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EUROPEAN
COMMISSION

Brussels, 11.6.2014
COM(2014) 342 final

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

Synthesis of the Commission's management achievements in 2013

1. EXECUTIVE SUMMARY

In adopting this synthesis report, which is based on the assurances and reservations registered by the Directors-General and heads of service in their annual activity reports, the Commission takes overall political responsibility for the management of the EU budget.

In the area of the *direct management* of EU funds, the Commission considers that strengthened internal control systems and genuine simplification of eligibility and other rules have been key elements in aiming at a reduction in error rates. However, **more detailed controls are costly and the Commission considers that additional controls should be performed only where the potential benefits can be shown to outweigh the costs** to the Commission and the beneficiaries.

To address specific challenges in *shared management*, the Commission takes a clear position on a number of issues:

- **Member State authorities should make maximum use of all available instruments** to prevent errors and effectively discharge their responsibilities and obligations for all programmes under shared management, in order to protect the EU budget. They should tackle remaining deficiencies in their management and control systems. The Commission will continue to supply **meaningful control indicators and statistics**, which facilitate thorough analysis of Member States' management of the funds;

- **The Commission will intensify its audit framework and strategy,** where appropriate, to identify remaining weaknesses in the systems of the Member States, in particular those with the highest risk profiles concerning the implementation of EU programmes;

- **The Commission will continue to implement the rules on the suspension and interruption of payments** where serious shortcomings have occurred. If necessary, it will use the new mechanism for suspending agricultural payments as a new ex-ante instrument to protect the EU budget from weaknesses in Member States' control systems;

- The Commission imposes **financial corrections** on Member States that fail to implement sound systems. It will use the net financial corrections instrument whenever the conditions laid down in the new legal framework are fulfilled.

The financial scope of the reservations made by Directors-General increased as compared with 2012. This is the result of additional efforts, in terms of both resources and methodology, to assess more accurately the amounts at risk and residual error rates. It is certainly not due to a deterioration in financial management by the services. As the **programmes and control systems are multi-annual**, the real effect of weaknesses of the supervisory and control systems and of the management of the EU budget can be judged only by taking into account the financial impact of corrective measures in subsequent reporting years.

In this report, the Commission takes stock of the main achievements in improving the performance measurement and reporting systems. It reiterates its strong commitment to strengthen further these systems. In a concern to keep its reporting structures as streamlined as possible, a number of concrete

- As concerns the different overview reports, such as the evaluation report and the synthesis report, central services should do the necessary to avoid overlapping;

- As regards the individual annual activity reports: part 1 should present a fair and true view of the state of policy achievements. This is best done in the same format as in the planning documents. The declaration of assurance should focus on management and financial matters.

2. 1 ACCOUNTABILITY CHAIN AND MANAGEMENT REPORTING

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 requires Member States to cooperate with the Commission to ensure that the appropriations are used in accordance with these principles.

The college of Commissioners delegates 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 organisation of management is characterised by a clear demarcation of the various actors' responsibilities. The **authorising officers by delegation (AODs) are fully empowered to establish the most appropriate and effective control system** for ensuring the sound and efficient management of the resources for which they are responsible. The annual activity reports are the main means by which they account for their stewardship of the human and financial resources for which they are responsible. In them, they report on the performance of their duties[1] and document any issues arising from their management that need to be brought to the attention of the college.

Each annual activity report includes a signed declaration of assurance in which the Director-General or head of service, in his/her role as authorising officer by delegation, provides assurance concerning the true and fair view given by the report and concerning the legality and regularity and the sound financial management of all financial transactions under his/her responsibility, as well as for the non-omission of significant information. If deemed necessary, the declaration contains reservations related to defined areas of revenue and expenditure.

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[1] Article 66 of the Financial Regulation.

In part 1 of the annual activity report, the authorising officer by delegation provides information, on an annual basis, on the progress towards the achievement of the policy objectives established in the management plan, on the basis of available information at the moment of reporting. This information covers inputs, outputs, mid-term results and long-term impacts. A distinction should be drawn between the Commission's responsibility for reporting on the progress made towards policy objectives and accountability for their attainment. **Commission departments are accountable for the implementation of the budget and the management of the financial programmes** having due regard to the management mode. Moreover, whilst the Commission is engaged in making these financial programmes deliver the desired effects on the ground, the co-legislators, Member States' authorities and several other players at national, regional or local level have also an impact on the achievements of results and impacts. In addition, many external factors (social, demographic, economic and environmental), far beyond the control of the Directors-General, affect policy achievements (or failures) resulting from Commission departments' initiatives.

To ensure that declarations of assurance in the AARs remain fully in line with its financial responsibility for implementing the EU budget, the Commission confirms that they should focus on management and financial matters.

Each annual activity report confirms explicitly that the Commissioner(s) responsible has(have) been informed of the main aspects of the report, including any reservations the AODs intend to lodge, before final signature of the declaration of assurance.

This report was adopted after discussion by the college on 11 June 2014. **In adopting this synthesis report, which is based on assurances and reservations registered by the Directors-General and heads of service in their annual activity reports, the Commission takes overall political responsibility for management of the EU budget. In the report, the Commission also identifies the key management issues to be addressed as a matter of priority and action to be taken to address weaknesses that have been identified.**

Besides this synthesis of management achievements, the Commission will also present a synthesis of the results achieved by the spending programmes. This is done in the annual evaluation report on the Union's finances based on the results achieved, which is required by Article 318 of the Treaty on the Functioning of the European Union ('the Article 318 evaluation report'). The synthesis report and the Article 318 evaluation report each serve specific purposes and are the starting point for the budget discharge procedure. **For a broader readership, a wide range of other information is available on the Europa website.** Stakeholders requiring more detailed budgetary information can consult the Commission’s Report on Budgetary and Financial Management.[2] Citizens looking for more general

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[2] This report does include a description of the objectives achieved for the year, in accordance with the principle of sound financial management (Article 227 Rules of Application (RAP) to the Financial Regulation). In accordance with Article 141 of the financial regulation, all institutions and bodies of the consolidated accounts prepare an annual report on the budgetary and financial management of their

information on the achievements of the Europe 2020 strategy will find reports on the relevant flagship initiatives and individual spending programmes[3] on the respective websites.

The Commission instructs its departments to ensure that relevant, up-to-date information, tailored to the needs of different users, is available and to identify reports that are outdated or redundant so as to streamline reporting on achievements.

3. 2 STRENGTHENING THE COMMISSION'S PERFORMANCE MANAGEMENT FRAMEWORK

The ex-ante setting of objectives and indicators for spending programmes and non-spending activities in management plans and the ex-post measurement, evaluation and reporting of achievements are central elements of the Commission's performance management framework. This so-called mirroring has allowed the performance framework to be made more objective.

Following its undertaking in the 2012 synthesis report, the Commission has been working to strengthen its performance framework. This important shift of emphasis will allow provide evidence of the results and impacts of EU activities in the medium to long term.

