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*Committee on Budgetary Control*

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## **WORKING DOCUMENT**

on the European Court of Auditors' Special Report No 23/2014 (2014 Discharge): Errors in rural development spending: what are the causes and how are they being addressed?

Committee on Budgetary Control

Rapporteur: Miroslav Poche

### ***Audit scope, objectives and approach***

The audit addressed the following main question:

To what extent are the main causes of the high error rate for rural development 8.2% for the years 2011, 2012 and 2013<sup>1</sup> being effectively addressed by the Commission and the Member States?

The detailed questions which the audit aimed to answer were:

- What are the main causes of the error rate in investment measures?
- What are the main causes of the error rate in area-related aid?
- Do the Member States' action plans and the new EU legal framework have the potential to address these causes effectively?

To reply to the first two sub questions, the Court analysed the results reported for the sample of transactions selected randomly during the audits of legality and regularity for 2011, 2012 and 2013. Taking the results of 3 years instead of one allows for a more detailed analysis of the types of error. The analysis included reviewing 461 transactions, of which 160 had an impact on the error rate. This identification of the causes of errors was complemented by knowledge stemming from the Court's examination of the control systems operating in the Member States between 2011 and 2013.

In its reply to the 2012 Annual Report, the Commission indicated that extensive action plans had been implemented for each of the 27 Member States to identify the causes of errors and to develop appropriate remedial action. The Court selected 10 of these action plans and investigated whether they targeted the weaknesses identified by the Court, the Commission and the Member States themselves.

The auditors considered also the extent to which the changes introduced by the new legal framework for the new 2014-2020 rural development programming period were likely to have a significant impact on the causes of errors. The Member States' regulatory frameworks for the new programming period were still in the drafting stage and therefore did not fall under the scope of this report.

### ***Court's findings and observations***

1. The Court concludes that the Commission and the Member States are partially effective in addressing the main causes of the high error rate for rural development. This overall conclusion is mainly based on the assessment that, despite the Commission's initiatives, Member States' action plans did not systematically address the weaknesses identified.
2. Despite an equal share of expenditure, investment measures account for two thirds of the error rate and area-related aid for the remaining third.

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<sup>1</sup> The 8.2% is an average for the 3 years with a lower limit of 6.1% and an upper limit of 10.3%. The average is composed of 8.4% for 2011, 8.3% for 2012 and 7.9% for 2013

3. The Court has compared the Member States' financial implementation rates (i.e. the ratio of cumulative actual payments to plan) with their error rates. In order to obtain statistically representative information, the 27 Member States which had 2007-13 rural development programmes were divided into three groups of nine Member States in descending order of their financial execution rates as at 15 October 2013.<sup>1</sup> The following Member States are represented in the three groups.

- Highest financial execution rate: Belgium, Czech Republic, Estonia, Ireland, Latvia, Luxembourg, Austria, Slovakia and Finland.
- Medium financial execution rate: Germany, France, Lithuania, the Netherlands, Poland, Portugal, Slovenia, Sweden and the United Kingdom.
- Lowest financial execution rate: Bulgaria, Denmark, Greece, Spain, Italy, Cyprus, Hungary, Malta and Romania.

Since the beginning of the programming period until the end of the 2013 financial year figures show a strong negative correlation between financial implementation rates and error rates for the three groups of Member States; the Member States with highest financial implementation rate having an error rate of 3.6%, the Member States with medium financial implementation rate an error rate of 8.6% and the Member States with lowest financial implementation rate an error rate of 10%.

4. For investment measures, the causes of errors can be identified in two ways:

- from the beneficiary perspective, the main sources of non-compliance related to public procurement, eligibility criteria for private and public beneficiaries and suspected fraudulent actions by private beneficiaries;

The Court found two main reasons that could explain the breaches of public procurement rules: the limited experience of small municipalities when conducting public procurement procedures and the fact that certain beneficiaries prefer to work with specific contractors and therefore award contracts directly without publishing a contract notice or asking for offers from any other potential bidders.

In 4 % of the private investment projects audited (6 out of 152), the Court found indications that beneficiaries may have committed intentional irregularities. These cases account for one eighth of the average error rate for rural development.

The Court reports all cases where there are indications of intentional irregularities to OLAF for further analysis and appropriate follow-up.

The rural development measure 'adding value to agricultural and forestry products' made the most significant contribution to the error rate for private investments. This measure targets small and medium-sized enterprises (SMEs) and finances investment in facilities for processing primary products.

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<sup>1</sup> The information available does not enable showing results on individual Member States.

These facilities include wineries, grain mills, fruit and vegetable processing and 'packaging lines. Of the 19 projects audited for this measure, 10 were affected by error (three of these were reported to OLAF). The main shortcomings noted were non-compliance with the SME criterion and non-respect of appropriate private procurement procedures. Public aid for this measure is typically in the range of several million Euro per project. In this context, there is a strong incentive for applicants to circumvent the rules with the aim of receiving aid.<sup>1</sup>

- from the paying agency perspective, the Court concludes that most errors could and should have been prevented during administrative and on-the-spot checks.

5. For area related aid, three factors explain the error rate:

- limited incentives for beneficiaries to comply with farming commitments as the efforts to comply with the most environmentally friendly techniques are not rewarded by immediate positive effects on the farm;
- a low control rate for farming commitments and;
- weak deterrence by the sanction system.

