

**ANNUAL REPORT ON THE ACTIVITIES FUNDED
BY THE 8TH, 9TH, 10TH AND 11TH
EUROPEAN DEVELOPMENT FUNDS FOR THE
FINANCIAL YEAR 2017**

(2018/C 357/02)

**Annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds
for the financial year 2017**

TABLE OF CONTENTS

	<i>Paragraph</i>
Introduction	1-5
Brief description of the European Development Funds	2-5
Chapter I — Financial Implementation of the 8th, 9th, 10th and 11th EDFs	6-10
Chapter II — The Court's statement of assurance on the EDFs	11-41
The Court's statement of assurance to the 8th, 9th, 10th and 11th EDFs to the European Parliament and the Council Independent auditor's report	I-XXI
Information in support of the statement of assurance	11-41
Audit scope and approach	11-14
Reliability of accounts	15
Regularity of transactions	16-28
Annual activity report and other governance arrangements	29-41
Conclusion and recommendations	42-47
Conclusion	42-45
Recommendations	46-47
Annex 1 — Results of transaction testing for the European Development Funds	
Annex 2 — EDF Payments in 2017 by main region	
Annex 3 — Follow-up of previous recommendations for the European Development Funds	

THE COURT'S OBSERVATIONS

INTRODUCTION

1. This annual report presents our findings on the 8th, 9th, 10th and 11th European Development Funds (EDFs). **Box 1** gives an overview of activities and spending in this area in 2017.

