

# **The European Court Of Auditor's Perspective On The Management And Control Of EU Funds**

## *An overview of the current situation and the prospects for EU budget reform*

Vítor Caldeira, President of the European Court of Auditors

### **Introduction**

*The European Court of Auditors' position as an EU institution gives it a unique perspective on the management and control of EU funds. Its reports and opinions provide a good basis for assessing the current situation and the prospects for future reform.*

The European Court of Auditor's (ECA) position as the EU institution responsible for the external audit provides it with a unique perspective on the management and control of EU funds. Through its work, the ECA aims to contribute to improving the quality of the financial management of EU funds.

The ECA has three main outputs: its annual reports, which comprise the results of its financial and compliance audit work for a specific financial year; its special reports, published throughout the year, presenting the results of its other audits, mainly performance audits assessing the economy, efficiency and effectiveness of EU spending; and its opinions on draft legislation with financial management impact.

In addition to its reports and opinions on draft legislation the ECA seeks to contribute actively to the public debate on the future of the EU budget, launched by the Commission in 2007, with its publication "Reforming the Budget, Changing Europe"<sup>1</sup>.

---

<sup>1</sup> Communication from the Commission - Reforming the Budget, Changing Europe - A public consultation paper in view of the 2008/2009 Budget Review, SEC (2007) 1188 of 12.9.2007.

The purpose of this paper is to present an overview, based on the work of the ECA, of the current state of the management and control of the EU funds and of the prospects for future reform.

To this end, the first section provides some background information on the EU budget and the role of the ECA. The second section presents an outline of the situation in 2007, the most recent year for which the audit results of the ECA are available. In doing this the text presented below draws heavily on the ECA's 2007 Annual Report on the implementation of the EU budget<sup>2</sup>.

The final section, examines the prospects for improved management and control in the future and presents the views of the ECA expressed in its contribution on budget reform<sup>3</sup>. These views are based on lessons drawn from across all the ECA's outputs and address issues not just related to compliance with rules and regulations but also considerations of how to improve economy, efficiency and effectiveness.

## **The EU Budget and the Role of the ECA**

*The EU budget is the principal instrument for managing and controlling EU funds and an important tool for implementing EU policies through a multi-level governance model.*

The policies of the EU are implemented through a variety of means including regulatory measures, the loans of the European Investment Bank and expenditure programmes. The latter are funded principally through the general budget of the EU ("the EU budget"). The EU budget is composed of revenue and expenditure. For 2007, EU expenditure totalled 114 billion euro (see table 1), equivalent to around one percent of the Union's GNI<sup>4</sup>. This can be compared to Member States' public sector budgets which in many cases amount to around half of total GNI<sup>4</sup>. The audit of the implementation of the EU budget is the principal task of the ECA conferred upon it by the EC Treaty<sup>5</sup>.

The revenue of the European Union mainly consists of contributions from Members States based on their gross national income (GNI – 63 %,) and on a measurement connected to value added tax collected by the Member States (VAT –

---

<sup>2</sup> Annual Report of the Court of Auditors concerning the implementation of the financial year 2007 OJ C 286, 10.11.2008

<sup>3</sup> "Response by the European Court of Auditors to the Commission's communication "Reforming the Budget, Changing Europe" available at <http://ec.europa.eu/budget/reform/library/contributions/>

<sup>4</sup> Gross National Income

<sup>5</sup> Treaty establishing the European Community

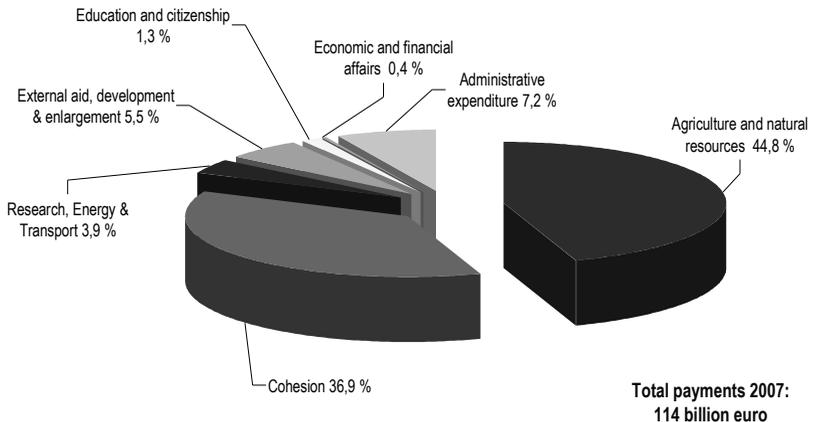
The European Court of Auditor's Perspective on the Management and Control of EU Funds.  
An overview of the current situation and the prospects for EU budget reform.

17 %). Customs and agricultural duties (so called traditional own resources – 14 %) also represent a significant share of revenue.

