EUROPEAN COMMISSION

Brussels, 1.6.2011
COM(2011) 323 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE COURT OF AUDITORS

Synthesis of the Commission's management achievements in 2010

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE COURT OF AUDITORS

Synthesis of the Commission's management achievements in 2010

1. INTRODUCTION

In line with Article 317 of the Treaty on the Functioning of the European Union (TFEU), the European **Commission implements the budget on its own responsibility** and within the limits of the appropriations, having regard to the principles of sound financial management. By adopting this Synthesis Report, the Commission takes overall political responsibility for the management by its Directors-General and Heads of Service, on the basis of the assurances and reservations made by them in their Annual Activity Reports (AAR). In the Synthesis Report, the Commission also identifies the key management issues to be addressed as a matter of priority and the action to be taken to address identified weaknesses.

In 2009, for the third successive year, the **Court gave an unqualified positive opinion** on the consolidated accounts. The **positive trend in reducing the overall error rate** continued. For the first time ever, the Court estimated that the most likely error rate across the budget was between 2% and 5%. The Court's assessment[1] of the quality of the AARs also improved.

Reporting on the Commission's management achievements is more than reporting on error-rates. The current economic climate has put added value and high quality spending uppermost in the minds of citizens. In their AARs, the Authorising Officers by Delegation present in part I how they used financial and human resources to achieve the policy objectives set by the College, in a sound financial manner, showing the reader how policies have generated added value for EU society.

In finalising its proposals for the next multi annual financial framework, the Commission will propose improvements, notably in shared management, where Member States implement some 80% of the budget.The Treaty on the Functioning of the European Union has reinforced the responsibility of Member States, which must cooperate with the Commission in implementating the budget, underlining their control and audit obligations[2].

2. STRENGTHENING THE BASIS OF ASSURANCE

The College delegates operational implementation to the Directors-General and Heads of Service, who, as 'Authorising Officers by Delegation' (AOD), are responsible for the sound and efficient management of resources and for ensuring adequate and effective control systems in their services. Directors-General and Heads of Service report on the performance of their duties in the AAR[3], which include a signed declaration of assurance covering the legality and regularity of financial transactions. Assurance is an objective examination of evidence for the purpose of providing an independent assessment of the effectiveness of risk management, control and governance processes. This examination is carried out by management, who monitor the functioning of the internal control systems on a continuous

1 OJ C 303, 9.11.2010, sections 1.27-1.31.
2 Article 317 of the Treaty on the Functioning of the European Union (TFEU).
3 Article 60 of the Financial Regulation.

basis, and by internal and external auditors. The results are reported in each AAR, which is the main vehicle for Directors-General to document their accountability to the College.

2.1. Impact of internal reorganisations on assurance

2010 saw the implementation of a number of important changes and reorganisations. The Treaty on the Functioning of the European Union, which entered into force on 1 December 2009, created the function[4] of High Representative of the Union for Foreign Affairs and Security Policy and Vice-President of the Commission, and specified that the High Representative be assisted by the **European External Action Service (EEAS)**. Preparations to create the **EEAS** took place throughout 2010, and the service was set up on 1 January 2011. Certain provisions of the Financial Regulation have been amended[5]. The Commission remains responsible for the implementation of the budget, including operational appropriations implemented by Heads of Delegations who are sub-delegated authorising officers of the Commission.

Following the establishment of the new College and the **allocation of portfolios, a number of DGs were restructured**[6]. This included, the creation of the new Directorates-General for Justice, for Home Affairs, for Climate Action, for Energy and for Mobility and Transport as well as the transfer of a number of Directorates between Directorates-General. In line with the Commission's policy of not asking for new posts from the budgetary authorities, Shared Resources Directorates and Shared Internal Audit Capabilities (SIACs) were created, allowing pooling professional expertise and generating economies of scale.

The Commission implemented these changes smoothly. Central Services helped by updating the circular[7] on how to proceed with the AARs in these circumstances. The new Directors-General received hand-over notes from their predecessors. The Internal Audit Service examined several aspects of these reorganisations, and thus contributed to improved administration and governance.

2.2. Dialogue between Directors General and the College

Each[8] AAR explicitly confirms that the responsible Commissioner(s) ha(s)ve been informed of the main aspects of the AARs, including any reservations envisaged, before the final signature of the declaration of assurance.

---

4 The Establishment Decision creating the EEAS was submitted to the Council on 22 April. It subsequently involved amendments to the Financial Regulation and the Staff Regulations and the adoption of an amending budget.

5 Regulation (EC) No 1081/2010 of 24 November 2010.

6 Announcement of portfolio decisions made by the President elect on 27 November 2009.

7 Circular SEC(2002) 657 was replaced by SEC(2010) 1333, section 3, 'Change of Directors General/Heads of Service/AOD and transfer/split of activities between services'.

8 The Directors General for Human Resources and Security and the Director of the European Personnel Selection Office did not indicate so in their AAR but did confirm accordingly in a note addressed to the Central Services.

The AARs are the main vehicle through which the AODs document their accountability to the College and are a source of evidence for the DAS. The Commission has instructed the Secretariat General and the Directorate-General for Budget to continue giving guidance to Directorates-General and Services, through a regular review of Standing Instructions, guidance notes, training measures and peer-review meetings. All Directors-General and Heads of Service are invited to give their active support to all measures promoted by the Central Services to enhance the quality of the reporting tools.

