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

Synthesis of the Commission's management achievements in 2012

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1 INTRODUCTION

Article 317 of the Treaty on the Functioning of the European Union (TFEU) gives the European Commission responsibility for implementing the EU budget, within the limits of the appropriations available and having regard to the principles of sound financial management. It provides for Member States to cooperate with the Commission to ensure that the appropriations are used in accordance with these principles.

By adopting this Synthesis Report, on the basis of the assurances and reservations made by its Directors-General and Heads of Service in their Annual Activity Reports (AARs), the Commission takes overall political responsibility for management of the EU budget. In this Synthesis Report, the Commission also identifies the key management issues to be addressed as a matter of priority and the actions to be taken to address identified weaknesses.

The College delegates the operational implementation of political and management objectives to the Directors-General and Heads of Service, who, as 'Authorising Officers by Delegation' (AODs) receive the means to act. This decentralised management organisation is characterised by a clear definition of the responsibilities of the different actors. The AOD's are fully empowered to define the most appropriate and effective control system for ensuring sound and efficient management of the resources for which they are responsible. The AARs are the main means by which the AODs account for their stewardship of the human and financial resources for which they are responsible. The AODs report on the performance of their duties in the AARs[1] and document any issues arising from their management which need to be brought to the attention of the College. These AARs include a signed declaration of assurance covering, amongst other things, the legality and regularity of financial transactions. Each AAR explicitly confirms that the responsible Commissioner(s) has(ve) been informed of the main aspects of the AAR, including any reservations the AOD intended to make, before the final signature of the declaration of assurance.

This Synthesis Report was adopted after discussion by the College on 5 June 2013.

[1] Article 66 of the Financial Regulation

2 STRENGTHENING PERFORMANCE MEASUREMENT

2.1 Performance measurement

The AARs are an important source of information, in particular for the Court of Auditors and for the Discharge Authority. Since 2011, with the support of the Parliament, the Council and the Court of Auditors, the Commission has been working to demonstrate the importance of the quality of spending and the added value of the EU budget. For example, it has presented a comprehensive report on the added value of EU spending in support of its proposals for the new generation of programmes under the next Multiannual Financial Framework[2].

The standing instructions for the 2012 AAR require AODs to deepen their reporting on how they have used the financial and human resources allocated to them to achieve the policy objectives set by the College, and on how these policies have generated added value for EU society. In this way the Commission is progressively developing a performance culture that will take several years to come to full effect, partly because new statistical and other tools need to be developed. Thus, the debate on the eligibility and regularity of payments, while remaining central, will be complemented by one on the performance of policies and the Commission has to be prepared to respond appropriately to this new development.

The Commission instructs its services to deepen the performance framework that should underpin all future AARs. Such a framework consists of a performance-driven culture throughout the organisation, ex-ante setting of objectives, regular monitoring, ex-post measurement and reporting of achievements. It instructs the Secretariat General and the Directorate-General for Budget to include the elements of performance reporting in the standing instructions for the 2013 AARs and 2014 MPs.

Performance reporting should focus on the real needs of stakeholders and strengthen the declaration of assurance with information on 'economy, 'effectiveness and 'efficiency' of financial and non-financial activities. The requirements should be sufficiently flexible to reflect the different nature of activities of the services.

In its proposals for the new generation of programmes under the next multi-annual financial framework (MFF), the Commission has included several elements to enhance the performance framework and simplify the rules and processes in order to reduce the risk of errors affecting payments. This should focus more on efficiency and effectiveness in attaining the overall objectives of the various policy areas while bearing in mind the necessity of ensuring that the level of error on financial transactions does not exceed a reasonable level.

The Commission is concerned that several of the proposals it has made as part of the new MFF to ensure a simpler, stronger framework are not being taken up by the co-legislators[3]. It calls on the Parliament and the Council to take greater account of these aspects in the on-going negotiations.

[2] Report on the added value of EU spending, (SEC(2011)867)

[3] Communication from the Commission "Second Simplification Scoreboard for the MFF 2014-2020" (COM(2013) 98 final)

2.2 The evaluation report (Article 318 TFEU)

In November 2012, the Commission reported[4] for the second time **on its evaluation of the EU's finances based on the results achieved.** This report, required by Article 318 TFEU, seeks to provide an overview of the objectives of EU programmes, and of the impacts and results achieved. The Commission is working to continuously improve this reporting, for example by streamlining it with the existing Strategic Planning Programming-process. This streamlining means that the performance indicators and targets are defined in the MPs, reporting on these is done in the AARs and complemented by Commission-wide evaluations in the Evaluation Report adopted in parallel with this Synthesis Report.

The Commission instructs the Secretariat General to continue to develop the content and coverage of the evaluation report, for example by using more performance information and by ensuring consistency between the evaluation report and the AARs. Examples of performance information include the performance audits carried out by internal and external auditors.

2.3 Revision of the Financial Regulation

The Financial Regulation contains the common financial rules and principles applicable to all policy areas. The Financial Regulation has been revised in 2012, reinforcing the need to align control systems with the identified risks and the cost-effectiveness of controls. It sets out a clear general implementation framework, covering all modes of management (including a common framework for shared management which accounts for the main part of the EU budget) and establishing dedicated rules for innovative financial instruments and prizes. For grants directly managed by the Commission, the revision specifically promotes the use of simplified methods to calculate eligible costs (such as lump sums, flat rates and standard scales of unit costs), facilitates the acceptance of costs declared according to the beneficiary's 'usual accounting practices', and introduces lighter procedures for small grants. The same approach has been proposed by the Commission in the sectorial legislation for shared management.

