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**Annex to the**

**REPORT FROM THE COMMISSION**

**Member States' replies to the Court of Auditors' 2004 Annual Report**

{COM(2006) 184 final}

**Analysis of Member States' replies to the Court of Auditors' 2004 Annual Report**

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## INTRODUCTION

The European Court of Auditors ('the Court') published its *Annual report concerning the financial year 2004* ('2004 Annual report') on 15 November 2005<sup>1</sup>. In the report, the Court presented its Statement of Assurance ('the DAS') and the supporting information, including observations concerning management in Member States.

As obliged by the Financial Regulation<sup>2</sup>, the Commission informed Member States immediately of such observations as well as the findings identified by the Court during its audits and attributed to Member States. Member States were invited to submit their replies by 15 December 2005.

The report summarizing the replies of Member States was adopted by the Commission on 20.4.2006 (COM(2006) 184). This working document presents in more detail the analyses of the replies and supporting information.

*Annex 1* contains a summary of Member States' general remarks as well as reactions to the Court's observations on own resources, agriculture policy and structural actions. The replies have been shortened so that only main issues raised by the Member States are included in the summary. It is not meant to present a full overview of Member States' positions on specific policies or cases of irregularity.

Annex I is based solely on the replies submitted by Member States concerning observations in the Court's 2004 Annual report. **It presents the views of Member States only.**

*Annex 2* contains an analysis of issues concerning the 2004 DAS statement. This includes an overview of the Court's DAS findings and an overview of the underlying sector letters.

Annex 2 is based partly on the replies submitted by Member States concerning observations in the Court's 2004 Annual report, partly on replies by Member States to the Court's sector letters concerning findings made during its preparation of the 2004 Annual report.

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<sup>1</sup> The report was published in the Official Journal C 301 of 30.11.2005. It is available on the Court's website: [www.eca.eu.int](http://www.eca.eu.int).

<sup>2</sup> Article 143(6) in The Financial Regulation applicable to the general budget of the European Communities, Council Regulation (EC, Euratom) No 1605/2002 of 25.6.2002.

## **ANNEX 1: SUMMARY OF MEMBER STATES' REPLIES**

The Commission sent a letter to each Member State on 15 November 2005, attaching:

- A list of points in the 2004 Annual report specifically concerning the Member State in question.
- A list of DAS findings for the financial year 2004 attributed by the Court of Auditors to the Member State in question.

Member States were asked to comment on the observations made by the Court in the 2004 Annual report. They were also asked to state for each substantive finding: 1) if they agreed with the Court's appreciation of the facts, 2) if the finding was systemic or one-off, 3) if the amount concerned would be or had been recovered, and 4) if remedial action had been or would be taken. Finally, Member States were given the opportunity to make general remarks.

All Member States but one replied. Most replied within or shortly after the deadline set by the Commission (15 December 2005).

The general remarks are summarised in table 1.a. The replies to observations by the Court in the Annual report are summarised in table 1.b (own resources), 1.c (agriculture policy) and 1.d (structural actions).

Table 1.a. General remarks

Member State	Observation
Denmark	Denmark considers it extremely important that the work of the Member States' Supreme Audit Institutions is incorporated in the Court's DAS audit wherever possible.
Finland	<p>Responses to the Court's preliminary observations have not always been taken into account in the annual report. For this reason, some of the conclusions are clearly wrong. Producing the responses and explanations often involves going to a lot of trouble compared to the minimum effect they then have on the Court's final conclusions.</p> <p>Finland would also like to draw attention to the European Court of Auditors' extremely limited ability to operate in a Finnish-language audit environment. As a result, not all the essential information gets through to the auditors.. Finland takes the view that the Court should ensure that its auditors have the appropriate language skills or interpreting resources at their disposal for audits in Member States.</p>
France	As an opening remark to structural measures, the French authorities state that they question if the Court's sample is representative (as defined by international audit standards). The sampling method is not mentioned in the report. In addition, general conclusions are based on a limited number of findings from isolated operations, often representing small amounts. They regret that the information needed to evaluate the importance of the error is never provided.
Germany	The stricter requirements for financial controls in the period 2000-2006 have given rise to a heavy control workload, which in Germany has to be covered to a large extent without any additional staff. The cost of management and control systems in Member States should be assessed by the Commission to ensure that the cost is proportionate to the results obtained. Simplifying the rules governing the management of funds and checks on their use would be more productive than more controls. Germany is opposed to additional costs for controls being defrayed from funding for technical assistance, since Member States are responsible for the administration costs entailed in the implementation of the Structural Funds.

Table 1.a. General remarks

Member State	Observation
Netherlands	The Netherlands Government endorses the need for good control systems, which constitute a precondition for adequate checking of the legitimacy of EAGGF Guarantee Section payments. It subscribes to the need for legal and regular payments and, in that context, a procedure which provides assurance about reliability and accuracy is indispensable.
Poland	<p>Poland mentions several issues:</p> <ol style="list-style-type: none"> <li>1. The certificating body within agriculture points out that subsequent certification audits can be planned in such a way as to provide direct assurance that information supplied by claimants is correct and that payments are legal and regular. It proposes that the duty to check that expenditure at beneficiary level is legal and regular and the scope of those checks should result directly from Community provisions. It should also be borne in mind that there are other other Community provisions requiring the Member State to check on beneficiaries may lead to duplication of controls and checks in the same area.</li> <li>2. The Court has not taken account of Poland's explanation of the errors found after the Court's mission. As a result, the explanatory material now being sent to the Commission is much that same as that previously sent to the Court.</li> <li>3. Lists of errors accompanying the annual letter requesting Member States to comment on the Court's Annual Report should be more detailed and contain the name of the institutions involved in the Court's inspection.</li> </ol>
Sweden	Sweden agrees with the Court that the Commission should send its results to the audited Member State as soon as possible after an audit is complete (relates to closure audits in the area of structural funds). Based on an audit of two Structural Funds programmes carried out by the Swedish National Audit Office, Sweden finds that the control systems function according to the rules. However, it agrees with the Court that the sampling method should be better documented and indeed complemented with a documented risk analysis.