The largest single element of European Union spending is on agriculture and rural development - principally in the form of payments to farmers - accounting for almost half of the budget. Another significant proportion is spending on cohesion - regional and social development – co-financing a wide range of projects, from road construction in Romania to courses for the unemployed in the UK. This constitutes about a third of the budget. With the exception of payments under the Agriculture Schemes, the EU budget part finances the activities of private and public agents rather than providing goods and services to EU citizens directly.

As a result, the European Union budget involves payments made to millions of individual final beneficiaries. Payments made are based on the compliance of the final beneficiaries with legal or regulatory conditions, as well as the accuracy and existence of the underlying activities and/or costs. Payments are legal and regular when these conditions are met, and the right beneficiaries receive the right amounts at the right time. The ECA refers to cases where the conditions for payment are not met as “errors”. The large number of payments made, the complexity of the conditions for payment and the fact that payments are made on the basis of self-declarations by those claiming the funds mean that EU expenditure is a inherent risk of errors occurring.

Table1



The Commission has overall responsibility for ensuring that the budget is properly spent, i.e. without errors and with due consideration for ensuring economy, efficiency and effectiveness<sup>6</sup>. However, for around 80 % of spending, including cohesion and agriculture, this responsibility is shared with the Union's 27 Member States. Depending on the spending schemes, national administrations may be responsible for setting spending strategies, selecting beneficiaries and projects, making payments and checking the expenditure.

Supervisory and control systems, the range of procedures and processes (such as checks) by which the Union administers and manages its budgets and ensures that funds are collected and spent properly, are operated to prevent errors or detect and correct them when they occur. In many areas of expenditure, these systems involve a number of different actors at different levels (i.e. local, regional, Member State and EU level). The ECA categorises the different layers of supervision and control for the different areas of the budget as follows<sup>7</sup>:

**Primary level controls**, which check compliance of final beneficiaries with their regulatory obligations.

**Secondary level controls**, which check the effectiveness of the primary level controls.

**Overall supervision** by the Commission, to ensure that Member States and/or Commission Directorates-General meet their obligations and responsibilities

The effectiveness of supervisory and control systems at preventing errors or detecting and correcting them when they occur for the different areas of budgetary expenditure depends on several factors. These include:

- the complexity of the eligibility rules and obligations with which beneficiaries must comply, and their familiarity with them;
- the way that claims are made and processed;
- the number and extent of checks made;
- the extent of sanctions imposed on over-claiming beneficiaries when errors are detected; and

---

<sup>6</sup> Article 274 (1) of the Treaty establishing the European Community.

<sup>7</sup> The Court's Opinion 2/2004 on the "single audit model", OJ C 107, 30.4.2004, provides a detailed analysis of supervisory and control arrangements, including a proposal for a "community internal control framework".

The European Court of Auditor's Perspective on the Management and Control of EU Funds.  
An overview of the current situation and the prospects for EU budget reform.

- the visibility - and associated deterrent effect - of the control procedures.

The Commission is accountable for the implementation of the EU budget to the European Parliament and Council. Each year the Commission draws up the annual accounts of the European Communities which consist of the financial statements and reports on the implementation of the budget.

The Commission's Accounting Officer draws up the annual accounts, consolidating the results of the various EU institutions and bodies. (subject to certain limitations). 2007 is the third year of accruals-based accounts for the Union's financial statements. Accruals-based accounting - in contrast to the more traditional cash-based system - requires income and expenses to be accounted for in the year to which they relate rather than when cash is received or paid.

Since 2000 the Commission has been working on a reform programme to improve the management of the EU budget, centred mainly around its own responsibilities. A major element of this has been improving reporting, with e.g. the introduction of annual activity reports for the departments of the Commission - the Directorates-General (DGs) - accompanied by declarations by the Directors-General that head them. The annual activity reports and declarations are compiled in a synthesis report signed by the Commission as a whole.

*The ECA audits the implementation of the EU budget and reports the results each year in its Annual Report. The audit comprises an examination of the operation of the supervisory and control systems and testing of representative samples of transactions.*

As required by the EC Treaty<sup>8</sup>, the ECA's annual report on the implementation of the EU budget includes a statement of assurance on the reliability of the final annual accounts of the European Communities and on the legality and regularity of the transactions underlying them. This statement of assurance is an audit opinion, it is generally known by its French acronym DAS ("Déclaration d'Assurance"). The ECA conducts its audit in line with international standards on auditing.

The Statement of Assurance provides stakeholders, such as the European Parliament and the Council and also all EU citizens, with an audit opinion as to whether EU income and expenditure is completely and accurately recorded in the accounts (reliability of accounts), and has been raised or spent in accordance with all contractual and legal obligations (legality and regularity of underlying transactions). The ECA gives an overall assessment of the legality and regularity of the transactions underlying the budget expenditure as a whole. It also provides assessments covering specific segments of the budget made up of suitable groups of policy areas. The conclusions of these assessments form the ECA's Statement of

---

<sup>8</sup> Article 248 (4) of the Treaty establishing the European Community

Assurance. Since its introduction in 1994 the ECA has not been able to provide unqualified (“clean”) audit opinions in its Statement of Assurance on the legality and regularity of the transactions underlying the accounts.