The new Financial Regulation includes provisions requiring services to provide information on their internal control systems as well as those of the Member States where shared management applies, an estimation of the costs and benefits of the controls implied by such a system and an assessment of the expected level of risk of error, when new or revised spending proposals are presented to the legislative authority. Furthermore, the Financial Regulation requires the AODs to take account of risks and cost-effectiveness when setting up control systems and to provide an overall assessment of the costs and benefits of controls in the AAR and, if the level of error is persistently high, to identify the weaknesses, analyse the costs and benefits of possible corrective measures and take or propose appropriate action.

The Commission instructs its Central Services to develop specific guidelines so that these new information requirements are reflected in the 2013 AARs in a timely and cost-efficient manner. For the costs of control beyond the boundaries of the Commission, the

[4] COM(2012) 675 final

necessary preparation should be undertaken with a view of reflecting this information in the 2015 AARs.

3 IMPROVING THE QUALITY OF THE ANNUAL ACTIVITY REPORTS

3.1 The assessment by the Court of Auditors

In its 2011 Annual Report, the Court of Auditors assessed the quality of several 2011 AARs. It took the line that for six AAR's, the scope or scale of a reservation should have been wider. At the same time, it acknowledged that the new guidance for calculating the residual error rate had led to an improvement, in particular for the AARs for the cohesion policy Directorates-General as well as for the Directorate-General for Research and Innovations.

The 2012 AARs explain the steps taken to address the issues highlighted by the Court of Auditors. The Commission is satisfied that all its Services have addressed the observations made by the Court of Auditors on the 2011 'management representations', and also contributing to address the concerns on the reliability of the AARs expressed in the discharge resolution[5].

3.2 A strengthened peer-review process

In a constant quest for continuous further improvements, the central services of the Commission work from an early stage to support Services in drafting the AARs. They discuss key issues with them and provide guidance when needed. Peer-reviews have proven to be an effective platform for sharing opinions on formulating crosscutting issues and tackling weaknesses.

Following an audit by the Internal Audit Service of the AAR process in the Commission, further improvements have been made to this process. First, the working arrangements for the peer review meetings have been formalised in a 'mutual expectations' paper. Second, Directorates-General are invited to report on how they will reflect the conclusions from the peer reviews in their final AAR, or to provide explanations if they do not agree with these recommendations ('comply or explain' principle). Third, more attention has been given to the conclusions in the AARs underpinning the assurance, including the reasons for making a reservation or not. This process, based on systematic scrutiny of the quality of the AARs has led to improved clarity, consistency and compliance with the standing instructions.

The Commission instructs the Secretariat-General and the Directorate-General for Budget to continue providing guidance to Directorates-General and Services, through a regular review of standing instructions, guidance notes, quality review of draft AARs, peer-review meetings and by providing appropriate training. The 2013 update of the standing instructions should help services by providing reporting templates and at the same time ensure services are compliant with the new Financial Regulation.

[5] European Parliament resolution of 17 April 2013, 2012/2167(DEC), § 56 to 72

3.3 Harmonisation of the quantification of procurement procedure errors

In November 2012, the central services updated their guidance on the determination of error rates and the criteria used to qualify the declaration of assurance with a reservation in the case of errors linked to public procurement procedures under direct management. This guidance, which took into account the wider approach by the Court, was aimed at ensuring transparency and comparability as well as producing a realistic calculation of actual financial exposure, while taking into account the possible reputational impact of serious procedural errors.

The Directorate-General for Regional and Urban Policy is leading a process to update the quantification principles used by the cohesion policy services. The Commission will build on this exercise to adopt a decision by end 2013 to harmonize the approach for all shared management services. It will also apply to the activities of certain other services to which public procurement is a significant part of their budgets.

3.4 Harmonisation of the materiality criteria

Directors-General and Directors of Executive Agencies include reservations in their declarations of assurance based upon their assessment of the materiality of weaknesses and/or observations regarding the building blocks of their AARs.

As instructed in the Synthesis Report 2011, the shared management DGs have worked to harmonise further the approach for determining materiality based on a) an assessment of the national management and control systems; b) using the error-rates projected in the Annual Control Reports from the national authorities; and c) calculating a cumulative residual error rate.

In its 2012 AAR, the Director General for Agriculture and Rural Development followed a more integrated approach, by disclosing the results of the **Commission's assessment of all operational programmes control systems,** taking into account the various levels of assurance obtained from the certification bodies, the Court of Auditors and its own audit findings. The results are mainly visible for the principal systems within pillar one ('direct support'). This approach will be adapted as necessary and extended to the rest of the first pillar[6] and to the second pillar ("rural development"). This will lead to increased precision of the amounts at risk.

The Commission considers that efforts to harmonise the materiality criteria improve the coherence, readability and transparency of the AARs. It instructs the Director-General for Agriculture and Rural Development to continue its efforts and extend the harmonisation of materiality criteria in line with the guidelines for shared management. The Commission instructs the Director-General for Agriculture and Rural Development to examine the situation of Member States where the error rate is above 2 % in particular by examining national audit opinions and statistics provided concerning error rates.

[6] This approach may however prove difficult to apply for market measures within the first pillar due to the large number and heterogeneous nature of the market support schemes

The Commission instructs the Directorate-General for Budget to use the implementation of the new Financial Regulation, and the discussion on the regulatory framework for the spending programmes under the next MFF, to provide advice to the services ensuring that the materiality criteria remain adapted to the level of complexity, the cost-effectiveness of the necessary controls and the risk environment in which the Commission is required to manage the funds.

The standing instructions require DGs to report on the analysis of errors, their root causes and the actions taken to correct and prevent them. A clear link is required between the reported multi-annual residual error rate and the information on recoveries/financial corrections presented in the notes to the accounts in order to show the residual financial risk and the impact on materiality after all measures to protect the EU budget have been applied.