Table 1.a. General remarks

Member State	Observation
United Kingdom	<p>As regards programme closures in general (Structural Funds), the closure process was hampered by the invoking of additional requirements for information above and beyond that contained in the Regulations. The Office of the Deputy Prime Minister (ODPM) accepts the general feel of the report and agree that there are still areas within the management of the fund where improvements are necessary both at the managing/paying authority level and at project level. Measures have been taken to this end.</p> <p>The UK would ask that consideration be given, especially to avoid confusion within the media circle, to the ECA report specifying that their findings were totally about the management of the fund and recommendations were being made for improvement, rather than anything fraudulent. The current style of reporting could be damaging for the programme, the region and affect the moral of those associated with it.</p> <p>Also, the ECA should perhaps consider organising 'open days' similar to those being organised by the Commission, or make a series of visits to Member States, explaining, for example, what they do and what they expect to see during their visits to Member States. This should include their interpretation of the regulations.</p> <p>With regard to audits in general, the United Kingdom is in agreement with many of the aspects of a <i>roadmap</i>, but feels that there should be some emphasis on simplifying Regulations rather than clarifying which seems to result in additional and more complicated Regulations. In addition, if audits could be set more as system and benefit cost audits rather than transaction tracing audits this would help enormously. Transaction tracing audits bring up specific timed errors, often of minor amounts, which when extrapolated can make it look as though the whole programme is in error. These errors are also often corrected later but this is not recognised when checks take place within a specific period.</p>

Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
Electronic customs clearance			
3.8-3.18	France	Risk profiles were not used.	They have been introduced.
3.9-3.18	Estonia	Fall back systems for computer systems are needed.	The Tax and Customs Board has taken several actions, inter alia developed and introduced server recovery plans. By the end of June 2006, back-up recovery will be tested with the new system.
3.9-3.18	Finland		In point 3.14, the Court urges Member States to make efforts to comply with an amendment of the Customs Code. Finland finds this premature as the implementing provisions are still being discussed.
3.9-3.18	Germany		Germany lists actions taken/replies made (extensive failure tests, the need to do random tests, assessment and analysis of filters), claiming that in all cases the European Commission has accepted these actions/replies.
3.9-3.18	Hungary		In 2004, the Court made an audit prior to the investigation carried out by the Commission



Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
			from 8-12.11 and mentioned a few shortcomings. However, considerations in point 3.10 can only indirectly compared to these findings. Considerable organisational development was implemented in the course of 2005. Information on the technical restoration process was handed over to the Court during its visit in October 2005.
3.9-3.18	Latvia		Fallback procedure has been developed. Some of the Court's recommendations on IT are not clear. A plan of measures on recommendations on customs procedures made by the Court following its visit to Latvia has been approved.
3.9-3.18	Lithuania		Fallback procedure is under development. Rules require that the customs officers check data introduced into the ASYCUDA system. Lithuanian customs use risk analysis and risk profiles in all the import and export procedures during customs clearance. In August 2005, the Customs Department has issued an order prohibiting customs officers from changing the control level selected by the ASYCUDA system to a less detailed

Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
			one.
3.9-3.18	Netherlands		The Court did not find shortcomings in the Netherlands customs system.
3.9-3.18	Poland		Comprehensive disaster plans have been partially drawn up but it has not been possible to test their effectiveness. The other points raised by the Court are not considered particularly relevant to Poland.
3.10-3.18	Slovakia		The customs administration has drawn up and tested a disaster plan. A new declaration system to be launched January 2006 will allow checks on the conformity of the electronic data with the data submitted on paper. Risk profiles are used.
3.9-3.18	United Kingdom		The Court's audit was done in May 2004 with sector letter sent 16.12.2004. The UK replied on 16.3.2005. Commission followed up in September 2005. Only two points are outstanding. Customs are in the process of obtaining the additional information requested by the Commission and will reply

Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
			when the details are available.
B-accounts			
3.23	Belgium	Delays in making entries, erroneous entries, omissions and incorrect cancellations made in several Member States.	The Court did not do audit in 2004, i.e. remark must be based on the results of the Commission's audit mission in November 2003 which led to two remarks. In most cases, the amounts collected had already been entered in the A accounts or had rightly been corrected. Thus, the amounts collected were made available to the Commission on time and the reliability of the B account is not an issue.
3.23	Cyprus		Only one erroneous entry worth £ 87 999. Was settled in October 2004. Another ex post erroneous entry of £ 169 was settled in March 2005. This is a finding made during a joint inspection by the Commission and the national authorities.

Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
3.23	Germany	An 2003, Germany removed entries totalling 40,1 million euro from its B account, without providing a full explanation of this reduction.	Germany is investigating the matter and expecting a detailed report to be submitted by 31.1.2006.
3.23	Ireland		Ireland issued new instructions to all Customs staff in September 2005 reminding them of the need to promptly inform about debts and recoveries. The B accounts are also being reviewed.
3.23	Poland		No comment necessary.
3.23	Slovakia		No comments necessary.
3.23	Sweden		The observations are based on an inspection carried out by the Commission in June 2004. The Commission's report showed that the B accounts were generally being handled in a satisfactory way. The Commission found two discrepancies. One is accepted, the other was based on a mistake.
3.23	United Kingdom		The Court's audit was done in February 2005 with sector letter sent 15.7.2005. The

Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
			UK replied on 5.9.2005. The Commission has not followed up. The B accounts have been centralised and significant progress has been made with the transfer of cases from the regional offices. The measures introduced should produce improvements in the accuracy and completeness of the B accounts.
GNI resource			
3.37	Italy	Quality report	Italy followed the standards supplied as regards content and format.
3.40	France	GNI inventories were presented in 2003 and not in 2000 as foreseen.	France wants to avoid delays in the future. It stresses that it reacted quickly to criticism raised by Eurostat in 2004 on France's method for estimating GNI.
3.42	Italy	Inventory	The Commission analysis of the inventory relating to Italy was amplified and also involved inspection visits.
3.43	Italy	Only a few Member States have included estimates of illegal activities in GNI.	Italy regards the inclusion in the GNI of an estimate of illegal activities as premature.

Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
3.47+3.48	France	Supervisory systems and controls vary between Member States.	No comments.
3.48	Germany	Supervisory systems and controls vary between Member States.	The Federal Statistical Office assesses the risk of being unable to compile annual GNI for Germany as extremely slight. Quality reports are being produced for by the end of 2005. Checks are done.
3.47+3.48	Greece		Member States submitted quality reports for the first time in September 2004. Harmonisation was needed. Greece followed all guidelines when preparing the quality report for 2005.
3.47+3.48	Hungary		No comments.
3.47-3.49	Italy	Supervisory systems and controls vary between Member States.	The layouts proposed by the Court need standardisation and broad dissemination among statistical institutions in order to adopt a “common language”. Many of the operations described are in fact already performed in Italy, although they are possibly not fully documented, precisely for want of such a “common language”.

Table 1.b. Own resources

Paragraph	Member State	Observation	Reply
3.47+3.48	Poland		Poland has no comments.
3.51	Germany	Eurostat annual activity report does not mention that a general reservation was in force for Germany at the end of 2004.	The general reservation was lifted in April 2005 and replaced by three specific observations on which the Federal Statistical Office has taken action. Corrected figures were sent to Eurostat in September 2005.

Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
IACS in Greece			
4.8	Greece	IACS in Greece can still not ensure compliance with legality and regularity for area aid and animal premium payments. The Court criticizes the farmers' union control of input of data into the computer system and inter alia mentions that for 2004, farmers' unions changed data for more than 22000 parcels more than five months after the claim period ended. The Court also finds that the quality of on-the-spot inspections is low and that some reports do not seem to be based on genuine inspections.	The Court of Auditors' remark that Farmers' Cooperative Unions have exclusive access to the database is incorrect. Checking error references is a job carried out exclusively by Agricultural Development Directorates. The changes made by the farmers' union in 22000 parcels are acceptable, in so far as the parcels represent only 1% of more than 2 million parcels. The Court's observation of poor quality of on-the-spot checks is not acceptable as this only concerns isolated cases.
Financial clearance decision for 2004			
4.19+4.20	Belgium	The Commission intends to make financial corrections for paying agency Region Wallonne.	The errors reported by the certifier are of a systemic nature and indicate that in future greater attention must be devoted to the points raised. The department will institute a procedure which makes it possible to avoid these errors. Recovery procedures are being considered jointly with the Commission. The amounts involved are relatively small.



Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
4.19	Czech Republic	Paying agency received qualified opinion on accounts.	The paying has confirmed that the volume of expenditure disbursed and declared is correct. The findings are of a formal nature.
4.19+4.20	France	Financial clearance decision for 2004: Failure of paying agency to carry out on-the-spot checks.	France accepts the criticism. The paying agency administered smaller budget lines. By the end of 2005, this responsibility should be transferred to other paying agencies.
4.19+4.20	Germany	Several paying agencies received qualified opinion on accounts.	One substantial error was identified, in each case, in the accounts of two paying agencies: Baden-Württemberg and Bayern Umwelt. In both cases, procedures are ongoing.
4.19+4.20	Portugal		Portugal considers the point is purely descriptive and has no comments.
4.20	Spain	The Commission postponed its clearance of accounts for payment agencies due to Insufficient work by certifying body. Intends to make financial corrections.	Spain rejects the need for financial corrections as errors either do not exceed the materiality level of the accounts or amounts may be recovered.

Table 1.c. Agriculture policy			
Paragraph	Member State	Observation	Reply
4.20	United Kingdom	The Court notes that the Commission intends to make corrections based on financial errors detected in paying agencies.	Two observations relate to findings made by the Certifying Body during the 2004 Certification of Accounts. One case was closed in February 2005. The other case will lead to a single correction in a future ad hoc compliance clearance decision.
Conformity decisions taken in 2004			
4.23	France	Corrections mainly concern France (EUR 213 million), Greece (EUR 46 million) and Spain (EUR 34 million).	France has taken steps to meet the demands of the Commission.
4.23	Greece	As above.	Greece has appealed against the Decisions and requested the Court of Justice to annul them.
Animal premium schemes			
4.40	Greece	Italy and Greece reported significantly higher levels of error for sheep and goat premiums than other Member States.	The higher numbers of missing animals are due to the strictness with which Greece carried out its on-the-spot checks.
Subsidies paid on the basis of quantity produced			

Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
4.44	Greece	<p>a) in Greece some claims for olive oil could not be verified as the parcels declared were not at the location indicated.</p> <p>b) Greece still did not have a functioning olive oil GIS (Geographical Information System) for the period relevant to the payments made in 2004 and the regulatory compensating on-the-spot checks were not carried out satisfactorily.</p> <p>c) in Greece cases were found of producer organisations failing to make the necessary checks, for example on the disposal of olive oil or on the milling certificate supporting the claim.</p>	<p>1) Crop declarations in GIS not verified because “the parcels declared were not at the location indicated” are isolated cases.</p> <p>2) As regards the olive-cultivation year 2002/03, Greece was not obliged to complete the olive-cultivation GIS. The identification and delivery of the olive-cultivation GIS has been completed in all the prefectures of Greece in accordance with the timetable approved by the Commission.</p> <p>3) The Agricultural Development Directorates and OPEKEPE carry out administrative checks, cross-checks, on-the-spot checks and targeted checks which are entirely representative.</p> <p>4) Producer organisations carry out checks.</p>
4.44	Spain	In Andalusia, incorrect calculations for the applications of sanctions for olive growers who had declared more olive trees than recorded in the GIS.	Differences in olive trees did not entail significant differences in the amounts paid as aid for the production of olive oil and/or table olives. The paying agency did revise its method of calculating the percentage in

Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
			excess for the 2003 marketing year.
4.45	Greece	Proposals by olive oil control agencies to revoke the authorisation of olive mills are often not implemented by the authorities in the Member States.	Inspections of olive mills are rigorous. Procedures are in place to impose penalties. The interested party has a right of appeal to the courts.
4.45	Portugal	As above.	Portugal considers the point is purely descriptive and has no comments.
Rural development			
4.47	Germany	Two paying agencies received qualified opinion on accounts.	Procedures are on-going.
4.47	Portugal	Two paying agencies received qualified opinion on accounts.	The need to include recovery modules within the respective computerised clearance systems was a priority in 2005. A computerised module was developed. The process of calculation and clearance relating to beneficiaries subject to recovery were thus finalised. The process of recovery was initiated.
4.47	Spain	Two paying agencies received qualified opinion on accounts.	For one agency, the Commission took the view that the opinion of the certifying body

Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
			was of minor significance. For the other agency, decoupling of relevant accounts was done.
Other expenditure			
4.54	Greece	The Court found weaknesses in subsidies for dried grapes.	The study closed with no proposals for financial corrections. Greece disagrees with some of the errors rates established by the Court in related DAS errors.
IACS in Greece			
4.56 (and annex 2 – IACS monitoring elements)	Greece	Even though the elements that constitute IACS are formally in place in Greece, there are serious deficiencies in the functioning of the system with the result that the system is not reliable.	Greece has commented on all critical points listed by the Court in annex 2 of the Annual report.
Random tests vs. risk-based tests			
4.63	Greece	The Commission should seek to continue to investigate the reasons why, for IACS checks on areas, tests performed on a random basis continue to show a higher	There had been a calculation error in the software's algorithm and figures were declared the wrong way round. The error has been corrected. The number of

Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
		level of error than those selected on the basis of risk analysis. It should also analyse the effects of the changes made in the risk analysis in 2004.	problematic applications from the risk analysis on-the-spot is 5 686 while for the random sample it is 1 218.
Accreditation of the EAGGF paying agencies in the new Member States			
4.66 and 4.68	Estonia	The paying agency (PRIA) was accredited for a limited period of time and has weaknesses in two areas.	The accreditation was conditional due to weaknesses found by Ernst & Young Baltic in the preliminary accreditation audit. The Ministry of Agriculture's internal audit department followed up the preliminary accreditation audit and aspects regarding IT were dealt with by Ernst & Young/PWC. On the basis of these audit amendments to the directive were made.
4.68	Cyprus	The paying agency (CAPO) has weaknesses in all areas checked by the Court.	CAPO was established on 27.2.2004. During 2004, it adopted and implemented all conditions and recommendations laid down by the Advisory Committee of the Ministry of Agriculture, Natural Resources and Environment. Final accreditation was granted 27.2.2005. CAPO has been audited by: its external auditors and the Commission (DG AGRI (accreditation audit - March

Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
			2005) and once more by DG AGRI (IACS audit - November 2005)).
4.68	Latvia	The paying agency (LAD) had weaknesses in four areas.	RSS was granted provisional accreditation in May 2004 following an accreditation examination by Pricewaterhouse Coopers. Further to information provided by RSS on the successful implementation of recommendations made by Pricewaterhouse Coopers, RSS was granted full accreditation as paying agency on 29.11.2005. The Commission audited RSS in July 2005 to check compliance with accreditation criteria and the internal control system. On 1.11.2005, RSS received notification from the Commission that it complied with all criteria and requirements corresponding to an EAGGF Guarantee Section paying agency accreditation (the letter from the Commission services said that “the overall opinion of the audit team is that the infrastructure established by RSS to manage EAGGF expenditure is generally satisfactory.”).

Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
4.68	Poland	The paying agency (ARiMR) has weaknesses in five areas.	There is a mistake in table 4.8. The EUR 10,8 million relate to another agency (ARR), not the ARiMR. All payments in 2004 were made solely through ARR which was fully accredited since 1.5.2004, i.e. this point is not relevant to Poland.
SAPARD			
4.74	Hungary	The review of payments revealed weaknesses and errors although with minor financial impact.	Audit made in November 2004. Comments sent to the Court in March 2005. Hungary has given a very detailed reply. It has looked into all critical points raised by the Court and agrees with some but not all.
4.74	Slovenia	1) There were not three price offers or two from same supplier. 2) Some checks not performed or not documented. 3) Environmental and socio-economic data not checked.	1) Accepted, but is due to the small size of the Slovenian market for some types of farm machinery. 2) Procedures and documents were prepared before implementation of SAPARD began. However, some of the checks were too detailed or limited, making constant changes in check lists, handbooks and instructions necessary. Last change was made in April



Table 1.c. Agriculture policy

Paragraph	Member State	Observation	Reply
			2004.  3) Found weaknesses in the monitoring and evaluation system. Have taken steps to remedy these weaknesses.
Follow-up to special report 8/2001 on potato and cereal starch			
4.92	Netherlands	The administrative controls were satisfactory on the whole but they were not sufficiently supported by physical checks.	The Court did not address the issue of the intensity of physical checks, as the recommended figure of 10 per cent was achieved, but the independence of the body carrying out the checks was discussed as some checks were carried out by the industry itself. TThe Minister for Agriculture, Nature and Food Quality decided at that time that the General Inspectorate for Agriculture was fully responsible for achieving the minimum 10 per cent level of checks.