In order to provide assurance as to whether the payments comply with the legal and regulatory frameworks, the ECA draws on the results of its examination of both supervisory and control systems and representative samples of the transactions (payments) themselves. The ECA checks most of the transactions it selects for testing down to the level of the final beneficiaries; this often means conducting on-the-spot visits. In addition, the ECA uses other sources of evidence to arrive at its conclusions, such as the analysis of annual activity reports of the Commission and the work of other auditors such as National Audit Institutions (NAI).

The ECA compares the estimated error rate based on the results of its representative samples of transactions against what is deemed to be a tolerable limit - or materiality threshold - to determine the nature of the opinion to be given. In the absence of a political decision setting a tolerable level of error, the ECA applies a threshold of two percent by value of the population under audit. The estimated error rate is thus an indication of the percentage of funds that should not have been paid out. If the level of error is judged not be material the ECA issues an unqualified (i.e. “clean”) opinion. Where the level of error is material, and depending on how pervasive it is, the ECA issues a “qualified” or “adverse” opinion.

It is important to note the occurrence of an error does not necessarily imply a fraud took place. Errors can arise from misapplication or misunderstanding of the often complex rules of EU expenditure schemes. Only if EU funds have intentionally been improperly claimed can it be considered as fraud. The ECA is not an investigative or judicial institution competent to judge whether fraud has occurred. However, if the ECA has reason to suspect that fraudulent activity might have taken place, it will report this to OLAF, the EU level antifraud office, which is responsible for carrying out any resulting investigations. Over the last 4 years the average number of cases reported annually by the ECA on the basis of its audits has been 3,5.

*The ECA concludes, for the first time, that the 2007 EU accounts are reliable but its opinion on the legality and regularity of underlying transactions is similar to previous years. Further improvement is needed in areas covering the majority of expenditure.*

Concerning the reliability of the 2007 annual accounts of the European Communities (“EU accounts”), the ECA concludes that the accounts give a fair presentation, in all material respects, of the financial position of the European Communities and the results of their operations and cash flows. The qualifications expressed in last year's annual report on the 2006 accounts are, due to the

The European Court of Auditor's Perspective on the Management and Control of EU Funds.  
An overview of the current situation and the prospects for EU budget reform.

improvements that have taken place, no longer necessary<sup>9</sup>. This is a positive development: for the first time under the accruals based accounting rules, the ECA provides an unqualified opinion on the consolidated accounts.

As regards the legality and regularity of the transactions underlying the accounts, the ECA gives unqualified opinions for revenue and for payments in two areas, "Economic and financial affairs" and "Administrative and other expenditure". In these areas the ECA concludes that transactions are free from material error and supervisory and control systems are implemented in a manner which ensures adequate management of the risk of illegality and irregularity.

For "Agriculture and natural resources"; "Cohesion"; "Research, Energy and transport"; "External aid, development and enlargement"; and "Education and citizenship" the ECA concludes that payments are still materially affected by errors, although to different degrees. Supervisory and control systems covering these areas are judged to be only partially effective. The Commission and the Member and other beneficiary states need to make further efforts to improve risk management.

In Research, Energy and Transport the ECA notes certain improvements in the supervisory and control systems. The same is true, at the level of the Commission, for the supervisory and control systems covering external aid, development and enlargement. In both instances these changes are however not significant enough to alter the nature of the opinions given.

*The picture is mixed regarding the legality and regularity of underlying transactions in the different areas of expenditure*

The table below summarises the overall assessment of the supervisory and control systems, as outlined in the relevant chapters of the 2007 Annual Report, and gives the broad results of the ECA's testing of representative samples of transactions for the different areas of expenditure audited by the ECA.

---

<sup>9</sup> Annual Report of the Court of Auditors concerning the implementation of the financial year 2006, OJ C 273 of 15.11.2007.

Table 2

	Assessment of systems	Error rate range
<b>Cohesion:</b> 42 billion euro	●	●
<b>Agriculture and natural resources:</b> 51 billion euro	●	●
<b>External aid, development and enlargement:</b> 6 billion euro	●	●
<b>Research, energy and transport:</b> 4,5 billion euro	●	●
<b>Education and citizenship:</b> 1,5 billion euro	●	●
<b>Administrative and other expenditure:</b> 8 billion euro	○	○
<b>Economic and financial affairs:</b> 0,5 billion euro	○	○
<b>Revenue</b>	○	○

Assessment of supervisory and control systems		Range in which the error rate (ER) is situated
<i>Not effective</i>	●	$ER > 5\%$
<i>Partially effective</i>	●	$2\% < ER < 5\%$
<i>Effective</i>	○	$ER < 2\%$ (below materiality)

### Cohesion is the area most affected by error

For “Cohesion”, the ECA estimated on the basis of its representative sample of transactions tested that at least 11 % of the total amount reimbursed should not have been reimbursed. This is comparable to previous years. In the cases audited by the ECA this year the most frequent causes of errors were inclusion of ineligible costs, over-declarations of money spent and serious failures to respect procurement rules.