The Commission instructs the Directorate-General for Budget to bring forward advice on how to present the information on the recoveries and financial corrections in a manner that valid conclusions can be drawn as regards the actual exposure of the EU budget.

Due to the lifecycle time span of the programmes, there is inevitably a time lag between the payment, the detection of an error and its correction – hence the advantages of adopting a cumulative approach to reporting. Financial corrections normally address systems weaknesses and cannot be directly linked to specific errors at the level of final beneficiaries. Multi-annual residual error rates and the information on cumulative recoveries/financial corrections reported in the AARs of a specific reporting year are key indicators allowing for an assessment of how the Commission protects the EU budget.

4 ASSURANCE GATHERED THROUGH THE AARS AND RESERVATIONS MADE BY THE DIRECTORS-GENERAL

Having examined the AARs, in particular the declarations signed by each Authorising Officer by Delegation (AOD) and the reservations they have made, the Commission notes that they all give reasonable assurance regarding the use of resources for the intended purpose, the observance of the principles of sound financial management and the fact that the control procedures used give the necessary guarantees of the legality and regularity of the underlying transactions.

Fifteen Directors-General and two Directors of Executive Agencies issued a total of **twenty-nine reservations** in their 2012 AARs. Reservations have been made in seventeen services which together account for 85% of the Commission financial operations in expenditure and for 12% in revenue. These included twenty-five of the twenty-seven reservations made in 2011 on which action was still on-going at the end of 2012, plus four new reservations. Two previous reservations could be lifted.

The total volume of operations affected by reservations rose due to a new reservation by the Director General of DEVCO[7], the better scope calculation by DG REGIO, and the financial quantification of the DG AGRI reservation related to decoupled direct payments within pillar one of the CAP which resulted in a quantified financial reservation for three Member States this year, while it was reputational last year and therefore not quantified.

The Commission calls on the Directorates General to review their internal control strategy to ensure that the controls they implement are efficient and cost-effective, and that they adjust the control intensity to the risks they confront while having due regard to their impact on the achievement of policy objectives. The Commission calls on the Directorate-General for Budget to provide guidance and to support this process.

To ensure consistency and comparability, the Commission instructs the Central Services to review the different approaches followed to evaluate the amounts estimated to be at risk.

In their AAR, the AODs estimate amounts at risk between EUR 2.6 billion and EUR 3.5 billion. This corresponds to 1.9% and 2.6% of all executed payments in the Commission budget and the EDF in 2012. With regard to the two largest spending areas (agriculture, natural resources and health, and cohesion) those amounts do not include future financial corrections and recoveries which may correct irregularities related to payments made in 2012. Based on the experience of the last four years (2009-2012), financial corrections and recoveries amounted to EUR 2.4 billion (confirmed/decided) and EUR 2.2 billion (implemented) on average each year in these two policy areas alone. Assuming similar levels will apply to 2012, financial corrections and recoveries protect adequately the EU budget as a whole.

The financial corrections and recoveries implemented across all policy areas amounted to EUR 4.5 billion for 2012 (EUR 1.8 billion in 2011). A detailed breakdown is presented in note 6 to the consolidated financial accounts. The significant increase compared to the previous year is mainly explained by the closure exercise of the ERDF programme for the 2000-2006 period and the resulting financial corrections.

It is noted that the residual error rates reported by the services, which are used to estimate the financial exposure, are not directly reconcilable with the error rates reported by the European Court of Auditors for each chapter in its Annual Report. This is due to a number of reasons, the main one being that the residual error rate is calculated taking account of the effect of the various multi-annual corrective mechanisms. The reported error rate of the Court of Auditors is based on transactions of a specific year. It should therefore be put into context by taking into consideration amount of financial corrections and recoveries effectively implemented.

Each Director General and Head of Service has identified the main reasons for his/her reservation(s) and set out remedial actions to address it/them. Generally, the most common concerns stem from the **complex eligibility rules for beneficiaries** and from the incorrect

[7] DEVCO reservation cover all their operational activities which counts for EUR 7.5 billion (EDF included) with an amount at risk of EUR 295 million.

application of **public procurement rules by beneficiaries** (a frequent cause of errors for shared and indirectly managed funds). The Commission has drawn operational conclusions from these experiences and has made proposals for major simplifications in the next generation of programmes. To date, however, the co-legislators do not appear to be responding adequately to these aspects of the Commission's proposals.

After assessment of the control results, two 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, to show that the measures were effective and to demonstrate that the weaknesses had been effectively addressed.

4.1 Revenue

The Commission continued its **actions to increase the effectiveness and efficiency of the collection of customs duties and VAT** in the Member States, to identify the channels and schemes allowing tax evasion and tax avoidance and to promote appropriate countermeasures. The full application of the Modernised Customs Code (MCC), which was replaced by the Union Customs Code (UCC), has been postponed to 2020 since, in the current economic and financial context, Member States could not commit to the timely development of the necessary IT systems.

The Commission will publish updated information on the VAT gap in all Member States. The same approach will be used as in 2009, by comparing accrued VAT receipts with the theoretical net VAT liability for the economy as a whole.

Traditional own resources (TOR) represent EUR 16 453[8] million of total revenue for the 2012 EU budget. They are established and collected by the Member States. Three quarters are paid to the EU budget, the remaining quarter being retained by the Member States to cover collection costs. Given its geographical position, Belgium is a major contributor of TOR, accounting for 9.7% of total TOR in 2012. Inspections carried out by the Commission and audits performed by the Court have highlighted a reconciliation issue between the amounts transferred and underlying records. Mitigating actions have been taken, including the enhancement of internal controls. However, the final financial impact cannot be measured yet pending the outcome of an on-going external audit. The Director-General for the Budget has therefore **maintained the reservation concerning insufficient assurance of the reliability of the Belgian clearance and accounting systems**.