Box 1 — European Development Funds — 2017 financial overview

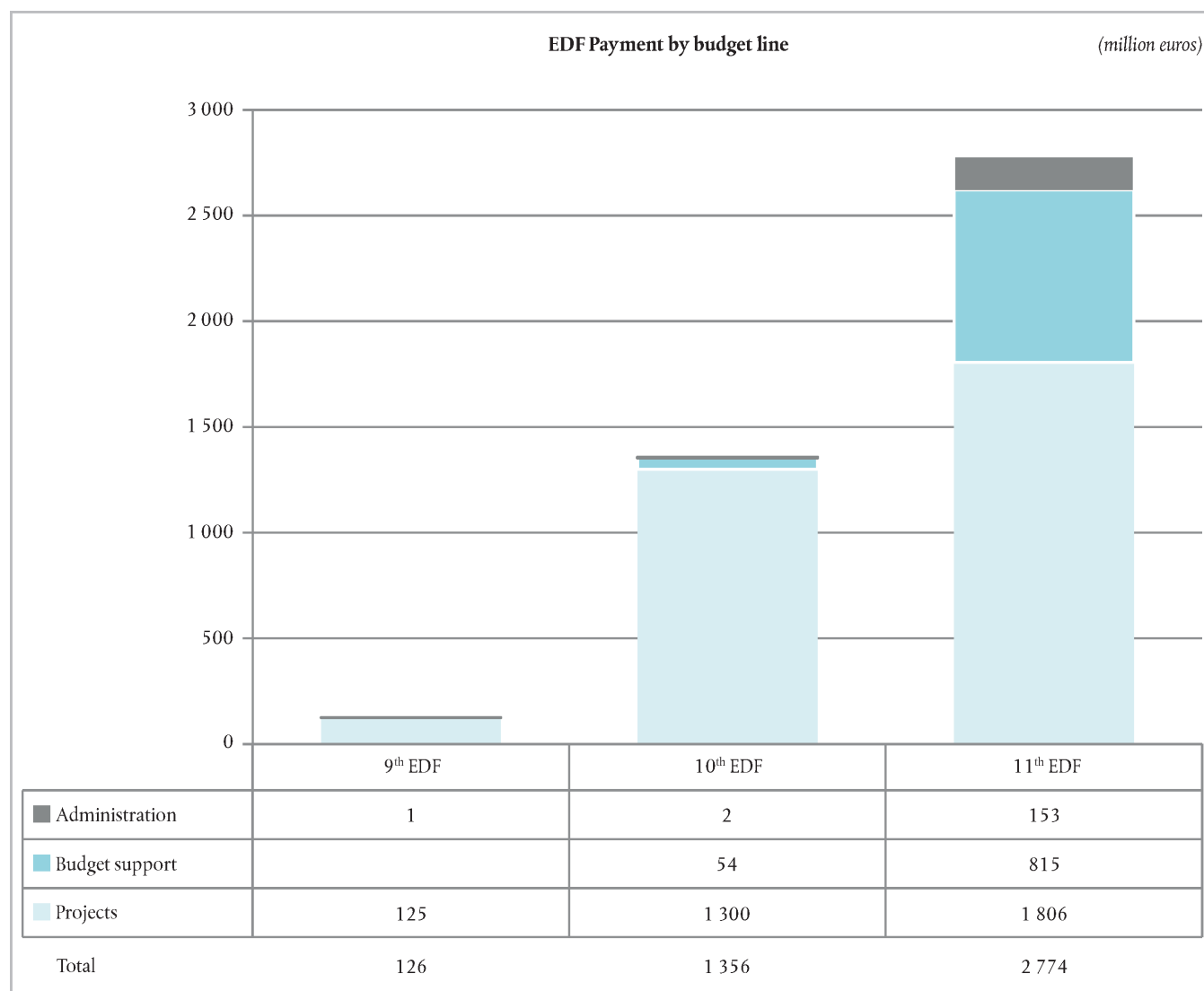


Table 1 — European Development Funds — Key information 2017

	(million euros)
Total payments	4 256
- advances and EDF contributions to EU Trust Funds	- 2 648
+ clearings of advances and EU Trust Funds	1 876
Audited population	3 484

Source: European Court of Auditors, based on the 2017 consolidated accounts of the 8th, 9th, 10th and 11th EDFs and DG DEVCO Annual Activity Report 2017.

THE COURT'S OBSERVATIONS

Brief description of the European Development Funds

2. Launched in 1959, the EDFs are the main instrument by which the European Union (EU) provides development cooperation aid to the African, Caribbean and Pacific (ACP) countries and overseas countries and territories (OCTs). The partnership agreement signed in Cotonou on 23 June 2000 for a period of 20 years ('the Cotonou Agreement') is the current framework governing the EU's relations with ACP countries and OCTs. Its primary objective is to reduce and ultimately eradicate poverty.

3. The EDFs are particular in that:

- (a) they are funded by the Member States according to quotas, or 'contribution keys', which are set by the national governments at the Council of the European Union;
- (b) they are managed by the Commission, outside the framework of the EU general budget, and the European Investment Bank (EIB);
- (c) due to the intergovernmental nature of the EDFs, the European Parliament (EP) exercises a more limited role in their functioning than it does for the development cooperation instruments financed by the EU general budget; notably, it is not involved in establishing and allocating EDF resources. However, the European Parliament is still the *discharge* authority, except for the Investment Facility, which is managed by the EIB and therefore outside the scope of our audit ⁽¹⁾ ⁽²⁾;
- (d) the principle of annuality does not apply to the EDFs: EDF agreements are usually concluded for a commitment period of five to seven years, and payments can be made over a much longer time frame.

⁽¹⁾ See Articles 43, 48-50 and 58 of Council Regulation (EU) 2015/323 of 2 March 2015 on the financial regulation applicable to the 11th European Development Fund (OJ L 58, 3.3.2015, p. 17).

⁽²⁾ In 2012, a tripartite agreement between the EIB, the Commission and the Court (Article 134 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th EDF (OJ L 78, 19.3.2008, p. 1)) set out the rules for the audit of these operations by the Court. The Investment Facility is not covered by the Court's statement of assurance.

THE COURT'S OBSERVATIONS

4. The EDFs are managed almost entirely by the Commission's Directorate-General for International Cooperation and Development (DG DEVCO) ⁽³⁾.

