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EUROPEAN  
COURT  
OF AUDITORS

# 2014

## EU audit in brief

Introducing the 2014 annual reports of  
the European Court of Auditors

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**2014**

**EU audit in brief**

**Introducing the 2014 annual reports of  
the European Court of Auditors**



This document, the 2014 EU audit in brief, summarises and explains the contents of the European Court of Auditors' (ECA) annual reports on the implementation of the 2014 EU budget and the European Development Funds.

In the reports, we provide assurance on how EU funds were used during the year, highlighting where they were most at risk of being spent irregularly. We also analyse why errors occur and provide recommendations on how to improve financial management. Our main aim is to assist the European Parliament and the Council in scrutinising EU financial management as part of the discharge procedure on the EU budget.

The financial year 2014 was the first year of the EU programming period 2014-2020. However, most of the EU's spending in 2014 was planned during 2007-2013. So, as would be expected, our report highlights similar financial management issues to previous years.

For many years now, we have identified persistently high levels of error in EU spending. So, we highlight the scope for making better use of available information and full use of corrective powers to reduce errors further and recover more misspent funds.

Of course, the EU must always strive to do more with what it already has in place. So, we have advocated that the focus should be more on performance when spending EU money during the current period.

The ECA also considers that EU policymakers need to develop a wholly new approach to the management of EU spending and investment for the future. The upcoming mid-term review of the EU's financial planning programme offers an opportunity to consider how best to both reduce errors and improve the overall performance of the EU budget.

In the meantime, we also draw attention to the pressing need for the Commission and Member States to deal with a number of financial backlogs that have built up. In some Member States, the total not yet claimed from EU funds represents a significant portion of their governments' annual spending.

If the EU institutions and the Member States want to achieve the full potential of the EU budget to invest in Europe's future, there needs to be a concerted effort to improve its effectiveness. That means improving the EU budget's potential to invest in the future of Europe by reducing errors, paying correct claims more quickly, investing in projects that match the Union's objectives, and measuring the returns on those investments to ensure they deliver and add value.

Citizens have a right to know the status of those investments and how they have performed. The ECA is committed to playing an important role in assuring that EU funds are soundly invested and performing well, warning where they are at risk and advising on how to improve their performance.

A handwritten signature in black ink, appearing to read 'Vitor Manuel da Silva Caldeira'.

Vítor Manuel da SILVA CALDEIRA  
President of the European Court of Auditors

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## Key findings and messages

### Summary of the 2014 Statement of Assurance

The European Court of Auditors gives a **clean opinion** on the reliability of the **2014 accounts** of the European Union.

**Revenue** for 2014, taken as a whole, is **legal and regular**.

**Payments** for 2014 are materially affected by error. We therefore give an **adverse opinion** on their legality and regularity.

*For the full text of our statement of assurance, please refer to Chapter 1 of the 2014 annual report.*



- The EU accounts for 2014 were correctly prepared in accordance with international standards and present a **true and fair view**. We were therefore able, once again, to give a clean opinion on their reliability. However, we gave an adverse opinion on the regularity of payments.
- The **estimated level of error**, which measures the level of irregularity, for 2014 payments is 4.4 %, close to that of 2013 (4.5 %) and persistently above the materiality threshold of 2 %.
- We found **the same estimated level of error** (4.6 %), under shared management with the Member States and for expenditure managed directly by the Commission. The highest levels of error were found in spending under 'economic, social and territorial cohesion' (5.7 %) and for 'competitiveness for growth and jobs' (5.6 %). Administrative expenditure had the lowest estimated level of error (0.5 %).
- There is a clear relationship between expenditure types and levels of error. Our estimated level of error for **cost reimbursement schemes** (5.5 %), where the EU reimburses eligible costs for eligible activities on the basis of cost declarations made by beneficiaries, is double that for entitlement programmes (2.7 %), where payments are made on meeting conditions rather than reimbursing costs.
- **Corrective action** by authorities in the Member States and by the Commission had a positive impact on the estimated level of error. Without this action, our overall estimated level of error would have been 5.5 %. There is further scope for the Commission to improve its assessment of risk and the impact of corrective actions.
- If the Commission, authorities in the Member States or independent auditors had made use of all information available to them, they could have **prevented, or detected and corrected** a significant proportion of the errors before these were made.
- **Amounts to be paid in the current and future years** remain at a very high level. It is essential for the Commission to take measures to deal with this persistent problem. For some Member States the backlog of unused funds represents a significant share of overall government spending.
- The periods of the 10-year **Europe 2020** strategy and the EU's 7-year budgetary cycles (2007-2013 and 2014-2020) are not aligned. Member States give inadequate attention to Europe 2020 achievements in partnership agreements and programmes. Both issues limit the Commission's ability to monitor and report on **performance and the contribution of the EU budget** to Europe 2020.
- The upcoming mid-term review of the 2014-2020 multiannual financial framework is a key point in the management of EU spending. It is important that the Commission **analyses the areas of persistently high levels of error** as soon as possible and assesses opportunities for reducing this while strengthening the focus on performance in spending.

## What we audited

### EU budget

**EU spending is a significant instrument for achieving policy objectives.** Every year we audit the revenue and expenditure of the EU budget and provide our opinion on the extent to which the annual accounts are reliable, and income and spending transactions comply with the applicable rules and regulations.

Spending totalled **€142.5 billion** in 2014, or around €285 for every citizen. It represented **nearly 2 % of total general government spending of EU Member States**.

The EU budget is agreed annually — within the context of 7-year financial frameworks — by the European Parliament and the Council. Ensuring that the budget is properly spent is primarily the responsibility of the Commission. Some 76 % of the budget is spent under what is known as **'shared management'**, with individual Member States distributing funds and managing expenditure in accordance with EU law (for example, in the case of expenditure in the area of economic, social and territorial cohesion and spending on natural resources).

### Where does the money come from?

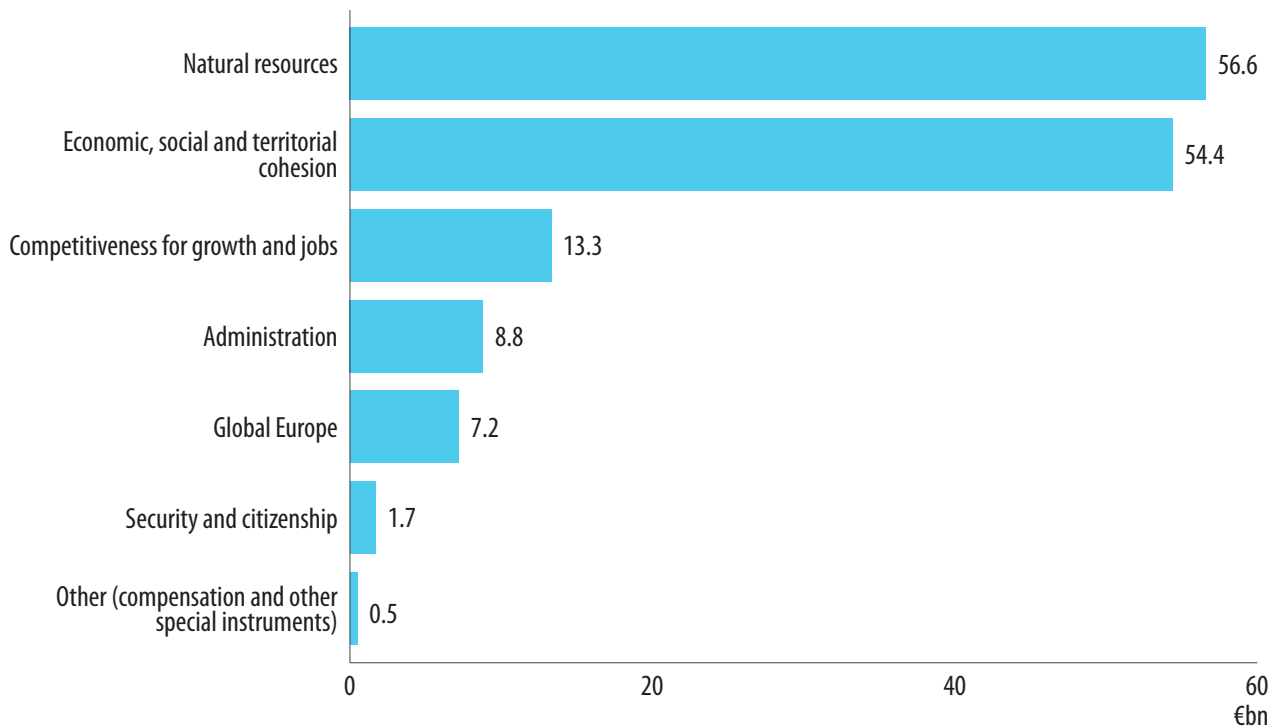
The EU budget is financed by various means. The largest proportion is paid by Member States based on their gross national income (€94.9 billion). Other sources include payments by Member States based on the value added tax they collect (€17.7 billion), as well as customs and agricultural duties (€16.4 billion).

### What is the money spent on?

The annual EU budget is spent on a wide range of areas (see *Diagram 1*). Payments are made to support activities as varied as farming and the development of rural and urban areas, transport infrastructure projects, research, training for jobless people, support to countries wishing to join the EU, or aid to neighbouring and developing countries.