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
Unclear definition, allocation and separation of functions			
5.21	Sweden	Checks underlying the certification of expenditure by the paying authority were made by a department which was not independent from the authorising service.	Sweden shares the assessment of the Court. The work and allocation of tasks is to be reorganised in the course of 2005.
5.21	United Kingdom	The unit responsible for 5% sample checks reported to the departmental head also having responsibility for the management and payment of assistance.	The Court's observation is accepted. However, the Scottish Executive believe that procedures for processing claims and the IT system have been developed to ensure a full and proper separation of MA and PA work. In addition, the unit responsible for the 5% sample checks is located in Edinburgh close to internal audit services whereas the other units within the Division have relocated to Glasgow.
Failure to provide a sufficient audit trail			
5.22	Belgium	The audit trail was deficient for three of the ten projects audited.	The managing department says there was only one project – rather than three – whose audit trail could not be traced. The IT system has been altered to address this problem. The three projects have been re-examined with

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
			the promoters and the necessary corrections made.
5.22	Finland	In one programme, audit trail problems were identified in most of the projects audited by the Court.	The observation is correct but concerns the 1995-99 programme period where the Community provisions were inadequate. The previous programme period should not be judged on the basis of the provisions and guidelines governing the new programme period.
5.22	Spain	Audit trail problems.	When the auditor concludes that “the audit trail was deficient”, this entails applying to the period 1994-99 concepts which had not been defined until the period 2000-2006.
5.22	Sweden	Audit trail was deficient for three out of eight projects audited.	Sweden does not share the assessment of the Court. The material requested was assembled, checked for confidentiality and then handed over to the Court.
Failure to carry out adequate checks			
5.23	Sweden	During their on-the-spot checks, the managing authorities had not verified the actual implementation of the activities	Sweden does not share the Court’s view. In the Swedish translation of Article 4 of the regulation, the relative proportion of “desk

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
		funded.	checks” and physical checks is unclear. Due to a large number of small projects, the managing authority chose to place the emphasis of its checking activity on desk checks. The extensive desk checks conducted enabled a large proportion of the project expenditure to be checked in an effective manner. However, Sweden intends to make further changes to the checking procedure to enable more resources to be devoted to actual physical checks. The effort expended must, however, be in proportion to the magnitude of the assistance.
Shortcomings in day-to-day management			
5.24	Belgium	No checks were made of activities performed by third parties and the Court found no evidence that this expenditure was eligible.	The Court of Auditors’ interpretation of the nature of the evidence seems restrictive.
5.24	Germany	The content and depth of checking were not sufficient and aspects of eligibility of the expenditure were not properly covered.	Procedures were functioning but needed improvement. It is therefore wrong to use the word “insufficient”. Saxony has acted on the points indicated by the Court with regard to

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
			optimising the checklists for on site checks.
5.24	Italy	The content and depth of checking were not sufficient and aspects of eligibility of the expenditure were not properly covered. In one case, no checks were made of activities performed by third parties and the Court found no evidence that this expenditure was eligible.	The checks provided for in Regulation 438/01 were in fact carried out, particularly those coming under article 4 of the regulation. Overall, the current arrangements used to ensure the eligibility of expenditure are backed up by an appropriate “safety net” which, while it might be improved, is in keeping with Community, national and regional provisions.
5.24	United Kingdom	The content and depth of checking were not sufficient and aspects of eligibility of the expenditure were not properly covered. A number of errors were found for this case which is a closed programme for which the final expenditure had been certified. (This relates to a 1994-99 programme).	The control environment applied to the programme was monitored by the independent bodies throughout the period and in particular during the closure process. The independent body considered the control environment to be sufficient to comply with the requirements of the regulation. Since the closure of the 1994-99 programme, significant enhancements have been made to the control checks.
5 % checks			

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
5.25	Belgium	Delays in reporting the results of the checks were noted in two cases.	Based on a risk analysis by the independent inspection authority, it was decided to increase the percentage of checks on 2000-2002 projects from 5% to 10%. The on-the-spot checks were done in 2004 and 2005. The 2003 projects are being checked now. The sample of projects for 2004 will be selected in 2006.
5.25	Finland	5 % checks: There were no audit working papers allowing the Court's auditors to verify the application of the sampling methodology and the audit work performed.	<p>The Court's observation is not correct.</p> <p>1) The Court's auditors worked on the assumption that all audit work should be documented by auditors' working papers. Where they were not provided with working papers fully satisfying them in every respect, they took the view that there was no evidence at all of any audit work having been carried out.</p> <p>2) For work efficiency reasons, national auditors include in their working papers only copies of those documents that are necessary for the subsequent examination and documentation of the audit observations.</p>

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
			<p>Copies are also taken of documents containing divergent observations. This procedure has proved to be satisfactory for initiating recovery actions.</p> <p>3) It was in practice impossible for the auditors during the audit to familiarise themselves with the Finnish-language audit reports and audit manuals that were all available at the time of the audit.</p>
5.25	France	Risk analysis was incomplete and checks did not sufficiently cover all aspects of eligibility.	France takes note that the sampling method must be better documented and that the point on eligibility must be further developed in the questionnaires used.
5.25	Portugal	Delays in reporting the results of the 5 % checks.	The delay in submitting the results affected the monitoring of the inspections, but not the taking of necessary measures. The paying agency has reminded the management authorities to report faster.
5.25	Spain	Risk analysis incomplete or could not be explained and the checks did not sufficiently cover all aspects of eligibility. Checks did not sufficiently cover the whole	Controls exceeded the percentage required. The two beneficiaries were subject to at least one control.