2.3. Internal Audit

The Audit Progress Committee (APC) focused its work on the main risks identified by audit engagements and improved the flow of information to the College on audit issues, including on issues of corporate dimension and including qualitative information on how action plans improve the overall control environment. In its annual report and information notes, the APC informed the College that progress had been made on implementating the outstanding accepted audit recommendations considered ‘critical’ or ‘very important’, as called for in the 2009 Synthesis Report. In 2010, no ‘critical’ recommendations and 26 ‘very important’ recommendations remained pending six months after their due date. 97 ‘very important’ recommendations were accepted but are pending for less than six months.

Based on the information provided by the APC, the Commission took note of the progress made in implementating the audit recommendations and instructs the Services to continue this work. Directors-General and Heads of Service should ensure that the outstanding recommendations are given due attention.

In March 2011, the Commission’s Internal Audit Service submitted the 2010 Annual Internal Audit Report for the year 2010 as stipulated under Article 86(3) of the Financial Regulation.

In May 2011, the Commission’s Internal Audit Service issued its first Overall Opinion. It is based on work carried out by the Internal Audit Capabilities and the Internal Audit Service during the period 2008 to 2010 as part of the coordinated strategic audit plan. The opinion focuses on financial management. The Commission’s Internal Auditor considers that, in 2010, the Commission has put into place governance, risk management and internal control procedures which are adequate to give reasonable assurance over the achievement of its financial objectives, with the exception of those areas of financial management over which Directors-General have expressed reservations in their declarations of assurance and subject to remarks about the management of the risks concerning errors in the underlying transactions. This opinion does not cover the Global Navigation Satellite System programme whose audit was not completed by end-2010. In particular, it takes into account that management has adopted plans which the IAS considers are adequate to address the residual risks identified by auditors over the last three years, and to implement the recommendations made, and that the implementation of these plans is monitored through reports by management and through follow-up audits.

The Commission took note of these reports, which provide comfort to the College as regards the performance of the governance and internal control in place in its Services and give reasonable assurance as regards its capacity to achieve its objectives.

2.4. Further improving the clarity and coherence of AARs

AARs constitute a major source of evidence for the European Court of Auditors (ECA) and the discharge authorities. In the Court's view, the quality of these reports has improved in recent years. In its Annual Report for 2009, the ECA gave all Commission DGs and Services' AARs 'A' and 'B'[9] grades.

The Standing Instructions for the AARs have been further fine-tuned to improve the quality of the evidence presented to support assurances made and the readability of the reports.Central Services continued to intervene early in the process of drafting the AARs, discussing key issues with Directorates-General and Services and providing the guidance needed to improve the quality of the final texts. Again, (pre-)peer-reviews have proven to be an effective platform for the different Services, as peers, to share their opinion on how to formulate a number of cross-cutting issues in their AAR, how to ensure coherence of approach and adequately tackle identified weaknesses.

During the peer-review process, a number of aspects were identified to improve the presentation, in particular the overall argumentation supporting assurance and the description of the contribution of the individual building blocks. These include: a) the reasoning to use when only a risk-based control sample is available; b) the description of the sampling methodology used and c) the mathematical methods used to extrapolate the results from the audit sample to the entire population.

The Commission is committed to continuously improving the readability and comparability of the AARs.

3. Assurance gathered through the AARs and reservations made by the Directors-General

Having examined the AARs, and in particular the declarations signed by each Director-General, the Commission notes that **they all give reasonable assurance** regarding the use of resources for the intended purpose, respect of the principles of sound financial management and the fact that the control procedures used give the necessary guarantees on the legality and regularity of the underlying transactions. Some Directors-General disclosed residual weaknesses and made reservations in their AAR, **without calling into question the overall level of assurance given**.

Twelve Directors-General and one Director of an Executive Agency issued a total of **seventeen reservations** in their 2010 AAR. These included fifteen of the twenty-one[10] reservations already made in 2009 and on which action was still ongoing at the end of 2010, plus two new reservations.

[9] An 'A' rating means that the Director-General's declaration and the AAR give a fair assessment of financial management in relation to regularity, 'B' means that the Director-General's declaration and the AAR give a partially fair assessment of financial management in relation to regularity, 'C' would mean that the Director-General's declaration and the AAR do not give a fair assessment of financial management in relation to regularity (OJ C 303, 9.11.2010, p. 88.).

[10] This number includes an adjustment to reflect the creation of the Directorates General for Mobility and Transport and for Energy. Last year, the reservation made by the Directorate General for Transport and Energy only counted for one in the Synthesis Report on 2009.

The most common concerns stem from the **complex eligibility rules for grant beneficiaries** (an issue which affects funds under direct centralised management) and from the application of **public-procurement rules** (a frequent cause of errors in Cohesion policy). Every Director-General and Head of Services identified the main reasons for their reservations and set out remedial actions to address them.

After assessing the control results, six reservations carried over from previous years were lifted. To lift a reservation, AODs were asked to present the measures put in place to address the weaknesses identified, that the measures were effective and that the weaknesses had been effectively addressed. In most cases, this implies audit evidence that error rates had decreased to an acceptable level or that systems have been strengthened and are functioning properly.

3.1. Agriculture and natural resources

For Agriculture and Natural Resources, a slight increase in the error rate to just above 2% led the Court, in its 2009 annual report, to conclude that this chapter was affected by material error. The Court reiterated that further efforts are required to simplify the rules and conditions in the area of Rural Development.