Diagram 1

**Total EU expenditure 2014 (€142.5 billion)**



EU spending can be characterised by two types of expenditure programmes involving distinct patterns of risk:

- **Entitlement programmes**, with payment based on meeting certain conditions, for example student and research fellowships (under competitiveness spending), direct aid for farmers (under natural resources), direct budget support (under Global Europe), or salaries and pensions (under administration).
- **Cost reimbursement schemes**, where the EU reimburses eligible costs for eligible activities. Such schemes include, for example, research projects (under competitiveness spending), investment schemes in regional and rural development (covered by expenditure under cohesion and natural resources), training schemes (under cohesion) and development projects (under Global Europe).

## What we found

### EU accounts present a true and fair view

The EU accounts for 2014 were correctly prepared in accordance with international public sector accounting standards, and present a true and fair view of the EU’s financial results for the year and its assets and liabilities at the end of the year. We were therefore able to give a clean opinion on the reliability of the accounts (‘signed off’), as we have done since 2007.

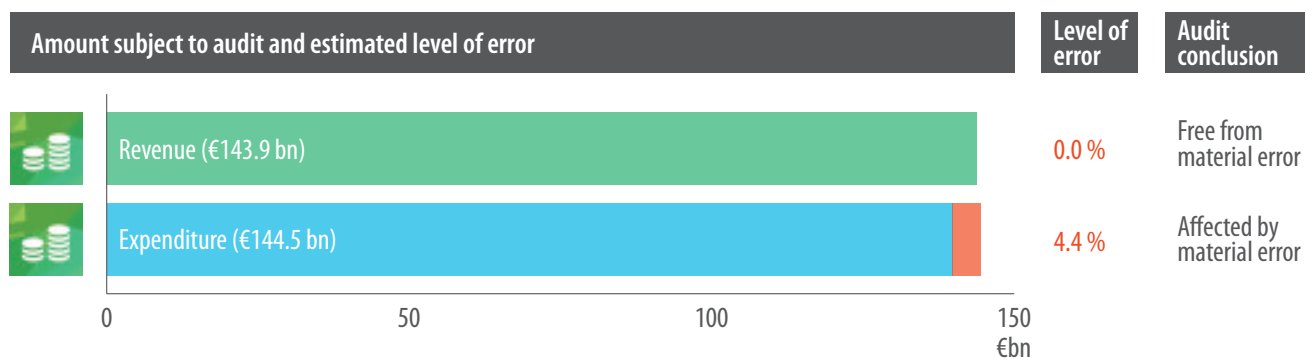
### Estimated level of error remains persistently above the materiality threshold of 2 %

A key element of our audit work is **the testing of samples** of transactions from across the EU budget to provide unbiased and rigorous estimates of the extent to which revenue and the different spending areas are affected by error.

*Diagram 2* summarises the results for 2014. For more information on our audit approach and the estimated level of error see pages 45 and 46.

Diagram 2

### 2014 results of transaction testing for EU budget as a whole



The estimated level of error is based on the quantifiable errors found in the statistical sample of transactions we tested.

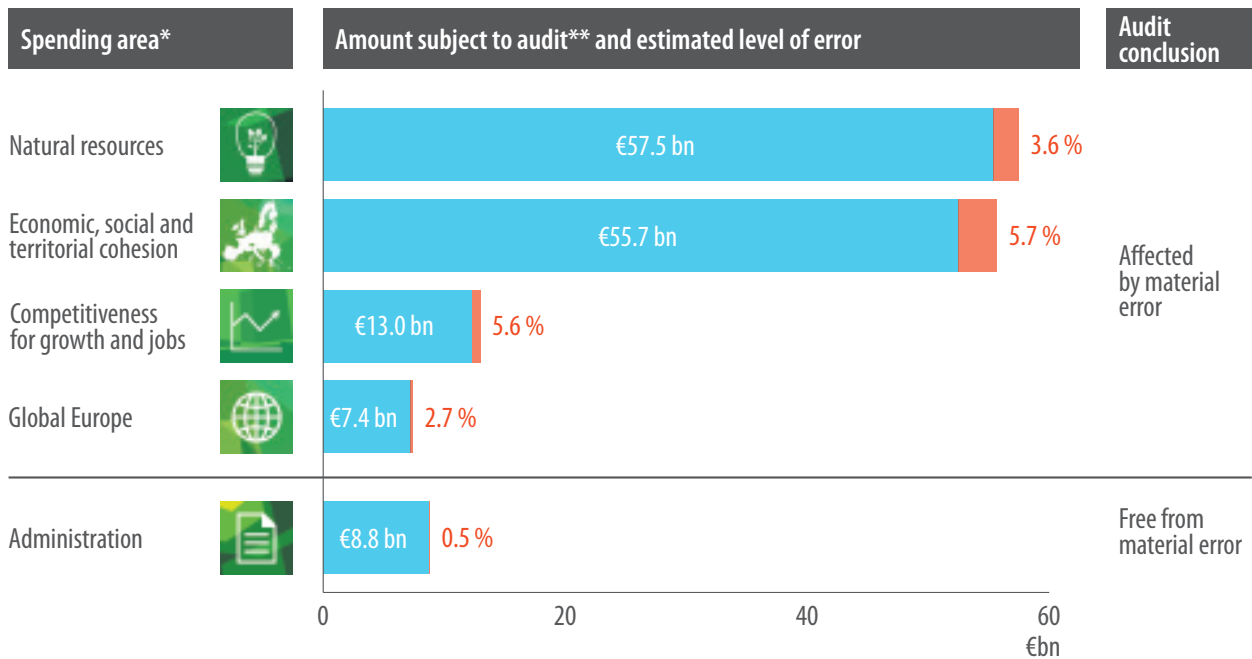
For 2014, we conclude that **revenue was free from material error**.

For the expenditure budget as a whole, **our estimated level of error of 4.4 %** leads us to provide an adverse opinion on the regularity of expenditure (for an explanation of 'regularity' please refer to page 46).

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

Further information on results in revenue and each spending area is given in pages 25 to 44 and in the related chapters of the 2014 annual report.

**Diagram 3 2014 results of transaction testing for EU spending areas**



% The estimated level of error is based on the quantifiable errors from our work, notably the testing of a sample of transactions. We use standard statistical techniques to draw this sample and to estimate the level of error (see Chapter 1 Annex 1.1 to the 2014 annual report).

\* We do not provide a specific assessment or separate chapter for spending under MFF heading 3 (Security and citizenship) and MFF heading 6 (Compensations), nor for other spending (special instruments outside the 2014-2020 MFF such as Emergency Aid Reserve, European Globalisation Adjustment Fund, European Union Solidarity Fund and Flexibility instrument). Work in these areas contributes however to our overall conclusion on spending for the year 2014.

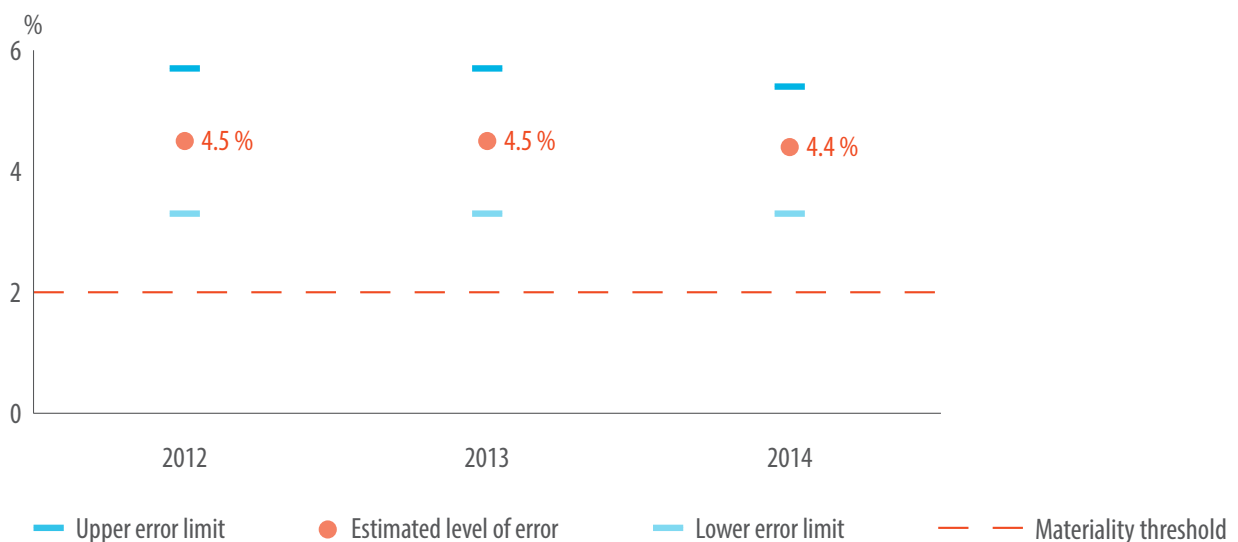
\*\* The difference in amounts in diagram 1 and 3 arise because we examine payment transactions when expenditure has been incurred, recorded and accepted. Advance payments are only examined when the recipients of funds justify their use of the money and the payment is cleared or becomes recoverable.