4.2 Agriculture: market and direct support

In his 2012 AAR, the Director General for Agriculture and Rural Development made **three reservations.** One of these reservations relates to direct support. Based on the more comprehensive approach described in chapter 3.4, the residual error rate for decoupled direct aid amounted to 2.4%. This new *financial* reservation accounts for the largest part of the increase in the Commission total scope of operations under reservation. Excluding **the very high rates of error found in three specific Member States (Bulgaria, Portugal and**

[8] Provisional net amount after deduction of 25% collection fee

France), the residual error rate would be at 1.68%, so below the materiality threshold. The Director General for Agriculture and Rural Development considers that action plans are needed for these countries and has made a reservation for them. The Directorate General will also examine the situation of the other Member States where the error-rate lies above 2%. For these Member States, on-going conformity clearance procedures cover the financial risk for the EU-budget. Furthermore, a general action plan is being developed in order to reinforce the assurance that can be taken from Member States' control system.

4.3 Rural development, environment, fisheries and health

The reservation made by the Director General for Agriculture and Rural Development made **on expenditure for rural development measures was maintained** despite the fact that the control statistics reported by the Member States indicated an error rate below materiality. However, given the concerns regarding the usability of the controls in some Member States, as well as the error rate reported by the European Court of Auditors, the error rate deriving from the Member States' statistics needed to be reconsidered. In order to achieve specific policy objectives, rural development is subject to a large number of complex conditions. This increases the risk of errors by beneficiaries and makes controls by the national authorities more difficult and costly.

The Commission is actively working together with all Member States' administrations to identify the root causes of systemic sources of error and to determine possible corrective actions. An information note to the responsible Ministers was the basis of a discussion in the Council on 29 November 2012. The European Network for Rural Development is being used to raise awareness among experts. Some Member States (Portugal, Spain, Bulgaria and Italy) have already amended their rural development programmes to reduce the risk of errors in implementation. The Parliament and the Council will be informed of the main results of this review. Through the Rural Development Committee, the Commission will continue to provide guidance to the Member States as they develop future rural development programmes.

The **reputational reservation for deficiencies in the supervision and control of organic production was also maintained** as the action plan in not yet fully implemented. Future improvements includes the EU supervision of the control systems in Member States and those of third countries, including supervision of the control bodies recognised for certifying imports of organic products into the EU.

The Director General for Maritime Affairs and Fisheries **maintained her reservation concerning the Financial Instrument for Fisheries Guidance (FIFG)** with regard to one programme in Germany, currently under closure procedure (no payments were made since 2009) but where the remaining correction has been assessed at EUR 5.3 million. **She also issued a reservation concerning European Fisheries Fund management and control systems** in nine Member States[9], with regard to the ineligibility of declared expenditure. The payments for the programmes concerned have been interrupted.

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[9] Belgium, the Czech Republic, Estonia, Spain, France, Italy, Romania, Sweden and the United Kingdom

The Director General for Climate Action maintained his previous reservation on the reputational damage to the Commission resulting from **a significant security breach in the national registries of the EU Emissions Trading System** (ETS). In the meantime, the national registries have been superseded by a single Union Registry since June 2012. An action plan to further enhance security has been engaged by the Directors General for Climate Action, Informatics and by the Security Directorate. There were no serious security incidents in 2012 but the security challenges are evolving constantly. For this reason, an updated in-depth risk assessment is planned for 2013.

The Director General for Health and Consumers maintained her reservation concerning the **accuracy of Member States' cost claims under the animal disease eradication and monitoring programmes in the food and feed policy area**. The main sources of the detected errors are cost claims from Member States that do not correctly apply the eligibility rules set out in the legislation. With a view to reducing the error rate in the feed and food area, the Director General for Health and Consumers had already taken a number of steps, but the legislative changes will only have an impact on the residual error rate starting as from 2014.

4.4 Regional policy, Energy and Transport

The **Director-General for Regional and Urban Policy issued two reservations**: one financial/reputational reservation for the period 2000-2006 on management and control systems for nine operational programmes in three Member States[10] and for two Cohesion fund sectors[11] . Another reservation for the period 2007-2013 covers ERDF/Cohesion Fund management and control systems for identified operational programmes in sixteen Member States[12], eleven cross-border programmes and the European Territorial Cooperation programmes, and the Adriatic program for Pre-Accession Assistance (IPA). The deficiencies concern, for instance, certification activities, high error rates, compliance with public procurement rules, and procedures for selecting operations. The **amount at risk is estimated to be EUR 320 million** corresponding to 0.9 % of interim payments for the year.

The Commission notes that the number of ERDF/cohesion operational programmes under reservation decreased from 123 to 86, following corrective measures taken in particular in some Member States (France, Latvia and the Netherlands and in some programmes in Italy) and by its services.

The AAR of the Director General for Regional and Urban Policy spells out the efforts made to speed up the internal procedures for interruptions and suspensions as a result of all available audit results.

The **Director General for Energy entered a reputational reservation on account of beneficiaries of grants under the European Energy Programme for Recovery (EEPR) not respecting public procurement rules when subcontracting.**

[10] Ireland, Italy and Spain

[11] Transport in Poland and Transport in Romania

[12] Austria, Belgium, the Czech Republic, Estonia, France, Germany, Greece, Hungary, Italy, Poland, Romania, Slovenia, Slovakia, Spain, Sweden and the UK.

The Commission welcomes DG ENER's approach to audit 100% of the final payments under the EEPR programme, as well as many first interim payments, ensuring that (by the end of the programme) all possible overpayments have been identified and the appropriate follow-up actions taken.

