initiatives (paragraphs 3.18 to 3.21)*	*Thematic objectives (for ESI funds only) (paragraphs 3.22 to 3.25)*
1. Employment: 75 % of 20- to 64-year-olds to be employed. 2. Research and Development (R&D): 3 % of the EU's gross domestic product (GDP) to be invested in R&D. 3. Climate change and energy sustainability: greenhouse gas emissions 20 % (or even 30 %, if the conditions are right) lower than 1990; 20 % of energy from renewables; 20 % increase in energy efficiency. 4. Education: reducing the rates of early school leaving below 10 %; at least 40 % of 30- to 34-year-olds completing third-level education. 5. Fighting poverty and social exclusion: at least 20 million fewer people in or at risk of poverty and social exclusion.	*Smart growth:* 1. Digital agenda for Europe. 2. Innovation Union. 3. Youth on the move. *Sustainable growth:* 4. Resource-efficient Europe. 5. An industrial policy for the globalisation era. *Inclusive growth:* 6. An agenda for new skills and jobs. 7. European platform against poverty.	1. Strengthening research, technological development and innovation 2. Enhancing access to, and use and quality of ICT. 3. Enhancing the competitiveness of small and medium enterprises (SMEs), of the agricultural sector (for the EAFRD) and of the fishery and aquaculture sector (for the EMFF). 4. Supporting the shift towards a low-carbon economy in all sectors. 5. Promoting climate change adaptation, risk prevention and management. 6. Preserving and protecting the environment and promoting resource efficiency. 7. Promoting sustainable transport and removing bottlenecks in key network infrastructures. 8. Promoting sustainable and quality employment and supporting labour mobility. 9. Promoting social inclusion, combating poverty and any discrimination. 10. Investing in education, training and vocational training for skills and lifelong learning. 11. Enhancing institutional capacity of public authorities and stakeholders and efficient public administration.

THE COURT'S OBSERVATIONS

3.15. At the highest level of Europe 2020 are the three priorities for smart, sustainable and inclusive growth, together with the five headline targets set out in Box 3.2. However, the relationships between the priorities and headline targets are multiple and complex. For example, the headline targets are defined as 'non-exhaustive' and 'representative' of the three priorities [11]; there is no clear link between the individual targets and priorities.

3.16. The headline targets are essentially political aspirations [12]. With the exception of the targets relating to greenhouse gas emissions and renewable energy, the headline targets are not supported by a legally binding framework at the EU level. The EU budget contribution is not identified separately in the context of the achievement of the headline targets.

3.17. That the headline targets are not hard, operational targets is also exemplified by the way that they have been transposed into separate targets for each Member State. For two headline targets, if each Member State were successful in achieving its own national targets, the overall headline targets at EU level would still not be achieved.

(a) fulfilling all national targets would yield an employment rate for the population aged 20 to 64 of 74 %, below the 75 % EU headline target;

(11) COM(2010) 2020 final of 3 March 2010, Communication from the Commission, 'Europe 2020 — A strategy for smart, sustainable and inclusive growth', Section 2.

(12) COM(2015) 100 final of 2 March 2015, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 'Results of the public consultation on the Europe 2020 strategy for smart, sustainable and inclusive growth', Section 1.

THE COMMISSION'S REPLIES

3.15. *These targets are neither meant to be mutually exclusive, nor are they intended to serve just one of the three priorities. There is a clear link between the individual targets and the triptych of smart, sustainable and inclusive growth. The targets were chosen to be mutually reinforcing and contributing altogether to the three dimensions of the triptych. The targets are deliberately non-exhaustive and do not capture all levers for growth. They are exemplary of the kind of change that the strategy is advocating and aim to highlight a selected number of key drivers for growth of relevance for all Member States, which could guide Member States' action. This selected approach also comes from the lessons learnt from the Lisbon strategy, whose priorities were diluted due to the too high number of targets. Europe 2020 aimed to keep focus on the essentials.*

3.16. *Most of the Europe 2020 areas remain in the hands of the Member States in terms of competences. Therefore, the EU can lead by example and set ambitious and realistic targets, but the definition of national ones remains a political choice at national level.*

The Commission/EU do not have legal competence for creating a legally binding framework. For example, concerning employment, the Union can only take measures to ensure coordination of the employment policies of the Member States, in particular by defining guidelines for these policies.

3.17. *This has been explained, in its Communication [1], by the Commission as a consequence of national political choices.*

(a) *See Commission reply to paragraph 3.16 on the division of competences between the Union and Member States as set out in Article 5 TEU.*

(1) *COM(2014) 130 of 5.3.2014, 'Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth'.*

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(b) fulfilling all national targets for research and development would lead to an investment of 2,6 % of GDP by 2020, some way below the headline target of 3,0 % ([13]).

3.18. The next tier in the structure of Europe 2020 is the seven flagship initiatives. They are grouped under the three priorities for growth. They were not designed to represent a more detailed set of objectives or indicators. Instead, according to the Commission, the flagship initiatives help to provide a framework for the action to be taken at EU and Member State level ([14]).

3.19. All the flagship initiatives, except for 'an industrial policy for the globalisation era', directly contribute to one or more of the headline targets, and all headline targets are directly addressed in at least one flagship initiative. However, the Commission has not carried out any detailed analysis of the relationship between the targets and flagship initiatives; nor has it used the flagship initiatives as a management tool — such as setting milestones, regular reporting on these initiatives, etc. — to drive progress towards the strategy.

3.20. In March 2015, feedback on the public consultation on the Europe 2020 strategy, as reported by the Commission, was that the flagship initiatives had generally served their purpose and that action in their respective areas needed to be pursued through other forms. Respondents to the consultation argued that the flagship initiatives should be replaced by more coherently organised and over-arching policy programmes ([15]).

THE COMMISSION'S REPLIES

(b) *Concerning the target for research and development, the Commission underlines that an investment of 3 % of GDP by 2020 is a European Union target. It is the responsibility of the Member States to set their national research and development targets at the level they consider the most appropriate and the Commission has limited scope to influence these targets. Achieving the Member State targets would indeed only add up to a level of investment of 2,6 %, but this is still a considerable increase. Progress towards the 3 % objective is monitored through the European Semester process, in which context Member States are encouraged to raise their research and development investments.*

3.18. *The flagship initiatives aimed to frame a number of policy/priority actions to pursue the Europe 2020 objectives. These priority actions were seen mostly as complementary to the structural reforms following Country Specific Recommendations.*

3.19. *Europe 2020 being an overarching strategy, it would not be useful to tie each target to a flagship and vice versa.*

During the first years following the adoption of the Europe 2020 strategy the Commission reported regularly in its Annual Growth Survey on the progress made towards implementing the headline targets and on the flagship initiatives. This reporting became less regular along with the completion of many of the initiatives of the flagships.

([13]) 'Smarter, greener, more inclusive? Indicators to support the Europe 2020 strategy', Eurostat (2015 edition), pp. 16, 46 and 77 (http://ec.europa.eu/eurostat/en/web/products-statistical-books/-/KS-EZ-14-001).

([14]) COM(2010) 2020 final of 3 March 2010, Section 2.

([15]) COM(2015) 100 final of 2 March 2015, Section 3.3.

THE COURT'S OBSERVATIONS

3.21. As is the case for the headline targets (paragraph 3.16), the main function of the flagship initiatives is to serve as politically-inspired action plans. They are not designed to translate the high-level Europe 2020 aims into operational objectives.

Eleven thematic objectives

3.22. One of the EU's main tools for achieving the aims of the Europe 2020 strategy is the MFF (paragraph 3.7), including the ESI Funds (paragraph 3.11). The mechanics of these funds, involving partnership agreements between the Commission and each Member State, and programmes at Member State level setting out how funds will be spent, are described more fully in part 2 of this chapter.

3.23. A key element of these structures at Member State level, intended to provide the link to Europe 2020, are 11 thematic objectives. Under the legislation, 'in order to contribute to the EU strategy for smart, sustainable and inclusive growth each ESI Fund shall support the following thematic objectives' — listed in Box 3.2. These thematic objectives must then be translated into priorities specific to each of the ESI funds ([16]). We analyse this further in part 2 of this chapter.

THE COMMISSION'S REPLIES

3.21. *The Commission never intended to translate the high level Europe 2020 aims into operational objects but to identify a set of key areas to drive the reform agenda of Member States and foster jobs and growth.*

([16]) Regulation (EU) No 1303/2013, Article 9.

THE COURT'S OBSERVATIONS

3.24. The thematic objectives are not operational objectives — with associated targets, milestones and indicators. They are high-level and broad by nature as they cover the entirety of the areas funded by the ESI funds. The scope of the thematic objectives goes wider than Europe 2020 (paragraph 3.5) and its headline targets and flagship initiatives. The key legislation governing the ESI funds and the thematic objectives does not set out the relationship between the thematic objectives and the headline targets and flagship initiatives. We were only able to find such a relationship in a Commission working document ([17]) where five thematic objectives were explicitly linked to the five headline targets, while a further three were indirectly linked. The remaining three thematic objectives — numbers 2, 5 and 11 in Box 3.2 — were not linked to a headline target. Concerning the flagship initiatives, four thematic objectives were linked in the staff working document of the Commission, with the result that three flagship initiatives did not have an associated thematic objective in that document.

3.25. The thematic objectives in themselves — like the headline targets and flagship initiatives — are not designed to translate Europe 2020 into useful operational objectives.

([17]) Commission staff working document SWD (2012) 61 final part II of 14 March 2012, 'Elements for a Common Strategic Framework 2014 to 2020 the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund'. The five thematic objectives explicitly linked to headline targets are numbers 1, 4, 8, 9 and 10; those indirectly linked are numbers 3, 6 and 7. Thematic objectives 1, 2, 3 and 6 are linked to flagship initiatives.

THE COMMISSION'S REPLIES

3.24. *The purpose of establishing an exhaustive list of high-level thematic areas to be supported by ESIF was to make the link between the five Funds, each with its own Treaty based mission, to the Europe 2020 Strategy. Thematic objectives are translated into specific objectives, accompanied with indicators, baselines and targets, at the level of the investment priorities in each ESIF programme ([2]).*

It was not the intention to establish a direct relationship between all of the thematic objectives and the headline targets. The headline targets are illustrative and do not capture the entirety of the Europe 2020 strategy. The assessment of the Funds' actual contribution to the overall policy objectives can only be done following a review of the actions concretely financed and of their results, through evaluation.

The fact that certain flagship initiatives are not mentioned in part 2 of the Staff Working Document does not mean that these cannot be associated to a thematic objective. The three flagship initiatives referred to by the Court are indeed linked to thematic objectives (8, 9 and 10 respectively). Concerning the flagship initiatives, a first estimation based on 2014-2020 operational programmes shows that the ESI funds are contributing to all flagship initiatives ([3]).

3.25. *The thematic objectives reflect the objectives of the Europe 2020 strategy and set the framework for defining useful operational objectives at the level of each ESIF programme, taking into account the specific characteristics of the Member State and the programme area.*

([2]) *As indicated in Article 2 point 34 CPR, a 'specific objective means the result to which an investment priority or Union priority contributes in a specific national or regional context through actions or measures undertaken within such a priority'.*

([3]) *Innovation Union: Thematic objective 1; Youth on the move: Thematic objectives 8 and 10; A digital agenda for Europe: Thematic objective 2; Resource efficient Europe: Thematic objectives 4, 5 and 6; An industrial policy for the globalisation era: Thematic objectives 3 and 7; An agenda for new skills and jobs: Thematic objectives 8 and 10; European Platform against poverty: Thematic objective 9. For more details see Working Document 1 attached to the DB2016.*

THE COURT'S OBSERVATIONS

So far, the Commission has not reported in a comprehensive way on the contribution made by the EU budget to the Europe 2020 objectives

3.26. This section considers the extent to which the Commission has been able to monitor and report on the contribution made by the EU budget — i.e. separately from the efforts made by Member States with national funds — towards the objectives of Europe 2020. It also considers two important factors in monitoring and reporting systems: whether there is ownership of strategic results, and whether there is a strategy in place for communicating results against the Europe 2020 objectives.

Monitoring and reporting on Europe 2020

3.27. Measuring and assessing the contribution of the EU budget towards Europe 2020 can only be done in a meaningful way if relevant, reliable and timely information, derived from a robust performance management and reporting system, is available to the Commission ([18]). This is not yet the case. The AARs ([19]) that we have examined in previous years' annual reports did not attempt to analyse progress towards Europe 2020. The extent to which the 2014 AARs address this issue is considered in part 3 of this chapter below.

([18]) See the 2012 annual report, paragraph 10.32.

([19]) The 2010 annual report, chapter 8: DGs Agriculture and Rural Development (AGRI), Regional and Urban Policy (REGIO) and Research, Innovation and Science (RTD); the 2011 annual report, chapter 10: DGs AGRI, Development and Cooperation — EuropeAid (DEVCO), REGIO; the 2012 annual report, chapter 10: DGs Competition (COMP), Maritime Affairs and Fisheries (MARE) and Mobility and Transport (MOVE); and the 2013 annual report, chapter 10: DGs Employment, Social Affairs and Inclusion (EMPL), Health and Consumers (SANCO) and the Office for Infrastructure and Logistics in Luxembourg (OIL).

THE COMMISSION'S REPLIES

3.27. *The framework defined by the co-legislators puts in place a robust reporting system for the 2014-2020 period, which from 2016 onwards will deliver more information on achievements by thematic objective, linked to the Europe 2020 objectives. This will allow a qualitative assessment as it is the role of evaluation to progressively assess the contribution of the ESIF to the Europe 2020 objectives.*

Where a more direct link can be established between funds and the Europe 2020 targets, the Commission has taken concrete measures to put in place a performance monitoring system ([4]).

AARs in previous years were linked to the 2007-2013 MFF designed before the Europe 2020 objectives were set.

([4]) *EMCO and SPC have developed the Employment Performance Monitor based on a comprehensive database on a large number of employment and social indicators linked to the Headline targets. The EPC has also a comprehensive monitoring system within the framework of LIME aimed at monitoring progress on Europe 2020.*

THE COURT'S OBSERVATIONS

3.28. Some elements of an effective monitoring and reporting system for Europe 2020 are in place. The statistical branch of the Commission, Eurostat, makes statistical data available on both EU-wide and national performance towards achieving the Europe 2020 headline targets. Its website provides regular updates on the targets, while dedicated reports present more in-depth analysis of trends and investigates the reasons behind the evolution of headline indicators.

3.29. The Commission's review of Europe 2020, which should have been available to the Council in March 2015, has been delayed until early 2016. In March 2014, the Commission issued a stocktaking communication to launch a public consultation on Europe 2020 ([20]). However, the summary results of the consultation do not provide any feedback on the role of EU programmes for Europe 2020 ([21]).

THE COMMISSION'S REPLIES

3.28. *Country Reports developed by the Commission in the context of the European semester look in detail at the socioeconomic situation and outlook in each Member State, and what are the most important actions necessary for improving socioeconomic progress. This analysis forms the basis for subsequent Country Specific Recommendations, proposed by the Commission and adopted by the European Council.*

Ensuring that the resulting Country Specific Recommendations are reflected in the 2014-2020 Partnership Agreements and Operational Programmes has been a major focus of the negotiations, so as to further strengthen the consistency of the specific objectives at operational programme level and the high level Europe 2020 objectives.

([20]) COM(2014) 130 final/2 of 19 March 2014, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 'Taking stock of the Europe 2020 strategy for smart, sustainable and inclusive growth'.

([21]) COM(2015) 100 final of 2 March 2015.

THE COURT'S OBSERVATIONS

3.30. As the Commission noted last year in its fourth evaluation report, for the 2007-2013 programming period 'it is not possible to single out what has been the exact contribution of each of the financial programmes in achieving Europe 2020 targets' ([22]). The Commission published its fifth evaluation report — on the financial year 2014 — in June 2015 ([23]). The fifth evaluation report includes more information on Europe 2020 than its predecessor. There is a dedicated section on Europe 2020, providing a summary account of progress towards Europe 2020 targets. The report also includes several references regarding the individual programmes' contribution to the achievement of Europe 2020. These references, however, are limited. The 2007-2013 MFF does not support comprehensive reporting on the EU budget contribution to Europe 2020, as it was designed prior to the adoption of the Europe 2020 strategy.

3.31. The evaluation report thus still provides an incomplete picture of the EU budget contribution to Europe 2020 (see also paragraph 3.9). Based on the framework for the 2014-2020 programming period, the Commission expects that, from the financial year 2017, the evaluation report will be able to provide better and more complete information on performance, including progress against Europe 2020 ([24]). However, in part 2 of this chapter we highlight some issues which will make it difficult for the Commission to report on the contribution of the ESI funds to Europe 2020 for this programming period.

THE COMMISSION'S REPLIES

3.30. *In its fourth evaluation report, the Commission pointed out that 'Europe 2020 is a common endeavour of Member States and the Commission and many external factors influence the achievement of Europe 2020 objectives'. The Court noted in paragraph 10.24 of its 2013 Annual report, that the fourth evaluation report represented an improvement in so far as it tried to establish a link between the main financial programmes presented by MFF heading and the available performance information relevant to the Europe 2020 strategy.*

In the fifth evaluation report the Commission refers to the limited size of the EU budget compared with total public spending in the EU and the variety of external factors involved in reaching Europe 2020 objectives.

The Commission is committed to report on the contribution of the EU budget to the achievement of Europe 2020 objectives. However, this is a challenging task, in particular isolating the effect of the EU budget from that of national budgets and external factors (see also the Commission reply to paragraph 3.1).

3.31. *The reporting arrangements for the 2007-2013 programmes were determined before the Europe 2020 objectives were set out. At this point in time, it is therefore not reasonable to expect the evaluation report to provide a complete picture of the EU budget contribution to Europe 2020.*

([22]) COM(2014) 383 final of 26 June 2014 'Report from the Commission to the European Parliament and the Council on the evaluation of the Union's finances based on the results achieved'.

([23]) Report from the Commission to the European Parliament and the Council on the evaluation of the Union's finances based on results achieved COM(2015) 313 final of 26 June 2015. The Treaty (Articles 318 and 319 of TFEU) requires that the Commission produce such a report, and that the report is part of the evidence on which the Parliament gives discharge each year to the Commission in respect of the budget.

([24]) See the 2013 annual report, paragraph 10.25 and reply by the Commission.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Ownership and commitment

3.32. For the Europe 2020 strategy to be successful, it needs to be fully owned by those to whom its objectives apply — the Member States and the EU. The reviews of the Lisbon strategy pointed to the absence of clear commitments by its stakeholders as constraining the effectiveness of the strategy. The report of the High-Level Group concluded that the 'lack of commitment at both the national and European level has meant that […] benefits have not been captured, exposing inconsistencies and incoherence' ([25]). The evaluation of the Lisbon strategy reached a similar conclusion, that 'implementation has suffered from variable ownership' ([26]).

3.33. For Europe 2020, the Commission has made efforts to develop a stronger sense of ownership of, and commitment to, the aims of the strategy on the part of stakeholders. The communication which accompanied the launch of the strategy includes a dedicated section setting out who should do what, addressing the roles of the European Council, the Council of Ministers, the Commission, the European Parliament, national, regional and local authorities, and stakeholders and civic society ([27]).

3.34. For the 2014-2020 MFF, much of the information on the EU budget contribution to Europe 2020 will — as in the past — have to come from Member States (in line with the principles of shared management). Thus commitment at all levels (national and EU) will be required to ensure that good-quality information is available and used for monitoring and reporting. To implement such a performance management and reporting system effectively takes time. Some elements of such a system are analysed in part 2 of this chapter. Once such a system is in place, it should allow the Commission to take responsibility for the sound financial management of the EU budget as well as its contribution to policy achievements in the declarations of assurance by directors-general in the AARs ([28]).

3.34. *As already outlined in the Commission reply to recommendation 3 in chapter 10 of the ECA's 2013 Annual Report, a distinction needs to be made between the direct responsibility of the Directors-General, on the one hand, for the management of the financial programmes and the implementation of the budget and, on the other hand, the policy achievements such as the impact of the financial programmes. The latter is also the responsibility of the co-legislators who contribute to the design of the programmes and adopt them, as well as of the Member States that often play a major role in the implementation of the programmes. Furthermore, many other factors in the economy and society, far beyond the control of the Directors-General, influence the overall performance of the programmes.*

The Commission therefore considers that the scope of the declaration of assurance provided by Directors-General should continue to focus on management and financial matters, fully in line with the financial responsibility of the Commission for implementing the EU budget. By adopting the Synthesis report, the Commission takes overall responsibility for management of the EU budget.

([25]) 'Facing the challenge — The Lisbon Strategy for Growth and Employment', p. 40.
([26]) SEC(2010) 114 final of 2 February 2010, p. 6.
([27]) COM(2010) 2020 final of 3 March 2010, Section 5.2.
([28]) Currently performance issues are excluded in the annual declarations of assurance of the DGs. See the 2013 annual report, paragraph 10.65 and recommendation 3, together with the Commission's reply.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

PART 2 — HOW EUROPE 2020 OBJECTIVES ARE REFLECTED IN MEMBER STATES' PARTNERSHIP AGREEMENTS AND PROGRAMMES

3.35. Good use of the ESI funds is important to EU's efforts to meet the Europe 2020 objectives (paragraph 3.11). Partnership agreements between the Commission and each Member State lie at the heart of the ESI funds framework. They outline each country's development needs and; for each of the ESI funds, set out a summary of the main results expected for each selected thematic objective ([29]). It is based on partnership agreements that Member States establish programmes for each fund (or for several funds), setting out the priorities for the country or region concerned.

3.36. Achieving the Europe 2020 strategy requires partnership agreements and programmes to focus on performance rather than just absorbing the available financial resources. The Commission needs to monitor and report regularly on the extent to which the ESI funds contribute to Europe 2020. In particular, the Commission will have to prepare strategic reports (by 2017 and 2019) on the contribution of the ESI funds to the achievement of the Europe 2020 strategy ([30]).

3.37. This section therefore examines whether:

(a) the benefits of bringing together the five ESI funds in partnership agreements and programmes are being realised (paragraphs 3.39 to 3.43);

(b) the Europe 2020 strategy is, at the level of partnership agreements and programmes, translated by Member States through thematic objectives into operational elements that will allow managers in the Commission to monitor and report on the contribution of the EU budget to the Europe 2020 strategy (paragraphs 3.44 to 3.48);

(c) the introduction of a common set of indicators for the ESI funds is likely to facilitate performance reporting (paragraphs 3.49 to 3.56);

(d) Member States focus on results in the partnership agreements and programmes (paragraphs 3.57 to 3.60);

(e) the new performance framework provides Member States with incentives to achieve results (paragraphs 3.61 to 3.65).

3.35. *The Commission refers to its reply to paragraph 3.1. The EU budget is only one of the EU levers for contributing to the achievement of the Europe 2020 objectives.*

([29]) Regulation (EU) No 1303/2013, Articles 15 to 17.
([30]) Regulation (EU) No 1303/2013, Article 53.

THE COURT'S OBSERVATIONS

3.38. We based our examination on an analysis of the legislative framework and a sample of five partnership agreements [31] along with, for each partnership agreement analysed, one programme [32]. This year we carried out the examination of these documents for Poland and Portugal in cooperation with the supreme audit institutions in these Member States. The cooperation included parallel audit work, the exchange of planning documents and findings, and activities aimed at sharing knowledge and experiences gained in this area.

The potential benefits of combining the five European Structural and Investment Funds have not been fully realised

3.39. A novelty for the period 2014-2020 is that the five ESI funds have been grouped under one umbrella regulation (known as the 'Common Provision Regulation' or CPR) [33] and, for each Member State, the planned use of the five ESI funds is set out in one partnership agreement. The purpose of this was to simplify and harmonise the approach to the implementation of ESI funds, and to ensure cross-sector complementarity and foster synergies.

Simplified and harmonised approach

3.40. As we previously noted, the overall structure of the legislative package remains complex. There are many layers (common provisions, general provisions, fund-specific provisions, delegated acts and implementing acts). In some cases national legislation may constitute an additional layer [34].

THE COMMISSION'S REPLIES

3.38. *See also Commission reply to paragraph 3.28.*

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(31) Those of Germany, France, Latvia, Poland and Portugal.
(32) France: ESF — Alsace; Germany: EAFRD — Saxony-Anhalt; Poland: ESF and ERDF combined — Podkarpackie Voivodeship; Portugal: ESF Human Capital; Latvia: ESF, ERDF and CF combined — Employment and Growth.
(33) Regulation (EU) No 1303/2013.
(34) See the Court's opinion No 7/2011, on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1083/2006 (OJ C 47, 17.2.2012, p. 1), paragraph 5 (http://eca.europa.eu). This finding is confirmed by the IAS ('IAS final report on gap analysis review of Regulation 2014-2020 for ESI funds').

THE COURT'S OBSERVATIONS

3.41. The equivalent of partnership agreements for the 2007-2013 period (national strategic reference frameworks) covered the cohesion family of funds: the CF, ERDF and ESF ([35]). Partnership agreements for 2014-2020 add two further funds, the EAFRD and EMFF. The common provision regulation includes a set of rules applicable to all funds covering important elements such as principles of Union support for the ESI funds, the strategic approach, monitoring, etc. Some parts of the CPR only apply to the cohesion family of funds and exclude the EAFRD or EMFF. For example, the CPR sets specific rules on programming which relate only to the cohesion family of funds.

3.42. At the level of the programmes only the cohesion family of funds can be combined (through 'multi-fund programmes', for example). In the 2007-2013 period only the CF and ERDF could do this. The rules governing how the funds are used differ depending on the fund — in particular between the cohesion family of funds and EAFRD/EMFF funds. These differences are also apparent in the way that the cohesion family and EAFRD/EMFF funds structure their objectives (see paragraph 3.45).

Complementarity and fostering synergies

3.43. As the partnership agreement is the only place where the five ESI funds are discussed together, this would be the place to identify complementarities and synergies amongst these five funds. In our examination of a sample of partnership agreements we found little evidence that the aims of complementarity and synergy were being put into practice by Member States. Furthermore, the programmes we examined provided little useful information on complementarity and synergies. Examples were rare and, where they did occur, they tended to be vague. There was a lack of operational guidance on how cross-sector complementarity and fostering synergies in the use of five ESI funds ought to be achieved in partnership agreements and programmes.

THE COMMISSION'S REPLIES

3.41. *Other important elements such as programming, evaluation and eligibility rules are also subject to common rules for all the ESI Funds.*

3.42. *In addition to the Commission's reply to paragraph 3.41 the rules governing the delivery system of EMFF are the same as those for the ERDF, ESF and the Cohesion Fund contained in Part Four of the Common Provisions Regulation.*

3.43. *The partnership agreement requires a description of the arrangements to ensure coordination between the ESI Funds. Programmes must set out the more detailed mechanisms to ensure such coordination.*

([35]) There were separate agreements covering the EAFRD and EMFF.

THE COURT'S OBSERVATIONS

The Europe 2020 strategy is not systematically translated through thematic objectives into operational targets in partnership agreements and programmes

3.44. Combining the five ESI funds into one partnership agreement should, according to the Commission, make it easier for both Member States and the Commission to report on the contribution of the five ESI funds to the over-arching thematic objectives ([36]). In the first part of this chapter we noted that the thematic objectives are not designed to translate Europe 2020 into operational objectives, but to provide the link to Europe 2020 and structure the information provided in the partnership agreements and programmes (paragraphs 3.22 to 3.25). This section therefore examines whether Europe 2020 is, at the level of partnership agreements and programmes, translated through thematic objectives into operational elements (objectives, associated indicators, milestones and targets) allowing managers to monitor and report on the contribution to the strategy of the ESI funds.

3.45. The common set of 11 thematic objectives (paragraph 3.23) is not applied directly and consistently to all five ESI funds, and thus neither to the programmes which draw on the funds. For the cohesion family of funds, the thematic objectives act as a structuring element, since they are supported directly by the hierarchy of objectives required in the relevant regulations. However, the EAFRD/EMFF funds use a different structure. At the highest level they are required to support 'Union priorities', but the legislation does not set out how these priorities are linked to the thematic objectives. While the legislative framework establishes a general link between EAFRD/EMFF funds and Europe 2020 strategy, the thematic objectives are not used to drive or structure these funds. Box 3.3 summarises the different structures used by the funds.

([36]) COM(2011) 500 final, part 1 of 29 June 2011, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 'A budget for Europe 2020', Section 5.2 and SWD (2012) 61 final part II of 14 March 2012, Section 1.3.

THE COMMISSION'S REPLIES

3.44. *The Commission refers to its reply to paragraph 3.24 as regards the role and purpose of thematic objectives. Thematic objectives are the means by which the funds with their Treaty-based missions are focused on Europe 2020 priorities. However, the funding programmes do not have as their sole objective the delivery of Europe 2020.*

3.45. *This is line with the missions of the respective funds.*

Rural development priorities are considered as a translation of thematic objectives into the specific context of the rural development policy.

The EAFRD legal framework establishes a clear link: the contribution to Europe 2020 shall be pursued through six priorities sub-divided into focus areas. This requirement is fully reflected in the structure of the EAFRD programmes. The progress towards targets set for the priorities/focus areas is monitored in the Annual Implementations Reports. In order to ensure consistency with the thematic objectives, correspondence tables have been annexed to the guidance documents.

The EMFF Union Priorities and their links with the Thematic Objectives are set out both in the Common Strategic Framework and at programming level, in the intervention logic which was discussed with Member States at successive EMFF Expert Group meetings in 2014.

THE COURT'S OBSERVATIONS

Box 3.3 — Hierarchy of objectives for the cohesion family funds and for EAFRD/EMFF funds according to the legislative framework

ESF/ERDF/CF: thematic objectives -> investment priorities -> specific objectives -> types of actions.

EAFRD: Union priorities for rural development -> focus areas -> measures.

EMFF: Union priorities for sustainable development of fisheries and aquaculture -> specific objectives -> measures.

3.46. All partnership agreements and four of the five programmes we examined used thematic objectives to structure the information. For the one programme, we examined where this was not the case (the EAFRD programme — Germany), the programme reflected the legislative requirements and made only passing references to thematic objectives. In this programme it was not possible to see a link between the thematic objectives as set out in the German partnership agreement with the priorities and focus areas of the programme. Even when using the correspondence table of the Commission guidance, which provides the links between the priorities and thematic objectives, it was difficult to aggregate information per thematic objective as priority four has two associated thematic objectives. While we identified this in the programme for Germany, this will be a general problem for all EAFRD programmes.

THE COMMISSION'S REPLIES

Box 3.3 — Hierarchy of objectives for the cohesion family funds and for EAFRD/EMFF funds according to the legislative framework

EAFRD: As explained in the Commission reply to paragraph 3.45 and shown inter alia in the guidelines for strategic programming for the period 2014-2020 the EAFRD priorities and focus areas are linked to the Europe 2020 and thematic objectives.

EMFF: Although the EMFF specific regulation links the Union Priorities with the specific objectives, and then the measures of the Fund, the intervention logic which has been used for programming and presented to Member States at the EMFF Expert Group on 25 June 2014 shows a hierarchy of objectives which includes the thematic objectives -> Union priorities for sustainable development of fisheries and aquaculture -> Specific objectives -> Measures.

3.46. *As mentioned, a correspondence exists between the 11 thematic objectives and the EAFRD priorities/focus areas. See also Commission reply to paragraph 3.45.*

In the EAFRD there are separate result indicators which enable links to be made to the individual thematic objectives. Therefore, results can be aggregated by thematic objectives.

THE COURT'S OBSERVATIONS

3.47. Partnership agreements are required to include national headline targets (paragraph 3.17). All the partnership agreements we reviewed did so. For the programmes we examined, only the Polish programme broke down these national targets further into operational targets through thematic objectives.

3.48. Portugal and Latvia defined operational objectives in their partnership agreements which they then used at the level of the programmes we examined. However, these objectives were not directly linked to their national headline targets.

THE COMMISSION'S REPLIES

3.47. *The inclusion of a reference to the headline targets in the partnership agreements is based on Commission guidance. Breaking down the targets into additional operational targets is up to the Member States. The setting of specific operational objectives with corresponding targets takes place at programme level.*

The introduction of common indicators for each fund is an important step but there are limitations in design

3.49. For the Commission to be able to aggregate performance at EU level, including information on the Europe 2020 strategy, it needs common indicators, including indicators on results, shared by funds where possible and used consistently by all Member States. These indicators should be accompanied by milestones and targets. In the previous MFF period, only the ESF and EAFRD required a set of common indicators. For the 2014-2020 period, the regulations introduce a common set of indicators for each of the five ESI funds.

3.49. *The five Funds of the ESIF each have their own Treaty-based mission and target different kinds of projects and investments. A single set of common indicators would therefore be difficult to achieve. There are targets for all indicators and milestones for the indicators included in the performance framework.*

The Commission promoted for the ERDF and the CF voluntary use of common or 'core' indicators and by 2013 all Member States reported against them. The obligatory requirement on common indicators for the 2014-2020 period is based on the lessons learnt from 2007-2013. Monitoring aggregate performance at EU level can also be calculated through the rate of target achievement.

The Commission will produce a report by the end of 2015 on the outcome of the negotiations which will include an analysis of the aggregate targets to be achieved by the end of the 2014-2020 programming period.

3.50. This represents potentially an important step towards enhancing the focus on performance. However, our analysis, set out in the paragraphs below, shows that there are some elements in the design of the system for common indicators which risk limiting their usefulness and relevance, and thus the Commission's ability to aggregate performance information.

3.50. *See Commission replies to paragraphs 3.51 to 3.56.*

THE COURT'S OBSERVATIONS

3.51. According to the legislation, Member States are not required to include the common indicators in their programmes ([37]). However, the Commission's reporting on performance is based on these common indicators (for example, the Commission's management plans and annual activity reports for the cohesion family of funds are solely based on the common indicators). There is therefore a risk that the inconsistent use of common indicators will have a significant knock-on effect on the quality of reporting by the Commission.

3.52. Each ESI fund has common output indicators. Only three of the funds, however, also have common result indicators ([38]). In addition, some of the indicators categorised as result indicators for the EAFRD are not true result indicators (see Box 3.4). It will therefore be difficult for the Commission to aggregate information on results for certain funds.

THE COMMISSION'S REPLIES

3.51. *Where common output indicators can be used (i.e. where they are relevant), the regulation requires that they are used and the Commission has insisted on this in the negotiations. Member States are required to report against all common indicators. The Commission reporting on common indicators will therefore capture the performance against them for all the programmes for which they are relevant.*

The use of indicators for outputs and results is obligatory. Member States are also required to report yearly on progress towards reaching all the targets set out in the programme, whether for common indicators or not. The Commission will thus be able to assess progress on a yearly basis.

3.52. *There are no common result indicators for the ERDF and CF because of the breadth of types of investment which can be supported and the variety of changes which the programmes target. The Commission will assess and report on results, but not through a simple aggregation of information, which was never its intention and which it does not consider useful due to the variety of results.*

For the EAFRD, the common indicators used in all RDPs are defined in Annex IV of Regulation (EU) No 808/2014.

The target indicators, which are a subset of the common result indicators, pragmatically reflect what can be quantified ex ante, *measured, collected and made available by all Member States through the monitoring system. The target indicators should not therefore be viewed in isolation, but in conjunction with the full set of result indicators specified in the legal framework.*

While there will always be scope for improvement, indicators are themselves subject to considerations of cost efficiency as there is a cost to establishing and monitoring indicators. Indicators which are retained in a common system must be operational, i.e. data must be realistically available.

See also Commission reply to Box 3.4.

([37]) With the exception of Youth Employment Initiative and EAFRD.
([38]) The CF and ERDF have no common result indicators.

THE COURT'S OBSERVATIONS

Box 3.4 — Examples of EAFRD indicators incorrectly classified as result indicators

'Percentage of agricultural holdings with RDP support for investments in restructuring or modernisation' measures the number of beneficiaries, which is an output of providing support, as opposed to efficiency gains in production, which would be a result.

'Percentage of rural population covered by local development strategies' counts the number of people for whom a development strategy was created instead of focusing on the improvements arising as a result of implementing the strategy.

THE COMMISSION'S REPLIES

Box 3.4 — Examples of EAFRD indicators incorrectly classified as result indicators

On percentage of agricultural holdings: *As stated in the Commission reply to paragraph 3.52, indicators which are used for policy monitoring and analysis must be operational, which puts some constraints on those indicators which can be retained.*

These include a set of common indicators at output, result, impact and context level. These will be used to compile aggregate data at EU level, not only for outputs, but also for results.

The first indicator referred to here is not a simple output indicator, but a proportion of the population which is affected by the support provided. It therefore already gives some indication of the scale and scope of RDP achievement: investment support for 38 % of the farm population is indicative of a very different outcome for the farming sector than support for 0,5 % for example. However, it is fully recognised that this target indicator alone does not give an adequate picture of the contribution of an RDP, or of rural development policy as a whole, to the evolution of farm competitiveness. The CMES therefore also includes a compulsory common complementary result indicator, 'Change in agricultural output on supported farms/Annual Work Unit'. This is a more complex indicator to assess, requiring not only more data at farm level, but also comparison with non-supported similar farms in order to assess the net results of the RDP intervention. It will therefore be assessed through evaluation, rather than monitoring, at three points in the programming cycle (2017, 2019 and ex post*) rather than annually.*

On percentage of rural population: *This indicator relates to the proportion of the relevant population covered, not the number of people, and therefore provides an indication of the scope of coverage. This indicator should be viewed in conjunction with R24/T23 (Jobs created in supported projects (Leader)).*

THE COURT'S OBSERVATIONS

3.53. The common indicators in place should permit aggregation within each fund. However, reporting on progress against Europe 2020 would require a higher level of aggregation, involving combining results from different funds. Only the CF and ERDF use the same common indicators (CF common indicators being a subset of those used for the ERDF).

3.54. The thematic objectives (paragraph 3.23) should provide the link between the funds and the strategy, and hence apply to all five funds. Common indicators are not directly linked to thematic objectives. In addition, since the common indicators are not shared by all five funds, they will not facilitate the aggregation of information at the level of thematic objectives.

3.55. The regulations set different requirements in terms of baselines, milestones and targets for the different funds [39]. Baselines are not always required and milestones are required only for those indicators which form part of the 'performance framework' (discussed in the next section). Targets for results do not always have to be quantified. Without milestones for results, it is difficult to track progress until the due date for the achievement of targets — 2023, three years after the end of the current programming period.

3.56. To be a useful incentive for performance, targets should strike the right balance between ambition and realism. In some of the five programmes reviewed, several targets were unlikely to be sufficiently challenging.

THE COMMISSION'S REPLIES

3.53. *Given that the Funds target different investments, it is unlikely that the same common indicators could be used for all funds (see Commission reply to paragraph 3.49). Note that Member States will report on the progress made in delivering the Europe 2020 objectives in 2017 and 2019 through the contribution of all the ESI Funds to the thematic objectives selected. The Commission will prepare a strategic report summarising all progress reports. Evaluation will also assess the contribution of the funds to the objectives for each priority.*

3.54. *For Cohesion policy funds, the reporting on indicators will be provided by priority axis and specific objective and will therefore be linked to thematic objectives. For EAFRD, see Commission reply to paragraph 3.45.*

3.55. *The Commission monitors the range of output and result indicators on a yearly basis. In particular, performance in relation to the progress of the programmes towards achieving results is tracked by the performance framework, including against milestones for output indicators. By monitoring progress every year from 2016 onwards (2015 for YEI), the Commission will be able to track progress towards the targets provided in the programmes and thus judge if they are on track to achieve the expected results.*

The different requirements as regards the use of baselines depend on the nature of the indicators (output or results). In the case of ESF, baselines for output indicators are set at zero given the nature of the indicators. However, in the case of result indicators, baselines are not always available and there is a procedure to fix them later according to the experience with the implementation.

3.56. *The Commission in the programme negotiations endeavours to achieve the right balance in target settings.*

(39) CF: Regulation (EU) No 1300/2013, Article 5; ERDF: Regulation (EU) No 1301/2013, Article 6; ESF: Regulation (EU) No 1304/2013, Article 5; EAFRD: Regulation (EU) No 1305/2013 of the European Parliament and of the Council (OJ L 347, 20.12.2013, p. 487), Article 69; and EMFF: Regulation (EU) No 508/2014 of the European Parliament and of the Council (OJ L 149, 20.5.2014, p. 1), Article 109.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

The focus on results should be further improved in particular in the partnership agreements

3.57. In our 2012 annual report, we stated that it is a challenge to obtain good qualitative results from schemes where funds are pre-allocated among Member States and absorption of these funds is an implicit objective ([40]). In response, one of the elements identified by the Commission as addressing this weakness for the 2014-2020 period is a reinforced 'intervention logic' ([41]): that is, Member States should identify their needs and commit to expected results before considering where and how to spend the funds. We therefore examined our sample of partnership agreements and programmes to see whether Member States did commit to expected results.

3.57. *The intervention logic aims to establish a link between the activities and expected effects (outputs, contribution to results) of an intervention to address the identified needs, as well as the assumptions that explain how the activities will lead to the effects in the context of the intervention.*

3.58. In their partnership agreements and programmes, Member States are required to follow the intervention logic outlined above. The partnership agreements and programmes we examined all identified needs before turning to analyse how and on what the EU funds might be spent.

3.58. *According to the regulatory framework the intervention logic is applied by Member States at the level of the programmes not the partnership agreements.*

3.59. However, there is a weak focus on results in the partnership agreements we examined. Member States are required to set out expected results in partnership agreements ([42]) and programmes. While in all five partnership agreements we examined Member States did identify results, in three of them ([43]) over half of the expected results were vague. Furthermore, where results were identified, they were usually expressed in qualitative terms, without stating the magnitude of change. A good example of a thematic objective which was accompanied by quantified result targets is 'Supporting the shift towards a low-carbon economy' (number 4 in Box 3.2). It is likely that this is because this particular thematic objective is directly related to one of the headline targets supported by a legally-binding framework (paragraph 3.16).

3.59. *The legislation requires a summary of the main results at the partnership agreement level.*

([40]) See the 2012 annual report, paragraph 10.4.

([41]) See the Commission's reply to the 2012 annual report, paragraph 10.3.

([42]) Regulation (EU) No 1303/2013, Article 15, states that partnership agreements should provide, for each of the selected thematic objectives, a summary of the main results expected.

([43]) Germany, France and Latvia.

THE COURT'S OBSERVATIONS

3.60. At the level of programmes, we examined, Member States did set quantified result targets. However, for the EAFRD programme in Germany, this was restricted to one of the six priorities (priority 6).

THE COMMISSION'S REPLIES

3.60. *As set out in Regulation (EU) No 808/2014, quantified targets for results are included for all priorities. The 2014-2020 Saxony-Anhalt RDP (as all other RDPs) includes in Chapter 11 a set of quantified targets covering all the Focus Areas included in the RDP, using the common target indicators (a subset of the result indicators as specified in the legal framework).*

Weaknesses in the design of the performance framework

3.61. The performance reserve, whereby a small proportion of EU funding to Member States is held back and only made available to them if they meet certain targets, is the main incentive for the Member States to continue to focus on performance once the programmes have started. The performance reserve is thus a key element within the performance framework, described in Box 3.5.

Box 3.5 — The performance framework

In the programmes, Member States set indicators with milestones for 2018 and targets for 2023, both at the level of fund priorities. The Commission will undertake a performance review in 2019, based on the information in Member States' annual implementation reports on the previous year relating to the achievement of these milestones. Depending on the outcome of this review, the Commission will allocate the performance reserve (between 5 and 7 % of the allocation to each priority within a programme) to the priorities which have achieved their milestones. The Commission can suspend payments if the 2019 performance review reveals a serious failure to achieve the milestones; similarly, it can apply financial corrections if the final implementation reports show that there has been serious failure to achieve the 2023 targets ([44]).

3.61. *It is an additional incentive rather than the main incentive.*

([44]) Regulation (EU) No 1303/2013, Articles 20 to 22.

THE COURT'S OBSERVATIONS

3.62. In last year's annual report, we pointed out that the effective operation of the performance reserve would depend in part on the Commission's success in negotiating suitable targets, pitched at the right level, and securing accurate, reliable and timely data from Member States [45]. An October 2014 report by the Commission's Internal Audit Service reached similar conclusions, finding that there were inherent risks that the Member States will set unambitious milestones and targets to avoid their non-achievement, and that they do not make sufficient effort to report accurate and reliable data to avoid the sanctions in the case of underperformance. The performance review will only take place in 2019, almost at the end of the MFF period. Furthermore any problems with the quality of the data provided by Member States will not become apparent until 2016, the first year in which annual implementation reports will have to be summarised by the Commission in the strategic reports (see paragraph 3.36) in terms of the contribution of ESI funds to Europe 2020. Thus for both these areas of risk, it will not be possible to judge the Commission's and Member States' success for some years to come.

3.63. In last year's annual report [46], and through our work in this area for the current report, we have identified some potential design flaws with the arrangements governing the performance framework:

(a) If programme priorities fail to reach the relevant milestones, the funding represented by the performance reserve is not lost to the Member State but can be reallocated to other priorities that have reached their milestones [47]. This weakens the incentive effect.

(b) The financial sanctions open to the Commission — suspension of payments or financial corrections — cannot be based on result indicators [48]. This weakens the focus on results.

THE COMMISSION'S REPLIES

3.63.

(a) *This is indeed what has been agreed by the co-legislators.*

As regards the weakening of incentive effects, the Commission does not agree. The funding is lost to the managers of the relevant priority axis or measure, so it does act as an incentive. In addition, reallocating funds to priorities which are more effective in delivering results actually increases the overall performance of the budget.

(b) *Again, this is what the co-legislators have agreed.*

On the substance, sanctions cannot be applied on the basis of result indicators both because of the timing issue (results can only be assessed in some cases a considerable time after outputs) and because of the influence of external factors.

(45) See the 2013 annual report, paragraph 10.14.
(46) See the 2013 annual report, paragraph 10.15.
(47) Regulation (EU) No 1303/2013, Article 22(4).
(48) Regulation (EU) No 1303/2013, Article 22(5) and 22(7).

THE COURT'S OBSERVATIONS

(c) Furthermore, the Commission's ability to impose financial corrections where targets have not been achieved is limited by a number of conditions and exceptions: proportionality, levels of absorption, undefined 'external factors', socio-economic factors, environmental factors, economic conditions and force majeure [49].

3.64. In addition, we have pointed to the risk that the focus on performance would be limited owing to the fact that, under the legislation [50], result indicators should be used in the performance framework 'only where appropriate'. The Commission decided to limit the possible use of result indicators to the ESF only on the grounds that EU-funded programmes by themselves do not have sufficient influence over the achievement of results, and that there can be considerable lead time between the spending of the money and the achievement of results [51].

3.65. While the five programmes (four of which covered the ESF) which we examined included indicators, milestones for the year 2018 and targets for the year 2023, none included any result indicators in the performance framework. Thus, for the programmes examined, the performance review will be based on input (such as the amount of public money spent) and output indicators (such as the number of beneficiaries funded). Box 3.6 includes further examples of the types of indicators, milestones and targets that will be used in the performance framework — and therefore may determine whether or not Member States qualify for the performance reserve. The evidence of the programmes examined supports the conclusion we reached last year that the impact of the performance reserve, in terms of encouraging an increased focus on results, is likely to be no more than marginal, since there remain no real financial incentives or sanctions in the 2014-2020 period relating to the results achieved with the EU funding.

THE COMMISSION'S REPLIES

(c) *The qualifications are the outcome of the legislative process between the Commission, Council and Parliament. The Commission considers that the objective of this provision will still be achieved.*

3.64. *This is a specific issue for the performance framework only. The overall monitoring of performance of a programme will include results indicators.*

3.65. *The performance reserve is only one of the elements supporting an increased focus on results.*

The core element of the results orientation is the intervention logic embedded in each programme with the output and result indicators associated.

The performance framework provides a mechanism for monitoring whether the implementation of the priorities is on track. The performance reserve provides an incentive to achieve the milestones, which necessarily are the precondition for obtaining the intended results.

(49) Regulation (EU) No 1303/2013, Article 22(7). The Commission's Internal Audit Service reached a similar conclusion in its October 2014 report arising from its gap analysis review of this Regulation.

(50) Regulation (EU) No 1303/2013, Annex II.

(51) See the 2013 annual report, paragraph 10.15; supported by the Commission's 'Guidance fiche — Performance framework review and reserve in 2014-2020' version 6 of 4 March 2014, p. 7 for Member States.

THE COURT'S OBSERVATIONS

Box 3.6 — Examples of indicators, milestones and targets used in the performance framework

Latvia, ESF, ERDF and CF combined — Employment and growth: Indicators used

In this programme a total of 46 indicators are identified of which 16 are input indicators and 30 are output indicators. The 16 input indicators are by nature the same: 'Financial allocation'.

Germany, EAFRD — Saxony-Anhalt: Two typical examples of indicators with milestones and targets

For the indicator 'Total amount of total public expenditure' the target for 2023 is the amount 135,7 million euro with the milestone for 2018 31,1 million euro.

For the indicator 'number of agricultural entities participating in the risk management programme' the target is 113 agricultural entities with the milestone for 2018 of 20 % of these entities.

France, ESF — Alsace: Typical indicators with milestones and targets

In this programme a total of six indicators are identified of which three are input indicators and three are output indicators.

For the input indicator 'Financial allocation' the target for 2023 is 35,4 million euro with the milestone for 2018 11,8 million euro.

For the output indicator 'number of unemployed people supported' the target for 2023 is 4 067 people with the milestone 2 324.

PART 3 – THE COMMISSION'S REPORTING ON PERFORMANCE

3.66. This part of the chapter covers the internal guidance provided to directorates-general (DGs) within the Commission, the transition from the old (2007-2013) to the new (2014-2020) MFF and performance reporting at the level of Commission DGs.

THE COMMISSION'S REPLIES

Box 3.6 — Examples of indicators, milestones and targets used in the performance framework

Germany, EAFRD — Saxony-Anhalt — indicator 'Total amount of total public expenditure': *The milestone for 2018 is set as a consequence of the 'n+2' rule, EAFRD allocation from the previous programming period being still available for payments till end of 2015, for such types of operations (implemented according to the RDP 2007-2013). This takes also into account the time needed for the approval of the RDP and for the preparation of the internal implementation guidelines.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

3.67. We reviewed the 2014 programme statements [52], management plans (MPs) [53] and AARs [54] of six DGs [55], based on requirements set out in the Financial Regulation, the Commission's internal control standards and the MP and AAR instructions issued by the Commission's SG and the Directorate-General for Budget (DG BUDG). The review excluded information relating to non-spending activities, as the relevant requirements are currently under revision.

Central guidance has improved but there are still weaknesses to address

3.68. In order to facilitate the preparation of programme statements, management plans and annual activity reports by DGs, SG and DG BUDG provide standing instructions and related guidelines. We found that over time this guidance has become more specific, more consistent and easier to understand [56]. Also, the requirement for DGs to include information in their 'programme statements' on the contribution of spending programmes to the Europe 2020 strategy (i.e. the link to associated headline targets and flagship initiatives) is an improvement. However, our examination showed that the information on Europe 2020 is not included in the subsequent stages of programming (in management plans) and reporting (in AARs).

3.68. *As indicated in the Synthesis reports of this and previous year as well as in its replies to previous annual reports, the Commission has gradually further developed the performance framework and has taken several measures with a view to demonstrating the importance of the quality of spending and the added value of the EU budget. Starting from the legal framework of the new MFF which is designed to contribute to Europe 2020 and includes stronger monitoring, evaluation and reporting arrangements thereto, the Commission has also introduced this focus on performance in its strategic planning and programing cycle as is reflected in the central guidance. As results will become more and more available during the lifecycle of the current MFF, it is expected that the reporting on these results will also gradually be more focused on the EU's strategic objectives.*

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(52) COM(2013) 450 final of 28 June 2013, 'Draft General Budget of the European Union for the financial year 2014'. The programme statements replaced the activity statements in justifying the funds requested in the draft annual budgets. They include for each spending programme objectives supported by indicators and targets, which should then be used in the DG's management plans and annual activity reports.

(53) Each DG establishes annual management plans to translate their long-term strategy into general and specific objectives, and to plan and manage their activities towards achieving those objectives.

(54) An annual activity report is a management report, giving account of the achievement of the key policy objectives and core activities. For this chapter, we examine part 1 of the AARs on the results achieved and on the extent to which the results had the intended impact.

(55) DG AGRI, DG DEVCO, DG EMPL, DG for Enterprise and Industry (DG ENTR) — now called DG for Internal Market, Industry, Entrepreneurship and SMEs (DG Growth), DG for the Environment (DG ENV) and DG REGIO.

(56) Feedback on the guidance from operational DGs in a survey carried out in August 2014 by the central services was mostly positive.

THE COURT'S OBSERVATIONS

3.69. Although a new MFF period started in 2014, an important part of the spending until 2016 still relates to the previous MFF. Performance reporting thus needs to cover both the old and the new MFF. Reports by the six DGs we examined did not present the transition between the old and the new MFF clearly. It was often not possible to identify which objectives and targets were kept or updated from the old MFF and which were discontinued. In the absence of comparable information there is a risk that it is not possible to assess whether previous objectives and targets have been achieved.

3.70. For example, one of DG AGRI's specific objectives in the old MFF was 'To encourage organic production and develop the market for organic products in the EU'. While DG AGRI continues to be active in the area of organic farming, this objective is no longer included in the management reports. The linked indicator remains but is not comparable with the previous MFF. While DG AGRI continues to reports on the indicator 'the total area under organic farming', the definition of this indicator has changed (from total area under organic cultivation to total area under organic cultivation receiving EU funds).

THE COMMISSION'S REPLIES

3.69. *Specific attention has been given in the guidance of the 2014 AARs on how to report on continued or discontinued programmes. The legislator may also have decided to shift the focus of some programmes or to discontinue others.*

For DG EMPL, the 2007-2013 objectives were replaced by a single objective to 'continue effective implementation of 2007-2013 programmes' with indeed only two indicators. This was a conscious decision to keep the report concise and management-oriented, e.g. to highlight the DG's actions for the three periods (preparation 2014-2020, finalise implementation 2007-2013, close 2000-2006).

For DG REGIO, and since the Management Plan 2014, all indicators associated with the specific objectives are categorised according to the programming period they refer to [5]*. In addition, performance information is structured in such a way that it will make possible to distinguish 2007-2013 and 2014-2020 achievements. This could not yet be reflected in the AAR 2014, as no performance information was available in relation to the new operational programmes.*

3.70. *In the context of the CAP 2013 reform, DG AGRI developed a monitoring and evaluation framework for the CAP as a whole. Given the fact that organic farming is considered to be beneficial for the climate and environment and the organic farmers are entitled to the related payments, the corresponding indicators have been adapted.*

(5) *'2007-2013 indicators discontinued in 2014-2020'; 'indicators which are common to 2007-2013 and to 2014-2020 programming period' and '2014-2020 indicators for which no exploitable data is available from 2007-2013'.*

THE COURT'S OBSERVATIONS

Performance planning and reporting at directorate-general level can be further improved

DGs' objectives not fit for management purposes

3.71. According to the Commission's 2014 MP instructions, DGs should establish general objectives with impact indicators (long-term) and specific objectives with result indicators (short-/medium-term). According to the Financial Regulation, DGs' objectives should be SMART — specific, measurable, achievable, relevant and timed ([57]).