The ECA's 2007 audit findings concerned payments in respect of the 2000-2006 period, as spending for the 2007-2013 period for 2007 is only in the form of advances. As such, any improvements in the control systems for the new period will only become evident in future years.

### **Agriculture and natural resources is still affected by a material level of error**

The ECA's estimate of the overall level of error in Agriculture and Natural Resources is not significantly different from the value obtained for 2006, but does not take account of certain serious errors which could not be quantified. Within Agriculture, Rural development accounts for a disproportionately large part of the overall error while for other agricultural expenditure (i.e. under the EAGGF Guarantee expenditure) the ECA estimates the value of the error rate to be slightly below the materiality threshold (2%).

The main supervisory and control system in this area, the integrated administration and control system for agriculture (IACS), continues to be effective in limiting the risk of irregular expenditure where properly implemented and if accurate and reliable data on entitlements are introduced. The recent introduction in the single payment scheme (SPS) of support measures, such as those related to olive oil, is a positive development although it entails new risks that might lead, in the short term, to a higher frequency of errors. The ECA considers that the systems for calculating the entitlements (i.e. the basis on which payments are made) were only partially effective and that they do not yet provide reasonable assurance that the annual SPS payments are correct.

### **External aid, development, enlargement: weaknesses at project level**

A large part of the expenditure in this area is managed by Commission delegations in the countries in which the EU finances projects. International organisations and NGOs as well as government institutions carry out the projects. The ECA found a material level of error at the project level relating to errors in contracting procedures, the inclusion of ineligible costs and lack of supporting evidence.

### **Research, energy and transport: simplification needed**

The ECA found a material level of error. Most errors found were the result of the Commission reimbursing overstated eligible costs declared by beneficiaries in their cost statements. One reason for this is the complex legal framework with a large number of eligibility criteria, including requirements to prove that costs are real and necessary for the implementation of the project. The ECA identified considerable scope for simplifying and clarifying the rules for the calculation and reporting of costs and recommended where possible to introduce results-based rather than input-based financing.

## **Education and citizenship: systems need improving**

Much of the spending is in the form of grants to promote citizenship, education and training. Projects are carried out by teaching organisations, private firms and public administrations for the benefit of individuals, mostly EU citizens. The ECA found a material level of error and made recommendations to improve specific aspects of the supervisory and control systems which it concluded were only partially effective.

## **Revenue, Administrative and other expenditure, and Economic and financial affairs are free from material error**

For revenue transactions the ECA concludes that they are free from material error and related supervisory and control systems are assessed as effective, although the ECA draws attention to certain weaknesses related to traditional own resources (TORs). However, the ECA limits the scope of this conclusion on the grounds that it does not directly audit the data underlying the macroeconomic aggregates and statistics for GNI and VAT on which Member States contributions are based and because for TORs it can not cover imports that have escaped customs supervision.

Administrative expenditure includes salaries allowances and pensions as well as rent payments, purchases and miscellaneous expenditure of the institutions<sup>10</sup>. The ECA concludes that this area is free from material error but recommends that the Institutions start to interpret and implement the regulations concerning certain aspects that contribute to the setting of EU staff salaries in the same way, in order to enable equal treatment.

Economic and financial affairs covers investment and assistance programmes, some of which are related to the same framework programmes covered in Research, energy and transport. The ECA concludes that this area is free from material error but recommends appropriate action regarding payments under research contracts to, amongst other things, implement simplified financial rules as regards eligible costs.

*Material levels of error persist due to high inherent risks and systems that are only partially effective in preventing errors or recovering incorrect payments. Complex rules and regulations lead to errors.*

The ECA's audit has shown over the years that significant amounts of EU funds under shared management (e.g. agriculture and cohesion) are irregularly spent. As outlined above, this is because expenditure in these areas is inherently risky as it

---

<sup>10</sup> European Parliament, Council, Commission, Court of Justice, Court of Auditors, Economic and Social Committee, Committee of the Regions, Ombudsman, and the Data Protection Supervisor.

involves making payments to millions of beneficiaries across the Union based on self-declarations by those who receive the funds.

Some final beneficiaries, who receive the funds, are prone to overstate costs and misapply the often complex rules and regulations that govern EU funds. This complexity can also lead to mistakes on the part of those paying out the funds. The results for 2007 of the ECA's audits in the areas of Agriculture and Natural resources, Cohesion, Research, energy and transport as well as Education and Citizenship show that such complexity has a considerable impact on the legality and regularity of payments.

Since the majority of errors occur at the level of the final beneficiary they can however often only be detected by detailed on-the-spot controls (primary level controls), which are costly and, consequently, cover only a small proportion of individual claims. The ECA finds weaknesses within Member State authorities concerning the checks in agriculture and cohesion policies. Cases of poor quality primary controls were also identified for direct management, including checks by the Commission on reimbursements to research beneficiaries failing to operate satisfactorily and poor quality audits carried out by independent auditors on individual claims.

