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EUROPEAN
COURT
OF AUDITORS

2013

EU audit in brief

Introducing the 2013 annual reports of
the European Court of Auditors

EUROPEAN COURT OF AUDITORS
12, rue Alcide De Gasperi
1615 Luxembourg
LUXEMBOURG

Tel. +352 4398-1

E-mail: eca-info@eca.europa.eu
Internet: <http://eca.europa.eu>

Twitter: @EUAuditorsECA
YouTube: EUAuditorsECA

More information on the European Union is available on the Internet (<http://europa.eu>).

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EU audit in brief

**Introducing the 2013 annual reports of
the European Court of Auditors**



In November each year, the European Court of Auditors reports on the results of its annual audits of EU financial management of the previous financial year. Based on the audit evidence we collect, we provide assurance on how EU funds were used, highlighting where EU funds were found to be at most risk of being misspent. The reports also include recommendations on how EU financial management could be improved. In this way, our institution assists the European Parliament and the Council to scrutinise EU spending and promotes effective accountability to EU citizens.

2013 EU audit in brief summarises and explains the main findings in our annual reports on the implementation of the 2013 EU budget and the Euro-

pean Development Funds. As in previous years, the reports provide insights into the extent to which those responsible for managing EU funds, at EU and national level, have faithfully reported on the management of funds, ensured the EU's financial rules were applied and respected the principles of economy, efficiency and effectiveness.

2013 was the final year of a 7-year programming period and we are publishing our annual reports on it at an important transitional time for the EU and its finances. The 2014–20 programming period is now underway and, as our reports show, a new European Parliament and Commission are facing both long-standing and new financial management and accountability challenges.

The continuing pressure on EU and national finances calls for careful management and control of EU funds, as well as better forecasting of long-range funding requirements. In particular, we highlight in our reports the need for the Commission and Member States' authorities to pay greater attention in their financial management of the EU budget to ensuring that EU money is used to achieve results that could not be achieved as efficiently or effectively in other ways. At the same time, the ECA's audit results also show that more can and should be done to ensure that EU money is spent in accordance with its rules.

The ECA looks forward to helping the new European Parliament and Commission to address these and other financial management and accountability issues facing the EU. To this end, we have also prepared two landscape reviews, based on the ECA's audit experience, to highlight the main accountability, audit and financial management challenges facing the EU.

Vítor Manuel da SILVA CALDEIRA

A handwritten signature in black ink, appearing to read 'V. Caldeira'.

President of the European Court of Auditors

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Key messages

Summary of the 2013 statement of assurance

The European Court of Auditors (ECA) gives a **clean opinion** on the reliability of the 2013 **accounts** of the European Union.

Revenue for 2013, taken as a whole, is **legal and regular**.

Commitments for 2013, taken as a whole, are **legal and regular**.

Payments for 2013 are materially affected by error. The ECA therefore gives an **adverse opinion** on their legality and regularity.

For the statement of assurance, please refer to Chapter 1 of the 2013 annual report.

- The **estimated error rate**, which measures the level of irregularity, for 2013 payments is 4.7 %, close to that of 2012 (4.8 %) and persistently above the materiality threshold of 2 %.
- Overall, with significant variations between Member States, the **supervisory and control systems** examined were partially effective in ensuring the regularity of payments.
- The two most error-prone spending areas were *regional policy, energy and transport* with 6.9 % and *rural development, environment, fisheries and health* with 6.7 %. For **shared management** as a whole, i.e. including also *agriculture: market and direct support* and *employment and social affairs*, the estimated error rate was 5.2 %.
- **Corrective and recovery action** by authorities in the Member States and the Commission had a positive impact on the estimated error rate. Without this action, the overall estimated error rate would have been 6.3 %.
- As in 2012, for a large proportion of the transactions affected by error in the shared management areas, **authorities in the Member States had sufficient information available** to have detected and corrected the errors before claiming reimbursement from the Commission.
- A **continued rise in sums to be funded from future budgets**, despite a significant increase in the 2013 payments budget, makes it essential for the Commission to plan its payment requirements for the medium and long term.
- Spending of EU funds in the 2007–13 programming period was focused on absorption ('use it or lose it') and compliance rather than good performance. This **lack of focus on performance** is a fundamental flaw in the design of much of the EU budget.

Spending EU money according to the rules

2013 EU money

Every year the ECA audits the revenue and expenditure of the EU budget and provides its opinion on the extent to which the annual accounts are reliable and income and spending transactions comply with the applicable rules and regulations.

EU budgetary spending totalled **€148.5 billion** in 2013, or around €290 for every citizen. This spending amounts to around one per cent of EU gross national income and represents approximately two per cent of total public spending of EU Member States.

The EU budget is agreed annually — within the context of seven year financial frameworks — by the European Parliament and the Council. Ensuring that the budget is properly spent is primarily the responsibility of the Commission. For around 80 % of the spending (principally agriculture and cohesion) this responsibility is shared with the EU's Member States.

Where does the money come from?

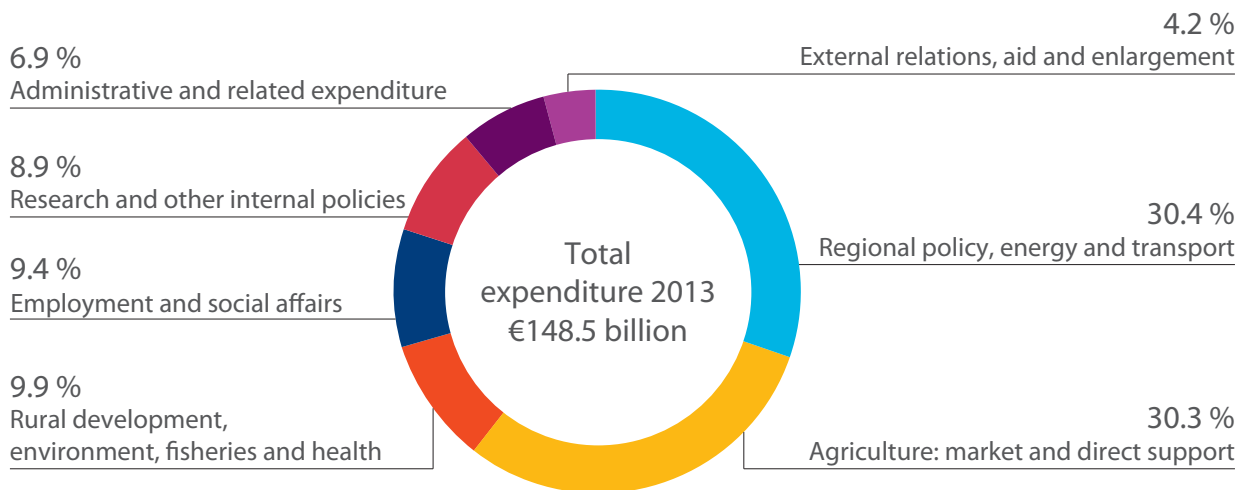
The EU budget is financed by various means. The largest proportion is paid by Member States based on their gross national income (€110.0 billion). Other sources include payments by Member States based on the value added tax they collect (€14.5 billion), as well as customs and agricultural duties (€15.4 billion).

What is the money spent on?

The annual EU budget is spent on a wide range of policies (see *Diagram 1*). Payments are made to support activities as varied as research projects, training for jobless people or agricultural production.

Diagram 1

2013 EU budget

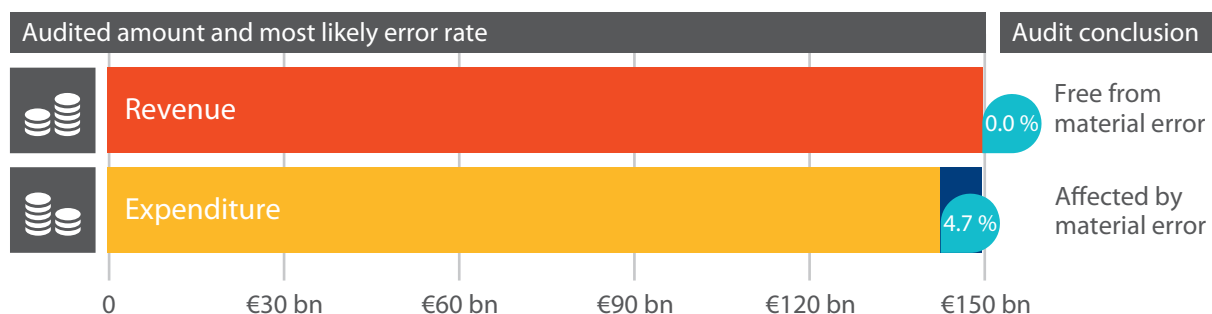


Audit findings for 2013

A key element of the ECA's audit work is the testing of samples of transactions from across the EU budget to provide statistically based estimates of the extent to which revenue and the different spending areas are affected by error. **Diagram 2** summarises the results for 2013. For more information on the ECA's audit approach and the estimation of the most likely error rate see page 35.