The Directors General for Energy and for Mobility and Transport are also concerned by the reservations on the **Sixth and Seventh Framework Research Programme (FP6 and FP7)**, covered in the below chapter 4.7 on Research and other internal policies.

4.5 Employment and social affairs

The **Director General for Employment, Social Affairs and Inclusion made two reservations**: one concerning management and control systems for identified operational programmes in four[13] Member States under ESF 2000-2006, and the other for identified operational programmes in eleven[14] Member States under ESF 2007-2013 and for the IPA programmes for both Turkey and the former Yugoslav Republic of Macedonia. Both reservations were made following serious deficiencies in key aspects of the management and control systems of the identified operational programmes.

The **overall amount at risk is estimated to be EUR 68.9 million, including EUR 68 million for the ESF,** corresponding to 0.63 % of interim payments for the year and EUR 0.9 million for the IPA corresponding to 1.5 % of the interim payments for the year.

In its proposals for the cohesion policy for 2014-2020, the Commission proposed to further improve the financial management and regularity of budget expenditure through retention of 10 % of payments to Member States during the year and annual clearance of accounts once Member States provide certified annual accounts for each programme.

4.6 External relations, development aid and enlargement

The budget for external relations, development aid and enlargement is spent in more than 150 countries and the implementing organisations vary greatly in size and experience. Most of the budget is implemented in a devolved manner through a network of 140+ EU Delegations; the Heads of Delegations (who belong to the EEAS), in their capacity of Authorising Officers by Sub-Delegation for the Commission, provide a statement of assurance and regular reporting to the headquarters through the External Assistance Management Reports (EAMR).

In 2012, the Directorate General for Development and Cooperation – EuropeAid commissioned a measurement study on the residual error rate on closed transactions in order to estimate the financial impact of residual errors once all ex-ante and ex-post controls have been implemented. On this basis, the **Director General for Development and Cooperation – EuropeAid made one new reservation** related to the estimated error rate of 3.6% derived from the study, as well as the error rate identified by the Court of Auditors in the framework of its Annual Report for 2011. The estimated amount at risk for this reservation is about EUR

[13] Germany, France, Italy and Spain

[14] Belgium, the Czech Republic, France, Germany, Ireland, Italy, Poland, Romania, Slovakia, Spain and the United Kingdom

259.5 million. The main causes were weaknesses and errors made by international organisations implementing EU funded projects, amounts not recovered following audits or expenditure verification missions, various errors regarding EU funds managed indirectly and lack of documentation in tender procedures.

The Commission instructs the Directorate General for Development and Cooperation – EuropeAid to implement promptly the recommendations by the IAS for improving the assurance building process within the Directorate General, in particular the need for reinforced reporting by the EU Delegations as these are key to its AAR.

The director for the Service for Foreign Policy Instruments (FPI), made a reservation concerning the **legality and regularity of Election Observation Missions** for which the legal basis of a number of disbursements need to be clarified.

4.7 Research and other internal policies

The Research DGs' common audit strategy (including an intensive audit campaign with extrapolation of systemic errors) for the **Sixth Framework Programme (FP6)** (2002-2006) has proved successful in terms of audit coverage and audit results achieved. At the end of the programme's lifecycle period, the multiannual residual error rate[15] had fallen substantially, reaching a level very close to the 2% target. While the FP6 reservations have been maintained by the Directors General concerned (ENTR, RTD, MOVE and ENER), the cost of additional controls would be disproportionate to the potential benefit of getting below 2%. As the amount of payments is also falling, it is expected that this reservation will not be maintained beyond 2012.

As the detected and residual error-rates from the representative audit sample in the **Seventh Framework Research Programme (FP7) (2007-2013)** exceed the 2% materiality threshold, the Research Directors General (ENTR, RTD, MOVE, ENER, CNECT) have maintained their reservation on FP7, as has the Director of the Research Executive Agency (for the 'Space and Security' and as from 2012 the 'SMEs' sub-activities).

Action is being taken to reduce errors furthermore, in particular through the following: improving guidance and feedback to participants and auditors on the most common errors; improvement of the ex-ante control strategy; and carrying out an appropriate number of ex-post audits to reduce, together with recovery actions, the residual error rate over a multiannual perspective. Due to prohibitive costs, even with these measures, the FP7 controls strategy will probably lead to a residual error rate of between 2% and 5% at the end of the FP7 lifecycle.

Under the current procedures, eight AODs are responsible for the management of the Research budget. In the past, each aimed to establish a representative error rate for his/her part of the budget. This led to considerable planning constraints and multiple audits of the same beneficiaries by different services. For that reason, as of 2012, a **Common Representative**

[15] The multiannual residual error rate gives the real impact of errors on the EU budget, taking into account corrections and recoveries over the entire lifecycle period of the framework programme.

Audit Sample (CRAS) was introduced across the Research family. This reduces the audit burden on beneficiaries by reducing the number of multiple audits and facilitates coordination.

The Commission is currently preparing a report analysing the results of the simplification measures and the actions taken to ensure harmonised implementation of FP7 across the Research family. It will detail the improvements to the audit strategy in particular as regards the measures taken to reduce the audit burden and to the guidance given to beneficiaries and auditors. This report will be presented to the European Parliament in June 2013.

The Commission welcomes the low residual error rate at the end of the Research FP6 lifecycle. It takes note of and supports the view of the DGs that a further reduction in the residual error rate could not be achieved without unreasonably high costs for the Commission and for the beneficiaries, which would damage the attractiveness of the Union's Research programme, thereby negatively affecting the achievement of the Union's research and innovation objectives.

The Director General for **Communication lifted his reputational reservation, on potential non-compliance with applicable legislation on intellectual property rights by Commission services**. This was possible thanks to efforts to raise awareness and put in place the necessary legal and contractual safeguards.