**Analysis of audit results**

The estimated level of error, which measures the level of irregularity in transactions, for payments in 2014 is 4.4 %, close to that of 2013 (4.5 %) and of 2012 (4.5 %). It remains persistently above the materiality threshold of 2 %. (see *Diagram 4*).

Diagram 4

**Estimated level of error for the EU budget as a whole (2012 to 2014)**



Notes:

We use standard statistical techniques to estimate the level of error. We are 95 % confident that the level of error for the population lies in the range between the lower and upper error limits (for more details, see Chapter 1, Annex 1.1 of the 2014 Annual Report).

The estimated levels of error for 2012 and 2013 have been adjusted using our updated approach for quantifying serious public procurement errors.

**Updating our audit approach: impact on 2013 and 2012 results**

In the 2013 and 2012 annual reports, we had reported an estimated level of error of 4.7 % and 4.8 % respectively for the EU budget as a whole. The comparable estimated levels of error for 2013 and 2012, presented in the 2014 annual report are 0.2 and 0.3 percentage points lower because we have updated the way we quantify **serious infringements of public procurement rules**. In particular we introduced a proportional approach to the calculation of errors related to the modifications of contracts. This adjustment has no impact on the conclusions that we reached, or on the substance of our overall findings, in either year. The level of error remains clearly material.



### Errors, waste and fraud

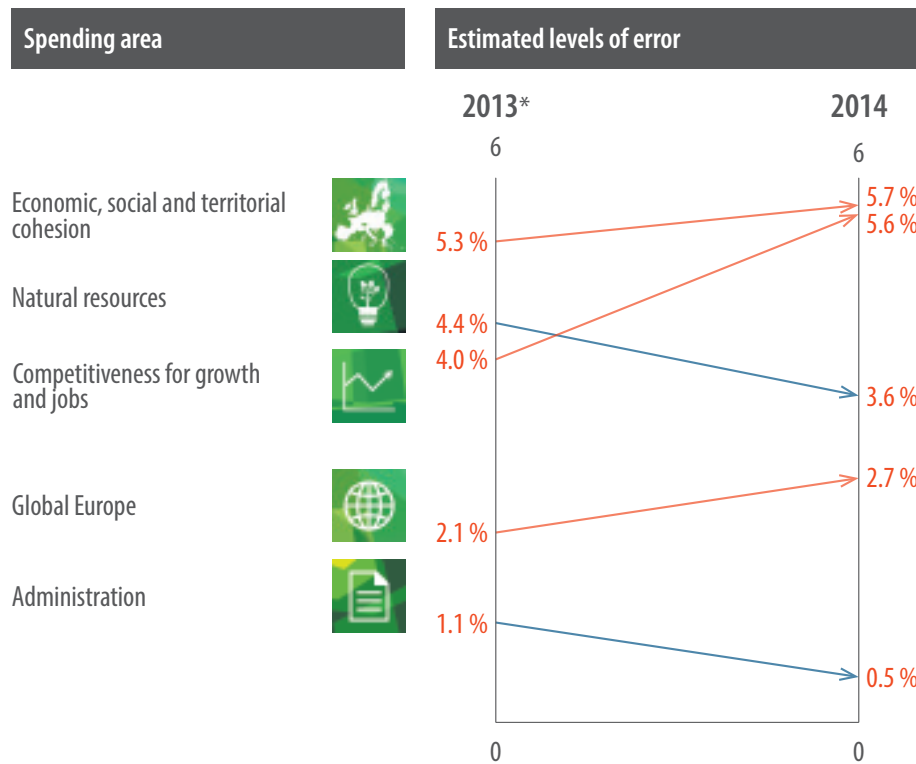
Our estimate of the level of error is not a measure of fraud, inefficiency or waste. It is an estimate of the money that should not have been paid out because it was not used in accordance with the applicable rules and regulations. Typical errors include payments for expenditure which was ineligible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

Fraud is an act of deliberate deception to gain a benefit. We report suspected fraud cases detected during our audit work to **OLAF**, the European Union's anti-fraud office, which investigates and follows up as necessary in cooperation with authorities in the Member States. Out of the some 1 200 transactions that we assessed for legality and regularity during the 2014 audit, we found 22 instances of suspected fraud (2013: 14) which we forwarded to OLAF. The most frequent instances of suspected fraud concerned declaration of costs not meeting the eligibility criteria, followed by cases of conflict of interest and other irregularities in procurement as well as the artificial creation of conditions to be eligible to receive a subsidy. During the year, we also have cases of suspected fraud that arise from work not related to the statement of assurance.

*Diagram 5* compares the estimated levels of error, taking into account the headings for the various spending areas under the new multiannual financial framework (MFF). Overall, increases in the estimated level of error for *competitiveness for growth and jobs; economic, social and territorial cohesion; and Global Europe* were offset by significant decreases in *natural resources and administration*.

Diagram 5

Comparison between estimated levels of error for EU spending areas (2013 and 2014)



% The estimated level of error is based on the quantifiable errors found in the sample of transactions. We use standard statistical techniques to draw this sample and to estimate the level of error (see Chapter 1 Annex 1.1 to the 2014 Annual Report).

\* The estimated levels of error for 2013 have been adjusted so as to allow comparison with the new MFF headings, and on the basis of the updated approach to quantifying serious public procurement errors.

The estimated level of error for the spending on *competitiveness for growth and jobs* is significantly higher in 2014 (5.6 %) than for the comparable spending in 2013 (4.0 %). Much of the expenditure is made on a cost reimbursement basis. The errors detected reflect different categories of ineligible expenditure (notably, personnel, other direct and indirect costs).

The 2014 estimated level of error for *economic, social and territorial cohesion* (5.7 %) is made up of an estimated level of error for expenditure under regional and urban policy of 6.1 % and an estimated level of error in the employment and social affairs area of 3.7 %. Almost all spending in this area takes the form of cost reimbursements and the main causes of error are serious infringements of public procurement rules (almost half of the estimated level of error), and ineligible costs in expenditure declarations (over a quarter of the estimated level of error).

We analyse in **Diagram 6** the contribution of specific spending areas by MFF heading to the overall estimated level of error. The expenditure for the *economic, social and territorial cohesion policy* is the second largest in the EU budget and has the highest estimated level of error. This makes it the biggest contributor to the overall estimated level of error (equal to half of the total). *Natural resources* has the largest share of the EU budget and also contributes significantly to the overall estimated level of error due to its high estimated level of error for 2014 (equal to one third of the total).

**Diagram 6** Breakdown of the overall estimated level of error by spending area and type of error (2014)

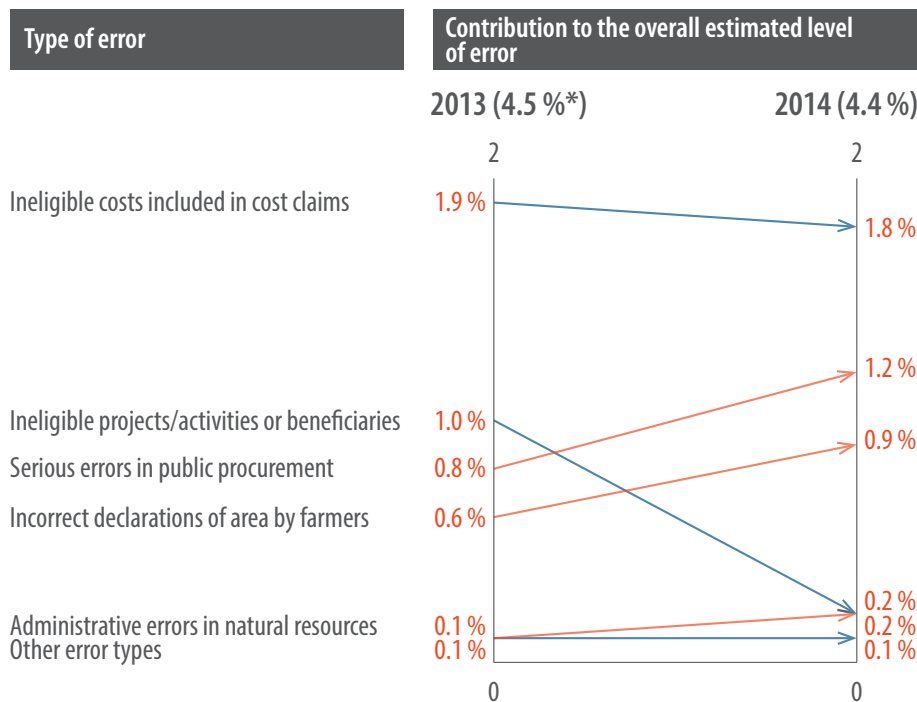


% Portion of the overall estimated level of error, expressed in percentage points.

Expenditure that did not fulfil the necessary conditions to be charged to EU-funded projects continues to make the greatest contribution to the overall estimated level of error (*ineligible costs included in cost claims*: 41 % of the overall estimated level of error). The second biggest contributor to the level of error in 2014 was *serious errors in public procurement*: 27 % of the overall estimated level of error. Furthermore, when compared with the previous year, errors due to *ineligible projects/activities or beneficiaries* contributed significantly less in 2014 to the overall estimated level of error than they did in 2013. (see **Diagram 7**)

Diagram 7

**Comparison of types of errors and their contribution to the overall estimated level of error (2013 and 2014)**



% Portion of the overall estimated level of error, expressed in percentage points.