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
		programme period and the sampling did not take account of risk analysis.	
5.25	Sweden	5% checks were lagging behind in terms of coverage.	Sweden does not share the assessment of the Court. There is no requirement that the checks must reach 5% at a particular point in time. However, Sweden agrees that a larger proportion of ESF projects should be checked.
5.25	United Kingdom	The risk analysis underlying the sampling was incomplete or could not be explained and the checks did not sufficiently cover all aspects of eligibility.	The Scottish Executive accept that the team responsible for the 5% checks only visited 11 out of 345 projects but would stress that they did achieve the 5% target. The 345 projects were sponsored in total by 90 applicants of which 20% were the subject of an on-the-spot inspection. There appears to be some confusion regarding the risk analysis and the selection criteria for the West of Scotland visits. Only projects above 1 million pounds were selected but this is clearly one of the restrictions of the risk analysis, especially when trying to ensure that the 5% target is achieved.



Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
5.26	France	For Reunion programme, paying agency did not have formal working procedures and insufficient checks had been done.	France takes note. The number of controls has increased.
Checks made by the paying authority before certifying statements of expenditure			
5.26+5.27	Belgium	The paying authority certified expenditure, relying solely on the checks done by the managing authority and without performing verification.	The department has just made some changes to the organisation that should take the Court's observation into account.
5.26	Germany	The coverage of checks by the certifying body had not been specified and checklists failed to cover aspects of eligibility.	The Court has withdrawn its observations in the final audit observations of 7.10.2005. The audit department now acknowledges that aspects of eligibility should be checked primarily by approval agencies and not by paying agencies.
5.26	Italy	In one case, the paying authority had no overview of the day-to-day management checks which had been carried out on the programme concerned.	The ESF paying authority had only a partial picture of the overall situation during the Court's audit. The authority now has all the necessary information, including on the checks that, implicitly, did not show up any irregularities noted during the sample check.

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
5.26	Sweden	The paying authority had no overview of the day-to-day management checks which had been carried out on the programme concerned.	Sweden does not share the Court's assessment. Reasonable assurance is obtained. However, follow-up procedures during physical checks could be improved further. New procedures were drawn up during 2005. The appropriate Swedish auditors will be monitoring that work in the course of 2006.
5.27	Finland	If not adequate checks, then increased risk of expenditure not legal and regular being declared to the Commission..	Observation is not correct in respect of Finland as adequate checks have been performed.
5.27	France	As above.	France contests this strongly. In the specific case of the Reunion programme, the Court itself stated that procedures for verifying legality and regularity were "good but minor improvements needed". The Court only made few observations on the legality and regularity of the expenditure it controlled.
5.27	Portugal	As above.	Portugal informs of number of checks done in the specific project audited by the Court. The procedure for the contracting of external auditors to carry out a second-level audit is currently under way.

Table 1.d. Structural measures			
Paragraph	Member State	Observation	Reply
5.27	Sweden	As above.	Sweden has no objections to the general findings..
Closing of 1994-99 programmes			
5.29	Austria	Closure of 1994-99 programmes: The Commission has closed programmes although closure statements submitted by Member States did not contain full details of methodology for e.g. risk analysis and sampling.	Closure was done in accordance with Regulation 2064/97. The Commission was satisfied with the closure statements provided.
5.29	France	As above.	France questions the value of this observation. The Court did not inform Member States of its findings in the Commission. Member States then find themselves mentioned in the annual report without having had the opportunity to contradict the Court's observation. In the specific case of the Lorraine programme, the representativeness of the checks was verified..
5.29	Italy	As above.	Italy describes checks done and sampling methods used.

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
5.29	Netherlands	As above.	The 5% figures was ultimately achieved.
5.29	United Kingdom	As above.	Sample selection was based on a mixture of risk and randomly selected checks. The United Kingdom agrees with the Commission's comment that "they had sufficient information to close the programme."
5.30	United Kingdom	Variable quality of the closure documentation submitted by Member States. Delays have persisted, partly because Member States have been slow to respond to enquiries from the Commission, partly because the Commission has failed to take timely action.	The Scottish Executive accept that the closure process took longer than expected, partly because resources had been directed to the operation of the 2000-2006 programmes. Planning has already started for the closure of 2000-2006 in order to ensure that resources are sufficient to support an efficient closure process.
Weaknesses in the management and control systems			
5.36	Finland	Failure to use a duly justified and equitable method for the allocation of overhead expenditure to projects.	The Court's appreciation is largely correct. Eligibility criteria were at the time not clarified as the private financing portion had still not been clarified. The shortcomings in the guidance were corrected for the 2000-

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
			2006 programming period.
5.36	France	Problems are wide-ranging.	France underlines that the Court's audit of the Reunion programme led to a recovery of around EUR 500 out of more than EUR 700 000. France finds it inappropriate – or at least excessive – to draw such a general conclusion about a programme where France has so far declared expenditure of EUR 1.4 billion.
5.36	Germany	Problems are wide-ranging.	Germany acknowledges that several problems were identified in the Court's audit of Saxony. Procedures have been improved, in order to avoid or minimise repetition of such errors in the future. In the case of the identification of eligible items of expenditure, as also with regard to the assessment of compliance with the rules governing the award of contracts, it has not been possible completely to resolve differences of interpretation between Saxony and the Court.
5.36	Italy	Problems are wide-ranging.	Italy will take action. Inter alia, the eligibility principles will be checked once