Poor performance in primary level controls cannot be compensated for directly by secondary level controls. The effectiveness of the latter is therefore determined by their ability to promote adequate control arrangements at the primary level, rather than the ability to detect and correct individual errors. The ECA's audit work on the 2007 financial year again found that secondary level checks by Member States and the Commission are not achieving the desired level of effectiveness. For example, the ECA found weaknesses in the Commission's conformity clearance in Agriculture, in audits in Cohesion spending and in ex-post financial audits in Research, Energy and Transport.

In the same way, weak primary and secondary controls cannot be compensated for by the Commission's supervision. The purpose of this supervision is to ensure that adequate primary and secondary level control arrangements are in place, and are being operated effectively. Weaknesses at the lower levels should be identified (for example in annual activity reports), and measures should be taken to remedy the situation.

In many areas of the budget, mechanisms exist for recovering incorrectly made payments from beneficiaries or, where Member States have incorrectly administered expenditure schemes, "disallowing" some expenditure, i.e. refusing to finance it from the EU budget. It is sometimes claimed that, over time, these corrective actions correct or compensate for the errors in payments detected by the ECA.

The ECA's audit has highlighted a lack of information on the impact of corrective actions (recoveries) and on the consequences for beneficiaries of EU spending, the EU budget and national budgets. The information provided on the

correction mechanisms applied for cohesion and agriculture at Member State level is incomplete and unreliable and do not provide a sufficient basis to support assertions that corrective actions are effective in mitigating errors of legality and/or regularity. In some cases, especially agriculture, correction normally means making national tax payers pay for part of the costs of misapplied schemes, not recovering payments from those directly involved.

*Significant efforts have been made by the Commission and Member States but it will take time before their impact can be assessed*

In spite of the persistently level of material error, it is fair to acknowledge that the Commission has made significant efforts since 2000 to address the existing weaknesses in supervision and control systems, mainly through developing and implementing a reform programme to improve the management of the EU budget, centred mainly around its own responsibilities. In early 2006 the Commission launched an action plan for further improving the supervisory and control systems of the Union<sup>11</sup>.

For 2007, the ECA has identified further progress in the Commission's supervisory and control systems, in particular in the area of monitoring and reporting. Most annual activity reports and declarations of the Commission's Directorates-Generals', including those relating to cohesion and agriculture, are now more in line with the ECA's own assessments. The financial impact of the reservations is higher than previously. However, the scope and scale of some reservations still appear to underestimate the problems.

Concerning its 2006 action plan, the Commission considers that, by the end of 2007, two thirds of the plan's sub-actions have been implemented<sup>12</sup>. However, the ECA notes that it is still too early for their impact on the legality and regularity of underlying transactions to be felt. Most of the expenditure audited in 2007 relates to rules in place for the period 2000 to 2006; the impact of new rules introduced for the financial framework period 2007 to 2013 will only be felt in subsequent years.

There is a tendency towards an increased role for Member States, and often National Supreme Audit Institutions (NAI), in the supervision and control of EU funds. For example, 2007 was the first year for which Member States were required to produce an annual summary of available audits and declarations. The Annual Summaries, as well as voluntary initiatives from Members States to issue National

---

<sup>11</sup> "Action Plan towards an Integrated Internal Control Framework", COM (2006) 9 final of 17.1.2006.

<sup>12</sup> Communication from the European Commission to the European Parliament, the Council and the European Court of Auditors - Report on the Commission action Plan towards an Integrated internal Control Framework, COM (2008) 110 final of 27.2.2008.

The European Court of Auditor's Perspective on the Management and Control of EU Funds.  
An overview of the current situation and the prospects for EU budget reform.

Declarations can stimulate, as outlined in the ECA's Opinion 6/2007<sup>13</sup>, improved management and control of EU funds. Although the process was adequately supervised by the Commission, annual summaries do not yet provide (e.g. due to the disparity of presentation) a reliable assessment of the functioning and effectiveness of the systems.

*More could be done to reduce errors and introduce cost-effective control systems*

### **A political decision on a tolerable level of risk**

As indicated above improved high level supervision and reporting although important cannot compensate for inadequate lower level controls. However, the benefits of increasing the number of on-the-spot checks have to be compared to the related costs. This requires recognition by all participants in the budget process that:

- not all final beneficiaries can be checked on-the-spot, and therefore there will always be some residual risk of error. The key issue is to set that risk at an appropriate (tolerable) level;
- costs of control are an important issue, both for the EU budget and Member or beneficiary States. The same is true for the administrative costs incurred by the final beneficiaries of EU aid;
- the cost/risk balance in individual areas is of such importance that it should be approved at the political level (i.e. by the budget/discharge authorities) in the name of the citizens of the Union; and
- if a scheme cannot be satisfactorily implemented at an acceptable level of cost and with tolerable risk it should be reconsidered.