\* The estimated levels of error for 2013 have been adjusted to allow comparison and on the basis of the updated approach to quantifying serious public procurement errors.

## Overall results

For operational expenditure, our estimated level of error is the same (4.6 %) for spending under shared management with the Member States (2013: 4.9 %) and for other forms of operational spending where the Commission has a leading role (2013: 3.7 %).

Administrative expenditure was free of material error, with an estimated level of error of 0.5 % in 2014 (2013: 1.0 %).

This year-on-year comparison is based on figures that have been calculated applying our updated approach to procurement errors (see **Box** on page 10).

### Reimbursement spending was most affected by error

The correct calculation of payments to recipients of funding often depends on information provided by the recipients themselves. This is especially significant in the area of reimbursement activities.

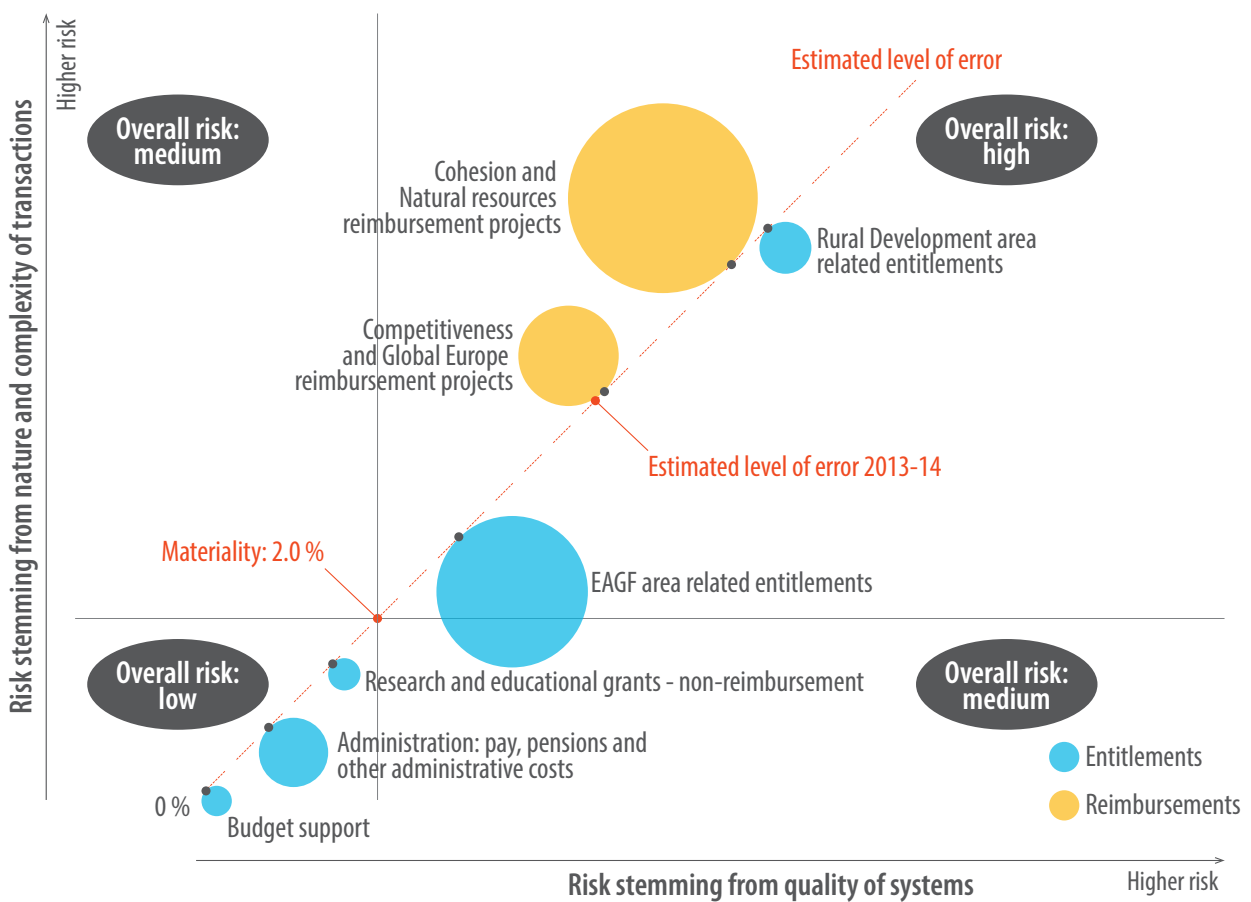
EU spending by programme expenditure type includes the following errors:

- **For reimbursement expenditure**, the estimated level of error is 5.5 % (2013: 5.6 %). Typical errors in this area include ineligible costs contained in the cost claims, ineligible projects, activities and beneficiaries, and serious infringement of public procurement rules.
- **For entitlement programmes**, the estimated level of error is 2.7 % (2013: 3.0 %), with typical errors including over-declarations by farmers of agricultural areas and administrative errors affecting payments to farmers.



**Diagram 8**, based on our audit testing of EU spending over the last 2 years, shows our assessment of the different risk profiles by transaction type as well by estimated levels of error. It is based both on elements of professional judgement (assessment of the impact of systems and risks related to transaction type) and empirical elements (levels of error over a 2-year period).

**Diagram 8** The relationship between transaction type, risk and estimated level of error in EU transactions (2013-2014)



**Explanation:**

- Payment streams are grouped according to their nature.
- The colour of the circles indicates whether expenditure is based on reimbursement or entitlement.
- The size of the circles represents their weight in overall spending.
- The position of the circles along the 45 degree line indicates relative levels of estimated errors.
- Reimbursements for Global Europe include multi-donor projects which in practice may have many of the attributes of entitlement spending and are affected by lower levels of error.
- The Commission establishes that recipients are entitled to budget support prior to payment.

### Corrective action significantly reduced the estimated level of error

The Member States and the Commission apply **corrective measures** in cases of irregular expenditure and when errors in payments had not been detected earlier in the process. The mechanisms applied to make and record corrective action are complex. We seek to take account of these measures in the results of our audits when they are made prior to payment or before our examination. We check the application of the corrections (for example, recoveries from beneficiaries and corrections at project level) and adjust the quantification of error whenever this is appropriate. While, we take note of corrections made after notification of our audits, we do not assume that a corrective action stimulated by our work is representative of the population as a whole.

In 2014, if such corrective measures had not been applied to the payments audited by us, our overall estimated level of error would have been 5.5 % rather than 4.4 %.

However, we also found that for some transactions affected by error, if the Commission, authorities in the Member States or independent auditors had made use of all information available to them, they could have prevented, or detected and corrected the errors before the related errors were made.

Based on transactions within our samples, this had the potential to reduce estimated levels of error both for shared management spending and spending directly managed by the Commission. For example, using all information available might have reduced the level of error by 3.3 percentage points for both expenditure under *regional and urban policy* (6.1 %) and for *rural development, environment, climate action and fisheries* (6.2 %) — see pages 34 to 38. In *competitiveness for growth and jobs*, directly managed by the Commission, the estimated level of error (5.6 %) might have been reduced by 2.8 percentage points — see pages 27 to 29.



## Scope for further improvement in the Commission's assessment of risk and impact of corrective actions

Each Commission directorate-general produces an annual activity report. The Commission's synthesis report incorporates a summary of this information and a statement whereby it takes overall political responsibility for its management of the EU budget.

We found the information in the synthesis report for 2014 to be better than in previous years. The accounts now show which corrections had been already made before payments were recorded. There is scope, however, for further information to be given and for ensuring a consistent and accurate assessment and presentation of risk and impact of corrective actions.



Want to know more? Full information on the main findings can be found in Chapter 1 'The statement of assurance and supporting information' of the 2014 annual report on the EU budget.

The full text of our annual report can be found on our website: <http://www.eca.europa.eu/en/Pages/AR2014.aspx>

### High level of potential claims and payments from 2007-2013 programming period

The budget for payments in 2014 was the second highest ever. As in 2013, the final level of payments (€142.5 billion) was approximately 5 % higher than the initial forecast in the MFF (€135.9 billion). This was realised through seven amending budgets and included the activation of the 'contingency margin' — a last-resort instrument to react to unforeseen circumstances.

The 'economic result' for 2014 was a deficit: liabilities grew faster than assets.

The level of commitments in 2014 was well within the overall limit (76.6 % of amount available). This reflected the level of progress in the approval of new programmes by the Commission in the first year of the MFF 2014-2020.

#### What are commitments and payments?

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

Backlogs in the absorption of multiannual funds are significant, and may pose a significant challenge to some Member States.

**We recommend that the Commission considers, in its budgetary and financial management, the capacity constraints in certain Member States.**

The accumulated outstanding budget commitments on expenditure of a multiannual nature remain at a very high level. Most of these commitments relate to the previous MFF covering 2007-2013. We also found excessive cash balances in financial instruments.