3.72. In line with our observations in previous years in relation to other DGs, we found that, for all six DGs reviewed, many of the objectives (general and specific) used in the MPs and AARs were taken directly from policy or legislative documents but were not translated into more operational objectives. They were thus at too high a level to be useful as management instruments (see Box 3.7).

Box 3.7 — Examples of objectives defined by the Commission as 'specific' not fit for management purposes

DG DEVCO: 'Support to Democracy' is set as a specific objective. It is not formulated as an objective and does not define what should be achieved.

DG ENTR: The objective 'To promote entrepreneurship and entrepreneurial culture' does not specify the types of activities to be undertaken and what they should achieve.

([57]) Regulation (EU, Euratom) No 966/2012, Article 30(3).

THE COMMISSION'S REPLIES

3.72. *The objectives (general and specific) as specified in the policy or legislative documents constitute the political reality in which the Commission operates. Moreover, the Commission needs to manage and report on programmes on the basis of the objectives and indicators set by the legislative authority.*

Box 3.7 — Examples of objectives defined by the Commission as 'specific' not fit for management purposes

DG DEVCO*: Supporting democracy is a general, rightly formulated policy objective. It is a long term process, particularly sensitive to political development in target countries, but this does not mean that supporting democracy is not a valid objective in itself. In many cases, the question to ask is 'how much would have the situation further deteriorated should the Commission not have been providing support to pro-democracy actors and democratic processes in a given country?'.*

DG ENTR*: In line with Commission's practice, this specific objective and the relating two indicators stem from the legal base of the COSME programme ([6]). The Commission considers that this specific objective is appropriately specified as indicators, outputs and explanation are provided in the DG's management plans and AARs.*

([6]) *See the COSME objectives and indicators in the annex http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R1287&from=EN*

THE COURT'S OBSERVATIONS

DG REGIO: The objective to 'Support for political reforms' is not measurable as the amount of support to be provided is not quantified.

THE COMMISSION'S REPLIES

DG REGIO*: As clarified in relation to paragraph 3.72 above, objectives which are included in the Programme Statements, MPs and AARs are taken from the legal bases. In line with Commission practice, this specific objective is consistent with the legal basis in relation to IPA II* [7]*.*

3.73. In total we reviewed 34 specific objectives of which only two fulfilled all the 'SMART' criteria. This result is similar to what we reported in previous years. While the objectives examined were relevant to the policy area in which the DGs operate, in many cases the indicators accompanying the objective do not exhaustively measure all aspects at the appropriate level.

Difficulties remain with indicators for monitoring performance

3.74. The choice of indicators should be based on considerations such as relevance, measurability, and the availability of timely and reliable performance data. As far as is possible, indicators should meet the 'RACER' criteria [58]. Indicators which measure outcomes over which DGs have limited influence should be complemented by other indicators measuring directly the DGs' activities.

3.74. *In line with the reply to paragraph 3.72, the objectives and indicators as set by the legislative authority in the legal bases form the basis on which the Commission needs to report. Not all of these indicators would fulfil the 'RACER' criteria.*

3.75. All six DGs have at least one performance indicator per objective to help management monitor, evaluate and report on achievements. Of the 98 indicators in these DGs we examined, 34 fulfilled all the RACER criteria. This is an improvement compared to what we reported in previous years. However, as in previous years, we have identified some additional shortcomings in the indicators being used (see Box 3.8).

3.75. *Please see Commission reply to paragraph 3.74.*

([58]) Relevant, accepted, credible, easy and robust: 'Part III: Annexes to impact assessment guidelines' (European Commission, 15 January 2009 — http://ec.europa.eu/smart-regulation/impact/commission_guidelines/docs/iag_2009_annex_en.pdf).

([7]) *Regulation (EU) No 231/2014 of the European Parliament and of the Council of 11 March 2014 establishing an Instrument for Pre-accession Assistance (IPA II).*

THE COURT'S OBSERVATIONS

Box 3.8 — Examples of problems with indicators

(a) *Indicators which were outside the DG's ability to influence*

DG ENV: 'Total waste generated' — Many factors have impact on this indicator, such as consumer habits or industry standards. Several of these are outside of DG ENV's scope of influence.

(b) *Indicators for which the reliability of supporting data was questionable*

DG AGRI: 'Support to the Local Production to maintain/develop the agricultural production' — The data for this indicator is extracted from annual implementation reports submitted by Member States. The Commission, however, identified shortcomings in the quality of the data submitted and concluded that this indicator 'shall be evaluated with due caution' ([59]).

(c) *Indicators presented as result indicators but were instead output-oriented*

DG EMPL: 'Number of persons receiving assistance from the Fund' — This indicator measures the number of beneficiaries instead of focusing on the improvement achieved as a result of providing support.

THE COMMISSION'S REPLIES

Box 3.8 — Examples of problems with indicators

(a) DG ENV: *Even though achievement of a favourable trend in 'total waste generated' also depends on factors outside the Commission's control, several directives include mandatory recycling and waste prevention targets.*

(b) DG AGRI: *In general, indicators are not to be taken at face value, and their quality should always be assessed in relation to the intended use. The Commission has already undertaken reflection with Member States in order to improve the indicator and the quality of the data provided.*

(c) DG EMPL: *This indicator is consistent with the aims of the European Fund for the Aid to the Most Deprived (FEAD) which aims to alleviate worst forms of poverty and does attempt to change their relative position (lift out of poverty). Such indicator is classified as a result indicator in the subsequently adopted delegated act (Regulation (EU) No 1255/2014) which includes a list of common input, output and result indicators.*

The numbers receiving assistance provide already an indication of the contribution of the FEAD to alleviate food and severe material deprivation. The nature of the fund does not make it possible (certainly not cost-effective) to provide information on the 'improvement achieved as a result of providing support'. These improvements would be impacts of the support provided that would go beyond the monitoring nature of the indicators.

([59]) See DG AGRI's 2014 Management Plan, p. 35 (http://ec.europa.eu/atwork/synthesis/amp/index_en.htm).

PART 4 — RESULTS OF OUR AUDIT ON PERFORMANCE

3.76. Our special reports examine whether the principles of sound financial management are applied to EU spending. We choose topics for special reports — specific budgetary areas or management themes — to have maximum impact, based on a range of criteria, such as the level of income or spending involved, the risks to sound financial management and the degree of stakeholder interest. In 2014, we adopted (60) 24 special reports, as listed in ***Annex 3.1***.

3.77. Each special report in itself constitutes an important contribution towards holding auditees accountable for their management of EU money, and towards helping them to make improvements in the future. These special reports in total cover the full range of the management life cycle, from conception to evaluation. They thus include, in many instances, information on the extent to which EU funding has led to tangible results. Our annual activity report (61) presents brief summaries of the 2014 special reports, grouped under the headings of the 2014-2020 MFF.

3.78. In previous years' annual reports, we have drawn out a limited number of themes, judged to be of particular relevance, from across the range of that year's special reports (62).In this annual report, we highlight, for the areas examined, whether there was a focus on results and whether projects likely to deliver maximum value for money were selected.

(60) Adopted means approved for publication.
(61) See the Court's 2014 annual activity report, pp. 17 to 32 (http://eca.europa.eu).
(62) In the 2011 annual report, these themes were needs analysis, design, and EU added value; in the 2012 annual report they were objectives and indicators, data on performance, and the sustainability of EU-funded projects; and in the 2013 annual report they were EU added value and deadweight.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

We found a weak focus on results

3.79. Paragraphs 3.57 to 3.60 analysed the lack of a focus on results in partnership agreements. The importance of this issue was also raised in our 2014 landscape review on risks to the financial management of the EU budget ([63]). In that review we stated that a lack of information about what had actually been achieved by funding can be one of the reasons behind poor value for money (paragraph 25(l)). The review called for a robust performance management system, with clearly defined, universally applied performance indicators focusing on outputs, outcomes and impacts ([64]).

3.80. For example, we concluded that the monitoring and evaluation systems used by EuropeAid did not provide adequate information on results achieved. As this report noted, it is not the first time that we have pointed to this weakness ([65]).

3.80. *The weakness reported in previous reports did not concern evaluation, but EuropeAid's reporting system, which was considered not to provide enough information on results, and to be focused more on activities implemented than on policy achievements.*

3.81. A similar conclusion was reached in the case of special report on the External Borders Fund, where weaknesses in the monitoring and final reports, IT systems and ex post evaluations meant that the responsible authorities did not monitor the achievement of results or did so insufficiently. As a consequence, we — as well as the Member States and Commission — were not able to assess the extent to which the Fund had supported the priorities set for it ([66]).

3.81. *The 2014-2020 legal framework for the EBF's successor, the Internal Security Fund, largely addressed the concerns raised in the ECA's report. In particular, it encompasses a reinforced reporting and monitoring framework based on a system of common indicators as well as a dedicated electronic system, SFC2014. Under the new implementation framework, the Member States will be obliged to report annually on the results achieved through the Funds.*

([63]) See the Court's landscape review 'Making the best use of EU money: a landscape review of the risks to the financial management of the EU budget' of 25 November 2014 (http://eca.europa.eu). This was one of two such reviews published in 2014; the other was on 'Gaps, overlaps and challenges: a landscape review of EU accountability and public audit arrangements' of 10 September 2014 (http://eca.europa.eu).

([64]) See the Court's landscape review 'Making the best use of EU money: a landscape review of the risks to the financial management of the EU budget', paragraphs 25(l) and 54(c) (http://eca.europa.eu).

([65]) Special report No 18/2014, 'EuropeAid's evaluation and results-oriented monitoring systems', paragraphs 69 and 51 to 52 (http://eca.europa.eu).

([66]) Special report No 15/2014, 'The External Borders Fund has fostered financial solidarity but requires better measurement of results and needs to provide further EU added value', paragraphs 76 to 77 (http://eca.europa.eu).

THE COURT'S OBSERVATIONS

3.82. In our special report on the effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies, we concluded that the potential benefits of this blending had not been fully realised due to Commission management shortcomings. We recommended that the Commission implement a results-measurement framework that included indicators for following up the impact of EU grants, and provide clear instructions to EU delegations regarding their role in monitoring EU support for blended projects [67].

THE COMMISSION'S REPLIES

3.82. *The Commission notes that the recommendations contained in the report are fully aligned with the recent reform process of the regional facilities and with the technical work carried out and conclusions presented by the EU Platform for Blending in External Cooperation (EUBEC).*

The result-measurement framework has already been established and included in the application form with accompanying guidelines.

A manual on blending operations is being elaborated, which summarises key features, modalities and operational aspects (incl. monitoring) of blending. It provides overall guidance on blending operations for, inter alia, EU delegations.

The projects likely to deliver maximum impact have not always been selected

3.83. Our 2013 annual report pointed to the problem that, for Member States, the 'use it or lose it' syndrome means that spending the EU money available can become of overriding importance when selecting projects to be funded [68]. This tendency was exemplified further in a number of special reports from 2014.

3.83. *Under the 2014-2020 legal framework the contribution of an operation to the expected results of a priority axis is now required to be included in the selection criteria.*

(67) Special report No 16/2014, 'The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies', paragraphs 53 and 59 (http://eca.europa.eu).

(68) See the 2013 annual report, paragraph 10.57.

THE COURT'S OBSERVATIONS

3.84. Member States can use the European Regional Development Fund to fund business incubators, to support the growth of small and medium enterprises. In our special report on this subject, we found that weak selection criteria and a lack of development goals for hosted companies had a negative impact on the effectiveness of the incubators audited, and adversely affected the overall efficiency of their incubation activities. The procedure for selecting incubators for co-funding had not given due consideration to several elements which are crucial for incubation activity, such as staff qualifications, the scope and relevance of incubation services and financial sustainability ([69]).

3.85. In our audit of the European Fisheries Fund's support for aquaculture, we concluded that projects audited in the Member States were often poorly selected. For example, some projects had already been completed when the decision to grant aid was taken; in some countries the budget available for measures to support aquaculture was greater than the total value of applications received, meaning that all projects which met the basic eligibility criteria received funding; and in one country projects were funded on a 'first come, first served' basis, with the result that, regardless of quality, projects submitted later in the programming period were rejected out of hand because the budget had been exhausted ([70]).

THE COMMISSION'S REPLIES

3.84. *The Commission welcomes the Court's conclusion concerning the ERDF financial contribution to the creation of business infrastructure.*

The Commission notes that the classification of the performance of the audited incubators as modest is based upon the comparison of the results of these more recently established incubators with the benchmarks set by well-established, more mature incubators. In particular, in the Member States that joined the EU in and after 2004, this kind of business infrastructure was missing in the past and is only being built now, also with Structural Funds support. Not much experience, therefore, has been gained and further efforts should be made to better learn how to effectively use these infrastructures to support adequately new business ideas/new start-ups.

Moreover, under the 2007-2013 legal framework, the project assessment and selection process falls under the responsibility of national authorities, the managing authority and the monitoring committee, with the Commission having only an advisory role in the latter. Under the 2014-2020 legal framework, the contribution of an operation to the expected results of a priority axis is now required to be included in the selection criteria.

3.85. *Under shared management, the responsibility to select and grant support to projects lies on the Member States who must ensure that selected projects have an additional value.*

In line with the general evolution of the ESI Funds, the co-legislators and the Commission have considerably reinforced the monitoring and evaluation systems to strengthen the result-orientation of the EMFF.

Furthermore, the Commission will encourage the Member States to adopt appropriate selection criteria for their aquaculture projects over the 2014-2020 programming period.

([69]) Special report No 7/2014, 'Has the ERDF successfully supported the development of business incubators', paragraphs 58 and Executive Summary V (http://eca.europa.eu).

([70]) Special report No 10/2014, 'The effectiveness of European Fisheries Fund support for aquaculture', paragraph 62 and Box 8 (http://eca.europa.eu).

THE COURT'S OBSERVATIONS

3.86. The potential effect of poor project selection was exemplified in our special report on EU-funded airport infrastructure. The need for such investments could only be demonstrated for around half the projects examined; around a third of the airports examined were not profitable and ran the risk that they would be closed without continuous public support. Our overall conclusion was that the EU-funded investments represented poor value for money [71].

THE COMMISSION'S REPLIES

3.86. *Under the 2007-2013 legal framework, the Commission could directly assess and approve airport infrastructure projects only if they were major projects. In appraising the 17 major projects received, the Commission paid significant attention to value-for-money considerations, notably to the demand analysis and to the financial sustainability of the infrastructure. For instance, the Commission urged national authorities to abandon certain projects [8] due to insufficient demand and to concerns linked with the financial sustainability of those airports.*

Lessons have already been learnt from past experience, as shown by the radically different approach in the 2014-2020 period [9] and by the adoption by the Commission of delegated and implementing acts concerning major projects, improving further the quality review process and the quality elements of the cost-benefit analysis to be respected by all major projects.

CONCLUSION AND RECOMMENDATIONS

The conclusion for 2014

3.87. The periods covered by the EU's ten-year strategy and its seven-year budgetary cycle are not aligned. The result is that, since it is very difficult to amend the reporting procedures underpinning the budget during the period covered, the Commission's ability to monitor the contribution of the EU budget to the Europe 2020 strategy is limited for the first half of the strategy period (see paragraphs 3.7 to 3.12).

3.87. *See Commission replies to paragraphs 3.7 to 3.12.*

3.88. Europe 2020 is a long-term, wide-ranging strategy, requiring acceptance by all 28 Member States as well as the EU. As a consequence its main aims — 'smart, sustainable and inclusive growth' — were necessarily high-level. Beneath these political aspirations, there is a complex architecture comprising five headline targets, seven flagship initiatives and for the ESI funds 11 thematic objectives. However, these various tiers are not, either individually or as a whole, designed to translate the political aspirations of Europe 2020 into useful operational objectives (see paragraphs 3.13 to 3.25).

3.88. *The translation of the Europe 2020 objectives and the 11 thematic objectives into useful operational objectives takes place at the programme level. Furthermore, estimates on the results of the ESI funds are made on the basis of modelling exercises and reported upon, for example, in respective Cohesion Reports (which under the Treaty provisions are to be published every 3 years).*

(71) Special report No 21/2014, 'EU-funded airport infrastructures: poor value for money', paragraphs 68 to 70 (http://eca.europa.eu).

(8) *E.g. airports in Kielce, and in Bialystok.*

(9) *E.g. existence of transport plans at regional or national level identified as a specific* ex ante *conditionality, investments limited to improvement of the environmental performance or safety features of the infrastructures, focus during the negotiations of 2014-2020 ESIF programmes on airports belonging to the core TEN-T network, etc.*

THE COURT'S OBSERVATIONS

3.89. The Commission has so far reported on the contribution of the EU budget to the Europe 2020 objectives in a limited way. Among the causes for this is the absence of good-quality information. Ownership within the Commission and in Member States of the strategy's targets and results is a prerequisite for a robust monitoring and reporting system (see paragraphs 3.26 to 3.34).

3.90. Combining the five ESI funds in one umbrella regulation and one partnership agreement per Member State offers potential advantages in terms of the coherence of EU action. However, these potential benefits have not been fully realised. Different rules continue to apply at fund and thus at programme level. Examples of complementarity and synergy in the partnership agreements and programmes examined were rare and superficial (see paragraphs 3.39 to 3.43).

3.91. High-level Europe 2020 targets are not systematically translated into operational targets in partnership agreements and programmes, and the legislation does not require the EAFRD and EMFF to be structured around thematic objectives. It will therefore be very difficult for the Commission to monitor and report consistently on thematic objectives for all five ESI funds and hence on the contribution of these funds to Europe 2020 (see paragraphs 3.44 to 3.48).

3.92. The designation of a set of common indicators in the regulations is a welcome attempt to create consistent data, across all Member States, which might then be aggregated to assess performance and report on Europe 2020 at the European level. According to the legislation, Member States are not required to include the common indicators in their programmes ([72]). Except for two funds (ERDF and CF), common indicators are not shared between different funds. True result indicators exist for only two of the five ESI funds. Milestones only exist for the performance framework and targets sometimes lack ambition. These factors will make it difficult to report on the ESI funds' contribution to Europe 2020 (see paragraphs 3.49 to 3.56).

THE COMMISSION'S REPLIES

3.89. *Funding programmes for 2007-2013 were not specifically designed to contribute to Europe 2020. For the 2014-2020 programmes, mandatory reporting of structured data will permit robust monitoring and reporting on the contribution of the EU budget to the Europe 2020 objectives, to be supported by evaluations.*

As regards the ownership on results, referred to in paragraph 3.33, the Commission reiterates that a distinction needs to be made between the direct responsibility for the management of the financial programmes and the results and impacts generated by these programmes, which also concern the responsibility of the co-legislators and the Member States. The overall performance of the programmes is equally influenced by various external factors in economy and society.

3.91. *The Commission will be able to report on the expected results for the Growth and Jobs objective through ESIF support by end 2015 through the Article 16 report using the common indicators. From 2016 onwards, the Commission will report each year to Council and Parliament on the progressive achievement of the targets in the programmes.*

Please see also Commission reply to paragraph 3.45.

3.92. *Where common output indicators can be used (i.e. where they are relevant), the regulation requires that they are used and the Commission has insisted on this in the negotiations. The Commission sees only marginal possibility for common indicators across the other funds because of the different missions of the Funds and the different types of investments they support. The Commission considers that the mandatory reporting by the Member States in 2017 and 2019 will allow it to report on the contribution of the ESI funds to Europe 2020.*

([72]) With the exception of Youth Employment Initiative and EAFRD.

THE COURT'S OBSERVATIONS

3.93. Our examination of partnership agreements and programmes identified some progress in terms of specifying results to be achieved, particularly in the programmes. However, the focus on results has to be further improved in particular for partnership agreements (see paragraphs 3.57 to 3.60).

3.94. There are weaknesses in the design of the performance framework. Poor performance in terms of results achieved does not lead to the loss of the performance reserve for Member States, and the financial sanctions available to the Commission are constrained in a number of ways, including the inability to take result indicators into account. In terms of the performance reserve, we pointed last year to some of the risks involved, and examination of some partnership agreements and programmes this year indicate that these risks are materialising (see paragraphs 3.61 to 3.65).

3.95. There have been some improvements in DGs' annual reporting on performance, notably in the central guidance. However, reporting is not fully adapted to the transition from the old to the new MFF and, as with previous years, DGs' objectives are not fit for management purposes and difficulties remain with indicators for monitoring performance (see paragraphs 3.66 to 3.75).

Recommendations

3.96. ***Annex 3.2*** shows the result of our review of progress in addressing recommendations made in previous annual reports. In the 2011 and 2012 annual reports, we presented five recommendations. Of these recommendations, one was not applicable, three were implemented in some respects and one was not implemented.

THE COMMISSION'S REPLIES

3.93. *The programmes examined by the Court almost all contained quantified results (even though these were not mandatory).*

3.94. *The design of the performance framework is the outcome of discussions among the co-legislators. The Commission believes the performance framework does have an incentive effect on performance as no manager of a priority axis wants to lose access to the reserve.*

In addition, it should be noted that the purpose of the performance reserve is not only to provide incentives for programme managers, but also to ensure that resources are allocated to high performing priorities. To withhold resources where there is potential for supporting meaningful operations could undermine the overall impact of the funds. As outlined above (see Commission reply to paragraph 3.63), result indicators are in most cases not appropriate for the performance frameworks in the programmes and for the application of financial sanctions due to timing issues and the effect of external factors.

3.95. *As mentioned in the Commission reply to paragraph 3.69, specific attention has been given in the guidance of the 2014 AARs on how to report on continued or discontinued programmes. In addition, the legislator may also have decided to shift the focus of some programmes or to discontinue others.*

THE COURT'S OBSERVATIONS

3.97. Recommendations 1 and 2 which follow stem from our conclusions on part 1 of this chapter, the focus of which was the Commission's ability to monitor and report against Europe 2020:

— **Recommendation 1**: the EU strategy and the MFF need to be better aligned, in particular concerning the time period and priorities. This would help to ensure that adequate monitoring and reporting arrangements are in place, and so make it easier for the Commission to report effectively on the contribution of the EU budget to the EU strategy. The Commission should make appropriate proposals to the legislator to address this issue;

— **Recommendation 2**: the high-level political aims of the EU strategy need to be translated into useful operational targets for managers. For the successor to Europe 2020, the Commission should propose to the legislator that:

  (a) the high-level political aims are reflected in EU level objectives;

  (b) partnership agreements and programmes ([73]) in turn translate these EU-level objectives into the operational objectives at the level of Member States; such a link is also required for programmes directly managed by the Commission;

— **Recommendation 3**: the focus on results should be reinforced as soon as possible. The Commission should propose to the legislator that:

  (a) Member States must include in their partnership agreements and programmes ([74]) the quantified results that the funding is intended to achieve.

  (b) All partnership agreements and programmes ([75]) should include common result indicators, where possible shared by the different funds, designed to monitor progress at the local, Member State and EU level.

  (c) The performance framework (including any performance reserve) ([76]) should be based, as far as possible, on these common result indicators.

THE COMMISSION'S REPLIES

3.97. *The Commission is committed to ensuring sound financial management and delivering maximum performance and value added of actions taken.*

The Commission partially accepts this recommendation.

While the Commission is not in a position to commit itself to make specific proposals to the legislator, it is ready to examine the Court's suggestions so as to ensure that when preparing relevant legislative initiatives the EU's spending priorities are fully aligned with its overarching policy objectives. The Europe 2020 strategy is currently under review. Any proposals that the Commission could make to the legislator to facilitate reporting and monitoring would have to take into account the fundamentally political nature of the strategy.

The Commission partially accepts this recommendation.

The Europe 2020 strategy is currently under review. Any proposals that the Commission could make to the legislator to facilitate reporting and monitoring would have to take into account the fundamentally political nature of the strategy. While the Commission is not in a position to commit itself to make specific proposals to the legislator, it will take into account the Court's suggestions, together with EU-level objectives, with a view to preparing evidence-based proposals for post 2020 for achieving the most effective use of EU Funds.

The Commission partially accepts this recommendation.

Given that the 2014-2020 partnership agreements and programmes have only just been put in place, it would be premature to propose changes before the effective implementation of the new performance related provisions can be fully assessed. The assessment of the strengths and weaknesses of the current framework will be carried out for the preparation of the post 2020 MFF.

While the Commission is not in a position to commit itself to make specific proposals to the legislator for the next MFF, it will take into account the Court's suggestions, together with the results of the studies which will be carried out examining the effectiveness of the different mechanisms for strengthening the focus on results in the Common Provisions Regulation, with a view to preparing evidence-based proposals for post 2020 for achieving the most effective use of EU Funds.

([73]) Or their future equivalents.
([74]) Or their future equivalents.
([75]) Or their future equivalents.
([76]) Or its future equivalent.

ANNEX 3.1

SPECIAL REPORTS ADOPTED BY THE COURT OF AUDITORS IN 2014

— No 1/2014 'Effectiveness of EU-supported public urban transport projects'

— No 2/2014 'Are preferential trade arrangements appropriately managed?'

— No 3/2014 'Lessons from the European Commission's development of the second generation Schengen Information System (SIS II)'

— No 4/2014 'Integration of EU water policy objectives with the CAP: a partial success'

— No 5/2014 'European banking supervision taking shape — EBA and its changing context'

— No 6/2014 'Cohesion policy funds support to renewable energy generation — has it achieved good results?'

— No 7/2014 'Has the ERDF successfully supported the development of business incubators?'

— No 8/2014 'Has the Commission effectively managed the integration of coupled support into the single payment scheme?'

— No 9/2014 'Is the EU investment and promotion support to the wine sector well managed and are its results on the competitiveness of EU wines demonstrated?'

— No 10/2014 'The effectiveness of European Fisheries Fund support for aquaculture'

— No 11/2014 'The establishment of the European External Action Service'

— No 12/2014 'Is the ERDF effective in funding projects that directly promote biodiversity under the EU biodiversity strategy to 2020?'

— No 13/2014 'EU support for rehabilitation following the earthquake in Haiti'

— No 14/2014 'How do the EU institutions and bodies calculate, reduce and offset their greenhouse gas emissions?'

— No 15/2014 'The External Borders Fund has fostered financial solidarity but requires better measurement of results and needs to provide further EU added value'

— No 16/2014 'The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies'

— No 17/2014 'Can the EU's Centres of Excellence initiative contribute effectively to mitigating chemical, biological, radiological and nuclear risks from outside the EU?'

— No 18/2014 'EuropeAid's evaluation and results-oriented monitoring systems'

— No 19/2014 'EU Pre-accession Assistance to Serbia'

— No 20/2014 'Has ERDF support to SMEs in the area of e-commerce been effective?'

— No 21/2014 'EU-funded airport infrastructures: poor value for money'

— No 22/2014 'Achieving economy: keeping the costs of EU-financed rural development project grants under control'

— No 23/2014 'Errors in rural development spending: what are the causes, and how are they being addressed?'

— No 24/2014 'Is EU support for preventing and restoring damage to forests caused by fire and natural disasters well managed?'

ANNEX 3.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR PERFOMANCE ISSUES

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2012	**Recommendation 1:** 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.			X				
	Recommendation 2: 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.				X			
2011	**Recommendation 1:** The Commission should, in the design of new spending programmes, seek to focus its activities on the results and impacts it wants to achieve. If results and impacts cannot be readily measured, the Commission should put in place indicators and milestones, based on 'SMART' objectives that would demonstrate that its activities support its desired goals.			X				
	Recommendation 2: The Commission should work with Member States with a view to improving the quality and timeliness of the data submitted. In particular, it should draw on any lessons to be learned from the steps being taken in the CSF funds to provide Member States with incentives to supply high-quality performance data.			X				
	Recommendation 3: For the next programming period, 2014-2020, the Commission should demonstrate and report how it secures EU added value.					X		

(*) At the moment, there is no reporting for the period 2014-2020.

CHAPTER 4

Revenue

TABLE OF CONTENTS

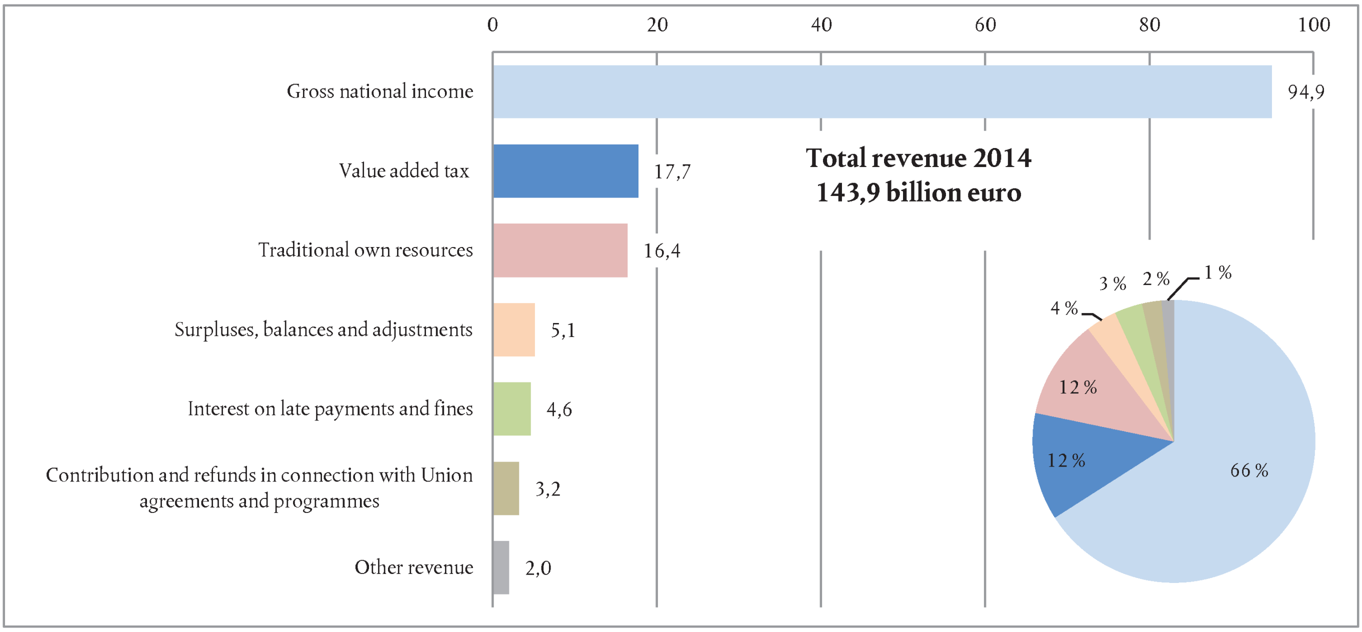
THE COURT'S OBSERVATIONS

INTRODUCTION

4.1. This chapter presents the specific assessment of revenue, which comprises own resources and other revenue. Key information on revenue in 2014 is provided in ***Graph 4.1***.

Graph 4.1 — Revenue

(billion euro)



Source: 2014 consolidated accounts of the European Union.

THE COURT'S OBSERVATIONS

Specific characteristics of revenue

4.2. Most revenue comes from own resources (90 %) ([1]) i.e. contributions from Member States ([2]), of which there are three categories:

— The gross national income (GNI)-based own resource (66 % of revenue) results from the application of a uniform rate to Member States' GNI. The calculation of Member States' contributions is based on forecast GNI data ([3]). After taking into account all other sources of revenue the GNI-based own resource is used to balance the EU budget ([4]). The principal risks are that the underlying statistics are not compiled in compliance with Union rules or are not processed by the Commission according to these rules in the calculation of Member States' contributions, including balances and adjustments. Other risks are that the Commission's verifications of Member States' GNI data are not efficient.

— Traditional own resources (TOR) (12 %) are customs duties collected on imports and sugar production charges. They are established and collected by the Member States. Three quarters are paid to the EU budget, the remaining quarter being retained to cover collection costs. The principal risks regarding TOR are the completeness, accuracy and timeliness of the duties made available to the Union.

([1]) The legislation currently in force is Council Decision 2007/436/EC, Euratom of 7 June 2007 on the system of the European Communities' own resources (Own Resources Decision) (OJ L 163, 23.6.2007, p. 17) and Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources (OJ L 130, 31.5.2000, p. 1), as last amended by Regulation (EU, Euratom) No 1377/2014 (OJ L 367, 23.12.2014, p. 14). On 26 May 2014, a new Own Resources legislative package was formally approved by the Council. When ratified by the Member States, it will be applied with retroactive effect from 1 January 2014.

([2]) The Own Resources Decision set up reductions to be applied to some Member States for GNI and VAT contributions for the period 2007-2013. As soon as the new legislative package is ratified (see footnote 1), some Member States will retroactively benefit from a reduction for the period 2014-2020. In addition, the Own Resources Decision also set a correction in respect of budgetary imbalances that is given to one Member State. This correction was still in force in 2014 and will continue under the new legislative package.

([3]) This data is agreed between the Commission and the Member States at the meeting of the Advisory Committee on Own Resources.

([4]) Any understatement (or overstatement) of GNI for particular Member States — while not affecting the overall GNI-based own resources — has the effect of increasing (or decreasing) the contributions from the other Member States, until the GNI data is corrected.

THE COURT'S OBSERVATIONS

— The value added tax (VAT)-based own resource (12 %) results from the application of a uniform rate to Member States' notionally harmonised VAT assessment bases. The principal risks lie in the completeness and accuracy of the information provided by Member States, the accuracy of the Commission's calculations of the contributions due and the timeliness of the Member States' payments.

4.3. The principal risks in respect of other revenue include the Commission's management of fines, and errors in the calculation of contributions in connection with Union/Community agreements.

Audit scope and approach

4.4. ***Annex 1.1***, ***part 2***, of chapter 1 describes our overall audit approach and methodology. For the audit of revenue the following specific points should be noted:

(a) The assessment of systems examined:

(i) the Commission's systems for ensuring that Member States' GNI data is appropriate as a basis for own-resources purposes and the Commission's systems for calculating and collecting the GNI-based own resource contributions [5] as well as GNI balances (see paragraph 4.6);

(ii) the Commission's systems for TOR [6], including its monitoring of Member States' post-clearance audits;

(iii) the TOR accounting systems in three selected Member States (Spain, Austria and the United Kingdom) [7] and a review of their systems for post-clearance audits;

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(5) Our audit took as its starting point the agreed forecast GNI data. We cannot provide a judgement on the quality of the data agreed upon between the Commission and the Member States.

(6) See also special report No. 2/2014 'Are Preferential Trade Agreements appropriately managed?' (www.eca.europa.eu)

(7) Our audit took as its starting point data included in the visited Member States accounting systems for TOR. We cannot cover undeclared imports or those that have escaped customs surveillance.

(iv) the Commission's systems for ensuring that VAT-based own resources and VAT balances (see paragraph 4.6) are correctly calculated and collected ([8]);

(v) the Commission's management of fines and penalties.

(b) The audit involved an examination at Commission level of a sample of 55 recovery orders ([9]). The sample is designed to be representative of all sources of revenue.

(c) The assessment of the annual activity reports included reports of the Directorate-General for Budget (DG Budget) and Eurostat.

REGULARITY OF TRANSACTIONS

4.5. ***Annex 4.1*** contains a summary of the results of transaction testing. Of the 55 transactions that we examined, none was affected by error.

— The Court's audit did not find any errors in the Commission's calculation of Member States' contributions on the basis of the VAT and GNI data or their payment.

— The Court found that, overall, the recovery orders raised by the Commission reflect the TOR statements sent by the Member States.

— The Court's audit did not find any errors in the calculations or payments of other revenue transactions.

([8]) Our audit took as its starting point the harmonised VAT base prepared by the Member States. We did not directly test the statistics and data provided by Member States.

([9]) A recovery order is a document in which the Commission records amounts that are due to it.

THE COURT'S OBSERVATIONS

EXAMINATION OF SELECTED SYSTEMS AND ANNUAL ACTIVITY REPORTS

GNI-based own resources

GNI balances

4.6. Every year Member States have to provide updates of their GNI and VAT data for the years still subject to change (four years) or to address the points under reservation [10]. The Commission uses this information to recalculate Member States' VAT and GNI contributions for the previous years (so-called VAT and GNI balances). In 2014 there were updates to the GNI data which led to adjustments to Member States' contributions of an unprecedented size — amounting to 9 813 million euro [11] — (see ***Table 4.1***). These updates still need to be assessed by Eurostat, and only after the lifting of the reservations will the figures be considered final.

4.7. Two types of updates in particular contributed to this significant impact: those addressing reservations and those revising Member States' methods and sources for the compilation of their GNI.

(10) This data is subject to revision for at least four years, after which it becomes time-barred, unless reservations are set (see paragraph 4.14).

(11) The net adjustment was of a total of 9 528 million euro, corresponding to a negative amount of 285 million euro for the VAT balances and a positive amount of 9 813 million euro for the GNI balances.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Reservations addressed

4.8. In 2014 Member States addressed most of the GNI reservations that had been set in 2012 ([12]) by the Commission at the end of the verification cycle ([13]) which covered a period starting in 2002 ([14]). As a consequence of this long time span (10 years), the resulting corrections had a significant impact on some Member States' contributions. As an example, the changes to the UK contribution were primarily linked to the work on reservations, representing 21 % of the UK's total budgeted contribution for VAT and GNI resources for 2014 (see ***Table 4.1***).

4.9. The large changes resulting from the work on reservations would have been mitigated if the Commission's verification cycle had been shorter (leaving a shorter period to be corrected by Member States when addressing the reservations). We have already drawn attention to the fact that the long verification cycles lead to budgetary uncertainty for Member States ([15]).

4.9. *Measures will be introduced to reduce the length of the Commission's next verification cycle (by adopting a more risk-based verification model, respecting the principle of cost-effectiveness) and reservations could be set and addressed at an earlier stage (thus reducing the gap between the end of the cycle and the resolution of the reservations).*

4.10. In October 2014 the Commission informed the GNI Committee ([16]) that they aim to conclude the next verification cycle in 2019. The reservations (see paragraph 4.16) set in 2014 cover the 2010 GNI data and can be lifted only after the analysis of the Member States' GNI inventories ([17]) by the Commission. The effect is that once the next verification cycle is complete, the reservations will cover at least nine years (similar to the previous one).

4.10. *The verification cycle starts when the GNI inventories are received from Member States, not with the first reference year. The inventories will be made available from the beginning of 2016. The Commission has made a commitment to complete the cycle by end 2019.*

([12]) In Bulgaria and Romania the reservations were set only in 2013.

([13]) Period of verification by the Commission of Member States' sources and methods used to compile GNI data.

([14]) For Member States that joined the EU in 2004 and 2007, the reservations cover a period starting in those years.

([15]) See special report No 11/2013 — 'Getting the GNI data right: a more structured and better-focused approach would improve the effectiveness of the Commission's verification', paragraphs 68 to 73 (www.eca.europa.eu).

([16]) This Committee is composed of the representatives of the Member States and chaired by the representative of the Commission. It assists the Commission in its procedures and checks on the calculation of GNI. See Council Regulation (EC, Euratom) No 1287/2003 of 15 July 2003 on the harmonisation of gross national income at market prices (GNI Regulation) (OJ L 181, 19.7.2003, p. 1).

([17]) An inventory is a Member State's detailed explanation of sources and methods used for estimating GNI. It is the basis for the Eurostat assessment of the quality and exhaustiveness of GNI data in the context of the GNI for own resources purposes.

THE COURT'S OBSERVATIONS

Revisions of methods and sources

4.11. Many Member States also presented revisions of their methods and sources during 2014 which had large impacts on their GNI figures for the years not time-barred (2010, 2011 and 2012). For example, for Cyprus and the Netherlands the increase in VAT/GNI contributions (41 % and 21 % respectively) is primarily due to these factors (see ***Table 4.1***).

4.12. The impact of these major revisions to the GNI balances could have been smaller if a common EU revision policy, harmonising the timetable for major revisions, had been in place. This would improve the comparability of data between Member States and reduce the risk of substantial adjustments caused by infrequent revisions each affecting a large number of years. The Commission put forward a proposal for such a policy in 2013 ([18]). Although 19 Member States indicated that they would at least partly align themselves with the EU revision policy by September 2014, the Commission has taken no further action to introduce a common EU revision policy.

4.13. The impact of these two sorts of updates was of such a magnitude that the Council amended the Own Resources Regulation ([19]) following a proposal from the Commission to allow some Member States to postpone their payments. Seven Member States ([20]) requested to postpone their payments (fully or partially) until 2015. The total amount requested to be postponed until 2015 is 5 432 million euro.

THE COMMISSION'S REPLIES

4.12. *The Commission ackowledges the fact that a common revision policy might lead to smaller revisions of GNI data, although they would become more frequent. Eurostat will continue to investigate whether the benefits of a common EU policy outweigh the disadvantages (e.g. lack of subsidiarity, delaying the introduction of more reliable data and/or sources and the possibility that such a policy might delay resolution of reservations).*

([18]) This was presented to the Committee on Monetary, Financial and Balance of Payments Statistics on 4 July 2013.

([19]) Council Regulation (EU, Euratom) No 1377/2014 of 18 December 2014 amending Regulation (EC, Euratom) No 1150/2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources. See also the Court's opinion No 7/2014 concerning a proposal for a Council Regulation amending Regulation (EC, Euratom) No 1150/2000 implementing Decision 2007/436/EC, Euratom on the system of the European Communities' own resources (www.eca.europa.eu).

([20]) Bulgaria, France, Italy, Cyprus, Malta, Slovenia and the United Kingdom. Nevertheless, Bulgaria made available the GNI and VAT balances at the end of 2014.

Table 4.1 — VAT/GNI balances for 2014

(million euro)

Member State	VAT and GNI balances	Total in the budget for VAT and GNI	Weight of VAT and GNI balances in the total budgeted for 2014
	(A)	(B)	(C) = (A)/(B)
Belgium	119	3 252	3,7 %
Bulgaria	36	338	10,8 %
Czech Republic	79	1 131	6,9 %
Denmark	- 126	2 146	- 5,9 %
Germany	1 359	24 063	5,6 %
Estonia	7	157	4,7 %
Ireland	112	1 202	9,3 %
Greece	222	1 474	15,1 %
Spain	589	8 638	6,8 %
France	562	17 933	3,1 %
Croatia	- 1	359	- 0,4 %
Italy	1 502	12 867	11,7 %
Cyprus	54	131	41,1 %
Latvia	25	199	12,3 %
Lithuania	8	286	2,6 %
Luxembourg	- 67	277	- 24,2 %
Hungary	40	807	4,9 %
Malta	18	60	30,6 %
Netherlands	1 103	5 205	21,2 %
Austria	- 57	2 706	- 2,1 %
Poland	- 27	3 282	- 0,8 %
Portugal	122	1 391	8,7 %
Romania	75	1 172	6,4 %
Slovenia	8	300	2,7 %
Slovakia	- 7	578	- 1,2 %
Finland	- 34	1 669	- 2,1 %
Sweden	190	3 638	5,2 %
United Kingdom	3 616	17 042	21,2 %
Total	**9 528**	**112 303**	**8,5 %**

Source: Column A, Draft Amending Budget (DAB) 6/2014; Column B, Amending budget No 7 of the European Union for the financial year 2014.

THE COURT'S OBSERVATIONS

Reservations management

4.14. A reservation is a means by which a doubtful element in GNI data submitted by a Member State can be kept open for correction after the statutory time-limit of four years. Reservations can be general or specific. General reservations cover all elements of the GNI compilation. Specific reservations cover discrete elements of GNI and can be transaction-specific ([21]), transversal ([22]) or process-specific ([23]). ***Table 4.2*** shows the reservations in place at the end of 2014. It also includes, for convenience, information related to VAT and TOR discussed later in the chapter.

Table 4.2 — Member States' GNI/GNP reservations ([24]), VAT reservations and TOR open points

Member State	GNI/GNP reservations (situation at 31.12.2014)	VAT reservations (situation at 31.12.2014)	TOR 'open points' (situation at 31.12.2014)
Belgium	7	5	18
Bulgaria	12	7	13
Czech Republic	7	0	5
Denmark	5	4	21
Germany	8	8	10
Estonia	7	1	3
Ireland	4	6	13
Greece	15	5	32
Spain	9	2	21
France	7	3	40
Croatia	0	0	1
Italy	9	11	15
Cyprus	12	0	6
Latvia	16	1	0

([21]) These reservations cover a specific transaction of GNI in a Member State.
([22]) Transversal reservations cover a specific transaction in all Member States.
([23]) Used when a particular stage in the process is concerned, see paragraph 4.16.
([24]) The process-specific (see paragraph 4.16) and general reservations (see paragraph 4.17) are not included in the table.

Member State	GNI/GNP reservations (situation at 31.12.2014)	VAT reservations (situation at 31.12.2014)	TOR ‘open points’ (situation at 31.12.2014)
Lithuania	4	0	5
Luxembourg	6	3	1
Hungary	12	1	9
Malta	12	0	2
Netherlands	4	7	42
Austria	6	12	8
Poland	15	5	11
Portugal	7	0	15
Romania	18	2	13
Slovenia	6	0	0
Slovakia	6	1	3
Finland	6	7	6
Sweden	7	5	14
United Kingdom	12	5	21
TOTAL 31.12.2014	**239**	**101**	**348**
TOTAL 31.12.2013	283	103	341

Source: European Court of Auditors.

THE COURT’S OBSERVATIONS

4.15. At the end of 2014 there were 239 (see ***Table 4.2***) reservations in place, of which 106 were transaction-specific and 133 transversal specific reservations. In the course of 2014, 44 reservations were lifted (8 transaction-specific and 36 transversal). There is still one transaction-specific GNP reservation outstanding relating to the period 1995-2001 ([25]). We have calculated the financial effect of GNI reservations lifted in 2014 ([26]) as a net increase of GNI-based own resources of 75,2 million euro ([27]) for the years in question.

([25]) Gross national product (GNP) was the national accounts aggregate used until 2001.

([26]) We have determined the financial effect of the lifting of reservations by taking into account all the changes to the GNI base due to the impact of reservations lifted in 2014 for the years which were already time-barred. The reservations were lifted by the Commission in 2014. However the financial effect occurred in 2012 and 2013, when the reservations were addressed by the Member States.

([27]) The balance of an increase of 77,3 million euro and a decrease of 2,1 million euro.

THE COMMISSION’S REPLIES

4.15. *In 2015 the Commission has already lifted 18 specific reservations and 15 transversal reservations.*

The Commission considers that the financial effect of GNI reservations lifted is not a suitable indicator for the outcome of the GNI own resource verification and cannot be used as an indicator of any trend.

THE COURT'S OBSERVATIONS

4.16. In addition, 27 process-specific reservations covering the year 2010 were set — these were the only reservations set in 2014. They cover the year 2010 for 27 Member States in order to allow the Commission to perform a check on the data established according to ESA 2010 ([28]). This check is to be based on the GNI inventories still to be delivered by Member States in 2015.

General reservations

4.17. The only general reservations in place at the end of 2014, were on Greek GNI data covering the years 2008 and 2009. Although advances were made on addressing these reservations, they were not lifted and nor was the long outstanding GNP reservation (see paragraph 4.15). However, during 2014 the Commission continued to follow closely the situation regarding the problems in Greece's compilation of national accounts and put in place a technical assistance programme with the objectives of creating an independent and reinforced National Statistical Authority. We consider that this work to improve the reliability of the Greek GNI data is important as the quality of that data can have an impact on all Member States' GNI-based own resources' individual contributions.

Traditional own resources

Post-clearance audits

4.18. Customs authorities may, after releasing the goods and in order to satisfy themselves as to the accuracy of the particulars contained in the declaration, inspect the commercial documents and data relating to the import operations ([29]). These checks, which include post-clearance audits ([30]), are referred to as post-clearance controls. They should be based on risk analysis on the basis of criteria developed at the national, EU and, where available, international level ([31]).

([28]) The European System of National and Regional Accounts (ESA 2010) is the newest internationally compatible EU accounting framework for a systematic and detailed description of an economy. It was implemented in September 2014; from that date onwards the data transmission from Member States to Eurostat is following ESA 2010 rules.

([29]) Article 78 of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code (OJ L 302, 19.10.1992, p. 1).

([30]) 'Post clearance audit is a method of controlling economic operators through examination of their accounts, records and systems.' *Source*: Customs audit guide.

([31]) Article 13(2) of Community Customs Code.

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4.19. In our visits to Member States we found similar problems relating to post-clearance audits as we had found in previous years ([32]). Weaknesses were again identified in the identification, selection and inspection of the importers audited by Member States. In addition, the quality, scope and the results of the post-clearance audits varied substantially across the three Member States visited ([33]).

4.20. In February 2014 the Commission issued an updated version of the Customs Audit Guide (CAG). We welcome the fact that the Commission has provided Member States with new guidance, however, we noted that some shortcomings which were identified during the visits to Member States, are not covered by the new CAG:

(a) no guidance is given on how to deal with imports cleared in other Member States (for the selection of companies to be audited or even during the inspection process);

(b) there is no clear guidance on how to deal with the risk of time-barring ([34]) during the audit phase;

THE COMMISSION'S REPLIES

4.19. *While the exchange of risk information is a legal requirement, the risk criteria as defined in the Customs Audit Guide (CAG) are not legally binding. Nevertheless, the CAG provides a common harmonised approach to the conduct of post-clearance audits.*

In the EU Action Plan (COM(2014) 527 final) the further development of EU common risk criteria and standards is foreseen. The Commission has formed a project group of Member State experts to consider in-depth the area of financial risks. The Commission will carefully consider the issue of imports done by an operator established in another Member State in this work.

The Commission will follow up the weaknesses identified by the Court and where appropriate will request them to take suitable remedial measures. It will continue to examine the national customs supervision in the course of its inspections and where deficiencies are found it will request the Member States to take measures to address those deficiencies.

4.20.

(a) *For goods cleared in one Member State by importers with HQ in another Member State, the Commission will look at the possibility to give further guidance to the Member States when addressing financial risk criteria.*

See also reply to paragraph 4.19.

(b) *The Commission services, in their inspection report, their examination of write-offs in accordance with Article 17 of Council Regulation (EC, Euratom) No 1150/2000, and in the bi-annual Advisory Committee on Own Resources (ACOR) meetings, regularly impress upon the Member States the necessity to exercise due diligence in the recovery procedure. When a Member State's failure to exercise due diligence results in the loss of TOR because of time-barring the Member State is held financially responsible for the amounts not recovered.*

([32]) See the 2012 annual report, paragraph 2.31, and the 2013 annual report, paragraph 2.14.
([33]) Spain, Austria and the UK.
([34]) Article 221(3) of the Community Customs Code (Regulation (EEC) No 2913/92) stipulates that communication to the debtor shall not take place after the expiry of a period of three years from the date on which the customs debt was incurred.

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(c) there is no recommended minimum coverage (by value or percentage of declarations) regarding the number of audits to be carried out each year.

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(c) *The EU risk management strategy, of which audit is a part, looks at trade facilitation, simplifications and risk-based controls. Establishing a single recommended minimum coverage (by value or percentage of declarations) would not be consistent with a risk-based approach, which has to cater for different types of traffic of goods and risks at different points in time.*

The Commission may nevertheless consider with the Member States possible minimum coverages which should take into account the mentioned differences.

A and B accounts

4.21. Each Member State sends the Commission a statement of the customs duties and sugar levies established on a monthly basis (the 'A accounts') and a quarterly statement of those established duties which are not included therein (the separate so-called 'B accounts') ([35]).

4.22. In our visits to Member States we found similar problems relating to the management of the B accounts as we had found in previous years ([36]), indicating systematic weaknesses ([37]). For example, in the UK the procedure for the preparation of the B accounts statements is complex as it is based on information from different databases that have to be manually consolidated. This has led to mistakes. There were also long delays in the updating of the amounts included in the B accounts. In Spain incorrect procedures in the management of the amounts written off led to an overstatement of the figures in the B accounts. In addition, during the Commission's inspections (see paragraph 4.23), in 19 out of 21 Member States visited they detected shortcomings in the management of the B accounts.

4.22. *Apart from isolated cases of systematic weakness which have arisen from time to time, the majority of shortcomings found by the Commission in its inspections comprise mistakes of a one-off nature which is understandable in an account of this nature (a repository of problem and contested cases). While the Court found problems in the management of the B accounts in 2014 and in previous years, these problems and mistakes do not in the Commission's view allow for a conclusion of systematic weaknesses in general. The finding of mistakes in a manual account (there is no requirement in the legislation for a Member State to utilise automated methods to manage these accounts) which can be affected by occasional error is not necessarily a systematic weakness. Where a procedure is incorrect the weakness may be systematic. The shortcomings found by the Court in the management of the accounts in these Member States and the incorrect procedure in Spain will be followed up by the Commission in the course of its normal follow-up of the Court's findings.*

([35]) When duties or levies remain unpaid and no security has been provided, or they are covered by securities but have been challenged, Member States may suspend making these resources available by entering them in these separate accounts.

([36]) See the 2013 annual report, paragraph 2.16 and the 2012 annual report, paragraphs 2.32 and 2.33.

([37]) These cases did not affect the reliability of the overall amount as established in the separate account (1 617 million euro) and the related write-down (1 144 million euro) as disclosed in the consolidated accounts of the European Union.

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Open points management

4.23. The Commission's inspections in Member States result in findings, so-called 'open points' [38]. These open points can have a potential financial impact and are closed when appropriately addressed by the Member States. At the end of 2014 a total of 348 (see ***Table 4.2***) points were open [39] but the Commission did not calculate the overall financial impact.

4.23. *Through its follow-up of inspection findings, the Commission seeks to quantify the potential financial impact of every open point, of every report, for every Member State on a case-by-case basis. The Commission does not keep a global figure of traditional own resources potentially due for all points of all open reports for all Member States as this would not prove useful for the follow-up which must be done on the basis of each point, of each report, for each Member State. However, the Commission always knows whether a point has potential financial impact and, when it has the information necessary to that effect, estimates it.*

VAT based own resources

4.24. At the end of the year, a total of 101 reservations were in place compared to 103 in 2013 (see ***Table 4.2***), of which 84 were placed by the Commission and 17 by the Member States. The Commission lifted 29 reservations in 2014. The number of long-outstanding reservations [40] set by the Commission decreased from 12 to 10. We calculated the net financial effect of addressing reservations in 2014 [41] as an increase of VAT-based own resources of 16,1 million euro [42].

4.24. *The Commission continued to cooperate with Member States during 2014 to resolve the issues underlying reservations it had set.*

The Commission considers that the net financial effect of lifting reservations is not a suitable indicator for the outcome of the VAT own resource inspection programme and cannot be used as an indicator of any trend.