Diagram 2

2013 results of transaction testing for EU budget as a whole



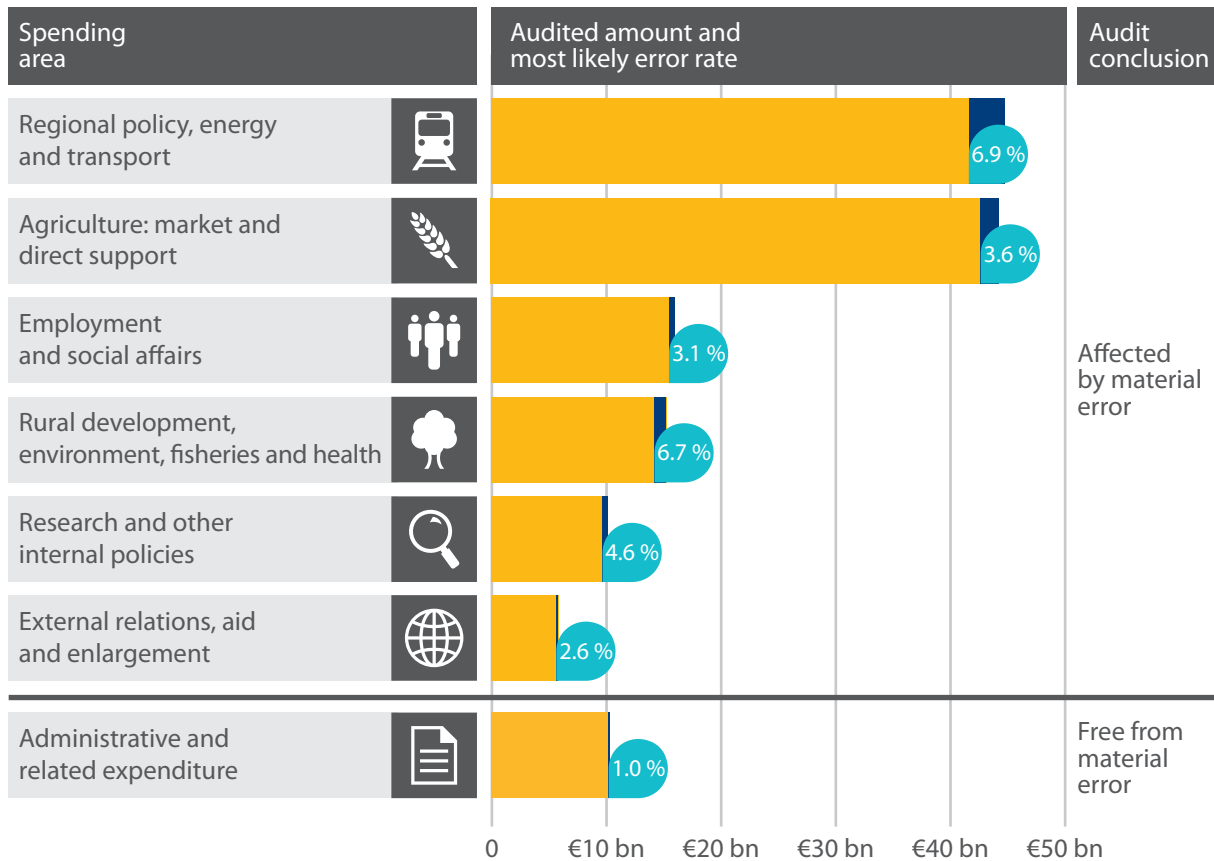
Most likely error rate (estimated error rate based on the quantifiable errors found in the statistical sample of transactions)

For 2013, the ECA concludes that revenue was free from material error. For the expenditure budget as a whole, the estimated error rate of 4.7 % leads to an adverse opinion on the regularity of expenditure (for an explanation of the term 'regularity' please refer to page 36).

The testing also provides results for each spending area as presented in *Diagram 3*.

Further information on each spending area is given on pages 18 to 34 and in the related chapters of the 2013 annual report.

Diagram 3 2013 results of transaction testing for EU spending areas



% Most likely error rate (estimated error rate based on the quantifiable errors found in the statistical sample of transactions)

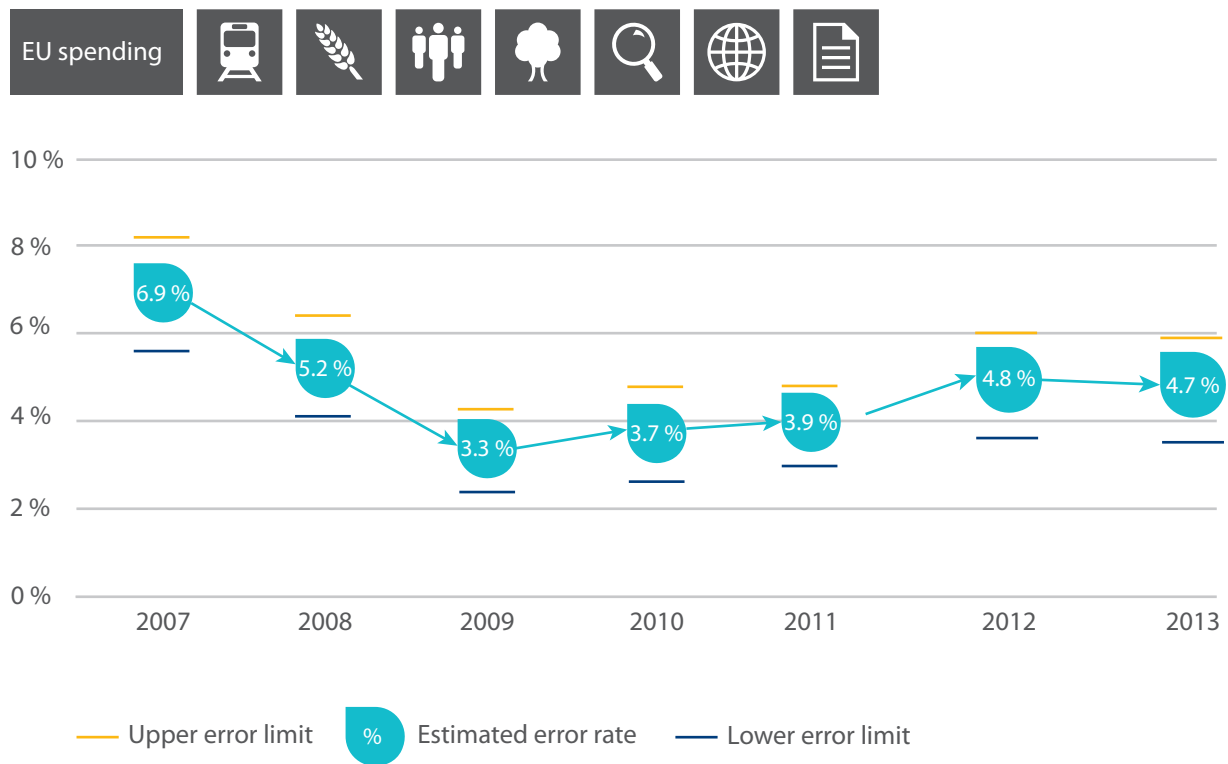
Note: The ECA uses standard statistical techniques to estimate the error rate. (See Chapter 1 Annex 1.1 to the annual report).