In the 2010 AAR, the Director-General for Agriculture and Rural Development made **one reservation**. Given the importance of the Integrated Administration and Control System (IACS) for the management and control of agricultural expenditure, and the serious **deficiencies in the IACS in Bulgaria, Portugal and Romania**, a reservation was made for reputational reasons, even if the financial impact of the deficiencies did not exceed the materiality threshold. This Directorate-General did lift 'the **reservation for expenditure for rural development measures under Axis 2** (improving the environment and the countryside), that was existing since 2007. In 2010, as a result of the work of the Directorate-General for Agriculture and Rural Development which has investigated Member States' reporting of errors for measures under Axis 2 and provided detailed guidelines for such reporting, the quality and reliability of Member States' control statistics and the degree of quantification of the errors found and reported have improved significantly. These improvements allow the Directorate-General for Agriculture and Rural Development to calculate the residual error rate more precisely than in previous years, when it did not have the necessary assurance that Member States compiled their statistics with the necessary rigor. On the basis of the figures reported by Member States, the residual error rate estimated for 2010 amounts to 1.84% and is, thus, below the 2% materiality threshold used by the Court of Auditors. Also the residual error rate for rural development as a whole is, with 1.13% (2.1% in 2009), below the materiality threshold. Moreover, the action plan set out in the reservation of previous years has now been completed. Any further reduction of errors could only be achieved by increasing the level of on-the-spot checks, which would not be cost effective.

Last year, the Director-General for Maritime Affairs and Fisheries made a reservation concerning different **operational programmes and measures related to the Financial Instrument for Fisheries Guidance (FIFG)**. An action plan was drawn up and successfully implemented. As a result, the reservation could be lifted for all expenditure except for one programme in Germany, for which further examination and additional checks were deemed necessary and are being carried out.

The results of an additional study on the legal framework and the arguments made by the Members States on the **eligibility rules for payments made to Member States compensating additional costs in the marketing of certain fishery products from the Outermost Regions**, showed that this reservation could be lifted.

The Directorate-General for **Environment successfully implemented the action plan issued last year after making a reservation on the eligibility of expenditure** declared by grant beneficiaries. The reservation was therefore lifted.

The Director-General for Climate Action issued a reservation as a result of the **reputational** damage to the Commission resulting from **a significant security breach in the national registries of the EU Emissions Trading System** (ETS).

The Commission recalls the need for proper implementation of the IACS in Bulgaria, Romania and Portugal. The Portuguese authorities are urged to reinforce their action plan. The Bulgarian plan will be closely monitored for its timely completion. Romania has already completed its action plan and will be closely followed so as to ensure the correct application of the new elements in the handling of the 2011 claims.

3.2. Cohesion

Cohesion Policy is implemented on the basis of shared management and has had for many years an estimated level of error considerably higher than the other policy groups. In 2009 there was a significant decrease in the Court's estimate of the most likely error. The Commission considers[11] that this improvement partly reflects the enhanced control provisions under the 2007-2013 regulatory framework for cohesion, and the impact of the 2008 Commission Action Plan which it has implemented in order to strengthen its supervisory role. However, year-to-year variations in detected error rates are also influenced by the relative stage in the multiannual implementation cycle. 2010 was the first year in which most programmes under the current regulatory framework were fully running, and most national authorities implemented projects and declared expenditure, thus increasing the inherent risk of errors.

Therefore, the Commission has proposed in the review of the Financial Regulation that national authorities provide an annual managerial declaration for all programmes under shared-management. This is the best way to provide a credible and reliable assurance that the EU budget as a whole is used and controlled properly.

Nonetheless, Cohesion Policy remains the area of expenditure with the highest error rate in the DAS 2009 and is the only policy area where the Court estimates that the likely error rate is above 5%. The Commission considered that enhanced efforts are required to reduce this error rate.

The **Director-General for Employment, Social Affairs and Inclusion made two reservations**: one concerns management and control systems for identified operational programmes under ESF 2000-2006 (in Germany, France, Italy and Spain) and the other under ESF 2007-2013 (in Austria, Belgium, Bulgaria, Germany, Ireland, Italy, Slovakia, Spain and the United Kingdom). The first reservation is quantified at 0.14% of interim payments for the 2000-2006 period; the second is quantified at 1.13% of interim payments for the 2007-2013 period. Both reservations were issued for reputational reasons, in view of serious deficiencies in key aspects of the management and control systems of the identified operational programmes.

[11] Communication from the Commission to the European Parliament, The Council and the Court of auditors, 'Impact of the action plan to strengthen the Commission's supervisory role under shared management of structural actions' - COM(2010) 52, 18.2.2010.

The **Director-General for Regional Policy issued two reservations**: one on management and control systems under the ERDF/Cohesion Fund in the period 2000-2006 (in Bulgaria, Germany, Hungary, Italy, Latvia, The Netherlands and concerning 9 Interreg programmes), and another on ERDF/Cohesion Fund management and control systems for the period 2007-2013 (in Bulgaria, Czech Republic, Germany, Greece, Italy, Latvia, Lithuania, Romania, Spain, The United Kingdom, 13 European Territorial Cooperation programmes and 6 programmes for IPA/cross-border cooperation).

Overall, the estimate of amount at risk for the operating programmes reported for the Cohesion Policy corresponds to between 0.8% and 1.5% of 2010 payments for Cohesion as a whole. This estimated average is without prejudice of underlying wide variations between Member States and, in some cases, among operational programmes and regions within a single Member State. While the risk of irregularities in a number of programmes can be considered manageable on a multiannual basis, it can be much higher than the estimated averages in a number of programmes and Member States when measured on an annual basis. The Commission will continue to rigorously exercise its supervisory role by pressing Member States to address the deficiencies detected in their management and control systems and also by applying interruptions and suspensions of payments, as well as financial corrections whenever necessary.