Annual activity reports

4.25. The 2014 AARs of DG Budget and Eurostat provide a fair assessment of financial management in relation to the legality and regularity of underlying transactions concerning own resources and other revenue and the information provided corroborates our observations and conclusions.

(38) A total of 28 inspection reports were issued during 2014 which led to 89 new 'open points'.

(39) 38 points are open for more than five years. The oldest points still open were set in 2002 on Germany, Greece and Portugal.

(40) We define long-outstanding reservations as dating back to a year at least 10 years previously, i.e. those in place at the end of 2014 concerning 2005 and earlier.

(41) We have determined the financial effect of the lifting of reservations by taking into account all the changes to the VAT base due to the control activity of the Commission for the years 2002 — 2010. The year 2010 became time-barred in 2014 and changes to the VAT base of 2010 and earlier years can only be made if a reservation has been in place. The effects of capping were taken into consideration.

(42) The balance of an increase of 18,2 million euro and a decrease of 2,1 million euro.

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CONCLUSION AND RECOMMENDATIONS

The conclusion for 2014

4.26. Overall audit evidence indicates that revenue is not affected by a material level of error. In particular for revenue:

— the examined systems are assessed as effective for GNI and VAT-based own resources and other revenue;

— the examined systems are assessed as overall effective for TOR. The key internal controls in Member States visited are assessed as partially effective ([43]);

— we found no errors in the transactions we tested.

Recommendations

4.27. ***Annex 4.2*** shows the result of our review of progress in addressing recommendations made in previous annual reports. In the 2011 and 2012 annual reports, we presented three recommendations. Of these recommendations, two were implemented in most respects, and one was implemented in some respects.

4.27.

4.28. Following this review and the findings and conclusions for 2014, we recommend that the Commission:

GNI-based own resources

— **Recommendation 1**: take measures during the next verification cycle in order to reduce the number of years that will be covered by reservations at the end of the cycle;

The Commission accepts the recommendation. The verification cycle will be shortened and reservations will be set and addressed at an earlier stage (in the course of the verification cycle).

— **Recommendation 2**: take measures to reduce the impact of the revisions presented by Member States.

The Commission accepts the recommendation.

([43]) See also special report No 2/2014, paragraphs 107 to 120.

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Traditional own resources

— **Recommendation 3:** improve the existing guidance on post clearance audits and encourage its implementation by Member States;

— **Recommendation 4:** ensure that Member States have adequate accounting systems for recording items in B accounts and encourage Member States to improve their management of the items in these accounts. For example, by reviewing them on a regular basis to ensure that older items are updated or written-off as appropriate.

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The Commission accepts the recommendation. It will address the Court's observations within the current framework of the Common Risk Management Strategy and its Action plan, particularly in the ongoing work on financial risk criteria.

The Commission accepts the recommendation. It will continue to examine the B accounts in the course of its inspections, and where shortcomings are found, it will request the Member States to improve the management of that account by regular reviews to ensure that items written off are removed from the account.

ANNEX 4.1

RESULTS OF TRANSACTION TESTING FOR REVENUE

	2014	2013
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions:	**55**	55
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**0,0 %**	0,0 %
Upper Error Limit (UEL)	0,0 %	
Lower Error Limit (LEL)	0,0 %	

ANNEX 4.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR REVENUE

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2012	The Commission should review its control framework for the verification of GNI data including carrying out a structured and formalised cost-benefit analysis, carrying out in-depth verification of material and risky GNI components, limiting the use of general reservations and setting materiality criteria for placing reservations.			X				*The new control framework is currently under development and will be finalised before the start of the next verification cycle in early 2016. Direct verification is already undertaken in the context of lifting existing reservations. A new policy limiting the use of general reservations is in place and a materiality threshold has been agreed.*
2011 and 2012	The Commission should encourage Member States to strengthen customs supervision in order to maximise the amount of TOR collected.		X					*The Commission in the course of its regular TOR inspections will continue to verify that the Member States have put in place appropriate control frameworks to protect the financial interests of the EU in the area of traditional own resources.*
	The Commission should encourage Member States to correctly use A and B accounts and to ensure that they are demonstrably complete and correct (*).		X					*The Commission will continue to examine the use of the A and B accounts in the course of its inspections and will request the Member States to ensure that they are complete and correct.*

(*) The Commission follows up the use of the A and B accounts every year. However, as the problem persists, the efforts need to be continued.

CHAPTER 5

'Competitiveness for growth and jobs'

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INTRODUCTION

5.1. This chapter presents our findings related to our specific assessment for 'Competitiveness for growth and jobs'. Key information on the activities covered and the spending in 2014 is provided in ***Graph 5.1***.

Specific characteristics of 'Competitiveness for growth and jobs'

5.2. The objectives of the spending include improving research and innovation, enhancing education systems and promoting employment, ensuring a digital single market, promoting renewable energy and energy efficiency, modernising the transport sector and improving the business environment, especially for small and medium-sized enterprises (SMEs).

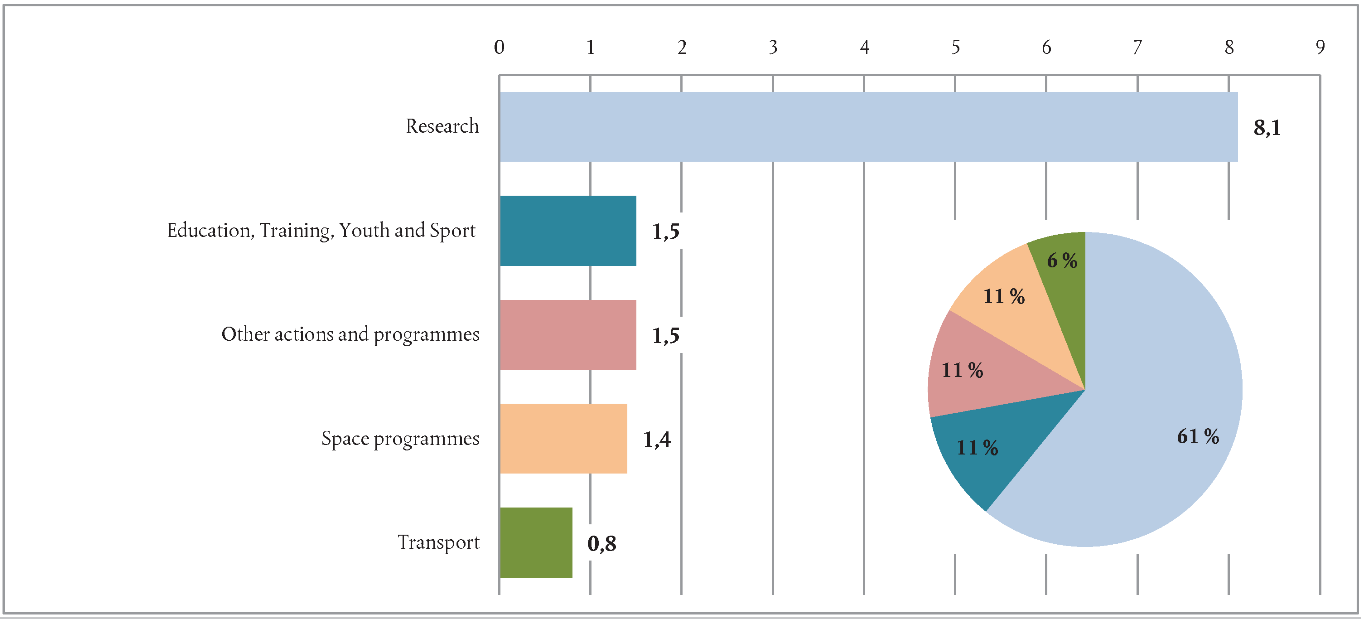
5.3. Research and innovation accounts for 61 % of spending, through the Seventh Framework Programme for Research and Technical Development 2007-2013 (the 'Seventh Research Framework Programme') and Horizon 2020 — the Framework Programme for Research and Innovation 2014-2020 ('Horizon 2020'). Other major spending instruments are: the Lifelong Learning Programme and Erasmus+ in the fields of education, training, youth and sport; the Trans-European Networks-Transport programme, which provides finance for the development of transport infrastructure; the European Energy Programme for Recovery in support of projects in the energy sector; the Connecting Europe Facility, which supports the development of networks in the sectors of transport, telecommunications and energy; the Galileo programme for the European satellite navigation system.

5.3. *The composition of the spending in this chapter is different from last year's report following the new MFF 2014-2020.*

5.4. Almost 90 % of the spending takes the form of grants to private or public beneficiaries participating in projects. Apart from pre-financing payments made upon signature of a grant agreement or financing decision, the payment of EU funds reimburses costs reported by beneficiaries. The principal risk to the regularity of transactions is that beneficiaries declare ineligible costs, which are neither detected nor corrected before reimbursement by the Commission.

Graph 5.1 — MFF sub-heading 1.a — 'Competitiveness for growth and jobs' — Key information 2014

(billion euro)



Total payments for the year	13,3
- *advances* [1]	6,9
+ *clearings of advances* [1]	6,6
Audited population, total	**13,0**

([1]) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 7).

Source: 2014 consolidated accounts of the European Union.

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Audit scope and approach

5.5. ***Annex 1.1, part 2***, of chapter 1 describes our overall audit approach and methodology. For the audit of 'Competitiveness for growth and jobs', the following specific points should be noted:

(a) The audit involved an examination of a sample of 166 transactions as defined in ***Annex 1.1***, paragraph 7. The sample is designed to be representative of the entire range of transactions within the MFF sub-heading area. In 2014, the sample consisted of 95 transactions for research and innovation (92 for the Seventh Research Framework Programme and three for the previous Sixth Research Framework Programme), 21 transactions for education and vocational training (under the Lifelong Learning Programme) and 50 transactions for other programmes and activities.

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(b) The assessment of the annual activity reports included reports of Directorate-General for Research and Innovation (DG RTD), Directorate-General for Education and Culture (DG EAC), Directorate-General for Mobility and Transport (DG MOVE), Directorate-General for Enterprise and Industry (DG ENTR [1]), Directorate-General for Energy (DG ENER) and of the Innovation and Networks Executive Agency.

REGULARITY OF TRANSACTIONS

5.6. ***Annex 5.1*** contains a summary of the results of transaction testing. Of the 166 transactions that we audited, 79 (48 %) were affected by error. On the basis of the 53 errors which we have quantified, we estimate the level of error to be 5,6 % [2].

5.6. *The error rate reported by the Court is one indicator of the effectiveness of the implementation of EU expenditure. However, the Commission has a multiannual control strategy. On this basis its services calculate a residual error rate, which takes account of recoveries, corrections and the effects of all their controls and audits over the period of implementation of the programme. The calculated residual error at the end of 2014 is 0,42 % for EEPR and 0,84 % for TEN-T and estimated at 3 % for the research family.*

5.7. ***Graph 5.2*** presents the extent to which the different types of errors contributed to the estimated level of error for 2014. The main source of quantifiable errors was the reimbursement of ineligible costs declared by beneficiaries in research and innovation projects.

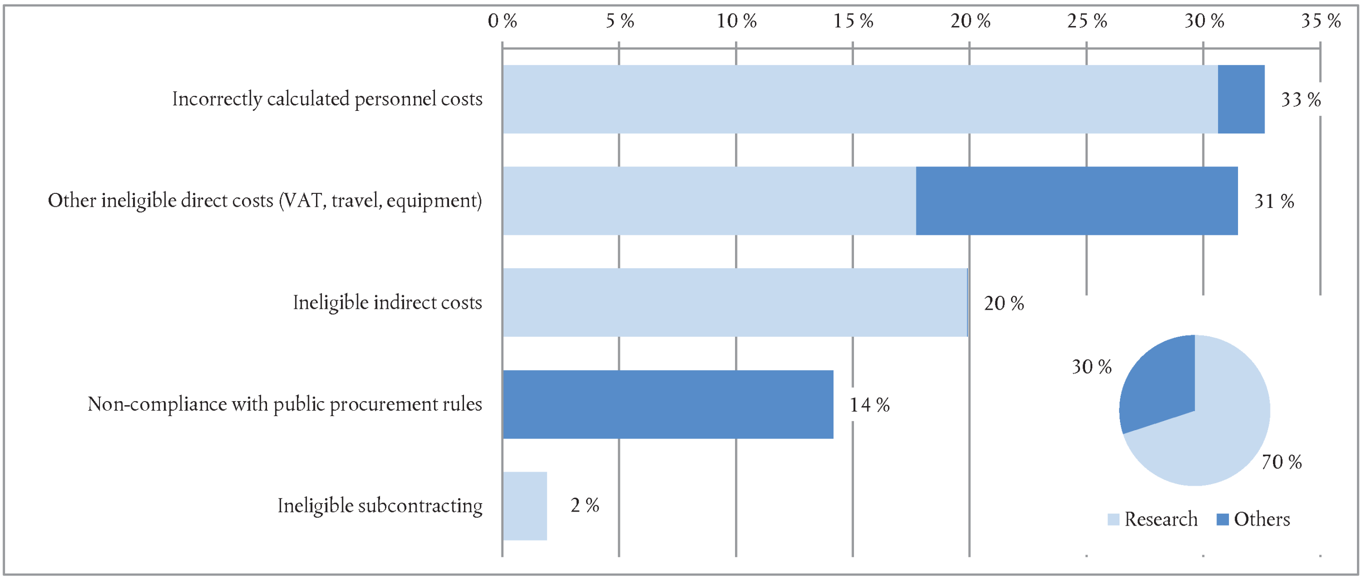
5.7. *In research and innovation projects, personnel costs and indirect costs account for most of the project costs. In order to accommodate the diversity of cost structures in the European research landscape, a conscious policy choice has been made to reimburse these cost categories on the basis of real costs, rather than unit costs or flat rates. That explains why they are prone to error, which is reflected in the graph.*

Horizon 2020 has been conceived to address, to the extent possible, these sources of error through the introduction of a number of simplifications — see paragraph 5.9 below.

[1] As from 2015, DG ENTR will be replaced by the Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW).

[2] We calculate our estimate of error from a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the rate of error in the population lies between 3,1 % and 8,1 % (the lower and upper error limits respectively).

Graph 5.2 — Contribution by type of error to the estimated level of error



Source: European Court of Auditors.

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5.8. In 27 cases of quantifiable errors, the Commission, national authorities or independent auditors ([3]) had sufficient information ([4]) to prevent or detect and correct the errors before accepting the expenditure. If all this information had been used to correct errors, the estimated level of error for this chapter would have been 2,8 percentage points lower.

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5.8. *The Commission has a sound system of ex ante controls in place including detailed automated checklists, written guidance and continuous training. The improvement of this system without imposing additional administrative burdens on beneficiaries, and whilst ensuring that payments are made promptly, is a constant challenge. The Court's findings will be used to make further improvements to ex ante controls, including further improved checklists, guidance and possible further automation of controls. The Commission is also working together with national agencies and authorities to ensure that their control mechanisms are operational to their full extent to prevent, detect and correct errors.*

As regards independent auditors certifying cost claims, this is a well-known issue, addressed in previous reports. In order to follow up on the Court's recommendations, the Commission has organised a series of meetings targeting beneficiaries and independent certifying auditors (> 300) to raise awareness of the most common errors. In addition, feedback has been provided to certifying auditors who have made errors, and a more didactic template for audit certificates provided in Horizon 2020. For research, audit certificates are estimated to reduce the error rate by 50 % compared to uncertified claims. So while it is recognised that they do not identify every error, they are an important tool to reduce the overall error rate.

([3]) In certain cases, for example cost statements for Seventh Research Framework Programme projects where the EU contribution exceeds 375 000 euro, independent auditors must certify that the declared costs are eligible.

([4]) On the basis of supporting documentation, including standard cross checks and mandatory checks.

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Research and innovation: complex rules in the Seventh Research Framework Programme increased the risk of errors

5.9. We found the same type and range of errors which we have detected throughout the course of the Seventh Research Framework Programme: incorrectly calculated personnel costs; other ineligible direct costs such as unsubstantiated costs for travel or equipment; ineligible indirect costs based on erroneous overhead rates or including ineligible cost categories not linked to the project (see Box 5.1).

Box 5.1 — Example of errors in costs reimbursed for a research and innovation project

We sampled a payment by the Commission to an international organisation working with four partners on a collaborative trans-national health-related project under the Seventh Research Framework Programme. On the basis of the cost statement submitted by the organisation, the Commission reimbursed around 132 000 euro. However, we detected several errors in the costs declared by the beneficiary organisation:

— overcharged personnel costs;

— declared travel costs not related to the project;

— incorrectly calculated indirect costs.

Moreover, the beneficiary used an incorrect exchange rate when converting the declared costs from local currency into euros, which further increased the overstatement. In total, the ineligible costs declared by the beneficiary amounted to 73 000 euro or 55 % of the claimed costs.

We detected cases of ineligible costs reimbursed by the Commission in 39 of the 95 sampled research and innovation projects. In 13 of those cases, the ineligible costs exceeded 10 % of the total costs declared by the beneficiary.

5.10. The Commission carries out its own programme of audits of reimbursed cost statements for research and innovation projects (see paragraphs 5.18 to 5.24), and finds similar errors with comparable range and frequency.

THE COMMISSION'S REPLIES

5.9. *The Commission's own audits have also shown that the type and level of errors remain stable as a result of the complex FP7 rules.*

However, as all FP7 contracts have been signed, the further modification of the legal framework is no longer an option. Over the course of FP7, however, the Commission has attempted to simplify the system within the existing legal framework, for example the simplification measures adopted by the Commission on 24 January 2011 (Decision C(2011) 174).

Horizon 2020 includes a radical simplification of the legal framework, in order to meet the expectations of both stakeholders and legislative authorities, focusing in particular on personnel and indirect costs as the main sources of error.

Box 5.1 — Example of errors in costs reimbursed for a research and innovation project

The Commission will recover the unduly paid amounts. This case also shows the challenge of dealing with international partners — while collaboration with researchers outside Europe is necessary to address the global challenges faced by society, these bodies are often not used to the EU eligibility rules.

THE COURT'S OBSERVATIONS

5.11. The persistent material level of error in research and innovation spending reflects risks inherent in the design and implementation of the Seventh Research Framework Programme. Eligibility rules are complex and the programme has multiple funding rates. The projects are carried out by multiple partners, which are widely dispersed geographically and include beneficiaries in non-EU countries. The types of beneficiary vary considerably and beneficiaries' accounting systems are often not compatible with the programme requirements.

5.12. In 2014, the Commission signed the first grant agreements and began to make prefinancing payments for the new Framework Programme for Research and Innovation. Horizon 2020 has simpler funding rules than the Seventh Research Framework Programme and the Commission has invested considerable efforts in reducing administrative complexity.

5.13. However, some elements introduced in Horizon 2020 represent an increased risk to the regularity of transactions. For example, with a view to supporting better research and innovation and delivering growth and jobs, the programme is designed to attract greater participation by SMEs and new entrants (many of whom are also SMEs) The Commission has found that these categories of participant are especially prone to error, as also illustrated by the example shown in Box 5.2.

THE COMMISSION'S REPLIES

5.11. *In view of the complexity of the rules, the Commission has introduced many simplifications into Horizon 2020.*

However, to achieve the policy aims, especially creating growth and jobs and addressing societal challenges through research and innovation, multinational and multi-disciplinary partnerships, widespread involvement of the private sector, especially small businesses, the reimbursement of personnel and indirect costs on the basis of real costs, are all essential. As the Court points out, this entails a number of inherent risks.

On the other hand, where policy objectives allow for simpler mechanisms, error rates are below 2 %. These grants (ERC grants, Marie Skłodowska Curie grants) are straightforward — they largely concern public bodies, use flat rates and lump sums more widely, and the majority are single beneficiary grants.

5.13. *Joint reply to paragraphs 5.13 and 5.14:*

The elements referred to by the Court were introduced by the legislative authorities and were the result of conscious policy choices by the legislator to achieve the objectives of the programme.

The involvement of SMEs is crucial for the success of the programme, for the creation of growth and jobs and for addressing societal challenges.

The administrative capacity of SMEs is limited. That is why, to the extent possible, the rules for SMEs have been simplified in order to reduce their administrative burden. An increased risk nevertheless remains.

As regards reimbursements linked to large infrastructure, this is intended to achieve fair compensation for strategic research partners with heavy investment in infrastructure. As regards additional remuneration, this is intended to ensure fair compensation for researchers across Europe, to spread excellence, close the innovation divide and maintain the attractiveness of the programme.

To mitigate the risks the Commission will carry out ex-ante assessments of all participants receiving payments for large research infrastructures, and has provided extensive guidance on the application of additional remuneration in the programme.

THE COURT'S OBSERVATIONS

Box 5.2 — Example of significant errors in costs declared for reimbursement by an SME in a research and innovation project

We examined a cost statement amounting to 764 000 euro from an SME working with 16 partners on a project under the Seventh Research Framework Programme concerning renewable energy. We found that the costs declared by the SME were almost entirely ineligible:

— the SME owner charged an hourly rate well above the rate set in the Commission guidelines;

— sub-contracting costs which were neither an eligible component of costs nor procured by means of a tendering procedure;

— the declared indirect costs included ineligible items, were based on estimates and could not be reconciled with the beneficiary's accounting records.

The ineligible costs reimbursed by the Commission gave rise to an error of more than 90 % of the total costs examined.

5.14. Furthermore, the introduction of specific eligibility criteria in certain cases, such as where researchers receive additional remuneration or where participants make use of a large research infrastructure, brings an increased risk to the regularity of transactions.

5.15. For Horizon 2020, there remains a multiplicity of bodies implementing the spending. Indeed, the number of bodies involved in programme management for Horizon 2020 has actually increased by comparison to the Seventh Research Framework Programme. The Commission needs to ensure that its internal systems are adequate to avoid differences of treatment for beneficiaries.

THE COMMISSION'S REPLIES

Box 5.2 — Example of significant errors in costs declared for reimbursement by an SME in a research and innovation project

The Commission emphasises that the beneficiary made a significant contribution to the project. However, its cost declaration was made largely using the standard business practices of the beneficiary (in particular the use of commercial charge-out rates rather than actual costs, and sub-contracting using its normal practices rather than following the principle of best-value recognised by EU rules). This underlines the challenges of dealing with SMEs.

5.15. *The Commission recognises the challenge of treating participants in a harmonised manner. It is investing heavily in ensuring uniform treatment for Horizon 2020, especially through the creation of the Common Support Centre, which brings together legal advice, business processes, IT and audit in a single directorate supporting all the services of the Commission managing research.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Other spending instruments: ineligible and unsubstantiated costs and non-compliance with rules on public procurement

5.16. We also detected errors in reimbursed costs for other major spending instruments under 'Competitiveness for growth and jobs', of a similar range and nature to those detected in previous years. These include unsubstantiated and ineligible costs, as well as cases of non-compliance with the rules on public procurement (see examples in Box 5.3).

Box 5.3 — Examples of errors in costs reimbursed for projects in other programmes under 'Competitiveness for growth and jobs'

(a) In a Trans-European Networks-Transport programme project in Sweden, the beneficiary directly awarded a contract for IT consultancy services without any form of publication. The value of these services was above the applicable thresholds defined by the European public procurement directives. Therefore, an open international procedure should have been followed.

(b) In a European Energy Programme for Recovery project in the United Kingdom, the beneficiary declared expenditure which was not in compliance with the conditions defined in the financing decision awarding funds to the project. In particular, the methodology applied for the calculation of personnel costs included ineligible non-statutory costs (bonuses based on the company's profit) and ineligible indirect costs not linked to the project.

(c) In a Trans-European Networks-Transport project in Italy concerning the construction of a high-speed train connection, the beneficiary declared ineligible expenditure concerning a legal settlement reached with one subcontractor in relation to a breach of contract.

(d) In a trans-national vocational training project in Greece under the Leonardo da Vinci strand of the Lifelong Learning Programme, the beneficiary responsible for implementing the project claimed excessive travel costs relating to the transfer from the airport to the city centre for students participating in the project. The national agency responsible for giving assurance on the eligibility of the activities supported with EU funds had performed a desk check of the project, but did not report any findings.

Box 5.3 — Examples of errors in costs reimbursed for projects in other programmes under 'Competitiveness for growth and jobs'

(a) *The Commission will recover the unduly paid amounts.*

(b) *The Commission will recover the unduly paid amounts.*

(c) *The Commission will recover the unduly paid amounts.*

(d) *The Commission will proceed to recover the relevant amounts from the beneficiary via the National Agency. In addition, the introduction of lump sums and flat rates under the Erasmus+ programme will reduce the scope for excessive claims of this nature.*

5.17. In total, we detected and quantifed errors in 14 out of 71 sampled transactions for programmes and activities other than research and innovation.

THE COURT'S OBSERVATIONS

EXAMINATION OF SELECTED SYSTEMS AND ANNUAL ACTIVITY REPORTS

Commission audits of research and innovation spending

5.18. For research and innovation, the Commission has taken into account the need expressed by beneficiaries and by the legislative authorities to limit the administrative burden and to facilitate the timely implementation of projects (5). Therefore, the Commission has reduced checks before payments and seeks to obtain most of its assurance through its audits of reimbursed costs.

5.19. The Commission began its programme of audits of projects under the Seventh Research Framework Programme in 2009. The programme has two main components: (i) audits selected on a random basis designed to establish a representative error rate for the Seventh Research Framework Programme, and (ii) corrective or risk-based audits selected on the basis of risk criteria and designed to reduce irregular expenditure.

5.20. The audits are carried out by Commission staff and by external audit firms on behalf of the Commission. The results provide essential input to the director-generals' annual declarations of assurance concerning the regularity of transactions and form the basis for the recovery from beneficiaries of any funds found to have reimbursed ineligible costs.

5.21. Since January 2014, the audits are coordinated by the Common Audit Service set up by the Commission as part of a Common Support Centre. The Centre is hosted by DG RTD and provides shared management services for all the DGs, executive agencies and joint undertakings involved in research and innovation spending.

5.22. By the end of 2014, the Commission had audited reimbursed costs amounting to 2 billion euro or 8 % of payments made of 24,5 billion euro for the Seventh Research Framework Programme. The Commission had closed 2 860 audits of the 3 000 planned in its audit strategy.

5.23. As a result of its audits, the Commission had recovered 47,6 million euro by the end of 2014 (2013: 29,6 million euro) and the outstanding recoverable amounts had increased to almost 20 million euro (2013: 17 million euro).

5.24. The Commission expects its audit strategy to significantly reduce the level of irregular expenditure in final claims but not to reduce the final level of error below 2 %.

(5) For example, in its 2012 discharge resolution, the European Parliament 'emphasises the necessity to strike the right balance between less administrative burden and effective financial control.'

Annual activity reports

5.25. We examined the reports for DG EAC, DG ENTR and DG RTD and consider that they generally provide a fair assessment of financial management in relation to the regularity of transactions, and the information provided corroborates our findings and conclusions in most respects. For example, the annual activity reports of DG RTD and DG ENTR, as well as those of the Directorate-General for Communication Networks, Content and Technology (DG CNECT), DG ENER and DG MOVE, each contain a reservation with regard to the accuracy of cost claims relating to grants under the Seventh Research Framework Programme.

5.26. Similarly to previous years, we found several errors in our sampled projects for the Trans-European Networks-Transport programme and the European Energy Programme for Recovery concerning non-compliance with EU and national public procurement rules and the declaration of ineligible expenditure by beneficiaries. Therefore, DG ENER and the Innovation and Networks Executive Agency have to ensure that the risks to the regularity of transactions are adequately managed, in particular in relation to compliance with EU and national public procurement rules.

Annual activity reports for DG ENER and the Innovation and Networks Executive Agency understate risks to the regularity of transactions

5.27. We identified specific matters in the methodology for calculating the indicators for the regularity of transactions used by DG ENER and by the Innovation and Networks Executive Agency:

— for the Trans-European Networks-Transport programme and the European Energy Programme for Recovery, the Commission has included in its calculation the results of audits carried out by the Court, but with a different error quantification;

— for the Trans-European Networks-Transport programme, the Commission does not systematically extrapolate the errors detected in the sample.

5.26. *The Commission acknowledges that there are procurement-related risks inherent to the EEPR and TEN-T programmes. The control systems put in place by DG ENER and INEA are designed to ensure that the residual error rates are below the 2 % materiality threshold.*

At the end of 2014, the multi-annual residual error rate for the TEN-T programme was 0,84 % and for the EEPR programme 0,42 %.

5.27. *The Commission emphasizes the following:*

— *the Commission includes in its calculation the results of audits carried out by the Court, but for the amounts for which it is in agreement with the Court's findings.*

— *The ex-post control results have revealed limited findings in relation to the sample testing of transactions. The procurement testing is made outside the sample of transaction testing. In case an error is detected in the sampling, the non-audited transactions are reviewed and in case the finding is considered systematic, the error is extrapolated by testing all possibly affected underlying transactions (e.g. for personnel costs). Errors of an isolated nature are considered to have been corrected following the audit.*

THE COURT'S OBSERVATIONS

5.28. These matters lead to an understatement of the detected level of error and an overstatement of the effect of corrective actions on the amounts at risk. As a result, we consider that the relevant indicators published in the annual activity reports of DG ENER and the Innovation and Networks Executive Agency understate the risks to the regularity of transactions.

Inconsistent approaches to the assessment of amounts at risk

5.29. In 2014, for the first time, the DGs were required to disclose an overall assessment of the risks relating to legality and regularity of the underlying transactions, by calculating the weighted average error rate for the total amount of expenditure under their responsibility and the resulting amount at risk (see paragraph 1.50).

5.30. While the detected error rate should have been used for this calculation, we found that DG MOVE and DG ENER used the error rate after corrections. For Nuclear Decommissioning Programme spending in DG ENER, estimated amounts as opposed to audit results were used.

5.31. Due to the different approaches taken to the calculation of the weighted average error rate and the resulting amount at risk, the assessments in the annual activity reports are not directly comparable.

CONCLUSION AND RECOMMENDATIONS

The conclusion for 2014

5.32. Overall audit evidence indicates that spending on 'Competitiveness for growth and jobs' is affected by a material level of error.

5.33. For this MFF sub-heading area, testing of transactions indicates that the estimated level of error present in the population is 5,6 % (see ***Annex 5.1***).

THE COMMISSION'S REPLIES

5.28. *In the Commission's view the overall amounts of risk are drawn up in a prudent manner to ensure that there will be no material understatement of the risks to regularity.*

5.29. *As mentioned in paragraph 1.50, the new instructions require directors-general to present an estimated detected error rate to estimate the amount at risk for the entire budget under their responsibility. This figure is disclosed alongside the estimated future corrections.*

5.30. *For DG MOVE and DG ENER, detected error rates (or if not available, best estimates) were used for all activities except, due to a clerical error, for FP7, where the residual error rate of 3 % was applied (instead of 5 %). However, the impact on the average error rate is limited (for DG MOVE 0,06 % and for DG ENER 0,41 %).*

Based on the latest audit reports on the nuclear decommissioning programme carried out by DG ENER, the error rates are far below the estimated detected error rate indicated in the DG ENER's AAR of 0,5 %, which thus represents a prudent approach.

5.33. *Please see the Commission's reply to paragraph 5.6.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

5.34. ***Annex 5.2*** shows the result of our review of progress in addressing recommendations made in previous annual reports. In the 2011 and 2012 annual reports, we presented nine recommendations. The Commission fully implemented three recommendations, while six were implemented in most respects.

5.35. Following this review and the findings and conclusions for 2014, we recommend that:

— **Recommendation 1:** the Commission, national authorities and independent auditors use all the relevant information available to prevent, or detect and correct errors before reimbursement (see paragraph 5.8);

The Commission accepts the recommendation.

The Commission has a sound system of ex ante controls in place including detailed automated checklists, written guidance and continuous training. The improvement of this system without imposing additional administrative burdens on beneficiaries, and whilst ensuring that payments are made promptly, is a constant challenge. The Court's findings will be used to make further improvements to ex ante controls, including further improved checklists, guidance and possible further automation of controls. The Commission is also working together with national agencies and authorities to ensure that their control mechanisms are operational to their full extent to prevent, detect and correct errors.

As regards independent auditors certifying cost claims, this is a well-known issue, addressed in previous reports. In order to follow up on the Court's recommendations, the Commission has organised a series of meetings targeting beneficiaries and independent certifying auditors (> 300) to raise awareness of the most common errors. In addition, feedback has been provided to certifying auditors who have made errors, and a more didactic template for audit certificates provided in Horizon 2020. For research, audit certificates are estimated to reduce the error rate by 50 % compared to uncertified claims. So while it is recognised that they do not identify every error, they are an important tool to reduce the overall error rate.

— **Recommendation 2:** based on its experience under the Seventh Research Framework Programme, the Commission develop an appropriate risk management and control strategy for Horizon 2020, including adequate checks of high-risk beneficiaries such as SMEs and new entrants and of costs declared under specific eligibility criteria (see paragraphs 5.13 and 5.14);

The Commission accepts the recommendation and agrees that an appropriate risk management and control strategy needs to be in place for Horizon 2020 taking into account the risks in the programme, but also the policy aims, especially the need to encourage SMEs and new entrants into the programme.

THE COURT'S OBSERVATIONS

— **Recommendation 3:** the Commission ensure that its services take a consistent approach to the calculation of weighted average error rates and the resulting assessment of amounts at risk (see paragraphs 5.29 to 5.31).

THE COMMISSION'S REPLIES

The Commission accepts the recommendation. After the first year of application of the weighted average error rate and related total amount at risk concepts, the Commission central services will use the lessons learned for further clarifying its instructions and/or guidelines — as needed. However, there may always be a need to adjust these concepts to the specific spending areas covered by the different Commission services.

ANNEX 5.1

RESULTS OF TRANSACTION TESTING FOR 'COMPETITIVENESS FOR GROWTH AND JOBS'

	2014	2013 [1]
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions:	**166**	160
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**5,6 %**	4,0 %
Upper Error Limit (UEL)	8,1 %	
Lower Error Limit (LEL)	3,1 %	

([1]) The figures for 2013 have been recalculated to match the structure of AR 2014 and thus to enable a comparison between the two years. ***Graph 1.3*** of chapter 1 presents how the 2013 results have been reclassified based on the 2014 annual report structure.

ANNEX 5.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'COMPETITIVENESS FOR GROWTH AND JOBS'

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2012	The Commission should: **Recommendation 1:** further intensify its efforts to address the errors found in interim and final payments and clearings, in particular by reminding beneficiaries and independent auditors of the eligibility rules and the requirement for beneficiaries to substantiate all declared costs.		X					*The Commission has been running a communication campaign — attended by more than 4 500 participants — to remind beneficiaries and their auditors of the eligibility rules.* *The Commission will continue to write to certifying auditors where the Commission's ex-post audits identify material differences between the certified cost statements and its own findings.*
	Recommendation 2: remind research FP project coordinators of their responsibility to distribute the funds received to the other project partners without undue delay.	X						
	Recommendation 3: review the cases of weaknesses in ex ante checks identified by the Court in order to assess if the checks require modification.		X					*Weaknesses in ex ante checks identified by different sources (also by the Court) are being addressed by the Commission on permanent basis. This process is now embedded in the business processes of Horizon 2020.*
	Recommendation 4: reduce delays in the implementation of ex post audits and increase the implementation rate for extrapolation cases.		X					*The Commission is monitoring the implementation of the Commission ex-post audit reports on permanent basis. Furthermore, the Annual Activity Reports (AAR) of the Commission's DGs provide information on progress on these aspects.*

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2012	**Recommendation 5:** reinforce the supervisory and control systems for CIP ICT-PSP.		X					*The Commission (DG CONNECT) has adopted an audit strategy covering the non-research strand of the DG's spending aiming at providing assurance to the DG's Director-General as to the management of the non-research funding.* *In 2014, 30 non-research audits were closed covering 10 million euro and 42 new CIP ICT PSP audits were launched. An additional 98 new audits will be launched in 2015.* *The progress of the implementation of the strategy is monitored on a monthly basis in the Audit Budget and Control (ABC) meeting chaired by the Director-General and attended by representatives of all Directorates.* *In 2012, simplification measures were adopted for SME owners. In addition, the CIP model agreement was revised following the entry into force of the new Financial Regulation in 2013 to cover extrapolation and third parties.*

Year	Court recommendation	Court's analysis of the progress made: Fully implemented	Being implemented: In most respects	Being implemented: In some respects	Not implemented	Not applicable	Insufficient evidence	Commission reply
2011	The Commission should: — in the area of the research FPs:							*See above responses.*
	Recommendation 1: intensify its efforts to address the errors found in interim and final payments;		X					
	Recommendation 2: enhance its initiatives to make beneficiaries and independent auditors aware of the errors detected during the Court's and the Commission's ex-post audits;		X					
	Recommendation 3: ensure that the external audit firms conducting audits on its behalf align their procedures with the Commission's guidelines and standard practice and in particular enhance the quality of their audit documentation.	X						
	Recommendation 4: The Commission should: — in the area of the other internal policies: introduce as soon as possible an ex-post audit strategy for the ICT-PSP programme, drawing on the lessons learnt by DG INFSO's risk-based ex-post audit strategy for framework programmes projects.	X						

CHAPTER 6

'Economic, social and territorial cohesion'

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INTRODUCTION

6.1. This chapter presents our findings for 'Economic, social and territorial cohesion' (MFF heading 1b). In part 1, the chapter presents the results of testing of:

— the European Regional Development Fund (ERDF) and the Cohesion Fund (CF), which are the main instruments of the regional and urban policy area; including the contribution from this policy to the cross border cooperation of the European Neighbourhood Instrument (ENI);

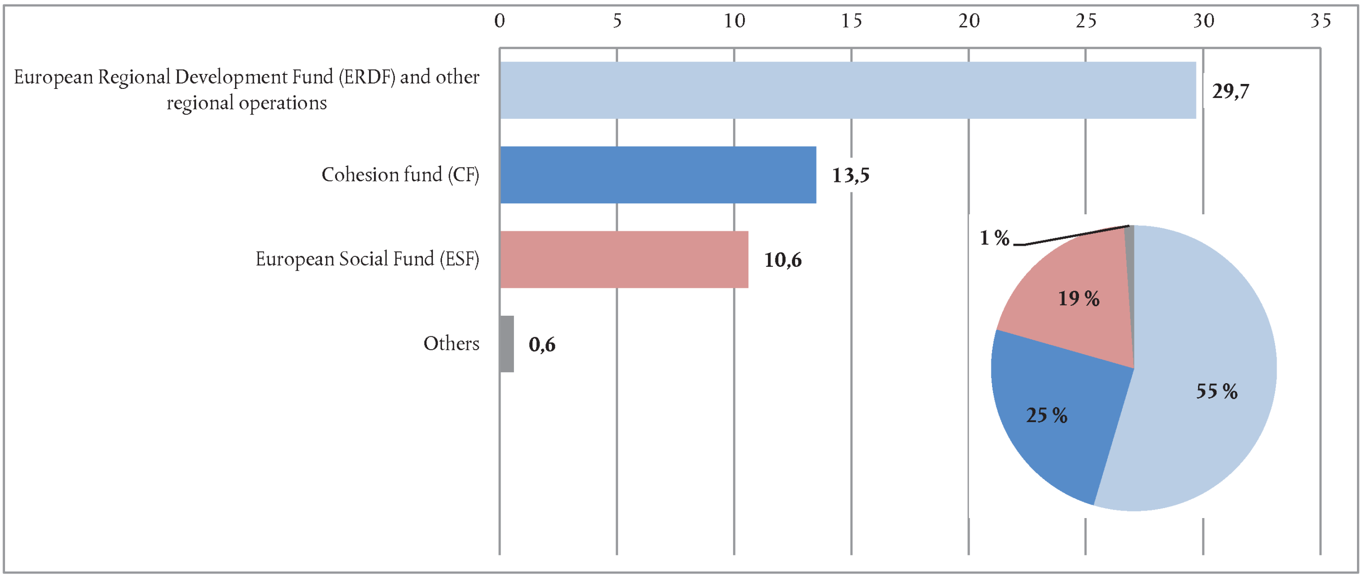
— the European Social Fund (ESF) and the Fund for European Aid to the Most Deprived (FEAD), which are the main instruments of the employment and social affairs policy area.

Part 2 of this chapter presents performance related issues in regards to the examined projects of 'Economic, social and territorial cohesion'.

Key information on the composition of MFF heading 1b is provided in ***Graph 6.1***.

Graph 6.1 — MFF heading 1b — 'Economic, social and territorial cohesion'

(billion euro)



Total payments for the year	54,4
– *advances* (1) (2)	*3,8*
+ *clearings of advances* (1)	*2,2*
+ *disbursements to final recipients from financial instruments under shared management*	*1,7*
+ *advances used by final beneficiaries of state aid projects*	*1,2*
Audited population, total	**55,7**

(1) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 7).
(2) This figure includes 1,7 billion euro of contributions to financial instruments under shared management and advances paid to beneficiaries of state aid projects.

Source: 2014 consolidated accounts of the European Union.

THE COURT'S OBSERVATIONS

6.2. During 2014, the vast majority of payments were interim payments to operational programmes (OPs) of the 2007-2013 programming period, whose eligibility period ends 31 December 2015. The advance payments to the 2014-2020 programming period amounted around 2 billion euro ([1]).

Specific characteristics of the MFF heading

Policy objectives

6.3. The MFF heading 1b — 'Economic, social and territorial cohesion' aims to reduce development disparities between different regions, restructuring declining industrial areas and diversifying rural areas and to encourage cross-border, trans-national and interregional cooperation ([2]).

Policy instruments

6.4. 'Economic, social and territorial cohesion' comprises two parts:

— the regional and urban policy area, which is mostly implemented through the ERDF, CF and the contribution to the ENI. It accounts for 80 % of spending covered by this chapter;

— the employment and social affairs policy area, which is overwhelmingly implemented through the ESF. It accounts for 20 % of spending covered by this chapter.

Regional and urban policy area

6.5. The ERDF finances infrastructure projects, the creation or preservation of jobs, regional economic development initiatives and activities supporting small and medium enterprises in the 28 Member States.

6.6. The CF finances investments in infrastructure in the fields of environment and transport in Member States whose gross national income per capita is below 90 % of the EU average (i.e. in 16 out of the 28 Member States) ([3]).

([1]) The advance payments of the 2014-2020 programming period by fund were: for ERDF: 661 million euro, for CF: 270 million euro, for ESF: 634 million euro and for FEAD: 410 million euro.

([2]) Articles 174 to 178 of the Treaty of the Functioning of the European Union (TFEU).

([3]) Bulgaria, Czech Republic, Estonia, Greece, Croatia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Portugal, Romania, Slovenia and Slovakia. Spain is eligible for CF transitional support.

THE COURT'S OBSERVATIONS

6.7. Other spending includes the contribution from the regional and urban policy area to the cross-border cooperation of the ENI that aims to bring EU and its neighbouring countries closer ([4]).

Employment and social affairs policy area

6.8. The ESF invests in human capital and supports actions in the 28 Member States that aim to improve the adaptability of workers and enterprises to the changes in working patterns, increase access to employment, reinforce the social inclusion of disadvantaged persons and strengthen the capacity and efficiency of administrations and public services.

6.9. Other spending takes the form of subsidies and grants to organisations implementing and coordinating social actions through the FEAD, which provide material assistance ([5]) to the most deprived to help people out of poverty.

Management and control of spending in cohesion policy funds (ERDF, CF and ESF)

6.10. The ERDF, the CF and the ESF are governed by common rules, subject to exceptions in the specific regulations of each fund, and are implemented through multiannual programmes, with management shared between the Commission and the Member States.

6.11. For each programming period, on the basis of Member States' proposals, the Commission approves OPs and indicative financial plans ([6]). Projects selected by the Member State authorities are financed through the OPs and are carried out by private individuals, associations, private or public undertakings or local, regional and national public bodies. The rules according to which costs can be reimbursed from the EU budget are set out in the regulations and/or in national eligibility rules.

THE COMMISSION'S REPLIES

6.11. *The establishment of eligibility rules at national level (Article 56 of Regulation (EC) No 1083/2006) was one of the main elements of simplification introduced in the 2007-2013 programme period. It aimed at providing Member States with more flexibility in adapting eligibility rules to the specific needs of regions or programmes and to harmonise them with rules in force for other national public schemes.*

([4]) Further information on the ENI is presented in chapter 8, MFF heading 4 — 'Global Europe', paragraphs 8.2 to 8.4.

([5]) This includes food, clothing and other essential items for personal use.

([6]) In total, 440 OPs were approved by the Commission for the 2007-2013 programming period: 322 for ERDF/CF (out of which 25 OPs contain CF projects) and 118 for ESF.

THE COURT'S OBSERVATIONS

6.12. For each project, beneficiaries declare the costs incurred to their national authorities. These individual declarations are aggregated into periodic expenditure declarations per OP certified by the Member State authorities and submitted to the Commission ([7]). The overall amount of EU co-financing is then reimbursed from the EU budget to the Member State.

Member States and regional level

6.13. Member States bear primary responsibility for preventing or detecting and correcting irregular expenditure, and report to the Commission. Responsibility for day-to-day administration lies with designated managing authorities and intermediate bodies ([8]). They must ensure through management verifications (desk reviews and on-the-spot inspections) that all projects are eligible for EU funding and that the costs declared comply with all conditions specified in the regulations and/or the national rules. Certifying authorities must ensure that adequate checks have been made and undertake additional verifications prior to declaring expenditure for reimbursement from the Commission.

6.14. In addition, for each OP (or a group of OPs), audit authorities in the Member States carry out system audits and, on a sample basis, ex post audits of operations ([9]). They report on these audits to the Commission through annual control reports, which include an annual audit opinion on the functioning of the systems and the audit authorities' error rate estimate (see paragraphs 6.53 to 6.57) ([10]).

([7]) The extent to which costs are reimbursed is determined in accordance with the rate set for such project by the OP, but also takes into account other criteria (such as specific ceilings in accordance with the regulations and/or state aid rules).

([8]) An intermediate body is a public or private body acting under the responsibility of a managing authority and carrying out duties on its behalf.

([9]) Article 62 of Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25).

([10]) Further details on the role and responsibilities of audit authorities and their contribution to the Commission's assurance process can be found in special report No 16/2013 'Taking stock of "single audit" and the Commission's reliance on the work of national audit authorities in Cohesion', paragraphs 5 to 11.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES

Commission level

6.15. The Commission (Directorate-General for Regional and Urban Policy and Directorate-General for Employment, Social Affairs and Inclusion) has to obtain assurance that the Member States have set up management and control systems which meet the requirements of the regulations, and that the systems function effectively [11].

6.16. If the Commission finds that a Member State has failed to correct irregular expenditure which had been certified and declared, or that there are serious failings in the management and control systems, the Commission may interrupt or suspend payments [12]. If the Member State does not withdraw the irregular expenditure (which may be substituted by eligible expenditure for other projects of the same OP until the end of the programming period) and/or does not remedy any detected system failures, the Commission may apply financial corrections [13] [14].

Risks to regularity

6.17. In implementing the OPs, Member State authorities face competing priorities. Spending has to be subject to appropriate checks intended to ensure regularity and sound financial management. At the same time, there is an interest in absorbing the funds allocated by the EU. This may in practice militate against the consistent application of effective controls so that infringements of rules are not detected and corrected and ineligible expenditure is ultimately reimbursed from the EU budget. This may also result in the funding of projects which are too costly, not efficiently implemented or unlikely to achieve the intended results [15] (see also paragraph 6.80). This tension increases when the end of the eligibility period approaches, since Member States risk losing the non-spent share of the funds initially allocated to them.

6.17. *Appropriate checks have to ensure regularity of all expenditure declared throughout the implementation period and up to closure. As the end of the eligibility period is 31 December 2015, the Commission expects that the risk referred to by the Court will be more acute for expenditure declared in 2015 and subsequent years.*

Closure documents from Member States are required by 31 March 2017 and will provide additional assurance. The Commission proactively adopted closure guidelines on 20 March 2013 (Decision C(2013) 1573) that were completed and updated on 30 April 2015. The Commission services have organised several closure seminars for Member States and have updated their risk assessments and consequently the Audit Strategy 2007-2013 to address any potential risk in view of the last part of the implementation period.

In November 2014 the Commission also put in place a Task Force for Better Implementation in order to improve the implementation of ERDF/CF in eight Member States, while ensuring full respect of legality and regularity of expenditure (see also Commission reply to paragraph 2.18).

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(11) Article 72 of Regulation (EC) No 1083/2006.

(12) Article 39(2) of Council Regulation (EC) No 1260/1999 (OJ L 161, 26.6.1999, p. 1); Articles 91 and 92 of Regulation (EC) No 1083/2006.

(13) Article 99 of Regulation (EC) No 1083/2006.

(14) Further information on the way in which the Commission has imposed interruptions/suspensions and has applied financial corrections is also provided in chapter 1, 'The statement of assurance and supporting information', paragraphs 1.30 to 1.44.

(15) Further information on performance issues is presented in chapter 3, 'Getting results from the EU budget', paragraphs 3.76 to 3.86.

THE COURT'S OBSERVATIONS

6.18. For several years we have detected a high incidence of irregularities in the area of cohesion. Since 2009, when most of the expenditure related to the 2007-2013 programming period, the estimated level of error has ranged between 4,5 % and 7,7 % ([16]). This rate is significantly lower than in previous years, when expenditure was linked to the 2000-2006 programming period.

6.19. For ERDF and CF expenditure the main risks relate to non-compliance with EU and/or national public procurement rules when awarding contracts and to the funding of projects which are not eligible or which do not comply with EU state aid rules ([17]). A further risk is that beneficiaries declare costs which are ineligible according to the regulations and/or national eligibility rules.

6.20. For ESF expenditure, the major risk relates to the intangible nature of the investments in human capital, and the involvement of multiple, often small-scale, partners in the implementation of projects. These factors can lead to non-compliance with EU and/or national eligibility rules resulting in ineligible costs being accepted by the systems in place.

THE COMMISSION'S REPLIES

6.18. *The Commission considers that the decrease in the error-rate level in relation to the previous programming period reflects the improvement of the management and control systems for the 2007-2013 programming period.*

6.19. *The Commission shares this assessment, as detailed in its Staff Working Documents (Analysis of errors in the Cohesion Policy for the years 2006-2009 (SEC(2011) 1179 of 5 October 2011)). The Commission has continued to take specific actions to mitigate these risks: e.g. additional guidance and training provided to managing authorities on the identified risks; timely implementation of financial corrections, interruption and suspension procedures; audits targeted to most risky areas. Such preventive and corrective actions were brought together with new initiatives under a comprehensive action plan set up in 2013 between DG Regional and Urban Policy and DG for Internal Market, Industry, Entrepreneurship and SMEs to improve the implementation of public procurement rules (see Commission reply under paragraphs 6.30 to 6.33).*

Another action plan with DG Competition to support programme authorities in implementing State aid rules, reviewed and simplified in 2014, is ongoing.

6.20. *The Commission has taken specific actions in order to mitigate the risks identified, which include in particular preventive and corrective measures such as guidance, training, simplification, a strict policy on interruptions and suspensions of payments and the timely implementation of financial corrections, when necessary. The Commission is also addressing this risk by actively promoting the use of simplified cost options by the Member States and by insisting on the importance of first-level checks by the Member States. Furthermore, the Commission updates its audit plan on an annual basis in order to address the most significant risks identified.*

([16]) See our report 'Agriculture and cohesion: overview of EU spending 2007-2013', paragraph 23 and Graph 6, based on unadjusted historical data.

([17]) A risk in this area has been reduced by retrospective application of the 2014 General Block Exemption Regulation setting out partially less restrictive rules. As a result, the Commission no longer opens some infringement cases, which would have been opened under the previous rules. We have applied the same approach in our audit. Further information on the Commission's role and responsibilities in relation to state aid can be found in the special report No 15/2011, 'Do the Commission's procedures ensure effective management of state aid control?'

THE COURT'S OBSERVATIONS

Audit scope and approach

6.21. ***Annex 1.1, part 2***, of chapter 1 describes our overall audit approach and methodology. For the audit of 'Economic, social and territorial cohesion' the following specific points should be noted for Part 1, assessment on regularity:

(a) the audit involved an examination of a sample of 161 transactions for regional and urban policy area ([18]) and another sample of 170 transactions for employment and social affairs policy area ([19]) as defined in ***Annex 1.1***, paragraph 7. Each sample is designed to be representative of the entire range of transactions within each of the two policy areas. In 2014, both samples taken together consisted of transactions from 21 Member States ([20]);

(b) the audit involved an examination of financial instruments under shared management mainly in terms of their disbursement rates (i.e. the proportion of funds used at the level of final recipients). This was done through a review of the Commission's progress reporting for 2013 and of seven ERDF and ESF financial instruments;

(c) the assessment of systems examined:

  (i) the Commission's supervisory activities of national and regional audit authorities in 18 Member States ([21]);

  (ii) the annual activity reports (AARs) of the Directorate-General for Regional and Urban Policy and of the Directorate-General for Employment, Social Affairs and Inclusion.

([18]) Of these transactions, 101 concerned ERDF projects, 55 CF projects and 5 financial instruments and all relate to the 2007-2013 programming period (see ***Annex 6.1***). The sample was drawn from all payments, with the exception of advances which amounted to 2,563 billion euro in 2014. The financial instruments examined were sampled from those funds for which disbursements to final recipients (such as loans, guarantees or equity investments) were made during 2014.

([19]) Of these transactions, 168 concerned ESF projects and 2 financial instruments and all relate to the 2007-2013 programming period (see ***Annex 6.1***). The sample was drawn from all payments, with the exception of advances which amounted to 1,215 billion euro in 2014.

([20]) *For regional and urban policy area*: Belgium, Czech Republic, Germany, Greece, Spain, France, Italy, Latvia, Lithuania, Hungary, Malta, Poland, Portugal, Romania, Sweden and United Kingdom (see ***Annex 1.5***).
For employment and social affairs policy area: Bulgaria, Czech Republic, Germany, Greece, France, Italy, Hungary, Netherlands, Austria, Poland, Portugal, Romania, Slovakia, Finland and Sweden (see ***Annex 1.5***).

([21]) Belgium, Bulgaria, Czech Republic, Germany, Greece, Spain, France, Italy, Lithuania, Hungary, Malta, Netherlands, Austria, Poland, Romania, Slovakia, Sweden and United Kingdom.

THE COURT'S OBSERVATIONS

6.22. The audit also assessed, as a pilot exercise, whether and to what extent the completed examined ERDF, CF and ESF projects have achieved their output and result objectives as set out in the grant agreements. We also verified if these objectives were in line with the OP objectives. This was done for the 186 of the 331 examined projects which were completed at the time of the audit. The results of this exercise are presented in Part 2, which is dedicated to performance related issues.

PART 1: OUR ASSESSMENT ON REGULARITY

REGULARITY OF TRANSACTIONS

6.23. ***Annex 6.1*** contains a summary of the results of transaction testing for 'Economic, social and territorial cohesion' as a whole as well as for each of the two policy areas involved (regional and urban policy and employment and social affairs).