**We recommend that the Commission considers measures to reduce outstanding commitments, including faster closure of the 2007-2013 programmes and a reduction of cash held by fiduciaries. We also recommend that a longer term perspective is adopted, including forecasts covering budgetary ceilings, payment needs, capacity constraints and potential de-commitments.**

## Reporting on performance is still weak

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

Europe 2020 is the EU's 10-year jobs and growth strategy. It provides a focus for both EU and national spending. The strategy was launched in 2010 to create conditions for 'smart, sustainable and inclusive growth'.

## Challenging framework for monitoring and reporting on Europe 2020

Beneath the political aspirations of Europe 2020, there is a **complex architecture** comprising five headline targets, seven flagship initiatives and, for the European Structural and Investment (ESI) funds, 11 thematic objectives. We found, however, these various tiers are not, either individually or as a whole, designed to translate the political aspirations of Europe 2020 into useful operational objectives.

The periods of the 10-year Europe 2020 strategy and the EU's 7-year budgetary cycle, known as the multiannual financial framework (MFF) are **not aligned**. The monitoring and reporting framework underlying the MFF was brought in line with Europe 2020 only from the 2014-2020 MFF period. The first half of the implementation of Europe 2020 has, therefore, taken place under an MFF designed for a different strategy. This limits the Commission's ability to monitor the contribution of the EU budget to Europe 2020 during the 2007-2013 MFF period.

We also found that the Commission has so far reported on the contribution of the EU budget to the Europe 2020 objectives only in a limited way. Some elements of an effective monitoring and reporting system are in place. The statistical branch of the Commission, Eurostat, makes statistical data available on the EU's and individual Member States achievements of the Europe 2020 headline targets. However, the Commission's review of Europe 2020 has been delayed until early 2016. Moreover, the results of public consultation on Europe 2020 do not provide any feedback on the role of EU programmes for Europe 2020.

**We recommend that the Commission makes appropriate proposals to the legislator to better align the EU strategy and the MFF. This would help to ensure that adequate and effective monitoring and reporting arrangements are in place for future EU strategies.**

## Overall results

### Inadequate focus on Europe 2020 achievements in partnership agreements and programmes

The potential benefits of combining European Structural and Investment (ESI) funds have not been fully realised. Good use of the ESI funds is central to EU's efforts to meet the Europe 2020 objectives. Combining the five ESI funds in one umbrella regulation and one partnership agreement for each Member State offers potential advantages in terms of the coherence of the EU action. However, different rules continue to apply at fund level and, as a result, at programme level.

#### What are partnership agreements and programmes?

**Partnership agreements** between the Commission and each Member State lie at the heart of the ESI funds framework. They outline each country's development needs and, for each of the ESI funds, set out a summary of the main results expected for each selected thematic objective. On the basis of these agreements, Member States establish **programmes** for each fund (or for several funds) setting out the priorities for the country or region concerned.



The focus on results should be further improved, in particular in the partnership agreements. Although some progress has been made, the focus on results needs to be strengthened. In some of the partnership agreements examined, the expected results were vague and often expressed in qualitative terms, without stating the magnitude of change. **We recommend that the Commission proposes to the legislator that Member States include in their partnership agreements and programmes the quantified results that the funding is expected to achieve.**

It will be difficult for the Commission to monitor and report consistently on thematic objectives for all five ESI funds and, hence, on the contribution of these funds to Europe 2020. High level Europe 2020 targets are not systematically translated into operational targets in partnership agreements and programmes. In the case of two ESI funds (EARFD and EMFF), legislation does not require that they are structured around thematic objectives. Furthermore, the introduction of common indicators for each fund is an important step but there are limitations in design which will have a knock-on effect on the quality of reporting by the Commission. **We recommend that all partnership agreements and programmes include common result indicators, where possible shared by the different funds, and designed to monitor progress at the local, Member State and EU level. The Commission should make proposals to the legislator to address these issues.**

Poor performance in terms of results achieved does not prevent Member States benefitting from the performance reserve. The performance reserve should be the main incentive for the Member States to continue to focus on performance once the programmes have started. A small proportion of EU funding at programme level can be held back and only made available if certain targets are met. However, there are flaws in the arrangements which weaken the performance framework in terms of use of indicators, incentives and focus on results. **We recommend that the Commission proposes to the legislator that the performance framework is based, as far as possible, on common result indicators.**



### Objectives need to be further adapted to a performance culture

There have been improvements in the annual reporting on performance by individual Commission directorates-general (DGs). This is notable in the central guidance provided for the preparation of programme statements, management plans and annual activity reports.

However, reporting is not fully adapted to the transition from the old to the new MFF. It is often not possible to identify which objectives and targets were kept or updated from the old MFF and which were discontinued. In the absence of comparable information there is a risk that it is not possible to assess whether previous objectives and targets have been achieved.

### Weak focus on results and best value for money

The 24 special reports we published in 2014 cover a wide range of performance audit subjects which assess whether the EU's intervention was managed in accordance with the principles of sound financial management (economy, efficiency and effectiveness). We have assessed these reports to highlight whether, in the examined areas, there was a focus on results and whether projects likely to deliver value for money were selected. The following are some examples.

#### ***Examples: Weak focus on results***

In our audit of EuropAid, we concluded that the monitoring and evaluation systems in place did not provide adequate information on results achieved (Special Report No 18/2014). Similarly, in our report on the External Borders Fund, we found that the responsible authorities did not monitor the achievement of results or did so insufficiently (Special Report No 15/2014).

#### ***Example: The projects likely to deliver the best value for money have not always been selected***

Poor project selection was found in our audit of EU-funded airport infrastructure. The need for such investments could only be demonstrated for around half of the projects examined. Also, around a third of the airports were not profitable and ran the risk that they would be closed without continuous public support (Special Report 21/2014).

# A closer look at revenue and spending areas



***Note on the naming of Member States in examples:***

Due to our sampling approach we do not audit transactions in every Member State, beneficiary state and/or region each year. The examples of errors given in this document are provided in order to illustrate the most frequent error types. They do not form a basis for drawing conclusions on the individual Member States, beneficiary states and/or regions concerned.

## A closer look at revenue and spending areas



### Revenue

€143.9 billion

### What we audited

The audit covered the EU's revenue, through which it finances its budget. In 2014, revenue contributions calculated on the basis of Member States' GNI and the VAT collected by them, provided 66 % and 12 % of the total respectively. Traditional own resources, mainly customs duties collected on imports and the sugar production charge collected by Member State administrations on behalf of the EU, provided 12 % of the revenue, with the remaining 10 % being from other sources.

### What we found

Affected by material error?

**No**

Estimated level of error:

**0.0 %** (2013: 0.0 %)

### Our audit of EU revenue

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

For customs duties and sugar levies, we examine the Commission's treatment of the statements submitted by the Member States and the controls in selected Member States, the receipts of the amounts by the Commission and their recording in the accounts.

Our overall audit evidence indicates that these systems were overall effective and we found no errors in the transactions we tested.

We draw attention to the **updates to GNI data** in 2014 that led to adjustments to Member States' contributions of an unprecedented size, in particular those addressing reservations and those revising Member States' methods and sources.

A reservation is a means by which a doubtful element in GNI data submitted by a Member State is kept open for possible correction. The **verification cycles** of the Commission for GNI cover a long period. The resulting corrections can have a significant impact on some Member States' contributions.

## A closer look at revenue and spending areas

In parallel, we identified the need for the Commission to **reduce the impact of major revisions** made by Member States on methods and sources they use for the compilation of their GNI. For example, Cyprus and the Netherlands both experienced significant increases in their contributions due to such revisions. The proposals put forward by the Commission in 2013 to manage this risk are still outstanding with no further action having been taken by the Commission to introduce a common EU revision policy.

Regarding **customs duties**, the Member States' customs authorities perform checks to verify whether tariff and import regulations are respected by importers. We found, as in previous years, that the quality of these checks varied across the Member States we audited. We also observed that the updated version of the Customs Audit Guide, issued by the Commission in 2014, does not cover some of the shortcomings we identified in our visits to Member States, such as issues related to how to deal with imports cleared in other Member States.

### What we recommend

We recommend that the Commission:

- takes measures to reduce the number of years covered by reservations at the end of the next verification cycle for GNI-based contributions;
- puts in place arrangements to reduce the impact of revisions of methods and sources presented by Member States for the compilation of their GNI;
- improves the guidance given to Member States' customs authorities for the checks they make; and
- ensures that Member States have the appropriate systems in place for preparing and managing their statements of customs duties and sugar levies.



*Want to know more? Full information on our audit of EU revenue can be found in Chapter 4 of the 2014 annual report on the EU budget.*

## A closer look at revenue and spending areas



### Competitiveness for growth and jobs

€13.0 billion

#### What we audited

The objectives of this spending include improving research and innovation, enhancing education systems and promoting employment, ensuring a digital single market, promoting renewable energy and energy efficiency, modernising the transport sector and improving the business environment, especially for small and medium-sized enterprises (SMEs).

Research and innovation accounts for about 60 % of spending. Expenditure is made through the **seventh framework programme for research and development 2007-2013 (FP7) and Horizon 2020**, the new framework programme covering the 2014-2020 period. Other major spending instruments support education, training, youth and sport (the Lifelong Learning Programme — LLP and Erasmus+); the development of transport infrastructure (the Trans-European Networks Transport Programme — TEN-T and Connecting Europe Facility — CEF); projects in the energy sector (the European Energy Programme for Recovery — EEPR); and the Galileo satellite navigation programme.