The Commission has taken a step-by-step approach. First, it has ensured that the legal bases of the 2014-2020 spending programmes include a more coherent framework for monitoring, evaluation and reporting on their performance. Secondly, the frameworks have been incorporated into the Directorates-General (DGs') 2014 management plans and, starting with the 2014 annual activity reports and the next edition of the Article 318 evaluation report, will serve as a basis for reporting on achievements. Thirdly, the Commission has undertaken to improve the performance framework for the 'non-spending activities[4]', starting with the 2015 management plans.

In addition, the **Internal Audit Service (IAS)** is carrying out a number of performance audits as part of its 2013-15 Strategic Audit Plan. In 2013, the IAS carried out 12 audits with a prevailing focus on performance issues. During the course of the audits, certain common findings began to emerge, in particular concerning systems of performance measurement, the management of human resources and management of IT projects and IT security. More detailed information on performance audits will be made available to the discharge authority as part of the report on internal audits required by Article 99(5) of the Financial Regulation.

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administrative expenditure. The report of the Commission deals with the operational expenditure of the European Union.

3 Such as the Annual Growth Survey, national reform programmes and the dedicated portal on Europe 2020 available on http://ec.europa.eu/europe2020.

4 'Non-spending activities' are being referred to as those activities which have no major operational budget other than administrative expenditure.

The Commission also considers the **European Court of Auditors' special reports to be very valuable instruments** for developing its performance management system further in various policy areas.

2.1 Performance requirements in the 2014-2020 Multiannual Financial Framework

Throughout 2013 and early 2014, the monitoring, evaluation and reporting elements established in the legal bases of the programmes under the 2014-2020 Multiannual Financial Framework (MFF) were elaborated further in a number of implementing and delegated acts and, in the case of the European structural and investment (ESI) funds, embedded in partnership agreements with the Member States and operational programmes. In addition, financial incentives have been built into the ESI funds in the form of a performance reserve (see section 2.6).

All performance frameworks for the 2014-2020 programmes and funds comply with the performance-related principles enshrined in the Financial Regulation. They include accurate and **detailed information on the added value** of the 2014-2020 financial interventions and their relevance to the Commission's strategic objectives and the EU's sectorial policy objectives, and specific objectives, along with quantitative and qualitative indicators measuring their achievement. It is important to remember that the co-legislators[5] were closely involved in the setting of the programme objectives and performance indicators.

2.2 Management plans

In the last quarter of 2013 and early 2014, the Commission departments incorporated **the main elements of the performance frameworks for the new spending programmes into the 2014 management plans**. These elements consisted of the objectives and indicators, and also the monitoring, evaluation and reporting provisions in the legal bases of the programmes. Particular attention was paid to establishing relevant baselines and sufficiently ambitious and realistic milestones and targets. Where appropriate, and given the time-lag between implementation of the spending programmes and their expected outcomes, Commission departments set additional internal indicators in order to be able to demonstrate meaningfully in their annual activity reports that the programmes are on track to deliver expected results. In addition, the DGs responsible for programme management described the intervention logic of each programme and fund (i.e. linkages between resources used, outputs produced and set objectives). In this context, they also explained how their own planned actions and deliverables would contribute to the achievement of programme objectives. The central services supported the preparation of the 2014 management plans, in particular by organising dedicated peer-review meetings.

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5 The Commission summarised the results of the legislative process of the 2014-2020 Multiannual Financial Framework in a dedicated Communication: "Final Simplificaiton Scoreboard for the MFF 2014-2020", COM(2014) 114 final.

It is important to note that, in several cases, the objectives in the DGs' management plans relate to societal problems that are being addressed in a variety of ways, including financial intervention, policy coordination, regulatory action and law enforcement organised at different levels of government. Separating out the DGs' contributions to the achievement of these objectives from the influence of external factors and the participation of other actors represents a considerable challenge. Nevertheless, **the Commission departments have a responsibility to monitor achievement of the Commission's political objectives and main policy priorities, with a focus on changes that will make a difference to the lives of EU citizens.**

The Commission welcomes the improvements made to the management plans for the spending activities with a view to reflecting appropriately the performance frameworks for the 2014-2020 spending programmes. It instructs its central services to develop the necessary guidance to strengthen also performance measurement and reporting for the "non-spending activities", such as law-making, monitoring and enforcement, policy development and coordination, and administrative support activities. The objective should be to focus on results (policy performance) while demonstrating the extent to which the Commission's own intervention (its performance) has influenced or contributed to their achievement.

2.3 Annual activity reports

The annual activity reports have become an important source of information, in particular for the European Court of Auditors and the discharge authority. Over recent years, the AODs have deepened 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 policies have generated added value for EU society.

The Commission considers that it has made significant progress in recent years in reporting on policy achievements, in addition to management achievements, and that its DGs' annual activity reports contain a wealth of useful information on policy objectives, results attained and their impact on society.

The 2014 annual activity reports and the subsequent Article 318 evaluation report will contain first elements of reporting on progress towards reaching the objectives of the new MFF programmes, albeit in relation to a very early stage of programme implementation.

In addition to a number of adjustments to the structure of the annual activity reports (see section 3.2), several measures have been taken to ensure a sharper focus on performance:

- the inclusion of examples of efforts to improve efficiency and economy of management;
- the incorporation of more exhaustive performance information from various sources, e.g. evaluations, studies, audits and impact assessments;
- the inclusion of representative examples demonstrating the EU added value of the programmes; and

- a closer alignment of management plans with annual activity reports (e.g. by using the same templates for reporting on objectives and indicators in both cases).

The Commission instructs the central services to build on this experience and enhance the strategic planning and programming (SPP) documents so that, over time as information becomes available, stronger and more comprehensive analysis of the extent to which EU spending has contributed to achieving general policy objectives becomes available. Central services should investigate whether more dedicated reports should be developed or the existing reporting tools can be enhanced for this purpose.

The central services have checked the annual activity reports for compliance with the standing instructions. The difficulties experienced by a number of Commission departments in complying with the instructions demonstrate a need for additional guidance and assistance from the central services on performance reporting. For instance, fewer than half of the DGs illustrated the annual activity report with appropriate **examples of concrete achievements under spending programmes**. 80 % provided examples of **initiatives to improve the efficiency and economy of their operations,** but the **quality of the examples varied**.

The Commission instructs the central services to develop a more tailor-made approach (e.g. by 'families' of services) to performance reporting in the 2014 annual activity reports, in particular to demonstrate better the Commission's responsibility in achieving policy objectives and to report on initiatives to improve the efficiency and economy of operations.

2.4 Evaluation report (Article 318 TFEU), a Commission-wide evaluation of the results of EU funding

In June 2013, the Commission reported[6] for the third 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 progress in programme implementation, and the impact and results achieved by EU funding. The report covers EU programmes in all policy areas involving MFF expenditure. Other performance-related information was included in addition to evaluation results.