Analysis of audit results

The estimated error rate, which measures the level of irregularity, for 2013 payments is 4.7 %, close to that of 2012 (4.8%) and persistently above the materiality threshold of 2 %. (see *Diagram 4*)

Diagram 4

Estimated error rate for the EU budget as a whole: 2007 to 2013



Note: The ECA uses standard statistical techniques to estimate the most likely error rate. The ECA is 95 % confident that the rate of error for the population lies in the range between the lower error limit and the upper error limit. For more details see Chapter 1 Annex 1.1 to the annual report and graph 1.3 of the annual report.

Errors, waste and fraud

The ECA's estimate of the error rate is not a measure of fraud, inefficiency or waste. It is an estimate of the money that should not have been paid out because it was not used in accordance with the applicable legislation. Typical errors include payments for expenditure which was ineligible or for purchases without proper application of public purchasing rules.

Fraud is an act of deliberate deception to gain a benefit. The ECA reports suspected fraud cases arising during its audit work to OLAF, the European Union's anti-fraud office, which investigates and follows-up as necessary in co-operation with authorities in the Member States.

A comparison of the estimated error rates for the various spending areas is shown in **Diagram 5**. Increases for *research and other internal policies* and *administrative and related expenditure* were offset by decreases in *rural development, environment, fisheries and health* and *external relations, aid and enlargement*.

As in 2012, the two most error prone spending areas were *regional policy, energy and transport* and *rural development, environment, fisheries and health*. These two areas, together with the two other **shared management areas** (*agriculture: market and direct support* and *employment and social affairs*), have an estimated error rate of 5.2%. All other operational expenditure (which is mostly directly managed by the Commission) has an estimated error rate of 3.7%. Finally, the ECA found a 1.0% estimated error rate in administrative expenditure.



Diagram 5

Comparison between 2012 and 2013 estimated error rates for EU spending areas

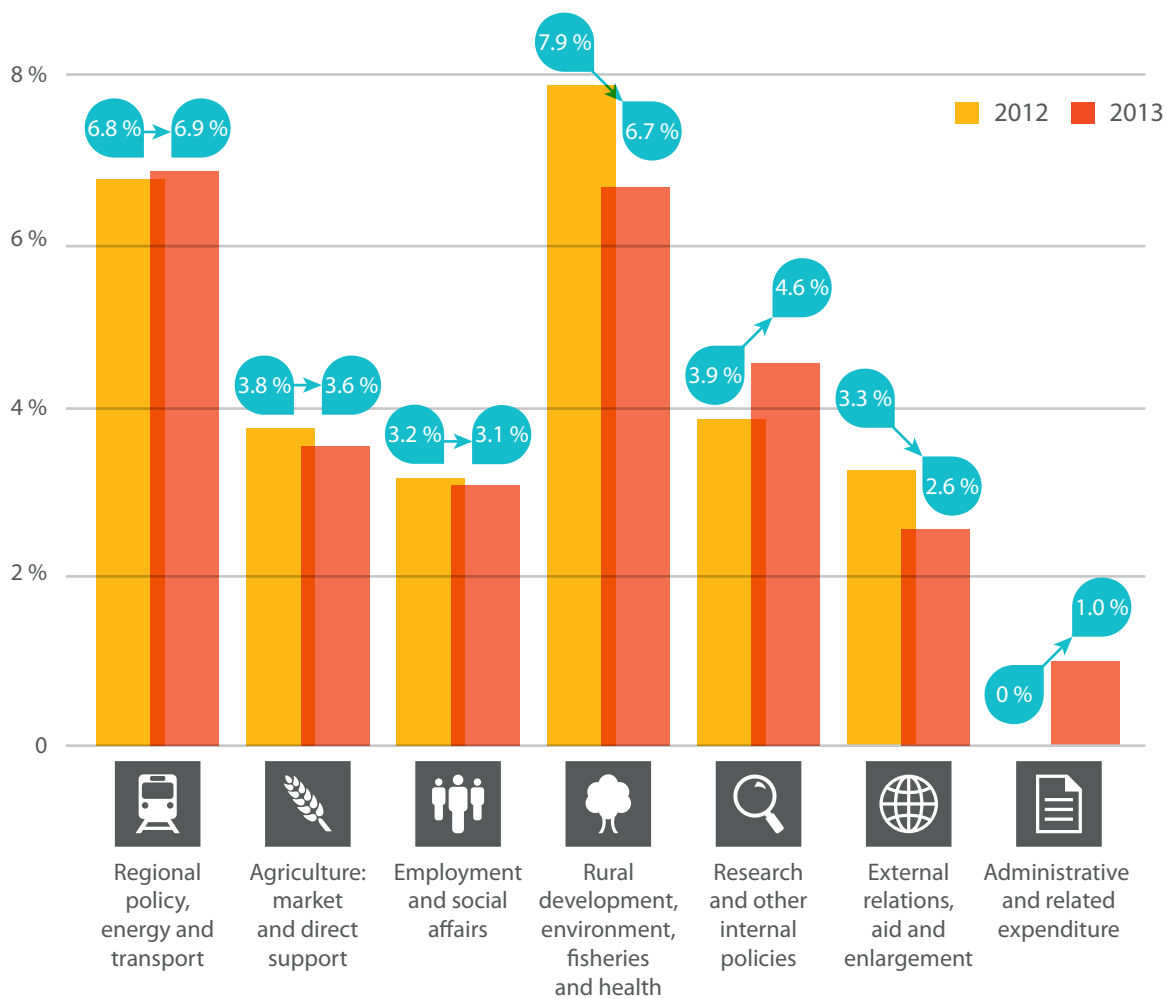
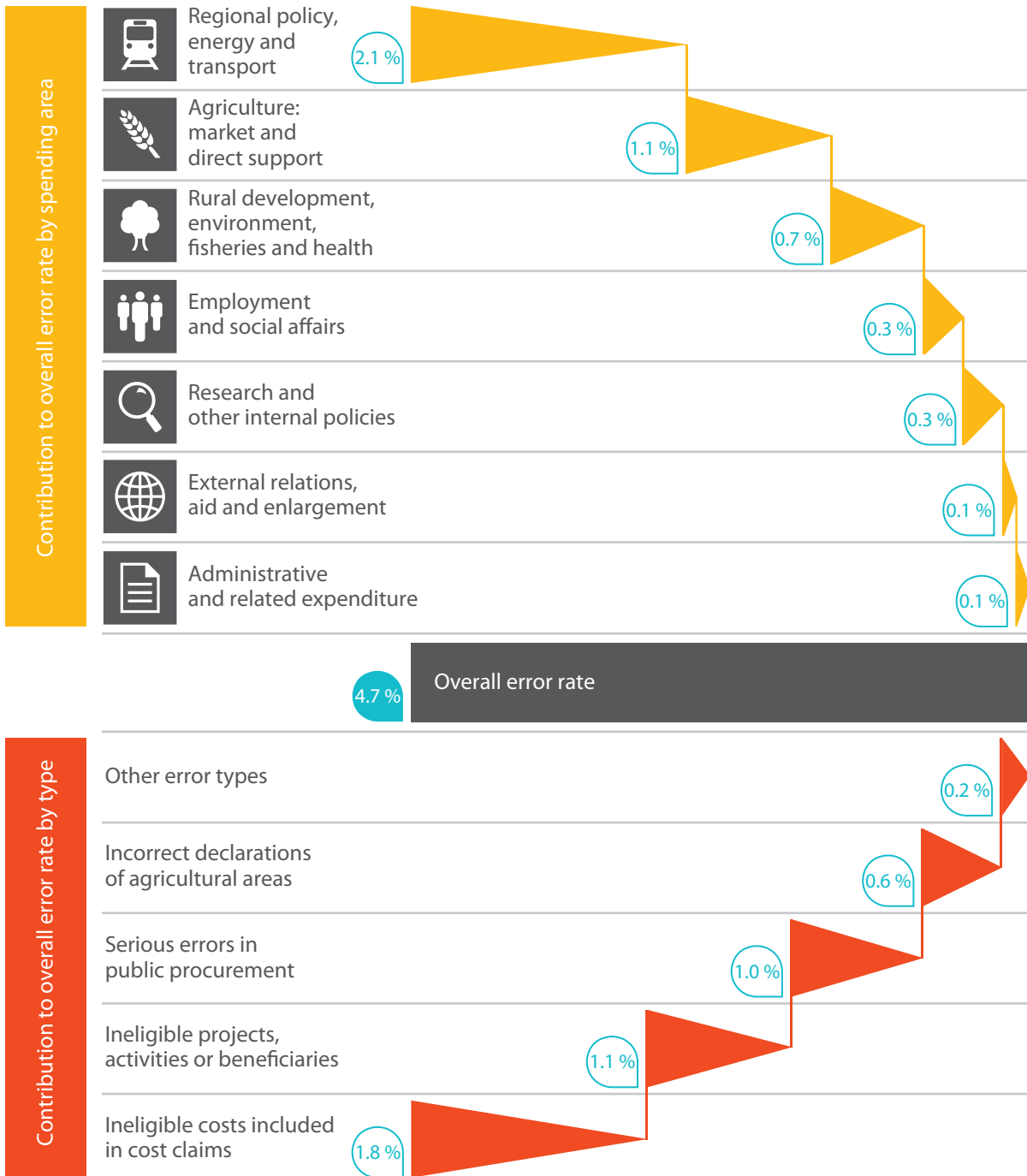