The Commission will focus its efforts notably on these systems, through concerted preventive and corrective actions.The amounts at risk differ from the error rate calculated by the European Court of Auditors for the DAS in its Annual Report. The difference between the reasonable assurance given by AODs and the Court's assessment of the control systems stems from various factors. These include the fact that in a number of policy areas the Commission implements multi-annual control strategies and, thus, the AODs assess the functioning of the control systems accordingly, while the Court is required to express an annual opinion. The amount at risk reported in the AARs by the Commission services for structural actions takes into account the various mitigating and corrective actions in place under the multi-annual management and control systems (allowing corrections to be made some years after the disbursement of funds by the Member State to the beneficiaries and by the Commission to the Member State) and the analysis covers the specific situation of each programme.

Therefore **the error rate in the Court's DAS is likely to be higher** as it includes errors which can be corrected in subsequent years once all actors in the control chain have intervened.. Another factor of difference is the fact that the error-rate reported annually by the Court is calculated on the basis of errors identified in the year in a sample of programmes and extrapolated to all expenditure under Cohesion. This can be explained by the fact that most programmes and authorities have now implemented projects on the ground and declared expenditure, thereby increasing the inherent risks of errors.

The reservations for the programming period 2007-2013 made by the Director-General for Regional Policy have a wider scope than in previous years, concerning more operational programmes in more Member States and with higher estimated amounts at risk. The reservations for the programming period 2007-2013 entered by the Director-General for Employment, Social Affairs and Inclusion concern less operational programmes than in 2009 but in more Member States and with an overall lower estimated rate of amount at risk.

Furthermore, 2010 was the first year in which the national audit authorities were required to report the error rate found following audits on representative samples of operations. As of this year, the Director-General for Employment, Social Affairs and Inclusion has relied on these rates for estimating the financial impact of the reservation, rather than on predefined estimated error levels[12], whenever these figures were deemed to be of adequate quality. The approach for the future is to rely as much as possible on error rates reported by the National Audit Authorities, if they are deemed to be of adequate quality.

The AARs clearly spell out the nature of the problems encountered and present robust action plans. **The following areas of action are notable examples**:

– Use of interruption and **suspension procedures and of financial corrections** (see section 4.2.1).

– Services will continue to **provide additional guidance and support** to national audit authorities, especially on the coverage and quality of the audits and on drawing up **annual control reports and audit opinions** to maximise the added value of these.

– Services will concentrate control efforts, but also guidance and administrative capacity building activities, on the eligibility of costs and on the application of **public procurement rules,** areas where the majority of the estimated errorshave occurred in 2008 en 2009. The Commission is taking initiatives to further streamline the public procurement processes (see section 4.4.2).

– Services will continue to carry out or where appropiate increase on–the-spot audits of operations and systems using a risk-based approach, under their audit strategies.

The Commission is also concerned about the effectiveness of EU funds spent by regions/Member States to re-imburse projects that have already been completed and paid for by national budgets before the starting date for eligibility and outside the frame of applicable project selection rules. ('retrospective projects'). The Commission will, in cooperation with the Member States, clarify eligibility rules, conditions and pre-requisites for the inclusion of legal and regular retrospective projects in the co-financed programmes and will propose in its package for the Structural Funds post 2013 new rules on this issue.

The Commission has proposed in the context of the revision of the Financial Regulation to introduce annual management declarations of assurance by the accredited bodies for all programmes under shared management.

The Commission calls on the Member States to already demonstrate their commitment to improving accountability by reinforcing where necessary control measures, in particular as regards first level management checks, before certifying expenditure to the Commission and by following its guidance on annual summaries to make them a valuable additional source of assurance. While the legal base for the annual summaries does not require an overall assurance statement, the Commission encourages all Member States to follow the example of the eleven that in 2010 included assurance statements and to take other measures to demonstrate their commitment to the sound management of EU funds.

[12] The so-called 'flat-rates for financial corrections'

The Commission has instructed the Cohesion Policy DGs to ensure a high level of transparency as regards their assessment of the control systems in each Member State, as well as information on interruptions, suspensions of payments, and financial corrections, reporting them systematically in their AARs. Furthermore, the Commission has also instructed them to continue with systematic and timely interruptions and suspension procedures, whenever serious control deficiencies or irregularities are identified.

3.3. Research, energy and transport

The Research DGs' common audit strategy for the **6th Framework Programme (FP6)** (2007-2010) has proved successful in terms of audit coverage and in achieved audit results. At the end of the period, the multi-annual residual error rate[13] fell substantially, for some DGs to a level very close to the 2% target. The recurrent FP6 reservations were not lifted, with the exception of the Director-General for Information Society and Media who decided not to qualify his declaration of assurance, despite having found a residual error rate slightly above the 2% threshold. The Director-General explained in his AAR why he expects the multi-annual error-rate (i.e. mesured for the whole FP6) to drop below the target in the course of 2011.

The **7th Framework Research Programme (FP7) is gaining momentum**. As a result, the amount of pre-financing will fall below the amount of payments against cost statements. The latter are considered to represent a higher inherent risk (and thus higher potential error rates). The audit sample that has been executed until now is not sufficiently representative to allow precise calculation of residual the error rate and to draw conclusions on assurance at this stage. It is expected that as of 2011, the audited sample will be sufficient for the AODs to rely also on the residual error rate criterion and to decide whether a reservation for this **Framework Programme is required.** The provisional error rates (between 4% and 5%) in the audits completed so far indicate that the error rate for the entire population could exceed the 2% threshold.