The Commission is working continuously to improve this reporting. Incorporating the Article 318 report into the strategic planning and programming (SPP) cycle requires it to be based on the information on evaluations in the annual activity reports, which in turn has required more focus on evaluations in Part 1 of the annual activity reports. This incorporation also ensures that performance indicators and targets are in line with those in the other SPP documents.

[6] COM(2013) 461 final.

Various evaluations have provided useful information on the policy achievements reported on in those reports. However, not all evaluations directly serve the purpose of the annual activity reports as, for example, the time frame they cover may not correspond to the year in question.

The Commission instructs its services to strengthen the performance-related aspects (i.e. results and impacts) of its monitoring and evaluations, so as to improve performance reporting in the evaluation report.

2.5 Reporting on the Europe 2020 strategy and the added value of the EU budget

The Commission has taken several measures with a view to demonstrating the importance of the quality of spending and the added value of the EU budget. For example, it presented a comprehensive report on the added value of EU spending in support of its proposals for the new generation of programmes under the new MFF.[7] In addition, all legal proposals for a new spending programme or fund included an assessment of their added value and their contribution to the Europe 2020 strategy.

2.6 Budget allocation by Member State and performance reserve

For the new MFF, the newly created performance reserve mechanism under the ESI funds will help to provide further incentive to achieve targets. The performance reserve represents 6 % of the total allocation for the 'investment for growth and jobs' goal, the European Agricultural Fund for Rural Development (EAFRD) and shared management measures in the area of maritime and fisheries policy. Member States and regions will have to announce in advance what objectives they intend to achieve with the available resources and identify precisely how they will measure progress. This will involve regular monitoring and follow-up of how financial resources are used. The reserve will be allocated only to programmes and priorities that are assessed, in a final performance review to be carried out by the Commission in 2019, as having achieved their milestones. This will facilitate sharper focus on performance and attainment of the objectives of the EU strategy for smart, sustainable and inclusive growth, and fund-specific objectives.

4. 3 IMPROVING THE QUALITY OF THE ANNUAL ACTIVITY REPORTS

3.1 Assessment by the European Court of Auditors

In its 2012 annual report, the Court of Auditors reviewed the annual activity reports for 2012. In general, its main observations refer to the need for a more coherent approach to determining scope and quantifying reservations, in particular as regards the amount at risk and the residual error rate. Since then, the Commission has made a specific effort to define (see Annex 2) and estimate (see section 4.1) the amount at risk in a consistent and comparable way across DGs.

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7 *Report on the added value of EU spending*, (SEC(2011) 867).

3.2 Revision of the structure of annual activity reports

The structure of the 2013 annual activity reports was revised significantly to help AODs comply with reporting requirements under the new Financial Regulation and to respond to a number of audit recommendations.

Over the past decade, the reports have proved their usefulness for both internal and external stakeholders. As a result, the Commission receives regular requests to include additional data and information. The revised instructions respond to these requests where possible, while making it clear that the reports are management reports to the college and, as such, must contain management conclusions on the achievement of policy and operational objectives, the functioning of internal control systems and, for financial management, information on whether the AOD has reasonable assurance that the resources assigned to the activities have been used for their intended purpose and in accordance with the principles of sound financial management. The information assessed in the report must be relevant in terms of supporting these conclusions.

In revising the instructions, much effort has been devoted to ensuring that the reports include only what is relevant and to improve clarity and consistency across DGs. The aim is to ensure compliance, conciseness, clarity and consistency while at the same time reducing the reporting burden.

The instructions have undergone **thorough examination with a view to excluding non-essential requirements**. As a result, there is now a clear distinction between compulsory requirements and guidance.

The reports are structured in three layers, with increasing degrees of detail, to meet the diverse needs of the various information users:

(1) an executive summary setting out concisely and in an accessible way for the non-specialist reader the main policy achievements and the management conclusions on control and assurance;

(2) the body of the report, providing the elements underlying the conclusions in the executive summary; and

(3) annexes containing more detailed (technical) information.

The use of a template with suggested introductory paragraphs has resulted in significantly greater clarity and comparability across DGs. The executive summaries have proved to be particularly useful to retrieve key information readily available on all DGs.

The Commission instructs its services to take steps to maintain an appropriate level of transparency, while keeping the annual activity reports to a reasonable length. The central services are further instructed to support them and to identify best practices.

3.3 Strengthened peer review process

In a continuing quest for further improvement, the central services work from an early stage to support the DGs in drafting the annual activity reports. They discuss key issues with them and provide guidance when needed. Peer reviews have proven to be an effective platform for sharing opinions on how to formulate cross-cutting issues and tackle weaknesses. Also, the Internal Audit Service was actively involved in these discussions and provided early feedback on the draft AARs.

3.4 Cost-effectiveness of controls

The revised Financial Regulation[8] includes new provisions requiring AODs to take account of risk and cost-effectiveness when setting up internal control[9] systems (Article 66(2) Financial Regulation) and determining the frequency and intensity of controls (Article 49 Rules of application of the Financial Regulation). AODs are now also required to include the overall cost and benefits of the controls in the annual activity report (Article 66(9) Financial Regulation).

The primary purpose of assessing the cost-effectiveness of controls is to support management decision-making concerning the design of the control systems and the allocation of related resources. Control strategies and systems should **ensure higher control intensity and frequency in riskier areas and ensure that controls consistently add value**.

The Commission's Central Financial Service has helped AODs throughout the Commission to develop a 'risk-differentiated' approach to control. To support implementation of this approach in an efficient manner, it has set up working groups and provided guidance on the revision of the internal control strategies, templates and examples of how to define and calculate the requisite cost-effectiveness indicators for the four main kinds of expenditure and management modes. All annual activity reports include control strategies in line with the proposed structure, so that it is possible to:

- establish a direct link between risks and controls;
- identify criteria for adapting control frequency and intensity to the risks; and

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8 The revised Financial Regulation entered into application in January 2013.
Financial Regulation: Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the General budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L298, 26.10.2012, p.1)
Rules of application: Commission Delegated Regulation (EU) No 1268/2012 of 29 October 2012 on the rules of application of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (OJ L362, 31.12.2012, p. 1)

9 The Financial Regulation defines 'control' as any measure taken to provide reasonable assurance as to the achievement of the internal control objectives. This entails all-encompassing internal control systems, covering all measures for the management of budget appropriations, from identifying needs and objectives, which precedes any legal commitment, to final decisions closing multi-annual programmes.

– develop indicators for assessing control effectiveness and efficiency.

However, further work is required to make better use of this information to modulate control intensity and frequency according to risk. Significant gaps are apparent as regards establishing indicators for control effectiveness. This is mainly due to the lack of systematic registration of control results and difficulties in estimating the benefits of control.

The Commission welcomes the efforts to review the internal control strategies to ensure that controls are efficient and cost-effective. Its services should continue to adjust control intensity to the risks they confront, with due regard to their impact on the achievement of policy objectives. Furthermore, it instructs the Director-General for Budget to continue to develop further guidance, identifying a limited number of cost-effectiveness indicators which could be used across the Commission, and define more precisely the methodology to be used to calculate them.