The Commission welcomes the work undertaken to address the issue of respect for intellectual property rights by all its services and is satisfied that this reservation could be lifted after four years of detailed work.

The Director of the Education, Audio-visual and Culture Executive Agency reported progress in the implementation of action plan to improve the control systems for the management of grants **but maintained his reservation for the Life-Long Learning programme (LLP)**. Steps have been taken to reduce the errors in the LLP projects in the remaining years of the current programme (2007-2013), but only the simplifications embedded in the next LLP generation (2014-2020) will provide a possibility for a significantly lower residual error rate.

The Commission notes the reservation for the LLP programme managed by the EAC Executive Agency, despite work done to better inform beneficiaries of the requirements. It calls on the Agency to step up its efforts for the next generation of the programme.

The Director General for Home Affairs lifted his reservation concerning the financial risk resulting from the non-audited population of grants in the financial programmes ‘Prevention, preparedness and consequence management of terrorism and other security-related risks’ (CIPS) and ‘Prevention of and fight against crime’ (ISEC). An increased number of audits combined with more and better information to beneficiaries successfully helped to reduce the error rate. **However, he maintained the reputational reservation concerning delays in implementing the SIS II project**. For this project, the detailed action plan was fully implemented, but the problems in Finland in timely carrying out the comprehensive testing and the changes to the transition of the operations towards eu-LISA have put strong pressure on the overall time-table for the project.

The Commission recognises that developing and managing large-scale IT systems such as SIS II presents particular challenges. It has put in place strong governance mechanisms and given top priority to maintaining close cooperation with stakeholders as far as SIS II is concerned. These measures allowed for a successful entry into operation of the system on 9 April 2013.

The **Director-General for Enterprise and Industry maintained his reservation relating to the reliability of financial reporting by the European Space Agency** (ESA) for another year. During 2012, the Commission continued implementing and further strengthening its monitoring and control strategy towards ESA and continuously supports ESA in implementing the action plan developed to address the recommendations made by ESA's external Audit Commission and to improve the quality of financial reporting to the Commission.

5 ASSURANCE GATHERED THROUGH THE WORK OF THE INTERNAL AUDIT SERVICE

The Audit Progress Committee (APC) continued to inform the College on audit issues, including issues with a corporate dimension. The APC also informed the College on the progress achieved in implementing the IAS's audit recommendations by the end of 2012. 78% of all recommendations accepted in the period 2008-2012 had been implemented. Out of 120 very important recommendations outstanding at the end of 2012, only 29 were overdue by more than 6 months compared to the initially planned target date.

In April 2013, the Commission's Internal Auditor submitted an Overall Opinion accompanied by the Annual Internal Audit Report for the year 2012 as stipulated under Article 99(3) of the revised Financial Regulation. In accordance with Article 99(5) of the revised Financial Regulation, a summary report of the work of the Internal Auditor will be forwarded to the Discharge Authority. The overall opinion is based on work carried out by the Internal Audit Capabilities and the Internal Audit Service during the period 2010 to 2012 as part of the coordinated strategic audit plan. It focuses on financial management.

The Commission's Internal Auditor considers that, in 2012, with the exception of those areas of financial management where Directors General have expressed reservations, 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. The Internal Auditor also considered the combined input of the amounts estimated to be at risk as disclosed in the AARs and concluded that financial reservations and recoveries are of a sufficient magnitude to protect the budget as a whole, even if the amounts at risk in a number of areas, in particular Rural Development, are likely to be underestimated due to reliability problems detected by the IAS.

The Commission notes that, in the *Emphasis of Matter* attached to the Overall Opinion, the Internal Audit Service highlights three issues that require particular attention:

First, as regards the AARs, the overall opinion underlines the need for reinforced reporting by the EU Head of Delegations (by making more effective use of the External Assistance Management Report (EAMR) and through improved support, coordination and supervision arrangements) and for harmonising further the different approaches followed on the cost-effectiveness of controls and for ensuring consistency in the way the overall amount at risk for the Commission is presented.

Second, all services are invited to improve efficiency and effectiveness of the control strategies, in particular as regards the risk assessment process and the setting of appropriate targets for audit coverage and for monitoring control activities through better quantitative and qualitative indicators.

Finally, based on the outcome of the review undertaken in a number of key spending Directorates General (AGRI, RTD and DEVCO), the Overall Opinion emphasises the importance of reliable error rates to the assurance process and the knock-on implications for management reservations and addresses specific recommendations to the audited services.

6 CROSSCUTTING ISSUES AND SOLUTIONS

6.1 Complexity of eligibility rules set out at national level

As in previous years, the incorrect application of eligibility criteria and failures to comply with public procurement rules were the most common errors identified by the Court of Auditors in its 2011 annual report. Some of these eligibility rules have been defined at national level to allow Member States to use the same national, regional and local rules for national schemes and EU-funded projects. The Commission will continue to focus on detecting errors and correcting all errors detected, as well as to **provide guidance to relevant national authorities, stressing at all occasions that compliance with applicable rules requires Member States to provide further guidance to implementing bodies.**

The Commission takes the necessary actions when it finds that national eligibility rules are either too complex or not compliant with EU regulations. For instance, as regards the ESF, progress is being made on extending the use of simplified cost options with a view to replacing detailed and sometimes burdensome national eligibility rules. Experience shows that the use of these options reduces administrative burden for beneficiaries and the cost of implementation, and helps to reduce error rates. These simplified cost options are also recommended for ERDF co-funded programmes where appropriate.

In 2013, the Directorate General for Regional and Urban Policy will revise its guidelines for determining financial corrections for non-compliance with the rules on public procurement, taking into account the experience obtained and providing more clarity to the managing and audit authorities (see paragraph 3.3 above).