6.24. Of the 331 transactions that we examined, 135 (41 %) were affected by error. On the basis of the 53 errors which we have quantified, the estimated level of error for 'Economic, social and territorial cohesion' as a whole is 5,7 % [22]. The results for the two areas covered by this chapter were the following:

([22]) We calculate our estimate of error from a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the rate of error in the population lies between 3,1 % and 8,2 % (the lower and upper error limits respectively).

THE COMMISSION'S REPLIES

6.24. *The Commission notes that the level of error reported by the Court is an annual estimate which takes into account corrections of project expenditure or reimbursements affected by errors detected and recorded before the Court's audit. The Commission underlines that it is bound by the Financial Regulation, which stipulates, in Article 32(2) (e), that its internal control system should ensure, among other things, 'adequate management of the risks relating to the legality and regularity of the underlying transactions, taking into account the multiannual character of programmes as well as the nature of the payments concerned'. The Commission will continue to exercise its supervisory role, in particular by implementing financial corrections and recoveries at the level that corresponds to the level of irregularities and deficiencies identified.*

The Commission further notes that given the multiannual character of the management and control systems under Cohesion policy, errors made in 2014 may also be corrected in subsequent years, as illustrated in section 4.2.2 of the respective 2014 AARs of DG Regional and Urban policy and DG Employment, Social Affairs and Inclusion.

For the 2014-2020 period the Commission's corrective capacity is further strengthened by providing for net financial corrections by the Commission and therefore reducing the possibility for Member States to re-use funds, for serious deficiencies detected by the Commission. This will be an important incentive for Member States to detect, report and correct serious irregularities before certifying annual accounts to the Commission.

THE COURT'S OBSERVATIONS

— for the regional and urban policy area, of the 161 transactions that we examined, 75 (47 %) were affected by error. On the basis of the 25 errors which we have quantified, the estimated level of error is 6,1 % ([23]);

— for the employment and social affairs policy area, of the 170 transactions that we examined, 60 (35 %) were affected by error. On the basis of the 28 errors which we have quantified, the estimated level of error is 3,7 % ([24]).

THE COMMISSION'S REPLIES

The Commission notes that the most likely error rate calculated for 2014 is lower than in 2013 and in line with the error rates presented by the Court in the four last years, and with the error-rate range in DG Regional and Urban Policy's 2014 AAR, subject to the differences set out in paragraph 6.70.

This confirms that the error rate for the 2007-2013 programming period remains stable and significantly below the rates for the 2000-2006 period, as indicated in paragraph 6.18. This development derives from the reinforced control provisions of the 2007-2013 period and the Commission's strict policy to interrupt/suspend payments as soon as deficiencies are identified, as reported in the 2014 AAR of DG Regional and Urban Policy (see pp. 53-54). The Commission will continue to focus its actions on the most risky programmes/Member States, to implement corrective measures when needed through a strict policy of interruptions and suspensions of payments up to closure, and to apply strict procedures at closure to exclude any remaining material risk of irregular expenditure.

The Commission also notes that the error frequency decreased compared to 2013.

The Commission notes that the most likely error rate calculated for 2014 is in line with the error rates presented by the Court for the last four years and with the error-rate range in DG Employment, Social Affairs and Inclusion's 2014 AAR, subject to the differences set out in paragraph 6.70.

This confirms that the error rate for the 2007-2013 programming period remains stable and significantly below the rates for the 2000-2006 period, as indicated in paragraph 6.18. This improvement derives from the reinforced control provisions of the 2007-2013 period and the Commission's strict policy to interrupt/suspend payments and implement any necessary financial corrections as soon as deficiencies are identified, as reported in the 2014 AAR of DG Employment, Social Affairs and Inclusion (see pages 59-62). The Commission will continue to focus its actions on the riskiest programmes/Member States and implement corrective measures when needed through a strict policy of interruptions and suspensions of payments and financial corrections up to closure, and to apply strict procedures at closure to exclude any remaining material risk of irregular expenditure.

([23]) The lower and upper error limits for regional and urban policy area are 3,0 % and 9,2 % respectively.

([24]) The lower and upper error limits for the employment and social affairs policy area are 1,9 % and 5,6 % respectively.

THE COURT'S OBSERVATIONS

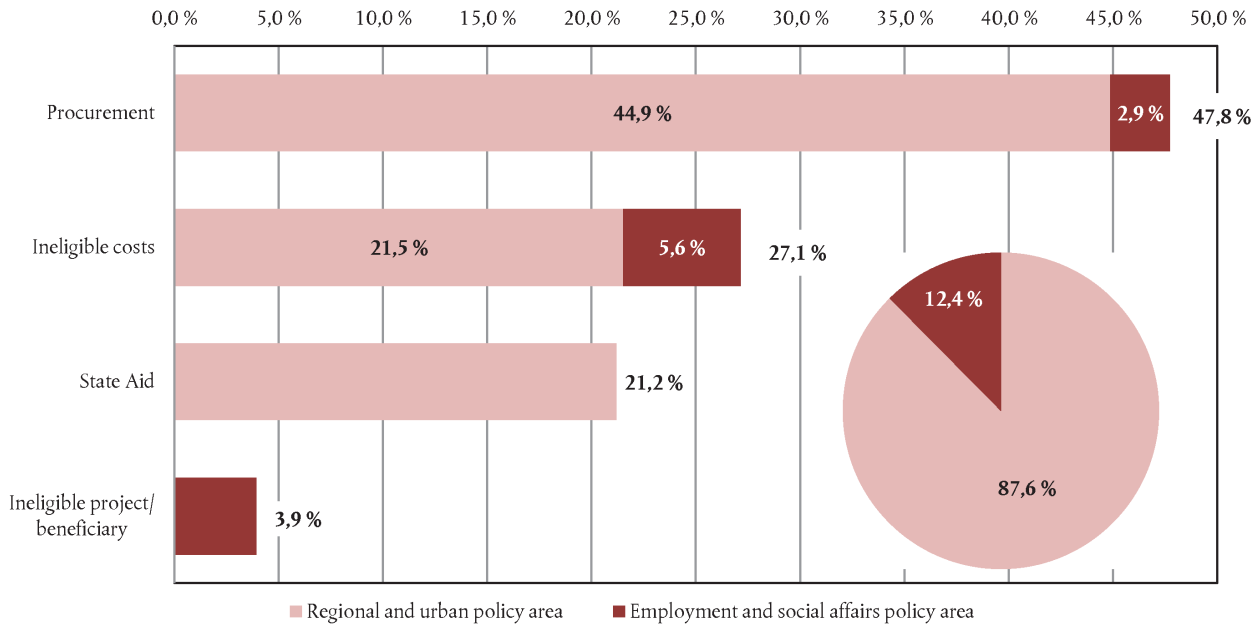
6.25. Chapter 1 contains an assessment of the accuracy and reliability of the figures for financial corrections presented in Note 6 to the EU consolidated accounts (see paragraphs 1.43 to 1.44). Chapter 1 of the 2012 annual report explained also how financial corrections are taken into account when calculating the estimated level of error ([25]).

6.26. ***Graph 6.2*** presents the extent to which the different types of errors contributed to our estimated level of error for 2014 for regional and urban policy, for employment and social affairs and for 'Economic, social and territorial cohesion' as a whole.

THE COMMISSION'S REPLIES

6.25. *The Commission refers to its replies under paragraphs 1.43 to 1.44.*

Graph 6.2 — Contribution by type of error to the estimated level of error for 'Economic, social and territorial cohesion' as a whole



Source: European Court of Auditors.

([25]) See the 2012 annual report, paragraphs 1.19 to 1.37.

THE COURT'S OBSERVATIONS

6.27. The main sources of error for 'Economic, social and territorial cohesion' as a whole continues to be infringements of public procurement rules, followed by the inclusion of ineligible expenditure in the beneficiaries' cost declarations, infringements of state aid rules and, finally, the selection of wholly ineligible projects.

6.28. For employment and social affairs policy area the proportion of transactions with public procurement procedures is much lower than for regional and urban policy area. The main source of error for this policy area is ineligible costs.

6.29. Over the last three years, we did not detect any quantifiable error related to the use of simplified cost options (SCOs) ([26]). In 2014, we sampled 42 transactions, relating to 16 of the 24 payments to ESF OPs, which included SCOs in their cost declarations. We detected only two non-quantifiable errors related to the specific use of SCOs. This demonstrates that projects using SCOs are less prone to error than the ones using actual costs. This aspect is especially relevant for the 2014-2020 programming period ([27]).

([26]) See the 2013 annual report, paragraph 6.16.

([27]) Regulation (EU) No 1304/2013 of the European Parliament and of the Council of 17 December 2013 on the European Social Fund (OJ L 347, 20.12.2013, p. 470) includes the obligation of using SCOs for small projects under 50 000 euro and Member States can still decide to make a larger use of SCOs for the 2014-2020 programmes that are in the early phase of implementation.

THE COURT'S OBSERVATIONS

Breaches of public procurement rules

6.30. Public procurement rules are a key instrument for spending public money economically and effectively and for establishing an internal market within the EU. As in previous years, public procurement procedures were particularly prone to error [28]. This is the main source of errors for regional and urban policy area and for 'Economic, social and territorial cohesion' as a whole.

THE COMMISSION'S REPLIES

6.30. *Common Commission reply to paragraphs 6.30 to 6.32.*

Public procurement rules are applicable for all public spending in the Member States and are not specific to Cohesion policy. Non-compliance with EU or national public procurement rules are a major source of errors in this policy area, in particular for regional and urban policy, mainly due to the types of projects co-financed. The Commission has therefore taken various preventive and corrective actions since the last programming periods in order to address weaknesses identified in that area.

The Commission Action Plan on public procurement set up in 2013 between DG Regional and Urban Policy, DG Employment, Social Affairs and Inclusion and DG Internal Market, Industry, entrepreneurship and SMEs aims at further improving the implementation of public procurement rules in the Member States through additional preventive measures. New actions are underway and include notably: guidance and training; identification and sharing of good practices between Member States; the establishment of a comprehensive manual for practitioners; the setting-up of a new peer-to-peer exchange platform; as well as country-specific action plans.

The legal framework for European Structural and Investment Funds 2014-2020 has also introduced ex ante *conditionalities for the effective and efficient use of Union funds, which cover inter alia Member States' public procurement systems. In that context, 12 country actions plans have been adopted and will have to be assessed by 2016. Suspensions of the interim payments may be decided in case of failure to fulfil an applicable* ex ante *conditionality by the end of 2016 (Article 19 of Regulation (EU) No 1303/2013).*

The 2014 Directives on public procurement introduce simplifications and are to be transposed into national laws by April 2016, and will thereafter start producing their effect on the ground.

The Commission notes that in its special report on public procurement errors in the area of Cohesion the Court calls on the Member States to improve their administrative capacity in this area. The Commission expects that Member States will now seize all offered opportunities to improve the capacity of their programmes and contracting authorities to comply with public procurement rules.

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(28) See the 2010 annual report, paragraphs 4.26 to 4.27, the 2011 annual report, paragraphs 5.31 to 5.33, the 2012 annual report, paragraphs 5.30 to 5.34, and the 2013 annual report, paragraphs 5.23 to 5.26.

THE COURT'S OBSERVATIONS

6.31. Chapter 1 contains a section explaining the update to our approach to the quantification of serious infringements of public procurement rules. This resulted in a clarification of the way in which we assess the impact of these infringements (see paragraph 1.13). We have also published a special report on the actions taken by Member States and the Commission to address the problem of public procurement errors in the area of cohesion ([29]).

6.32. In 2014, we examined 175 public procurement procedures related to contracts for works and services underlying the expenditure for the transactions tested for 'Economic, social and territorial cohesion'. The estimated contract value for these public procurements amounted to approximately 3,3 billion euro ([30]). The vast majority of these contracts are for projects co-financed by ERDF and CF Ops ([31]).

6.33. We identified instances of non-compliance with EU and/or national public procurement rules for 39 of the 175 procedures examined. 13 of these were serious failures to comply with these rules and thus classified as quantifiable errors (see Box 6.1). These errors account for 25 % of all quantifiable errors and make up approximately 2,7 percentage points of the estimated level of error.

Box 6.1 — Examples of serious failures to comply with public procurement rules

(a) *Unjustified direct award:* In a CF project in Malta related to the reconstruction and upgrade of a motorway section of a TEN-T road network (of the length of 7 km), the contracting authority negotiated directly a contract above EU-thresholds with one company without a prior call for competition. Thus, the declared expenditure for this contract is ineligible.

Similar cases were found in other ERDF projects in Sweden and the United Kingdom and ESF projects in Germany and Italy.

THE COMMISSION'S REPLIES

6.31. *The Commission will follow up all errors reported by the Court in accordance with Commission Decision C(2013) 9527 final on 'the setting out and approval of the guidelines for determining financial corrections to be made by the Commission to expenditure financed by the Union under shared management, for non-compliance with the rules on public procurement'.*

6.33. *The Commission will follow up the cases identified by the Court and propose actions as it deems necessary.*

([29]) See special report No 10/2015 'Efforts to address problems with public procurement in EU Cohesion expenditure should be intensified'.

([30]) This amount represents the total expenditure for the contracts awarded, part of which has been certified under the examined expenditure declarations.

([31]) For around 53 % of the 175 public procurement procedures that we examined the contract value was above the threshold which made them subject to EU public procurement rules as transposed into national law (71 of the public procurement procedures examined whose contract value was above the threshold concerned the ERDF/CF and 23 the ESF).

THE COURT'S OBSERVATIONS

(b) *Unjustified direct award of additional works/services (absence of unforeseen circumstances):* For an ERDF project in Germany related to the renovation and rehabilitation of a university building, expenditure related to a contract amendment was declared for co-financing. In particular, the architect increased the fees arguing the high complexity of the construction, the risk of delays and cost overruns. However, the reasons put forward to explain the increase in compensation are not based on unforeseeable circumstances. Therefore, the increase of fees of this contract amendment is considered to be ineligible.

Similar cases were found in other ERDF projects in Belgium and Italy.

(c) *Unlawful exclusion of bidders:* In a CF project in Hungary related to the reconstruction of a railway line, the contracting authority was not consistent in assessing the compliance with the selection criteria. As a result, all bidders but one were excluded. If the reasons for exclusion had been applied in a coherent way, the outcome of the tender would have been different. This represents a breach of the principles of transparency and equal and non-discriminatory treatment and, thus, the declared expenditure for this contract is ineligible.

Similar cases of unlawful award criteria were found in another CF project in Hungary and an ERDF project in Sweden.

(d) *Conflict of interest and discriminatory selection criteria:* In the case of an ESF project in Finland concerning actions to promote the business growth, multiple irregularities were found in the public procurement procedure. Conflict of interest was identified as the CEO of the sole bidding company was employed by the contracting authority at the time when the tender procedure was carried out. Also, the tender specifications included discriminatory selection criteria disallowing the equal access of tenderers in the procedure. As a result, all expenditure related to the public procurement is irregular and ineligible for co-financing.

6.34. Other errors relating to tendering and contracting procedures occurred in a further 26 of the 175 public procurements examined. These errors include cases of non-compliance with information and publication requirements, incorrect application of the selection criteria and shortcomings in the tender specifications. These errors do not contribute to the error rate we estimated [32].

THE COMMISSION'S REPLIES

6.34. *The Commission will follow up the cases identified by the Court and propose actions as it deems necessary.*

[32] Further information regarding our approach to the quantification of public procurement errors is set out in ***Annex 1.1***, paragraphs 13 and 14.

THE COURT'S OBSERVATIONS

6.35. For eight transactions in six Member States [33], the national authorities had identified serious cases of non-compliance with public procurement rules and imposed specific financial corrections at project level [34]. These corrective measures have been taken into account in the calculation of our estimated level of error, since the corrective measures were taken before the notification of our audit.

THE COMMISSION'S REPLIES

6.35. *The Commission notes that adequate corrective action is indeed taken by some programme authorities in the quoted Member States, though not in all cases identified by the Court. The objective of the Commission's action plan referred to in the reply to paragraphs 6.30 to 6.32 is to increase the occurrence of such proactive corrective actions at Member State level.*

Ineligible expenditure

6.36. When declaring costs to the Commission, national authorities are certifying that these costs have been incurred in compliance with a number of specific provisions laid down in EU regulations, national legislation or eligibility rules, specific OP rules, calls for interest, decisions approving projects for co-financing or grant agreements (see paragraph 6.13).

6.37. Ineligible expenditure is the main source of error for employment and social affairs policy area and the second most important for regional and urban policy area. We found that ineligible costs had been declared in 10 % of the transactions examined (see Box 6.2). These cases account for 60 % of all quantifiable errors and make up approximately 1,5 percentage points of the estimated level of error.

6.37. *The Commission will follow up the cases identified by the Court and propose actions as it deems necessary.*

The Commission notes that in some cases national or regional rules applied to Cohesion Policy expenditure are more demanding than those foreseen in the national legislation for similar nationally funded expenditure. These additional requirements can be seen as an instance of unnecessary administrative burden and complexity to Cohesion Policy expenditure imposed by the Member States on themselves as described in the reports on gold plating and simplification issued by DG Employment, Social Affairs and Inclusion in 2013.

Box 6.2 — Examples of ineligible costs declared

(a) *Expenditure declared outside the eligibility period:* In an ERDF project in Czech Republic related to the extension and reconstruction of a tramway track some of the invoices declared for co-financing were incurred and paid before the project's eligibility start date. This expenditure is ineligible for EU co-financing.

A similar case was found in another ERDF project in Germany.

(33) Czech Republic, Hungary, Poland, Portugal, Romania and Slovakia.
(34) In accordance with Commission Decision C(2013) 9527 final of 19.12.2013.

THE COURT'S OBSERVATIONS

(b) *Overcharged salaries:* In an ESF project in Portugal related to a three-year training programme for young people that earn a degree on secondary education and a professional qualification, the beneficiary used for the calculation of teachers' eligible salaries a different method than the one foreseen in the grant agreement. In addition, the teachers did not work as many hours as declared. This resulted in higher personnel costs declared for co-financing. The difference between the expenditure declared and the expenditure resulting from the approved formula is ineligible for EU co-financing.

Similar cases were found in another ERDF project in Poland and ESF projects in Germany and Finland.

(c) *Costs not related to the project*: In an ESF project in the Netherlands the beneficiary undertook training and employability courses in the aviation sector and engaged a consultant to assist with the ESF administration of the projects. Contrary to the eligibility rules, part of the project costs for the consultancy services for another project was charged to the examined project.

Similar cases were found in other ESF projects in Poland and Portugal.

(d) *Non-compliance with national eligibility rules:* A training centre in Poland organised training courses and provided advisory services to improve competitiveness and adaptation skills of 50 micro, small and medium enterprises as regards environmentally friendly solutions. Four coaches were hired to provide these services, none of whom had relevant education nor professional experience in the subject matter. Thus the costs in relation to all four coaches are ineligible. The beneficiary conducted 84 projects funded by EU funds between 2008 and 2015 for a total amount of 17 million euro.

(e) *Revenue not deducted:* An ESF project in Austria concerned the integration in the labour market of unemployed persons with difficulties to find employment through temporary posts in non-profit organizations. The income generated from the project, such as revenue from sales in shops, was not deducted from the ESF funded items. This is a breach of national eligibility rules and the revenue should have been deducted from the declared costs.

THE COURT'S OBSERVATIONS / THE COMMISSION'S REPLIES

Infringements of state aid rules

6.38. State aid is deemed incompatible in principle with the internal market since it may distort trade between Member States ([35]). The Commission directly enforces the EU state aid rules. Member States must notify all cases of state aid to the Commission (either through a scheme or case-by-case for a project), unless the project is below a 'de minimis' ceiling or is covered by the General Block Exemption Regulation (GBER) ([36]). For all cases notified, the Directorate-General for Competition forms a view on whether the aid is compatible with the internal market or not. This comprises an assessment of whether the same project would also have been undertaken without such aid.

6.38. *Common Commission reply to paragraphs 6.38 to 6.40.*

In case of a State aid notification, the Commission assesses whether the support constitutes State aid and, if so, whether it is compatible with the internal market. A decision on State aid entails a Commission decision.

Not all decisions on State aid require an assessment on whether 'the same project would have been undertaken without such aid'. Also, the requirements for the so-called 'incentive effect' differ depending on the applicable State aid rules.

The 2014 GBER introduced the following changes regarding the provisions on the incentive effect:

— *with respect to aid to small and medium enterprises, in addition to the fact that an application for aid must always be submitted before the start of works or activity (as was already the case under the 2008 GBER), such application has to comply with minimum requirements about the type of information to be submitted,*

— *with respect to aid to large companies, the requirement for a counter-factual scenario to demonstrate the economic incentive effect is no longer necessary if the measure is scheme based. It remains however mandatory for ad-hoc aid.*

6.39. We identified this year 14 ERDF/CF projects in 8 Member States that infringed the EU state aid rules ([37]). Where necessary, we requested and obtained a preliminary assessment by the Directorate-General for Competition. This assessment and the case law of the European Court of Justice were taken into account when classifying errors.

6.39. *The Commission will follow up the cases identified by the Court and propose actions as it deems necessary.*

6.40. For three of these projects, we consider that the project should have obtained no or less public funding from the EU and/or the Member State according to the state aid rules. The main reasons for non-compliance with state aid rules refer to the absence of economic incentive effect and the lack of notification to the European Commission of projects affected by state aid rules. These quantified errors make up approximately 1,5 percentage points of the estimated level of error for regional and urban policy area (see Box 6.3). In two other cases, we applied retrospectively the 2014 GBER and, therefore, did not quantify these errors ([38]). The 9 other cases of non-compliance with state aid rules do not impact upon our estimated level of error.

([35]) Article 107(1) of the TFEU.
([36]) Commission Regulation (EC) No 800/2008 (OJ L 214, 9.8.2008, p. 3).
([37]) Belgium, Czech Republic, Germany, Spain, Malta, Poland, Romania, the United Kingdom.
([38]) See also footnote 17.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Box 6.3 — Example of a project infringing state aid rules

The aid is not compatible with the internal market: An ERDF project in Romania related to the purchase of a truck to carry gravel and sand from quarries. In accordance with state aid rules, the call for proposals was open only to small-medium enterprises (SMEs) and cooperative enterprises. We found, however, that the beneficiary was not an SME, but rather part of a large group. As a result, the beneficiary is not eligible for co-financing and, thus, the aid granted is not compatible with the internal market.

Ineligible projects

6.41. We identified five ESF projects for which the eligibility conditions set out in the regulations and/or the national eligibility rules were not met and the errors were quantified. These projects account for 9 % of all quantifiable errors making up approximately 1,2 percentage points of the estimated level of error for employment and social affairs (see Box 6.4).

6.41. *The Commission will follow up the cases identified by the Court and propose actions as it deems necessary.*

Box 6.4 — Example of an ineligible project

Co-financed project not in line with the objectives specified in the OP: An ESF project in Greece aiming to boost local employment through public benefit programs was initially approved under the OP Human Resources Development. In 2013, the Commission amended the OP Administrative Reform for inclusion of further projects underlining that the national authorities should ensure that these projects were eligible under this OP. After the project's implementation, the national authorities moved the project from the OP Human Resources Development to the amended OP Administrative Reform under the target related to e-Government, although the examined project did not fulfil any objectives laid down in that OP. As a result, the statement of expenditure included costs for operations which are ineligible.

Box 6.4 — Example of an ineligible project

The Commission understands the issue raised and notes that the public works scheme, which was agreed in the Memorandum of understanding signed between, at the time, Troika and the Greek Government, was conceived as a temporary emergency measure to enable the long-term unemployed and the young not in employment, education training, to obtain basic work experience in activities benefitting the local community. The support of the ESF has been key for the delivery of such a programme, strongly advocated under the exceptional circumstances faced by Greece at the time and still now. Therefore, the Commission decided in December 2013 to amend the relevant ESF programme as the main available source of funding in order to accommodate the public works scheme, which was implemented by the Greek authorities with the involvement of local public authorities and NGOs.

THE COURT'S OBSERVATIONS

Beneficiaries not reimbursed in time and unjustified payment of advances to a Member State

6.42. Beneficiaries declare paid expenditure to the national authorities which reimburse these as soon as possible and submit periodic aggregated expenditure declarations to the Commission for reimbursement. However, we have found that in some cases Member States have built up treasury reserves not in line with the rules. The regulation ([39]) stipulates that payments by national authorities to beneficiaries shall be made 'as quickly as possible and in full'. In three Member States we identified 12 cases where the beneficiaries were only paid several months after the related statement of expenditure was settled by the Commission or were not reimbursed at the time of the audit, seven to nine months after the Commission's settlement (see Box 6.5(a)).

6.43. In addition, the regulation also sets out that advance payments are payable if the underlying projects constitute state aid which is an exception to the rule of only claiming incurred and paid expenditure ([40]). Nevertheless, we found that a Member State (Greece) declared advances for projects wrongly classified as state aid. This remained undetected and the Commission accepted and paid the amount claimed without verifying whether the conditions for making such payments were fulfilled (see Box 6.5(b)).

Box 6.5 — Example of Member States not reimbursing beneficiaries in time and unjustified payment of advances to Member States

(a) *Beneficiary reimbursed five months after the Commission payment*: For an ESF project in Italy aiming at drawing up a report to map training needs in various Italian regions the beneficiary submitted the cost claim to the managing authority in March 2014. The costs included in the claim were certified by the national authorities and submitted to the Commission. Although the Commission settled the costs declared already in June 2014, the beneficiary received the interim payment only five months later, in November 2014.

Similar cases were found in further four ESF projects in Italy, one project in France, and six projects in The Netherlands.

THE COMMISSION'S REPLIES

6.42. *The Commission underlines that, under the programming period 2014-2020, the Common Provision Regulation (CPR) has reinforced the rules both for the use of pre-financing (Article 82(1) CPR) and for payment to beneficiaries (Article 132(1) CPR).*

6.43. *The Commission notes that verifying whether the conditions to claim advance payments in the context of State aid are met is the responsibility of the competent national authorities. It will continue to work with the Greek authorities to strengthen controls in that area. The Commission will follow up closely in order to ensure that all advances unduly claimed by the Member State are recovered as foreseen by the Regulation.*

Box 6.5 — Example of Member States not reimbursing beneficiaries in time and unjustified payment of advances to Member States

([39]) Article 80 of Regulation (EC) No 1083/2006.
([40]) Article 78(2) of Regulation (EC) No 1083/2006.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
(b) *Unjustified payment of advances to a Member State*: In an ESF project in Greece for non-economic research carried out by a university, the Member State claimed an advance payment even though the related project did not constitute State aid. The Commission accepted and paid the unjustified amount claimed. Similar cases were found in other ESF projects in Greece.	**(b)** *See the reply of the Commission in paragraph 6.43.*

Insufficient reliability of checks at Member State level

6.44. In 21 cases of quantifiable errors made by beneficiaries, national authorities had sufficient information [41] to prevent or detect and correct the errors before declaring the expenditure to the Commission. If all this information had been used to correct errors, the estimated level of error for this chapter would have been 1,6 percentage points lower. In addition, we found that for 13 cases, the error that we detected was made by national authorities. These errors contributed 1,7 percentage points to the estimated level of error.

6.44. *Common Commission reply to paragraphs 6.44 and 6.45.*

The Commission is strictly following up these cases and agrees that sound and timely management verifications must be in place in order to prevent irregularities occurring in the first place or being included in payment claims.

Since 2010, the Commission has been carrying out targeted audits on management verifications of high-risk programmes where it has identified that deficiencies could remain undetected or not detected in a timely manner by the programme audit authority. For DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion, results of these audits conducted up to 2014 are presented in their respective 2014 AARs (see pages 50 and 56, respectively).

The Commission refers to the reinforced procedures in the regulatory framework for the 2014-2020 programming period, where management verifications and controls (including on-the-spot checks) will have to be carried out on time for the certification to the Commission of programme accounts and submission of management declarations by the managing authorities on an annual basis. Audit authorities will have to estimate reliable residual levels of error in the accounts as a result of all verifications, controls and corrections made since the end of the accounting year. The Commission considers that these reinforced control procedures should result in lasting reductions of the error rate.

Furthermore, the Commission has developed new guidance in order to further strengthen the reliability of management verifications in the 2014-2020 programming period. This guidance, which draws on the lessons learned from the previous programming period, has been presented to Member States and will be published in July 2015.

6.45. Checks at Member State level were not fully reliable in both policy areas. The estimated level of error could have been reduced by 3,3 percentage points for the regional and urban policy area and 3,2 percentage points for the employment and social affairs policy area.

(41) On the basis of supporting documentation, including standard cross checks database information and required mandatory checks.

THE COURT'S OBSERVATIONS

EXAMINATION OF FINANCIAL INSTRUMENTS UNDER SHARED MANAGEMENT

6.46. Financial instruments under shared management provide assistance to enterprises or urban projects by way of equity investments, loans or guarantees [42]. They can be used in mainly three areas: for the support of small-medium enterprises (SMEs) [43], for urban development [44] and for the promotion of energy efficiency.

6.47. By the end of 2013, 941 financial instruments had been set up under 176 ERDF and ESF OPs in all but three Member States (Croatia, Ireland and Luxembourg). Taken together, they have an endowment of around 14 278 million euro [45].

6.48. In general, funds implementing financial instruments receive a contribution from the OP when their legal structure is set up, and subsequently use this money to support projects. Such financial support can be provided only to projects which fall within the scope of the OP. These financial instruments are designed to have a revolving character or, for certain types of guarantee funds, to achieve a high leverage effect. Any resources returned from investments or loans made, including profits, are to be used again for the purpose of the activities implemented by the financial instrument.

(42) Article 44 of Regulation (EC) No 1083/2006.

(43) This includes the Joint European Resources for Micro to Medium Enterprises (JEREMIE) programme implemented together with the European Investment Bank (EIB) and the European Investment Fund (EIF) to support additional SME financing.

(44) This includes the programme Joint European Support for Sustainable Investment in City Areas (JESSICA) which is implemented together with the EIB to make repayable investments (in the form of equity, loans or guarantees) in urban development.

(45) European Commission, 'Summary of data on the progress made in financing and implementing financial instruments reported by the managing authorities in accordance with Article 67(2)(j) of Regulation (EC) No 1083/2006, situation as at 31 December 2013', EGESIF_14-0033-00, 19 September 2014. The figures of 2014 will be published in September 2015.

THE COURT'S OBSERVATIONS

Slow implementation of financial instruments

6.49. According to the Commission, the average disbursement rate for 941 ERDF and ESF financial instruments under shared management was 47 % at the end of 2013. This represents a 10 percentage points increase in comparison to 2012 and a 13 percentage points increase in comparison to 2011 [46].

6.50. According to the structural funds regulations, only the payments or guarantees provided to final recipients and the management costs and fees of the fund managers are considered eligible at closure when unused endowments of financial instruments are to be returned to the EU budget [47].The overall disbursement rate as reported by the Commission is still too low to expect that all funds available will be used at least once. Particular problems were noted for financial instruments in five Member States (Bulgaria, Greece, Spain, Romania, and Slovakia) where the disbursement rates are significantly below the EU average for 2013.

THE COMMISSION'S REPLIES

6.49. *Common Commission reply to paragraphs 6.49 and 6.50.*

The disbursement rate at the end of 2013 varies between Member States and financial instruments (FIs), established between 2008 and 2013.While some FIs are underperforming, 459 representing 15 % of total amounts paid into FIs have already achieved 100 % absorption and are now re-investing revolving funds.

The Commission will report on 1 October 2015 on the situation at the end of 2014 and expects further progress in implementation.

The Commission, together with the Member States, has undertaken a number of measures to ensure that the remaining investments made by FIs will reach final recipients in a timely manner, mainly by:

— *improving the close monitoring by concerned managing authorities of the performance of the FIs and encouraging active fund management by reallocation of amounts from low-performing funds to well-performing funds,*

— *encouraging managing authorities, together with the financial institutions implementing FIs, to make changes to the instruments and financial products offered in order to adapt them to changing market conditions,*

— *for FIs supporting long-term investments in urban development or energy efficiency where payments are made gradually with the progress of the projects, advising managing authorities to request a reporting of the investment pipeline and feedback to the Commission so as to allow a closer follow up of the progress of these instruments.*

The Commission notes that a detailed analysis by Member States requires an assessment of the various constraints affecting the implementation of each FI and should in particular also take into account that the ERDF FIs in Bulgaria, Greece, Spain, Romania and Slovakia are severely hit by the economic and financial crisis.

(46) See the 2013 annual report, paragraphs 5.33 to 5.36 and Box 5.5.

(47) Article 78(6) of Regulation (EC) No 1083/2006.

THE COURT'S OBSERVATIONS

Incomplete and/or inaccurate reporting on financial instruments by Member States

6.51. Information on implementation of financial instruments under shared management is based on data received directly from the Member States. Since 2011, substantial efforts were made by the Commission to improve the quality of these data. Nevertheless, the Commission acknowledges in its report on the implementation progress of financial instruments that the data presented in this report are in some cases incomplete or inaccurate. This was also the case for five of the seven financial instruments examined by us in 2014.

Extension of the 2007-2013 eligibility period through a Commission decision only

6.52. Article 56(1) of Regulation (EC) No 1083/2006 establishes 31 December 2015 as the deadline for the eligibility period of payments. In April 2015 the Commission decided to extend the eligibility period until 31 March 2017 through a Commission decision [48] instead of asking the Council and Parliament to amend the Regulation. We consider that this way of extending the eligibility period does not respect the hierarchy of norms, by which a legal provision can only be modified by legislation of equal or superior legal value.

THE COMMISSION'S REPLIES

6.51. *In May 2015, the Commission presented to the Member States an updated guidance note on reporting on financial instruments clarifying the reporting requirements. Furthermore, the Commission has improved its reporting tools.*

6.52. *The Commission is convinced that it has acted, as requested under the impetus of the European Council of December 2014, within the margin offered by the existing regulatory framework.*

The modification decision on the closure guidelines of the Commission does not affect Article 56(1), according to which the contribution from the funds into FEIs must have been paid at latest at 31 December 2015. This remains the rule.

The modification clarifies that Article 78(6) of Regulation (EC) No 1083/2006 provides specific modalities for the declaration of expenditure of financial engineering instruments at closure. Paragraph 6 indicates that, by way of derogation from paragraph 1, as regards financial instruments as defined in Article 44, the statement of expenditure shall include the total amount of expenditure paid in establishing or contributing to such funds or holding funds.

The Article also specifies what the eligible expenditure will be at closure: 'At partial or final closure of the OP eligible expenditure shall be the total of the support provided by the funds to the final recipients together with eligible management costs and fees'.

As 31 March 2017 is the final date for submission to the Commission of the closure documents, the modification of the closure guidelines clarifies that closure as referred to in Article 78(6) of the General Regulation is the date of submission of the closure documents, i.e. 31 March 2017.

(48) Commission Decision C(2015) 2771 amending Decision C (2013) 1573 on the approval of the guidelines on the closure of operational programmes adopted for assistance from the European Regional Development Fund, the European Social Fund and the Cohesion Fund (2007-2013).

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

EXAMINATION OF SELECTED SYSTEMS AND ANNUAL ACTIVITY REPORTS

Assessment of the Commission's supervision of audit authorities

Commission uses the work of audit authorities in Member States to estimate the level of error

6.53. Audit authorities provide assurance to the Commission as to the effective functioning of the management systems and internal controls for an OP and the legality and regularity of the expenditure certified. This information is provided by audit authorities in their annual control reports, audit opinions and system audit reports (see paragraph 6.14) ([49]). Since 2009, the Commission has carried out enquiries of the main audit authorities, including on-the-spot reviews of their work, to assess the level of reliance they can place on them.

6.53. *The Commission is closely cooperating and coordinating with audit authorities, and started reviewing their methodologies and audit results as early as 2009. This contributed to capacity building by providing advice, guidance and recommendations to audit authorities through the Commission's re-performance of audit work carried out by audit authorities.*

The Commission underlines that its assessment of the reliability of the work of audit authorities is to be seen in that context. As a result of its audit programme that entailed 265 audit missions carried out on the spot cumulatively since 2009, DG Regional and Urban policy concluded by end 2014 that the work of 42 reviewed audit authorities in charge of auditing around 91 % of ERDF/CF allocations for the 2007-2013 period can in general be relied upon. For the remaining five reviewed audit authorities, improvements were required.

Concerning DG Employment, Social Affairs and Inclusion, at the end of 2014, 87 audit authorities out of 92 have been assessed (94,6 %). They cover 113 out of 118 OPs, representing 99,1 % of the financial programming of the 2007-2013 programming period.

In their 2014 AARs, DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion provided a detailed assessment of the accuracy and reliability of the audit information and results reported by audit authorities in their 2014 annual control reports in relation to 2013 expenditure (see pages 40 to 45 of DG Regional and Urban Policy's 2014 AAR and pages 51 to 54 of DG Employment, Social Affairs and Inclusion's 2014 AAR).

([49]) Overall, the EU-28 Member States have set up 113 audit authorities for the 440 ERDF/CF and ESF OPs approved for the 2007-2013 programming period. 63 of these authorities are in charge of both ERDF/CF and ESF OPs. For all 440 OPs taken together, 199 annual control reports and audit opinions had been prepared by audit authorities by the end of December 2014.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
6.54. The Directorates-General for Regional and Urban Policy and for Employment, Social Affairs and Inclusion make use of this information when preparing their annual activity reports (AARs) and throughout the year to decide on possible interruptions and/or suspensions of payments to OPs.	**6.54.** *In 2014, DG Regional and Urban policy indicated in its AAR that around two thirds of the interruptions and pre-suspensions of payments were based on audit results reported to the Commission by audit authorities during the year or at year end (see page 54 of DG Regional and Urban Policy's 2014 AAR).* *In the course of 2014, interruptions and pre-suspension procedures concerned 121 ERDF/CF programmes and almost EUR 7,9 billion of payment claims submitted by the Member States but not paid unless the Commission has obtained additional evidence that all necessary corrections had been made by the Member State concerned.* *For ESF, as reported on page 60 of DG Employment, Social Affairs and Inclusion's AAR in 2014, the Commission sent 11 warning letters and 18 pre-suspension letters; it decided 31 interruptions of payments and suspended 11 operational programmes. In total, EUR 1,3 billion of payment claims were interrupted.*
6.55. In order to assess whether they can rely on this information, the directorates-general check the error rates reported by the audit authorities for each OP (or group of OPs) [50]: — if the Commission considers the error rate to be reliable (and representative for the expenditure certified), it accepts the rate reported by the audit authority. Also the Commission may recalculate the rate for its own assessment based on additional information obtained from the audit authority; — in the case of unreliable error rates, the Commission applies a flat error rate (between 2 % and 25 %) in line with the results of its assessment of the functioning of management and internal control systems.	**6.55.** *The Commission underlines that this assessment of the reliability of error rates each year is based on a thorough desk analysis of all available information completed when necessary by risk-based on-the-spot fact-finding missions, also taking account of the overall assessment of the reliability of the work of audit authorities as a result of the comprehensive audit enquiry referred to in the reply to paragraph 6.53. When necessary the Commission requests and obtains from the audit authorities any additional information required.*

[50] The error rates reported by audit authorities for the year n are calculated on the basis of a sample of audits of operations which should be statistically representative of the expenditure certified to the Commission in the year n-1 (special report No 16/2013, paragraph 11).

THE COURT'S OBSERVATIONS

6.56. The Commission also calculates a 'residual error rate' for each OP, which takes into account all financial corrections since the start of the programming period. This includes corrections already implemented at EU and/or national level ([51]).

6.57. Based on these two indicators and additional information at its disposal, the Commission forms its assessment of the management and control system for the OP. That assessment also takes account of the system audits submitted by audit authorities throughout the year and additional information available to the Commission. This assessment is then reported in the annual activity report of the directorate-general ([52]).

THE COMMISSION'S REPLIES

6.57. *The Commission assesses the effective functioning of the management and control system for each programme and for each authority (managing, certifying and audit authorities), based on all available EU and national system audit results on 15 key regulatory requirements according to a methodology shared with audit authorities. Error rates reported by Member States and residual error rates calculated by the Commission are important elements of this assessment, but not the only ones. Operational line managers and authorising officers by sub-delegation also assess the level of assurance.*

For the purpose of the assurance disclosed in the AARs, the opinion for each operational programme is, therefore, the result of an overall assessment based on all information available to the Commission. This provides a comprehensive and detailed assessment of the effectiveness of management and control systems per Member State and, for operational programmes included in the 2014 reservations, information on the main issues identified and the actions taken.

([51]) Directorate-General for Regional and Urban Policy's annual activity report, p. 49. Directorate-General for Employment, Social Affairs and Inclusion's annual activity report, p. 63.

([52]) See special report No 16/2013, paragraphs 5 to 11.

THE COURT'S OBSERVATIONS

Commission's assessment of annual control reports can only partly address the risk of under-reporting of errors and over-reporting of financial corrections by national authorities

6.58. The robustness of the Commission's assessment of ERDF, CF and ESF OPs depends on the accuracy and reliability of information reported by Member State authorities. Our audits in previous years have identified two main risks in this regard:

— audit authorities may understate the errors and/or may not extrapolate them properly. As a consequence, the reported error rates may not always be fully reliable;

— information on financial corrections reported by Member States may not always be reliable or accurate and, as a result, the Commission's calculation method may result in an understated cumulative residual risk.

THE COMMISSION'S REPLIES

6.58. *Common Commission reply to paragraphs 6.58 to 6.60.*

As explained in their respective AARs, both directorates-general have taken measures to improve the reliability of audit information and financial corrections reported by Member States. To mitigate the risk, the Commission is implementing two audit enquiries:

— *the assessment of the reliability of audit information, reported by audit authorities, including the error rate, is made following an in-depth audit programme to verify whether audit findings are confirmed, including through on-the-spot re-performance by Commission auditors. The desk review is complemented by fact-finding missions and covers a wide range of verifications linked e. g. to the accuracy of the calculations, parameters used, treatment of errors detected or reconciliation of the audited population (see also the Commission's reply in paragraph 6.53),*

— *specific risk-based on-the-spot audits (so far covering 68 OPs over the last three years) in order to ensure that the corrections reported are effectively implemented and, in case of doubts or insufficient evidence, deduction of the amounts concerned from the cumulative financial corrections taken into account for the purposes of the calculation of the residual error rate. As a result of their audits and desk consistency checks on the reliability of the article 20 statements submitted by 31 March 2014 for all programmes, the Commission services decided to exclude some of the reported financial corrections for the calculation of the cumulative residual risk (77 % of the financial corrections reported were used for ERDF and CF calculations and 91 % in case of ESF).*

The legal framework for 2014-2020 programming period has also evolved. Audit authorities will give their audit opinion based on residual error rates after corrections have been implemented, and therefore the accuracy of financial corrections will be systematically checked as part of the audit on accounts.

THE COURT'S OBSERVATIONS

6.59. The Commission's verifications of the annual control reports consist mainly of desk reviews and can therefore only partly address these risks. In particular, we consider that the Commission's scope for validating (and, where necessary, adjusting) the reported error rates is limited since audit authorities are not systematically requested to provide the Commission with more specific information on their audits of operations (scope, coverage/sub-sampling, details on error classification) for its verification of the annual control reports.

6.60. During 2014, both directorate generals performed on-the-spot checks on financial corrections implemented by 12 Member States. For 7 of the 12 Member States visited, deficiencies requiring adjustments to the financial corrections reported were identified. These findings confirm our own assessment and highlight, in the context of the new 2014-2020 programming period, the importance of ensuring that reliable reporting systems are put in place [53].

Commission considers that expenditure declared for 57 % of all OPs was free of a material level of error

6.61. For 2014, the Commission considers that it had assurance that 250 of the 440 ERDF/CF and ESF OPs (57 %) were free from a material level of error: audit authorities had reported error rates below the Commission's materiality threshold of 2 %, and these rates had been validated by the Commission. These OPs represent around 55 % of the 2014 payments.

6.62. In 2014, as in previous years, we examined whether the Commission was effective in verifying the accuracy and reliability of the error rates reported by audit authorities. This was done for a sample of 139 OPs in 20 Member States (105 of the 322 ERDF/CF OPs and 34 of the 118 ESF OPs) on the basis of the Commission's working files. Our sample included OPs for which the Commission had accepted the rates reported by audit authorities, but also OPs for which rates had been recalculated or where flat rates had been imposed.

[53] See special report No 16/2013, paragraphs 35 to 40.

THE COURT'S OBSERVATIONS

6.63. ***Table 6.1*** contains a summary of the results of the systems we examined.

THE COMMISSION'S REPLIES

6.63. *The Commission notes the improvement in the assessment of Commission's verification of error rates reported by audit authorities, and in particular the fact that none of the issues found by the Court would have required additional reservations or different quantifications, given that these issues are mainly of a technical nature.*

Table 6.1 — Assessment of Commission's verification of error rates reported by audit authorities

	2014			2013		
	ERDF/CF OPs examined	ESF OPs examined	TOTAL	ERDF/CF OPs examined	ESF OPs examined	TOTAL
We found:						
— no or limited issues with the Commission's checks (*)	84 (80 %)	30 (88 %)	**114 (82 %)**	108 (77 %)	47 (87 %)	**155 (80 %)**
— significant issues with the Commission's checks, but without any impact on the number of reservations reported in the AARs (or their quantification)	21 (20 %)	4 (12 %)	**25 (18 %)**	17 (12 %)	6 (11 %)	**23 (12 %)**
— significant issues with the Commission's checks, requiring additional reservations or different quantifications	0 (0 %)	0 (0 %)	**0 (0 %)**	15 (11 %)	1 (2 %)	**16 (8 %)**
TOTAL number of OPs examined	**105 (100 %)**	**34 (100 %)**	**139 (100 %)**	**140 (100 %)**	**54 (100 %)**	**194 (100 %)**

(*) See also paragraph 6.65.

Source: European Court of Auditors.

Commission's validation (or recalculation) of the error rates is coherent with the evidence provided by audit authorities

6.64. In relation to 25 OPs, we identified weaknesses that had not been detected (or properly addressed by the Commission) (see Box 6.6). However, we consider that none of these cases should have led the Commission to make additional reservations (or reservations with a higher financial impact) in the 2014 annual activity reports.

Box 6.6 — Examples of weaknesses in the Commission's validation of error rates reported by audit authorities

(a) *Population checked by the audit authority not in line with the expenditure declared:* For 8 of the 139 OPs sampled it was not possible to reconcile the population checked by the audit authority with the expenditure declared. The Commission's desk reviews did not identify this issue for 3 OPs.

Box 6.6 — Examples of weaknesses in the Commission's validation of error rates reported by audit authorities

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
(b) *Incorrect sampling methodology applied by the audit authority:* For 11 of the 139 OPs, the audit authority applied an incorrect sampling methodology: either it differed from the one described in the audit strategy approved by the Commission or had parameters which were not in line with the applicable Commission guidance on sampling. In those cases, the sample size was lower than it would normally have been required. In all cases the Commission's desk checks identified the issue and concluded correctly that it did not affect the audit opinion.	**(b)** *The sampling methodology may evolve in accordance with the characteristics of the population to be audited. This evolution and the changes to the approved audit strategy are discussed in the annual coordination meeting between the Commission and the concerned audit authority.*
(c) *Incorrect extrapolation of errors found in sub-samples*: For 59 of 139 OPs examined, the audit authority conducted the audits on the basis of the sample of invoices (sub-sample). If this approach is applied, the financial impact of the errors found in the sub-sample has to be extrapolated on the audited projects or claims before they are included in the calculation of the error estimate for the entire population. For five OPs, the errors found in the sub-samples checked were not correctly extrapolated. This led to an understatement of the total projected error rate, but did not affect the audit opinion.	**(c)** *The Commission recommends audit authorities to systematically disclose in the annual control reports the cases when the total population was not effectively audited and the 'subsampling' system used.*

Deficiencies in audit authorities checks on state aid

6.65. In 2014, we also examined whether national audit authorities carried out appropriate checks of state aid rules. For 42 of the 139 OPs sampled the state aid checks done by the audit authorities were inadequate (for example providers of services of general economic interest were not covered or notified aid schemes and the aid intensity were not verified). An appropriate coverage of state aid is required by the Commission guidelines, but these deficiencies were not always identified by the 2014 desk reviews.

6.65. *During the annual control report (ACR) review, the Commission examines whether the audit authority's opinion is solidly grounded on the basis of the results of system and operations audits.*

The examination of the work of the audit authorities with regards to State aid is included, amongst other issues, in the Commission's review on audit authorities which include an examination of the methodology for system audits and audits of operations (including check-lists) as well as re-performing audits already done by audit authorities (see reply to paragraph 6.53).

In some cases the Commission had already recommended to the audit authorities concerned, through its own audit reporting, to reinforce their check-lists to better cover the verification of State aid issues. The Commission will continue to ensure that audit authorities use appropriate checklists.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Commission guidance requires audit authorities to include contributions to financial instruments to the audited population rather than checking the actual disbursements

6.66. Financial contributions from the OPs to funds implementing financial instruments for the whole period are generally made through a single payment as soon as the legal structure of the holding funds has been set up. Alternative financing arrangements can be specified in the funding agreements. In accordance with the regulation, these payments are certified to the Commission as expenditure incurred ([54]). Ex post verification of such payment by audit authorities generally relate to the financial year in which the payment has been made. These checks generally have a limited scope because within the first year few operations are selected for support and limited amounts are disbursed to final recipients and projects.

6.66. *Common Commission reply to paragraphs 6.66 and 6.67.*

In line with Article 78(6) of Regulation (EC) No 1083/2006, the funds' contribution into financial instruments is included in the payment claims to the Commission. These payments constitute part of the population to be audited by audit authorities through sample checks in line with the updated Commission guidance. As set out in the joint audit strategy for Structural Funds and as specified in the Commission's audit framework for ESI Funds, audit authorities and the Commission may carry out thematic audits on financial instruments which cover both the constitution of the fund and the actual implementation of projects through the audit of a sample of projects carried out by final recipients. Audit authorities verify the performance of first-level checks by management authorities and will have to obtain sufficient assurance on the funds by closure.

As regards the fund managed by the European Investment Bank, the Commission regrets the limitations to the access rights. A memorandum of understanding between the Commission and the European Investment Bank is under signature so that in the future, managing and audit authorities have the possibility to use the services of a contractor selected by the Commission for the verification and the audit work of the European Investment Bank.

6.67. Unless specific verifications are envisaged, the actual implementation of financial instrument operations is therefore unlikely to be checked by audit authorities until the closure of the 2007-2013 programming period. Where the financial instruments are managed by the European Investment Bank (EIB), the audit authority cannot check the contributions to the fund due to limitations imposed to the access rights by the EIB.

Very low error rates reported by the audit authorities for OPs for which we have found significant errors

6.68. For 110 of the 440 ERDF/CF and ESF OPs, the Commission has validated error rates equal or below 0,5 %. In 13 of these OPs, we performed at least one examination during the last two financial exercises. For five OPs we found significant errors in the projects examined (see paragraphs 6.61 and 6.62).

([54]) Article 78a of Regulation (EC) No 1083/2006.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

Review of the Commission's annual activity reports

6.69. We assessed the 2014 annual activity reports (AARs) and accompanying declarations of the Directorates-General for Regional and Urban Policy, and Employment Social Affairs and Inclusion ([55]). In particular:

— we checked the consistency and accuracy of the Commission's calculation of the amounts at risk;

— we assessed the reservations made for 2014.

Commission's calculation of the amounts at risk for ERDF/CF and ESF OPs

6.70. Overall, the Commission's calculation of the amounts at risk in the 2014 annual activity reports is consistent and accurate with the available information reported and/or provided by the audit authorities. We recall however that the annual error rates reported by the Commission in the annual activity reports are not directly comparable to those estimated by us ([56]).

6.70. *The Commission agrees that the Court's error rate and that of the Commission are not directly comparable. However, the objective of this process is essentially the same, i.e. assessment of the risk to the EU budget in a particular year.*

The Commission takes into account all the differences quoted by the Court in its special report 16/2013 in its assessment (see Commission reply to paragraph 11 of this report). Except for these differences, the Commission considers that for the 2014 annual report, as was the case for the last four years in a row for DG Employment, Social Affairs and Inclusion and three years in a row for DG Regional and Urban Policy before this annual report, the result of the Commission's assessment is in line with the error rates calculated by the Court (see pages 90 and 92 of the respective AARs).

— the Directorate-General for Regional and Urban Policy estimated that between 2,6 % and 5,3 % of the interim and final payments for ERDF/CF OPs of the 2007-2013 programming period authorised during the year were at risk of error. The Commission made 52 % of payments to OPs it assessed as affected by material levels of error above 2 %;

DG Regional and Urban Policy made 52 % of payments to OPs it assessed as affected by a material level of error above 2 %, but for the vast majority of these programmes sufficient corrections were made in order to bring the cumulative residual risk below materiality. Payments made to programmes with an error rate above 5 % concerned only 4 % of the payments (see the respective 2014 AAR, page 44). Reservations were made for all but three concerned programmes as disclosed in the AAR.

([55]) In March of every year, each directorate-general prepares an annual activity report for the previous year which is submitted to the European Parliament and the Council and is published. Together with this report, the director-general must provide a statement indicating whether the budget under his or her responsibility has been implemented in a legal and regular way. This will be the case if the level of irregularities is below the Commission's own 2 % materiality threshold. Otherwise, the director-general may issue full or partial reservations for certain areas (or programmes).

([56]) See special report No 16/2013, paragraph 11.

THE COURT'S OBSERVATIONS

— the Directorate-General for Employment, Social Affairs and Inclusion estimated that between 2,8 % and 4,0 % of the interim and final payments for ESF OPs of the 2007-2013 programming period authorised during the year were at risk of error. The Commission made 45 % of payments to OPs it assessed as affected by material levels of error above 2 %.

THE COMMISSION'S REPLIES

DG Employment, Social Affairs and Inclusion made 45 % of payments to OPs it assessed as affected by a material level of error, but for the vast majority of these programmes sufficient corrections were made in order to bring the cumulative residual risk below materiality. Payments made to programmes with an error rate above 5 % concerned 25 % of the payments (see the respective 2014 AAR, page 53). Reservations were made for all concerned programmes.

Commission's reservations for ERDF/CF and ESF OPs

6.71. In cohesion policy, the Commission issues reservations on OPs (or groups of OPs) when:

— significant weaknesses in the OPs management and control systems have been identified, or

— the OPs validated error rate exceeds 5 %.

For OPs with a validated error rate between 2 % and 5 %, the Commission also considers whether the OPs 'cumulative residual risk' exceeds 2 %.