5. 4 ASSURANCE GATHERED THROUGH THE ANNUAL ACTIVITY REPORTS AND RESERVATIONS BY THE DIRECTORS-GENERAL

Having examined the annual activity reports, in particular the AODs' declarations, and noting their reservations, the Commission notes that they all give reasonable assurance as to the use of resources for the intended purpose, observance of the principles of sound financial management and the fact that control procedures give the necessary guarantees of the legality and regularity of the underlying transactions.

4.1 Number of reservations and amount at risk

The number of reservations in the annual activity reports fell from 29 in 2012 to 21 in 2013. There were three[10] new reservations, while eleven were lifted.[11] Four reservations are 'reputational', while the other seventeen concern the legality and regularity of financial operations.

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[10] The most significant new reservation concerns the European Agricultural Guarantee Fund (EAGF) market measures and the second the Instrument for Pre-Accession Assistance in Rural Development (IPARD) (both DG Agriculture and Rural Development). The third is reputational and relates to accountability issues in European Schools (DG Human Resources and Security).

[11] To lift a reservation, AODs were asked to demonstrate that the weaknesses had been effectively addressed. The reservations lifted concerned:
- four remaining FP6 reservations (research DGs);
- certified organic products (DG Agriculture and Rural Development);
- the Financial Instrument for Fisheries Guidance (FIFG) (DG Maritime Affairs and Fisheries);
- the European Energy Programme for Recovery (EEPR) (DG Energy);
- the second-generation Schengen Information System (SIS II) project (DG Home Affairs);
- the reliability of the financial reporting of the European Space Agency (DG Enterprise and Industry);
- election observation missions (Service for Foreign Policy Instruments); and
- the revenue-related reservation on traditional own resources (TOR) (DG Budget).

The number of reservations is not an indicator of the number or extent of the problems encountered by the services because a single issue may affect programmes managed by several services and may result in a disproportionately high number of reservations being issued.[12] Also, the nature and scope of the underlying causes or constraints are seldom comparable. As the lifted reservations were associated with spending activities with lower financial volumes, the **lower number did not translate into a reduction in the scope or amount at risk[13]**. On the contrary, both the scope and the financial exposure from the reservations increased in 2013.

The AODs identified the main reasons for their reservations and set out remedial actions to address them. Annex 1 to this report provides a quantified overview of the reservations and the following table shows the amount at risk (EUR 3 807 million) for the part of expenditure under reservations (scope of EUR 129 149 million).

Table. 2013 reservations — scope and amount at risk (EUR million)[14]

Area	Total expenditure	Scope	Amount at risk
Agriculture	58 227	58 051	1 888
Cohesion	58 912	57 723	1 506
Subtotal shared mgmt.	*117 139*	*115 774*	*3 394*
External aid	6 383	3 768	126
Research	11 539	6 291	180
Other internal policies	4 217	354	8
Administration	5 488	0	0
Subtotal direct/indirect mgmt	*27 626*	*10 412*	*314*
Total EU budget	144 766	126 186	3 708
EDF	2 963	2 963	99
Total	147 729	129 149	3 807

12 This applies particularly in the area of research policy, where the issues regarding the management of the framework programmes concern six DGs and two executive agencies.

13 The concept of amount at risk is defined in annex 2.

14 Unless otherwise indicated, the sources for all figures quoted in the present report are the provisional consolidated accounts of the EU for the 2013 financial year and the AARs. In case of discrepancy, the figure used is that of the provisional accounts. These instances are specifically disclosed.

Financial reservations are made when the amount at risk exceeds the 2 % materiality threshold. However, the remainder of the expenditure, which is not included in this scope, is not necessarily free from instances of non-compliance. Nevertheless, the amount at risk on this expenditure free from reservations will not be higher than 2% and therefore represents maximal EUR 372 million[15] in 2013.

Therefore, the **Commission is confident that the maximum total amount at risk** for the entire 2013 expenditure (EU and EDF budget), including both amounts at risk on expenditure under reservation and expenditure not under reservation, is below EUR 4 179 million (EUR 3 807 million + EUR 372 million) which **corresponds to 2.8 %[16] of all expenditure disbursed.**

In 2013, in accordance with the Financial Regulation and sector-specific rules, the **Commission implemented financial corrections and recoveries amounting** to EUR 3 362 million, which represented **2.3 % of payments** from the EU budget. The drop from 2012 (EUR 4 419 million) is due to a significant case (representing 49 % of the total amount of financial corrections implemented in 2012) related to the implementation in 2012 of a financial correction of EUR 1.8 billion concerning Cohesion Fund 2000-06 programmes in Spain. The resulting decrease by 34% of financial corrections implemented in 2013 (from EUR 3 742 million to EUR 2 472 million) was only partially compensated by an increase by 31% of recoveries implemented in 2013 (from EUR 678 million to EUR 890 million).

The multi-annual character of the controls and audits designed in accordance with Article 59 of the Financial Regulation, including ex-post controls by the Commission and Member States, implies that **cumulative figures have to be used to provide a more meaningful picture of the significance and effectiveness of the corrective mechanisms applied by the Commission and the Member States and their impact on the residual amount at risk.** The following indicators demonstrate clearly an increasing trend in the financial impact of the corrective capacity of the Commission's supervisory and control systems for the last five years. The total amount of financial corrections and recoveries in 2013 (EUR 3 362 million) exceeds by EUR 632 million the average amount for 2009-13 (EUR 2 730 million). For the period 2009-2013, the average amount of financial corrections and recoveries represented 2.13% of the average amount of payments from the EU budget, while for 2009-2012 it represents 2.07%.

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15 EUR 372 million corresponds to 2 % on the difference between EUR 147 729 million and EUR 129 149 million

16 Errors should not be confused with fraud. Errors are mistakes such as not filling out a form correctly, or not respecting the proper tendering procedure. Only a minority of errors are committed deliberately. Fraud is a deliberately committed irregularity constituting a criminal offence. Cases of suspected fraud are systematically forwarded to the European Anti-Fraud Office (OLAF).

4.2 Revenue

Concerns as to the reliability of the Belgian authorities' traditional own resources declarations were addressed by means of improved internal controls. As a result, the Director-General for Budget was able to lift **the reservation concerning insufficient assurance of the reliability of Belgium's clearance and accounting systems**.

4.3 Administrative expenditure

DG Human Resources and Security entered a reputational reservation following the European Court of Auditors' findings on the European Schools' annual accounts for 2012 and the detection of **irregularities linked to potential fraud in relation to one of the schools**.

DG Human Resources and Security has already taken measures, under the existing governance framework, such as continued insistence on the implementation without delay of the recommendations from the Court and the IAS, in particular regarding the new accounting system (SAP). In addition, it will take the opportunity of the revision of the Financial Regulation of the European Schools to propose the way of re-designing the accountability system of European Schools.