Diagram 6

Breakdown of the overall estimated error rate by spending area and type of error



Overall estimated error rate for EU budget as a whole

Portion of the overall error rate, expressed in percentage points

The ECA analyses the contribution of specific types of error as well as specific spending areas to the overall estimated error rate (see *Diagram 6*).

Expenditure that did not fulfil the necessary conditions to be charged to EU funded projects made the greatest contribution to the overall estimated error rate ('ineligible costs included in cost claims': 39 % or 1.8 percentage points of the overall estimated error rate). Second came projects where either the funded object/activity or the beneficiary were not permitted under the applicable rules ('ineligible projects/activities or beneficiaries': 22 %; 1.1 percentage points of the overall estimated error rate).

Regional policy, energy and transport is the biggest spending area and has the highest estimated error rate. This combination makes it by far the biggest contributor to the overall estimated error rate (44 %; 2.1 percentage points of the overall estimated error rate). With a similar volume of spending, *agriculture: market and direct support* contributes about half as much to the overall estimated error rate.

Corrective measures have a positive impact on the error rate

The Member States and the Commission use corrective measures to protect the EU budget in cases of ineffective control systems or irregular expenditure. If such corrective measures had not been applied to the 2013 payments audited by the ECA, the overall estimated error rate would have been 6.3 %, rather than 4.7 %.

However, there is still considerable scope to reduce the estimated error rate through better use of existing control systems and corrective measures. The ECA found that, for a large proportion of transactions affected by error in the shared management areas, authorities in the Member States had sufficient information available to have detected and corrected the errors before claiming reimbursement from the Commission. For instance, this would have reduced the estimated error rate in *regional policy, energy and transport* from 6.9 to 3.9 %, in *rural development, environment, fisheries and health* from 6.7 to 2.0 % and in *employment and social affairs* from 3.1 to 1.9 %.

New challenges in presenting reliable financial information

The reporting of the aforementioned corrective adjustments does not clearly distinguish between the main types of corrective adjustments, and the information is largely provided outside the accounting system. This makes further analysis difficult and reduces the accuracy of the figures presented in the accounts and in related financial reporting.

Another development is the growing use of financial instruments. They provide support for investments by way of loans, guarantees, equity and other risk-bearing mechanisms to projects with potential economic viability. Due to their complex structure, financial instruments require particular attention in measuring and recording them in accordance with international public sector accounting standards.

Continued increase in sums to be funded from future budgets

Key features of EU budgetary and financial management in 2013 included:

- a large increase in the volume of payments that the Commission was allowed to make through amending budgets — 9.6% of the initial budget;
- a continued growth of obligations to make payments in the future by 2.6%, in spite of the high level of payments;
- a persistently lengthy period (over 2 years on average) from initial commitment to acceptance by the Commission of spending claims;
- only 37% of funds paid into financial engineering instruments had been disbursed to final recipients at the end of 2012; and
- a failure to record as revenue €259 million of repayments, interest and dividends that had accumulated since 2008.

What are commitments and payments?

The EU budget has two components: commitments (amounts to be paid in the current or future years) and payments (covering payments of funds in the current year). Payments can only be made against a valid commitment. The annual ceilings for commitments and payments are laid down in the multiannual financial frameworks agreed by the Parliament and the Council.

The nature of EU spending programmes, in particular the long time lag between commitment and payments, leads to growing pressure on future payments budgets. This is evidenced by the large increase in the 2013 payments budget and is expected to affect future budgets in a similar way.

How to improve budgetary and financial management

The ECA considers that the Commission should:

- publish more meaningful information on the operation of corrective mechanisms (timing, origin and nature) and increase assurance on the accuracy of its figures by recording the information within conventional accounting systems;
- record and measure all financial instruments and financial engineering instruments in accordance with international public sector accounting standards, in particular through reliable procedures for identifying and recording falls in asset values;
- provide information on cash held pending disbursement to final beneficiaries; and
- prepare and publish a long-range cashflow forecast to be updated annually. This would assist stakeholders in assessing future payment requirements and budgetary priorities.



Want to know more? Full information on the main findings can be found in Chapter 1 'The statement of assurance and supporting information' of the 2013 annual report on the EU budget.



Getting results with EU money

EU money should be spent in line with the principles of sound financial management: economy, efficiency and effectiveness. Achieving good performance involves inputs (financial, human, material, organisational or regulatory means needed for the implementation of the programme), outputs (the deliverables of the programme), results (the immediate effects of the programme on direct addressees or recipients) and impacts (long-term changes in society that are, at least partly, attributable to the EU's action). The ECA assesses these attributes through its performance audits.

Insufficient focus on performance

When spending EU funds in the 2007–13 programming period, the focus was on absorption ('use it or lose it') and compliance rather than good performance. For instance, the choice of projects to receive EU funds focused first on spending the EU money available, secondly on complying with the rules, and only then — and to a limited extent — on achieving results and impact. This lack of focus on performance is a fundamental flaw in the design of much of the EU budget.

The Commission claims that the 2014–20 programming period has a stronger focus on performance, with the main incentive being performance reserves. Through these reserves the Commission will withhold 6 % of the funds earmarked for an individual Member State until performance is deemed satisfactory. However, input and output indicators will still in practice largely determine the release of the funds. Results indicators will only be used by the Commission in some areas.

Making the performance reserves work more effectively will depend on the Commission's success in negotiating suitable targets and milestones at the start of the programming period and in obtaining accurate, reliable and timely data from Member States to determine whether the targets have been met.

Reporting not adapted to aspirations of a performance culture

Reporting on performance at the level of the entire budget is fragmented into several overall reports. These reports do not cover progress towards the Europe 2020 strategy goals, nor do they provide a comprehensive overview of results in terms of EU added value. However, the fourth evaluation report represents a step in the right direction as it tries to establish a link between the main financial programmes and the available performance information relevant to the Europe 2020 strategy.

At the level of individual Commission directorates-general, performance objectives are set for their policy responsibilities in management plans and then reported on in their annual activity reports. The ECA's review of the management plans and annual activity reports of Commission directorates-general revealed that assurance is limited to issues of regularity and internal control and does not address performance issues. In addition, objectives were at too high a level to be fit for management purposes and the selected indicators are not always suitable for measuring performance.

Added value of EU spending not always demonstrated

The 19 special reports adopted by the ECA in 2013 cover a wide range of performance audit subjects which assess whether the EU's intervention was managed in accordance with the principles of sound financial management (economy, efficiency and effectiveness).

The ECA examined the lessons that can be learned from its 2013 special reports for the preparation of new programmes and projects for the 2014–20 programming period and found that:

- o **EU added value had not always been secured;**

Example: European globalisation adjustment fund

The European globalisation adjustment fund compensates workers affected by mass redundancies. The ECA found that one third of the funding would anyway have been paid by the Members States. (Special Report No 7/2013 'Has the European Global Adjustment Fund delivered EU added value in reintegrating redundant workers?')

- o **in several cases there was potential deadweight, meaning that beneficiaries would have undertaken the activity even without the EU funding.**

Example: Risk-sharing finance facility

The Commission had not sufficiently demonstrated that the EU support under the risk-sharing finance facility (a financial instrument designed to improve access to debt financing for research) leads to investments above the level that beneficiaries would undertake in its absence. (Special Report No 2/2013 'Has the Commission ensured efficient implementation of the seventh framework programme for research?').