6.72. The number of OPs subject to reservation increased from 73 to 77 for ERDF/CF OPs in 2014 and remained unchanged to 36 OPs for ESF. Meanwhile, the estimated financial impact of these reservations decreased from 423 million euro in 2013 to 224 million euro in 2014 for ERDF/CF ([57]) and increased from 123,2 million euro in 2013 to 169,4 million euro in 2014 for ESF. Our analysis found that the reservations made by the Commission in the 2014 annual activity reports were in line with the Commission's instructions and the information made available to the two directorates-general.

6.72. *This demonstrates the maturity of the methodology used for reservations in the respective AARs and the strict implementation of this methodology by DG Regional and Urban Policy and DG Employment, Social Affairs, and Inclusion.*

Both directorates-general follow a strict approach with regard to the interruption and suspension of payments. They also apply a preventive approach as regards payments, i.e. no payments are made to operational programmes for which an audit mission is planned until the audit mission is completed. Payments are resumed afterwards unless significant deficiencies were identified.

6.73. The Commission estimates the 'cumulative residual risk' to be 1,1 % of the payments during for all ERDF/CF OPs and 1,2 % for all ESF OPs. These figures are based on the reported error rates by audit authorities and take also into account the financial corrections reported by Member States to the Commission.

([57]) These figures include fully and partially quantified reservations for OPs for which interim and/or final payments were authorised during the year (55 in 2013 and 25 in 2014) and for OPs for which no such payments were made (19 in 2013 and 15 in 2014).

THE COURT'S OBSERVATIONS

6.74. The robustness of the calculated cumulative residual risk depends on the accuracy and reliability of the information reported by the Member States and on the capacity of the Commission to address these problems. We recall that the work of audit authorities presents some weaknesses [58] that the Commission cannot correct under the current scope of verifications. Moreover, the amount of financial corrections reported by the Member States to the Commission is not fully reliable (see paragraphs 6.58 to 6.60). Given the above, we consider that there remains a risk that the cumulative residual risk as calculated by the Commission is understated for some OPs.

THE COMMISSION'S REPLIES

6.74. *For 'Economic, social and territorial cohesion', the use of a 'cumulative residual risk' is only an additional criterion to possibly make additional reservations in the AAR, following the system assessment and consideration of the validated error rate (see the common Annex 4 'Materiality criteria' of the AARs of DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion).*

The Commission is aware of the risks related to error rates and to amounts of financial corrections reported by the Member States and has taken appropriate mitigating actions (see Commission reply to paragraphs 6.53 to 6.60 above).

The Commission thus considers that there is no significant risk that the cumulative residual risk it calculated is understated.

Commission's recalculation of our 2013 error rate estimate

6.75. The Directorate-General for Regional and Urban Policy also included in its 2014 annual activity report a recalculation of the estimated level of error published in our 2013 annual report [59]. As a matter of principle, we consider that it is not appropriate for the Commission (being our auditee) to present a view on our audit findings in its annual activity report misrepresenting our audit findings [60].

6.75. *The recalculation provided by DG Regional and Urban Policy in its 2014 AAR intended to illustrate the impact of the different methodological approaches used by the Commission and the Court when quantifying errors, in particular for public procurement errors and flat rate corrections already applied at the level of programmes. This was not an assessment of the validity of the Court's findings.*

(58) For example, state aid is not verified systematically by 10 audit authorities.

(59) Directorate's General for Regional and Urban Policy 2014 annual activity report, section 2.1.1.2.B, p. 45: 'However, in this context it is also important to highlight that the directorate-general's methodological approach to the best estimate of the annual error rate and the error rate calculated by the Court in its annual report are not directly comparable, as indicated by the Court itself. When the elements which are taken into account by the Commission but not by the Court are factored in, a Court's estimate of level of error of 4,8 % is obtained (instead of 6,9 %) for 2013 expenditure. This recalculated error rate falls within the range indicated by the Commission in its 2013 annual activity report (i.e. between 2,8 % and 5,3 % […])'.

(60) See the 2013 annual report, paragraph 0.7.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

CONCLUSION AND RECOMMENDATIONS

The conclusion for 2014

6.76. Overall audit evidence indicates that spending on 'Economic, social and territorial cohesion' and in both policy areas covered by this specific assessment (see paragraph 6.24) is affected by a material level of error.

6.76. *Common Commission reply to paragraphs 6.76 and 6.77.*

The Commission notes that the most likely error rate calculated for 2014 is in line with the range presented by the Court in the last four years (see paragraph 6.18 above). It is also consistent with the error rates reported in the respective AARs, subject to the differences set out in paragraph 6.70. The error rate for the 2007-2013 programming period remains stable and significantly below the rates for the 2000-2006 period. This development derives from the reinforced control provisions of the 2007-2013 period and the Commission's strict policy to interrupt/suspend payments as soon as deficiencies are identified, as reported in the 2014 AARs. However, the error rate remains too high and the Commission will continue to focus its audits and actions on the most risky programmes/Member States and implement corrective measures when needed through a strict policy of interruptions and suspensions of payments up to closure, and to apply strict procedures at closure to exclude any remaining material risk of irregular expenditure.

The Commission further notes that given the multiannual character of the management and control systems under Cohesion policy, errors made in 2014 may also be corrected in subsequent years as illustrated in section 4.2.2 of the respective 2014 AARs of DG Regional and Urban policy and DG Employment, Social Affairs and Inclusion.

For the 2014-2020 period, reinforced requirements on legality and regularity include the introduction of annual accounts, reinforced management verifications and accountability as well as audit opinions based on residual levels of errors each year. The Commission's corrective capacity is further strengthened by the possibility to apply net financial corrections for serious deficiencies under certain conditions, thereby reducing the possibility for Member States to re-use funds. This will be an important incentive for Member States to detect, report and correct serious deficiencies before certifying annual accounts to the Commission. All these elements should contribute to a lasting reduction in the error rate.

See also Commission reply to paragraph 6.24.

6.77. For this MFF heading area, testing of transactions indicates that the estimated level of error present in the population for the 'Economic, social and territorial cohesion' as a whole is 5,7 % (for regional and urban policy area 6,1 % and for employment and social affairs policy area 3,7 %) (see ***Annex 6.1***).

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

Recommendations

6.78. ***Annex 6.2*** shows the result of our review of progress in addressing recommendations made in previous annual reports. In the 2011 and 2012 annual reports, we presented 11 recommendations. Of these recommendations, the Commission fully implemented four recommendations, while six were implemented in most respects, and one was implemented in some respects.

6.79. Following this review and the findings and conclusions for 2014, we recommend that in the area of 'Economic, social and territorial cohesion':

— **Recommendation 1:** the Commission should carry out a focused analysis of the national eligibility rules for the 2007-2013 and 2014-2020 programming periods in view of identifying good practices. Based on such analysis, it should provide guidance to Member States on how to simplify and avoid unnecessarily complex and/or burdensome rules that do not add value with respect to the results to be achieved by the policy ('gold-plating');

The Commission accepts this recommendation. However, the Commission recalls that under shared management, the establishment of national eligibility rules is the responsibility of the Member States who should in the first instance review and simplify their national eligibility rules and disseminate good practices, based on cumulative national and EU audit results from the 2007-2013 programming period and experience collected by managing authorities and intermediate bodies. The Commission also notes that it is providing observations on selection criteria to be decided by monitoring committees and has issued extensive and timely guidance to Member States during the start-up of the 2014-2020 programming period. It will continue to guide the Member States in order to simplify and avoid unnecessarily complex and burdensome rules whenever specific instances of gold plating are identified. In this framework, the Commission and the Member States meet on a regular basis to discuss and clarify these issues. The Commission is also heavily investing on the use of simplified cost options during the 2014-2020 programming period (see reply of the Commission under Recommendation 3).

The Commission will also continue cooperating with national audit authorities to encourage them to identify and report, in system audits and other audits, eligibility rules which are unnecessarily complex and that can be simplified without putting at stake the legality and regularity of expenditure.

THE COURT'S OBSERVATIONS

— **Recommendation 2:** managing authorities and intermediate bodies in Member States should intensify their efforts to address the weaknesses in 'first level checks' by taking into account all available information. In addition, the Commission should request audit authorities through their system audits to re-perform some of these checks and share the good practices and lessons learnt;

THE COMMISSION'S REPLIES

The Commission notes that the first part of this recommendation is addressed to Member States. It agrees on the importance of the 'first level' checks conducted by the Member States and shares the view that these should be further strengthened. Therefore, it has given guidelines to Member States on the way managing authorities should define and implement their management verifications, including in relation to public procurement and State aid issues. This comprehensive guidance note on management verifications for the 2014-2020 programming period, drawing on the lessons learned in the 2007-2013 programming period and the Court's findings, has been drafted and discussed with Member States in the second half of 2014 and will be published in July 2015.

Audit authorities have the responsibility to perform audits of the management and control systems. They provide the Commission with system audit reports and annual control reports on the functioning of these systems and in particular the quality and effectiveness of the first level checks performed by management authorities. In that context, the Commission accepts the second part of the recommendation to request that audit authorities, through their system audits and control testing, should re-perform some of these checks and share the good practices and lessons learnt. In that respect, the Commission launched a new tool in 2015 for peer-to-peer exchanges among managing, certifying and audit authorities in Member States ('Taiex Regio Peer 2 Peer'). This tool aims at helping Member States to improve their administrative capacity in managing the European Regional Development Fund and the Cohesion Fund, including in the area of management verifications.

In line with its audit strategy as updated in 2015, the Commission will also continue to focus its audits on management verifications following a risk-based approach for 2007-2013 programmes, up to closure.

THE COURT'S OBSERVATIONS

— **Recommendation 3:** Member States should make better use of the possibilities set out in the Common Provisions Regulation and ESF Regulation for the 2014-2020 programming period concerning simplified cost options for projects exceeding 50 000 euro public support;

THE COMMISSION'S REPLIES

The Commission takes note of this recommendation which is addressed to the Member States.

The Commission has actively worked since the introduction of the simplified cost options in the regulations to progressively extend their use by Member States and considers that these efforts have already led to positive results, in particular for the ESF. The Commission continues to actively promote the use of simplified cost options by Member States in the 2014-2020 programming period, where they have been significantly strengthened both in the Common Provisions Regulation and in the specific ESF Regulation, based on the lessons learned and the good practices identified in the previous programming period, in order to reduce the administrative burden on the beneficiaries, increase the focus on results and further reduce the risk of error. As regards ERDF and CF, the Commission encourages Member States to further explore the opportunities offered by the 2014-2020 legal framework regarding simplified cost options in order to widen the use of such options, in particular for thematic objectives 1 and 3.

Furthermore, as part of its efforts to promote the use of simplified cost options by Member States, the Commission has recently issued extensive practical guidance concerning the options set out in the Common Provisions Regulation and in the specific ESF Regulation, and conducted a second round of simplification seminars in a significant number of priority Member States where the simplification opportunities have not been sufficiently leveraged in the previous programming period. Furthermore, the Commission launched surveys in June 2015 in order to assess the planned take up of the simplification opportunities, including simplified cost options by Member States in the current programming period.

THE COURT'S OBSERVATIONS

— **Recommendation 4:** Member States should ensure the full and timely payment of funding under the 2007-2013 programming period by reimbursing the beneficiaries within a reasonable time after they have submitted for reimbursement a payment claim. In alignment with the rules applicable to the 2014-2020 programming period, we consider that all such payments should be made within 90 days after the submission of a correct payment claim by the beneficiary;

THE COMMISSION'S REPLIES

The Commission takes note of this recommendation which is addressed to Member States.

The Commission agrees that Member States should comply with Article 80 of Regulation (EC) No 1083/2006. This Article does not provide specific benchmarks. In the context of the programming period 2014-2020, Article 132 of the Common Provisions Regulation (EU) No 1303/2013 on ESI Funds has established specific rules for the reimbursement of funding to beneficiaries by national authorities. Subject to the availability of funding, the Managing Authority shall ensure that a beneficiary receives the total amount of eligible public expenditure due in full and no later than 90 days from the date of submission of the payment claim by the beneficiary.

THE COURT'S OBSERVATIONS

— **Recommendation 5:** the Commission should submit a legislative proposal to amend, through a legislative act of equal legal value, Regulation (EC) No 1083/2006 with respect to the extension of the eligibility period for financial instruments under shared management to the Council and the Parliament;

THE COMMISSION'S REPLIES

The Commission does not accept this recommendation.

The Commission considers that the modifications introduced in its closure guidelines were within the scope of Article 78(6) of Regulation (EC) No 1083/2006, as amended, and therefore did not require an amendment of the legislative act.

THE COURT'S OBSERVATIONS

— **Recommendation 6:** the Commission should extend to all Member States its assessment of the reliability of the financial corrections reported by the certifying authorities and its impact on the Commission's calculation of the 'residual error rate';

THE COMMISSION'S REPLIES

The Commission accepts this recommendation that it is already implementing in line with previous recommendations of the external and internal auditors in that regard.

The Commission has widened the scope of its assessment and now performs consistency checks and desk reviews on the financial correction statements for all Member States and operational programmes whose results are reflected in the calculation of the cumulative residual risk. In addition, it carries out a risk assessment annually to decide which audit missions are to be carried out in which Member States to obtain reasonable assurance, in this case, of the financial corrections reporting. In the frame of this risk assessment the Commission also takes account of the need to conduct on-the-spot audits in all Member States with a material impact on the calculation of the cumulative residual risk, by the end of the programming period.

THE COURT'S OBSERVATIONS

— **Recommendation 7:** the Commission should further strengthen the control system for audit authorities by:

— requesting audit authorities to provide specific information on audits of operations (in particular the coverage) to verify the accuracy and reliability of the information provided in the annual control reports;

— ensuring that all audit authorities appropriately cover in their audit of operations checks of compliance with state aid and public procurement rules;

— requesting audit authorities to certify the accuracy of the data on financial corrections reported by certifying authorities for each OP whenever such action is deemed necessary.

THE COMMISSION'S REPLIES

— *The Commission accepts the recommendation which it is already implementing by requesting and obtaining additional specific information from audit authorities each time it deems it necessary, in particular in case of doubts, and by carrying out desk or on-the-spot review of annual control reports. As an example, DG Regional and Urban Policy has foreseen in its updated strategy for 2007-2013 to launch reinforced 'pre-annual control report' missions to prepare for the review of annual control reports to be provided in December 2015 for the last time and of closure declarations and opinions planned for March 2017. Furthermore, both DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion intend to continue covering a significant number of annual control reports through on-the-spot missions, on a risk basis.*

— *The Commission accepts this recommendation and is already implementing it in the context of its audit enquiries concerning the review of the work of audit authorities. It will circulate the Court's findings to ensure, where necessary, that reinforced checklists are used for the remainder of the 2007-2013 programming period and for the next one.*

— *The Commission accepts this recommendation which was already accepted in 2014.*

For the 2014-2020 programming period, the audit authorities are requested each year to issue an audit opinion based on a residual rate of error in the certified accounts. For the revision of the calculation of this rate, audit authorities have to check the accuracy of the financial corrections reported by the certifying authorities during the period for each operational programme and as reported in the certified accounts.

PART 2: PERFORMANCE RELATED ISSUES

ASSESSMENT OF PROJECTS' PERFORMANCE

6.80. Implementing the EU budget under the principle of sound financial management requires that spending should not only focus on complying with the rules but also on the achievement of intended objectives ([61]). 186 of the 331 ERDF/CF and ESF projects examined were completed at the time of the audit (see paragraph 6.22). In addition to checking the regularity of these 186 transactions, we assessed as a pilot exercise and based on information provided by the beneficiaries whether and to what extent:

— the objectives specified for projects funded under ERDF/CF and ESF in the project application, grant agreement, contract and/or decision for co-financing were in line with those set out in the OPs;

— projects had achieved those objectives. Our analysis focused on project outputs and, where possible, we also assessed the extent to which results were achieved ([62]).

Moreover, we also assessed whether projects were implemented in line with the principles of sound financial management.

Three quarters of the projects examined achieved either fully or partially their objectives

6.81. Based on the project outputs observed (and, where possible, the assessment of the intended results), we conclude that 89 of the 186 projects (48 %) reached (or exceeded) all targets that had been specified to measure the project performance. For 56 projects (30 %) we found that one or several indicators specified for the project did not attain the intended target value. For 17 cases (9 %) the deadline to attain the targets was reached for some, but not all targets by the time of the audit.

6.81. *The Commission notes that 143 projects out of the 186 examined have reached (either fully or partially) or exceeded their targets.*

Member States monitor implementation throughout the life of the projects. It is, however, only at the stage of the closure of the programmes in 2017 that the performance of projects financed by Operational Programmes will be finally evaluated and reported to the Commission.

The Commission notes that under the Regulations for the 2007-2013 programming period the requirements to measure the performance of EU-funded projects have been strengthened.

Performance evaluation of programmes has been further reinforced for the 2014-2020 period: as foreseen in the regulatory framework (Article 22(6) and (7) of Regulation (EU) No 1303/2013), the Commission will be able to sanction Member States in case of serious underachievement, as a result of the performance review (Article 22(6) of Regulation (EU) No 1303/2013) and at closure (Article 22(7)).

([61]) See the 2013 annual report, paragraph 10.10.
([62]) See chapter 3, Box 3.1, for an explanation of the concept of output and results.

THE COURT'S OBSERVATIONS

6.82. For three cases (2 %), none of the objectives of the project (as set out in the OP and/or the grant agreement) were attained. These projects do not add value because the investments are either not used, or cannot be used (see Box 6.7). This will represent a waste in spending of the EU funds unless the problems are addressed by the closure of the OPs.

Box 6.7 — Example of projects without added value

Project delivered but remains unused: A CF project in Greece consisted of the construction of a sewage plant and of a sewerage network for two municipalities. The infrastructure works were completed in 2013. However, the project cannot be used until connections from private households and industry to the sewerage network are also constructed. From the initial announcement of the project (in 2006) the municipality had enough time to design and implement such connections to the sewerage network. However, at the end of 2014, our audit found that such connections were still not in place. The project of the private connections has been procured during 2015.

6.83. For 13 projects (7 %) the achievement of objectives could not be assessed since no relevant data was provided.

6.84. We also found that eight projects (4 %) had objectives that were not in line with those specified for the OP and the priority axis under which the project was funded (see Box 6.8). The achievement of the performance for these projects was concluded as 'cannot be determined'.

Box 6.8 — Example of indicators not in line with OP

Indicator for the project not specified: In Italy, an ERDF project consisted of an equipment purchase for a hospital. No relevant performance indicator was defined for the project. Moreover, no specific indicator was found for the measure under which the project was approved. Instead, the managing authority monitors some indicators defined at national level (such as the surface covered by a project in square meters, the total man/working days achieved and the number of projects physically completed), which do, however, not allow to measure the performance of the examined project.

THE COMMISSION'S REPLIES

6.82. *The Commission will monitor with the concerned programmes authorities that these investments become functional by closure, which is a condition for the eligibility of the corresponding expenditure at that time.*

Box 6.8 — Example of indicators not in line with OP

The 2007-2013 Regulations foresee the use of aggregate result indicators at actions level and not systematically of performance indicators at project level. These indicators measure the progress as compared to the initial situation and the effectiveness of the chosen interventions to reach the specific objectives.

THE COURT'S OBSERVATIONS

Performance-based funding arrangements are the exception rather than the rule

6.85. Only in very few cases, the achievement of performance objectives has an impact on the level of EU funding. In one of these cases, we found however that the non-achievement of the agreed targets did not yet result in any corrective action by the managing authority (see Box 6.9).

Box 6.9 — Example of projects with a performance based funding system

Expenditure to be withdrawn when result indicators are not met: The grant agreement of an ERDF project in Romania related to the purchase of equipment to optimise the production flow of a plant, foresaw that the beneficiary has to return part of the grant received if the result indicators defined in the grant agreement were not met when the project is completed. The project's result indicators set by the grant agreement were not fully achieved upon completion. However, the Managing Authority has not yet adjusted the funding for this project.

Some national eligibility rules include provisions which go against the principle of sound financial management

6.86. In other cases, national eligibility rules contain provisions that allow beneficiaries to claim costs which are excessive when compared to usual market prices in the Member State concerned (Box 6.10).

Box 6.10 — Example of national eligibility rules going against the principle of sound financial management

Different allocation salary rate used for the EU co-funded project: For an ESF project in Romania funding scholarships of young PhD researchers and salaries of the management team running a post-doctoral programme in the field of nanomaterials the salary rates applied to the hours dedicated to the project are up to three times higher than those of the market. This practice is in line with national eligibility rules that allow different ceilings for salaries of people working for EU projects and those working for national projects or projects funded from own resources. Following aCommission's and one of our previous audits in 2012 ([63]), the ceilings for salaries for people working for EU projects were reduced, but still remained too high. A second adjustment was made in July 2014.

Similar cases were found in other ESF projects in Italy and Romania.

THE COMMISSION'S REPLIES

Box 6.10 — Example of national eligibility rules going against the principle of sound financial management

The salary situation in ESF-funded projects in Romania was an issue already identified by DG Employment, Social Affairs and Inclusion in an audit conducted in 2012. A flat-rate financial correction of 25 % has been systematically applied to this OP. As a result the Managing Authority concerned commissioned a study on the cost structure and the wage bill to serve as a basis for establishing maximum wage levels to be applied in future projects.

The Commission made further recommendations to the Managing Authority concerning the parameters to be used for the determination of wage ceilings to be applied to ESF-funded projects since the current ones are still considered too high.

([63]) See the 2013 annual report, paragraph 6.23 and Box 6.4.

ANNEX 6.1

RESULTS OF TRANSACTION TESTING FOR 'ECONOMIC, SOCIAL AND TERRITORIAL COHESION'

	2014	2013 [1]
SIZE AND STRUCTURE OF THE SAMPLE		
Regional and urban policy	**161**	168
Employment and social affairs	**170**	175
Total transactions 'Economic, social and territorial cohesion'	**331**	343
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error: Regional and urban policy	**6,1 %**	7,0 %
Estimated level of error: Employment and social affairs	**3,7 %**	3,1 %
Estimated level of error: 'Economic, social and territorial cohesion'	**5,7 %**	5,9 %
Upper Error Limit (UEL)	8,2 %	
Lower Error Limit (LEL)	3,1 %	

The lower and upper error limits for regional and urban policy are: 3,0 % and 9,2 %
The lower and upper error limits for employment and social affaires are: 1,9 % and 5,6 %

([1]) The figures for 2013 have been recalculated to match the structure of 2014 annual report and thus to enable a comparison between the two years. ***Graph 1.3*** of chapter 1 presents how the 2013 results have been reclassified based on the 2014 annual report structure. The estimated level of error for 2013 was calculated on the basis of the approach to quantification of public procurement errors applicable at the time of the audit. The 2013 audit results recalculated to take account of the updated approach to quantification of these errors (see paragraph 1.13) are presented in ***Table 1.1*** and ***Graph 1.3***.

ANNEX 6.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR ‘ECONOMIC, SOCIAL AND TERRITORIAL COHESION’

E = DG Employment, Social Affairs and Inclusion; R = DG Regional and Urban Policy; X = Common assessment for both DGs

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2012	**Recommendation 1** (recommendation 2 of chapter 6 and recommendation 3 of chapter 5 of 2011): addresses weaknesses in ‘first level checks’ carried out by managing authorities and intermediate bodies for the ERDF and the CF, through specific guidance material and, where appropriate, through training measures.	E	R ([1])					
	Recommendation 2 (recommendation 1 of 2011): on the basis of its experience gained of the 2007-2013 programming period, carries out an assessment of the use of national eligibility rules in view of identifying possible areas for further simplification and eliminating unnecessary complex rules (‘gold-plating’).		E ([2])	R ([3])				
	Chapter 5, **recommendation 3**: specifies clear rules and provides robust guidance on how to assess the eligibility of projects and calculate the co-financing for revenue-generating ERDF and CF projects under the 2014-2020 programming period.		R ([4])					
	Chapter 6, **recommendation 3:** promotes the extensive use of simplified cost options with a view to reducing the risk of error in cost declarations and the administrative burden on beneficiaries. The flat rates for simplified cost options should be systematically approved/validated in advance by the Commission to ensure that they meet the regulatory requirements (fair, equitable and verifiable calculation).		E					
	Recommendation 4: seeks improvement in the work done by audit authorities and the quality and reliability of the information provided in annual control reports and audit opinions.		X ([5])					

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
	The recommendations issued in the context of the 2011 annual report that are substantially similar to those issued in 2012 have been analysed in conjunction.							
2011	Chapter 6, **recommendation 3**: encourages national authorities to rigorously apply the corrective mechanisms prior to certification of the expenditure to the Commission (2008). Whenever significant deficiencies in the functioning of the management and control systems are identified, the Commission should interrupt or suspend payments until remedial corrective action has been taken by the Member State and make financial corrections if necessary.	X						
	Recommendation 4: provides further guidance to audit authorities for the current programming period, in particular on sampling and the scope of verifications to be undertaken for audits of projects and quality control; encourages audit authorities to carry out specific system audits concerning 'first level checks' done by managing authorities and intermediate bodies.		X ([5])					
	Chapter 6, **recommendation 5**: rigorously verifies the accuracy and completeness of information disclosed by audit authorities in their annual control reports and audit opinions. The Commission's verification should take full account of the information available on system audits and audits of operations undertaken by the audit authorities.		E					
	Chapter 6, **recommendation 6**: encourages the use by Member States of the simplified cost options permitted in the regulations in order to reduce the scope for error.	E						
	Chapter 5, **recommendation 1**: makes sanction systems more effective by increasing the impact of financial corrections and by reducing the possibility of replacing the ineligible expenditure with other expenditure, as proposed by the Commission in the area of cohesion for the next programming period. There should be a presumption that any irregularity detected subsequent to presentation of the annual accounts will lead to a net financial correction.	R						

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented: In most respects	Being implemented: In some respects	Not implemented	Not applicable	Insufficient evidence	
2011	Chapter 5, **recommendation 5**: in order to make the procedure for closing multiannual programmes in the area of cohesion more efficient:							
	— reminds the Member States to ensure that the final declarations submitted for the 2007-2013 programmes are reliable,	R						
	— examines the specific weaknesses identified by the Court in the winding-up declarations for closures of 2000-2006 programmes,	R						
	— considers whether these problems have also occurred for other OPs, and apply financial corrections where necessary,	R						
	— ensures that ongoing closure audits adequately address the issues raised by the Court.	R						

(1) See paragraphs 6.42 and 6.43 and recommendations 1 and 2 of chapter 5 of the 2013 annual report.
(2) The situation has not been altered in 2014.
(3) A systematic assessment of national eligibility rules in view of simplification was not carried out.
(4) No guidance on how to assess the eligibility of projects was provided. The guidance regarding expenditure eligibility rules is still in a draft stage and has not been disseminated to the Member States. The Guide to Cost-Benefit Analysis of Investment Projects for Cohesion Policy 2014-2020 was issued in December 2014.
(5) See Box 6.6. Despite the new guidance to audit authorities issued during the year 2013, we still found some particular weaknesses in the guidance issued by the Commission to the audit authorities, namely the treatment of financial instruments — see paragraphs 6.66 and 6.67. In addition, the recommendation to have the audit authorities carrying out specific system audits concerning 'first level checks' done by managing authorities and intermediate bodies could not be evidenced.

CHAPTER 7

'Natural resources'

TABLE OF CONTENTS

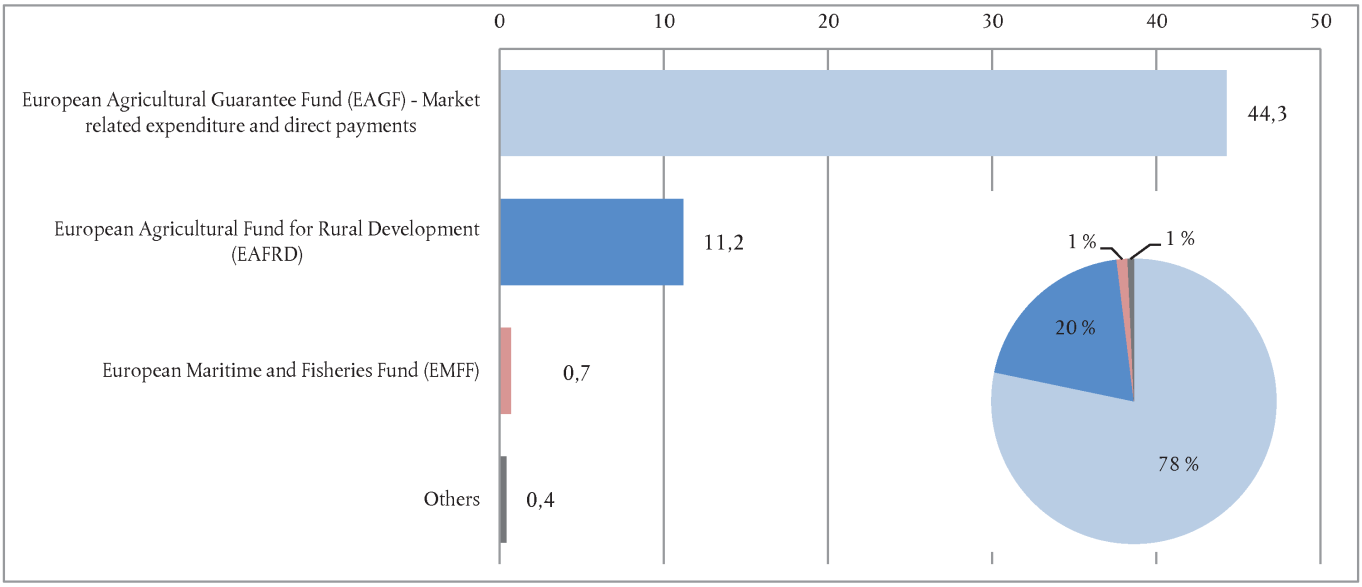
THE COURT'S OBSERVATIONS

INTRODUCTION

7.1. This chapter presents our findings related to our specific assessments for 'Natural resources'. The chapter presents separately the results of testing of the European Agricultural Guarantee Fund (EAGF) and for other spending ('Rural development, environment, climate action and fisheries') in the multi-annual financial framework (MFF) heading. Key information on the composition of this MFF heading is provided in ***Graph 7.1***.

Graph 7.1 — MFF heading 2 — 'Natural resources'

(billion euro)



Total payments for the year	56,6
- *advances* ([1])	*0,5*
+ *clearings of advances*	*1,4*
Audited population, total	**57,5**

([1]) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 7).

Source: 2014 consolidated accounts of the European Union.

7.2. In addition to our findings with regard to regularity for the specific assessments, this chapter presents, in a separate section, the results of some performance-related issues for a sample of rural development projects.

THE COURT'S OBSERVATIONS

Specific characteristics of the MFF heading

Common agricultural policy

7.3. The common agricultural policy (CAP) aims [1] to increase agricultural productivity, thus to ensure a fair standard of living for the agricultural community, stabilise markets, assure the availability of supplies and ensure that supplies reach consumers at reasonable prices.

7.4. The CAP is implemented under shared management by the Commission's Directorate-General for Agriculture and Rural Development (DG AGRI) and the Member States through two funds [2]: the EAGF, which fully finances EU direct aid and market measures [3], and the European Agricultural Fund for Rural Development (EAFRD), which co-finances rural development programmes together with the Member States.

7.5. The main measures financed by the EAGF are the following:

— The direct aid '*Single Payment Scheme*' (SPS), which accounted for 30,8 billion euro in 2014. This scheme provides decoupled [4] income support based on 'entitlements', each of which is activated by one hectare of eligible land.

— The direct aid '*Single Area Payment Scheme*' (SAPS), which accounted for 7,4 billion euro in 2014. This is a simplified decoupled income support applied in 10 Member States [5] which joined the EU in 2004 and 2007, providing for the payment of uniform amounts per eligible hectare of agricultural land.

— Other direct aid schemes, 3,5 billion euro in 2014, which provide mainly coupled payments [6] linked to specific types of agricultural production.

— Interventions in agricultural markets, 2,5 billion euro in 2014, covering, in particular, specific support for the wine and fruit/vegetable sectors and specific measures for the outermost regions.

(1) Article 39 of the Treaty on the Functioning of the European Union.
(2) Council Regulation (EC) No 1290/2005 of 21 June 2005 on the financing of the common agricultural policy (OJ L 209, 11.8.2005, p. 1).
(3) With the exception of certain measures such as promotion measures and the school fruit scheme, which are co-financed.
(4) Decoupled payments are granted for eligible agricultural land irrespective of whether it is used for production or not.
(5) Bulgaria, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Poland, Romania and Slovakia.
(6) Coupled aid payments are calculated on the basis of the number of animals kept (e.g. suckler cows, sheep and goat) and/or the number of hectares cultivated with a specific crop (e.g. cotton, rice, sugar beet).

THE COURT'S OBSERVATIONS

7.6. The EAFRD co-finances the rural development expenditure disbursed through Member States' rural development programmes. The expenditure covers 46 measures [7] which include both area-related measures [8] and non-area-related measures [9]. In 2014, rural development accounted for 11 186 million euro of expenditure.

7.7. Under all EAGF direct aid schemes and all area-related EAFRD measures [10], beneficiaries have an obligation to fulfil cross-compliance requirements. These requirements comprise statutory management requirements (SMRs) relating to the protection of the environment, public health, animal and plant health, animal welfare, and the maintenance of agricultural land in good agricultural and environmental condition (GAEC obligations). If farmers do not comply with these requirements their aid is reduced [11] (see also paragraph 7.14(b)).

THE COMMISSION'S REPLIES

7.7. *Cross-compliance is a sanction mechanism by which farmers are penalised when they do not respect a series of rules which stem in general from other policies than the CAP and apply to EU citizens independently of the CAP. The respect of cross-compliance obligations does not constitute an eligibility criterion for any CAP payment and, therefore, the controls of these requirements do not pertain to the legality and regularity of any underlying transaction. These principles have been in force since the beginning of the Single Payment Scheme in 2005. The fact that cross-compliance does not affect the eligibility of payments has been explicitly confirmed by the European Court of Justice (case T-588/10) and has been further clarified by Article 97(4) of Regulation (EU) No 1306/2013 for claim years 2015 and onwards.*

Thus, the Commission reiterates its view that reductions imposed for violations of cross-compliance requirements should not be taken into account for the calculation of the error rates for the CAP.

(7) The measures are listed under point 7a in Annex II to Commission Regulation (EC) No 1974/2006 of 15 December 2006 laying down detailed rules for the application of Council Regulation (EC) No 1698/2005 on support for rural development by the European Agricultural Fund for Rural Development (EAFRD) (OJ L 368, 23.12.2006, p. 15).

(8) Area-related measures are those where payment is linked to the number of hectares, such as agri-environment payments and compensatory payments to farmers in areas with natural handicaps.

(9) Non-area-related measures are typically investment measures, such as modernisation of agricultural holdings and the setting up of basic services for the economy and rural population.

(10) Council Regulation (EC) No 73/2009 of 19 January 2009 establishing common rules for direct support schemes for farmers under the common agricultural policy and establishing certain support schemes for farmers, amending Regulations (EC) No 1290/2005, (EC) No 247/2006, (EC) No 378/2007 and repealing Regulation (EC) No 1782/2003 (OJ L 30, 31.1.2009, p. 16).

(11) According to Articles 66 and 67 of Commission Regulation (EC) No 796/2004 of 21 April 2004 laying down detailed rules for the implementation of cross-compliance, modulation and the integrated administration and control system provided for in of Council Regulation (EC) No 1782/2003 establishing common rules for direct support schemes under the common agricultural policy and establishing certain support schemes for farmers (OJ L 141, 30.4.2004, p. 18), the level of the reduction per SMR or GAEC not complied with can vary between 1 % and 5 % in case of negligence and can lead to full rejection of the aid in case of intentional non-compliance. The amounts resulting from the aid reductions are retained from the aid payment and credited to the EU budget as assigned agricultural revenue.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

7.8. Expenditure under both funds is channelled through some 80 paying agencies that are responsible for checking the eligibility of aid applications and making payments to beneficiaries. The accounts and payment records of the paying agencies are examined by independent audit bodies (certification bodies) which submit annual certificates and reports to the Commission.

7.9. The main risks with regard to the regularity of direct aid payments are that aid may be paid for ineligible land, to ineligible beneficiaries or to more than one beneficiary for the same plot of land, or that entitlements are calculated incorrectly or animal premiums are paid for non-existent animals. In the case of interventions in agricultural markets, the main risks to regularity are that aid is granted to ineligible applicants or for ineligible or overstated costs or quantities.

7.10. For rural development, the main risk is that expenditure is ineligible, due to non-compliance with often complex rules and eligibility conditions in particular for investment measures.

7.10. *The Commission shares the Court's view that areas of the rural development expenditure are governed by complex rules and eligibility conditions. The Commission is of the view that this is a consequence of the ambitious objectives of the rural development policy and explains why this policy is particularly prone to errors.*

The CAP legal framework for the 2014-2020 programming period contains provisions both regarding simplification and the introduction of preventive measures (e.g. ex-ante analysis of the rural development programmes, suspensions and interruption of payments).

The Commission is committed to the simplification of the CAP rules and will insist on the simplification of the national rules by the Member States, without jeopardising sound financial management.

Environmental policy and the common fisheries policy

7.11. The Union's policy on the environment aims to contribute to protecting and improving environmental quality, the life of its citizens, and the rational utilisation of natural resources with expenditure managed on a centralised basis by the Commission's Directorate-General for Environment (DG ENV) and by the Commission's Directorate-General for Climate Action (DG CLIMA). The programme for the environment (LIFE) ([12]) is the most important. LIFE co-finances projects in the Member States relating to nature and biodiversity, environment policy and governance, and information and communication (221 million euro expenditure in 2014).

([12]) Regulation (EU) No 1293/2013 of the European Parliament and of the Council of 11 December 2013 on the establishment of a Programme for the Environment and Climate Action (LIFE) and repealing Regulation (EC) No 614/2007 (OJ L 347, 20.12.2013, p. 185).

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

7.12. The common fisheries policy pursues similar overall objectives to those of the common agricultural policy (see paragraph 7.2). The European Fisheries Fund ([13]) (EFF), which is managed by the Commission's Directorate-General for Maritime Affairs and Fisheries (DG MARE) and the Member States under shared management, is the main tool for the implementation of the common fisheries policy (569 million euro expenditure in 2014).

7.13. The main risk to regularity for the environmental and fisheries policy areas is that aid is granted for ineligible or overstated costs.

Audit scope and approach

7.14. ***Annex 1.1***, ***part 2***, of chapter 1 describes our overall audit approach and methodology. For the audit of 'Natural resources', the following specific points should be noted:

(a) for the two specific assessments, the audit involved an examination of a sample of 183 transactions for EAGF and 176 transactions for 'Rural development, environment, climate action and fisheries' respectively, as defined in ***Annex 1.1***, paragraph 7. Each sample is designed to be representative of the entire range of transactions within each of the two specific assessments. In 2014 the EAGF sample consisted of transactions from 17 Member States ([14]). For the second specific assessment the sample consisted of 162 transactions for rural development and 14 transactions concerning environment, climate action and fisheries from 18 Member States ([15]);

7.14.

([13]) Council Regulation (EC) No 1198/2006 of 27 July 2006 on the European Fisheries Fund (OJ L 223, 15.8.2006, p. 1).

([14]) Belgium, Czech Republic, Denmark, Germany (Bavaria, Brandenburg Lower Saxony, Schleswig Holstein, Rhineland Palatinate), Estonia, Ireland, Greece, Spain (Andalusía, Aragon, Castilla-La Mancha, Catalonia, Extremadura, Canary Islands), France, Italy (Lombardy, AGEA), Hungary, the Netherlands, Poland, Portugal, Slovakia, Finland and the United Kingdom (England, Wales).

([15]) Bulgaria, Czech Republic, Germany (Mecklenburg-Western Pomerania, Rhineland Palatinate, Saxony-Anhalt), Greece, Spain (Galicia, Castilla-La Mancha), France, Italy (Puglia, Umbria, Veneto), Latvia, Lithuania, Hungary, the Netherlands, Austria, Poland, Portugal, Romania, Slovakia, Sweden and the United Kingdom (England, Wales). The sample also included three transactions under direct management.

THE COURT'S OBSERVATIONS

(b) for cross-compliance we focused our testing on selected GAEC obligations [16] and selected SMRs [17] for which evidence could be obtained and a conclusion reached at the time of the audit visits [18] (see also paragraph 1.15);

(c) for the EAGF, the assessment of selected systems [19] examined the integrated administration and control system (IACS) in Croatia, the remedial actions taken in response to major weaknesses in the systems reported by us in previous annual reports for six Member States [20] and the work performed under the reinforcement of assurance procedure [21] in Greece. In addition, we reviewed 14 of the Commission conformity audits;

(d) for rural development, we reviewed 12 Commission conformity audits and re-performed Commission checks and tested selected key controls on-the-spot for five of these [22]. For the other policy areas, we examined the systems of the European Fisheries Fund in Italy and of DG ENV;

(e) in order to assess the basis for the Commission's clearance decisions, we reviewed DG AGRI's clearance of accounts audit work (for both the EAGF and EAFRD);

(f) the assessment of the annual activity reports covered reports by DG AGRI and DG ENV.

THE COMMISSION'S REPLIES

(b) *The Commission welcomes the change of approach announced by the Court of Auditors from 2015 and stresses the importance of examining the estimated level of errors independently of the cross-compliance element.*

See Commission replies to paragraphs 7.7, 7.22 and 7.33.

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(16) Avoiding the encroachment of unwanted vegetation, retention of terraces, maintenance of olive groves and respect of minimum livestock stocking rates or mowing obligations.
(17) Requirements for SMR 4 (Nitrates Directive) and 6 to 8 (concerning the identification and registration of animals).
(18) Cross-compliance obligations are substantive legal requirements that must be met by all recipients of EU direct aid. They are the basic and in many cases the only conditions to be respected in order to justify payment of the full amount of direct aid, hence our decision to treat cross-compliance infringements as errors.
(19) Selection of the Member States and the systems audited was risk based and therefore the results cannot be taken to be representative for the EU as a whole.
(20) Bulgaria, Greece, Spain (Andalusia, Castilla-La Mancha, Extremadura), Italy (Lombardia), Portugal and Romania.
(21) See paragraph 7.44.
(22) Ireland, Italy (Campania), Portugal, Romania and Sweden.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

PART 1: OUR ASSESSMENT ON REGULARITY

Regularity of transactions

7.15. ***Annex 7.1*** contains a summary of the results of transaction testing for 'Natural resources' as a whole as well as for each of the two specific assessments (EAGF and 'Rural development, environment, climate action and fisheries'). Of the 359 transactions that we audited, 177 (49 %) were affected by error. On the basis of the 129 errors which we have quantified, we estimate the level of error for 'Natural resources' as a whole to be 3,6 % ([23]) ([24]).

7.15. *The Commission takes note of the most likely error estimated by the Court which is lower than last year.*

The Commission is of the view that net financial corrections resulting from multiannual conformity audit procedures, as well as recoveries from beneficiaries reimbursed to the EU budget, represent a corrective capacity that has to be taken into account in a comprehensive assessment of the overall system of internal control. The Commission also notes that as reported in the 2014 Annual Activity Report of the Directorate General for Agriculture and Rural Development, its corrective capacity amounted in 2014 to 863,5 million euro (1,55 % of the total CAP expenditure) (see paragraphs 7.70 and 7.71 of the Court's report).

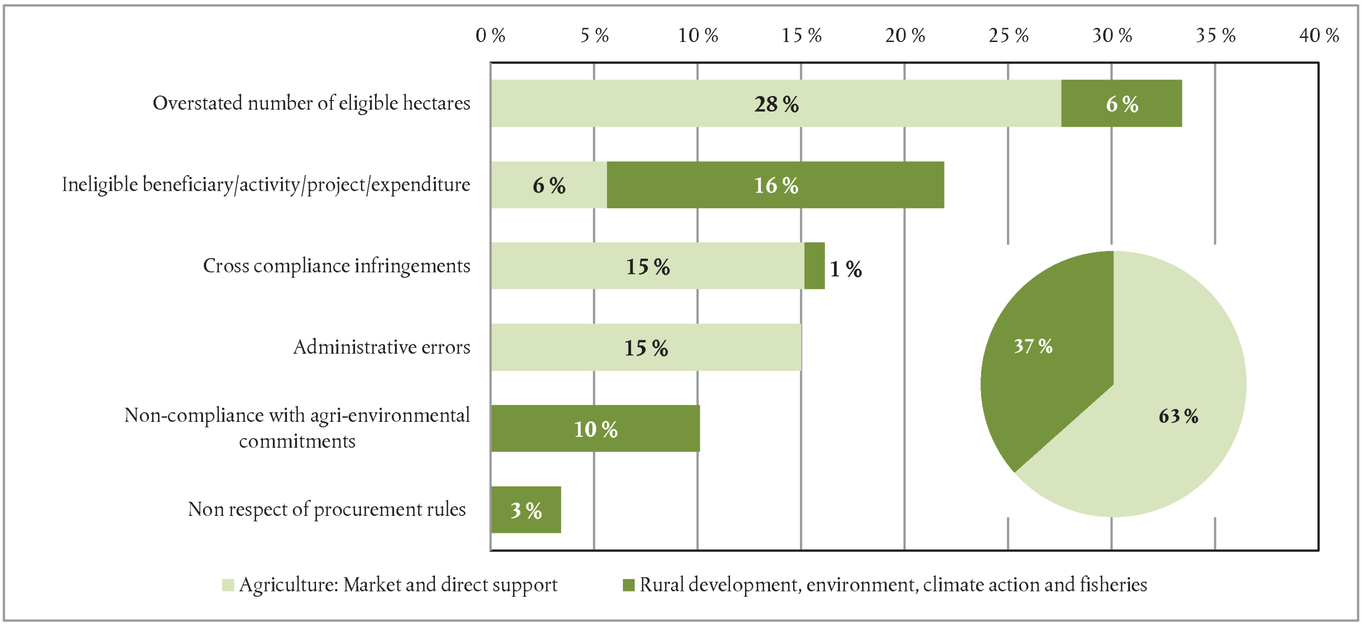
The Commission considers that infringements to cross compliance obligations (0,6 percentage points) should not be taken into account in the estimation of the level of errors (see Commission reply to paragraph 7.7). Without cross-compliance, the most likely error rate is 3,0 %.

7.16. ***Graph 7.2*** presents the extent to which the different types of errors contributed to our overall estimated level of error for 2014.

([23]) We calculate our estimate of error from a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the rate of error in the population lies between 2,7 % and 4,6 % (the lower and upper error limits respectively).

([24]) Of which cross-compliance errors had an impact of 0,6 percentage points.

Graph 7.2 — Contribution by type of error to the estimated level of error — 'Natural resources'



Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

7.17. The nature and pattern of errors is significantly different between the two specific assessments. Accordingly, each assessment is dealt with separately in the following paragraphs.

EAGF — Market and direct support

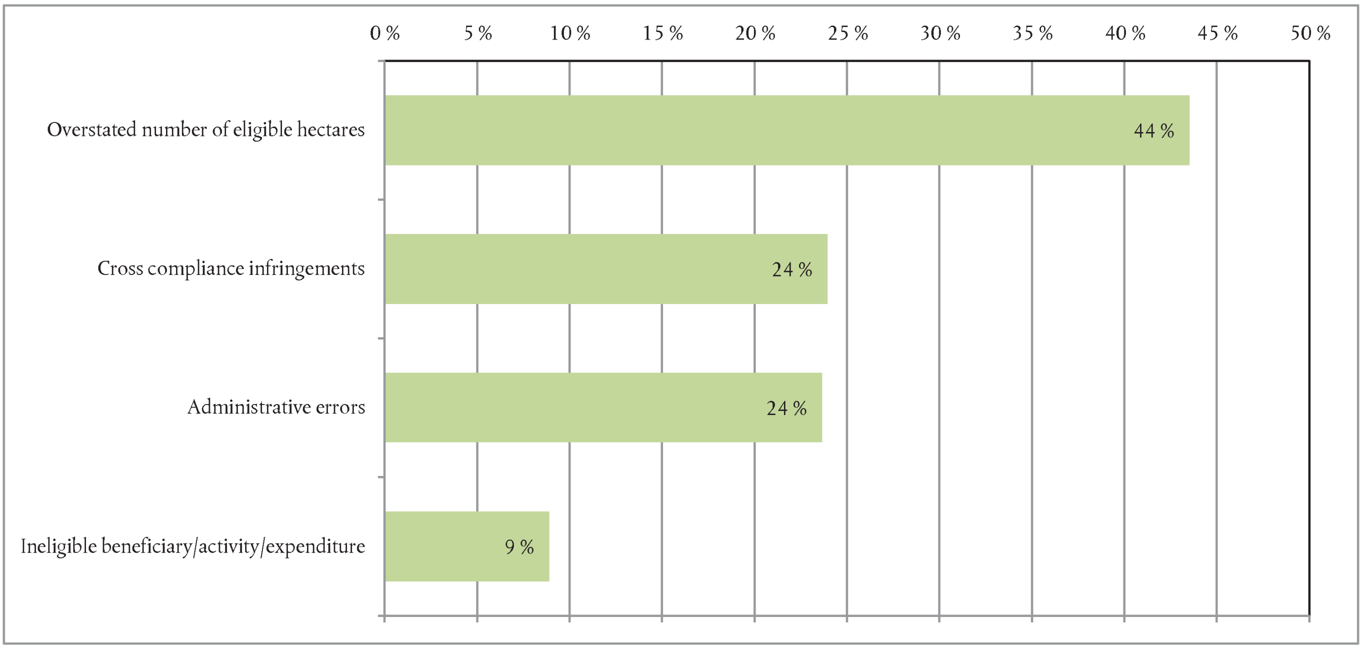
7.18. For the EAGF, of the 183 transactions that we audited, 93 (51 %) were affected by error. On the basis of the 88 errors which we have quantified, we estimate the level of error to be 2,9 %.

7.19. ***Graph 7.3*** presents the extent to which the different types of errors contributed to our estimated level of error for 2014 for EAGF.

THE COMMISSION'S REPLIES

7.18. *The Commission takes note of the most likely error estimated by the Court, which is lower than last year. Without cross-compliance which accounts for 0,7 percentage points, the most likely error rate for EAGF is 2,2 %*

Graph 7.3 — Contribution by type of error to the estimated level of error — EAGF



Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

7.20. In 26 cases of quantifiable errors made by final beneficiaries, national authorities had sufficient information ([25]) to prevent or detect and correct the errors before declaring the expenditure to the Commission. If all this information had been used to correct errors, the estimated level of error for this specific assessment would have been 0,6 percentage point lower. In addition, we found that for 34 cases, the error that we detected was made by national authorities. These errors contributed 0,7 percentage points to the estimated level of error.

THE COMMISSION'S REPLIES

7.20. *The Commission welcomes the Court's assessment on Member States' role and is of the view that Member States should have done more to reduce errors. The Commission continues to work with Member States to reduce errors.*

([25]) On the basis of supporting documentation, including standard cross-checks and mandatory checks.

THE COURT'S OBSERVATIONS

7.21. There was no particular concentration of errors related to overstated eligible hectares in specific Member States. In 2014, such errors were found in 12 out of the 17 Member States visited. Half of these errors were less than 2 % and thus had only a limited impact on the overall estimated level of error. As in previous years, the larger errors in this category related to payments for ineligible land declared as eligible permanent pasture (see Box 7.1). An example of an error for overstated eligible arable land is also given in Box 7.1.

Box 7.1 — Examples of payments for overstated eligible land

Permanent pasture

In Greece two out of 12 beneficiaries examined received SPS aid for parcels of land claimed as permanent pasture but found to be covered with dense shrubs, bushes, trees and rocks. The parcels should have been excluded wholly or partly from EU aid. These errors occurred because the eligible areas for the parcels concerned were overstated in the Greek Land Parcel Identification System (LPIS) database (see also Box 7.8 and paragraph 7.43). The Greek authorities re-evaluated the eligibility of parcels and detected the overpayments for these cases. However, the Greek authorities did not initiate recovery proceedings for either case. For one of the two cases we found that the eligible areas recorded in the LPIS after the re-evaluation were still overstated.

Situations where area aid was paid for parcels partly covered with ineligible vegetation were also found in the Czech Republic, Spain, France, Poland and Slovakia.

Arable land

In Spain (Castilla-La Mancha) SPS aid was paid for a parcel claimed and recorded in the LPIS as arable land. In reality the parcel was a motocross track.

Situations of overstated eligible arable land were also found in the Czech Republic, Denmark, Germany (Rheinland-Pfalz and Schleswig-Holstein), Spain (Andalusia, Aragon), France, Italy (Lombardia), Poland, Slovakia, Finland and the United Kingdom (England).

THE COMMISSION'S REPLIES

7.21. *The Commission is aware of the weaknesses regarding permanent pasture. Actions plans are on-going in different countries and their effectiveness is recognised by the Court in box 7.7.*

Box 7.1 — Examples of payments for overstated eligible land

The Commission had already identified similar deficiencies in Greece and in Spain and ensured that they were addressed through action plans which led to important improvements.

In Greece, the action plan aimed at taking out of the LPIS ineligible parcels. The Greek authorities implemented this plan, which resulted in a decrease in the area recorded as permanent pasture in the Greek LPIS d from 3,6 million ha in 2012 to 1,5 million ha in October 2014 (see box 7.8).

In addition to correcting the LPIS, the Greek authorities have identified the undue amounts.

Financial corrections covering the amounts not recovered by the Greek authorities have already been adopted by the Commission for financial years 2010, 2011 and 2012. For financial years 2013 and 2014 the conformity procedure is expected to be finalised by the end of 2015.

The Member States mentioned have been audited by the Commission. No significant deficiencies were identified for Poland and Czech Republic. Whenever necessary, weaknesses found in the control system for cross-compliance are followed up through conformity clearance procedures which result in net financial corrections, ensuring that the risk to the EU budget is adequately covered.

The national authorities had detected this in February 2014, when updating their LPIS with the latest (2012) ortho-images available. The payment had, however, been made in December 2013 before this update. A recovery procedure has been launched in November 2014 for the years concerned.

THE COURT'S OBSERVATIONS

7.22. On the basis of our examination of selected cross-compliance obligations (see paragraph 7.14(b)), we found infringements in 46 of the 170 payments subject to these obligations. The error frequency for cross-compliance (27 %) is consistent with the frequency reported by the Member States in their control statistics. The cross-compliance errors had an impact on the estimated level of error presented in paragraph 7.18 of 0,7 percentage points. Examples of cross-compliance errors are provided in Box 7.2.

Box 7.2 — Examples of cross-compliance errors

EU legislation on cross-compliance requires cattle movements/births/deaths to be notified to the national animal database within seven days. Such rules are important for reducing the risk of diseases spreading, by controlling animal movements and improving traceability. In order to reduce water pollution, another cross-compliance rule sets an upper limit of 170 kg of nitrate of animal origin applied to one hectare of land in nitrate vulnerable zones.