5. The expenditure covered in this report is delivered using a wide range of delivery methods ⁽⁴⁾ implemented in 79 countries.

CHAPTER I — FINANCIAL IMPLEMENTATION OF THE 8TH, 9TH, 10TH AND 11TH EDFS

6. The budget of the 8th EDF (1995-2000) was 12 840 million euros, that of the 9th EDF (2000-2007) 13 800 million euros, and that of the 10th EDF (2008-2013) 22 682 million euros.

7. The Internal Agreement establishing the 11th EDF ⁽⁵⁾ (2015-2020) came into force on 1 March 2015 ⁽⁶⁾. The 11th EDF holds 30 506 million euros ⁽⁷⁾, of which 29 089 million euros is allocated to the ACP countries and 364,5 million euros to the OCTs.

8. **Box 2** shows the use of EDF resources both in 2017 and cumulatively.

⁽³⁾ With the exception of the 4 % of the 2017 EDF expenditure managed by the Directorate-General for Humanitarian Aid and Civil Protection (ECHO).

⁽⁴⁾ Such as works/supply/service contracts, grants, budgetary support, programme estimates.

⁽⁵⁾ OJ L 210, 6.8.2013, p. 1.

⁽⁶⁾ Between 2013 and 2015 funds were committed via the bridging facility.

⁽⁷⁾ Including 1 139 million euros managed by the EIB.

Box 2 — Use of EDF resources at 31 December 2017

	Situation at end of 2016		Budgetary implementation during the 2017 financial year (net) ⁽⁶⁾						Situation at end of 2017						(million euros)
	Total amount	Implement. rate ⁽²⁾	8th EDF ⁽³⁾	9th EDF ⁽³⁾	10th EDF	11th EDF ⁽³⁾	Total amount	8th EDF	9th EDF	10th EDF	11th EDF	Total amount	Implement. rate ⁽²⁾		
A — RESOURCES ⁽¹⁾	76 896		-7	-37	-119	191	28	10 385	15 430	21 488	29 621	76 924			
B — USE															
1. Global commitments ⁽⁴⁾	60 097	78,2 %	- 9	- 38	- 5	5 807	5 755	10 382	15 391	21 052	19 027	65 852	85,6 %		
2. Individual commitments ⁽⁵⁾	53 032	69,0 %	- 3	- 20	550	5 684	6 211	10 376	15 289	20 125	13 453	59 243	77,0 %		
3. Payments	45 339	59,0 %	- 1	111	1 277	2 770	4 157	10 375	15 164	17 753	6 206	49 498	64,3 %		
C — Outstanding commitments (B1 - B3)	14 758	19,2 %						7	227	3 299	12 821	16 354	21,3 %		
D — Available balance (A - B1)	16 799	21,8 %						3	39	436	10 594	11 072	14,4 %		

⁽¹⁾ Include initial allocations to the 8th, 9th, 10th and 11th EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.

⁽²⁾ As a percentage of resources.

⁽³⁾ Negative amounts correspond to decommitments.

⁽⁴⁾ Global commitments relate to financing decisions.

⁽⁵⁾ Individual commitments relate to individual contracts.

⁽⁶⁾ Net commitments after decommitments. Net payments after recoveries.

Source: European Court of Auditors, based on the 2017 consolidated annual accounts of the 8th, 9th, 10th and 11th EDFs. The figures presented do not cover the EDF part managed by the EIB.

THE COURT'S OBSERVATIONS

9. In 2017 DG DEVCO continued its efforts to reduce old prefinancing and unspent commitments with a target of 25 % ⁽⁸⁾ (see **Box 3**).

Box 3 — KPIs on reduction of old prefinancing, old unspent commitments and old expired contract

DG DEVCO's target was exceeded with a reduction of old prefinancing of 37,60 % for its entire area of responsibility (32,58 % for EDF) and 38,49 % (37,63 % for EDF) reduction of old unspent commitments.