The provisions on the costs eligible for funding are complex and the audits revealed that differences of interpretation of these povisions caused most of the errors detected in the Chapter 'Research, energy and transport'. In 2010, a high-level Task Force examined management and organisational issues in the research area and issued recommendations including ways to improve the goverance of audits and control in this area.

In the meantime, further corrective actions have been introduced for FP7 by providing a common framework for external auditors to deliver audit certificates, including the definition of a compulsory set of procedures. Moreover, the simplification measures[14] introduced on 24 January 2011 are expected to further reduce the error rate. The decision to allow beneficiaries to apply their statutory accounting methods when requesting reimbursement for average personnel costs and the possibility reimbursing SME-owners (and other natural persons not receiving a salary) through flat-rate payments is expected to have a positive effect on error rates. Despite the positive effects of simplification measures, the situation will be reviewed again, once the amount of payments against cost statements will be higher and the audit sample statistically wide enough.

[13] The multi-annual residual error rate, is the real impact of an error on the EU-budget taking into account corrections and recoveries, including those done in subsequent years.

[14] C(2011) 174 final, 24.1.2011, Commission Decision of 24 January 2011 on three measures for simplifying the implementation of Decision No 1982/2006/EC of the European Parliament and of the Council and Council Decision No 970/2006/Euratom and amending Decisions C(2007) 1509 and C(2007) 1625.

In its 2010 Communication, 'Simplifying the Implementation of the Research Framework Programmes'[15], the Commission presented measures and options for simplifying EU research funding and called on the other EU institutions to join the debate and give feedback on the options.

3.4. External aid, development and enlargement

Overall, the internal control situation regarding External Action was satisfactory in 2010. 'To better substantiate the assurance in the area of external aid, DG EuropeAid is developing an indicator for the estimated impact of residual errors with a commitment to put in place a methodology for this during 2011.

The Director-General for **External Relations lifted the reservation made on reputational grounds on the management of the Common Foreign and Security Policy (CFSP) and the Stability Instrument** following improvements made to the methodology and the capacity for executing ex-post controls.

The Commission has created the Service for Foreign Policy Instruments responsible for ensuring financial control of instruments, including the CFSP budget and the Stability Instrument. This Commission service reports directly to the Vice-President and High Representative of the Union for Foreign Affairs and Security Policy.

The Commission has instructed the Head of the Service for Foreign Policy Instruments to closely monitor the further implementation of the action plan initiated previously by the Director-General for External Relations.

3.5. Education and citizenship

The Director-General for **Communication maintained the 2008 reservation on the potential non-compliance with applicable legislation on Intellectual Property Rights by Commission services**, on reputational grounds. Most corrective action detailed in the action plan has been taken, in particular on training, awareness raising and international coordination. The Director-General for Communication has announced that this reservation will be lifted once the copyright agreements related to the preparation of a daily press review compiled by this Directorate-General are in place.

The Director-General for **Education and Culture maintained the reservation regarding the error rate in centralised direct management**, given the significant occurrence of errors in the underlying transactions found through ex-post controls. This reservation was extended with a reservation by the Director of the Education, Audiovisual and Culture Executive Agency. The error rate in the parent DG **was 3.4%, while the error-rates of two of the seven main programmes managed by the Executive agency, respectively the Culture program and the Youth programme, amounts to 4,28% and 7,38%.** The observed errors mostly concern the inability of beneficiaries to produce justifying documents or documents of sufficient quality. The parent DG and the Agency have a coordinated action plan to improve the information to beneficiaries and desk control strategies based on a risk assessment.

The Director-General for **Home Affairs made two reservations** in the AAR 2010, both **concerning reputational damage due to delays in implementing large-scale IT systems**,

[15] COM(2010) 187, 29.4.2010.

the VIS and the SIS II projects. Significant progress was made in 2010 towards their successful deployment. The detailed action plan was fully implemented but news events caused additional delays, such as lack of readiness in some Member States and the political situation in North Africa which had an impact on the rollout of VIS.

The Director-General for **Justice was able to lift the reservation** on the financial risk corresponding to the residual error rate estimated at 2,15% in the **non audited population of grants** under ABB activity 1804 - fundamental rights and citizenship.

The Commission is satisfied with the work undertaken to adress the potential violation of Intellectual Property Rights by its Services.

The Commission regrets that the ex-post controls by the Directorate-General for Education and Culture show an increase in error rates and that the reservation has been extended to two programmes managed by the Executive Agency, despite work done to better inform beneficiaries of the requirements. It invites the Services to step up their efforts.

The Commission recognises that developing and managing large-scale IT systems such as SIS II and VIS present particular challenges. It will continue its efforts to enhance governance and improve cooperation with stakeholders as far as the SIS II is concerned, and to follow-up the political situation in the Member States and in North Africa in order to mitigate the risk of delays in the VIS.

3.6. Economic and financial affairs

Also for 2010, the Director-General for **Enterprise and Industry issued a reservation relating to the reliability of financial reporting by a delegated body**. The actions related to the improvement of the monitoring and control framework as well as the weaknesses in the procurement procedures were addressed as announced in 2009. But audit evidence on the annual accounts 2009 indicated other weaknesses in the internal control systems of the delegated body and highlighted concerns on the reliability of the financial reporting for 2010. It is not possible to quantify the impact, if there is any, since it will only be known after the audits of the 2010 financial reports, scheduled to take place in 2011.

Joint management presents particular challenges, in terms of management of EU funds. The Commission has instructed the Secretariat-General and the Directorate-General for Budget to launch, together with the relevant services, a review of the most frequently encountered problems and, if appropriate, to propose improvements to joint management.