Agri-environment aid is the most error prone area-related measure. Infringements of agri-environment commitments accounted for one eighth of the total error rate.<sup>2</sup>

6. As a response to the high error rate in rural development, the Commission asked Member States to develop action plans to prevent and correct the causes of errors. While this is a positive development, the action plans mainly have a reactive role, and do not systematically address the problems that caused the errors in all Member States.

In particular the Commission did not request Member States to systematically address the most serious widespread deficiencies encountered at EU level, such as non-compliance with irregularities and insufficient administrative checks of agri-environmental commitments.

7. The EU legal framework for the 2014-2020 Programming period is a potential means of addressing the causes of error. However, two stages in the regulatory set-up which are currently ongoing provide the main potential for reducing errors; the Commission's review and approval of rural development programmes, and the Member States' implementation of national regulatory frameworks. In the context of reducing the causes of error, an appropriate balance should be achieved between the number and complexity of rules and the need to guarantee the legality and regularity of spending.

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<sup>1</sup> The Court identified also one investment measure (setting up of young farmers) and two area-related measures 'payments for less-favoured areas', which had low error rates. These measures have three main characteristics: a focused scope, a limited number of requirements and the use of lump sum payments.

<sup>2</sup> Agri-environment is the most financially significant rural development measure to which approximately EUR 20 billion has been allocated (a fifth of the total rural development budget for the 2007-2013 programming period).

### ***ECA recommendations***

In light of his findings the ECA recommends that

- the Commission should complete its corrective actions concerning the errors for rural development spending;
- The Commission should closely monitor the implementation of rural development programmes;
- The Commission and the Member States should analyse how to simplify the design and implementation of an increased number of support measures; how to improve the scheme for supporting investments in the processing of agricultural products and how to improve the controllability of the agri environment payments measures.

### ***Replies of the Commission***

The Commission fully or partially accepts all the recommendations issued by the Court. It announces that it will prepare in 2017 a strategic report on the European Rural Development Fund summarising the annual progress reports submitted by the Member States and that it will assess with the Member states the performance of the rural development programmes during the review process foreseen under Article of Regulation 1303/2013. In the light of this analysis and of its audit findings the Commission will assess the policy conception and the eventual need to make proposals for the following programming period.

### ***Draftsman's recommendations for possible inclusion in the annual discharge report:***

The European Parliament:

- recognizes the effort made by the Member states and the Commission with a view to reducing errors in rural development spending, especially in this time of difficult economic situation and fiscal austerity;
- notes, that on the basis of Member states' and its own audits findings, the Commission has implemented or is in a process of implementing corrective measures in many fields identified in the ECA report;
- is concerned by the high error rate detected by the Court of Auditors in rural development policy but welcomes the slight downward development in the recent 3 years;
- highlights that the easier the rules, the less prone to errors they are and is worried that the error rate regarding the new complicated rules of the reformed CAP can again rise in the upcoming years, therefore calls for a real simplification of the CAP;
- is persuaded that the costs of management and controls (EUR 4 billion) for the whole CAP is sufficient and the emphasis should be put on improving the efficiency of the controls and not increasing their number. In this context appeals to the Commission and Member States

to focus on the root causes of error for rural development spending. The following preventive and corrective actions should be taken by the Member States where relevant:

*(a) Public procurement*

In the application of the concept of ex ante conditionality Member States should develop and provide detailed guidance to beneficiaries on how to apply public procurement rules.

The national authorities specialising in monitoring compliance with public procurement rules should be involved in this process. Focus should be put on the three main breaches of rules: unjustified direct award without proper competitive procedure; misapplication of selection and award criteria; lack of equal treatment of tenderers.

*(b) Intentional circumvention of rules*

Based on the specific eligibility and selection criteria from their rural development programmes, Member States should establish guidelines to help their inspectors to identify indicators of suspected fraudulent actions.

*(c) Agri-environment payments*

Member States should increase the scope of their administrative controls, to include commitments which can be checked based on documentary evidence and which are currently verified only during the 5 % on-the-spot checks. In-addition, the system of reductions and sanctions should be designed to have an effective dissuasive effect on potential rule breakers.

- requests that the Commission closely monitors the implementation of the rural development programmes and in its conformity audits takes account of the applicable rules including those adopted at national level where relevant, in order to reduce the risk of repeating weaknesses and errors encountered during the 2007-13 programming period;
- believes that there are still many ambiguities in methodologies of error rate calculation not only between the Commission and Member States but also within the Commission services which makes the introduction of appropriate home legislation in Member States even more complicated. Calls on the Commission to apply a unified reading of the error rate calculation methodology that could be fully reflected in the methodologies of Member States;
- supports a more intensive use of the simplified cost methods where relevant and in compliance with legislative rules and requests the Commission and the Member States to analyse to what extent the characteristics of a more focused scope, limited eligibility criteria and the use of simplified cost options can be replicated into the design and implementation of an increased number of support measures, without jeopardising the overall objectives of those measures;
- requests the Commission and Member States to analyse how to improve the scheme for supporting investments in the processing of agricultural products and to analyse the agri-

environment payments measure so that, as far as possible, commitments can be controlled via Member States' administrative checks;

- appeals to the Commission to perform a detailed cause analysis of negative correlation between the financial execution rate and the error rate.