Almost 90 % of spending is in the form of grants to private and public beneficiaries, with the Commission reimbursing costs declared by the beneficiaries in project cost statements.

#### What we found

Affected by material error?

**Yes**

Estimated level of error<sup>1</sup>:

**5.6 %** (2013: 4.0 %)

<sup>1</sup> Equivalent estimated levels of error for 2013 to reflect the new MFF headings.

In the area of research and innovation, we found the same type and range of errors that we have detected throughout the course of our audit of FP7: incorrectly calculated personnel costs; other ineligible direct costs such as unsubstantiated costs for travel or equipment; as well as ineligible indirect costs based on erroneous overhead rates or including costs categories not linked to the project.

### **Example: Significant errors in research and innovation costs declared for reimbursement under FP7 by an SME**

We found that €764 000 of costs declared by an SME working with 16 partners on a renewable energy project financed through FP7 were almost entirely ineligible. The SME owner had charged an hourly rate well above that set in the Commission's guidelines. Moreover, we identified sub-contracting costs which were neither an eligible component of costs nor procured by means of a tendering procedure. The declared indirect costs also included ineligible items, which were based on estimates and could not be reconciled with the beneficiary's accounting records.

Horizon 2020 has simpler funding rules than FP7 and the Commission has invested considerable effort in reducing administrative complexity. However, some elements in the new framework programme actually bring an increased risk of error. For example, with the aim of supporting better research and innovation and generating growth and jobs, Horizon 2020 is designed to increase the participation of SMEs and new entrants, but these types of participants are especially prone to error. Horizon 2020 also introduces specific eligibility criteria in certain cases (for example, where researchers receive additional remuneration or where participants make use of a large research infrastructure).

We also detected errors in reimbursed costs in the other major spending instruments. These include unsubstantiated and ineligible costs, as well as cases of non-compliance with the rules on public procurement.

### **Examples: Errors in costs reimbursed in other programmes**

#### **TEN-T**

In one project, the beneficiary directly awarded a contract for IT consultancy services without following the required open international procedure. In another project, the beneficiary incorrectly declared as eligible expenditure a legal settlement with a subcontractor over a breach of contract.

#### **EEPR**

A beneficiary included ineligible non-statutory costs (bonuses based on the company's profit) in its calculation of personnel costs and also claimed for indirect costs not linked to the project.

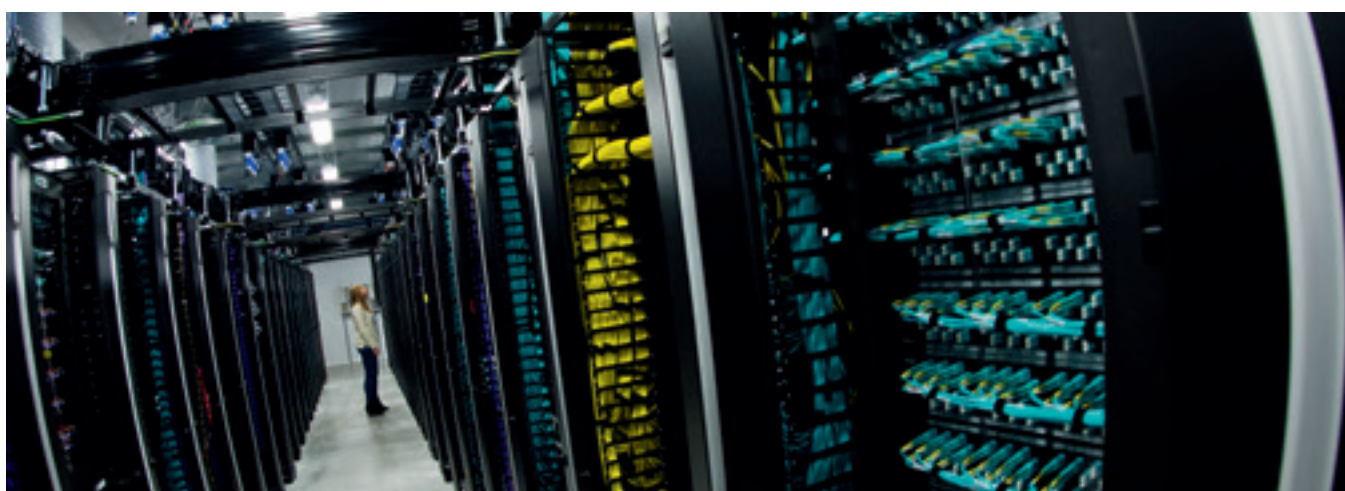
We found weaknesses in the Commission's systems and inconsistencies in the assessments of amounts at risk and error rates made by directorates-general.

## A closer look at revenue and spending areas

### What we recommend

We recommend that the Commission:

- along with national authorities and independent auditors, use all the relevant information available to prevent, or detect and correct errors before reimbursement;
- develops an appropriate risk management and control strategy for Horizon 2020, based on its experience under FP7. This should include adequate checks of high-risk beneficiaries and of costs declared under specific eligibility criteria; and
- ensures that its services adopt consistent approach for the calculation of weighted average error rates and the resulting assessment of amounts at risk.



*Want to know more? Full information on our audit of EU expenditure on competitiveness for growth and jobs can be found in Chapter 5 of the 2014 annual report on the EU budget.*

## A closer look at revenue and spending areas



### Economic, social and territorial cohesion

€55.7 billion

#### What we audited

This spending area comprises two parts: regional and urban policy which accounts for 80 %; and employment and social affairs which covers the remaining 20 %:

- The EU's regional and urban policy is mostly implemented through the **European Regional Development Fund (ERDF) and the Cohesion Fund (CF)**. The ERDF finances infrastructure projects, the creation or preservation of jobs, regional economic development initiatives and activities supporting small and medium enterprises. The CF finances investments in infrastructure in the fields of environment and transport.
- Employment and social affairs policy is mainly financed by the **European Social Fund (ESF)**. The expenditure in this area covers investments in human capital and support actions aimed at improving the adaptability of workers and enterprises to the changes in working patterns, increasing access to employment, reinforcing the social inclusion of disadvantaged persons and strengthening the capacity and efficiency of administrations and public services.

ERDF, CF and ESF are governed by common rules, subject to exceptions in the specific regulation of each fund. The management of expenditure is shared with Member States and involves the co-financing of projects within approved spending programmes. Eligibility rules for the reimbursement of costs are set out at national or regional level and may vary from one Member State to another.

#### What we found

Affected by material error?

Regional and urban policy:

**Yes**

Employment and social affairs:

**Yes**

Estimated level of error<sup>1</sup>:

**Economic, social and territorial cohesion overall:**

**5.7 %** (2013<sup>2</sup>: 5.9 %)

**Regional and urban policy:**

**6.1 %** (2013<sup>2</sup>: 7.0 %)

**Employment and social affairs:**

**3.7 %** (2013: 3.1 %)

Comprising

<sup>1</sup> Equivalent estimated levels of error for 2013 to reflect the new MFF headings.

<sup>2</sup> These figures for 2013 are calculated on the basis of the approach for the quantification of public procurement errors applicable at the time of the audit. They do not reflect the impact that the updated approach for the quantification of these errors had on the estimated level of error.

## A closer look at revenue and spending areas

The **main source of error** for the spending on economic, social and territorial cohesion as a whole continues to be infringement of public procurement rules, accounting for nearly half of the estimated level of error. This is followed by the inclusion of ineligible expenditure in the beneficiaries' cost declarations, infringement of state aid rules and the selection of ineligible projects. The impact of errors varies between these two spending areas.

Cases of serious failure to comply with public procurement rules that we identified in our audit work include, for example, unjustified direct award of contracts, additional works or services, unlawful exclusion of bidders, as well as cases of conflict of interest and discriminatory selection criteria.

### ***Example: Unjustified direct award of public works***

In a project in Malta related to the reconstruction and upgrade of a motorway section of a TEN-T road network, the contracting authority negotiated directly a contract with one company without a prior call for competition. This is not in line with EU and national procurement laws and the expenditure declared for this contract is ineligible. Another main cause of error is ineligible expenditure. This is due to, for example, expenditure declared outside the eligibility period, overcharged salaries, the declaration of costs not related to the project, non-compliance with national eligibility rules, or revenue that has not been deducted from the declared costs.

### ***Example: Incorrect declaration of salaries***

In a project in Portugal related to a training programme for young people, the grant agreement provisions on how teachers' salaries are to be calculated were not complied with by the beneficiary. In addition, the teachers did not work as many hours as declared. This resulted in personnel costs being overcharged.

We also verify whether EU **state aid rules** have been respected. Unlawful state aid represents an unfair advantage for the beneficiary entities and thereby distorts the internal market. Errors related to infringement of EU state aid rules accounted for around a fifth of the estimated level of error of spending under this MFF heading.