Most ECA recommendations implemented

The ECA's follow-up of its performance audit recommendations is a key element in the cycle of accountability, and helps encourage the effective implementation of report recommendations by the Commission. The ECA reviewed the Commission's follow-up of the recommendations of eight special reports adopted in the period 2007–10 and found that 79% of recommendations were either fully or mostly implemented.

The ECA recommends that the Commission should:

- on the next occasion that the Financial Regulation is reviewed, rationalise its reporting framework for performance;
- ensure that the evaluation report presents a summary account that brings together all the information available on the progress towards Europe 2020 targets; and
- further develop its performance management and reporting system to allow the Commission to take responsibility for sound financial management as well as the EU budget's contribution to policy achievements.

A closer look at revenue and spending areas



Revenue

€149.5 billion

What we audited

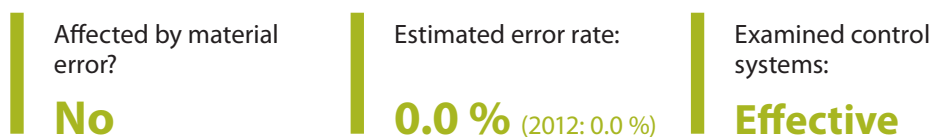
The audit covered the EU's revenue, through which it finances its budget. In 2013, revenue contributions calculated on the basis of Member States' GNI and VAT collected by them provided 74 % and 10 % respectively. Customs duties collected on imports and the sugar production charge collected by Member State administrations on behalf of the EU provided 10 % of the revenue, with the remaining 6 % being other revenue.

Explaining the audit of EU revenue

GNI- and VAT-based EU revenue is calculated on the basis of macroeconomic statistics and estimates provided by Member States. The ECA's audit of the regularity of the underlying transactions covers the Commission's processing of this data but not its initial generation by the authorities in the Member States. As a consequence, the ECA's audit conclusion addresses the impact of any Commission errors on the overall amount of revenue.

For customs duties, the ECA examines the Commission's treatment of the statement of the duties submitted by the Member States and the controls in selected Member States.

What we found



The ECA draws attention to the issue of **data on the non-observed economy** which is included in the Member States' calculation of the GNI-based contribution. This data is not sufficiently harmonised between Member States.

A reservation is a means by which a doubtful element in GNI data submitted by a Member State can be kept open for correction. There is a **general reservation on Greek GNI data** for the years 2008 and 2009 because it is still based on preliminary estimates. This is part of a problem in Greece's national accounts.

A closer look at revenue and spending areas

The Member States' customs authorities perform checks to verify whether tariff and import regulations are respected by importers. The ECA found that the quality of these checks varied substantially across the Member States visited. This can lead to importers choosing to declare goods in a Member State different from the one where they are domiciled to reduce the likelihood of being subject to controls and to complicate the collection of owed duties. One such example where it appeared so was of an importer who unloaded Chinese textile goods in Hamburg (Germany), transported them to Rotterdam (Netherlands) to declare them there for free circulation and then drove them to Poland for final sale.

What we recommend

The ECA recommends that the Commission:

- promote harmonisation between Member States of their methodologies for compilation of data on the non-observed economy;
- put in place and closely monitor a detailed action plan with clear milestones to address the problems in the compilation of Greece's national accounts; and
- establish minimum standards for the checks by Member States' customs authorities to allow better targeting of risky importers.



Want to know more? Full information on the ECA's audit of EU revenue can be found in Chapter 2 of the 2013 annual report on the EU budget.

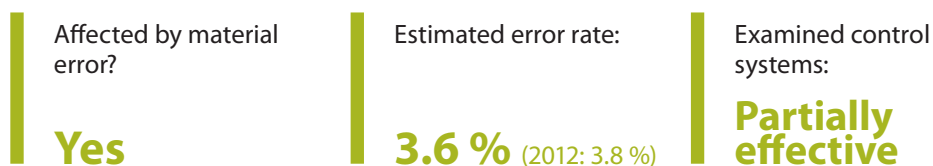


Agriculture: market and direct support €45.0 billion

What we audited

This spending area covers the European Agricultural Guarantee Fund (EAGF), one of the two main instruments of the common agricultural policy of the EU. This policy seeks to increase agricultural productivity, to ensure a fair standard of living for the agricultural community, to stabilise markets and to ensure the availability of food supplies at reasonable prices. Management of the spending is shared with Member States.

What we found



A majority of expenditure in this area is calculated based on agricultural land surface. Many quantifiable errors are the result of inaccurate claims by beneficiaries, with the most frequent being **over-declaration of land area** (see example).

Example: Over-declarations — claiming aid for ineligible land

In Germany, Ireland, Greece, France, Poland and Romania* some land claimed and paid for as **permanent grassland** was in reality fully or partly covered with ineligible vegetation (dense bushes or trees). These ineligible areas should have been excluded from EU aid. In Greece this error occurred because such areas were classified as eligible grassland and recorded accordingly in the land parcel identification system.

* Note on the naming of Member States in examples: Due to its sampling approach the ECA does not audit transactions in every Member State, beneficiary state and/or region each year. The examples of errors are provided in order to illustrate the most frequent error types. They do not form a basis for conclusions to be drawn on individual Member States, beneficiary states and/or regions concerned.

Beneficiaries of EU aid in all EAGF direct aid schemes have a legal obligation to fulfil **cross-compliance requirements**. These requirements relate to the protection of the environment, public health, animal and plant health, animal welfare, and to the maintenance of agricultural land in good agricultural and environmental condition. If farmers do not comply with these obligations their aid is reduced. In its testing the ECA found infringements in 25 % of the transactions subject to cross-compliance obligations.

For a significant number of transactions affected by error, **authorities in the Member States had sufficient information available** to have detected and corrected the error prior to claiming reimbursement from the Commission. If this information had been used to correct errors before declaring the expenditure to the Commission, the estimated error rate in this area would have been 2.5 %.

A closer look at revenue and spending areas

The ECA's examination of **integrated administration and control systems (IACS)** in four Member States (Germany, Ireland, France and Italy) revealed:

- weaknesses in the administrative control procedures including quality of databases in three Member States (Ireland, France and Italy);
- deficiencies in the quality of on-the-spot checks in two Member States (Germany and Italy); and
- weaknesses in the procedures to ensure recovery of undue payments in two Member States (Ireland and Italy).

Notwithstanding the weaknesses that were detected by the audit, IACS makes on the whole a significant contribution to preventing errors in the expenditure it covers.

In the Member States that acceded in 2004 or later, EU aid is available to **fruit and vegetable producer groups**. To be recognised as such, producer groups have to comply with conditions in relation to the number and relative size of member producers. The ECA found that nine out of 40 audited producer groups in Poland did not meet the conditions. In its 2013 annual activity report the Commission reported that it had established a reservation worth 25 % of the total spending under the measure at risk in Poland.

What we recommend

The ECA recommends that:

- the Commission and Member States take the necessary measures to ensure that the IACS is used to its full potential, for instance by ensuring that the eligibility and size of agricultural parcels are correctly assessed and recorded; and
- the Commission monitor the remedial action with regard to the deficiencies in EU aid to producer groups in Poland.



Want to know more? Full information on the ECA's audit of EU expenditure on market and direct support in agriculture can be found in Chapter 3 of the 2013 annual report on the EU budget.



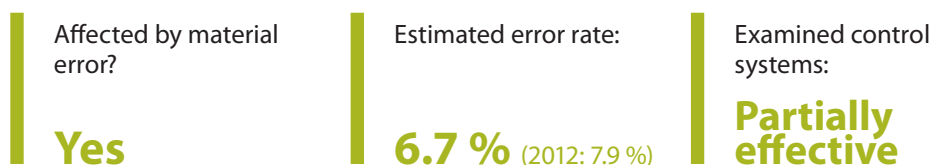
Rural development, environment, fisheries and health €15.6 billion

What we audited

This spending area covers rural development; environment and climate action; maritime affairs and fisheries; and health and consumer protection.