6.2 Internal control standards

The Commission took note of the Overview of the State of Internal Control as prepared by the Director General for the Budget and is satisfied with the positive trend as regards the effectiveness of control systems and regarding standards being embedded in day-to-day operational procedures.

The Commission instructs the Directorate-General for Budget to pursue its efforts to simplify internal control standards, making them more focussed on effectiveness and efficiency, and to revise them accordingly.

6.3 Impact of delegated bodies on the chain of assurance

The new Financial Regulation provides for the potential creation of new types of delegated bodies (e.g. Joint Undertakings), and different forms of externalised management are now already up and running. Such bodies are increasingly exposed to assurance related concerns and reservations (cf. REA, EACEA, Artemis, ENIAC, financial reporting concerns with ESA, etc.). The Commission concludes that supervision by the parent services needs to be strengthened.

The Commission instructs the Directorate-General for Budget to develop specific guidance on the most relevant internal controls strategies for externalised management and on best practices for the supervisory controls by parent DGs and their documentation.

Directorates General implementing budgets through Joint Undertakings should take into account any negative control results (high error rates) or control systems weaknesses (missing ex-post controls), even if those entities are subject to a separate discharge procedure.

The Commission confirms that the declaration of assurance covers all resources assigned to its Directorates General, irrespective of the management mode used. The AODs should ensure that the declaration of assurance covers resources managed through delegated bodies and should make reservations where necessary.

6.4 Protecting the EU-budget through interruptions and suspension of payments, financial corrections and recoveries

The Commission rigorously exercises its supervisory role by calling on Member States to immediately address any deficiencies detected in their management and control systems. It also interrupts or suspends payments and makes financial corrections whenever necessary. According to the European Court of Auditors' annual report for 2011, around two thirds of the errors could have been identified and corrected by the national authorities.

The Commission calls on the Member States to demonstrate their commitment to improving accountability and transparency by reinforcing control measures, where necessary, for the remainder of the current programming period, in particular as regards first-level management checks, before certifying expenditure to the Commission.

The Commission has encouraged its services to interrupt payments and to propose suspension procedures as soon as the legal conditions are met. Regarding shared management, the Commission interrupts or suspends payment procedures as soon as there is sufficient evidence suggesting a significant deficiency in the management and control systems of Member States. The AARs of Directorate General for Regional and Urban Policy and the Directorate General for Employment, Social Affairs and Inclusion show clear improvement in this regard.

The Commission confirms that AOD's should systematically interrupt payment procedures and propose to the College that payment procedures be suspended as soon as the applicable conditions are met and until the necessary corrective measures have been implemented by the relevant national authorities.

The Commission's actions in this regard were also further harmonised in 2012, in particular in the area of cohesion policy where both the Director General for Regional and Urban Policy and the Director General for Employment, Social Affairs and Inclusion now apply the same approach. As regards interruptions and suspensions in agriculture, the Commission will look into amending the relevant Commission rules to allow for more targeted intervention. For the new programming period 2014-2020, the Commission's proposal for common provisions for the European Funds under shared management provides for further harmonisation of the interruption of payments for all these funds, including rural development, and the possibility for net corrections in some cases.

The Commission welcomes, and calls on the Council to endorse, the European Parliament's proposal for amending article 43 of the Commission proposal for a new regulation on the financing, management and monitoring of the Common Agricultural Policy for the new programming period 2014-2020 which would broaden the possibility for the Commission to suspend payments when serious deficiencies are detected and would allow for a further harmonisation of the legislation on suspension across policies.

6.4.1 Information on interruption and suspension of payments by the Commission

The services carrying out transactions in shared management mode have reported all interruption/suspension decisions in their AARs. This information includes the operational programmes concerned, the Member States affected, the type of weaknesses, the main facts triggering each decision and the budgetary impact of the decision. This information constitutes an important dimension of reasonable assurance and accountability.

Following the introduction of the new interruption instrument for the 2007-2013 programming period, the Directorates General operating in shared management took, in 2012, formal decisions to **interrupt payment deadlines to 140 cases totalling EUR 4.8 billion.** The College also adopted **seven[16] decisions suspending payments** to 2007-2013 programmes (during 2012 and first quarter of 2013). Payments will not be resumed until Authorising Officers by Delegation (AOD's) obtain clear audit evidence that reasons for interruptions and/or suspensions have been remedied the necessary financial corrections have been carried out and there are no further risks for future expenditure to be certified to the Commission.

6.4.2 Financial corrections imposed by the Commission on Member States

Financial corrections are imposed by the Commission on Member States that fail to implement sound systems.

[16] Two suspension decisions concerning the ERDF (a programme in Calabria (Italy) and in Saarland (Germany)), and five suspension decisions concerning the ESF (in the Czech Republic and Slovakia (in 2012), in France, Germany and the United Kingdom (in the first quarter 2013))

Overall the Commission was very active in 2012 in recovering undue amounts and making financial corrections. Financial corrections and recoveries implemented in 2012 across all policy areas amount to about EUR 4.3 billion (EUR 1.8 billion in 2011). The significant increase compared to the previous year is mainly explained by the closure exercise of the ERDF programme for the 2000-2006 period and the resulting financial corrections.

The Directorate-General for Regional and Urban Policies reported an amount of financial corrections resulting from EU audits implemented in 2012 of EUR 2.6 billion concerning the programming periods 1994-99, 2000-06 and 2007-13. On the same basis, the Directorate-General for Employment, Social Affairs and Inclusion reported EUR 430 million and the Directorate-General for Agriculture and Rural Development reported EUR 610 million.