In Italy (Lombardia) a beneficiary reported 370 cattle movements or births out of which 291 notifications were late. The same beneficiary exceeded the 170 kg per hectare nitrate limit by almost 200 %. For another beneficiary we found that 237 out of 627 animal notifications were late and that the nitrate limit was exceeded by 380 %.

Non-compliance with the notification deadlines for animal movements were also found in Belgium, Denmark, Germany (Bavaria), Estonia, Spain (Canary Island), France, Hungary, the Netherlands, Poland, Slovakia and the United Kingdom (Wales).

THE COMMISSION'S REPLIES

7.22. *See Commission replies to paragraphs 7.7 and 7.14(b).*

Box 7.2 — Examples of cross-compliance errors

The Commission carries out cross-compliance audits in Member States and, in many of them, has observed weaknesses in the control and sanctioning of the reporting obligations and, in general, in relation to identification and registration of animals. When a systemic non-compliance is established, the Commission always follows it up via the conformity clearance procedure. Concerning the problems found for the identification and registration of animals, the Commission shares the Court's observation and pays particular attention to these requirements during its cross- compliance audits.

THE COURT'S OBSERVATIONS

7.23. In a number of cases we also found errors in the administrative processing of aid applications by the national authorities. The most frequent error related to exceeding the ceiling for SPS entitlements in France. Although we reported this systematic error in our 2011, 2012 and 2013 annual reports ([26]), it was still present in 2014 ([27]). However, the Commission took a conformity decision to exclude part of the expenditure from EU financing for the (financial) years 2011 and 2012.

7.24. We found two cases where the beneficiary or the expenditure were not eligible for EU aid (see Box 7.3).

Box 7.3 — Example of a payment for ineligible expenditure

In France EU aid under the support programme for the wine sector was granted to a winery for the modernisation of its storage facilities. Some of the aid reimbursed the costs of dismantling and removing the old equipment, which were not eligible for EU support.

A case where aid was paid to an ineligible beneficiary was found in Poland.

THE COMMISSION'S REPLIES

7.23. *In the framework of this conformity clearance procedure, the Commission has assessed in details the risk to the fund. It has already been covered by net financial corrections for claim years 2011 and 2012 and conformity clearance procedures are on-going for the remaining claim years concerned.*

The action plan introduced aims at fully remedying the situation for claim year 2014 and it is being closely monitored by the Commission.

([26]) Example 3.2 of the 2011 annual report, Box 3.1 of the 2012 annual report and Box 3.5 of the 2013 annual report.

([27]) The French authorities initiated remedial action in 2013, with a view to correcting the value of the entitlements as from 2015 financial year (claim year 2014).

THE COURT'S OBSERVATIONS

'Rural development, environment, climate action and fisheries'

7.25. For 'Rural development, environment, climate action and fisheries', out of the 176 transactions that we audited, 84 (48 %) were affected by error. On the basis of the 41 errors which we have quantified, we estimate the level of error to be 6,2 %.

7.26. ***Graph 7.4*** presents the extent to which the different types of errors contributed to our estimated level of error for 2014 for 'Rural development, environment, climate action and fisheries'.

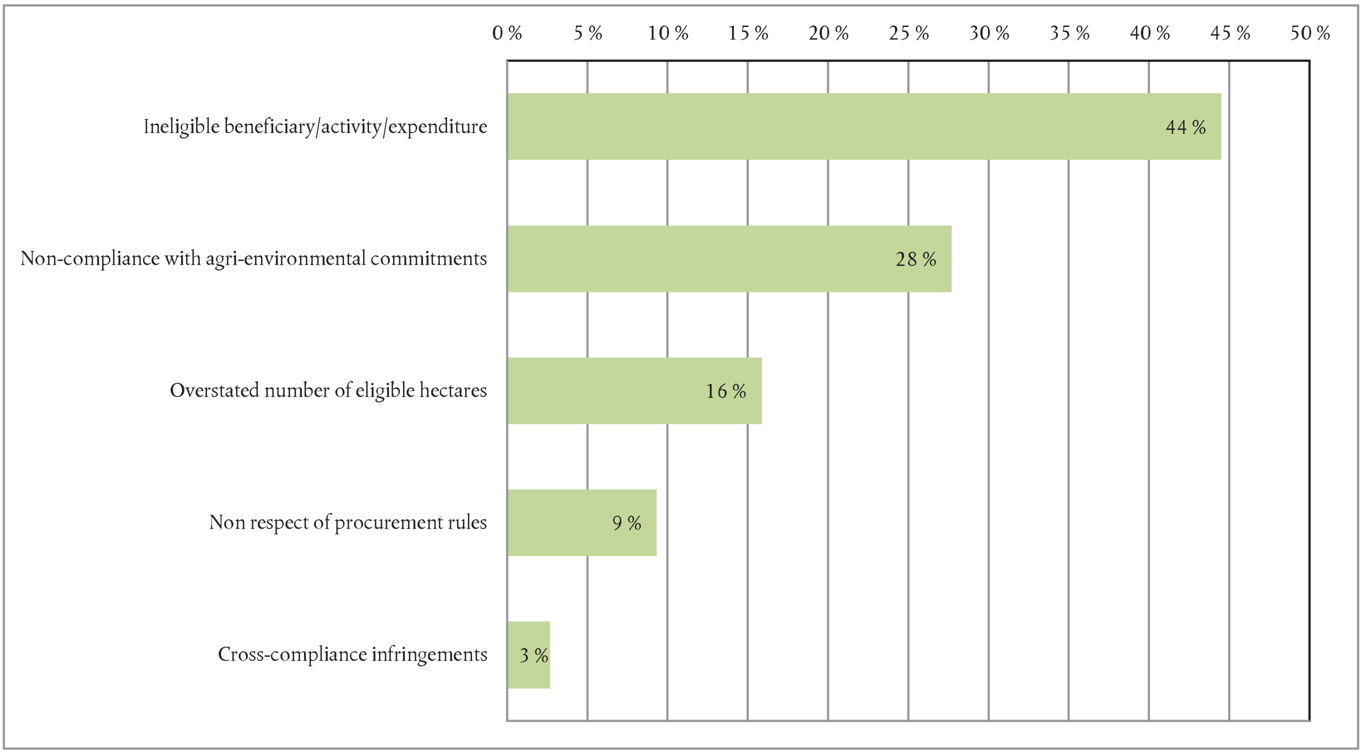
THE COMMISSION'S REPLIES

7.25. *The Commission takes note of the most likely error estimated by the Court, which is lower than that last year.*

Without cross-compliance, the most likely error rate for 'Rural development, environment, climate action and fisheries' is 6,0 %.

See also Commission reply to paragraph 7.18.

Graph 7.4 — Contribution by type of error to the estimated level of error — 'Rural development, environment, climate action and fisheries'



Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

7.27. For rural development, of the 162 transactions, 71 were area-related and 91 non-area-related. Of these 162 transactions, 79 (49 %) were affected by error. As regards environment, climate action and fisheries, of 14 transactions sampled, five (36 %) were affected by error, of which three were quantifiable.

7.28. In 15 cases of quantifiable errors made by final beneficiaries, national authorities had sufficient information ([28]) to prevent or detect and correct the errors before declaring the expenditure to the Commission. If all this information had been used to correct errors, the estimated level of error for this specific assessment would have been 3,3 percentage points lower. In addition, we found that for three cases, the error that we detected was made by national authorities. These errors contributed 0,6 percentage points to the estimated level of error.

THE COMMISSION'S REPLIES

7.27. *The frequency of errors (both quantified and not-quantified) found by the Court on rural development has decreased from 57 % in 2013 to 49 % in 2014. The error rate for rural development must also be appreciated in light of the ambitious objectives of rural development policy.*

The Commission notes that 10 of the transactions affected by errors only concerned cross-compliance infringements. Therefore, in the Commission's view, since cross-compliance requirements affect neither the eligibility of farmers to CAP support (first and second pillar) not the regularity of the payments, excluding these errors brings the number of transactions affected by errors down to 69 (43 %).

The lower level of errors for area related measures confirms that IACS remains an effective system to prevent and correct errors.

7.28. *The Commission is aware that the national authorities could potentially have detected many of the errors found by the Court. The CAP rules provide the Member States with all necessary instruments to mitigate most of the risk of errors.*

Deficiencies in the control systems identified by the Commission have triggered action plans by the Member States to identify the root causes of errors and take appropriate remedial actions.

([28]) On the basis of supporting documentation, including cross-checks and mandatory checks.

THE COURT'S OBSERVATIONS

7.29. Errors were found in the sampled transactions in all 18 Member States visited. The level and types of errors are very similar to those found in previous years. As in previous years, the major component (54 %) of the estimated level of error reported in paragraph 7.25 concerned non-area-related measures. In this context, we published a special report in February 2015 analysing the causes of errors in rural development spending and how they are being addressed ([29]).

7.30. Specific requirements for investment projects help target the aid at certain categories of beneficiaries, thus aiming to improve the effectiveness of rural development spending. However, of the 91 non-area related transactions examined, 14 (15 %) did not comply with the eligibility requirements. We assessed that in three of the 14 cases, the beneficiaries have artificially created conditions to circumvent eligibility criteria. Further details are given in Box 7.4. For environment, climate action and fisheries, two of the three quantifiable errors were due to ineligible expenditure.

([29]) See special report No 23/2014 'Errors in rural development spending: what are the causes, and how are they being addressed'.

THE COMMISSION'S REPLIES

7.29. *During its own audits in a number of Member States the Commission found shortcomings similar to those detected by the Court of Auditors. Substantial net financial corrections have been imposed on the Member States concerned in order to protect the EU budget. Clearance of accounts procedures are on-going. Furthermore where reservations were made, Member States concerned are required to take remedial actions.*

In the Annual Activity Report 2014 the Director General of the Directorate General for Agriculture and Rural Development has issued reservations concerning rural development expenditure for 16 Member States (28 paying agencies). The reservations were issued where weaknesses in the management and control system were detected and when necessary were accompanied by a request to the Member States concerned to address the deficiencies via remedial actions.

The Commission appreciates the Court's analysis of the root causes of errors in its special report 23/2014 which largely confirmed the Commission's own analysis presented to the European Parliament and the Council in June 2013 (SWD(2013) 244), according to which ambitious policy objectives of the policy and insufficient control systems are contributing factors to the level of errors.

The Commission stresses that the high level of errors in non-area related measures does not necessarily mean fraud or misuse of EU funds. Very often, the policy objectives for the individual action have indeed been met and the taxpayers' money has not been lost.

For the programming period 2014-2020 all Rural Development Programmes were required to include an ex-ante assessment on the verifiability and controllability of the measures, conducted jointly by the Managing Authority and the Paying Agency.

7.30. *Artificial conditions, as assessed by the Court, account for only three of the 91 transactions examined for non-area related measures. The main deficiencies for investment transactions relate to ineligibility issues (expenditure or beneficiary).*

The Commission shares the Court's concern about artificial conditions, but would like to stress that they are difficult to prove and can only be established following the strict conditions set out by the European Court of Justice.

Following its own audits the Commission has applied net financial corrections for non-area related measures and will continue to do so as necessary. Most common reasons for the financial corrections were weaknesses in the checks of the eligibility criteria, reasonableness of costs or application of the selection criteria. In the action plans for reducing the rural development error rate, particular focus is put on corrective actions for eligibility requirements in non-area measures.

THE COURT'S OBSERVATIONS

Box 7.4 — Eligibility errors — Possible artificially created conditions to obtain aid contrary to the objectives of an investment measure

We identified three cases of suspected intentional circumvention of rules with the aim of obtaining aid contrary to the objectives of the measure concerned (in two cases modernisation of agricultural holdings and in one case business creation and development). These cases have been forwarded to the European Anti-Fraud Office for analysis and possible investigation. For confidentiality reasons, specific details of these cases cannot be disclosed. However, the following are illustrative of typical cases:

— well-established companies, which would not qualify for financing when applying directly by themselves, set up new entities under the umbrella of which the project is designed so that it formally fulfils the eligibility and selection criteria. Conditions which may have been artificially met in this manner are related to fulfilling the criteria for being a micro-enterprise (less than 10 employees and less than 2 million euro of turnover or balance sheet value) or to the enterprise being owned and managed by a young farmer (a person below 40 years of age who commences activities in the agricultural sector);

— groups of persons (part of the same family or part of the same economic group) set up several entities for the purpose of obtaining aid which exceeds the ceiling allowed under the conditions of the investment measure. Although the beneficiaries declared that these entities operated independently, in substance this was not the case as they were designed to function together. They were effectively part of the same economic group, with the same place of business, staff, clients, suppliers and financing sources.

THE COMMISSION'S REPLIES

Box 7.4 — Eligibility errors — Possible artificially created conditions to obtain aid contrary to the objectives of an investment measure

In the Court's assessment, there are three cases of suspected artificially created conditions to circumvent eligibility criteria. Based on the European Court of Justice ruling C-434/12, in order to prove 'artificially created conditions' both the subjective and objective elements have to be demonstrated independently. In that respect the Commission would like to underline that 'artificially created conditions' imply proof of an intentional act, involving the use of deception to obtain an unjust or illegal advantage.

The Commission shares the Court's concern. In order to prove artificial conditions, the strict conditions set out by the European Court of Justice need to be followed. It is vital to preserve legal certainty of beneficiaries who act in accordance with the applicable legislation. Therefore, paying agencies can only refuse payment based on clearly established evidence, and not on suspicions only. Accordingly, they often invest time and effort to gather conclusive evidence and subsequently launch recovery procedures.

Especially in one of the cases reported by the Court, the Member State itself identified the risk of 'artificially created conditions', far in advance of the Court's audit and before making any payments to the final beneficiary, and diligently acted by implementing all the procedural steps required according to national law in case of suspected artificially created conditions, including contacting the competent national anti-fraud authorities. Before disbursing the funds to the final beneficiary, the Member State had concluded that it did not have sufficient evidence to refuse payment. However, the Member State continued to follow up this case and based on subsequent evidence it has taken steps to recover the funds.

THE COURT'S OBSERVATIONS

7.31. The sample examined included 36 transactions for agri-environment payments, which concern the use of agricultural production methods compatible with protection of the environment, landscape and natural resources. We found that in six cases (17 %), farmers had not met all the conditions for payment. An example of such an error is provided in Box 7.5.

Box 7.5 — Example of non-compliance with agri-environment commitments

A beneficiary in the United Kingdom (Wales) undertook, for environmental reasons [30], to close off a hay meadow from grazing before 15 May each year and keep it closed for at least the following 10 weeks. We found that neither commitment had been respected.

Similar cases of non-compliance with agri-environment requirements were detected in Germany (Rheinland-Pfalz), Italy (Umbria) and the United Kingdom (England).

7.32. For 27 transactions examined, the beneficiaries were required to comply with public procurement rules. These rules are designed to ensure that the goods and services required are purchased on the most favourable terms, while guaranteeing equal access to public contracts and compliance with the principles of transparency and non-discrimination. We found that in 13 cases (48 %) one or more of these rules had been breached. An example of such an error is given in Box 7.6.

(30) Such farming practices have a number of environmental benefits, such as encouraging declining plant species to re-establish in a diverse wildlife habitat which will provide food sources and shelter for wildlife.

THE COMMISSION'S REPLIES

7.31. *The Commission has audited the implementation of agri-environmental measures in all Member States in the 2007-2013 programming period, financial corrections have been applied and will continue to be in the future, when necessary. Remaining weaknesses notwithstanding, the overall quality of the implementation has improved over the period.*

Box 7.5 — Example of non-compliance with agri-environment commitments

The Commission also had already detected similar weaknesses in some Member States during its audits. Net financial corrections have been and will continue to be applied to cover the risk to the EU budget, if appropriate.

7.32. *The Commission has already found similar shortcomings on public procurement. In some of the Member States cited by the Court in box 7.6 substantial net financial corrections have already been applied or conformity clearance procedures are still underway and net financial corrections will be applied, if needed. Public procurement is also one of the central elements in the action plans for rural development.*

The Commission notes that only one error reported by the Court has been quantified.

Moreover, on 19 December 2013, the Commission adopted new guidelines for determining financial corrections to be made to expenditure financed under the shared management, for non-compliance with the rules on public procurement. According to these guidelines, the non-respect of procurement rules is to be judged based on the principle of proportionality.

A guidance document on most common irregularities in the management of European Structural and Investment Funds has already been presented to Member States.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Box 7.6 — Example of non-respect of public procurement rules

A public body in Poland, in charge of water management, received support for the renovation of two pumping stations. The construction works were awarded to a private company through a public procurement procedure. The beneficiary seriously breached public procurement law by restricting equal access and fair competition for potential bidders. The winning offer — the only one submitted — did not meet the selection criteria. In addition, the offer was prepared in conjunction with the same company which also prepared the technical specifications and bill of quantities for the tender. For these reasons, the winning company should have been excluded from the tender.

Non-respect of public procurement rules was also found in Bulgaria, Germany (Sachsen-Anhalt), Greece, Spain (Castilla-La Mancha), France, Italy (Puglia), the Netherlands and Romania. However, these errors were not quantified.

7.33. On the basis of our examination of selected cross-compliance obligations (see paragraph 7.14(b)), we found infringements in 17 (27 %) of the 64 payments subject to these obligations. The cross-compliance errors had an impact on the estimated level of error presented in paragraph 7.25 of 0,2 percentage points.

7.33. *See Commission replies to paragraphs 7.7 and 7.14(b).*

7.34. National authorities are required to check the reasonableness of costs. We found for 20 investment projects that this check was not carried out as required. Such errors, however, generally cannot be quantified as the amount of ineligible expenditure cannot be determined. Further information on the reasonableness of costs is included in the section 'Rural development performance-related issues' (see paragraph 7.88).

7.34. *The Commission considers that administrative checks of the reasonableness of costs are essential for ensuring the effectiveness of the control system. The Commission has during its conformity audits also found weaknesses in the assessment of reasonableness of costs and has imposed financial corrections in this respect to protect the EU's financial interest.*

The Commission would like to note that for the next programming period 2014-2020 simplified costs for the reimbursement of payments (flat rate financing, standard scale of unit costs and lump sums) will be used more widely. This should contribute to a more efficient and correct use of the Funds.

See also Commission reply to paragraph 7.88.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

Examination of selected systems and annual activity reports

Member States' systems related to regularity of EAGF transactions

Integrated administration and control system

7.35. IACS is the main management and control system in operation to ensure the regularity of direct aid payments [31]. It covers more than 90 % of EAGF expenditure and makes a significant contribution in preventing and reducing the levels of error in the aid schemes to which it applies, as confirmed both by the Commission [32] and our own audits.

7.35. *The Commission welcomes the Court's assessment that IACS makes a significant contribution in preventing and reducing the level of error. The Commission is of the view that the quality and coverage of the IACS is essential for assuring the regularity of direct aid payments.*

In addition, the Commission notes that IACS also covers 40,2 % of EAFRD expenditure, in particular agri-environmental measures and less-favoured areas.

7.36. The system consists of databases of farm holdings and aid applications, an LPIS, animal databases and a database of entitlements in the Member States implementing the SPS. The paying agencies carry out administrative cross-checks between these databases with the objective of ensuring that payments are made for the correct amount, to the eligible beneficiary for eligible land or animals. Most applicants (95 %) receive payments upon successful completion of these administrative checks. The remaining 5 % are subject to additional checks performed on-the-spot.

7.37. We examined the IACS in Croatia and observed only minor deficiencies in the administrative treatment of claims and in the quality of on-the-spot inspections by the Croatian authorities. These deficiencies do not affect the reliability of the system.

7.37. *The Commission shares the view of the Court.*

7.38. In addition, we carried out a desk review of a sample of 14 of the Commission's conformity audits for EAGF expenditure. The Commission reported significant weaknesses for 10 out of the 14 Member States' systems concerned. We found that the quality of the Commission's work was satisfactory (see paragraph 7.62).

7.38. *The Commission welcomes the views of the Court.*

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(31) For area-related rural development measures, verification of certain key elements such as eligible area is also made through the IACS.

(32) For direct aid, which is almost entirely managed under IACS, DG AGRI's 2014 annual activity report stated an adjusted level of error of 2,54 % (Annex 10, part 3.2) and for market measures, which are managed by systems other than IACS, an adjusted error rate of 3,87 % (Annex 10, part 3.1).

THE COURT'S OBSERVATIONS

Remedial action taken in respect of IACS weaknesses reported in previous annual reports

7.39. During the period 2007-2013 we carried out IACS systems audits in 35 paying agencies and reported the major shortcomings observed in the respective annual reports. For this report, we visited eight paying agencies in six Member States with a view to assessing whether they had addressed the shortcomings relating to LPIS in an effective and timely way, and whether the Commission had applied financial corrections ([33]) reflecting the losses of EU funds for all financial years affected by those failures. Correct information on eligibility of land in the LPIS database is a prerequisite for reliable administrative cross-checks and correct aid payments.

7.40. Our assessment revealed that all the paying agencies examined have, under the close guidance and active supervision of the Commission, taken remedial action which overall led to an improvement in the situation. However, remedial action was not always taken promptly and, in several instances, weaknesses still persist, although to a lesser degree. In all cases examined financial corrections were imposed or conformity clearance procedures launched by the Commission.

7.41. We found that the weaknesses in the LPIS had been addressed in all of the Member States audited. For three Member States the overall results were satisfactory (see Box 7.7). Nevertheless, some important weaknesses still persist in the remaining three Member States (see Box 7.8).

THE COMMISSION'S REPLIES

7.40. *See also Commission replies below for boxes 7.7 and 7.8.*

In some cases, the extent of the remedial action required a lengthy action plan or for new elements to be added to existing action plans. Nevertheless, all the action plans, finalised or still underway, have brought about significant improvements in the quality of the LPIS and the Commission will remain vigilant that these improvements continue and/or are maintained. Until remedial action has been fully implemented, financial corrections will cover the risk to the fund.

7.41. *See also Commission replies below for boxes 7.7 and 7.8.*

In all cases, conformity clearance procedures are on-going and, where weaknesses persist, will result in further net financial corrections.

More information on the action plans can be found in Annex 10, Part 3.2, of the Directorate General for Agriculture and Rural Development's Annual Activity Report 2014.

([33]) Amounts clawed back from the Member State concerned under the conformity clearance procedure, see Article 52 of Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy and repealing Council Regulations (EEC) No 352/78, (EC) No 165/94, (EC) No 2799/98, (EC) No 814/2000, (EC) No 1290/2005 and (EC) No 485/2008 (OJ L 347, 20.12.2013, p. 549).

THE COURT'S OBSERVATIONS

Box 7.7 — Member States in which remedial action concerning LPIS weaknesses was satisfactory

Bulgaria: In previous annual reports ([34]), we reported that the eligible areas recorded in the Bulgarian LPIS were not reliable and that the results of on-the-spot checks were of unsatisfactory quality. An action plan was established to address these shortcomings. Its implementation started in 2009 and finished in 2011. Our review found that effective remedial action had been taken. LPIS has improved and is regularly updated. The quality of on-the-spot inspections has also improved.

Portugal: In our 2007 annual report ([35]) we reported serious shortcomings in the Portuguese LPIS. In 2011 Portugal set up a major LPIS review which was finalised in 2013. However, Commission audits showed that the quality of the work was adversely affected by the fact that it was based on orthoimages dating from 2010 and 2011. A further review, based on more recent orthoimages, started in 2013, in order to remedy the remaining weaknesses. Our audit showed that the eligibility data based on the analysis of the most recent orthoimages is generally of adequate quality.

Romania: In previous annual reports ([36]) we reported serious shortcomings in Romania with regard to keeping the LPIS up to date. Romania adopted an action plan in 2009 and completed it in 2011. We found that progress had been made in improving the quality of LPIS.

THE COMMISSION'S REPLIES

Box 7.7 — Member States in which remedial action concerning LPIS weaknesses was satisfactory

The Commission's audits confirm that in Bulgaria, Portugal and Romania, the remedial actions implemented have improved the system.

([34]) See Annex 5.2 of the 2008 annual report and Example 3.4 of the 2010 annual report.
([35]) See Annex 5.1.2 of the 2007 annual report.
([36]) See Annex 5.2 of the 2008 annual report and Example 3.3 of the 2011 annual report.

THE COURT'S OBSERVATIONS

Box 7.8 — Member States where LPIS weaknesses persist

Greece: In previous annual reports ([37]) we reported weaknesses in the Greek LPIS particularly as regards the eligibility of permanent pasture parcels. A first major review of the LPIS was only finalised in 2013, with a special focus on rough grazing areas. A second review was carried out in 2014 at the request of the Commission. As a result of these reviews the eligible permanent pasture area recorded in the Greek LPIS was reduced from 3,6 million hectares in 2012 to 1,5 million hectares in claim year 2014.

We found that overall the new eligible areas, after the latest review, better reflect the actual situation. However, further substantial corrective action is required, particularly for rough grazing parcels. For two out of 15 randomly selected permanent pasture parcels inspected by us the eligible areas recorded in the LPIS still overstated the actual grass cover on the parcel after both reviews (a further case is presented in Box 7.1) ([38]). Furthermore, we noted that the Greek Ministry of Agriculture has decided not to recover from the beneficiaries any overpayments that occurred in the past as a result of incorrect eligible rough grazing land in the Greek LPIS.

THE COMMISSION'S REPLIES

Box 7.8 — Member States where LPIS weaknesses persist

See also Commission reply to box 7.1.

The follow-up audits carried out by the Commission on the implementation of the action plans have identified similar deficiencies. The Commission is of the view that while considerable remedial work has been carried out, some deficiencies persist with regard to the eligibility for permanent pasture in Greece and Spain. The Commission would, however, like to point out that the remedial actions carried out in 2014 and 2015 have proved satisfactory for both countries, resulting in ineligible areas being excluding from both LPIS: in Greece, the area registered as permanent pasture decreased from 3.6 million ha to 1,5 million ha, while in Spain eligible land decreased from 18,4 million ha to 15,6 million ha.

Any remaining weaknesses found are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered by net financial corrections.

Information on the implementation of the action plans requested by the Commission is available in the Directorate General for Agriculture and Rural Development's Annual Activity Report 2014.

([37]) See Annex 3.2 of the 2009 annual report, Example 3.2 of the 2010 annual report and Box 3.1 of the 2013 annual report.

([38]) A Commission audit in November 2014 concluded that for permanent pasture the LPIS update is not finalised since in many cases ineligible areas such as land covered with bushes, shrub or rocks are still recorded as eligible in the LPIS. As a consequence, DG AGRI raised a reservation for Greece in its 2014 annual activity report because Greece had failed to properly address the issue of permanent pasture areas in the context of its action plan (see also paragraph 7.43).

THE COURT'S OBSERVATIONS

Spain (Andalusia, Castilla-La Mancha and Extremadura): In previous annual reports [39] we reported substantial shortcomings in the LPIS for Spain (Andalusia [40], Castilla-La Mancha and Extremadura). Reference parcels, which in reality were fully or partly covered by rocks, dense forest or bushes, were claimed and paid for as permanent pastures. The Spanish authorities implemented an action plan aimed at improving the LPIS at national level, which was reported as completed in 2013. However, the Commission found that the eligibility assessment for pasture land was not reliable and requested the Spanish authorities to further review and improve the eligibility for pasture, applying much stricter criteria as of 2015.

We equally found that, for claim year 2013, the results of remedial actions were not satisfactory. However, we noted that further corrective action was initiated in 2014 and 2015 aimed at improving the situation.

Italy: In our 2011 annual report [41] we reported shortcomings in the LPIS in Italy (Lombardia) concerning rough grazing parcels in mountainous areas. We found that the weaknesses regarding the eligible areas for permanent pasture land recorded in the LPIS had not yet adequately been addressed, particularly for small parcels. For 12 out of 18 selected permanent pasture parcels which had been subject to a review by the Italian authorities, we found that the eligible area recorded in the LPIS was still overstated.

THE COMMISSION'S REPLIES

The implementation of the action plan to improve the information in the LPIS continued in 2014 and 2015, with close monitoring from the Commission (audits in July and November 2014).

Because the Commission judged the situation not to be fully satisfactory, reduction of the payments to Greece was decided for the financial year 2015 (claim year 2014).

The Greek authorities have identified the amount unduly paid because of past overpayments. These amounts are being pursued through the conformity clearance procedure.

The Commission considers that the actions taken by the Spanish authorities were partially satisfactory. Further corrective action is on-going, as noted by the Court, for 2014 and 2015.

The Commission will continue to monitor the situation and any remaining weaknesses will be followed up through conformity clearance procedures to ensure that the risk to the EU budget is adequately covered.

(39) See Annex 3.2 of the 2010 annual report and first case under Example 3.1 of the 2011 annual report.
(40) The first case in Box 3.1 of the 2011 annual report relates to Andalusia.
(41) See Annex 3.2 of the 2011 annual report.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Follow-up given to our findings by the Commission

7.42. The Commission included in its own audits a follow-up of weaknesses we had identified. For all Member States the Commission imposed financial corrections or initiated conformity clearance procedures ([42]). The details are set out in ***Table 7.1***:

7.42. *For Spain and Italy the financial years indicated are not yet covered by financial corrections as the conformity clearance procedure is still on-going.*

Table 7.1 — Financial corrections by the Commission for system weaknesses in LPIS

Member State	System weakness reported by the Court in financial year	Last financial year affected by the system weakness	Financial years covered by financial corrections	Total amount of financial corrections *(million euro)*	Financial years not covered by financial corrections as of end of 2014	Conformity clearance procedures underway but not yet finalised
Bulgaria	2008	2012	2008-2012	65,8	—	
Greece	2009	2014	2007-2012	608,6	2013, 2014	yes
Spain (Andalucia)	2010	2014			2010, 2012, 2013, 2014	yes
Spain (Castilla-La Mancha)	2010	2014			2010, 2012, 2013, 2014	yes
Spain (Extremadura)	2010	2014			2010, 2012, 2013, 2014	yes
Italy (Lombardia)	2011	2014	2009-2011	0,1	2012, 2 013, 2014	yes except for 2012
Portugal	2007	2013	2007-2012	186,4	2013	yes
Romania	2008	2014	2008-2012	80,8	2013, 2014	yes

Source: European Court of Auditors.

([42]) Covering all IACS-related weaknesses including those reported by us.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

7.43. In addition to making financial corrections for past financial years affected by major shortcomings, the Commission has, under the new CAP legislation ([43]), enhanced powers to reduce or suspend payments to Member States where there are significant and persisting deficiencies in national systems. This reinforced instrument is applicable as of financial year 2014. As at May 2015 the Commission had used this possibility on one occasion by reducing EAGF payments for Greece as of financial year 2015.

Assessment of the reinforcement of assurance exercise

7.44. In 2010, the Commission introduced the 'reinforcement of assurance procedure' applicable on a voluntary basis for Member States. Under this procedure an independent audit body (certification body, hereafter called CB) designated by the Member State delivers an opinion not only on the proper functioning of the internal systems but also, based on a detailed review of a representative statistical sample of transactions, on the legality and regularity of expenditure declared to the EU. The sample is drawn randomly from the applications inspected on-the-spot by the paying agency. As from financial year 2015, certification bodies will be required to deliver an opinion on the legality and regularity of the transactions underlying the expenditure claimed from the EU budget.

7.44. *The Commission would like to clarify that following the introduction of Regulation (EU) No 1306/2013, the Reinforcement of Assurance, as described in paragraphs 7.44 to 7.50 no longer applies.*

In order to support and guide the new work to be done by the Certification Bodies from financial year 2015, the Commission developed detailed guidelines on how to sample and report the results of their re-verification of primary level controls initially made by the Paying agencies. If done properly, the results of the re-verification will be the basis for a statistically valid opinion on the legality and regularity of the underlying transactions.

The detailed guidelines have been extensively explained to the Paying Agencies and Certification Bodies, and their implementation is being closely monitored by the Commission.

7.45. Under the voluntary procedure, if the Commission judges that a Member State applies these procedures correctly and the residual error rate established by the Member State is less than 2 % for two consecutive years, the Member State in question is entitled to reduce the rate of on-the-spot checks from 5 % to 1 % ([44]).

7.46. In the period 2011 to 2013, we audited the reinforcement of assurance' procedure in five ([45]) of the six Member States or regions which had opted to apply the procedure on a voluntary basis. In 2014, we completed our examination of this procedure in the remaining Member State (Greece).

7.47. Greece implemented the reinforcement of assurance' procedure for financial years 2013 and 2014. We reviewed the work performed for financial year 2014 for which the CB gave a clean opinion and reported a level of error of 0,2 % for EAGF IACS aid schemes.

([43]) Article 41(2) of Regulation (EU) No 1306/2013.
([44]) A further condition for the reduction of the rate of checks is that the Member State in question has assessed its LPIS to be reliable.
([45]) Bulgaria, Romania (see paragraph 3.38 of the 2011 annual report), Luxembourg, the United Kingdom (Northern Ireland) (see paragraph 4.36 of the 2012 annual report) and Italy (see paragraphs 3.30 to 3.35 of the 2013 annual report).

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

7.48. The CB did not fully respect the Commission guidelines concerning sampling, audit scope and timing of the checks. In particular, it had systematically disregarded in its error quantification any overpayments which occurred as a result of incorrect eligible areas for permanent pasture recorded in the LPIS. Furthermore, the CB disregarded overpayments resulting from the fact that the paying agency allowed beneficiaries, after the expiry of the deadline, to replace ineligible parcels in their applications with eligible ones. This was in contrast to the approach applied by the CB for the 2013 financial year where such overpayments were included in the overall level of error quantification. This change of approach is the main reason why the level of error reported by the CB for 2013 at 10,2 % was reduced to 0,2 % for 2014.

7.48. *The Commission is aware that some Certification Bodies, including Greece, did not respect the sampling guidelines. It is for this reason that the Commission did not accept the reported error rates, but used the results of its own audits to calculate the error rate for the Directorate General for Agriculture and Rural Development's Annual Activity Report 2014.*

See also Commission reply to paragraph 7.44.

7.49. In light of these weaknesses, the level of error reported by the Greek CB for financial year 2014 is therefore significantly underestimated.

7.49. *In its Annual Activity Report 2014, the Directorate General for Agriculture and Rural Development used the results of its own audits to calculate an adjusted error rate of 4,5 %.*

7.50. Overall for the six Member States which had opted for the voluntary application of the procedure, we found that, with the exception of Luxembourg, the weaknesses in its implementation render the reported levels of error unreliable.

7.50. *See Commission reply to paragraph 7.44.*

Member States' systems related to regularity of transactions in rural development

7.51. Member States' authorities are responsible for putting in place and operating:

(a) appropriate administrative and control procedures to ensure the accuracy of declarations made by the claimant and the fulfilment of eligibility requirements;

(b) on-the-spot checks which, depending on the aid scheme, should cover at least 5 % of all beneficiaries or of the relevant expenditure ([46]).

7.51. *The same principles have also applied to EAGF since 2007. From 2014 onwards, a common horizontal regulation (Regulation 1306/2013) applies for both EAGF and EAFRD.*

7.52. Our examination of systems in this area was based partly on audits carried out by the Commission (DG AGRI) (see also paragraph 7.62). We carried out a desk review of a sample of 12 of the Commission's conformity audits for rural development, and visited five of the paying agencies concerned ([47]). The Commission reported significant weaknesses for nine out of the 12 Member States' systems concerned. We found that the quality of the Commission's work was satisfactory.

([46]) Articles 12 and 25 of Commission Regulation (EU) No 65/2011 of 27 January 2011 laying down detailed rules for the implementation of Council Regulation (EC) No 1698/2005, as regards the implementation of control procedures as well as cross-compliance in respect of rural development support measures (OJ L 25, 28.1.2011, p. 8).

([47]) Ireland, Italy (Campania), Portugal, Romania and Sweden.

THE COURT'S OBSERVATIONS

7.53. We found that, for the five paying agencies visited on-the-spot, the system weaknesses were very similar to those found and reported in previous years [48]. We identified deficiencies in administrative checks related to eligibility conditions, in particular those concerning environmental conditions and the maximum size of companies. Like in previous years, we also found persistent weaknesses in checking public procurement procedures. System failures are an important cause of the errors detected during transaction testing (see paragraph 7.27).

7.54. For public procurement, we examined a sample of 32 projects subject to public procurement in the five Member States visited, of which 15 (47 %) were affected by errors. In particular, our review of procedures to select the most economically advantageous tender showed significant deficiencies. We also reviewed a sample of eight cases for which Member States had not applied public procurement procedures. In two of these cases, a public procurement procedure was required and thus the expenditure declared to the EU was ineligible.

Action plans

7.55. In an effort to reduce the level of error in rural development spending, in 2012 the Commission actively encouraged all Member States to develop action plans to identify the causes of error and to implement targeted corrective action to reduce the risk of occurrence of errors. We reviewed whether, for frequently found errors, the root cause of the error was covered in the action plan of the Member State concerned.

THE COMMISSION'S REPLIES

7.53. *Common replies to paragraphs 7.53 and 7.54:*

The Commission is aware of weaknesses in the Member States' control system for EAFRD and underlines that the Member States are primarily accountable for the implementation of the policy and control systems. In the Directorate General for Agriculture and Rural Development's 2014 Annual Activity Report, 35 % of the paying agencies were subject to a reservation for EAFRD expenditure with a request to take the necessary remedial actions (apart from previous action plans still under implementation). As mentioned in paragraph 7.52, part of the Court's assessment of Member States systems is based on the findings of the conformity audits carried out by the Commission services.

The Commission concurs with the Court's conclusions in the special report 23/2014 that the scope of administrative checks should be increased by the Member States.

The Commission is aware of the shortcomings related to eligibility, including procurement procedure and maximum size of companies. These issues are the main focus of the audits carried out in the Member States on investment measures. Also, these problems have been and are still being addressed in the action plans set up with Member States for reducing the error rates.

(48) See paragraph 4.20 of the 2013 annual report, paragraphs 4.21 to 4.25 of the 2012 annual report and paragraphs 4.22 to 4.32 of the 2011 annual report.

THE COURT'S OBSERVATIONS

7.56. We looked at 24 of the more significant quantifiable errors detected in 14 Member States during our transaction testing ([49]). Of these, nine errors (37,5 %) could be linked to a specific action in a Member State's action plan whilst 15 (62,5 %) could not. A similar analysis for the weaknesses detected as part of our audit of Member States systems corroborated these percentages. The majority of error types and system weaknesses were therefore not addressed in the action plans we reviewed (see Box 7.9).

Box 7.9 — Examples showing that Member States' action plans are not yet fully effective

The Irish action plan contains 20 actions, none of which had been implemented at the time of the audit. Moreover, all 20 actions concern area-related measures, despite the fact that investment measures are more risky. We found six system weaknesses, five of which led to ineligible expenditure. All findings related to investment measures, and had therefore not been addressed by the action plan.

The Romanian action plan to address the root causes of error in rural development shows that the Romanian authorities carried out targeted actions to address the risk of artificially created conditions for the measures 'modernisation of agricultural holdings' and 'business creation and development'.

We found that the actions taken by the Romanian authorities have the potential to address the issue for newly approved projects, but that the payments which are made for projects approved in the past will continue to be affected by significant irregularities. We found clear indicators of artificially created conditions to obtain aid contrary to the objectives of the measure in seven out of 20 projects randomly selected for the two measures referred to above. Typical cases involved splitting an investment in two or more sub-projects carried out at the same time, for the purpose of circumventing specific eligibility and selection criteria and obtaining aid in excess of the permissible ceilings. The Commission reported similar weaknesses and initiated a conformity clearance procedure.

THE COMMISSION'S REPLIES

7.56. *The close monitoring by the Commission shows that for certain Member States some shortcomings detected during its audits and the Court's audits were not sufficiently addressed. The Commission has asked the Member States concerned to reinforce their action plans accordingly.*

Box 7.9 — Examples showing that Member States' action plans are not yet fully effective

Actions are included once shortcomings are detected and identified by national authorities, the Commission or the European Court of Auditors. The Commission monitors closely the action plan and ensures that new findings are addressed in the action plans.

Audits carried out by the Commission in 2013 and 2014 to Ireland showed weaknesses in both administrative and on-the-spot checks. The Member State has put in place an action plan and while not yet fully implemented, progress has been reported to the Commission. The Irish authorities have been encouraged to continue the implementation of the action plan in order to address the weaknesses identified in the context of the recent audit and provide regular updates on the implementation.

In the case of Ireland, since the Commission did not reimburse any EAFRD expenditure in 2014, no reservation was considered necessary in the Directorate General for Agriculture and Rural Development's Annual Activity Report 2014 in respect of rural development.

Regarding the Romanian action plan, many remedial actions have been put in place by Romania which have improved the situation but have not yet produced the necessary effect to address all the weaknesses in the management and control system found by the Commission and Court's audits. The Commission is aware that weaknesses persist in the management of investment measures, including weaknesses in the assessment of the creation of artificial conditions. In order to further improve the situation, the Romanian authorities have been asked to reinforce the implementation of their action plan, including the scrutiny of projects before payment in order to exclude those affected by artificial conditions.

([49]) Errors above 5 % excluding cross-compliance errors.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

Member States' systems related to regularity of transactions under the European Fisheries Fund (EFF)

7.57. In the Member States, audit authorities check the effective functioning of the management and control systems operated by the EFF managing and certifying authorities. We assessed the effectiveness of these checks by the audit authority in Italy. In addition, we re-performed selected audit authority audits on operations funded by the EFF.

7.58. While we observed that the methodology for audits of operations and systems was effective, we found weaknesses in the management and documentation of audit tasks and in the verification of eligibility conditions. The audit authority did not carry out its audit activities as planned. There were no formal procedures for quality control review, the audit documentation was deficient, and the sampling methodology did not comply with the Commission's guidelines. These weaknesses, although identified by the Commission during its previous audits, had still not been fully addressed by the audit authority at the time of our audit. Additionally, in some cases, the audit authority did not perform the required on-the-spot checks and did not carry out adequate checks on the eligibility conditions for vessels which received funding for the permanent cessation of their activities.

7.58. *Most of these issues had been identified by the Commission during its audits and are subject to ongoing follow up.*

As regards permanent cessation, the Commission will request the audit authority to carry out adequate checks to confirm that the national eligibility requirements have been complied with.

DG AGRI's systems and annual activity report

The Commission's clearance of accounts procedures

7.59. Management of the bulk of expenditure on agriculture is shared between Member States and the Commission. Paying agencies in the Member States disburse aid to farmers and other beneficiaries; the Commission reimburses the Member States for these costs each month (for the EAGF) or each quarter (for the EAFRD). To enable it to assume final responsibility for implementation of the budget, the Commission applies two separate procedures:

(a) An *annual financial clearance procedure* covering the annual accounts and internal systems of each accredited paying agency. The resulting clearance of accounts decision is based on audits carried out by independent certification bodies in the Member States, which are submitted to the Commission.

(b) A *multi-annual conformity clearance procedure*, which may lead to financial corrections for the Member State concerned if expenditure has infringed EU rules. The resulting conformity decisions are based on audits performed by the Commission.

THE COURT'S OBSERVATIONS

7.60. We checked the 2014 financial clearance procedure. As in previous years, we found that the Commission had satisfactorily managed this task.

7.61. The Commission's conformity audits assess whether Member State systems ensure that aid payments to beneficiaries are regular. Systems weaknesses detected lead to financial corrections which are often made on a flat-rate basis and cover expenditure relating to several budgetary years. Flat-rate corrections, typically 2 % or 5 %, are applied regardless of how many systems weaknesses were found and rarely lead to recoveries from the beneficiaries (see also paragraphs 1.36 and 1.37).

7.62. We checked compliance with ISSAI 4100 (International Standard of Supreme Audit Institutions) and with the main regulatory provisions of a sample of 26 [50] out of 120 conformity audits [51]. Most key elements were in place and compliant with the main regulatory provisions, and we consider that the Commission's audits were of a quality which enabled us to use the results as part of our assessments of Member State systems (see paragraphs 7.38 and 7.52).

7.63. In 2014, the Commission adopted three conformity decisions (covering 56 separate financial corrections), leading to corrections of 443,1 million euro (403,2 million euro relating to EAGF and 39,9 million euro to EAFRD). A further decision was adopted in January 2015, leading to a significant correction of 1 409 million euro (1 243 million for EAGF and 166 million for EAFRD), which was included in the 2014 accounts as accrued income (see also paragraph 7.24 and Box 1.3).

THE COMMISSION'S REPLIES

7.61. *Where possible, the amount of financial corrections is calculated on the basis of the loss actually caused to the EU budget. Where this is not possible, flat-rates are used which reflect the gravity of the deficiencies in the national control systems. The use of flat-rate corrections has been upheld by the European Court of Justice as being in conformity with the legal rules governing the conformity work. Article 52 'Conformity clearance' of Regulation (EU) No 1306/2013 explicitly confirms that where the amounts to be excluded cannot be identified with proportionate effort, extrapolated or flat-rate corrections may apply.*

Moreover, as agricultural expenditure is implemented under shared management, the Member States are better placed than the Commission to assess and provide evidence of the real financial loss or risk for the EU budget. Therefore, a more precise calculation of the financial loss for the EU budget requires the active cooperation of the Member State concerned at all levels of the conformity clearance procedure because only the Member State has all the necessary information to make such a calculation. In particular, the European Court of Justice has confirmed that it is not up to the Commission to undertake the checks necessary to put a precise figure to the losses incurred, but rather it is for the Member State to show that the Commission's estimate was excessive.

7.62. *The Commission welcomes the Court's conclusion that the quality of Commission's audits allows the results to be used as part of their assessment of Member States systems.*

(50) 14 for EAGF and 12 for EAFRD.
(51) The number of audits reported in 2014.

THE COURT'S OBSERVATIONS

7.64. In recent annual reports, we drew attention to the persistent problem that conformity procedures are too lengthy, resulting in a significant backlog of open files ([52]). The backlog at the end of 2014 was 15 % lower than at the end of 2013. Despite this positive trend, a considerable backlog of 180 audits still remains.

THE COMMISSION'S REPLIES

7.64. *The Commission has dedicated specific resources to tacking backlog cases and continues to address the issue of open files as a high priority. For the specific backlog identified (cases open from 2012 and before), clear interim targets were established which so far have been met and exceeded and the Commission is on schedule to close all cases within the targeted deadline.*

DG AGRI's annual activity report (AAR)

7.65. In its 2014 AAR DG AGRI assesses the expenditure at risk for the main spending areas. The starting point of this assessment is the levels of error reported by the Member States (for each paying agency) in their control statistics. Subsequently, the Commission adjusts those levels of error based mainly on the Commission's and the Court's audits carried out in the last three years. The resulting adjusted error rates (AERs) are then aggregated and used to calculate the total expenditure at risk, i.e. the level of error that the Commission estimates to affect the EU budget. Other than the weaknesses described hereafter, we consider that this is generally a valid approach which can provide sufficient basis for reservations at the level of individual paying agencies.

7.66. Certification bodies are required to provide an assessment of the quality of on-the-spot checks carried out by the paying agencies and the results as reflected in the control statistics. While in 2014 the certification bodies gave a positive assessment on all EAGF-IACS statistics and on 88 % of the EAFRD statistics, the Commission based its estimate of the expenditure at risk predominantly on its own adjustments. This indicates that the Commission's reliance on Member States' control statistics is very limited. This situation is described in further detail in special report No 18/2013 ([53]).

7.66. *The Commission would like to clarify that until financial year 2014, as part of the annual certification report, the Certification Bodies were required to conclude whether the control statistics are correctly compiled and reconciled to the database by the Paying agencies with a sufficient audit trail.*

In addition, and based on the results of a separate sample, the Certification Body was required to report on the level of discrepancy it detected. In all cases, the Certification Bodies reported that the control statistics were correctly compiled and reconciled to the relevant Paying Agency data.

However, this assurance is not sufficient to conclude that the control statistics may be used to estimate a reliable error rate, because it might be that the controls performed by paying agencies are not effective enough.

As from Financial year 2015 (claim year 2014), the Certification Bodies will be required to deliver an opinion on the legality and regularity of the transactions, which will entail a re-verification of a representative sample of transactions already checked by the Paying Agency. This is expected to provide, amongst other things, a robust opinion on the quality of the controls and a greater level of assurance on the error rates reported by Member States.

([52]) The Commission considers as a backlog an audit which has not been closed within two years after being carried out.

([53]) Special report No 18/2013 'The reliability of the Member States' checks of the agricultural expenditure'(www.eca.europa.eu).

THE COURT'S OBSERVATIONS

7.67. The Commission made adjustments to determine the AERs on the part of expenditure for which its own or our audit results were available. However, DG AGRI did not disclose in its AAR which part of the expenditure was not adjusted because no such audit results were available. In such cases, the Commission places reliance on Member States control statistics which may result in an underestimated AER.

7.68. The average financial corrections over the last three years for EAGF corresponds to 1,2 % of the expenditure concerned, while for EAFRD this is 1 %. This shows that overall the Commission has applied financial corrections covering slightly less than half of the level of the adjusted error rate for EAGF. However, for EAFRD the coverage was around one fifth. One of the main reasons for this much lower percentage for EAFRD is the significant number of individual systems.

7.69. This significant number of systems for EAFRD arises from the fact that the policy is implemented via 46 measures ([54]), and often via sub-measures, each with different conditions. These measures are implemented through rural development programmes. Some Member States have national programmes while others (such as Germany, Spain or Italy) have regional programmes. During the period 2007-2013, rural development policy was implemented through 94 national or regional rural development programmes ([55]). This leads to a complex and fragmented policy delivery structure with numerous systems and limits the Commission's conformity audit coverage for EAFRD expenditure.

7.70. The expenditure covered by the Commission's conformity audits is related to financial corrections. In case the Commission identifies systems weaknesses for individual control systems, financial corrections can only be extrapolated to the systems audited. DG AGRI reported in its 2014 AAR that in 2014 these audits covered expenditure of 24 % for EAGF market measures, 35 % for EAGF direct aid and 19 % for EAFRD. ***Table 7.2*** gives the key data used to assess DG AGRI's 2014 AAR.

([54]) See paragraph 7.6.

([55]) For the 2014-2020 programming period, Member States submitted 118 national or regional programmes.

THE COMMISSION'S REPLIES

7.67. *The Commission examines the situation for each Paying Agency not only based on its own and the Court's audit findings over the three previous years, but also on the basis of the opinions received for the financial year concerned from the Certification Body for each Paying Agency. There are therefore audit results available in all cases.*

7.68. *The Commission's corrective capacity includes financial corrections and recoveries from beneficiaries made by Member States. When taking into account the recoveries reimbursed to the EU budget, the corrective capacity reaches 1,5 % for EAGF and 1,8 % for EAFRD — see table 'Error rate and corrective capacity', page 18 of the Directorate General for Agriculture and Rural Development's Annual Activity Report for 2014.*

7.69. *Given the limited resources available, any increase of the coverage for rural development would have to be balanced against the need to maintain an adequate coverage for the EAGF which accounts for 79 % of the CAP budget.*

For rural development, the Commission has established that there are potentially 576 different audit fields (paying agency/control system pairs). It is not possible with reasonable resources to audit all audit fields every three years. The Commission was able to carry out 48 rural development audits on the spot in the Member States in 2014. Because of the heterogeneity of the rural development measures, there is therefore both a limitation to the expenditure coverage of audits as well as to the scope of the eventual financial corrections which are applied.

Table 7.2 — Overview of key data relevant to assess DG AGRI's 2014 AAR

Main spending area	2014 expenditure *(million euro)*	Average level of error reported by the Member States in 2014 AAR	Aggregated adjusted error rate (DG AGRI) in 2014 AAR	Corrective capacity in 2014 AAR				
				Average financial corrections over the last three years in 2014 AAR *(million euro)*		Average recoveries over the last three years in 2014 AAR *(million euro)*		Total
EAGF	44 137,85	0,5 %	2,6 %	536,4	1,2 %	117,8	0,3 %	**1,5 %**
EAFRD	11 186,0	1,5 %	5,1 %	113,6	1,0 %	95,6	0,9 %	**1,9 %**

Source: European Court of Auditors based on DG AGRI annual activity report.

THE COURT'S OBSERVATIONS

7.71. The Commission defines corrective capacity as a mechanism for correcting the errors made and protecting the EU budget. For EAFRD the 2014 figures show that the corrective capacity is insufficient to reduce the expenditure at risk below materiality by the end of the programming period.

DG ENV's systems and annual activity report

7.72. We examined DG Environment's systems of internal control, focusing on late payments management, payment suspensions and recovery procedures. We identified weaknesses mainly in the management of late payments. Similar to previous years, 11 % of payments were made after the regulatory deadline in 2014.

7.73. We examined DG Environment's 2014 annual activity report, focusing on whether the information provided was in line with our own findings, and whether the estimations used by the Commission to calculate the average level of error were reasonable. Our available audit findings did not call into question the information provided in the annual activity report, and the estimations used by the Commission were reasonable.

THE COMMISSION'S REPLIES

7.71. *In the 2014 Annual Activity Report, the Director General for Agriculture and Rural Development gives assurance for the CAP as a whole, taking into account the overall amount at risk for the year concerned as well as the corrective capacity.*

For EAFRD, the Director General noted that 'Rural Development remains an area which merits very close scrutiny and continued assessment of whether, with reasonable effort, it will be possible for the adjusted error rate to descend below 2 %'.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

Conclusion and recommendations

The conclusion for 2014

7.74. Overall audit evidence indicates that spending on 'Natural resources' and on both areas subject to a specific assessment (see paragraphs 7.18 and 7.25) is affected by a material level of error.

7.75. For this MFF heading, testing of transactions indicates that the estimated level of error present in the population is 3,6 % (see ***Annex 7.1***).

7.75. *The Commission takes note of the most likely error estimated by the Court, which is lower than last year. The Commission is of the view that this decrease is the result of all the remedial actions taken by the Commission and the Member States to improve the management and control systems.*

Without cross-compliance which accounts for 0,6 percentage points, the most likely error rate is 3,0 %.

Recommendations

7.76. ***Annex 7.2*** shows the result of our review of progress in addressing recommendations made in previous annual reports. In the 2011 and 2012 annual reports, we presented 21 recommendations. The Commission and the Member States fully implemented five recommendations, while four were implemented in most respects and 12 in some respects.

7.76. *The Commission takes note of the latest assessment made by the Court of the progress in addressing recommendations made in previous annual reports.*

The Commission will continue working with the Member States to further improve the way they follow-up the Court's recommendations.

7.77. Following this review and the findings and conclusions for 2014, we recommend that, for EAGF:

7.77. *By their nature and their formulation, certain of the Court's recommendations are permanent. The Commission considers that it has followed similar recommendations for many years and that it has done everything possible to bring about the requested improvements.*

— **Recommendation 1:** the Member States make further efforts to include reliable and up-to date information in their LPIS databases on the size and eligibility of agricultural land, notably of permanent pasture, and systematically analyse and use all the information available in the context of administrative checks, including up-to-date orthoimages, in order to avoid payments for ineligible land;

The Commission supports this recommendation.