The European Agricultural Fund for Rural Development (EAFRD) represents 88% of the payments in this area. Management of the spending is shared with Member States. The EAFRD co-finances rural development expenditure through Member States' rural development programmes. The expenditure covers area-related measures (such as agri-environment payments and compensatory payments to farmers in areas with natural disadvantages) and non-area-related measures (such as modernisation of agricultural holdings and the setting up of basic services for the economy and rural population).

What we found



The reason for most errors was **non-compliance with eligibility requirements**, in particular those concerning agri-environment commitments (see example), specific requirements for investment projects and procurement rules.

Example: Non-compliance with agri-environment commitments

A farmer in Sardinia (Italy) was compensated for not using **environmentally harmful plant protection products on artichokes**. During its on-the-spot visit, the ECA found that the beneficiary had used such products 12 times during the period audited. This made the payment ineligible.

Similar cases of non-compliance with agri-environment commitments were also detected in Piemonte (Italy), Hungary, the Netherlands, Poland and Romania.

A closer look at revenue and spending areas

For a significant number of transactions affected by error, **authorities in the Member States had sufficient information available** to have detected and corrected the error prior to claiming reimbursement from the Commission. If this information had been used to correct errors before declaring the expenditure to the Commission, the estimated error rate in this area would have been 2.0%.

The ECA's examination of rural development **control systems** revealed:

- weaknesses in the **checks of eligibility conditions**, such as not detecting ineligible VAT or risk of double financing (with the exception of Poland, in seven out of eight Member States examined — Germany, Spain, Italy, Latvia, Malta, Romania and Slovenia);
- insufficient evaluation of the **reasonableness of the costs** (in all four Member States examined — Italy, Latvia, Poland and Romania);
- deficiencies in the design and implementation of **cross-compliance checks** (in all four Member States examined — Czech Republic, Spain, Italy and Malta). Cross-compliance obliges beneficiaries to fulfil specific conditions to be eligible for funding, such as environmental or social standards; and
- weaknesses in the **checks of procurement rules** (in all three Member States examined — Italy, Latvia and Poland; see example).

Example: Insufficient Member State checks of procurement rules

In Latvia, the paying agency was the beneficiary of €2 million in EAFRD aid, to finance its **outsourced IT system**, the contract for which was subject to public procurement rules. The ECA found that the contract award for the IT system and its subsequent maintenance was affected by several serious errors. For instance, the paying agency applied a negotiated procedure rather than an open or restricted procedure as required by legislation. Failure to follow the required procedures renders the expenditure ineligible for EU financing.

What we recommend

The ECA recommends in the area of rural development that:

- Member States carry out their existing administrative checks better, by using all relevant information available to the paying agencies. This has the potential to detect and correct the majority of errors; and
- Member States ensure that action plans to address the high estimated error rate in rural development include all regions and measures, particularly investment measures, and take the Commission's and ECA's audit findings into account.



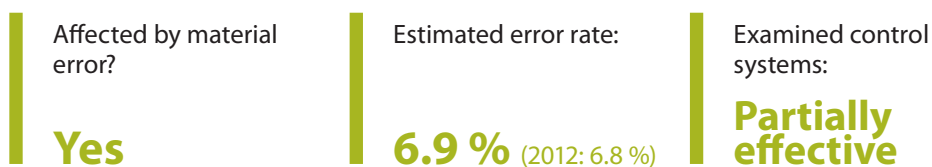
Regional policy, energy and transport €45.5 billion

What we audited

This audit covered regional policy (96 % of the payments in this spending area), which is mostly financed through the European Regional Development Fund (ERDF) and the Cohesion Fund (CF). Regional policy aims at strengthening economic and social cohesion within the European Union by reducing development disparities between different regions. Management of regional policy expenditure is shared with Member States, and involves the co-financing of projects within approved spending programmes.

Energy and transport represent the remaining 4 % of this spending area audited. Energy and transport policies aim to provide European citizens and businesses with secure, sustainable and competitive energy and transport systems and services. This expenditure is managed directly by the Commission.

What we found



The ECA found **serious errors in public procurement**, accounting for 39 % of the estimated error rate. The combined estimated contract value for the 122 public procurement procedures examined amounted to €4.2 billion.

Example: Unjustified direct award

Contracts for additional construction works for an **airport passenger terminal** in Germany were awarded directly to the original contractor. These additional works were the consequence of poor project preparation, planning and implementation rather than of unforeseeable circumstances. In such cases a direct award is unlawful and the additional works should have been put out to tender.

Similar cases of unjustified direct awards were found in projects in Belgium, Czech Republic, elsewhere in Germany, Spain, Italy and Sweden.

A closer look at revenue and spending areas

ECA auditors also verify if EU **state aid rules** are respected. Unlawful state aid represents an unfair advantage for the beneficiary entities and thereby distorts the internal market. State aid errors accounted for 17 % of the estimated error rate in this area (see example).

Example: State aid for profitable project

Aid was granted to a small or medium-sized enterprise (SME) in Slovenia for **research and development activities in the automotive industry**. However, the SME was wholly owned by large companies and carried out its research activities exclusively for them. Because public financing rules are stricter for large undertakings, the company did not have the right to receive all the funding.

Similar cases were found in Bulgaria and Hungary.

For a significant number of transactions affected by error, **authorities in the Member States had sufficient information available** to have detected and corrected the errors prior to claiming reimbursement from the Commission. If this information had been used to correct errors before declaring the expenditure to the Commission, the estimated error rate in this area would have been 3.9 %.

The ECA auditors also found that **financial engineering instruments** (FEIs) continue to have low rates of disbursement to final recipients in 2013. These funds provide assistance to enterprises or urban projects by way of equity investments, loans or guarantees. They receive a contribution when their legal structure is set up, and subsequently use this money to support projects. In total, 940 FEIs had been set up in 25 Member States with an endowment of around €12.6 billion.

What we recommend

The ECA recommends that the Commission:

- require from Member States, in their management declarations, an explicit confirmation regarding the effectiveness of the first-level checks performed by the managing and certifying authorities;
- carry out an in-depth assessment, as required by the Financial Regulation, of the persistent problem with the first-level checks by authorities in the Member States during the 2007–13 programming period;
- analyse the reasons for the high frequency of non-compliance with EU state aid rules; and
- reduce the persistent delays in disbursement of EU funds through FEIs.

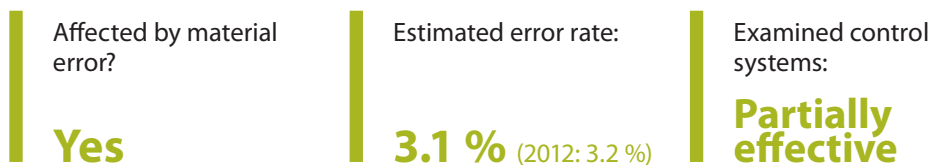


Employment and social affairs €16.2 billion

What we audited

The audit covered the *employment and social affairs* spending area, part of the EU's cohesion policy. The main objectives of the spending are to combat unemployment, to develop human resources and to promote integration in the labour market. The European Social Fund (ESF) is the main tool for the implementation of employment and social policy, accounting for 98 % of the payments in the spending area in 2013. The ESF funds investments in human capital through training and other employment measures. Management of the spending is shared with Member States.

What we found



The majority of errors detected — 93 % of the estimated error rate — concerned the reimbursement of **ineligible costs, projects, beneficiaries or participants** (see example). The remainder involved public procurement errors.

Example: Over-declaration of personnel cost

According to the applicable rules, overhead costs should be allocated pro rata to the projects funded with EU money according to fair and equitable methods. In a **private school** in Portugal, the full salary of the school director was charged to the EU project, although he also had other responsibilities. In addition, the maximum co-financing for salaries was not respected.

Similar findings were also identified in projects in Germany, Spain, Italy, Poland and the United Kingdom.

For a significant number of transactions affected by error, **authorities in the Member States had sufficient information available** to have detected and corrected the error prior to claiming reimbursement from the Commission. If this information had been used to correct errors before declaring the expenditure to the Commission, the estimated error rate in this area would have been 1.8 %.