## A closer look at revenue and spending areas

For a significant proportion of transactions affected by quantifiable errors, **authorities in the Member States had sufficient information available** to prevent, or detect and correct the errors before claiming reimbursement from the Commission. If all this information had been used to correct errors before declaring the expenditure to the Commission, the estimated level of error for expenditure under economic, social and territorial cohesion would have been 1.6 percentage points lower. In addition, we found that for a number of cases, the error that we detected was made by national authorities. These contributed 1.7 percentage points to the estimated level of error.

By the end of 2013, the **average disbursement rate to final recipients** of financial instruments was 47 %. These funds provide assistance to enterprises or urban projects by way of equity investments, loans or guarantees. In total, since 2007, Member States have set up 941 financial instruments with an endowment of around €14.3 billion. In April 2015, the Commission extended the eligibility period for these instruments through a Commission decision, instead of asking the Council and the Parliament to amend the deadline specified in the related Council regulation. In our view, this way of extending the eligibility period does not respect the hierarchy of the norms.

ESF projects whose costs are declared using **simplified cost options** (lump-sum and flat rate payments and standard scales of unit cost) are less prone to error than those using actual costs.

Beneficiaries declare paid expenditure to the national authorities and should be reimbursed 'as quickly as possible and in full'. However, we have found that in some cases Member States have built up treasury reserves and beneficiaries were only paid several months after the related statement of expenditure was settled by the Commission, or had not been reimbursed at all at the time of the audit.

In general, the Commission's assessment of error rates reported by audit authorities is largely coherent with the evidence provided by these audit authorities. However, the Commission's verification of annual control reports can only partly address the **risks of under-reporting of errors and over-reporting of financial corrections** by national authorities in Member States. In particular, checks on state aid done by audit authorities were inadequate for nearly a third of the examined operational programmes.

In addition to checking the regularity of transactions, we assessed whether and to what extent ERDF, CF and ESF projects that had already been completed by the end of 2014 had achieved their objectives as set out in the grant agreements, and whether these objectives were in line with the objectives specified at programme level. We found that three quarters of the projects we examined had fully or partially achieved their objectives. Only in three cases were none of the project objectives attained. We also identified some cases of projects that had objectives that were not in line with those specified for the operational programme and the priority axis under which the project was funded.



## A closer look at revenue and spending areas

Finally, our review revealed that performance-based funding arrangements are the exception rather than the rule. In most cases, failure to achieve project objectives agreed in grant agreements did not impact on the level of EU funding received.

### What we recommend

We recommend that:

- the Commission carries out a focused analysis of the national eligibility rules for 2007-2013 and 2014-2020 programming periods and uses it to provide guidance to Member States on how to simplify and avoid unnecessary complex and/or burdensome rules;
- the Commission further strengthens the control system for audit authorities, ensuring adequate checks of compliance with state aid and public procurement rules and that they provide the specific information on audits of operations. The Commission should assess in all Member States the reliability of the financial corrections reported by the certifying authorities;
- the Commission submits a legislative proposal to amend the applicable regulation concerning the extension of the eligibility period for financial instruments under shared management;
- managing authorities and intermediate bodies in Member States intensify their efforts to address weaknesses in 'first level checks'. In addition, the Commission should request audit authorities to include in their systems audits the re-performance of some of these checks; and
- Member States extend the use of the simplified cost options for projects exceeding €50 000 as well as ensure that reimbursement to beneficiaries is done within 90 days after the submission of a correct payment claim by the beneficiary.



*Want to know more? Full information on our audit of EU expenditure for economic, social and territorial cohesion can be found in Chapter 6 of the 2014 annual report on the EU budget.*

## A closer look at revenue and spending areas



### Natural resources

€57.5 billion

### What we audited

This spending area covers the common agricultural policy (CAP), common fisheries policy (CFP) and environmental measures:

- The CAP aims to increase agricultural productivity, ensure a fair standard of living for the agricultural community, stabilise markets, assure the availability of supplies and ensure that supplies reach the consumers at reasonable prices. It is implemented through two funds: the **European Agricultural Guarantee Fund (EAGF)** which fully finances EU direct aid and market measures and the **European Agricultural Fund for Rural Development (EAFRD)** which co-finances rural development programmes together with the Member States. Management of the CAP spending is shared with Member States. Expenditure under both funds is channelled through some 80 paying agencies that are responsible for checking the eligibility of aid applications and making payments to beneficiaries.
- The CFP pursues similar objectives to those of the CAP and the main tool for implementation is the **European Fisheries Fund (EFF)**. The fund is managed by the Commission and the Member States under shared management.
- The EU's policy on environment aims to contribute to protecting and improving environmental quality, the life of citizens, and the rational utilisation of natural resources. Expenditure in this area is managed centrally by the Commission. The **programme for environment (LIFE)** is the most important. It co-finances projects related to nature, biodiversity, environmental policy and governance, information and communication.

### What we found

Affected by material error?

Agriculture — market and direct support:

**Yes**

Rural development, environment, climate action and fisheries:

**Yes**

Estimated level of error<sup>1</sup>:

**Natural resources overall:**

**3.6 %** (2013: 4.4 %)

**Agriculture — market and direct support:**

**2.9 %** (2013: 3.6 %)

**Rural development, environment, climate action and fisheries:**

**6.2 %** (2013: 7.0 %)

Comprising

<sup>1</sup> Equivalent estimated levels of error for 2013 to reflect the new MFF headings.

## A closer look at revenue and spending areas

The nature and pattern of errors varies significantly between EAGF and the other spending areas under natural resources.

### Agriculture — market and direct support (EAGF)

Many of the errors identified in our audits are the result of inaccurate or ineligible claims by beneficiaries, with the most frequent being the over-declaration of agricultural land surface or ineligible parcels of land (see examples). Having a reliable and up-to-date Land Parcel Identification System database (LPIS) can help to reduce such errors.

#### *Examples of overstated or ineligible claims*

##### ***Aid for permanent pasture***

In the Czech Republic, France, Greece, Poland, Slovakia and Spain, some land claimed and paid for as permanent grassland was in reality fully or partly covered with ineligible vegetation (dense shrubs, bushes, trees and rock).

##### ***Aid for arable land***

In the Czech Republic, Denmark, Finland, France, Germany, Italy, Poland, Slovakia, Spain and the United Kingdom, we found cases of land claimed by beneficiary farmers as arable when this was not the case. In Spain, aid was paid for land claimed and recorded in the land parcel identification system as arable land which was, in reality, a motocross track.

In several cases of quantifiable errors made by final beneficiaries, national authorities had sufficient information to prevent, or detect and correct the errors before declaring the expenditure to the Commission. If all the information had been used to correct errors, the estimated level of error would have been 0.6 percentage points lower. In addition, we detected a considerable number of cases of errors made by the national authorities. These contributed 0.7 percentage points to the estimated level of error.

Beneficiaries of EAGF direct support and of EARDF area-related support have a legal obligation to fulfil **cross-compliance requirements**. These requirements relate to the protection of the environment, public health, animal and plant health, animal welfare and to the maintenance of agricultural land in good agricultural and environmental condition. If farmers do not comply with these obligations their aid is reduced. In our testing, we found infringements in 27 % of the transactions subject to cross-compliance obligations. The cross-compliance errors had an impact of 0.7 percentage points on the estimated level of error.

## A closer look at revenue and spending areas

The **integrated administration and control system (IACS)** is the main management and control system for ensuring the regularity of EAGF payments. For 2014, we examined the operation of IACS in Croatia and identified only minor deficiencies that do not affect the reliability of the system. We additionally carried out desk reviews of 14 conformity audits carried out by the Commission on systems in Member States and found the work done to be satisfactory. Remedial action has also been taken on IACS weaknesses that we reported in previous years. However, this was not always done promptly and, in several instances, weaknesses continue to persist, although to a lesser degree.

The payments under market measures represent around 6 % of the EAGF. However, they contribute disproportionately to a larger share of the overall estimated level of error for the Fund.

We also completed our examination of the **reinforcement of assurance procedure** that is applicable on a voluntary basis in six Member States or regions. In these Member States or regions, an independent audit body provides an opinion on the proper functioning of systems and the regularity of expenditure declared to the EU. With the exception of one Member State, the weaknesses in the implementation of this procedure make the levels of error they report unreliable.



## A closer look at revenue and spending areas

### Rural development, environment, climate action and fisheries

We found errors in all 18 Member States which we audited. The main reasons for errors in this spending area were ineligibility of the beneficiary, activity, project and/or expenditure, or non-compliance with agri-environment commitments to use agricultural production methods compatible with protection of the environment, landscape and natural resources.

#### **Examples of eligibility errors**

We found three cases of suspected intentional circumvention of the rules when claiming for aid. These cases were forwarded to the European Anti-Fraud Office for analysis and possible investigation. For confidentiality reasons, we cannot disclose specific details of these cases but can describe the general nature of these errors:

- Well-established companies, which would not qualify for financing, set up new entities to artificially meet the eligibility and selection criteria.
- Groups of persons set up several entities for the purpose of obtaining aid which exceed the ceiling allowed under the conditions of the investment measure. Although the beneficiaries declared that these entities operate independently, this was not the case in practice.

#### **Examples of non-compliance with agri-environment commitments**

We detected six such cases in Germany, Italy and United Kingdom. For example, in the United Kingdom, a beneficiary did not respect the commitment he made to close off a hay meadow for grazing before 15 May of each year.