In order to assist and provide guidance to Member States in their implementation of the area based direct payments, a new unit has been specifically created within the Directorate General for Agriculture and Rural Development.

In addition, shortcomings in Member States' management and control systems are addressed through targeted and comprehensive action plans where necessary. When the Commission detects such problems during the course of their audits, they request the Member State to take remedial actions. Where the problem is particularly acute, the Member State is required to implement a remedial action plan which is closely followed by the services. So far such plans have been found to be very effective.

When the implementation of the action plan is not deemed to be effective, payments can be reduced or suspended in order to protect the EU budget.

THE COURT'S OBSERVATIONS

for rural development that the Commission:

— **Recommendation 2:** take appropriate measures to require that Member States' action plans include remedial actions addressing the frequently found causes of error;

— **Recommendation 3:** revise the strategy for its rural development conformity audits so as to establish whether systems weaknesses found in one specific region, for Member States with regional programmes, are also present in the other regions, especially for investment measures;

THE COMMISSION'S REPLIES

The Commission accepts the recommendation. The Commission is working intensively with the Member States in order to identify and remedy the causes of errors in the implementation of the policy. This work will continue with the aim to further address identified shortcomings, including those found by the Court of Auditors.

In the follow up process of the action plans on error rates conducted in 2014 all Member States were already asked to link the action plans and mitigating actions to different audit findings communicated by the Commission or the Court of Auditors.

The Commission is notably taking this issue on board in all Annual Review meetings and Monitoring Committees with the Managing Authorities, insisting in the completeness and effectiveness of the action plans.

A new IT monitoring tool is in place to track the implementation of the necessary remedial actions.

The Commission accepts the recommendation.

The Commission is extending its audit coverage for rural development. This includes verifying whether weaknesses found in one region or measure may also be present in other regions/measures.

The Commission is also reinforcing its use of external auditors on specific issues.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

and for both the EAGF and rural development that the Commission:

— **Recommendation 4:** ensure that the new assurance procedure on legality and regularity of transactions, which will become mandatory as of the financial year 2015, is correctly applied by the certification bodies and produces reliable information about the level of error, so as to be able to rely on it.

The Commission accepts the recommendation.

Detailed guidelines on the new role of the Certification Bodies have been drawn up, and discussed in 2013 and 2014.

Their implementation is being closely monitored by the Commission. In this context, bi-annual Expert Group meetings are held with Paying Agencies and Certification Bodies where practical issues of the legality and regularity work are clarified.

There are regular audit missions to Member States to review the working methods of the Certification Bodies in the context of the legality and regularity of transactions.

Certification Bodies' representatives are also invited to participate, for training purposes, in regular conformity audits.

While the Commission accepts this recommendation, it emphasises that there will be a learning curve for the Certification Bodies and as from 2015 it will report in the Annual Activity Reports on the progress made.

7.78. Furthermore, we recommend that, in the area of fisheries, the Commission:

— **Recommendation 5:** ensure that Member State audit authorities carry out their tasks more thoroughly, notably by performing the required on-the-spot controls, applying quality control procedures and improving audit documentation.

The Commission accepts the recommendation and considers that it is being implemented by means of its ongoing audit work and the provision of guidance when required and takes the necessary steps in the context of shared management to assist the Member State audit authorities to discharge their tasks effectively.

PART 2: RURAL DEVELOPMENT PERFORMANCE-RELATED ISSUES

Assessment of projects' performance

7.79. In our 2013 annual report we found that the selection of projects under shared management — a Member State responsibility — has focused first on the need to spend the EU money available, second on the need to comply with the rules and only third — and to a limited extent — on their expected performance ([56]). This year, as part of a pilot-exercise we also checked some performance issues, in addition to checking the regularity of transactions.

7.80. For this pilot-exercise we only selected those projects where the performance aspects could reasonably be examined. Therefore, out of all 162 rural development transactions we focused on 71 projects which included investments in tangible assets. 42 of these 71 projects were completed at the time of the audit visit. In addition to checking the regularity of these transactions, we also assessed their economy and effectiveness by testing performance criteria for each project.

7.81. We checked for the completed projects examined that the investment had been carried out as planned ([57]). This criterion was fulfilled for most projects (93 %). However, for the projects overall, we found the following main performance issues:

— deficiencies in targeting measures and selecting projects;

— insufficient evidence that costs are reasonable.

([56]) 2013 annual report paragraph 10.10.

([57]) The performance criterion 'There is evidence from the on-the-spot visit that the project output was delivered as planned' was considered fulfilled if the project's output was achieved as planned. The criterion was considered not fulfilled when the project was not or only partly completed, without acceptable justifications for this situation.

THE COURT'S OBSERVATIONS

Deficiencies in targeting the measures and selecting projects

7.82. We tested whether support was targeted at clearly defined objectives reflecting identified structural and territorial needs and structural disadvantages ([58]). This criterion was not fulfilled for 21 % of the investment projects audited. We also tested whether the project had been selected on the basis of a transparent procedure, based on comparative merits with relevant selection criteria ([59]). This criterion was not fulfilled for 51 % of the investment projects audited.

7.83. We found the targeting and selection procedures insufficient. In the majority of cases paying agencies did not have to apply a rigorous targeting and selection procedure. There were enough funds available for the projects that were presented to them. For these paying agencies there was no incentive to underspend the available budget by applying performance criteria. Only one case of good practice was found. Examples are given in Box 7.10. We reported on the lack of adequate targeting for rural development investments in several of our recent special reports ([60]).

THE COMMISSION'S REPLIES

7.82. *This issue has been addressed in the Guidelines on selection criteria for 2014-2020 programming period, where the existence of a ranking of projects and a minimum threshold must be ensured. Some bad practices, few extracted from the Court's reports, have also been included as illustration.*

([58]) This criterion was considered fulfilled if the objectives were defined in a clear manner, and eligibility conditions and selection criteria for the measure restricted the scope of the aid to specific beneficiaries or geographical areas in line with real needs identified in the RDP.

([59]) This criterion was considered fulfilled if a competitive selection procedure was used, which was correctly documented, and if the selection criteria were based on comparative merits and linked to the objectives of the measures with appropriate weighting.

([60]) See for instance special report No 8/2012 'Targeting of aid for the modernisation of agricultural holdings', special report No 1/2013 'Has the EU support to the food-processing industry been effective and efficient in adding value to agricultural products', and special report No 6/2013 'Have the Member States and the Commission achieved value for money with the measures for diversifying the rural economy?'

THE COURT'S OBSERVATIONS

Box 7.10 — Examples of good and bad practices in targeting and selection

In the Netherlands, a call for applications with a budget of 3,6 million euro was launched for the sub-measure 'knowledge sharing'. The 40 eligible applications were assessed by four independent experts, who each allocated points to the projects for a number of selection criteria. A weighted score was then used to rank the projects. Only the 13 highest-ranked projects, with a total amount of 2,9 million euro, were approved, as the other projects were considered to be insufficient value for money. We consider this a case of good practice, as principles of sound financial management were prioritised above spending the funds, as demonstrated by the fact that the remaining budget was not used to fund eligible but less effective projects.

In Bulgaria, support for the measure 'adding value to agricultural and forestry products' was not targeted, as all enterprises with less than 750 staff or an annual turnover less than 200 million euro were eligible for funding. Furthermore, despite the fact that selection criteria had been defined, these were not used to target the support, as the available budget was sufficient to finance all eligible projects.

We found 20 more cases where selection criteria were effectively not used because sufficient funds were available to finance all eligible projects. In all cases the expenditure was paid in 2014 from the budgets available for the 2007-2013 period. Such a situation can arise when budgets exceed actual needs.

THE COMMISSION'S REPLIES

Box 7.10 — Examples of good and bad practices in targeting and selection

Projects selected by Managing Authorities must contribute to the achievement of the policy goals. The Rural Development Programmes define the eligibility of the operations within the given legal framework (first targeting), establishes the principles for the selection criteria (second targeting), they are then concretized in the Monitoring Committee (third targeting) and finally, if done as the Commission requests, projects are ranked leaving outside those that do not pass a threshold. Therefore, the existing legal framework already takes on board all the necessary elements to ensure an adequate targeting of EU funds.

THE COURT'S OBSERVATIONS

7.84. We also tested the performance criterion as to whether, as part of targeting and selection, there was a focus on job creation ([61]). To measure progress in meeting the Europe 2020 goals, five headline targets have been agreed for the whole EU, the first one of which is to employ 75 % of the 20-64 year-olds by 2020. In line with this goal, the Commission informs on its website ([62]) that one of the three long-term strategic objectives for EU rural development policy in the 2014-2020 period is achieving a balanced territorial development of rural economies and communities including the creation and maintenance of employment. Rural development aid would be focused on addressing one of the EU's main problems if the creation of jobs were an eligibility condition for obtaining the aid, and/or if projects were prioritised in the ranking and selection procedures depending on the number of jobs to be created.

7.85. We consider that for 34 projects it would have been possible to include job creation as an eligibility condition and/or selection criterion. For example, Poland allocated 932 million euro to the measure 'Increasing the added value to basic agricultural and forestry production'. Beneficiaries can receive EAFRD support of up to 12,8 million euro without considering whether any jobs have been created.

7.86. However, for 24 of the 34 investment projects (70 %), the number of jobs to be created was neither an eligibility condition nor a selection criterion. No case was found where jobs for young people were to be created.

([61]) This criterion was considered fulfilled if the number of jobs created was an eligibility condition or selection criterion for the project. A focus on youth job creation was considered as good practice.

([62]) http://ec.europa.eu/agriculture/rural-development-2014-2020.

THE COMMISSION'S REPLIES

7.84. *Job creation is not the only relevant performance indicator to look at. Equally important is the need for maintaining jobs in view of stopping depopulation. Therefore, the performance is not only to be assessed in terms of job creation but also in terms of jobs maintained. Furthermore, it is important to note that the increase in productivity linked to innovation and technology might have adverse impacts on employment in job creation, especially in the agricultural sector. Since, accordingly, the employment rates in primary sectors have been decreasing for the last decades, related policy performance cannot be appropriately measured by referring only to net effects.*

See also Commission reply to paragraph 7.86.

7.85. *The job creation indicator should be redefined in order to include job maintenance, and limit the scope to those measures where the performance can be assessed in these terms.*

Investments in physical assets (ex-Axis 1) contribute to farm viability and competitiveness (Priority 2 of Regulation (EU) No 1305/2013). Job creation is mostly covered under Priority 6: promoting social inclusion, poverty reduction and economic development in rural areas. Therefore, to negatively assess the performance of the projects because this criterion has not been taken into account for the selection is not appropriate. This criterion should only be assessed for those projects where indeed the Managing Authority decided to use it for the selection of operations.

Otherwise, there is a mismatch between strategic priorities in rural development as laid down in the legal texts and the assessment of the performance of the projects carried out by the Court.

7.86. *The Commission notes that the observation on lack of focus on job creation is limited to certain measures and within the measures only to specific types of projects as it not fully relevant to all investment measures/types of projects.*

THE COURT'S OBSERVATIONS

7.87. For only four projects was the decision to grant the support conditional on the creation of one or more jobs. This was the case, for example, in Poland for the measure 'Support for the creation and development of micro-enterprises', where the beneficiary was required to create two job places and maintain them for at least two years. In addition, in only 10 cases was job creation a selection criterion. However, as reported in Box 7.10, such procedures were generally not effective. Moreover, the number of points awarded for a job to be created was mostly too low to be decisive in selecting the projects.

Insufficient evidence that costs are reasonable

7.88. For 49 of the 71 investment projects (69 %), we found sufficient evidence that project costs were reasonable ([63]). However, for 22 investment projects (31 %), this was not so. Box 7.11 gives two examples of investment projects where there was no evidence that the costs were reasonable. We recently published a special report containing a detailed examination of this topic ([64]).

THE COMMISSION'S REPLIES

7.87. *Making the provision of evidence for job creation in micro-enterprises a condition for support by EAFRD could be risky in terms of error rate. It would impose an additional burden on the beneficiaries, who in some cases would be incapable to create those jobs due to external circumstances. Furthermore, it needs to be kept in mind that support for micro-enterprises contributes in many cases to a range of objectives, including diversification, local development, innovation, economic performance, and adding value to agricultural products.*

7.88. *The Commission has included in the Guidance Document on controls and penalties for the 2014-2020 period the checklist for assessing the reasonableness of costs produced by the Court and annexed in the Special Report 22/2014. A specific training was organised for Paying Agencies and Managing Authorities under EAFRD on the subject of reasonableness of costs and public procurement on 17 March 2015 in Brussels. The Court was also represented in the event.*

([63]) The performance criterion 'There is evidence that the costs are reasonable' was considered fulfilled if a competitive tendering procedure was used with selection on the basis of the lowest price or best value for money, or if reliable reference costs were used.

([64]) See special report No 22/2014 'Achieving economy: keeping the costs of EU-financed rural development project grants under control'.

THE COURT'S OBSERVATIONS

Box 7.11 — Examples of lack of evidence that costs were reasonable

Portugal uses reference costs for the measure 'Restoring forestry production potential damaged by natural disasters and introducing appropriate prevention instruments'. For one investment project, six reference costs were established for vegetation control which ranged from around 47 to 1 138 euro/ha, depending on the different types of forest works and on the conditions of the parcels (such as the slope and vegetation cover). The rates for the project audited ranged from around 232 to 1 138 euro/ha. We found that the paying agency had not carried out any checks on the reasonableness of the costs. In particular, there was no check on the conditions of the parcels, making it impossible to conclude that the price per hectare of the forest work was reasonable.

In the Netherlands, projects for the measure 'Vocational training for persons employed in agriculture and forestry' were assessed by an evaluation committee before being approved. For a project audited under this measure, the committee reported that they considered the project expensive in relation to the content and potential result. This issue was not followed up by the paying agency. In fact, we did not find any evidence that the paying agency had checked the reasonableness of the costs at all.

Conclusion

7.89. Our examination of performance aspects for rural development investment projects demonstrated deficiencies in targeting and a lack of evidence that costs were reasonable. This confirms the conclusions which we reported in a number of special reports, and shows that the problems still persist.

THE COMMISSION'S REPLIES

Box 7.11 — Examples of lack of evidence that costs were reasonable

See Commission reply to paragraph 7.34.

7.89. *The Commission has improved guidance to Member States for the 2014-2020 programming period, including better targeting and selection of projects and how to assess the reasonableness of costs. Impact of such guidance is therefore only expected in the implementation of the new generation of Rural Development Programmes.*

ANNEX 7.1

RESULTS OF TRANSACTION TESTING FOR 'NATURAL RESOURCES'

	2014	2013 [1]
SIZE AND STRUCTURE OF THE SAMPLE		
Agriculture: Market and direct support	**183**	180
Rural development, environment, climate action and fisheries	**176**	171
Total transactions 'Natural Resources'	**359**	351
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error: Market and direct support	**2,9 %**	3,6 %
Estimated level of error: Rural development, environment, climate action and fisheries	**6,2 %**	7,0 %
Estimated level of error: 'Natural Resources'	**3,6 %**	4,4 %
Upper Error Limit (UEL)	4,6 %	
Lower Error Limit (LEL)	2,7 %	

The lower and upper error limits for Agriculture: Market and direct support are: 2,6 and 6,8 %.
The lower and upper error limits for Rural development, environment, climate action and fisheries are: 3,2 and 9,3 %.

(1) The figures for 2013 have been recalculated to match the structure of 2014 annual report and thus to enable a comparison between the two years. ***Graph 1.3*** of chapter 1 presents how the 2013 results have been reclassified based on the 2014 annual report structure.

ANNEX 7.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'NATURAL RESOURCES'

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2012	3.37. Following this review and the findings and conclusions for 2012, the Court recommends that the Commission and Member States increase and speed up their efforts to ensure that:							
	Recommendation 1: the eligibility of land, and in particular permanent pasture is properly recorded in the LPIS, especially in cases where areas are fully or partly covered with rocks, shrubs or dense trees or bushes or where land has been abandoned for several years.			X				
	Recommendation 2: immediate remedial action is taken where administrative and control systems and/or IACS databases are found to be deficient or out of date.		X					
	Recommendation 3: payments are based on inspection results and that on-the-spot inspections are of the quality necessary to determine the eligible area in a reliable manner.		X					
	Recommendation 4: the design and quality of the work performed by the directors of paying agencies and the certification bodies in support of their respective declarations and statements provide a reliable basis for the assessment of the legality and regularity of underlying transactions.			X				
	4.44. Following this review and the findings and conclusions for 2012, the Court recommends in the area of rural development that:							
	Recommendation 1: the Member States carry out their existing administrative checks better, by using all relevant information available to the paying agencies, as this has the potential to detect and correct the majority of errors.			X				

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2012	**Recommendation 2:** the Commission ensures that all cases where the Court detected errors are followed up appropriately.	X						
	Recommendation 3: the Commission, in DG AGRI's annual activity report, applies a similar approach for EAFRD as for decoupled area aid, where the Commission takes account of the results of its own conformity audits in assessing the error rate for each paying agency.	X						
	For the CAP as a whole that: **Recommendation 4:** the Commission ensures adequate coverage in its conformity audits.			X				
	Recommendation 5: the Commission addresses the weaknesses identified in its conformity audits and the persistent problem of long delays in the conformity procedure as a whole.		X					
	Recommendation 6: the Commission further improves its method of determining financial corrections so as to take better account of the nature and gravity of the infringements detected.	X						
	4.45. In the policy area of health and consumer protection that:							
	Recommendation 7: the Commission addresses the weaknesses identified in systems for procurement and grant agreements.	X						

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2011	3.45 Following this review and the findings and conclusions for 2011, the Court recommends for the current programming period that the Commission and Member States take appropriate action to ensure that:							
	Recommendation 1: the eligibility of permanent pasture is properly assessed, especially in cases where areas are partly covered with bushes, shrubs, dense trees or rocks.			X				
	Recommendation 3: on-the-spot inspections are of the quality necessary to identify the eligible area in a reliable manner.		X					
	Recommendation 4: the design and quality of the work performed by the certification bodies provides a reliable assessment of the legality and regularity of operations in the paying agencies.			X				
	4.53. It should be noted that the Court's recommendation to further simplify the rules and conditions for rural development remains valid.			X				
	4.54. Following this review and the findings and conclusions for 2011, the Court recommends in the area of rural development for the current programming period that:							
	Recommendation 1: the Member States carry out administrative and on-the-spot checks in a more rigorous manner so as to mitigate the risk of declaring ineligible expenditure to the EU.			X				

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2011	**Recommendation 2:** the Commission and the Member States ensure that the existing rules are better enforced concerning: — public procurement and VAT rules when public bodies are beneficiaries of the aid, — agri-environment commitments and eligibility rules for modernisation of holdings.			X				
	Recommendation 3: the Commission analyses the reasons for the material error rate.	X						
	Recommendation 5: the Commission extends the guidelines for the certification bodies with the requirement that these bodies include, in their audit strategy and reports, findings from previous audits by the Commission and the Court.			X				
	Recommendation 6: regarding cross-compliance, the Member States should ensure the respect of the requirements concerning animal identification and registration and improve the spread of checks throughout the year so that all relevant requirements are properly checked.			X				
	4.55. In the policy areas of environment, maritime affairs and fisheries, health and consumer protection, the Court recommends that the Commission improves the monitoring of fish catches under fisheries partnership agreements with countries outside the EU.			X				

CHAPTER 8

'Global Europe'

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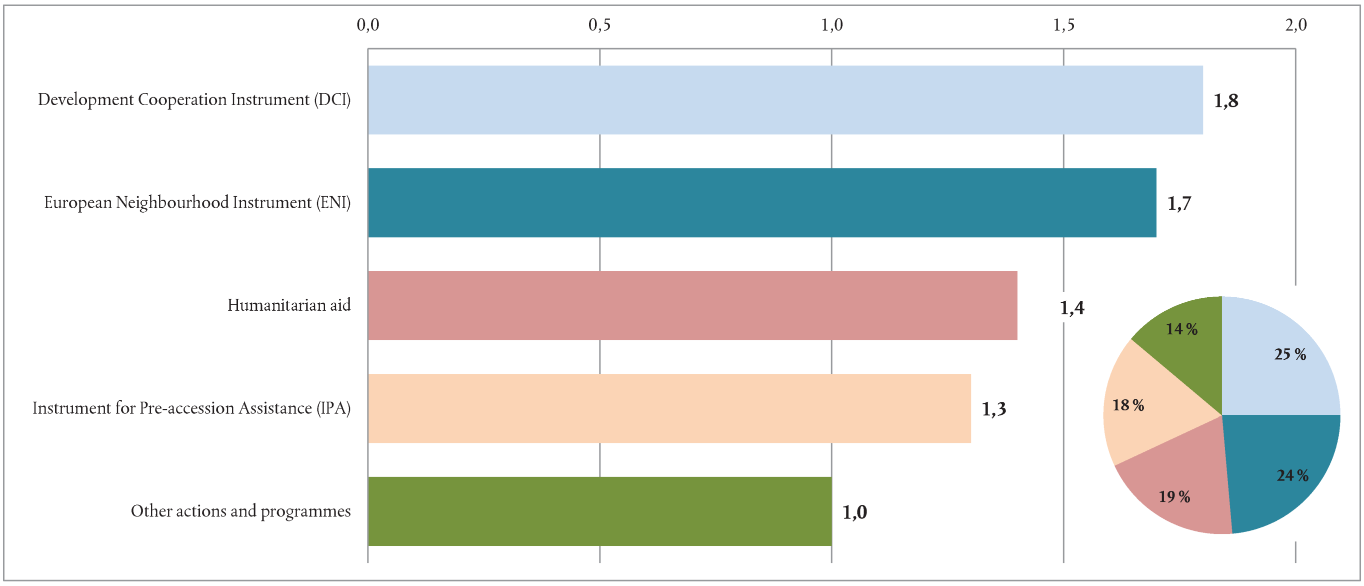
THE COURT'S OBSERVATIONS

INTRODUCTION

8.1. This chapter presents our findings related to our specific appraisal for 'Global Europe'. It has a broader coverage than the former chapter 7 on 'External relations, aid and enlargement' [1] as it also includes expenditure related to regional policy (300 million euro), rural development (150 million euro) and research and other internal policies (100 million euro). Key information on the activities covered and the spending in 2014 is provided in ***Graph 8.1.***

Graph 8.1 — MFF heading 4 — 'Global Europe'

(billion euro)



Total payments for the year:		7,2
— operational expenditure	6,0	
— budget support	0,9	
— administrative expenditure	0,3	
- *advances* [1]		4,3
+ *clearings of advances*		4,5
Audited population, total		**7,4**

[1] In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 7).

Source: 2014 consolidated accounts of the European Union.

[1] Paragraph 0.7 of the General Introduction explains the new structure of our annual report.

THE COURT'S OBSERVATIONS

Specific characteristics of 'Global Europe'

8.2. 'Global Europe' covers all external actions ('foreign policy') funded by the EU budget. Payments in 2014 for 'Global Europe' amount to 7,2 billion euro channelled through several instruments. The Development Cooperation Instrument (DCI), the European Neighbourhood Instrument (ENI), the Instrument for Pre-accession Assistance (IPA) and humanitarian aid make up more than 86 % of the MFF heading area.

8.3. In the field of development cooperation, the EU's primary objective is the reduction and, in the long term, the eradication of poverty [2]. The objective of the neighbourhood policy is to support partners who undertake reform towards democracy, rule of law and human rights; to contribute to their inclusive economic development and to promote a partnership with societies alongside relations with governments. Pre-accession aid aims to assist candidate and potential candidate countries to respect the values of human dignity, freedom, democracy, equality, the rule of law and human rights. Humanitarian aid provides ad hoc assistance, relief and protection for people in third countries who are victims of natural or man-made disasters.

8.4. The most significant directorates-general for implementing the budget for external action are the Directorate-General for International Cooperation and Development (EuropeAid), the Service for Foreign Policy Instruments (FPI), the Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR, former DG ELARG) and the Directorate-General for Humanitarian aid and Civil Protection (ECHO).

8.5. The expenditure of MFF heading 'Global Europe' is made under a wide range of cooperation instruments and delivery methods [3], applied in more than 150 countries. Rules and procedures are often complex, including those for tendering and the award of contracts.

(2) Based on the Lisbon Treaty and on the 2005 European Consensus on Development.

(3) External actions may, in particular, finance procurement contracts, grants, including interest rate subsidies, special loans, loan guarantees and financial assistance, budgetary support and other specific forms of budgetary aid.

THE COURT'S OBSERVATIONS

8.6. In two areas the nature of the instruments and of payment conditions limits the extent to which transactions are prone to errors. These are budget support [4] and EU contributions to multi-donor projects carried out by international organisations [5] such as the United Nations (UN).

8.7. Budget support contributes to a state's general budget or its budget for a specific policy or objective. We examined whether the Commission complied with the specific conditions for making budget support payments to the partner country concerned and verified that general eligibility conditions (such as progress in public sector finance management) had been complied with.

8.8. However, the legal provisions offer broad scope for interpretation and the Commission has considerable flexibility in deciding whether these general conditions have been met. Our audit of regularity cannot go beyond the stage at which aid is paid to the partner country. The funds transferred are then merged with the recipient country's budget resources. Any weaknesses in its financial management will not generate errors in our audit of regularity.

8.9. When the Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of expenditure, the Commission assumes that EU eligibility rules are complied with as long as the pooled amount includes sufficient eligible expenditure to cover the EU contribution. This is what the Commission calls the 'notional approach'. The notional approach applied by the Commission limits the work of the auditors in case of substantial contribution of other donors, which the Commission then considers sufficient to cover any ineligible expenditure we may have found.

(4) Budget support payments made from the general budget in 2014 amounted to 850 million euro.

(5) The payments made to international organisations from the general budget in 2014 amounted to 1 640 million euro.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Audit scope and approach

8.10. ***Annex 1.1***, ***part 2***, of chapter 1 describes our overall audit approach and methodology. For the audit of 'Global Europe', the following specific points should be noted:

(a) The audit involved an examination of a sample of 172 transactions as defined in ***Annex 1.1***, paragraph 7. The sample is designed to be representative of the entire range of transactions within the MFF heading area. In 2014, the sample consisted of 122 transactions approved by the EU Delegations in 11 beneficiary states ([6]) and 50 transactions approved by the Commission headquarters.

(b) The assessment of the annual activity reports included reports of EuropeAid and ECHO.

REGULARITY OF TRANSACTIONS

8.11. ***Annex 8.1*** contains a summary of the results of transaction testing. Of the 172 transactions that we audited, 43 (25 %) were affected by error. On the basis of the 28 errors which we have quantified, we estimate the level of error to be 2,7 % ([7]).

8.11. *Common reply to paragraphs 8.11 to 8.20.*

The Commission's checks are designed in such a way that the detection and correction of errors, through ex post *audits — after final payments — is still possible. An extensive programme of* ex post *audits is planned and implemented by the external aid DGs on an annual basis, based on a formal risk assessment process.*

8.12. When excluding from the audited sample budget support and multi-donor transactions referred to in paragraphs 8.6 to 8.9, the estimated level of error is 3,7 % ([8]).

8.13. In seven cases of quantifiable errors, the Commission had sufficient information ([9]) to prevent or detect and correct the errors before accepting the expenditure. If all this information had been used to correct errors, the estimated level of error for this chapter would have been 0,2 percentage points lower. In five other transactions, we found errors that had not been detected by the auditors appointed by the beneficiaries.

8.14. ***Graph 8.2*** presents the extent to which the different types of errors contribute to our estimated level of error for 2014.

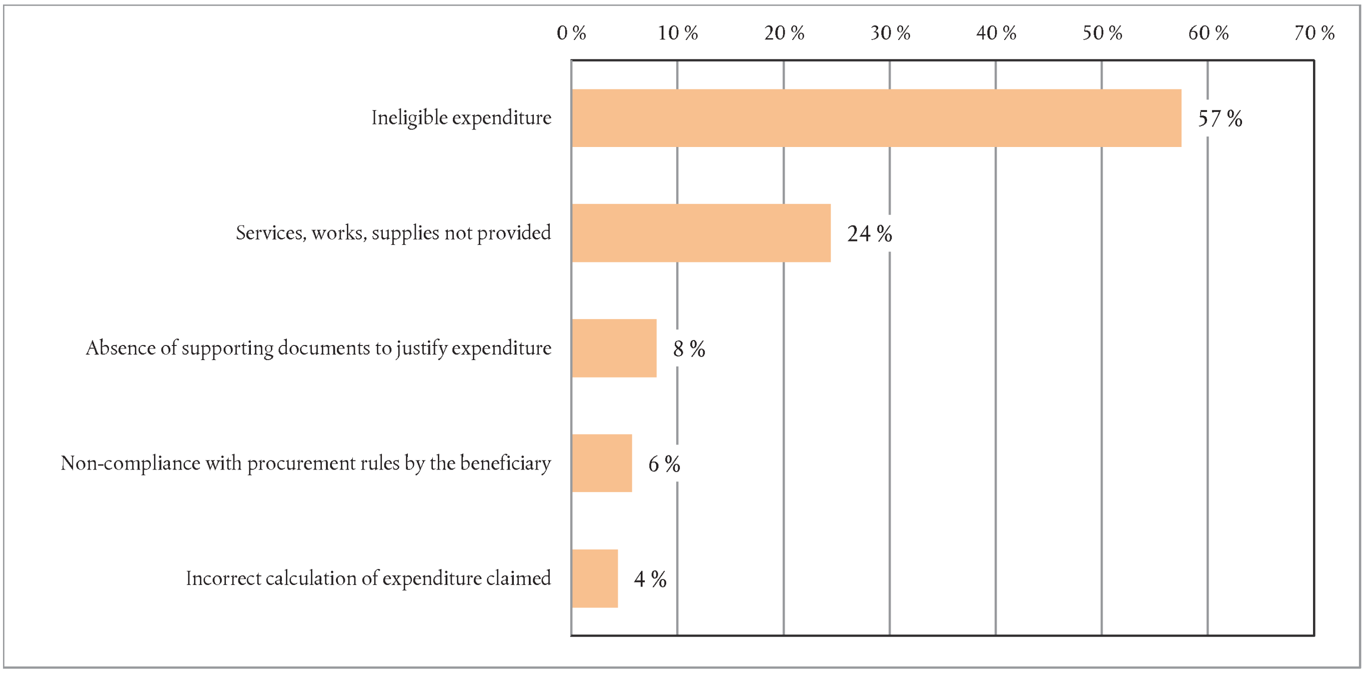
([6]) Belize, Bosnia and Herzegovina, Colombia, Jamaica, Laos, Moldova, Niger, Palestine, Serbia, Thailand and Tunisia.

([7]) We calculate our estimate of error from a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the rate of error in the population lies between 0,9 % and 4,4 % (the lower and upper error limits respectively).

([8]) 129 transactions, lower error limit (LEL) 1,3 % and upper error limit (UEL) 6,0 %, with 95 % confidence.

([9]) On the basis of supporting documentation and mandatory checks.

Graph 8.2 — Contribution by type of error to the estimated level of error



Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

8.15. The most significant type of error (14 out of 28 cases), representing 57 % of the estimated level of error, concerns ineligible expenditure. This consists of expenditure related to activities not covered by the contract or incurred outside the eligibility period, ineligible taxes, non-compliance with the rule of origin and indirect costs wrongly charged as direct costs (see example in Box 8.1). All of these reported cases relate to grant contracts or contracts implemented by international organisations.

THE COURT'S OBSERVATIONS

Box 8.1 — Ineligible expenditure

EuropeAid — Laos

The Commission signed a grant agreement of 150 000 euro with a national operator in Laos with the overall objective of reducing the number of casualties caused by unexploded ordnance through risk education. The contractually agreed implementation period started in January 2009. Salary costs of the field staff for December 2008 were charged and accepted by the Commission. The accepted costs were therefore overstated.

8.16. 24 % of the estimated level of error represented five cases for which the Commission incorrectly accepted (and cleared) expenditure for service, works and supplies not incurred at the moment the Commission accepted it (see example in Box 8.2).

Box 8.2 — Expenditure not incurred

EuropeAid — Belize

The Commission signed a contribution agreement with a Caribbean bank for an amount of 6,5 million euro for the establishment of a revolving credit facility for sugar cane replanting in Belize. The Commission financed the action in full.

In 2014 the Commission accepted expenditure amounting to 2,3 million euro of which 740 000 euro represented loan contracts to farmers signed by the financial institution but not yet paid out. By accepting the full amount as incurred expenditure the Commission incorrectly cleared too much of the previously paid pre-financing.

THE COURT'S OBSERVATIONS

8.17. 8 % of the estimated level of error was due to the absence of support documents. 4 % of the estimated level of error arose from cases when the expenditure claimed has been wrongly calculated due to mathematical errors or incorrect exchange rates.

8.18. 6 % of the estimated level of error related to irregular procurement or contracting procedures carried out by the beneficiaries (see example in Box 8.3).

Box 8.3 — Irregular contracting procedure

EuropeAid — Tunisia

The Commission signed a grant agreement of 230 000 euro with a Swiss NGO with an aim to stabilise radio broadcasting and to ensure distribution of information to a wide audience in Tunisia when preparing for the general elections after the revolution.

The NGO has signed a contract with a service provider for an amount of 11 500 euro with no evidence that three service providers were consulted when awarding the contract.

8.19. 15 transactions out of 172 were affected by non-quantifiable errors relating to non-compliance with legal or contractual obligations.

8.20. The 20 budget support transactions examined were free from errors of legality and regularity.

8.21. In our 2013 annual report we reported a systemic error as DG ELARG was accepting expenditure based on their own estimates rather than on incurred, paid and accepted costs. During this year's audit, we noted that such bookings also occurred in 2014 (96 million euro). In May 2014, DG ELARG corrected the incorrectly made clearings from their accounts for 2013 and 2014. It also revised the instructions laid down in the ELARG Manual on Accounting which now state that pre-financing should be cleared on the basis of accepted eligible expenditure.

THE COMMISSION'S REPLIES

Box 8.3 — Irregular contracting procedure

This is an isolated case due to an urgent and immediate need. The NGO has been reminded to apply correct procurement rules in the future.

8.21. *Further to the observations of the Court in the DAS 2013 process, ex DG ELARG immediately implemented significant changes to its systems, which are now followed through.*

The progress made by DG NEAR on this topic was communicated to the other institutions.

THE COURT'S OBSERVATIONS

EXAMINATION OF SELECTED SYSTEMS AND ANNUAL ACTIVITY REPORTS

EuropeAid

8.22. Transaction testing has revealed that the Commission's ex ante systems have in some cases failed. The expenditure verification carried out by the auditors appointed by the beneficiaries has not always detected the errors. This has led to acceptance of ineligible costs by the beneficiaries.

8.23. The detailed results of the assessment of EuropeAid systems including the residual error rate study carried out by EuropeAid and examination of its annual activity report are presented in our annual report on the 8th, 9th, 10th and 11th European Development Funds, paragraphs 36-46.

ECHO

8.24. Following a rotational approach ([10]), we have examined the annual activity report of ECHO in the area of 'Global Europe'.

8.25. In his declaration of assurance for the year 2014, the Director-General for ECHO declared he had reasonable assurance that the control procedures put in place provided the necessary guarantees concerning the legality and regularity of the underlying transactions and that the information provided in the report was reliable, complete and correct. This declaration is supported by the findings and conclusions based on our audit work on ECHO transactions in 2014.

([10]) In the previous years we have examined the 2013 annual activity report of FPI and 2012 annual activity report of DG ELARG.

THE COURT'S OBSERVATIONS

CONCLUSION AND RECOMMENDATIONS

The conclusion for 2014

8.26. Overall audit evidence indicates that spending on 'Global Europe' is affected by a material level of error.

8.27. For the spending on this MFF heading area, testing of transactions indicates that the most likely error present in the population is 2,7 % (see ***Annex 8.1***).

Recommendations

8.28. ***Annex 8.2*** shows the results of our review of progress in addressing recommendations made in previous annual reports [11]. In the 2011 and 2012 annual reports, we presented eight recommendations. The Commission fully implemented four recommendations, while two were implemented in most respects and two were implemented in some respects.

8.29. As stated in paragraph 8.22 the testing of transactions in 2014 has revealed weaknesses in the expenditure verifications. This matter has already been presented in our 2012 annual report where we invited the Commission to take effective steps to ensure the quality of expenditure checks carried out by external auditors. Since then EuropeAid has taken actions addressing the weaknesses regarding external audits and verifications. However, the impact of these actions is too early to be assessed as some actions are still under development.

8.30. The results of the transaction testing have demonstrated that in some cases the controls to prevent and detect ineligible expenditure for grant contracts have failed. A recommendation on grant supervision was issued in our 2011 annual report but the actions taken by the Commission are considered to be implemented only in some respects.

THE COMMISSION'S REPLIES

8.29. *Since the issue is more complex in practical terms than expected, the development of the quality grids for expenditure verification reports is taking a longer time than foreseen. The grids should be available by the last quarter of 2015.*

(11) The objective of this follow-up was to verify the introduction and existence of corrective measures in response to our recommendations. It did not aim to assess their effective implementation. For some measures which were still under development the verification was too early to be made.

THE COURT'S OBSERVATIONS

8.31. Following this review and the findings and conclusions for 2014, we recommend that the Commission, and particularly EuropeAid:

— **Recommendation 1**: set up and implement internal control procedures to ensure that pre-financing is cleared on the basis of actual incurred expenditure not including legal commitments;

— **Recommendation 2**: strengthen the ex ante controls for grant contracts namely by EuropeAid making operational the intended actions following the recommendation made in the EDF 2011 annual report for risk-based planning and systematic follow-up for verification and on-the-spot monitoring visits.

THE COMMISSION'S REPLIES

The Commission accepts this recommendation.

The Commission will further clarify clearing rules for Contribution Agreements in the DEVCO and NEAR Companions.

The Commission accepts the recommendation. Measures are already being implemented.

ANNEX 8.1

RESULTS OF TRANSACTION TESTING FOR ‘GLOBAL EUROPE’

	2014	2013 [1]
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions:	**172**	182
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**2,7 %**	2,1 %
Upper Error Limit (UEL)	4,4 %	
Lower Error Limit (LEL)	0,9 %	

([1]) The figures for 2013 have been recalculated to match the structure of the 2014 annual report and thus to enable a comparison between the two years. ***Graph 1.3*** of chapter 1 presents how the 2013 results have been reclassified based on the 2014 annual report.

ANNEX 8.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'GLOBAL EUROPE'

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2012	**Recommendation1:** The Commission should ensure timely clearance of expenditure.		X					
	Recommendation 2: The Commission should promote better document management by implementing partners and beneficiaries.	X						
	Recommendation 3: The Commission should improve the management of contract awarding procedures by setting out clear selection criteria and documenting the evaluation process better.	X						
	Recommendation 4: The Commission should take effective steps in order to enhance the quality of expenditure checks carried out by external auditors.		X					
	Recommendation 5: The Commission should apply a consistent and robust methodology for the external relations directorates-general to calculate residual error rates.	X						

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2011	**Recommendation 6:** EuropeAid, DG ECHO and FPI improve the supervision of grant contracts, making better use of on-the-spot visits to prevent and detect ineligible expenditure declared and/or increase the coverage of the audits contracted by the Commission.			X				
	Recommendation 7: FPI should ensure that all CFSP missions are accredited in accordance with the 'six-pillar assessments'.			X				*Long-established missions have now become compliant with Article 60 Financial Regulation requirements, with FPI assistance. In keeping with its action plans in response to various audit findings, FPI achieved the objective of making the three largest CFSP missions compliant. In addition, one medium sized mission (EUPOL COPPS) was assessed and found compliant by the end of 2014. The four compliant missions (EULEX Kosovo, EUMM Georgia, EUPOL Afghanistan and EUPOL COPPS) consumed approximately EUR 192 million or 61 % of the 2014 CFSP budget. The assessment of a fifth mission (EUCAP Nestor) started in 2014 and will be completed in 2015. Another mission (EUCAP Sahel Niger) will be assessed in 2015.*
	Recommendation 8: FPI should accelerate the closure of old CFSP contracts. (This is the 2011 follow up/update of a 2009 recommendation).	X						

CHAPTER 9

‘Administration’

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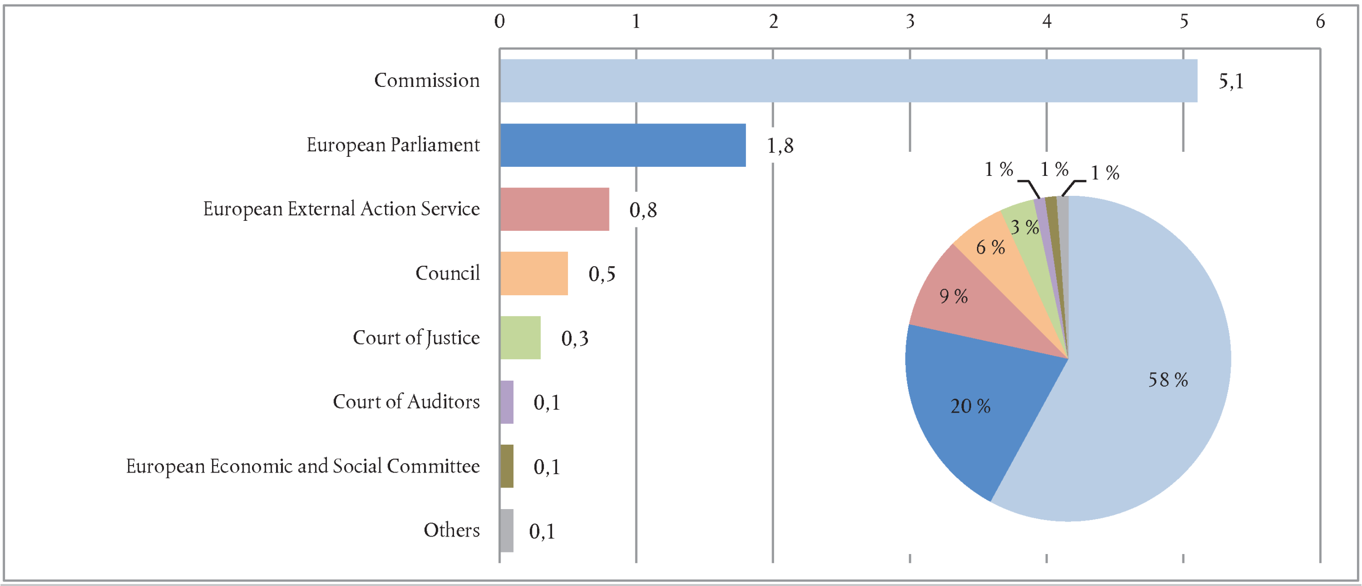
THE COURT'S OBSERVATIONS

INTRODUCTION

9.1. This chapter presents our findings related to our specific assessment for 'Administration' ([1]). Key information on the activities covered and the spending in 2014 is provided in ***Graph 9.1***.

Graph 9.1 — MFF heading 5 — 'Administration' ([2])

(billion euro)



Total payments for the year	8,8
- advance ([1])	*0,1*
+ clearings of advance ([1])	*0,1*
Audited population, total	**8,8**

([1]) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 7).

Source: 2014 consolidated accounts of the European Union.

9.2. We report separately on the EU agencies and other bodies ([3]). Our mandate does not cover the financial audit of the European Central Bank.

([1]) This includes the administrative expenditure of all the European Union (EU) institutions, pensions and payments to the European Schools. For the latter, we issue a specific annual report which is submitted to the Board of Governors of the European Schools. A copy of this report is sent to the European Parliament, the Council and the Commission.

([2]) A proportion of administrative expenditure can also be found under MFF headings other than Heading 5. The total appropriations implemented in 2014 under these headings amount to 1,3 billion euro.

([3]) Our specific annual reports on agencies and other bodies are published in the Official Journal.

THE COURT'S OBSERVATIONS

Specific characteristics of the MFF heading

9.3. Administrative expenditure comprises expenditure on human resources (salaries, pensions and allowances), accounting for about 60 % of the total, as well as expenditure on buildings, equipment, energy, communications and information technology.

9.4. The main risks regarding administrative expenditure are non-compliance with the procedures for procurement, the implementation of contracts, recruitment and the calculation of salaries, pensions and allowances. Overall we consider this MFF heading to be a low risk area.

Audit scope and approach

9.5. ***Annex 1.1***, ***part 2***, of chapter 1 describes our overall approach and methodology. For the audit of 'Administration', the following specific points should be noted:

(a) The audit involved an examination of a sample of 129 transactions as defined in ***Annex 1.1***, paragraph 7. The sample is designed to be representative of the entire range of transactions within the MFF heading. In 2014 the sample consisted of 92 payments of salaries and pensions, related allowances and other staff costs, 14 payments in respect of contracts related to buildings and 23 payments connected with other expenses (energy, communication, information technology, etc.).

(b) The audit also examined ([4]) the procedures for recruiting temporary and contract staff ([5]) and the procurement procedures ([6]) at the European Economic and Social Committee, the Committee of the Regions and the European Ombudsman.

([4]) Based on the rotational approach applied since 2012, the systems audit covers two or three institutions or bodies every year, with a sample of transactions being examined for each institution or body and system.

([5]) In 2014, the audit included the examination of 15 recruitment procedures for the European Economic and Social Committee, 15 recruitment procedures for the Committee of the Regions and 10 recruitment procedures for the European Ombudsman.

([6]) In 2014, the audit included the examination of 15 procurement procedures for the European Economic and Social Committee, 15 procurement procedures for the Committee of the Regions and seven procurement procedures for the European Ombudsman.

THE COURT'S OBSERVATIONS

(c) The assessment of the annual activity reports included the reports of the Commission's directorates-general (DGs) and offices ([7]) primarily responsible for administrative expenditure and of all the other institutions and bodies.

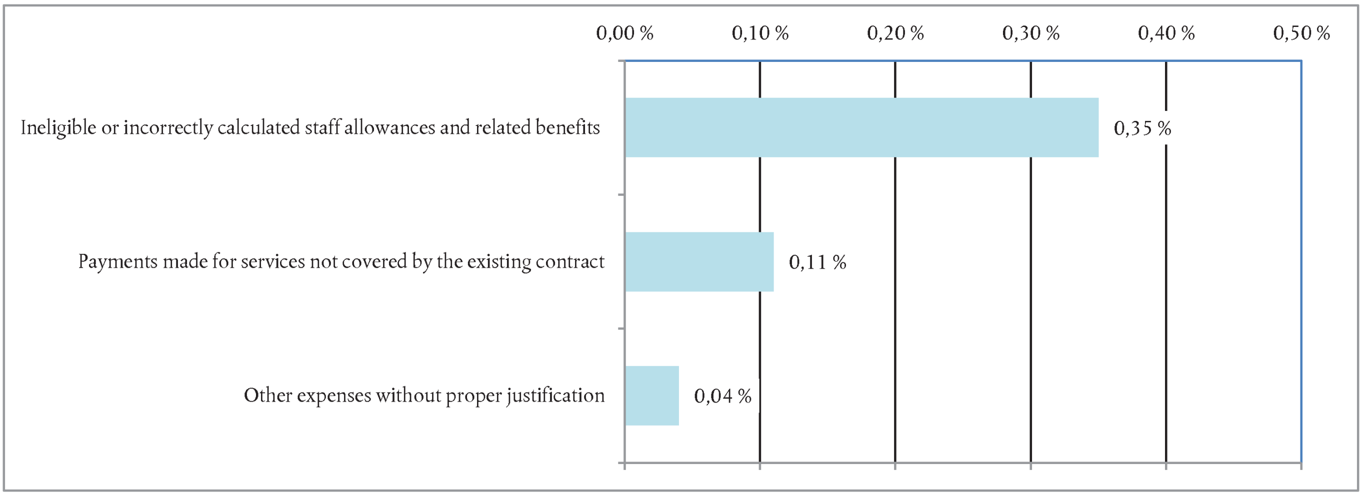
9.6. The Court of Auditors' own spending is audited by an external firm ([8]). The results of its audit of our financial statements for the year ending 31 December 2014 are given in paragraph 9.14.

REGULARITY OF TRANSACTIONS

9.7. ***Annex 9.1*** contains a summary of the results of transaction testing. Of the 129 transactions that we audited, 20 (15,5 %) were affected by error. On the basis of the 12 errors which we have quantified, we estimate the level of error to be 0,5 % ([9]).

9.8. ***Graph 9.2*** presents the extent to which the different types of errors contributed to our estimate of the level of error for 2014.

Graph 9.2 — Contribution by type of error to the estimated level of error



Source: European Court of Auditors.

([7]) DG for Human Resources and Security, Office for the Administration and Payment of Individual Entitlements (PMO), Office for Infrastructure and Logistics in Brussels and DG for Informatics.

([8]) PricewaterhouseCoopers, Société à responsabilité limitée, Réviseur d'Entreprises.

([9]) We calculate our estimate of error from a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the rate of error in the population lies between 0,1 % and 0,9 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

EXAMINATION OF SELECTED SYSTEMS AND ANNUAL ACTIVITY REPORTS

9.9. We did not identify any significant weaknesses in the selected systems and annual activity reports of the institutions and bodies.

OBSERVATIONS ON SPECIFIC INSTITUTIONS AND BODIES

9.10. We did not identify any serious weaknesses in respect of the topics audited for the Court of Justice, the Committee of the Regions, the European Ombudsman and for the European Data Protection Supervisor. Our observations on the following specific institutions and bodies are not material to administrative expenditure as a whole. However, they are significant in the context of the individual institution or body concerned.

REPLY OF THE EDPS

9.10. *The EDPS takes good note of the results of the Court's analysis and will continue to improve its system for timely monitoring and control.*

European Parliament

9.11. Of the 28 payments audited for the European Parliament, one related to the operating grant paid in 2013 to a European political party ([10]). We found weaknesses in the checks carried out by the European Parliament on the political party's expenditure as regards the costs reimbursed by the latter to its affiliated organisations ([11]) and in some of the procurement procedures it organised (see Box 9.1) ([12]).

REPLY OF THE EUROPEAN PARLIAMENT

9.11. *The Parliament recalls that procurement procedures and resulting payments conducted by the political parties at European level (hereinafter 'parties') are only in a limited way comparable to the procurement procedures and payments made directly by the authorising officers of the institutions. Although not directly influencing the tendering procedures of the parties, the Parliament's Authorising Officer provides them with an extensive support. However, responsibility remains with the parties for their financial transactions.*

([10]) Regulation (EC) No 2004/2003 of the European Parliament and of the Council of 4 November 2003 on the regulations governing political parties at European level and the rules regarding their funding (OJ L 297, 15.11.2003, p. 1), as amended by Regulation (EC) No 1524/2007 (OJ L 343, 27.12.2007, p. 5) and Decision of the Bureau of the European Parliament of 29 March 2004 laying down the procedures for implementing Regulation (EC) No 2004/2003 of the European Parliament and of the Council on the regulations governing political parties at European level and the rules regarding their funding (OJ C 112, 9.4.2011, p. 1).

([11]) Affiliated organisations are defined as follows: they must be officially recognised by the European party concerned; they must be listed in the statutes of the party or the collaboration between the party and the affiliated organisation must be based on an established factual partnership; parties need to describe such 'affiliation' at the stage of the grant application.

([12]) See also our opinion No 1/2013 concerning the proposal for a regulation of the European Parliament and of the Council on the statute and funding of European political parties and European political foundations and concerning the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU, Euratom) No 966/2012 as regards the financing of European political parties (OJ C 67, 7.3.2013, p. 1).

THE COURT'S OBSERVATIONS

Box 9.1 — Weaknesses in the European Parliament's controls on the operating grants paid to European political parties

The European Parliament did not ensure that costs reimbursed by a political party to affiliated organisations were actually incurred. Moreover, in one case the ceiling of 60 000 euro for financial support to an individual affiliated organization was exceeded ([13]).

The European Parliament did not take all the necessary actions to ensure that contracts signed by political parties are appropriately tendered. In one procurement procedure, a political party could not fully demonstrate that the contract was awarded to the most economically advantageous offer. In another case, there was no documentary evidence that the award of a contract resulted from a tendering procedure.

REPLY OF THE EUROPEAN PARLIAMENT

Box 9.1 — Weaknesses in the European Parliament's controls on the operating grants paid to European political parties

Financial support to affiliated organisations in excess of the ceiling of 60 000 euros was only accepted for the transitory period of the 2013 financial year as the Financial Regulation had just come into force and the interpretation of the rules for financial support to third parties was only stabilised during the year. From 2014 on, no such excess will be accepted any more as eligible expenses. Following the preliminary remarks of the Court, the Parliament has clarified the requirements for the financial support of affiliated organisations and for procurement in the revised version of the Guide on operating grants awarded by the EP to parties and foundations at European level *of 1 June 2015. Further clarifications will be presented for adoption by the Bureau of the European Parliament in the framework of the closure of the accounts of the parties and foundations for the 2014 financial year.*

European Economic and Social Committee (EESC)

9.12. We found weaknesses in four cases out of the 15 procurement procedures examined. In three of these cases, the EESC did not properly assess whether the tenders complied with the required specifications and made clerical mistakes in valuing the tenderers' bids. In the fourth case, the EESC did not appropriately apply the exclusion criteria for the awarding of the contract.

REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

9.12. *The weaknesses referred to were mostly of a formal nature and, with two exceptions, did not affect the outcome of the procurement procedure. The Court's observations relate to procurement contracts awarded by directorates other than the EESC's logistics directorate (the latter is shared between EESC and the Committee of the Regions and benefits since many years from a specialised service for assisting financial actors with their procurement procedures). The EESC has recently set up a similar support service for public procurement to assist directorates other than the logistics directorate. This service is now staffed with two officials and is fully operational.*

([13]) Article 210 of Commission Delegated Regulation (EU) No 1268/2012 of 29 October 2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 (OJ L 362, 31.12.2012, p. 1).

THE COURT'S OBSERVATIONS

Other institutions and bodies

9.13. As in previous years, we detected a small number of errors relating to the calculation of staff costs and some weaknesses in the management of family allowances at the European Parliament, the Council, the Commission and the European External Action Service (EEAS). We also noted weaknesses in the calculation of staff costs resulting from the operation of service-level agreements between the PMO and the institutions and bodies ([14]).

REPLY OF THE EUROPEAN PARLIAMENT

9.13. *The Parliament has taken note of the Court's observations. By end of 2014, the Parliament had already corrected retrospectively the amounts of the allowances concerned by the cases identified by the Court of Auditors. The debts have been recovered during the first semester of 2015. The introduction at the Parliament in the near future of Sysper2, the system used already by other institutions for the management of human resources, will allow for the automatic transfer of data to the NAP system (system used for the payment of salaries and allowances to staff), avoiding the human errors that might happen with a manual transfer of data.*

REPLY OF THE COUNCIL

9.13. *The Council considers itself to be in full compliance. However, further attention will be given to strengthen procedures for the control of family allowances.*

THE COMMISSION'S REPLY

9.13. *Measures have been taken to correct the detected weaknesses.*

Since February 2013 (updated in August 2014) a new procedure has been implemented by the PMO: rights are granted on a provisional basis (in the year n) for a limited time span (n+2).