A closer look at revenue and spending areas

On the recommendation of the ECA, and with the aim of reducing the likelihood of error and the administrative burden on project promoters, the use of **lump-sum and flat-rate payments** instead of reimbursing 'real costs' was extended in 2009. In its 2013 audit the ECA did not detect any quantifiable errors related to the specific use of lump-sum and flat-rate payments. This indicates that projects whose costs are declared using such payment options are **less error prone**.

What we recommend

The ECA recommends that the Commission:

- encourage Member States to strengthen the checks related to public procurement rules, non-project-related costs and projects without EU added value;
- should ensure that the Member States address the issue of charging personnel costs at higher rates for EU projects compared to those financed by national funds; and
- ensure that Member States have considered all simplification possibilities allowed by the 2014–20 European Structural and Investment Funds regulations.



Want to know more? Full information on the ECA's audit of EU expenditure in employment and social affairs can be found in Chapter 6 of the 2013 annual report on the EU budget.

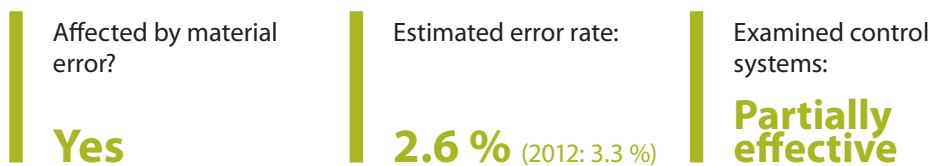


External relations, aid and enlargement €6.0 billion

What we audited

This spending area covers expenditure in the fields of external relations, development and humanitarian aid and measures for EU candidate and accession countries. Development projects are dispersed throughout more than 150 countries, and the implementing organisations vary greatly both in size and experience. To be eligible for EU support, projects are required to comply with conditions set out in specific financing agreements as well as other rules covering, for example, tendering and contract award procedures. Spending is implemented directly by Commission directorates-general, either from their headquarters in Brussels, by EU delegations in recipient countries or jointly with international organisations.

What we found



A majority of errors involve ineligible expenditure incurred at final beneficiary level, such as: expenditure incurred outside the eligibility period; inclusion of ineligible expenditure (e.g. VAT, staff costs and unjustified overheads) in project cost claims; and expenditure without adequate supporting documents.

Example: Expenditure not incurred

The Commission signed a €9.5 million contribution to the United Nations development programme to **foster social development in Moldova**. In 2013, the Commission accepted contracts for reimbursement worth €1.8 million for which no underlying expenditure had been incurred.

Pre-accession expenditure totalling €150 million was validated by the Commission without supporting documentation confirming that expenses had been incurred and were eligible. The validated amounts were based on the Commission's own estimates rather than on incurred, paid and accepted costs proven by supporting documents. Following the detection of this **systemic error** by the ECA, the Commission made accounting corrections for the transactions concerned.

A closer look at revenue and spending areas

EuropeAid, a directorate-general of the Commission, manages most of the EU budgetary external action spending. The examined systems of EuropeAid are assessed as partially effective. In May 2013 EuropeAid adopted an action plan to address the main weaknesses identified.

What we recommend

The ECA recommends that the Commission:

- ensure the instructions to staff state that clearings should be made only on the basis of incurred expenditure and not be based on their own estimates. The Commission has already agreed to amend its clearance procedure accordingly.



Want to know more? Full information on the ECA's audit of expenditure in external relations, aid and enlargement from the EU budget can be found in Chapter 7 of the 2013 annual report on the EU budget.

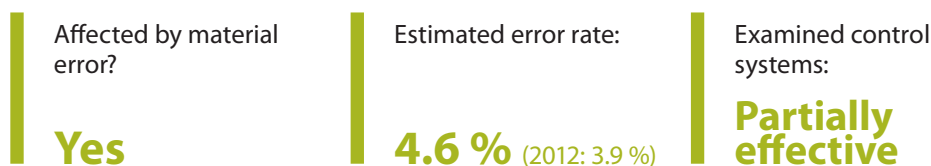


Research and other internal policies €10.4 billion

What we audited

The main component of this spending area is research and innovation projects, with €7.7 billion of payments in 2013. Other internal policies cover spending on a range of policy objectives, including education and culture, security, migration and measures to combat the effects of the financial crisis. The majority of the expenditure is managed directly by the Commission.

What we found



For most payments in this spending area, the Commission reimburses costs declared in project cost statements by beneficiaries of the funding. Errors arise when beneficiaries declare ineligible costs which are not detected by the control systems prior to reimbursement by the Commission. 35 % of the estimated error is caused by **incorrectly calculated or ineligible personnel costs**. This includes declaring budgeted rather than actual personnel costs, as well as charging time that was not spent on the project.

Aside from the lack of compliance with spending rules, the reimbursement of ineligible costs also hinders the successful implementation of policy objectives and therefore limits the **added value brought by EU support** (see example).

Example: Ineligible expenditure reduces EU added value

The EU provides funding to support efficient and effective controls at the EU's external borders. The ECA examined a project in Spain which consisted of the **purchase of four helicopters**, to be used 75 % of their operating time for EU external border surveillance and control. However, the ECA found that the helicopters were only used 25 % of their operating time for this purpose. This implies that the EU should have only paid 25 % of the cost of the helicopters and not 75 % as was the case.

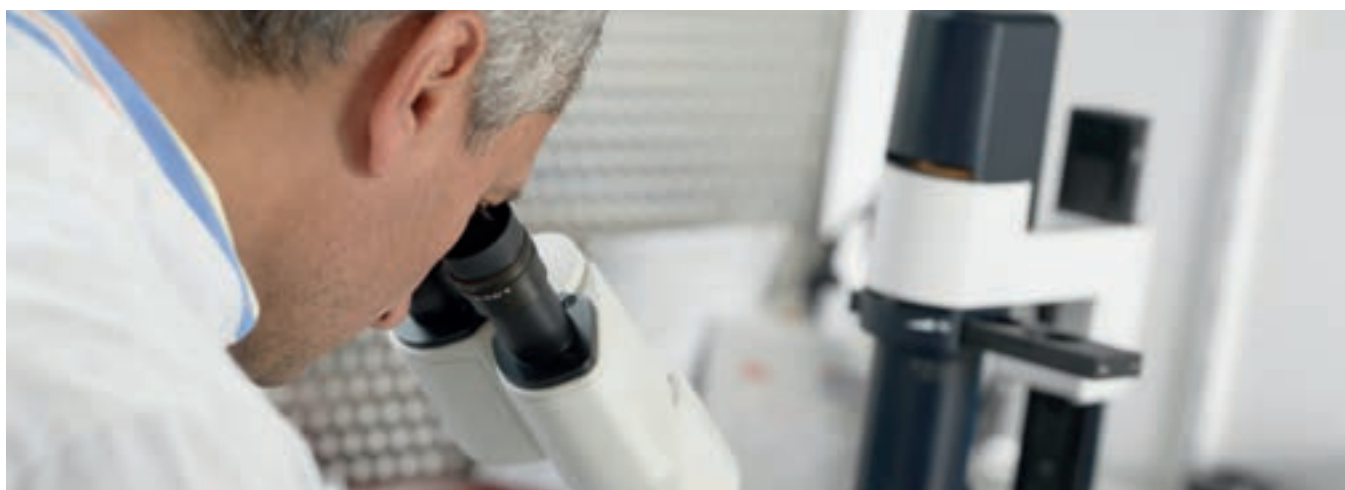
A closer look at revenue and spending areas

As part of the control systems for research spending, the **Commission checks** progress reports and cost statements of funded projects before payments are made. The ECA found that the Commission does not always apply its procedures uniformly, which can reduce programme efficiency and increases the administrative burden on beneficiaries.

What we recommend

The ECA recommends that the Commission:

- provide timely, consistent and clear guidance to beneficiaries and authorities in the Member States about the eligibility rules and control arrangements for the new 2014–20 programmes for research (Horizon 2020) and other internal policies; and
- make its control activities more risk driven, focusing checks on high-risk beneficiaries (for example entities with less experience of European funding) and reducing the burden of checks on less risky beneficiaries.



Want to know more? Full information on the ECA's audit of EU expenditure in research and other internal policies can be found in Chapter 8 of the 2013 annual report on the EU budget.