The Commission instructs DG Human Resources and Security to help strengthen control procedures and to improve the overall control environment in the European Schools by continuing to insist, via the Board of Governors, that the Schools take the necessary decisions and action. The Schools must follow up on the recommendations from the European Court of Auditors and the Internal Audit Service, in particular as regards the new accounting system.

4.4 Agriculture and rural development, environment, fisheries and health

The Director-General for Agriculture and Rural Development issued **a new reservation on the market measures funded by the European Agricultural Guarantee Fund (EAGF)** for miscellaneous aid schemes in nine Member States (Austria, the Czech Republic, France, Italy, the Netherlands, Poland, Spain, Sweden and the United Kingdom). The amount at risk corresponds to 7.43% of the expenditure disbursed. For the majority of the measures concerned, the deficiencies were identified by the Commission in the course of on-the-spot audits. In the other cases (producer organisations in the Netherlands and school milk schemes in France and Sweden), the reservation was triggered by the high error rate reported by the paying agency or certifying body. In all cases, the necessary corrective actions have already been identified and notified to the Member States concerned.

The Director-General **maintained his reservation on direct payments from the EAGF** for 20 paying agencies in six Member States (Spain (15), France, the United Kingdom (England), Greece, Hungary and Portugal). The amount at risk corresponds to 2.34% of the expenditure disbursed. As the deficiencies were identified by the Commission itself, the necessary corrective actions have already been identified and those Member States have been notified.

The Director-General **maintained his reservation on expenditure from the European Agricultural Fund for Rural Development (EAFRD) in respect of 31 paying agencies in 19 Member States** (Belgium, Bulgaria, Cyprus, Germany (2), Denmark, Spain (6), Finland, France (2), the United Kingdom (2), Greece, Hungary, Ireland, Italy (5), Luxembourg, the Netherlands, Poland, Portugal, Romania and Sweden). The amount at risk corresponds to 5.12 % of the expenditure disbursed. As the deficiencies were identified by the Commission itself, the necessary corrective actions have already been identified and those Member States have been notified.

The Director-General also issued **a new reservation on expenditure in Turkey from the Instrument for Pre-Accession Assistance in Rural Development (IPARD)**. The amount at risk corresponds to 5.46 % of total IPARD expenditure.

The Director-General for Maritime Affairs and Fisheries **maintained her reservation on the European Fisheries Fund (EFF) management and control systems** (eligibility of declared expenditure for six Member States (the Czech Republic, Denmark, Spain, Finland, the Netherlands and the United Kingdom). **Payments in respect of the six programmes in question have been or will be interrupted**. An action plan will be developed for each case, specifying measures to be taken to rectify the weaknesses that gave rise to the high error rates, and the applicable timeframes. Payments will resume only when these issues have been satisfactorily addressed. The amount at risk of these six programmes with high error rates represent together only 1.91% of the total EFF payments.

4.5 Regional policy, energy and Transport

The Director-General for Regional and Urban Policy maintained two reservations. The main one relates to the **2007-13 European Regional Development Fund (ERDF)/Cohesion Fund/Instrument for Pre-Accession Assistance (IPA)** management and control systems, in 2013, for 68 operational programmes in 15 Member States (Austria, Belgium, Bulgaria, the Czech Republic, Germany, Estonia, Spain, Hungary, Italy, Malta, the Netherlands, Poland, Slovenia, Slovakia, and the United Kingdom), five European territorial cooperation programmes and two IPA programmes. The amount at risk corresponds to 2.66% of the ERDF/CF and IPA payments made in 2013. The other reservation relates to the **2000-06 ERDF/Cohesion Fund** management and control systems, in 2013, for five operational programmes in Italy and Ireland and for the Cohesion Fund (transport sector) in Poland and Romania, but with no final payments affected in 2013.

In each case, specific action has been taken or planned, including:

- warning letters to prevent submission of payment claims concerning irregular expenditure;
- suspension of payment deadlines;
- launching correction procedures when the Commission considers that the national authorities did not sufficiently carry out checks prior to winding-up projects;

- complementary guidance and support for national authorities;
- audit peer reviews to check the ability of national auditors to fulfil their obligations;
- updating of the audit plan and a continuous focus on risk-based audits; and
- the monitoring of implementation of agreed remedial action plans following the interruption/suspension of payments.

As regards the 2000-06 programming period, specific action has been taken or planned in each case, including:

- launching the financial correction procedure as part of the closure process; and
- asking the authorities to carry out further checks before winding up the projects.

4.6 Employment and social affairs

The **Director-General for Employment, Social Affairs and Inclusion maintained two reservations** for serious deficiencies in key aspects of the management and control systems for identified operational programmes. The main reservation is a financial reservation for the 2007-13 European Social Fund (ESF) in 2013 for 36 operational programmes in 11 Member States (Belgium, the Czech Republic, France, Germany, Ireland, Italy, Poland, Romania, Slovakia, Spain and the United Kingdom). The amount at risk for the 2007-2013 reservation corresponds to 2.4 % of the payments made for the ESF in 2013.

The other reservation concerns a reputational reservation for 2000-06 ESF in 2013 for six operational programmes in four Member States (France, Italy, Sweden and the United Kingdom). As regards the 2000-06 programming period, there is no financial risk, as final payments will be executed only when all issues are resolved and agreement has been reached with the Member States concerned on the level of financial correction to be applied. The Commission has taken or plans specific action for each programme in question, with a view to obtaining assurance that the required corrective measures have been implemented.

In addition to pursuing a strict policy of interruptions and suspensions to protect EU funds, the Commission actively promoted the benefits of using simplified cost options for the ESF in the context of negotiations for partnership agreements and operational programmes for the 2014-20 programming period.

As Spain still accounts for a third of the operational programmes under reservation, a specific targeted action plan will be developed in close cooperation with the Spanish authorities to address the specific issues identified.

DG Employment, Social Affairs and Inclusion will also closely follow Romania's implementation of the action it had requested to improve the management and control system.

4.7 External relations, development aid and enlargement

The **Director-General for Development and Cooperation — EuropeAid maintained his overall reservation**, i.e. covering all activities and management cycles, since the **overall residual error rate in terms of legality and regularity of underlying transactions was 3.35 %** in 2013. An action plan has been drawn up following the 2012 reservation. This action plan is already being implemented and also addresses the recurrent reservation.

4.8 Research and other internal policies

A third of the reservations in the 2013 annual activity reports relate to the Seventh Research Framework Programme (FP7). This is due to the fact that the programme is implemented through six distinct DGs and two executive agencies. As the detected error rate from the common representative audit sample was 4.14% at the end of 2013, all relevant AODs maintained their reservation. Only the European Research Council Executive Agency (ERCEA) and the Research Executive Agency (REA) did not do so, for two specific sub-populations (the Ideas and People projects) that have different beneficiary profiles and simpler grant modalities, leading to lower-than-average error rates for the programme.

The director of REA made a reservation related to the specific sub-population of small and medium-sized enterprises (SME projects) because he judges that the residual error rate may be up to 14% due to the relatively higher risk profile.