### **Streamlining internal control arrangements**

Establishing an internal control framework around these principles would allow control systems to be defined in terms of what they should achieve (output targets), as well as laying down agreed criteria against which to judge and audit their performance. The ECA encourages the Commission to conclude its analysis on the cost of controls, and on the different levels of risk inherent in the spending areas. A

---

<sup>13</sup>See Opinion 6/2007 on the annual summaries of Member States, national declarations of Member States, and audit work on EU of national audit bodies, OJ C 216 of 14.9.2007.

realistic, transparent, rational and cost-effective approach to risk management would, in the ECA's view, benefit contributors and beneficiaries alike.

### **Better monitoring and reporting**

The ECA recommends the Commission to continue its efforts to improve its monitoring and reporting. The Commission should ensure that annual activity reports and declarations present a consistent assessment of the systems, compatible with the reservations presented. It should also collaborate with Member States to improve the information provided in annual summaries and demonstrate how it is used for increased assurance or added value in annual activity reports. Furthermore, it should complete an appropriate follow-up of the relevant measures of the action plan, including that on recovery systems. The ECA also gives a number of recommendations on improving not least the information on these multi-annual corrections and their impact.

### **Simplified rules and regulations**

The ECA also calls for due consideration to be given to simplification. Well designed rules and regulations which are clear to interpret and simple to apply decrease the risk of error, streamline the required controls and consequently also reduce their cost. In areas such as rural development and research the ECA has consistently advised the political authorities to consider simplifying the regulatory frameworks.

## **Future Reform of the EU Budget**

The EU budget is an important instrument of EU policy delivery. Recognising this the European Commission launched a consultation process in 2007 with its communication "Reforming the Budget, Changing Europe" on how the EU budget can best assist the Union in meeting the challenges of the next decade and beyond. The ECA welcomed the consultation process and prepared a written contribution based on its unique perspective and experience as the external audit institution of the EU. The views expressed in the ECA's contribution form the basis of the views presented about future reform of the EU budget.

### **Assessing EU added value is essential when choosing expenditure priorities**

In its communication, the Commission recognises that EU spending must be based on an assessment of the added value of EU spending. The ECA welcomes

The European Court of Auditor's Perspective on the Management and Control of EU Funds.  
An overview of the current situation and the prospects for EU budget reform.

this emphasis. Expenditure programmes which do not add European value are by definition unlikely to be an effective and efficient use of the EU taxpayer's money.

The ECA suggests that an attempt might be made to define and articulate this concept, drawing for example on the following principles:

- Expenditure from the Community budget within the Union must offer clear and visible benefits for the EU and for its citizens which could not be achieved by spending only at national, regional or local level, but could rather, by reason of the scale or effects of the proposed action, be better achieved at Union level;
- Expenditure with trans-frontier effects or common interest is prima facie a stronger candidate for EU action than expenditure with limited geographical effects;
- Reasonable concentration of expenditure is prima facie likely to support the objective of adding value;
- For expenditure outside the Union, such as on development assistance, value added is also likely to be enhanced by a selective approach: for example, focusing on the coordination of development assistance in areas where there is global donor endorsement and focusing on activities for which specific EU expertise is of particular value.

Such principles might be embodied in a suitable political declaration or in EU legislation. Like the guidance on subsidiarity and proportionality in the Treaties, they would provide criteria for the guidance of the Union's political authorities.

### **A number of principles should be applied when developing expenditure programmes**

In the ECA's view, if the EU budget is to meet the standards proposed in the Commission's consultation paper ('targeted to best effect, managed to the highest standards, bringing tangible improvements to the daily lives of citizens') close attention must be paid to eligibility, governance and management arrangements. The ECA suggests that, the following principles should be applied.

### **Clarity of objectives: what is to be achieved should be clear**

The ECA's audits have revealed a lack of clarity in the objectives of some spending programmes. Examples can be found in the ECA's special reports 7/2006 (investment in rural development), 1/2007 (structural funds mid-term processes) and 9/2007 (evaluation of the RTD framework programme)<sup>14</sup>. If the objectives of an expenditure scheme are unclear (and numerous), it is unlikely to provide clear added value to the Union.

Lack of clarity and potentially contradictory goals mean that essentially political decisions are not taken at the right level. It is also harder to assess and audit the results of the Union's interventions, as is for instance demonstrated in the area of development assistance where the impact of actions is either not known at all or limited, and where performance indicators are not well developed: special reports 4/2005 (Commission's management of economic cooperation in Asia) and 6/2007 (effectiveness of technical assistance in the context of capacity development).

### **Simplification: rules should be no more complex than necessary**

The ECA has frequently drawn attention in its annual and special reports to the complexity of the eligibility conditions for many expenditure schemes. Examples can be found in the chapters of the ECA's annual reports dealing with structural actions and internal policies and in special report 1/2004 (management of indirect actions under the 5th RTD framework programme). The Commission has also commented adversely, for example in its 'Synthesis Report' on the Commission's management activities in 2006, on the complexity of rules related to eligible costs<sup>15</sup>.