Administrative and related expenditure €10.6 billion

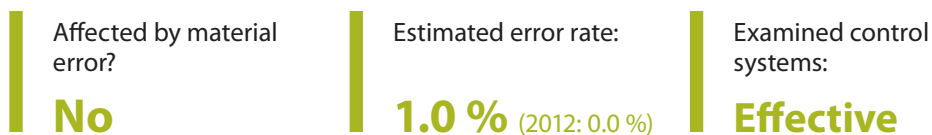
What we audited

Administrative and related expenditure covers the expenditure of EU institutions and other bodies. These are the Parliament, European Council and Council, Commission, Court of Justice, Court of Auditors, European External Action Service (EEAS), European Economic and Social Committee, Committee of Regions, Ombudsman and Data Protection Supervisor.

Spending on human resources (salaries, allowances and pensions) accounts for 60 % of the spending area; expenditure on buildings, equipment, energy, communications and information technology accounts for the remainder.

The results of the ECA audits of the European Union agencies and other decentralised bodies are reported in specific annual reports, which are published separately, together with a summary of the results.

What we found



The examination of most control systems did not reveal any serious weaknesses. But the ECA notes repeated errors in the payment of salaries and allowances by the Commission and the EEAS, as well as weaknesses in the procurement procedures of EU delegations (run by the EEAS).

What we recommend

The ECA recommends that:

- the Commission and the EEAS should take further steps to ensure that staff records affecting payment of salaries and allowances are up to date; and
- the EEAS should provide support and guidance to EU delegations in relation to procurement procedures.



European Development Funds (EDFs)

€2.6 billion

What we audited

The EDFs provide European Union assistance for development cooperation to the African, Caribbean and Pacific (ACP) states and overseas countries and territories (OCTs). Spending aims to reduce and eventually eradicate poverty, and to promote sustainable development and the integration of ACP countries and OCTs in the world economy.

The EDFs are funded by the Member States, governed by their own financial regulations and managed by the European Commission outside the framework of the EU budget. External aid financed by the EDFs is implemented in a high-risk environment, notably due to geographically dispersed activities and weak institutional and administrative capacity in partner countries.

What we found

Reliability of the EDFs' accounts:

2013 accounts fairly present the financial position of the EDFs, the results of their operations, their cash flows and the changes in net assets.

EDFs' revenue affected by material error?

No

EDFs' commitments affected by material error?

No

EDFs' payments affected by material error?

Yes

Estimated error rate:

3.4 % (2012: 3.0 %)

Examined control systems:

Partially effective

Non-compliance with procurement rules was responsible for around half of the estimated error rate (see example). Another significant source of errors is the absence of supporting documents to justify expenditure.

Example: Failure by the beneficiary to comply with procurement rules

The ECA examined a tender for **IT equipment to a business information centre** financed by a micro- and small enterprises support programme. The audit revealed that the contract was not awarded to the lowest bid — despite the lowest price being the award criterion. The error was not detected by the Commission's framework auditor performing a financial audit of this programme.

The EDFs are also used to provide **budget support**, i.e. direct payments into the state budget of a developing country subject to certain conditions. The ECA detected errors in budget support transactions where fulfilment of conditions had been wrongly measured and the wrong exchange rate used to convert budget support to local currency.

EuropeAid, a directorate-general of the Commission, manages most of the external spending under the EU budget and almost all of the spending under the EDFs. The examined systems of EuropeAid are assessed as partially effective. However, in May 2013 EuropeAid adopted an action plan to address the main weaknesses identified.

What we recommend

The ECA recommends that the Commission:

- recover interest generated by pre-financing;
- revise the quantification of the benefits of controls implemented; and
- report on the progress in the implementation of the action plan to address weaknesses in the control system.



Want to know more? Full information on the ECA's audit of the European Development Funds can be found in the 2013 annual report on the activities funded by the 8th, 9th and 10th European Development Funds (EDFs).

Audit approach at a glance

The ECA's statement of assurance opinions are based on objective evidence obtained from audit testing in accordance with international auditing standards. This is how the work is done.

Reliability of the accounts

Do the EU annual accounts provide complete and accurate information?

The EU budget is complex. Hundreds of thousands of accounting entries are initiated by Commission directorates-general each year, which capture information from many different sources (including Member States). The ECA checks that accounting processes work properly and the resulting accounting data are complete, correctly recorded and properly presented.

- **Evaluation of the accounting system** to ensure it provides a good basis for reliable data (complete and accurate).
- **Verification of key accounting procedures** to ensure they function correctly.
- **Analytical checks of accounting data** to ensure they are presented consistently and appear reasonable.
- **Direct checking of a sample of accounting entries** to ensure the underlying transaction exists and is accurately recorded.
- **Checking of financial statements** to ensure they fairly present the financial situation.

Regularity of transactions

Do the EU income and expensed payment¹ transactions underlying the EU accounts comply with the rules governing them?

The EU budget involves millions of payments to beneficiaries in both the EU and the rest of the world. The majority of this spending is managed by Member States. To obtain the evidence it needs, the ECA tests income and expensed payments directly and assesses the systems by which they are administered and checked.

- **Samples of transactions are drawn** from across the EU budget using statistical techniques to provide a basis for detailed testing by ECA auditors.
- **The sampled transactions are audited in detail**, usually at the premises of final recipients (e.g. a farmer, a research institute, a company providing publicly procured works or services) to obtain direct evidence that the underlying event 'exists', is properly recorded and complies with the rules under which the payments concerned are made.
- **Errors are analysed and classified** as either quantifiable or not.
- **The impact of errors is calculated** through the extrapolation of quantifiable errors in the form of a 'most likely' error rate (estimated error rate).
- The **estimated error rate** is compared against a materiality threshold of 2 % to determine the ECA's opinion.
- **A number of control systems are assessed** to determine their effectiveness in making sure the transactions they manage are legal and regular.
- **Other relevant information** is taken into account, such as annual activity reports and reports of other external auditors.
- **All findings are discussed** with both the authorities in the Member States and the Commission to ensure the facts are correct.
- **The ECA adopts its opinions** based on the work done and results achieved.

1 Expensed payments: interim payments, final payments and clearing of advances.

The European Court of Auditors and its work

The European Court of Auditors (ECA) is the independent **audit institution** of the European Union. We are based in Luxembourg and employ around 900 professional and support staff of all EU nationalities. Since our creation in 1977 we have focused attention on the importance of EU financial management and contributed to its improvement.

The ECA's audit reports and opinions are an essential element of the **EU accountability chain**. Our output is used to hold to account — notably within the annual discharge procedure — those responsible for managing the EU budget. This is mainly the Commission, but also concerns the other EU institutions and bodies. Member States also play a major role in shared management.

Our principal tasks are:

- **financial and compliance audits**, principally in the form of the statement of assurance;
- **performance audits** of topics selected to maximise the impact of our work; and
- **opinions** on regulations related to budgetary management and other issues of importance.

We aim to manage our **resources** in a way that ensures an appropriate balance between our various activities, helping achieve robust results and good coverage across the different areas of the EU budget.



Our output

We produce:

- **Annual reports** on the EU budget and European Development Funds. The annual reports mainly comprise the statement of assurance opinions and results, and are published each year in November;
- **Specific annual reports** setting out the ECA's financial audit opinions on each of the EU's various agencies and bodies. 53 to be published in 2014;
- **Special reports** on selected audit topics, published throughout the year. They are mainly performance audits. About 25 will be published in 2014;
- **Opinions** used by the European Parliament and the Council when approving EU laws and other decisions with significant financial management implications. Six to be published in 2014;
- **Landscape reviews** on selected areas of EU policy analysing broader challenges and long term trends. Two to be published in 2014;
- **Annual activity report** providing information and insight on our activities for the year.

Our work contributes to raising awareness and increasing transparency about EU financial management, providing assurance on the state of that management and making recommendations for further improvement. We do so in the interests of the **citizens of the European Union**.

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The European Court of Auditors is the independent external audit institution of the EU — guardians of the EU's finances

In its annual reports on the EU budget and the European Development Funds, the ECA gives its opinion — or statement of assurance — on the reliability of the accounts and the legality and regularity of the transactions that underlie them. The purpose of this publication is to provide a summary of the main findings and conclusions. The full texts of the reports are available on the ECA's website and are published in the *Official Journal of the European Union*.



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