4. CROSS-CUTTING ISSUES AND SOLUTIONS

4.1. The cost-effectiveness of control

Public spending requires effective, efficient and proportionate controls, providing assurances to citizens and their representatives. However, there is a level of control beyond which the additional controls would conflict with the objective of the effectiveness of the programme (if it results in potential applicants choosing not to apply for EU support) and/or the objectives of sound financial management.

In 2010, the Commission adopted a **Communication proposing a Tolerable Risk of Error (TRE)** for Research, Energy and Transport policies and for Rural Development[16]. The TRE-initiative was prompted by the need to provide a clear and shared understanding of the proper risk/control balance, taking into account the EU added value of investing in certain areas, while keeping control systems within an acceptable level of cost. Inter-institutional discussions on this concept are ongoing.

In the meantime, Directorates-General for whose policy area the Commission has already published a proposal are providing **more information on the cost effectiveness of controls** in their AARs. Their analysis compares the costs of potential additional controls and their benefits, i.e. the value of errors likely to be detected and corrected. This analysis does not change the currently applicable 2% materiality level for legality and regularity, but provides valuable information to the AOD on whether additional controls are justified in view of the risks, taking into account the principles of sound financial management.

The Commission instructs the Central Services to assist other services in further developing their analysis and reporting on the cost-effectiveness of controls in the next AARs and to expand this analysis to other policy areas.

The Commission calls upon the AOD to align control systems with the risks identified and the cost-effectiveness of controls, in line with the new requirements proposed in the revised Financial Regulation[17], expected to enter into force as of 2012. The Commission will continue to work together with the competent authorities in the Member States to optimise the (cost)-effectiveness of the control systems.

4.2. Improvement of information in shared management on suspension of payments, recoveries and financial corrections

4.2.1. Information on interruption of payment procedures and suspension of payments

The Commission encouraged its services to interrupt payments procedures and to propose suspension procedures, where necessary and as soon as the legal conditions are met.

Regarding shared management, the Commission has increased the number of interruptions or suspension of payment procedures, as soon as there is evidence suggesting a significant deficiency in the management and control systems in accordance with Articles 91 and 92 of Regulation (EC) No 1083/2006.

The services operating transactions in shared management mode have reported on all interruption/suspensions decisions in their AAR. This information includes the operational programmes concerned, the Member States affected, the type of weaknesses, the main facts triggering the decision and the budgetary impact of the decision. This information constitutes an important aspect of reasonable assurance.

Following the introduction of the new interruption instrument for the 2007-2013 programming period, in 2010, Directors-General operating in shared management made the formal decision to **interrupt payments** totalling EUR 2.6 billion. The College also adopted six decisions **suspending payments**.

[16] COM(2010) 261, 26.5.2010.
[17] COM(2010) 815, Article 63(2).

The Commission confirms that Authorising Officers by Delegation should systematically interrupt payment procedures and propose to the College to suspend procedures when the applicable conditions are met and until the necessary corrective measures have been implemented by the relevant national authorities.

4.2.2. Information from Member States on financial corrections and recoveries made at their level

Correcting amounts unduly paid is a major aspect of sound financial management. In 2010, continued efforts have been made to impose financial corrections when necessary, improve the quality of the Member States data on financial corrections and recoveries and promote the use of best practices so to ensure an improved recovery mechanism at Member State and EU level.

Regarding shared management, the AARs provide detailed information on financial corrections implemented and reported by Member State to the Commission and an assessment of the national control systems (see section 4.2.4). This additional information comes in response to the requests made by the discharge *rapporteur* during the discussion on the 2009 discharge resolution.

In the area of Cohesion policy, Member States implement financial corrections resulting from their own audit work work and from EU audits. These are reported with one year's delay, so in 2010 they reported on their 2009 corrections.

Regarding Regional Policy, Member States reported that by the end of 2009, they had made EUR 3.6 billion of cumulative **financial corrections** on the 2000-2006 programmes (including recoveries of EUR 1.7 billion and withdrawals of EUR 1.9 billion).

Regarding Employment, Member States reported having implemented cumulative financial corrections for the 2000-2009 period of EUR 1.2 billion (out of which, recoveries amounted to EUR 0,2 billion and withdrawals EUR 1.0 billion).

4.2.3. Financial corrections imposed by the Commission on Member States

The other reported **financial corrections** were those **imposed by the Commission on Member States**. The Directorate-General for Regional Policy reported cumulative financial corrections resulting from EU audits in the period 2000-2010 of EUR 6.7 billion. More than half of the total corrections were made in the last three years of this period (EUR 3.9 billion for 2008-2010). The Directorate-General for Emploiment, Social Affairs and Inclsuion reported cumulative financial corrections resulting from EU audits of EUR 1.5 billion. In financial year 2010, DG AGRI executed financial corrections resulting from EU audits of EUR 834 million. 97% of agreed/decided financial corrections for programmes under Cohesion Policy as a whole have already been implemented by end 2010 (through recovery orders or withdrawals by Member States from subsequent paument claims).

Since 2009, the notes to the annual accounts of the European Union contain more extensive information on financial corrections decided by the Commission and implemented in the course of the year as well as on recoveries. This information will be expanded in the notes to the 2010 accounts.

4.2.4. *Assessment of control systems in Member States*

For the first time, the 2010 AARs disclosed the **Commission's assessment of each Member State's control system** taken into account the various levels of assurance per programme in each Member State. The number of Member States for which the assessment resulted in a reservation varied between policy areas: 12 Member States plus several cross-border programme for Regional aid policy, compared to 10 Member States for Employment policy, 4 Member States for Fisheries policy and 3 Member States for Agriculture. Information is also provided on how the assessment of control systems leads to the Directors-General' quantification of the total amount under reservation.