Community expenditure programmes are most likely to be effective in adding value, and least likely to be inherently prone to high levels of irregularity, if eligibility conditions are kept as simple as is realistically possible. In designing Community expenditure programmes it is appropriate to ask what are the simplest eligibility conditions likely to ensure that expenditure is undertaken which meets the intentions of the legislator.

If simplification is to bring its full benefits, it needs to be applied at the practical as well as the conceptual level. For example, the CAP single payments scheme is conceptually a simplifying measure. But its implementation involved considerable complexities because of the wide choices available to the Member States. This is illustrated by the ECA's audit findings in its 2006 Annual Report and

---

<sup>14</sup>Concerning the ECA's Special Reports mentioned in this article see Annex - List of ECA's Special Reports.

<sup>15</sup>See COM(2007)274 final of 30.5.2007.

The European Court of Auditor's Perspective on the Management and Control of EU Funds.  
An overview of the current situation and the prospects for EU budget reform.

acknowledged by the Commission in the context of the CAP Healthcheck<sup>16</sup>. The difference between the establishment of objectives and their implementation was also well illustrated in the ECA's special report 8/2006 on Producer Organisations.

As the ECA's opinion 2/2004 underlines, internal control systems will not be effective and efficient unless the legislation setting up the expenditure scheme concerned is sufficiently clear to permit the effective use of funds. Unnecessary complexity in legislation – such as requirements which do not contribute to the scheme's main objectives – should be avoided.

### **Realism: conditions for payment should be verifiable**

The ECA has found that some expenditure programmes are set up in a way which makes it difficult or impossible to ensure that the conditions for spending are met. Examples can be found in the ECA's special reports 1/2004 (management of the 5th RTD framework programme) and 3/2005 (rural development)<sup>17</sup>. and also the ECA's opinion 1/2006 on the 7th RTD framework programme. A scheme whose eligibility conditions are unrealistic is unlikely to add value to the Union. Expenditure programmes should either be established on a realistic basis - or should not be undertaken. In the area of development assistance the ECA has noted (see for instance special report 6/2006 on environmental aspects of development cooperation) that the Commission's expertise is often too limited for the role it seeks to undertake.

The ECA points out that simplification, clarity of objectives and realism are all principles that should make it easier to design and run successful cost-effective expenditure programmes in the Union. It is better to set up schemes that run with relative ease than to attempt to compensate for complex eligibility requirements by complex governance and management arrangements.

### **Transparency and Accountability: responsibilities should be clear**

For decision-makers to be responsible for their decisions - and thus accountable - underlying information has to be clear and transparent. Lack of transparency makes evaluation and "follow up" harder and decreases the general public's possibility to hold decision makers accountable. In order to make the budget more transparent it should for example be ensured that there is no ambiguity as to what is included in different budget headings.

---

<sup>16</sup> See COM(2007) 722 final: Communication from the Commission - Preparing for the "Health Check" of the CAP reform

<sup>17</sup> See also the Court's Opinion 1/2006 on the rules for the participation of undertakings, research centers and universities in actions under the 7<sup>th</sup> RTD framework programme, OJ C 203 of 25.8.2006.

Without clear lines of responsibility and accountability, expenditure cannot be well managed. The ECA has drawn attention, notably in its Opinion 2/2004 on a Community Internal Control Framework, to the need for clear accountability arrangements for EU spending. A clear allocation of responsibilities is of particular importance in areas of the budget where management responsibilities are shared between the Commission and the Member States.

***Political authorities should be prepared to think radically about a number of issues***

The ECA recommends that the political authorities should be prepared, in the context of a fundamental review of the EU budget, to think radically about the design of expenditure programmes in the future.

In this context, the ECA suggests that consideration should be given to the following questions:

- Is it possible to recast expenditure programmes in terms of acceptable outputs rather than eligible inputs, with programmes based on a set of concrete objectives and disbursements linked to the achievement of results?
- Where expenditure schemes involve contributing towards costs, is it possible to radically to simplify the basis of calculation e.g. by making greater use of lump sum or flat rate payments instead of the reimbursement of 'real costs'?
- What should be the degree of national, regional or local discretion in managing expenditure programmes in which the Community budget supports national, regional or local policy initiatives?
- Can control systems be defined in terms of their output (the risk objective and the resulting acceptable level of error to be achieved) rather than input as is currently the case (the number of the checks to be undertaken)?
- Can better use be made of the concept of "tolerable risk" when designing expenditure schemes or programmes, not just to define and focus the control system?

*There is considerable scope for simplifying and improving transparency of the arrangements for funding the EU budget*

The European Court of Auditor's Perspective on the Management and Control of EU Funds.  
An overview of the current situation and the prospects for EU budget reform.