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
			again in accordance with Community law and the rules laid down by this administration.
5.36	Portugal	1) Declaration of expenditure incurred outside the eligible period. 2) Failure to take account of potential generation of revenue or other income. 3) Inadequate supporting documents.	1) The ineligible amount corresponds to an error rate of 3,9 per cent and will be rectified. 2) The promoter involved in the project did not submit the requested financial analyses. 3) Portugal accepts the Court's observations.
5.36	Spain		Spain does not agree with the Court's assessment of the facts.
5.36	Sweden	1) Declaration of costs unrelated to the programmes or projects concerned. 2) Inadequate supporting documents. 3) Failure to use a duly justified and equitable method for the allocation of overhead expenditure to projects.	Sweden is waiting for the Commission's assessment. The requested supporting documentation has been forwarded to the Court of Auditors.
5.36	United	Problems are wide-ranging.	The United Kingdom authorities have taken

Table 1.d. Structural measures

Paragraph	Member State	Observation	Reply
	Kingdom		several actions in order to ensure better guidance to all project sponsors. One of the Court's comments relate to the failure to use a duly justified and equitable method for the allocation of overhead expenditure to projects. The eligible period aspect was a matter of discussion at an article 48 committee which gave a verbal instruction that quite probably was interpreted differently by Member States or even regions within Member States.
Work of other auditors			
5.37+5.38	Denmark	A Working Group on Structural Funds of the Contact Committee of the SAIs and the European Court of Auditors produced a report in December 2004 on "...the Parallel Audit of the Management and Control Systems for Assistance Granted under the Structural Funds". The Court has included the main conclusions of this report in the 2004 annual report.	Denmark's welcomes the Court's mention of the work carried out by the Member States' Supreme Audit Institutions. Denmark considers it extremely important that the work of the Member States' Supreme Audit Institutions is incorporated in the Court's DAS audit wherever possible. For the first time the National Audit Office has provided a statement on the use of EU funds in Denmark. The statement is included as a section (D) in the report on the audit of the national budget for 2004. It concludes in point 10 that: <i>"Overall the National Audit Office takes the view that the administration, payment,</i>

Table 1.d. Structural measures			
Paragraph	Member State	Observation	Reply
			<i>accounting and control of EU funds were satisfactory and complied with the orders and regulations.”</i>
Follow-up of observations from previous Statements of Assurance: further action to be taken by the Commission			
5.46	Portugal	Significant delays in the Commission’s follow-up	Portugal is not aware of the Commission’s position in the project mentioned by the Court.



## ANNE X 2: THE 2004 STATEMENT OF ASSURANCE

The European Court of Auditors is obliged by the Treaty to provide the European Parliament and Council with an annual statement as to the reliability of the accounts and the legality and regularity of the underlying transactions (also known as ‘the DAS’).

As regards the legality and regularity of the underlying transactions, the Court bases its audit opinion on “*a consolidation of the specific assessments concerning own resources and each of the six operational chapters of the financial perspective 2000-2006. These specific assessments [...] are based on four sources of evidence:*

- (a) An examination of the way in which the supervisory and control systems set up both in the Community institutions and in the Member States and third countries work;*
- (b) A testing of samples of transactions for each major area by carrying out checks down to the beneficiary level;*
- (c) An analysis of the annual activity reports and declarations of the Directors-General and of the procedures applied in drawing them up;*
- (d) Where possible, an examination of the work of other auditors who are independent of Community management procedures.”<sup>3</sup>*

In the following, a more detailed analysis of the Court’s findings concerning the financial year 2004 is presented.

Section 1 gives an overview of findings made whereas section 2 examines the timetable for exchange of information between the Court and the auditees (Commission and Member States).

### 1. DAS FINDINGS

The Commission is responsible for the implementation of the budget but in practice EU funds are managed not only by the Commission (centralised management) but also by Member States (shared management), third countries (decentralised management) and other international organisations (joint management). The vast majority of funds are implemented by Member States<sup>4</sup>.

Controls exist at each level of management in order to ensure that payments to the final beneficiaries are legal and regular. In order to verify that controls are in place and working well, the Court goes on-the-spot to audit procedure and transactions in the Commission, authorities in Member States as well as final beneficiaries in Member States and third countries.

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<sup>3</sup> Point 1.46 in the 2004 Annual report.

<sup>4</sup> In the financial year 2004, almost 80 per cent of EU funds were managed by Member States.

The findings made by the Court are split into four groups:

- Formal findings - cases where the Court concludes that, e.g., tender procedures have not been respected or payments are made late but the irregularity does not have any financial consequence for the EU budget<sup>5</sup>.
- Substantive findings - cases where the irregularity does have a financial consequence for the EU budget. Typical examples are the farmer who declares a too big area for a field or the beneficiary who claims ineligible expenditure.
- Weaknesses in the supervisory systems and controls - these findings cover issues such as lack of 5 % controls for structural actions, use of inappropriate sampling methods, lack of risk analysis, lack of documentation of checks made, unjustified delays in closure of programmes and inappropriate set-up of roles and responsibilities among authorities performing controls.
- Other findings – these may relate to the accounts or they are findings that the Court has not classified as either formal, substantive or system weakness.

In 2004, slightly more than half the total findings were attributed to Member States. However, Member States accounted for 3 out of 4 substantive findings, *cf. table 2.a*.