In some cases of quantifiable errors made by final beneficiaries, national authorities had sufficient information to prevent, or detect and correct the errors before declaring the expenditure to the Commission. If all information had been used to correct errors, the estimated level of error for this spending area would have been 3.3 percentage points lower. In addition, we detected a few cases of errors made by the national authorities. These contributed 0.6 percentage points to the estimated level of error.

We found significant weaknesses in nine of the 12 reviewed systems of Member States. For the five paying agencies that we visited on the spot, the system weaknesses that we found were very similar to those identified and reported in previous years.

For 2014, based on a pilot exercise that we undertook on some **project performance** issues, we found that for 93 % of the completed rural development projects we examined, the investment had been carried out as planned. However, the targeting of the support and the selection of the projects were not as rigorous as could be expected. We additionally observed that there was insufficient evidence that costs were reasonable.

In the case of fisheries, we assessed the effectiveness of the checks done by the audit authority in Italy and found that while the methodology for audits of operations and systems was effective, there were weaknesses in the management and documentation of audit tasks and in the verification of eligibility conditions.

### What we recommend

We recommend that:

- for EAGF, Member States make further efforts to include reliable and updated information in their LPIS database and to use all the information available to avoid payments for ineligible land;
- for rural development, the Commission takes the appropriate measures to strengthen the Member States' action plans addressing frequent causes of error, and to revise the strategy for its rural development conformity audits;
- for both the EAGF and rural development, the Commission ensures that the new assurance procedure which will become mandatory from 2015 is correctly applied and reliable; and
- in the area of fisheries, the Commission ensures that Member States carry out their tasks more thoroughly, notably through required on-the-spot controls, applying quality control procedures and improving audit documentation.



## A closer look at revenue and spending areas



### Global Europe

€7.4 billion

#### What we audited

This spending area covers expenditure in the fields of foreign policy, support to EU candidate and potential candidate countries, as well as development assistance and humanitarian aid to developing and neighbouring countries (with the exception of the European Development Funds).

Expenditure is dispersed throughout more than 150 countries, using a broad range of cooperation instruments and delivery methods. Spending is implemented directly by Commission directorates-general, either from their headquarters in Brussels, by EU delegations in recipient countries, or jointly with international organisations.

#### What we found

Affected by material error?

**Yes**

Estimated level of error<sup>1</sup>:

**2.7 %** (2013: 2.1 %)

<sup>1</sup> Equivalent estimated levels of error for 2013 to reflect the new MFF headings.

The majority of errors we identified from our audits involve **ineligible expenditure** claimed by final beneficiaries, particularly expenditure incurred outside the eligibility period, inclusion of ineligible taxes, non-compliance with the rule of origin, and indirect costs wrongly charged as direct costs. We also found cases of beneficiaries claiming costs without supporting documentation to justify the expenditure, instances of non-compliance with procurement rules, as well as errors in calculation.

Other errors we found related to the acceptance and clearance of payment by the Commission for services, works or supplies that had not yet been incurred by the beneficiary.

#### **Example: Expenditure not incurred**

The Commission concluded a €6.5 million contribution agreement with a Caribbean bank for the establishment of a revolving credit facility for sugar cane replanting in Belize. In 2014, the Commission accepted expenditure amounting to €2.3 million, of which €740 000 represented loans to farmers which had been approved by the bank but had not been paid out at the time. They led to the Commission clearing a higher amount of pre-financing than was justified.

## A closer look at revenue and spending areas

The testing of transactions of EuropeAid, one of the directorates-general of the Commission managing a significant part of the Global Europe spending, revealed, in some cases, **a failure to detect errors**. The shortcomings in these checks, carried out *ex ante* by auditors appointed by the beneficiaries, led to the reimbursement by the Commission of ineligible costs.

### What we recommend

We recommend that the Commission:

- sets up and implements internal control procedures to ensure that pre-financing payments are cleared on the basis of actual incurred expenditure; and
- strengthens the *ex ante* controls for grant contracts, including the use of risk-based planning and systematic follow-up and on-the-spot visits.



Want to know more? Full information on our audit of EU expenditure for Global Europe can be found in Chapter 8 of the 2014 annual report on the EU budget.



### Administration €8.8 billion

#### What we audited

Administration covers the expenditure of EU institutions and other bodies. These are the Commission, Parliament, European External Action Service (EEAS), European Council and Council, European Court of Justice, European Court of Auditors, European Economic and Social Committee, Committee of Regions, European Ombudsman and European Data Protection Supervisor. It also includes payments to the European Schools.

Spending on human resources (salaries, allowances and pensions) accounts for about 60 % of the total. Expenditure on buildings, equipment, energy, communications and information technology accounts for the remainder.

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

#### What we found

Affected by material error?  
**No**

Estimated level of error<sup>1</sup>:  
**0.5 %** (2013: 1.1 %)

<sup>1</sup> Equivalent estimated levels of error for 2013 to reflect the new MFF headings.

**Our examination of systems did not reveal any significant weaknesses overall.** However, we found some areas where there is scope for improvement in certain institutions and bodies. These are covered in the following recommendations.

### What we recommend

We recommend that:

- the European Parliament reinforces the controls concerning the reimbursement of costs by European political parties to their affiliated organisations as well as for public procurement by the political parties;
- the European Economic and Social Committee strengthens its procurement procedures; and
- the institution and bodies improve their systems for updating information for calculating family allowances.



*Want to know more? Full information on our audit of EU expenditure for administration can be found in Chapter 9 of the 2014 annual report on the EU budget.*



## European Development Funds (EDFs)

€3.1 billion

### What we audited

The EDFs provide European Union assistance for development cooperation to the African, Caribbean and Pacific (ACP) states and overseas countries and territories (OCTs). EDF spending and cooperation instruments aim to overcome poverty, and to promote sustainable development and the integration of ACP countries and OCTs in the world economy.

The EDFs are funded by the Member States. They are managed outside the framework of the EU budget by the European Commission and, for some assistance, by the European Investment Bank. Each EDF is governed by its own financial regulation. External aid financed by the EDFs is implemented in a high risk environment, notably due to the geographically dispersed activities and weak institutional and administrative capacity in partner countries.

### What we found

Reliability of the EDFs accounts:

**2014 accounts present fairly the financial position of the EDFs, the results of their operations, their cash flows and the changes in net assets.**

Is the revenue of EDFs affected by material error?

**No**

Are the payments of the EDFs affected by material error?

**Yes**

Estimated level of error:

**3.8 %** (2013: 3.4 %)

As in previous years, the level of error we found — including in some final claims which had been subject to external audits and expenditure verifications — point to weakness in the *ex ante* checks. Errors relating to **non-compliance with procurement rules** (see example) and the **absence of supporting documents to justify expenditure** were the cause of nearly two thirds of the estimated level of error.

### **Example: Failure by the beneficiary to comply with procurement rules**

We examined the procurement of IT services by an organisation in charge of agricultural cooperation between ACP countries. The audit revealed that the beneficiary had not complied with the procurement procedure stipulated in the grant agreement which required the publication of a tender notice at international level. The beneficiary only sent invitations to tender to three selected companies in its country of location, resulting in restricted competition.

EuropeAid is the directorate-general of the Commission which manages almost all of the spending under the EDFs. It is currently implementing an action plan to address weaknesses in its systems. As some actions are still under development, it is too early for us to assess the impact of these developments on the effectiveness of its systems.

### **What we recommend**

We recommend that the Commission:

- strengthens controls over the clearance of pre-financing and for ensuring the correct use of exchange rates by partner countries to convert budget support disbursements into their national currencies; and
- improves the arrangements in place to assess the efficiency and cost-effectiveness of controls.

## Audit approach at a glance

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

### Reliability of the accounts

#### Do the EU annual accounts provide complete and accurate information?

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

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

### Regularity of transactions

#### Do the EU income and expensed payment<sup>1</sup> transactions underlying the EU accounts comply with the rules governing them?

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

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

<sup>1</sup> Expensed payments: interim payments, final payments and clearing of advances.

### The European Court of Auditors and its work

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

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

Our principal tasks are:

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

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



### Our output

We produce:

- **annual reports** on the EU budget and European Development Funds. The annual reports mainly comprise the statement of assurance opinions and results, and are published each year in November;
- **specific annual reports** setting out the ECA's financial audit opinions on each of the EU's various agencies and bodies. 51 published in 2014;
- **special reports** on selected audit topics, published throughout the year. They are mainly performance audits. 24 published in 2014;
- **opinions** and other outputs used by the European Parliament and the Council when approving EU laws and other decisions with significant financial management implications. 14 published in 2014;
- **landscape reviews** on selected areas of EU policy analysing broader challenges and long-term trends. Two published in 2014;
- **annual activity report** providing information and insight on our activities for the year.

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

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## Introducing and explaining the EU auditor's 2014 annual reports

The European Court of Auditors is the EU's independent audit institution — guardians of the EU's finances. This publication provides a summary of the main findings and conclusions of the ECA's 2014 annual reports on the EU budget and the European Development Funds. It covers the reliability of the accounts, the regularity of income and spending and getting results from the budget. The full texts of the reports are available on <http://eca.europa.eu> and in the Official Journal of the European Union.



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