4.3. Adding value to declarations from responsible public authorities

2010 was the first year of full implementation of the **single audit system** in the Cohesion Policy for the 2007-2013 programming period. As for all new systems, there were some start-up problems as regards the reliability of the information submitted by the audit authorities in the Member States. The **annual control reports** submitted at the end of 2010 covered the results of audits carried out during the previous 12-month period ending on 30 June 2010. Out of the 460 national audit opinions due, 14 included a disclaimer of opinion (207 in 2009), 265 were unqualified (108 in 2009), 175 were qualified (93 in 2009) and 5 were adverse (2 in 2009)[18], and 1 was not received. The Commission carefully analysed the reported audit opinions and added its own assessments, where appropriate. In future years, all parties will have gained more experience, and reliability of the reported error rates is expected to improve.

Member States' increased responsibility for implementing funds under shared management was also proposed in the triennial revision of the Financial Regulation, introducing a requirement for all entities entrusted with the management of EU funds under shared management[19] to provide management declarations of assurance.

Regarding Agricultural and Rural Development Policy, all 82 paying agencies provided an annual statement of assurance which covers the completeness, accuracy and veracity of the accounts as well as a declaration that a system is in place which provides reasonable assurance on the legality and regularity of the underlying transactions. In addition, those Member States with more than one paying agency (except for Romania) provided an annual summary in accordance with the legal requirements. The extent of the qualifications to these statements and summaries is presented in the related AAR and is not material overall.

The Commission launched an external evaluation of the annual summaries from the Member States, which has recently been made available to the other institutions. This study concludes that the annual summary in its current form has provided little added value.

[18] There were also four 'not applicable' cases', where the compliance assessment had not yet been approved.

[19] Expenditure under shared management mode mainly concerns structural and agriculture expenditure.

The Commission will continue to organise annual meetings such as the annual meetings of the 'Homologues Group'[20] and bilateral control coordination meetings and annual management meetings, as well as training measures. To further reinforce Member States' accountability under Article 317 of the TFEU, the Commission included in its proposal for the triennial revision of the Financial Regulation the requirement for the responsible bodies accredited in the Member States to provide annual management declarations covering all funds in shared management.

Although not a formal legal requirement, four[21] Member States also issue **national declarations** issued at senior national level. These are valuable to render the controls and accountability structures more transparent. They are not intended to provide information in addition to that included in existing reports.

4.4. Simplifying and reducing the administrative burden

The complexity of the provisions fixing what costs are eligible for funding, including the requirement to reimburse actual costs incurred, has been a frequent reason for the reservations made by the AOD's. It has been the cause of recurring reservations in the Chapter on 'Research, Energy and Transport' for several years, and has affected some areas of expenditure in the Chapters on 'Cohesion Policy' and 'Education and Citizenship'.

4.4.1. Revision of the Financial Regulation and its Modalities of Execution

In 2010, the Commission used the triennial revision of the Financial Regulation to adapt the financial rules. It had three objectives: simplifying rules, notably in grant management by allowing the extended use of lump sums, flat rates and scales of unit costs; increasing the leverage of EU funds by allowing the use of EU trust funds, financial instruments and public-private partnerships and increasing accountability of the Commission and implementating partners by harmonising the current management modes and strengthening their provisions.

The next step is to use this opportunity to change sectoral legislation along similar lines. An **inter-service group** has been set up with a mandate to ensure coherence between the Financial Regulation provisions and sectoral legislation. The end product of this exercise should **meet three criteria**: a) reduce the risk of errors, b) reduce administrative burden for beneficiaries (in particular SMEs) and other stakeholders (such as implementing bodies and contractors), and c) reduce the operating cost of controls.

The Commission calls on the other institutions to react positively to its proposal for the triennial revision of the Financial Regulation.

4.4.2. Rules on grants and public procurement

Errors in the application of laws governing public procurement are an important cause of underlying errors in the Chapter on 'Cohesion'. The Commission presented a Green Paper[22]

[20] Contact group for cooperation with the Audit Authorities from Member States, the Commission, and the Court of Auditors.

[21] National (governmental) declarations have been signed by the respective Minister of Finance of The Netherlands and Sweden; the UK's Permanent Secretary; and the Auditor-General in Denmark.

[22] Examining implementation of the current EU directives (2004/18/EC and 2004/17/EC).

on updating the EU rules governing public procurement with the objective of ensuring that contract money is spent in the best possible way.

Together with the results of the economic evaluation of the effectiveness of the current rules, the results of the Green Paper consultation will feed the reflection on how exactly the EU public procurement rules can be improved. A legislative proposal has been announced in the Single Market Act for end 2011.

Regional policy has been particularly concerned by irregularities linked to incorrect implementation of public procurement rules, as well as weaknesses in management verifications to detect these irregularities. Actions are foreseen to address this particular source of errors, in particular through an in-depth analysis and subsequent discussions with the concerned managing authorities in the Member States concerned. Additional targeted guidance and training to public authorities and to beneficiaries are envisaged in order to enhance the administrative capacity where necessary.

4.5. Corporate Strategy for Management Information Systems

The audit work performed by the Internal Audit Service in recent years on large IT systems and corporate IT systems confirmed the need to improve IT strategic decision-making, procurement and project management processes at both DG and Commission levels, in order to ensure that IT projects are properly aligned with the Commission's objectives, are better coordinated, provide value for money and are successfully implemented in a timely manner.