Simplification measures introduced in 2011 have had a positive impact on the error rate. However, the Commission considers that possibilities for simplifying the rules have been exhausted for FP7.

The Commission instructs the services managing the Seventh Research Framework Programme to maintain measures to reduce errors, e.g. through ongoing efforts to give guidance and feedback to participants and certifying auditors to prevent errors occurring. The control and audit work should be continued, balancing legality and regularity with other objectives such as the attractiveness and success of EU research policy, international competitiveness, scientific excellence, encouraging participation by small and medium-sized enterprises and containing the costs of controls.

The **Education, Audiovisual and Culture Executive Agency (EACEA) maintained its reservation on the Lifelong Learning Programme (LLP)** in view of the residual error rate (3.04%) still above 2%. The agency is analysing the most frequent errors and, if necessary, takes further action, taking into account the cost and benefits of any corrective measures. The mandatory use of audit certificates by beneficiaries, together with improved communication on financial obligations, should allow the 2% materiality threshold to be reached for projects committed in the last year of the current programming period, namely 2013. However, based on an estimate of the director of EACEA, the error-rate for the entire 2007-13 Lifelong Learning Programme will trigger a the reservation for at least a couple of years.

The Director-General for Climate Action maintained his reputational reservation relating to remaining significant security weaknesses identified in the EU Emissions

Trading System (EU ETS) Registry. Following the organised cyber-attacks on some national registries between November 2010 and January 2011 and the theft of a considerable number of allowances, significant and systemic weaknesses were detected in the relevant security provisions. An operator lodged a complaint against the Commission before the European Court of Justice about the theft of allowances. This led to the recording of a contingent liability of EUR 16.2 million in DG Climate Action's accounts. The proceedings in court are ongoing. There were no security incidents in 2012 or 2013, but the Commission continues to improve the security level. The 'security statement' issued jointly by DG Climate Action and DG Informatics at the end of January 2013 includes an action plan proposing five additional security measures to address jointly six identified business risks. The timely and successful rolling out of the action plan by 2015 would provide reasonable assurance that the residual risk of any successful cyber-attack had been reduced to an acceptably low level.

The Director-General for Health and Consumers maintained her reservation on **the accuracy of Member States' cost claims (residual error rate of 2.3 % in 2013) under the animal disease eradication and monitoring programmes in the food and feed area**. The DG had already taken a number of mitigating measures to reduce the error rate in that area. A more precise and restrictive definition of eligible expenditure was introduced in the Commission Decision on the veterinary programmes starting on 1 January 2011. The use of unit costs in the 2012 and 2013 programmes will help reduce the errors in the cost claims. The cumulative effect of all measures is expected to reduce the error rate further, probably below the 2 % threshold.

6. 5 ASSURANCE GATHERED THROUGH THE WORK OF THE INTERNAL AUDIT SERVICE

The Audit Progress Committee (APC) informs the college on audit issues, including those with a corporate dimension. The 2013 Internal Audit Report[17] reported on progress in implementing the IAS's audit recommendations. By the end of 2013, 79 % of the recommendations accepted in 2009-13 had been implemented. As regards recommendations issued in 2009-13 and rated 'very important' or 'critical', implementation of only ten (2.3 %) 'very important' recommendations were overdue by more than six months (based on the deadline in the initial action plan). Implementation of three 'very important' recommendations issued before 2009 was also overdue. No critical recommendation is outstanding. The APC was regularly informed of cases in which implementation of 'critical' or 'very important' recommendations were overdue by more than six months. The IAS's follow-up work confirmed that, overall, recommendations are being implemented in a satisfactory way and the control systems in the audited services are improving. The IAS 'closed' 96 % of the recommendations followed up during this period.

The Commission's Internal Auditor submitted an overall opinion, mainly based on its own work and that of the Internal Audit Capabilities (IAC) and focusing on financial management.

[17] Article 99(3) of the Financial Regulation.

It considered that the Commission has put in place governance, risk management and internal control procedures which, taken as a whole, are adequate to give reasonable assurance on the achievement of its financial objectives. The overall opinion is qualified with respect to the reservations as expressed by the Authorising Officers by Delegation in their AARs. Furthermore, the Internal Auditor added an 'emphasis of matter' paragraph highlighting three issues that require particular attention:

(1) Concerning reporting on the cost-effectiveness of controls in the annual activity reports (see section 3.4 above), he suggests that guidance should be further refined so that services demonstrate more clearly that controls are effective and proportionate and that scarce resources are being used in a targeted and rational manner;

(2) He recognises progress in the way residual error rates are formulated and presented in the annual activity reports, in particular concerning the structural funds, research, agriculture and rural development. He considers it essential that the DGs continue to demonstrate that residual rates are reliable and solidly based. Where information from the Member States on error rates and financial corrections is used, the DGs should take all reasonable steps through their control and audit work to verify its accuracy. Ultimately, they must ensure that their own corrective measures are applied rigorously in practice; and

(3) IAS audits in 2013 of the work of the Executive Agency for Competitiveness and Innovation (EACI)[18] and the REA highlighted significant findings as regards control strategies and systems and outlined corresponding action to be taken.

The 2014-20 Multiannual Financial Framework will involve more tasks being delegated to the executive agencies. The agencies' growing operational budgets and responsibilities will require them appropriately to reinforce their internal control systems in order to meet future challenges and fully address the risk of error in the underlying transactions.

Concerning the corrective capacity of the multi-annual supervisory and control systems, the Commission's Internal Auditor states that **it is reasonable to assume that comparable annual average level of financial corrections and recoveries, as in the last four years, will relate to payments made in 2013. Consequently, financial corrections and recoveries are estimated to be of a sufficient magnitude to protect the budget as a whole and over time.**

A summary report of the work of the Internal Auditor will be forwarded to the discharge authority in accordance with Article 99(5) of the revised Financial Regulation.

[18] Subsequently renamed the Executive Agency for Small and Medium-sized Enterprises (EASME).

7. 6 THE CHALLENGE OF SHARED MANAGEMENT

Under shared management, the Member States have the responsibility to establish and maintain reliable management and control systems. Under Article 317 TFEU and the new Financial Regulation, **shared management also means shared responsibility between the Commission and the Member States**. According to the European Court of Auditors' 2012 annual report, **around two thirds of the errors could have been identified and corrected by the national authorities.**

6.1 Member State authorities should make maximum use of available instruments to prevent errors and fulfil their responsibilities and obligations for all programmes under shared management, in order to protect the EU budget and tackle remaining deficiencies in their management and control systems.

Additional national measures will be needed to target the weakest links in the assurance chain, i.e. deficient management and control systems checks at the level of the managing/paying authorities and agencies which carry out ineffective first-level checks, resulting in unreliable control results. The Commission will strengthen its supervisory role vis-à-vis Member State authorities in order to ensure as effectively as possible that future errors do not occur and past expenditure be corrected. Therefore, the Commission will continue its targeted capacity-building actions. In addition, it encourages the widest use of simplified payment schemes, which are much less prone to errors than the traditional spending mechanisms.