Starting in September this year, the Commission will prepare a user-friendly presentation of the amounts recovered through financial corrections and recoveries in the course of the preceding year. This communication will respond to a request from the European Parliament. It will cover preventive and corrective actions and, wherever possible, their impact in ensuring a lasting improvement to management and control systems as reflected in the error rates.

6.4.3 Information from Member States on financial corrections and recoveries

Correcting amounts unduly paid is an important aspect of sound financial management. In 2012, continued efforts were made to make financial corrections when necessary, improve the quality of Member States data on financial corrections and recoveries, and promote the use of best practices so as to improve recovery mechanisms at Member State and EU levels.

Regarding shared management, the AARs provide detailed information on the financial corrections implemented and reported by Member States to the Commission and an assessment of the national control systems. In the area of cohesion policy, Member States implement financial corrections resulting from their own audit work and from EU audits. These are reported cumulatively for the programming period 2007-2013 with a one-year delay by 31 March, so in 2012 they reported on their 2011 corrections. In addition to corrections resulting from EU audits, Member states reported corrections following their own audits for an amount of EUR 938 million. Nevertheless, the AOD's reported the latest figures known at the time of signing their AARs[17].

6.5 Annual summaries and national declarations

The provision of reliable and complete financial information and audit data by the Member States is one area where improvements are necessary. This is why the Commission will continue to transmit a copy of the annual summaries of the Member States to the discharge authority in accordance with Article 319 of the Treaty on the Functioning of the European Union and of annex II of the Framework Agreement on relations between the European Parliament and the European Commission.

[17] For Agriculture, the information on financial corrections and recoveries relates to the year of the report.

The Commission also calls on the Member States to follow its guidance on the treatment of errors and annual control reports, as well as on annual summaries, to make them a valuable additional source of assurance for the Commission and a useful source of information for the discharge authority. The Commission encourages all Member States to follow the example of the Member States that have included assurance statements in their annual summaries and to take other measures to demonstrate their commitment to the sound financial management of EU funds and transparency. For 2012, 18 Member States have followed the Commission's recommendations and have provided a voluntary overall analysis and 11[18] provided a declaration on the overall level of assurance in their annual summaries.

The Commission considers that the overall assurance process relies on effective and reliable assurance statements from all actors, at both European and national levels and therefore encourages the issuing of national declarations. In its discharge resolution of 17 April 2013, the European Parliament requested to establish a template for national management declarations to be issued by Member States at the appropriate political level. The Commission is prepared to examine this request and is willing to invite the European Parliament and the Council to participate in a working group with the view to issue by the end of this year recommendations for the use of national declarations. For Agriculture, a declaration of assurance of the heads of the paying agencies, covering completeness, accuracy and veracity of accounts as well as legality and regularity of the underlying transactions is required.

The Commission is pleased that, as part of the revision of the Financial Regulation, annual management declarations by the bodies designated by the Member States to be responsible for the management and control of union funds are being introduced for all funds managed under shared management. The new provision on shared management introduces reinforced mandatory reporting, including the submission of compulsory management declarations, the accounts, annual summaries of audits and controls and audit opinions, as well as the possibility for the Member state to provide declarations at the appropriate political level based on the above information.

The Commission considers that the reinforced mandatory reporting should provide it with substantial additional assurance on the use of EU funds by Member States and contribute to more effective reporting by the Member States. Moreover, the Commission will continue to encourage Member States to use national declarations.

6.6 Commission Anti-Fraud Strategy (CAFS)

Following the adoption of the new Commission Anti-Fraud Strategy,[19] all Directorates-General are required to develop an anti-fraud strategy by 2013. Measures in this area (such as specific risk analysis of beneficiaries, close monitoring of selected projects or contracts, or any other measures to mitigate fraud risks) are already outlined in some of the AARs, together

18 For the ERDF and ESF, 11 Member States provided a voluntary 'Overall level of assurance statement' in their Annual Summary: Bulgaria, Cyprus, Denmark, Estonia, Finland, Malta, Portugal, Romania, Slovakia, Spain and the United Kingdom.

19 COM(2011) 376 final.

with the specific results of anti-fraud actions taken during the reporting year and any elements of assurance that can be drawn from them. This will be generalised in the 2013 AARs.

The Commission welcomes the fact that most DG's are already well advanced in the development and implementation of an anti-fraud strategy. All services are instructed to do this by the end of 2013. The Commission instructs its services to continue to include information on fraud prevention as part of their assessment of their internal control systems.

On 6 December 2012, the Commission adopted a comprehensive and ambitious action plan on fighting tax fraud and tax evasion. A series of measures are proposed to better combat tax fraud and evasion, including VAT fraud. The plan includes the Quick Reaction Mechanism against VAT fraud that the Commission proposed in July 2012. It enables Member States to apply where necessary a 'reverse charge mechanism' making the recipient of the goods or services liable for VAT. This would significantly improve the Member States' capacity to effectively tackle complex fraud schemes, such as carousel fraud. In order to deal with possible new forms of fraud in the future, other anti-fraud measures can also be authorised and established under the Quick Reaction Mechanism. Moreover, the action plan was accompanied by two recommendations to Member States promoting specific countermeasures to deal with aggressive tax planning and to treat the issue of tax havens. As regards customs duties, the Commission is thoroughly following up the recommendations made by the European Court of Auditors in past and recent audits.

The Commission has also put forward an ambitious proposal for a Directive on combating fraud detrimental to the EU's financial interests by means of criminal law. The new rules, when adopted, would harmonise and strengthen the protection of EU revenue.

This priority action also raises the issue of the impact of uncollected revenues on the availability of the EU own resources. The Commission would like to reassure all concerned that, wherever relevant, it will reiterate the general imperative of effective revenue collection.