**Table 2.a. Findings underlying DAS 2004. Total number of findings = 100.**

	Formal	Substantive	Systems	Other	Total
Member States	15	20	17	4	56
Commission	12	7	17	7	44
Total	27	27	34	11	100

The findings vary in importance. It is not possible to quantify the relative importance of formal findings or findings relating to the supervisory systems and controls. However, for substantive findings, the importance is measured by the financial consequence for the EU budget. Error rates are calculated showing the amount estimated to be in error in relation to the total value of the transaction.

In many cases, such error rates are easy to calculate. If the Court measures a field and finds the area is 3 per cent smaller than declared by the farmer, then the error rate is considered to be 3 per cent. Likewise, if the Court considers expenditure claimed on a structural funds project to be ineligible, then the error rate is calculated as the ineligible amount as a share of the total amount paid out from the EU budget.

The error rates are lower for findings relating to agriculture policy than for findings relating to structural actions, *cf. table 2.b*. For agriculture policy, one quarter of the substantive findings have error rates less than 2 per cent, almost one half have error rates between 2 and 10 per cent and the remaining findings have error rates higher

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<sup>5</sup> This assessment is not always shared by the Commission, which may find it necessary to apply financial corrections for conduct, e.g. in the public procurement area, which is classified as a formal error by the Court.

than 10 per cent. For structural actions, almost half the error rates are higher than 10 per cent.

**Table 2.b. Distribution of error rates for substantive DAS findings relating to agriculture policy and structural actions in 2004. Total = 100 for each category.**

	Less than 2 %	2 - 10 %	More than 10 %	Total
Agriculture policy	25	46	29	100
Structural actions	27	27	46	100

There is also a difference between findings relating to agriculture policy and structural actions when considering Member States' tendency to accept the finding or not, *cf. table 2.c*. For agriculture, Member States only reject the finding in 15 per cent of the cases whereas they reject slightly more than half the findings relating to structural actions. The rejection of findings is negligible in cases where the Court has found that areas have not been declared correctly. This may well be because the claims selected by the Court fell into the 95% of claims which the Member States, under IACS rules, are not required to check. The Court's findings did not therefore put the Member State's control system into question.

**Table 2.c. 2004 findings accepted or not accepted by Member States. Total = 100 for each category.**

	Member State accepts, even if only partly	Member State does NOT accept	Total
Agriculture policy	85	15	100
Of which:			
Finding relating to size of area	98	2	100
Structural actions	47	53	100

## 2. EXCHANGE OF INFORMATION BETWEEN THE COURT AND THE AUDITEES

When the Court has completed an audit mission to the Commission or a Member State, it analyses information collected and sends a so-called sector letter to the appropriate management level (Commission or Member State) with its preliminary findings. In practice, letters are addressed to the appropriate Commissioner or the supreme audit institution in the Member State. The Court usually invites the recipient of the letter to reply within a deadline of 6-8 weeks. When the recipient has replied, the Court usually sends a new letter with its analysis of the reply, indicating if the findings are maintained.

The Court bases itself on the findings when assessing the legality and regularity of the transactions underlying the accounts. The final assessment is presented in the Annual report which until now should be published by 30 November at the latest<sup>6</sup>.

<sup>6</sup> As of the financial year 2005, the deadline for publication of the Annual report is one month shorter, i.e. 31 October.

However, due to time needed for translation of the report and the contradictory procedure with the Commission, the Court already adopts its first draft of the report in May/June.

The Court must ensure that audit missions are carried out and letters sent in due time before the preparation of the Annual report. This is complicated, not least because time is often needed for translating supporting documents as well as letters and analyses.

An analysis of the sector letters containing substantive findings identified for the financial year 2004 shows that almost 4 in 10 of the underlying missions were carried out in the first months of 2005, *cf. table 2.d.* The Court sent its last sector letters to Member States and the Commission in July, i.e. almost two months after the Court had adopted its first draft of the Annual report.

**Table 2.d. Share of missions carried out by the Court of Auditors as well as letters, replies and analyses exchanged between the Court of Auditors and Member States. Total for each category = 100.**

	2004				2005				2006	
	Jan – Mar	Apr – Jun	Jul – Sep	Oct – Dec	Jan – Mar	Apr – Jun	Jul – Sep	Oct – Dec	Jan – Mar	Total
	----- Per cent -----									
Findings concerning Member States										
Agriculture policy										
Audit missions		4	9	36	40	11				100
Letters from the Court						42	58			100
Replies from MS							92	8		100
Analyses of the Court								40	60	100
Structural actions										
Audit missions		3	30	42	24					100
Letters from the Court					31	69				100
Replies from MS						50	50			100
Analyses of the Court						17	42	42		100
Findings concerning the Commission										
Audit missions		2	11	36	32	18				100
Letters from the Court					31	38	31			100
Replies from MS					7	38	41	14		100
Analyses of the Court							52	43	5	100
Preparation of the Annual report										
2004 Annual report						First draft	Con- tradictory proce-	15 Nov: Publi- cation		

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Note: The table is based on sector letters containing substantive findings. The sector letters could also include formal findings or findings concerning weaknesses in the supervisory systems and controls.

All letters from the Court received a reply from the relevant Member State or Commissioner. Member States replied the Court within 60 days in half the cases concerning agriculture policy but only in a quarter of the cases concerning structural actions, *cf. table 2.e*. The Commission replied within 60 days in slightly more than half the cases.

**Table 2.e. Distribution of replies from MemberStates/Commission to the Court (based on calendar days between the date in the sector letter and the date in the reply).**

	60 days or less	Between 60 and 90 days	90 days or more	Total	Average
	----- Per cent -----				Days
Member States	36	50	14	100	71
Agriculture policy	50	50	0	100	64
Structural actions	25	50	25	100	76
Commission	55	31	14	100	66