The European Union's own resources system should be equitable, transparent, cost-effective and simple and must be based on criteria which best express each Member State's ability to contribute<sup>18</sup>.

The present system is excessively complex, lacks transparency, is incomprehensible for EU citizens, and is not fully auditable.

- The VAT-based resource resembles national contributions based on statistical data and estimates in addition to VAT actually received. Their calculation is complex and is the result of a number of detailed adjustments. There is no direct, clear relationship between VAT paid by the taxpayer and the "VAT-based" resource;
- The GNI-based own resource is based on macro-economic statistics for which harmonization could still be improved;
- The various correction mechanisms linked to the correction of budgetary imbalances introduce great complexity into the VAT and GNI call-up rate;
- The underlying data can be audited directly only in the case of traditional own resources (customs duties, agricultural duties and sugar levies)<sup>19</sup>.

The design of the revenue side of the budget raises issues on which it is for the Union's political authorities to pronounce. The ECA however points out that there is considerable scope for simplifying and clarifying the own resources system.

The review of arrangements for the correction of budgetary imbalances (UK rebate, lump sum payment to the Netherlands and Sweden, reduced VAT call-up rate for Austria, Germany, the Netherlands and Sweden, as well as the 25% collection costs for traditional own resources) should take account of the principles and observations set out above.

As explained above, the "VAT-based" resource is levied on a 'virtual' basis (harmonised VAT base which may be subsequently capped and takes into account compensation arrangements for UK) which is complex to the point of incomprehensibility; the ECA recommends that consideration should be given to the question whether the "VAT" resource still constitutes an appropriate part of the own resources system.

---

<sup>18</sup>See conclusions of the 1999 Berlin European Council meeting as recalled in the Court's Opinion 4/2005 on the system of the European Communities' Own Resources, OJ C 167 of 7.7.2005; and Court's Opinion 2/2006 also on the system of the European Communities' Own Resources, OJ C 203 of 25.8.2006.

<sup>19</sup>See the ECA's Opinion 4/2005 on the system of the European Communities' Own Resources, OJ C 167 of 7.7.2005; see also the ECA's Annual Report 2006, Chapter on Revenue, paragraph 4.7.

## **Conclusion**

The EU budget is the principal instrument for managing and controlling EU funds and an important tool for implementing EU policies. The Commission has overall responsibility for the budget which it implements in cooperation with the Member States. The ECA's role is to audit the implementation of the budget and report what it finds to the EU's political authorities and citizens. For the financial year 2007, the most recent for which there are audit results, the ECA concludes, for the first time, that the 2007 EU accounts are reliable. However, its opinion on the legality and regularity of underlying transactions is similar to previous years, as further improvement is needed to control the risk of errors in areas covering the majority of expenditure. Significant efforts have been made by the Commission and Member States but it will take time before their impact can be assessed.

The ECA recommends a political decision be taken setting tolerable risk of error for the different areas of the budget, due consideration be given to simplifying rules and regulations, and action to improve monitoring and reporting and streamline control arrangements. Beyond that, as part of the review of the budget, the ECA encourages the EU's political authorities and the Commission to be prepared to think radically both about how EU funds are spent and raised. It recommends considering EU added value when choosing expenditures priorities and applying the principles of clarity of objectives, simplification, realism, and transparency when designing expenditure programmes.

Through its audit reports and its opinions, the ECA's objective is to contribute towards transparency and promote accountability. Transparency and accountability are both essential to securing the ongoing trust of EU citizens in the Institutions that provide the basis for the functioning of the Union and the direction sustaining it into the future. The ECA looks forward to continuing this work and using its unique perspective to actively contribute to the improvement of the management and control of EU funds in the context of the ongoing public debate on budgetary reform.

## **Annex - List of ECA's Special Reports**

- Special Report 1/2004** on the management of indirect actions under the 5th RTD framework programme (FP5), OJ C 99 of 23.4.2004
- Special Report 3/2005** concerning Rural Development, OJ C 279 of 11.11.2005
- Special Report 4/2005** concerning the Commission's management of economic cooperation in Asia, OJ C 260 of 19.10.2005
- Special Report 1/2006** on the contribution of the European Social Fund in combating early school leaving, OJ C 99 of 26.4.2006
- Special Report 6/2006** concerning the environmental aspects of the Commission's development cooperation, OJ C 235 of 29.9.2006
- Special Report 7/2006** on Rural Development Investments: Do they effectively address the problems of rural areas? OJ C 282 of 20.11.2006
- Special Report 8/2006** on the effectiveness of the EU support for fruit and vegetable producer's operational programmes, OJ C 282 of 20.11.2006
- Special Report 1/2007** concerning the implementation of the mid-term processes on the Structural Funds 2000-2006, OJ C 124 of 5.6.2007
- Special Report 6/2007** on the effectiveness of technical assistance in the context of capacity development, OJ C 312 of 21.12.2007
- Special Report 9/2007** concerning the evaluation of the EU Research and Technological Development (RTD), OJ C 26 of 30.1.2008