The Commission calls on the Member States to demonstrate their commitment to improving accountability and transparency by reinforcing control measures, where necessary, in particular as regards first-level management checks, before certifying expenditure to the Commission, and by adopting clear eligibility rules to reduce the risk of error.

Correcting amounts unduly paid is an important aspect of sound financial management. In 2013, continued efforts were made to implement financial corrections where 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.

As regards shared management, the annual activity reports provide detailed information on the corrections that Member States implement and report to the Commission, and assessments of national control systems. In the area of cohesion policy, as well as in the area of agricultural policy, Member States implement corrections resulting from their own audit work and from EU audits. For the 2007-13 programming period, these are reported cumulatively by 31 March, with a year's delay, so in 2013 Member States reported on their 2012 corrections. In addition to corrections resulting from EU audits, these included corrections and recoveries following their own audits, for a total of EUR 1 411 million. The AODs reported the latest figures known at the time of signing their annual activity reports.[19]

6.2 The Commission will intensify its audit framework and strategy to help tackle remaining weaknesses in systems in the Member States, in particular those with the highest risk profile for the implementation of EU programmes.

The European Court of Auditors found that the Member States' audit reports, on which the Commission's risk analysis is based, are sometimes unreliable. Although the majority of the audit reports on the Member States are reliable, the Commission does not unquestionably rely on the results, but always assesses them and draws conclusions for its assurance.

In the field of **agriculture**, the Commission will maintain its risk-based approach, but move towards a multi-annual audit strategy for the 2014-20 period to strike a better balance between risk coverage and geographical coverage. No Member State will be left out, but some affected by higher risks will be audited more intensively. Commission audits will continue to focus on paying agencies' controls before paying the final beneficiaries. In all cases of serious deficiency, the Member States will be required to draw up and implement precise remedial action plans and the Commission will monitor their implementation. A new unit will be devoted to this activity for direct payments, including improvements to the Land Parcel Identification System (LPIS). Failure to remedy sufficiently the deficiencies in line with an action plan will trigger the suspension of payments. Independently (as part of the separate conformity clearance procedure), net financial corrections are imposed to protect the EU budget.

Under the reform of the common agricultural policy (and as laid down in the revised Financial Regulation), as from claim year 2014, the certification bodies have to re-perform primary controls on a representative sample of transactions at beneficiary level, and give an opinion on the legality and regularity of the transactions. DG Agriculture and Rural Development will audit the reliability of this opinion and use it to consolidate its assurance and fine-tune the risk analysis for its own audits at the level of the primary controls. In the field of cohesion policy, the Commission's multi-annual audit strategy for 2007-13, which is updated annually based on a risk assessment, consists of two main components:

- verification (through on-the-spot 're-performance' of the national audit work, including at the level of beneficiaries) of the extent to which it can rely on the work of national audit authorities, their reported audit results and error rates; and

- direct auditing of programmes or authorities it has assessed as not sufficiently addressing the high risks identified, including on-the-spot audits at the level of beneficiaries to confirm the results of the targeted system audits.

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19 For agriculture, the information on financial corrections and recoveries relates to the year of the report.

The new single audit strategy for 2014-20 reflects the upgrading of certain aspects of the annual financial management and control cycle, which will end in the provision, by 15 February each year, of the programme certified accounts, management declaration and annual summary, audit opinion on the functioning of systems, legality and regularity of expenditure and accounts, and the relevant control report.

Based on their extensive audits since 2009 assessing the reliability of the most important audit authorities (covering 96 % of allocations), DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion will continue to monitor the authorities' performance to ensure that they work to required standards. They will require a remedial action plan for the few audit authorities not working well and will provide them with guidance and common methodological tools.

Managing authorities'/paying agencies' first-level checks of beneficiaries' expenditure declarations are the cornerstone of the assurance chain. The Commission will verify through its own risk-based system audits (which include on-the-spot audit visits to beneficiaries) that national authorities are carrying out adequate checks. It follows up its audit findings until it has assurance that systemic weaknesses have been addressed and remedied, and will impose financial corrections in order to protect the EU budget.

6.3 The Commission will continue to suspend payments in the event of serious shortcomings which are not yet addressed in due time by the Member States concerned. It will use a reinforced suspension mechanism for agriculture as an ex-ante instrument to protect the EU budget from weaknesses in Member States' control systems.

In their annual activity reports, the services carrying out transactions in shared management mode have reported all interruption/suspension decisions, including the relevant operational programmes, the Member States affected, the types of weakness, 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 2007-13 programming period, the DGs operating in shared management took formal decisions in 2013 to **interrupt payment deadlines in 265 cases for a total of EUR 4 930 million.** In 2013 and the first quarter of 2014, the college also adopted 17 [20] **decisions to suspend payments** under 2007-13 programmes. Payments will not be resumed until AODs obtain clear audit evidence that the reasons for interruptions and/or suspensions have been remedied, the necessary financial corrections have been implemented and there are no further risks for future expenditure to be certified to the Commission.

[20] Fifteen suspensions were decided in 2013 and two in the first quarter of 2014. Six decisions concerned the ERDF and 11 the ESF.

This experience in shared management confirms the effectiveness of suspensions as an incentive for Member States to take appropriate remedial action.

6.4 The Commission imposes financial corrections on Member States that fail to implement sound systems. It will use the net financial corrections instrument.

Overall, the Commission was very active in 2013 in recovering undue amounts and making financial corrections. Section 4.1 demonstrates clearly that it adequately protects the EU budget from expenditure incurred in breach of the law. More details on these figures and the corrective mechanisms in the applicable legislation can be found in **Note 6 to the 2013 accounts and the Commission's Communication** to the discharge authority and the Court of Auditors every September. At the request of the European Parliament, the Communication will provide a breakdown of financial corrections by Member State, data on net financial corrections which lead to assigned revenue for the EU budget and the results of Member States' corrective work.

The Commission will continue to work with Member States whose audit systems display persistent and systematic weaknesses. In addition, it uses all available instruments to prevent errors and protect the EU budget.

In the area of agricultural policy, including rural development, financial corrections are applied wherever irregular expenditure is detected. The aim now is also to reduce further the time to implement a decision on a net financial correction. Currently, the procedure, with its contradictory and conciliation stages, takes too long. **A quicker procedure[21] should create more of an incentive for Member States to address weaknesses** in their management and control systems in a timely manner, although it should be stressed that the EU budget is well protected even where corrections are implemented late.

For ESI funds, the new provision on net financial corrections comes in addition to the existing correction procedures, where a Member State can re-use the EU funds made available for other projects or programmes if it agrees to the correction. However, for serious deficiencies detected after submission of the annual accounts, the Commission will apply corrections which reduce the Member State's allocations, so that the corrected amounts cannot be re-used. The Common Provisions Regulation (CPR) covering the ESI funds lays down clear rules[22] and conditions for applying the corrections[23]. The Commission must apply them if a serious deficiency is detected. Given the need for a contradictory procedure with the Member State in question, the Commission would expect corrections to be applied within 10 to 12 months of the findings being notified.