After the necessary developments of the SysPer information system (programmed for 2015-2016), follow-up of agents' family situation will be done systematically by the system on a regular basis and through proactive notifications automatically sent to staff.

Regarding the weaknesses in calculation of staff costs for other institutions and bodies, it should be duly noted that the quality of the control carried out by the concerned (PMO) services depends upon the Appointing Authority (AIPN) powers delegated in the various Service Level Agreements.

([14]) The audit of EU agencies revealed some errors in the calculation of salaries resulting from incorrect information transmitted from the agencies to PMO in the context of the transition to the revised 2004 EU Staff Regulation.

THE COURT'S OBSERVATIONS

Court of Auditors

9.14. The external auditor's report [15] states that 'the financial statements give a true and fair view of the financial position of the European Court of Auditors as of 31 December 2014, of its financial performance and its cash flows for the year then ended'.

CONCLUSION AND RECOMMENDATIONS

The conclusion for 2014

9.15. Overall, audit evidence indicates that spending on 'Administration' is not affected by a material level of error. For this MFF heading area, testing of transactions indicates that the estimated level of error present in the population is 0,5 % (see ***Annex 9.1***).

Recommendations

9.16. ***Annex 9.2*** shows the result of our review of progress in addressing recommendations made in previous annual reports. In the 2011 and 2012 annual reports, we presented 10 recommendations. Of these recommendations, two were not reviewed this year given our rotational approach [16]. The institutions and bodies concerned implemented five recommendations in most respects and three were implemented in some respects.

9.17. Following this review and the findings and conclusions for 2014, we recommend that:

— **Recommendation 1**: the European Parliament reinforce its checks on the costs reimbursed by European political parties to their affiliated organisations. In addition, the European Parliament develop appropriate rules for political parties on public procurement and monitor their application through appropriate checks and better guidance (see paragraph 9.11);

9.17.

REPLY OF THE EUROPEAN PARLIAMENT

See reply to paragraph 9.11.

(15) See the external auditor's report on the financial statements referred to in paragraph 9.6.
(16) See footnote 4.

THE COURT'S OBSERVATIONS

— **Recommendation 2:** the EESC improve the design, coordination and conduct of procurement procedures through appropriate checks and better guidance (see paragraph 9.12);

REPLY OF THE ECONOMIC AND SOCIAL COMMITTEE

Please refer to the EESC's comments on item 9.12.

— **Recommendation 3**: the institutions and bodies improve their monitoring systems for the timely updating of the personal situation of staff members which may have an impact on the calculation of family allowances (see paragraph 9.13).

REPLY OF THE EUROPEAN PARLIAMENT

See reply to paragraph 9.11.

THE COMMISSION'S REPLY

The Commission accepts the recommendation and has already taken measures to improve the monitoring system in place. In addition a systematic follow up on the family situation of the staff will be ensured in the near future (2015/2016). Please see reply to paragraph 9.13.

ANNEX 9.1

RESULTS OF TRANSACTION TESTING FOR 'ADMINISTRATION'

	2014	2013 [1]
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions:	**129**	135
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**0,5 %**	1,1 %
Upper Error Limit (UEL)	0,9 %	
Lower Error Limit (LEL)	0,1 %	

[1] The figures for 2013 have been recalculated to match the structure of the 2014 annual report and thus to enable a comparison between the two years. ***Graph 1.3*** of chapter 1 presents how the 2013 results have been reclassified based on the 2014 annual report structure.

ANNEX 9.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'ADMINISTRATION'

Year	Court recommendation	Court's analysis of the progress made						Institution's reply
		Fully implemented	Being implemented		Not mplemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2012	**Recommendation 1 (European Parliament):** *Procurement* The European Parliament should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2012 annual report, paragraphs 9.12 and 9.19, and the 2011 annual report, paragraphs 9.15 to 9.17 and 9.34).		The audit found weaknesses in the procurement procedures (see paragraph 9.11).					*See above reply to paragraph 9.11.* *The Court's observation in paragraph 9.11 specifically relates to procurement of political parties.*
	Recommendation 2 (European Council and Council): *Procurement* The Council should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2012 annual report, paragraphs 9.14 and 9.19, and the 2011 annual report, paragraph 9.18).		X					*The Council's procurement process has been strengthened, e.g. by improved controls on the appropriateness of expenditure, revision of the Internal Rules on buildings, supplies, services and works contracts, improved templates, targeted training and development of further guidance.*
2011	**Recommendation 3 (European Parliament):** *Updating of the personal situation and of allowances received by staff* The European Parliament should take steps to ensure that staff deliver at appropriate intervals documents confirming their personal situation and implement a system for the timely monitoring of these documents (see the 2011 annual report, paragraphs 9.12 and 9.34).			The audit found that weaknesses persisted in the management of family allowances (see paragraph 9.13).				*See above reply to paragraph 9.13.*

Year	Court recommendation	Court's analysis of the progress made						Institution's reply
		Fully implemented	Being implemented		Not mplemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2011	**Recommendation 4 (Commission):** *Updating of the personal situation and of allowances received by staff* The Commission should take steps to ensure that staff deliver at appropriate intervals documents confirming their personal situation and implement a system for the timely monitoring of these documents (see the 2011 annual report, paragraphs 9.19 and 9.34).			The audit found that weaknesses persisted in the management of family allowances (see paragraph 9.13).				*The Commission has taken measures to improve the monitoring system in place. In addition, a systematic follow up on the family situation of the staff will be ensured in the near future (2015/2016). Please see reply to paragraph 9.13.*
2011	**Recommendation 5 (European External Action Service):** *Updating of the personal situation and of allowances received by staff* The European External Action Service should take steps to ensure that staff deliver at appropriate intervals documents confirming their personal situation and implement a system for the timely monitoring of these documents (see the 2011 annual report, paragraphs 9.25 and 9.34).			The audit found that weaknesses persisted in the management of family allowances (see paragraph 9.13).				
2011	**Recommendation 6 (European Parliament):** *Recruitment of temporary and contract staff* The European Parliament should take steps to ensure that the provisions of the relevant regulations are applied when concluding, extending or modifying employment contracts with non-permanent staff (see the 2011 annual report, paragraphs 9.13 and 9.34).		X					*The required actions were implemented. The Parliament is of the opinion that its recruitment procedures are adequate, which so far has been confirmed by the absence of findings by the Court in this field during the last three years.*

Year	Court recommendation	Court's analysis of the progress made						Institution's reply
		Fully implemented	Being implemented		Not mplemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2011	**Recommendation 7 (European Economic and Social Committee):** *Recruitment of temporary and contract staff* The European Economic and Social Committee should take steps to ensure that the provisions of the relevant regulations are applied when concluding, extending or modifying employment contracts with non-permanent staff (see the 2011 annual report, paragraphs 9.23, 9.24 and 9.34).		X					*New decisions and guidelines regarding recruitment and grading of temporary staff and contract staff were implemented in the course of 2014. The management of posts is now done electronically, using Sysper2. Special attention is given to the transparency of selection procedures.*
	Recommendation 8 (European External Action Service): *Recruitment of temporary and contract staff* The European External Action Service should take steps to ensure that the provisions of the relevant regulations are applied when concluding, extending or modifying employment contracts with non-permanent staff (see the 2011 annual report, paragraphs 9.26 and 9.34).					X (*)		
	Recommendation 9 (Commission): *Procurement* The Commission should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2011 annual report, paragraphs 9.20, 9.21 and 9.34).		X					*The services concerned have implemented since mid-2011 several simplification measures in the area of procurement with a view to enhancing the quality of tender files. Compliance with the Financial Regulation is ensured whilst applying common sense, hereby fostering the participation of more tenderers.*

Year	Court recommendation	Court's analysis of the progress made						Institution's reply
		Fully implemented	Being implemented		Not mplemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2011	**Recommendation 10 (European External Action Service):** *Procurement* The European External Action Service should ensure that authorising officers improve the design, coordination and performance of procurement procedures through appropriate checks and better guidance (see the 2011 annual report, paragraphs 9.28 and 9.34).					X (*)		

(*) Under the approach for rotating the in-depth examination of control systems among the institutions and bodies, the follow-up of these recommendations will be performed in future years.

ANNUAL REPORT ON THE ACTIVITIES FUNDED BY THE 8TH, 9TH, 10TH AND 11TH EUROPEAN DEVELOPMENT FUNDS (EDFs)

(2015/C 373/02)

Annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds (EDFs)

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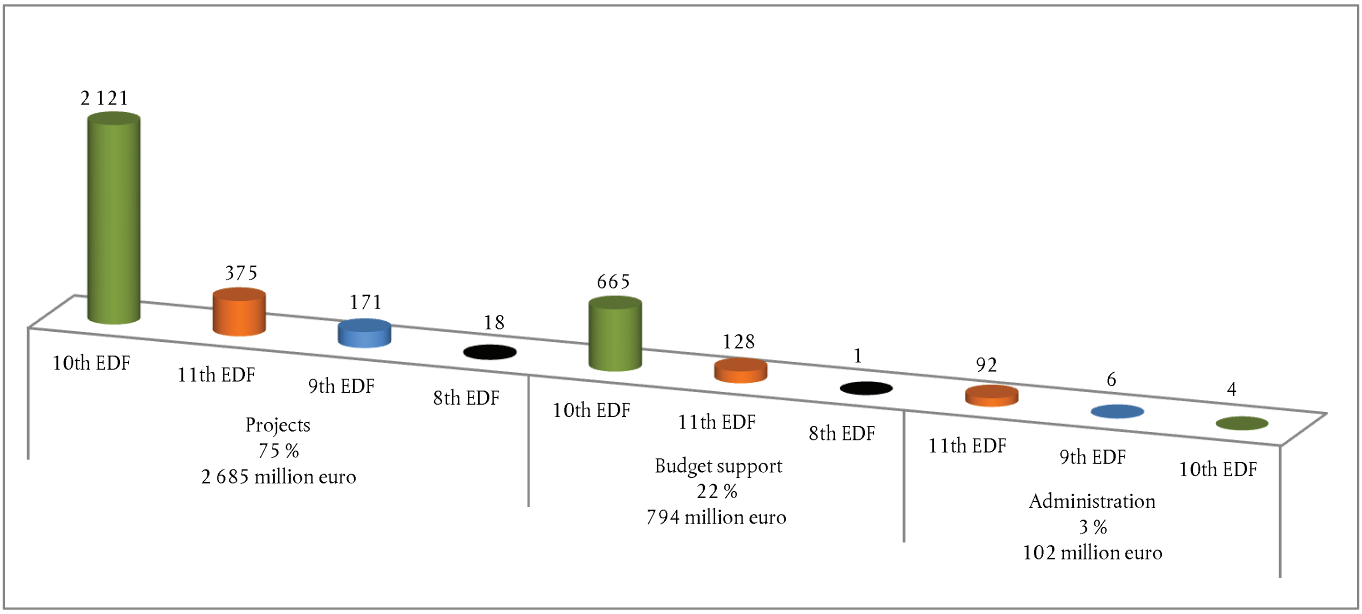
THE COURT'S OBSERVATIONS

INTRODUCTION

1. This annual report presents our assessment of the European Development Funds (EDFs). Key information on the activities covered and spending in 2014 is provided in ***Graph 1***.

Graph 1 — European Development Funds — Key information 2014



(million euro)

Total operational expenditure (Projects)	2 685
Total operational expenditure (Budget support)	794
Total administrative expenditure ([1])	102
Total payments	**3 581**
– *advances*	*2 105*
+ *clearings of advances*	*1 597*
Audited population	**3 073**
Total individual commitments ([2])	**3 380**
Total global commitments ([2])	**621**

([1]) Contribution from the EDFs to cover expenditure incurred both at the Commission and in EU Delegations on the administrative support needed to manage operations financed under the EDFs.

([2]) Global commitments relate to financing decisions. Individual commitments relate to individual contracts.

Source: 2014 consolidated accounts of the 8th, 9th, 10th and 11th EDFs.

THE COURT'S OBSERVATIONS

Specific characteristics of the European Development Funds

2. Since 1958, the EDFs have been the main instrument for providing European Union aid for development cooperation to the African, Caribbean and Pacific (ACP) States and overseas countries and territories (OCTs). The partnership agreement signed in Cotonou on 23 June 2000 for a period of 20 years ('the Cotonou Agreement') is the current framework for the European Union's relations with ACP States and OCTs. Its main focus is on reducing and eventually eradicating poverty.

3. The EDFs are of a particular nature:

(a) they are funded by the Member States according to contribution keys [1] set in an internal agreement between the governments of the Member States, meeting within the Council, which are different from those for the EU general budget;

(b) they are managed by the European Commission, outside the framework of the EU general budget, and by the European Investment Bank (EIB);

(c) due to the intergovernmental nature of the EDFs, the European Parliament has a more limited role in their functioning than that it plays for the development cooperation instruments financed by the EU general budget: notably, it does not intervene in the establishment and allocation of EDF resources. However, the European Parliament is the discharge authority, except for the Investment Facility managed by the EIB [2] [3].

(1) For each EDF, the contribution key of each Member State is defined as a percentage of the total amount of resources.

(2) See Articles 43, 48-50 and 58 of Council Regulation (EU) No 567/2014 of 26 May 2014 amending Regulation (EC) No 215/2008 on the Financial Regulation applicable to the 10th European Development Fund as regards the application of the transition period between the 10th European Development Fund and the 11th European Development Fund until the entry into force of the 11th European Development Fund Internal Agreement (OJ L 157, 27.5.2014, p. 52). See also the Court's Opinion No 9/2007 on the proposal for a Council Regulation on a Financial Regulation applicable to the 10th European Development Fund (OJ C 23, 28.1.2008), paragraphs 5 and 6.

(3) In 2012, a tripartite agreement between the EIB, the Commission and the Court (Article 134 of Council Regulation (EC) No 215/2008 (OJ L 78, 19.3.2008, p. 1)) set out rules for the audit of these operations by the Court. The Investment Facility is not covered by the Court's statement of assurance.

THE COURT'S OBSERVATIONS

4. Each EDF is governed by its own Financial Regulation. The Court has suggested on several occasions that a single Financial Regulation, applicable to all present and future EDFs, would ensure continuity, without the risk of interrupting the implementation of the EDFs, and simplify management ([4]).

5. While the EDF Financial Regulations have been progressively aligned with the General Financial Regulation ([5]), significant differences remain. One main difference is that the principle of annuality does not apply to the EDFs: EDF agreements are usually concluded for a commitment period of five to seven years, and payments can be made over a much longer period. In 2014, spending was made under four EDFs simultaneously, and payments were still made under the 8th EDF opened in 1995.

6. The EDFs are managed almost entirely by the Commission's Directorate-General for International Cooperation and Development (EuropeAid), which also manages a wide range of expenditure from the EU budget ([6]) ([7]).

7. EDF interventions are implemented through projects and budget support ([8]) under four main arrangements. In 2014, 38 % of payments were made under direct management, of which 22 % of the total related to budget support. The remaining 62 % were made under indirect management, of which 32 % through international organisations, 25 % through third countries and 5 % through national bodies of the EU Member States ([9]).

([4]) See the Court's Opinion No 3/2013 on the proposal for a Council Regulation on the Financial Regulation applicable to the 11th European Development Fund (OJ C 370, 17.12.2013), paragraph 6.

([5]) Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).

([6]) The Directorate-General for Humanitarian Aid and Civil Protection (ECHO) managed 3,4 % of 2014 expenditure from the EDFs.

([7]) See chapter 8 'Global Europe' of the 2014 annual report on the implementation of the EU budget.

([8]) Budget support involves the transfer of funds by the Commission to the national treasury of the partner country. It provides additional budgetary resources to support a national development strategy.

([9]) Under direct management, aid is implemented directly by the Commission (head office or the delegations). Under indirect management, implementation is delegated to a third country (former decentralised management), an international organisation (former joint management) or a national body, such as the development agencies of the EU Member States (former indirect centralised management).

THE COURT'S OBSERVATIONS

Risks to regularity

8. The expenditure covered in this report is delivered using a wide range of methods implemented in 79 countries. Rules and procedures are often complex, including those for tendering and awarding contracts. The absence of a stand-alone, user-friendly Financial Regulation for the 11th EDF significantly increases this complexity ([10]).

9. In two areas — budget support ([11]) and EU contributions to multi-donor projects carried out by international organisations ([12]) such as the United Nations (UN) — the nature of the instruments and payment conditions limit the extent to which transactions are prone to errors.

10. Budget support contributes to a state's general budget or its budget for a specific policy or objective. We examined whether the Commission complied with the specific conditions for making budget support payments to the partner country concerned and verified that general eligibility conditions (such as satisfactory progress in public finance management) had been complied with.

11. However, the legal provisions offer broad scope for interpretation and the Commission has considerable flexibility in deciding whether the general conditions have been met. Our audit of regularity cannot go beyond the stage at which aid is paid to the partner country. The funds transferred are then merged with the recipient country's budget resources. Any weaknesses in its financial management will not generate errors in our audit of regularity.

THE COMMISSION'S REPLIES

8. *The 11th EDF is governed by its own Financial Regulation (FR) (Regulation (EU) 2015/323) adopted by the Council on 2 March 2015. The real simplification is obtained through the alignment with the general budget FR, which the 11th EDF FR achieved through transparent and clear references to the general budget FR and its Rules of Application (RAP). In this way the 11th EDF FR ensures not only coherence in the applicable financial procedures and greater efficiency, but also allows a reduction in risks and errors.*

The rules and templates for tendering and awarding contracts for both the general budget and the EDF compiled in the Procurement and Grants practical guide (PRAG) developed by DG DEVCO, are widely commended by the European federations of contractors.

([10]) See the Court's Opinion No 3/2013 on the proposal for a Council Regulation on the Financial Regulation applicable to the 11th European Development Fund, paragraphs 3 and 4.

([11]) Gross budget support payments made from the EDFs in 2014 amounted to 794 million euro.

([12]) Gross payments from the EDFs in 2014 to multi-donor projects carried out by international organisations amounted to 776 million euro.

THE COURT'S OBSERVATIONS

12. When the Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of expenditure, the Commission assumes that EU eligibility rules are complied with as long as the pooled amount includes sufficient eligible expenditure to cover the EU contribution. This is what the Commission calls the 'notional approach'. The notional approach applied by the Commission limits the work of the auditors in case of substantial contribution of other donors, which the Commission then considers sufficient to cover any ineligible expenditure we may have found.

CHAPTER I — IMPLEMENTATION OF THE 8TH, 9TH, 10TH AND 11TH EDFs

Financial implementation

13. The 8th EDF (1995-2000) amounts to 12 840 million euro and the 9th EDF (2000-2007) to 13 800 million euro. The 10th EDF (2008-2013) totals 22 682 million euro. Of this amount, 21 966 million euro is allocated to ACP countries and 286 million euro to OCTs. These sums include, respectively, 1 500 million euro and 30 million euro for the Investment Facility managed by the EIB, mainly for support to the private sector in the ACP countries and OCTs. Finally, 430 million euro is earmarked for the Commission's expenditure on programming and implementing the EDF.

14. The Internal Agreement establishing the 11th EDF ([13]) was adopted in August 2013. It came into force on 1 March 2015 following ratification by all EU Member States. The 11th EDF totals 30 506 million euro ([14]), of which 29 089 million euro is allocated to ACP countries and 365 million euro to OCTs.

([13]) OJ L 210, 6.8.2013, p. 1.
([14]) Including 1 139 million euro managed by the EIB.

THE COURT'S OBSERVATIONS

15. In order to ensure the availability of funds between January 2014 and the entry into force of the 11th EDF, transitional measures, known as the 'Bridging Facility', were adopted by the Council in December 2013 ([15]). The resources available under the Bridging Facility in 2014 amounted to 1 616 million euro. They were funded by:

— funds decommitted from the 8th and 9th EDFs up to 31 December 2013 (936 million euro);

— uncommitted balances from the 10th EDF at 31 December 2013 (75 million euro);

— funds decommitted in 2014 from the 10th and previous EDFs (586 million euro); and

— interest and other receipts (19 million euro).

They are accounted for under the 11th EDF, but do not constitute additional resources to the 11th EDF.

16. ***Table 2*** shows the use, during 2014 and cumulatively, of EDF resources.

([15]) Council Decision 2013/759/EU of 12 December 2013 regarding transitional EDF management measures from 1 January 2014 until the entry into force of the 11th European Development Fund (OJ L 335, 14.12.2013, p. 48).

Table 2 — Use of EDF resources at 31 December 2014

(million euro)

	Situation at end of 2013		Budgetary implementation during the financial year 2014 (net) (6)					Situation at end of 2014					
	Total amount	Implement. rate (2)	8th EDF (3)	9th EDF (3)	10th EDF	11th EDF	**Total amount**	8th EDF	9th EDF	10th EDF	11th EDF	***Total amount***	*Implement. rate (2)*
A — RESOURCES (1)	**49 026**		***- 64***	***- 373***	***- 1 105***	***1 616***	***74***	***10 417***	***15 739***	***21 328***	***1 616***	***49 100***	
B — USE													
1. **Global commitments (4)**	**47 952**	**97,8 %**	***- 63***	***- 381***	***- 95***	***1 160***	***621***	***10 415***	***15 703***	***21 294***	***1 160***	***48 573***	**98,9 %**
2. **Individual commitments (5)**	**41 410**	**84,5 %**	***- 37***	***- 1***	***2 687***	***731***	***3 380***	***10 400***	***15 407***	***18 252***	***731***	***44 790***	**91,2 %**
3. **Payments**	**35 384**	**72,2 %**	***16***	***145***	***2 760***	***595***	***3 516***	***10 379***	***14 941***	***12 985***	***595***	***38 900***	**79,2 %**
C — Outstanding commitments (B1-B3)	**12 568**	**25,6 %**						***36***	***762***	***8 309***	***565***	***9 673***	**19,7 %**
D — Available balance (A-B1)	**1 074**	**2,2 %**						***2***	***36***	***34***	***456***	***527***	**1,1 %**

(1) Include initial allocations to the 8th, 9th, 10th and 11th EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.
(2) As a percentage of resources.
(3) Negative amounts correspond to decommitments.
(4) Global commitments relate to financing decisions.
(5) Individual commitments relate to individual contracts.
(6) Net commitments after decommitments. Net payments after recoveries.

Source: Court of Auditors, based on the EDF reports on financial implementation and financial statements at 31 December 2014.

THE COURT'S OBSERVATIONS

17. The level of net commitments made in 2014 was extraordinarily low (621 million euro) compared to previous years [16]. This was due to the delayed entry into force of the 11th EDF, which limited the resources available for commitments under the Bridging Facility. On the other hand, payments made in 2014 reached a historical high (3 516 million euro) [17], in particular because of 595 million euro paid out from the Bridging Facility, notably for large disbursements of budget support and advances for operations under the African Peace Facility in the Central African Republic and Somalia.

18. At the end of 2014, almost all resources available had been committed (98,9 % for financing decisions, 91,2 % for individual contracts). Outstanding commitments [18] decreased by 23 % from 12,5 billion euro at the end of 2013 to 9,7 billion euro at the end of 2014. This was the result both of the efforts made by EuropeAid to decrease outstanding commitments and of the low level of financing decisions made in 2014.

19. For its whole area of responsibility [19], EuropeAid pursued its efforts to decrease old prefinancing and old unspent commitments [20] and to reduce the number of open expired contracts [21]. The 2014 targets set for old prefinancing and unspent commitments were largely exceeded [22]. However, while the 2014 target set as regards the share of expired contracts on the total number of contracts was almost met for EuropeAid's whole portfolio [23], progress has been less satisfactory for the EDFs [24].

(16) 2013: 3 923 million euro; 2012: 3 163 million euro.
(17) 2013: 2 963 million euro; 2012: 3 209 million euro.
(18) *Reste à liquider* (RAL).
(19) EDFs and general budget together.
(20) Old RAL.
(21) A contract is considered to have expired if it is still open more than 18 months after the end of its operational period. Delays in contract closure increase the risk of regularity errors as the supporting documentation might be difficult to retrieve if it has not been archived properly and key project staff have left. Late contract closure may also delay recovery of unspent prefinancing and ineligible expenditure.
(22) Reduction of old open prefinancing: 46 % achieved (25 % target); reduction of old RAL: 51,24 % achieved (25 % target).
(23) 15,52 % share achieved (15 % target).
(24) Of 5,3 billion euro in expired contracts, 3,7 billion (69 %) concerns the EDFs. The share of expired contracts on the number of all open EDF contracts is 25 %, compared to 15,5 % for the whole EuropeAid portfolio. For 477 (1,3 billion euro) of 1 528 expired EDF contracts (31 % in number; 35 % in value) the operational period expired before 2010.

CHAPTER II — THE COURT'S STATEMENT OF ASSURANCE ON THE EDFs

The Court's statement of assurance on the 8th, 9th, 10th and 11th EDFs to the European Parliament and the Council — Independent auditor's report

I — Pursuant to the provisions of article 287 of the Treaty on the functioning of the European Union (TFEU) and Article 49 of the Financial Regulation applicable to the 10th EDF as regards the application of the transition period between the 10th European Development Fund and the 11th European Development Fund until the entry into force of the 11th European Development Fund Internal Agreement, which also applies to previous EDFs, we have audited:

(a) the annual accounts of the 8th, 9th, 10th and 11th European Development Funds which comprise the balance sheet, the economic outturn account, the statement of cash flow, the statement of changes in net assets and the table of items payable to the European Development Funds and the report on financial implementation for the financial year ended 31 December 2014 approved by the Commission on 24 July 2015; and

(b) the legality and regularity of the transactions underlying those accounts within the legal framework of the EDFs in respect of the part of the EDF resources for whose financial management the Commission is responsible ([25]).

Management's responsibility

II — In accordance with Articles 310 to 325 of the TFEU and the applicable Financial Regulations ([26]), management is responsible for the preparation and presentation of the annual accounts of the EDFs on the basis of internationally accepted accounting standards for the public sector ([27]) and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them. The Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the EDFs (Article 317 of the TFEU).

Auditor's responsibility

III — Our responsibility is to provide, on the basis of our audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. We conducted our audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require that we plan and perform the audit to obtain reasonable assurance as to whether the annual accounts of the EDFs are free from material misstatement and the transactions underlying them are legal and regular.

IV — An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and the regularity of the transactions underlying them. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the EDFs, whether due to fraud or error. In making those risk assessments, internal control relevant to the preparation and fair presentation of the accounts, and supervisory and control systems implemented to ensure legality and regularity of underlying transactions, are considered in order to design audit procedures that are appropriate in the circumstances but not for the purposes of expressing an opinion on the effectiveness of internal control. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made, as well as evaluating the overall presentation of the accounts.

V — We consider that the audit evidence obtained is sufficient and appropriate to provide a basis for our opinions.

([25]) Pursuant to Articles 16, 43, 48, 49, 50 and 58 of the Financial Regulation applicable to the tenth EDF this Statement of Assurance does not extend to the part of the EDFs resources that are managed by the EIB and for which it is responsible.

([26]) Financial Regulations applicable to 8th, 9th and 10th EDFs. The 10th EDF Financial Regulation applies also to the Bridging Facility which is accounted for under the 11th EDF.

([27]) The accounting rules and methods adopted by the EDF accounting officer are drawn up on the basis of International Public Sector Accounting Standards (IPSAS) or by default, International Financial Reporting Standards (IFRS) as respectively issued by the International Federation of Accountants and the International Accounting Standards Board.

Reliability of the accounts

Opinion on the reliability of accounts

VI — In our opinion, the annual accounts of the 8th, 9th, 10th and 11th EDFs for the year ended 31 December 2014 present fairly, in all material respects, the financial position as at 31 December 2014, the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the EDF Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue underlying the accounts

VII — In our opinion, revenue underlying the accounts for the year ended 31 December 2014 is legal and regular in all material respects.

Payments

Basis for adverse opinion on the legality and regularity of payments underlying the accounts

VIII — Our estimate for the most likely error rate for expenditure transactions from the 8th, 9th, 10th and 11th EDFs is 3,8 %.

Adverse opinion on the legality and regularity of payments underlying the accounts

IX — In our opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2014 are materially affected by error.

16 July 2015

Vítor Manuel da SILVA CALDEIRA

President

European Court of Auditors

12, rue Alcide de Gasperi, 1615 Luxembourg, LUXEMBOURG

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Information in support of the statement of assurance

Audit scope and approach

20. ***Annex 1.1, part 2***, of chapter 1 of the Court of Auditors' 2014 annual report on the implementation of the budget describes our overall audit approach and methodology. For the audit of the EDFs, the following specific points should be noted.

21. Our observations regarding the reliability of the EDF accounts concern the financial statements [28] of the 8th, 9th, 10th and 11th EDFs [29] approved by the Commission in compliance with the EDF Financial Regulation [30] and received, together with the accounting officer's letter of representation, by us on 24 July 2015. The audit involved testing amounts and disclosures, and assessing the accounting principles used, significant estimates made by the management and the overall presentation of the accounts.

22. The audit of the regularity of transactions involved:

(a) an examination of all contributions from Member States and a sample of other types of revenue transaction;

(b) an examination of a sample of 30 commitments [31];

(c) an examination of a sample of 165 transactions [32]. The sample is designed to be representative of the entire range of payments within the EDFs. It consisted of 127 payments authorised by 28 EU delegations [33] and 38 payments authorised by the Commission departments [34]. Where errors were detected, the relevant systems were analysed to identify the specific system weaknesses involved;

(28) See Article 44 of Regulation (EU) No 567/2014: the financial statements comprise the balance sheet, the statement of financial performance, the statement of cash flow and the statement of changes in net assets.

(29) See Article 44 of Regulation (EU) No 567/2014: the reports on financial implementation include tables of allocations, commitments, assigned funds and payments.

(30) See Article 43 of Regulation (EU) No 567/2014.

(31) Global financial commitments and the corresponding legal commitments (financing agreements) following the adoption of a financing decision by the Commission.

(32) As defined in ***Annex 1.1***, paragraph 7, of the 2014 annual report on the implementation of the budget.

(33) African Union, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Central African Republic, Democratic Republic of the Congo, Dominican Republic, Eritrea, Ethiopia, Fiji, Guinea-Bissau, Haiti, Ivory Coast, Lesotho and Swaziland, Liberia, Madagascar, Mali, Mauritania, Mauritius, Mozambique, Niger, Nigeria, Rwanda, Senegal, Sierra Leone and Uganda.

(34) EuropeAid: 34 payments; ECHO: four payments on humanitarian aid.

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(d) an assessment of systems examined at EuropeAid and EU delegations, covering: (i) ex ante checks by Commission staff, external auditors or supervisors before payments were made, and (ii) monitoring and supervision, notably the follow-up of external audits, verification missions, monitoring visits, and EuropeAid's 2012, 2013 and 2014 residual error rate (RER) studies;

(e) a review of the annual activity report (AAR) by the Director-General of EuropeAid; and

(f) a follow-up of our previous recommendations.

23. As indicated in paragraph 6, EuropeAid implements most of the external assistance instruments financed from the general budget and the EDFs. Our observations concerning both the systems and the reliability of the AAR and the Director-General's declaration for 2014 refer to EuropeAid's entire area of responsibility.

Reliability of accounts

24. Since 2007, year of the modernisation of the EDF accounting, the cut-off estimation method applied by the Commission does not include accrued costs related to budget support contracts for which no payment request were submitted by the ACP countries during the year. The Commission considers that, in view of the nature of budget support, the event for the recognition as an expense is the disbursement. The Commission has indeed a broad margin of judgement when assessing the compliance with the eligibility conditions. However, budget support is not a discretionary grant, but an entitlement, under the Commission's accounting rules: as for other non-exchange expenses, the Commission is obliged to make the payments when eligibility conditions are met.

24. *The Commission has been applying this approach to budget support operations since 2007, on the basis of the 2006 accounting rules.*

The Commission has considered that recognition as an expense should take place when 'disbursement' takes place, as at this stage all eligibility conditions have been duly assessed by the Commission services. The Commission also includes in the cut-off payment requests made by ACP States during the year and not yet paid because the Commission considers that when an ACP State sends a request for payment related to budget support, there is a high probability that the contractual criteria for eligibility are met.

25. For prefinancing payments over 750 000 euro, the Commission is required to recover interests on an annual basis (3 million euro recovered in 2014 and 5,7 million recovered in 2013). As mentioned in previous years [35], we found that the authorising officers by delegation still do not comply systematically with this rule and the amount of interests revenue disclosed in note 3.5 to the financial statements is partially based on estimates. Furthermore, the interest earned on prefinancing between 250 000 euro and 750 000 euro were still not recognised as financial revenue in the financial statements because the development of the Common External Relations Information System (CRIS) was completed only in late 2014.

25. *Improvement has been recorded over the past 3 years as regards better yearly recovery of interest on prefinancing, rather than at the end of the contract.*

Instructions are regularly sent to the authorising officers to remind them of the obligation to recover interest on pre-financing when due. A monitoring system has also been put in place.

[35] Paragraph 19 of the 2012 annual report and paragraph 20 of the 2013 annual report.

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Regularity of transactions

Revenue

26. Our audit of revenue transactions found them to be free from material error.

Payments

27. ***Annex 1*** contains a summary of the results of payment transaction testing. Of the 165 payment transactions that we audited, 54 (33 %) were affected by error. On the basis of the 36 errors which we have quantified, we estimate the level of error to be 3,8 % ([36]).

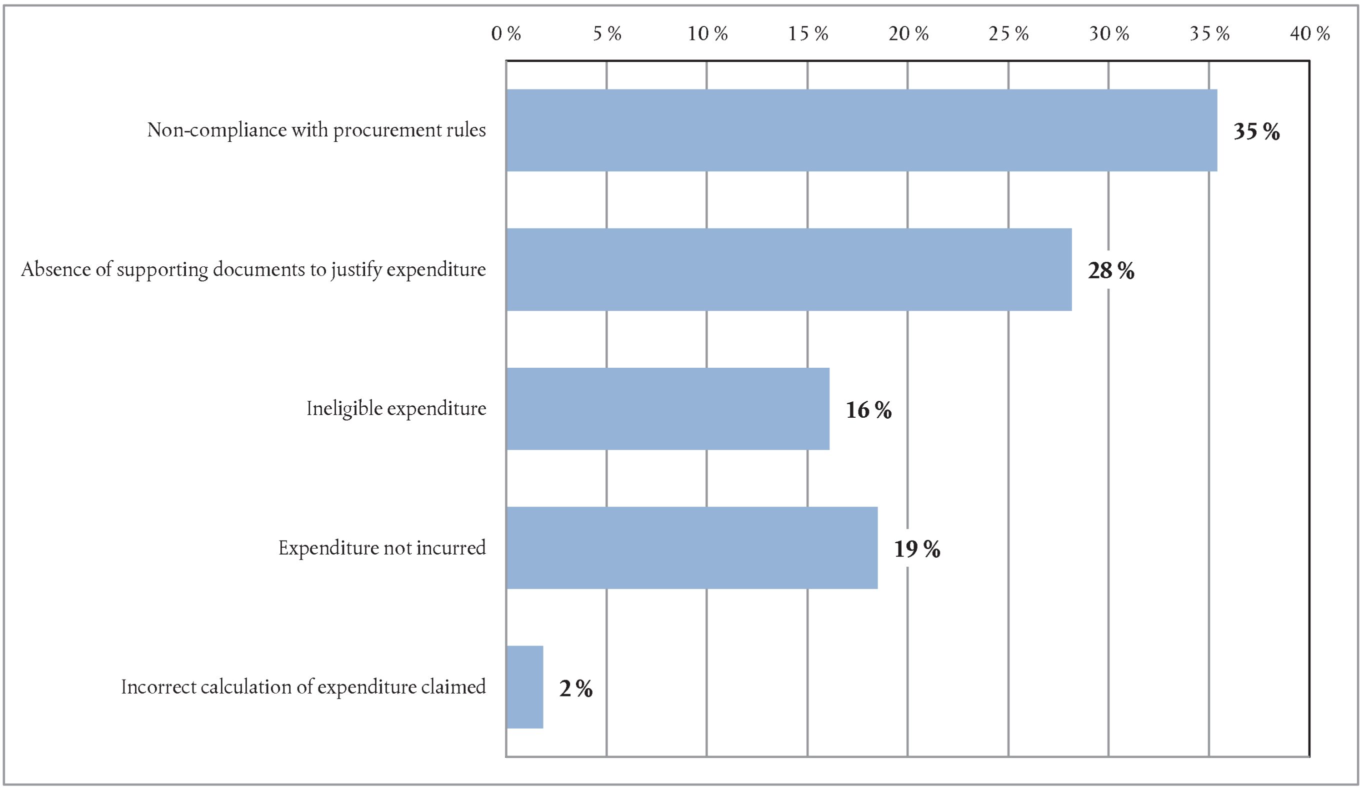
28. When excluding from the audited sample budget support and multi-donor transactions referred to in paragraphs 9 to 12, the estimated level of error is 4,8 % ([37]).

29. ***Graph 2*** presents the extent to which the different types of errors contributed to our estimated level of error for 2014. Errors relating to non-compliance with procurement procedures by beneficiaries and the absence of supporting documents account for 63 % of the estimated level of error.

([36]) We calculated our estimate of error from a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the rate of error in the population lies between 2,1 % and 5,6 % (the lower and upper error limits, respectively).

([37]) The figure quoted is the best estimate based on a representative sample of 127 transactions. We have 95 % confidence that the rate of error in the population lies between 2,7 % and 6,9 % (the lower and upper error limits, respectively).

Graph 2 — Contribution by type of error to the estimated level of error



Source: European Court of Auditors.

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Projects

30. Of the 133 payment transactions relating to projects that we audited, 52 (39 %) were affected by error, of which 34 (65 %) were quantifiable errors. Of the 34 payment transactions affected by quantifiable errors, 14 were final transactions authorised after all ex ante checks had been performed.

31. As was the case in previous years ([38]), errors were more frequently found in transactions relating to programme estimates, grants and contribution agreements with international organisations than in other forms of support. Of the 66 transactions of this type audited, 29 (44 %) were affected by quantifiable errors accounting for 75 % of the estimated level of error.

32. The main types of quantifiable error detected in payment transactions related to projects concerned:

(a) non-compliance by the beneficiary with procurement rules (eight transactions);

([38]) Paragraph 25 of the 2013 annual report.

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(b) absence of supporting documents showing that eligible activity occurred (11 transactions) ([39]);

(c) ineligible expenditure, such as expenditure relating to expenditure incurred outside the implementation period (three transactions), ineligible VAT (two transactions), activities not covered by the contract (one transaction) or indirect costs claimed as direct costs (one transaction);

(d) expenditure not incurred by beneficiaries (10 transactions);

(e) incorrect calculation of expenditure (two transactions).

Box 1 — Examples of quantifiable errors in project transactions

Failure by the beneficiary to comply with procurement procedures

We examined the final clearance of expenditure under a grant agreement to an organisation in charge of agricultural cooperation between ACP countries and found an error in the procurement of IT services amounting to 225 900 euro. The grant beneficiary based in the Netherlands did not follow an international restricted procurement procedure, which requires a tender notice to be published. Invitations were sent only to three Dutch companies of his choice. The failure to comply with procurement rules stipulated in the grant agreement resulted in restricted competition.

Absence of supporting documents to justify expenditure

We examined the final clearance of expenditure incurred under the 'Facilitating Agricultural Commodity Trade' programme implemented across the Pacific region. We tested 20 expenditure items. For seven of them, relating to construction works, staff costs, daily allowances and hotel accommodation amounting to 22 117 euro, the essential supporting documents for the expenditure (e.g. invoices, proof of payment, evidence demonstrating the link between staff costs and project activities, evidence of travel and meeting participation to justify daily allowances and hotel accommodation) were not provided ([39]).

([39]) We report quantifiable errors in cases where no documentation is available at all, where there is no evidence to support an activity reported to have taken place, or where there is no link between the expenditure charged and the documentation provided. There are two main reasons for the absence: (i) either the document has never existed, which should have been detected by ex ante checks; or (ii) the document exists, but could not be retrieved, which points to a weakness in document management.

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Box 1 — Examples of quantifiable errors in project transactions

Failure by the beneficiary to comply with procurement procedures

The Commission is implementing relevant corrective measures, i.e. issuing a recovery order for the full amount of the final contract value 251 124 euro. A pre-information letter was sent to the beneficiary on 1 June 2015.

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Ineligible expenditure

We examined a clearance of the EDF contribution to the TerrAfrica Leveraging Trust Fund. The administration agreement for the Trust Fund was signed in November 2012. The clearance made by the Commission was based on total disbursements of the Trust Fund during its lifetime from 2006 to 2013. Out of 6 714 489 euro accepted by the Commission, expenditure of 4 664 666 euro was incurred before the administration agreement entered into force. In addition, it had already been cleared by the Commission under the previous Trust Fund agreement, and was therefore paid twice.

Expenditure not incurred by the beneficiary

We examined a clearance of prefinancing made under the 'Implementation of humanitarian demining operations in Senegal (Casamance)' programme. The international organisation implementing the programme claimed as actual expenditure the amount of a service contract for demining that had not yet been fully paid out. The demobilisation phase had not been completed (the equipment and material had not been removed from the project site and handed over to the national authorities, and the final report had not been submitted by the contractor) and the corresponding expenditure, 207 437,87 USD, had not been incurred by the beneficiary.

33. In 21 ([40]) cases of quantifiable error, the Commission, via its systems, had sufficient information ([41]) to prevent, detect, and correct the errors before accepting the expenditure. If all this information had been used to correct errors, the estimated level of error would have been 2,3 percentage points lower.

34. Non-quantifiable errors mainly included shortcomings in the procurement procedures followed (eight transactions) and insufficient procurement documents (seven transactions).

Budget support

35. Of the 32 transactions relating to budget support that we audited, two were affected by quantifiable errors of minor impact (less than 0,1 percentage point) relating to the beneficiary governments' failure to comply with the provisions of the financing agreements in respect of exchange rates to convert budget support disbursements to local currency.

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Ineligible expenditure

The Commission has fully implemented relevant corrective measures. The sampled clearing was cancelled and re-encoded taking into account the overstated amount.

Expenditure not incurred by the beneficiary

The Commission is implementing relevant corrective measures, i.e. the recovery procedure has been initiated. In addition, a verification mission is planned for the closure of the project.

35. *Given the fact that, for both errors, the financing agreements do not set a clear reference to the exchange rate to be applied, the Commission considers that it is difficult to quantify these errors.*

([40]) Including one known error detected outside the sample.
([41]) On the basis of supporting documentation and required mandatory checks.

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Examination of selected systems and annual activity reports

36. As in previous years, the frequency of errors that we found, including some affecting final claims which had been subject to external audits and expenditure verifications, point to weaknesses in these ex ante checks.

37. In May 2013, EuropeAid adopted an action plan to address weaknesses identified in the implementation of EuropeAid's system [42]. Implementation of all 23 planned actions started in 2013 and 2014. By the end of 2014, 15 actions had been fully implemented and eight were ongoing [43]. It is too early to assess the impact of the action plan as some actions are still under development.

38. The following measures have been taken to improve external audits and expenditure verifications:

(a) risk analysis was made compulsory for the preparation of annual audit plans by EU delegations and EuropeAid's services;

(b) grant contract templates have been revised so that auditors can be selected or contracted directly by EuropeAid;

(c) awareness-raising about the most common types of error, training and reinforcing of financial and control skills of EuropeAid staff and beneficiaries.

39. While planned for December 2013, EuropeAid has not yet developed the quality/eligibility grids assessing the reliability of expenditure verification reports and providing guidance in the event of non-compliance.

40. As indicated in our previous annual reports [44], there are still shortcomings in EuropeAid's management information system on the results and the follow-up of external audits, expenditure verifications and monitoring visits. These make it difficult for the Director-General to hold heads of unit or heads of EU delegations accountable for the timely follow-up and correction of the system weaknesses and errors identified. EuropeAid is developing a new audit application to improve the follow-up of audit reports.

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39. *Since the issue is more complex in practical terms than expected, the development of the quality grids for expenditure verification reports is taking a longer time than foreseen. The grids should be available by the last quarter of 2015.*

40. *As far as audits, expenditure verifications and similar engagements contracted by the Commission are concerned, the rollout of a new management information system on the results and the follow-up of external audits, expenditure verifications and similar engagements, is expected to lead to significant improvements over time.*

(42) See EuropeAid's 2013 annual activity report, pp. 188-190 and 195-196.
(43) See EuropeAid's 2014 annual activity report, pp. 114-115.
(44) Paragraph 42 of the 2010 annual report, paragraph 43 of the 2011 annual report, paragraph 35 of the 2012 annual report and paragraph 35 of the 2013 annual report.

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2014 residual error rate study

41. EuropeAid carried out its third RER study to estimate the level of error which has evaded all management checks to prevent, detect and correct errors. The RER study is based on an appropriate methodology and provides useful information, which allows EuropeAid to identify where the implementation of control systems should be improved.

42. The study consisted of an examination of a representative sample of transactions relating to contracts closed between September 2013 and August 2014. Its results are presented in the AAR ([45]). Following a recommendation made in our 2013 annual report ([46]), the AAR discloses the scope of the RER study and the estimated lower and upper limits. The study estimates the RER at 2,81 %, i.e. above the 2 % materiality level set by the Commission. The main types of error identified by the study are:

(a) absence of satisfactory documentation demonstrating eligibility provided by beneficiary organisations (42,70 % of the RER);

(b) absence of legal basis for payment, over-claim and other non-compliance issues (32,83 % of the RER);

(c) errors which were estimated because insufficient evidence was available to check the regularity of transactions (16,76 % of the RER);

(d) unrecovered and uncorrected amounts (7,71 % of the RER).

43. Our review of the 2014 RER study found that it was carried out overall in accordance with the methodology and provides sufficient evidence that the RER is material. For some transactions examined, we found that there was scope for improvement in a number of respects, relating to:

(a) the compliance with the conditions set for placing reliance upon previous control work;

(b) the adequacy of the documentation of the audit evidence to support the conclusions;

(c) the justification for the decision not to extrapolate the error found in the sample tested to the whole transaction amount; and

(d) a too wide margin of judgment was left when error rates on individual transactions had to be estimated.

43. *The Commission welcomes the Court's conclusion that the RER is based on an appropriate methodology, that it provides useful information and that it was carried out overall in accordance with the methodology. It will examine, together with the contractor, the issues raised by the Court.*

([45]) See EuropeAid's 2014 annual activity report, pp. 84-86.
([46]) Paragraph 51 and recommendation 5 of the 2013 annual report.

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Review of annual activity report

44. In his declaration of assurance, the Director-General makes a reservation concerning the legality and regularity of transactions, since the amount considered at risk (205,7 million euro) represents more than 2 % of payments made by EuropeAid in 2014. However, the Director-General also states that the control procedures in place give the necessary guarantees concerning the legality and regularity of the underlying transactions. As for last year ([47]), we consider that this is not a logical conclusion because systems are not effective when they fail to prevent, detect and correct material error.

45. The reservation relates to the legality and regularity of all of the expenditure managed by EuropeAid. A reservation is appropriate when control weaknesses relate only to defined areas of revenue or expenditure ([48]), but not when they affect the operation of the system as a whole and the financial impact exceeds the materiality threshold for the whole budget under the Director-General's responsibility. However, the Commission's standing instructions for 2014 AARs do not clearly address such a situation.

46. The AAR states that EuropeAid's controls are efficient for each internal control template under direct and indirect management and that total costs of controls, estimated at 370,6 million euro, are reasonable compared to their benefits ([49]). The extensive information provided in the AAR reflects a significant effort made by EuropeAid to comply with the requirement stipulated in the General Financial Regulation ([50]). However, the assertions about the efficiency and the cost-effectiveness of controls are not satisfactorily demonstrated because:

(a) a full cost approach was not followed, as not all direct costs were included ([51]) and overheads were omitted. In addition, the basis for the allocation keys of indirect staff costs is not clear;

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44. *Given the risk environment DG DEVCO operates in, and the fact that the residual error is not a consequence of the design of the control system, but rather of weaknesses in its implementation, it is still reasonable to conclude that the control procedures in place give the necessary guarantees concerning legality and regularity of the underlying transactions. As a matter of fact, there is no evidence in the RER that there should be system weakness in the control procedures. However, DG DEVCO acknowledges that there are shortcomings in its implementation, which it is currently addressing.*

45. *The Commission is considering how to increase the extent to which it takes the result of DG DEVCO controls into account, in order to provide a more risk differentiated assurance.*

46. *Some of the management and reporting duties in Article 66 of the Financial Regulation are still a rather recent challenge for the Commission in general. Central services are playing an important role in ensuring that control systems and related reporting practices progress in a coherent manner throughout the Commission. The Commission will take the observations of the Court into account alongside an assessment of their impact on the use of resources, with a view to achieving sustainable improvements.*

([47]) Paragraph 43 and 44 of the 2013 annual report.
([48]) See Article 66(9) of Regulation (EU, Euratom) No 966/2012 and Article 38 of Regulation (EC) No 215/2008.
([49]) See EuropeAid's 2014 annual activity report, pp. 86–89 and 93–95.
([50]) Article 66(9) of Regulation (EU, Euratom) No 966/2012.
([51]) E.g. Evaluation of staff costs and external costs for the supervision of works contracts.

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(b) as regards quantifiable benefits, EuropeAid's management information systems do not yet provide accurate information on errors detected and corrected following external audits and expenditure verifications (see paragraph 40), and the Commission's own checks;

(c) EuropeAid did not set objectively verifiable indicators, including target values, against which to assess the efficiency and cost-effectiveness of controls.

CONCLUSION AND RECOMMENDATIONS

The conclusion for 2014

47. We conclude that the EDFs' accounts for the financial year ending 31 December 2014 present fairly, in all material respects, the financial position of the EDFs and the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the accounting officer.

48. We conclude that, for the financial year ending 31 December 2014:

(a) the revenue of the EDFs was free from material error;

(b) EDF payment transactions were affected by material error (see paragraphs 27 to 32). Testing of transactions indicates that the estimated level of error present in the population is 3,8 % (see ***Annex 1***).

THE COMMISSION'S REPLIES

(b) *As far as audits, expenditure verifications and similar engagements contracted by the Commission are concerned, the roll-out of a new management information system on the results and the follow-up of external audits, expenditure verifications and similar engagements is expected to lead to significant improvements over time.*

(c) *Reporting is already based on verifiable indicators, including in some cases target values. With the guidance of the central services, the Commission system is still being improved and refined.*

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Recommendations

49. *Annex 2* shows the result of our review of progress in addressing recommendations made in previous annual reports [52]. In the 2011 and 2012 annual reports, we made 12 recommendations. Of these recommendations, one is no longer applicable. EuropeAid fully implemented four recommendations, while five were implemented in most respects and two were implemented in some respects. As regards one of the recommendations implemented in some respects only, EuropeAid was taking action by:

(a) developing a tool to help EU delegations to screen their portfolio of projects more effectively and prioritise visits to those in particular need of monitoring based on risk assessments;

(b) preparing new guidelines for the verification missions to delegations entailing risk-based planning and follow-up of the verification visits .

50. Following this review and the findings and conclusions for 2014, we recommend that EuropeAid:

— **Recommendation 1**: set up and implement internal control procedures to ensure that prefinancing is cleared on the basis of actual incurred expenditure not including legal commitments;

The Commission accepts this recommendation.

The Commission will further clarify clearing rules for Contribution Agreements in the DEVCO Companion and insist on the obligation for clearing to be based on actual incurred expenditure not including legal commitments.

— **Recommendation 2**: reinforce the systematic verification that partner countries use the correct exchange rate to convert budget support disbursements into their national currency;

The Commission accepts this recommendation.

— **Recommendation 3**: ensure together with the contractor in charge of the RER study that the issues that we have found are addressed;

The Commission accepts this recommendation.

— **Recommendation 4**: improve its indicators in respect of target values against which to assess the efficiency and cost-effectiveness of controls, its cost approach, and its procedures and management information systems to measure the benefits of controls.

The Commission accepts this recommendation within the framework defined by the central services.

(52) The objective of this follow-up was to verify the introduction and existence of corrective measures in response to our recommendations. It did not aim to assess their effective implementation. For some measures which were still under development the verification was too early to be made.

ANNEX 1

RESULTS OF TRANSACTION TESTING FOR EUROPEAN DEVELOPMENT FUNDS

	2014	2013
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions:	**165**	165
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**3,8 %**	3,4 %
Upper Error Limit (UEL)	5,6 %	
Lower Error Limit (LEL)	2,1 %	

ANNEX 2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR THE EUROPEAN DEVELOPMENT FUNDS

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2012	**Recommendation 1:** EuropeAid should review its RER methodology (see the 2012 annual report, paragraph 51, recommendation 1).	x						
	Recommendation 2: EuropeAid should provide an accurate description in the AAR of the results of RER studies (see the 2012 annual report, paragraph 51, recommendation 2).	x						
	Recommendation 3: EuropeAid should ensure the timely clearance of expenditure (see the 2012 annual report, paragraph 51, recommendation 3).		x					
	Recommendation 4: EuropeAid should promote better document management by implementing partners and beneficiaries (see the 2012 annual report, paragraph 51, recommendation 4).	x						
	Recommendation 5: EuropeAid should take effective measures in order to enhance the quality of expenditure verifications carried out by external auditors (see the 2012 annual report, paragraph 51, recommendation 5).		x					
	Recommendation 6: EuropeAid should ensure the correct application of specific conditions for budget support payments (see the 2012 annual report, paragraph 51, recommendation 6).	x						
	Recommendation 7: EuropeAid should make sure that recovery orders in respect of interest on prefinancing over 750 000 euro are issued annually (see the 2012 annual report, paragraph 51, recommendation 7).			x				

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable (*)	Insufficient evidence	
			In most respects	In some respects				
2011	**Recommendation 1:** EuropeAid should improve the management of contract awarding procedures, by setting out clear selection criteria and better documenting the evaluation process (see the 2011 annual report, paragraph 59(a)).	x						
	Recommendation 2: EuropeAid should introduce documented risk-based planning and systematic follow-up for verification visits [see paragraph 40] and on-the-spot monitoring visits (see the 2011 annual report, paragraph 59(b)).			x				
	Recommendation 3: EuropeAid should render compulsory the guidelines on risk analysis for the preparation of annual audit plans by delegations and EuropeAid's headquarters (see the 2011 annual report, paragraph 59 (c)).		x					
	Recommendation 4: EuropeAid should review the design of KPIs to ensure that they are unambiguous and easy to interpret (see the 2011 annual report, paragraph 59(d)).		x					
	Recommendation 5: EuropeAid should assess the IAC's capacity to perform its task effectively (see the 2011 annual report, paragraph 59(e)).					x		

(*) EuropeAid's internal audit function has been centralised within the Internal Audit Service (IAS). IAC ceased to exist at the end of February 2015.

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