In 2010, an inter-service Task Force was set up with a mandate to study the current IT situation in the Commission. Its findings were formally endorsed in a Communication to the Commission[23]. As follow-up, a new IT governance has been put in place. The new ABM+IT Steering Committee[24] will propose **a corporate IT strategy for the Commission,** oversee the streamlining and harmonisation of IT projects and set targets for efficiency gains and IT security.

To improve preparedness and allow for a co-ordinated response to cyber attacks aimed at the Commission a **Cyber Attack Response Team (CART)** was set up by the Directorate-General for Human Resources and Security in co-operation with the Directorate-General for Informatics.

4.6. Human resources

Since 2008, the Commission has regularly monitored recruitment by setting targets by Directorate-General and by function group and endorsing a monitoring system aiming at re-adjusting geographical balance after the 2004 enlargement and at obtaining a balanced distribution across different services. The **transitional period for the recruitment of EU-10 nationals** ended on 31 December 2010. The target for EU-10 recruitment had already been exceeded globally in 2008, although there remains a relatively high proportion of temporary agents. In 2010, the share of temporary agents constantly decreased, as effect of the recruitment of laureates of internal and open EU-10 targetted competitions. By way of analogy with the EU-10, recruitment targets were set for EU-2 recruitments and a monitoring system was introduced in 2009, to be maintained until the end of the EU-2 transition period (end 2011).

---

[23] SEC(2010) 1182, 7.10.2010, 'Getting the Best from IT in the Commission'.

[24] Activity Based Management Steering Group for IT, presided by the Secretary General.

In a climate of zero-growth, new political priorities need to be achieved through **optimal allocation of staff** and **internal redeployment of posts**. As the result of targeted measures in these areas, the 2009 annual 'screening report' and updates in 2010 showed a continuous decrease in the share of Commission staff working in administrative and support functions.

The Commission reiterates its commitment to reducing overheads and re-allocating savings to front-line activities.

EXECUTIVE SUMMARY

– The Commission notes that the Authorising Officers by Delegation were successful in correcting the weaknesses in 25% of the reservations formulated last year. These improvements include improved compliance with the eligibility rules for expenditure declared by grant beneficiaries.

– There are still areas for improvement, in particular in some areas of shared management. The Commission will work with the Member States in the light of their increased responsibilities under Article 317 of the Treaty on the Functioning of the European Union. It invites them to continue strengtening the management and control systems and especially the first level management checks, before expenditure is certified to the Commission. It will continue to rigorously exercise its supervisory role by asking Member States to address the weakest points in their management and control systems, and by applying in a systematic and timely manner interruptions and suspensions of payments, and financial corrections whenever necessary. The Commission calls on the other institutions to support its proposal on annual management declarations for all expenditure under indirect/shared management in the context of the revision of the Financial Regulation, and on the Member States to anticipate the entry into force of these provisions.

– The Commission acknowledges the difficulties posed by complex rules for grant beneficiaries. It has already put forward proposals to simplify the rules for grant schemes in the context of the triennial revision of the Financial Regulation and is now working on following these simplifications through into sectoral legislation.

– The EU's public procurement rules should be modernised. A Green Paper[25] on updating the EU rules governing public procurement has been presented covering a broad range of possible aspects of the future legislative reform. The Commission has announced the adoption of a legislative proposal for the revision of the public procurement directives end 2011.

– The Commission invites the other institutions and the Member States to use the discussions on the next multiannual financial framework to improve the design of funding schemes, as well as their delivery, management and control mechanisms, in order to enhance their effectiveness and ensure that the control of EU expenditure is efficient, proportional and cost-effective.

– The Commission notes that for Cohesion Policy, most programmes and authorities have now implemented projects on the ground and declared expenditure. Although Cohesion programmes are multiannual by nature, this increased volume of transactions also increased the inherent risk of error in 2010. For Cohesion policy as a whole, the reporting year saw a significant increase in the rate of error and the volume of erroneous payments. The reservations made by the Directorates-General for Regional Policy in 2010 cover more operational programmes in more Member States than in previous years. For Employment and Social Affairs, the reservations made concern less operational programmes than in 2009 but in more Member States (43 programmes in reservation in 2010 from both 2000-2006 and 2007-2013 programming periods in 10 Member States, compared to 59 programmes in 7 Member States in 2009). Furthermore,

[25] Green Paper on the future modernisation of the EU public procurement Directives (2004/18/EC and 2004/17/EC).

in 2010, the Directorate-General for Employment, Social Affairs and Inclusion relied on the error rates reported by audit authorities in the Member States whenever these figures were considered of adequate quality. This difference in approach partially explains the difference in the rates reported by the European Court of Auditors.

– The Commission welcomes the initiative taken in Denmark, the Netherlands, Sweden and the United Kingdom to provide voluntary national declarations. In 2010, the Commission issued a staff working document[26] examining in detail the scope and content of voluntary national declarations. In the same document, the Commission provided technical guidance for public authorities on adding value to declarations and increasing assurance on execution in shared management. The document was sent to the European Parliament and to the Council of the European Union on 23 February 2011. The guidance concludes that the Commission’s Financial Regulation proposal for annual management declarations signed by the accredited bodies, would however constitute a first more practical and useful step. This is reinforced by the recent external evaluation of the annual summaries which concludes that these documents, in their current form, provided little added-value to the Commission's assurance process.

[26] Commission staff working paper, ‘Adding value to Declarations: increasing assurance on execution in shared management’ - SEC(2011) 250, 23.2.2011.