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[21] For further details, see point 2.b.

[22] Serious deficiencies will be defined in terms of (non-)compliance with the main elements of the management and control systems, assessed in detail according to 18 key requirements for all programme

The Commission instructs its services to ensure an effective system for applying net financial corrections as soon as possible under the regulations for the new programming period as from 2016 and to take steps to speed up the existing conformity procedure in agriculture.

6.5 The Commission will continue to supply meaningful statistics to facilitate thorough analysis of Member States' performance.

Annual activity reports are a very valuable source of information for the discharge authority, as they show in a transparent way how the Commission fulfils its responsibility to ensure the legality and regularity of shared management policies at the level of individual Member States and programmes (for cohesion policy) or paying agencies (for agriculture). The reports contain estimates of error rates and residual amount at risk, broken down by paying agency/programme and by Member State. They also help the discharge authority to assess the situation in more detail, because they give an indication of actual risk once Member States and the Commission (for net financial corrections) have implemented corrective action.

In 2013, the Commission communicated the amounts recovered through financial corrections and recoveries in the course of 2012. The information covered preventive and corrective action and, wherever possible, its impact in ensuring a lasting improvement of management and control systems, as reflected in the error rates.

It should also be noted that the residual error rates reported by the Commission services are used to estimate financial exposure, and these differ from the error rates reported by the European Court of Auditors. The main reason for this is that they take account of the effect of the various corrective mechanisms once actually implemented.

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authorities. The main elements to be assessed on the basis of detailed and comprehensive audit results include:

- adequate separation of functions of programme authorities and supervision over all intermediate bodies involved in the management and control system;
- adequate selection of operations and effective verifications by managing authorities to avoid errors in the first place;
- effective anti-fraud measures;
- appropriate procedures for drawing up payment applications and for certifying the completeness, accuracy and veracity of the programme accounts to the Commission; and
- effective audits on systems, operations and accounts.

Weak or no compliance with one of the specified key requirements proposed in the delegated act, or two or more of the key requirements will automatically lead the Commission to conclude that there are serious deficiencies, leading to net financial corrections.

[23] The delegated act will also establish the criteria to be used by the Commission to determine the level of flat-rate correction (5 %, 10 %, 25 % or 100 %). These are linked to the relative scale of the serious deficiency, its frequency and extent, and the loss for the Union budget. The act will also provide that flat rates can be raised to the next level in cases of repeated serious deficiencies due to the programme authorities' failure to take the necessary measures to correct the system following application of a financial correction in a previous accounting year.

8. 7 CROSS-CUTTING ISSUES AND SOLUTIONS

7.1 Internal control standards

The Commission has taken note of the 'Overview of the State of Internal Control' prepared by the Director-General for Budget and is satisfied with the positive trend as regards operational procedures.

The Commission instructs DG Budget to pursue its efforts to simplify internal control standards, focusing them more on effectiveness and efficiency, and to revise them accordingly.

7.2 Impact of entrusted entities on the chain of assurance

The revised Financial Regulation has simplified the definition of management modes and methods by incorporating them into a common logical framework including:

- direct management where EU funds are transferred by an AOD to grant beneficiaries and contractors; and
- indirect management or shared management where EU funds are entrusted to other entities or to a Member State before being transferred to final recipients.

Also, the Regulation provides for the potential creation of new types of delegated actors to which AODs entrust budget implementation tasks under a wide range of arrangements, including amongst other:

- cross-delegations to other AODs;
- operating budgets for executive agencies;
- funds for joint undertakings;
- funds for EuropeAid Contribution Agreements with third countries;
- financial instruments managed by the European Investment Bank (EIB) and the European Investment Fund (EIF);
- budget executed via national agencies; and
- mandates with other international organisations.

In 2013, 22 Commission services relied on entrusted bodies to help implement the budget through operations for a total of EUR 6 572 million. All but one, the Trans-European Transport Network Executive Agency, concluded that they had adequate information to conclude on assurance.

In the 2012 synthesis report, the Commission confirmed that the declaration of assurance covered all resources assigned to its DGs, irrespective of the management mode used and whether the entrusted body was subject to a separate discharge decision. The AODs should ensure appropriate supervision, take into account any negative control results or control system weaknesses and lodge reservations where necessary.

DG Budget has provided instructions, templates and guidance for a dedicated section and annex in the annual activity reports in which services can report on their supervision and assurance-building as regards the entities to which they, as parent DGs, have entrusted budget implementation tasks.

DG Economic and Financial Affairs, in particular, has indicated the challenges of implementing the guidance in view of the plethora of specific arrangements with entrusted bodies under agreements that date back several years.

The peer reviews on the draft annual activity reports have also discovered a gap in the prescribed control strategy. It is not fully applicable in cases where funding does not cover operational expenditure but is exclusively used to finance the administration costs of the entrusted body.

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

7.3 Commission Anti-Fraud Strategy (CAFS)

The Communication on the Commission Anti-Fraud Strategy[24] emphasised the need for DGs and services to strengthen their internal control systems to address the risk of fraud. One of the key measures was to design and adopt their anti-fraud strategies by the end of 2013.

12 services[25] have already fully implemented their strategies and the others have indicated the expected date of full implementation and identified outstanding measures, in so far as these can be made public without endangering their effectiveness. No unmitigated residual risk has been reported.

The quantified indicators reported are essentially the number of fraud suspicions transferred to or being investigated by the European Anti-Fraud Office (OLAF). DG Employment, Social

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24 COM(2011) 376, 24.6.2011.

25 The DGs for Agriculture and Rural Development (AGRI), Communications Networks, Content and Technology (CNECT), for Employment, Social Affairs and Inclusion (EMPL), for Home Affairs (HOME), for Justice (JUST), for Regional Policy (REGIO) and The Service for Foreign Policy Instruments (FPI), The Internal Audit Service (IAS), The European Anti-Fraud Office (OLAF), The Legal Service (SJ), The Bureau of European Policy Advisers (BEPA) and The Education, Audiovisual and Culture Executive Agency (EACEA).

Affairs and Inclusion and DG Health and Consumers also provide, as financial indicators, the amounts involved in riskier financial operations subject to close monitoring.

On the basis of the annual activity reports, it is possible to conclude that, in view of the services' implementation of the Anti-Fraud Strategy and although not all their individual strategies have been fully implemented yet, there are no unmitigated risks which would suggest that this control objective is not adequately met.

Measures in this area (e.g. specific risk analysis of beneficiaries, close monitoring of selected projects or contracts, other measures to mitigate fraud risks) are already outlined in some of the annual activity reports, together with the specific results of anti-fraud action taken during the reporting year and any elements of assurance that can be drawn from them. This will be done across the board in the 2014 reports.

The Commission welcomes the fact that most DGs are already well advanced in the development and implementation of their anti-fraud strategies. It instructs its services to continue including information on fraud prevention as part of their assessment of their internal control systems.