Even if for the EDFs the set target of keeping the share of expired contracts ⁽⁹⁾ below 15 % of the total of open contracts was not achieved (18,75 %), the overall target was achieved (14,95 %). The main reason for a lower percentage for EDF contracts is that the closure of old expired contracts under EDF is technically more complex if there are uncashed recovery orders. In September 2017, DG DEVCO initiated a new procedure to address this problem. We will follow up on the new procedure in the context of our 2018 annual audit.

10. Unlike for the ageing of prefinancing, the Commission does not have a KPI to monitor the ageing of advance contributions paid to EU Trust Funds (the Békou trust fund and the EU emergency trust fund for Africa).

THE COMMISSION'S REPLIES

10. *According to the accounting rules, EDF contributions to the EU Trust Funds are presented in the EDF annual accounts. They are monitored and controlled on a yearly basis. Furthermore, the RAL ⁽¹⁾ absorption period of the EU Trust Funds which directly impacts the ageing of those contributions is monitored in real time through KPI 4 (RAL absorptions capacity). The Commission considers therefore that the ageing of EDF contributions to EU Trust Funds is correctly monitored and that the creation of an additional KPI is not necessary.*

⁽⁸⁾ This target was set for both the entire area of responsibility and specifically for the EDFs.

⁽⁹⁾ A contract is considered to have expired if it is still open more than 18 months after the end of its operational period.

⁽¹⁾ The RAL is the sum of outstanding commitments agreed to, but that have not yet translated into payments.

CHAPTER II — THE COURT’S STATEMENT OF ASSURANCE ON THE EDFs**The Court’s statement of assurance to the 8th, 9th, 10th and 11th EDFs to the European Parliament and the Council Independent auditor’s report****Opinion**

I. We have audited:

- (a) the annual accounts of the 8th, 9th, 10th and 11th EDFs which comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets and the report on financial implementation for the financial year ended 31 December 2017, approved by the Commission on 27 June 2018, and
- (b) the legality and *regularity* of the *transactions* which underlie those accounts and of which financial management falls to the Commission ⁽¹⁰⁾,

as required by Article 287 of the Treaty on the Functioning of the European Union (TFEU) and Article 49 of the *Financial Regulation* applicable to the 11th EDF, which also applies to previous EDFs.

Reliability of the accounts*Opinion on the reliability of the accounts*

II. In our opinion, the annual accounts of the 8th, 9th, 10th and 11th EDFs for the year ended 31 December 2017 present fairly, in all material respects, their financial position as at 31 December 2017, the results of their operations, their cash flows and the changes in their net assets for the year then ended, in accordance with the EDF Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

Legality and regularity of the transactions underlying the accounts**Revenue***Opinion on the legality and regularity of revenue underlying the accounts*

III. In our opinion, revenue underlying the accounts for the year ended 31 December 2017 is legal and regular in all material respects.

Payments*Adverse opinion on the legality and regularity of payments underlying the accounts*

IV. In our opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2017 are materially affected by error.

⁽¹⁰⁾ Pursuant to Articles 43, 48-50 and 58 of the Financial Regulation applicable to the 11th EDF, this statement of assurance does not extend to the EDF resources managed by the EIB.

Basis for opinion

V. We conducted our audit in accordance with the IFAC International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under those standards are further described in the 'Auditor's responsibilities' section of our report. We are independent in accordance with the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for Professional Accountants, and we have fulfilled our other ethical responsibilities under those standards and requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Basis for adverse opinion on the legality and regularity of payments underlying the accounts

VI. The expenditure recorded in 2017 under the 8th, 9th, 10th and 11th EDFs is materially affected by error. Our *estimated level of error* for expenditure underlying the accounts is 4,5 %.

Key audit matters

VII. Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters.

Accrued charges

VIII. We assessed the accrued charges presented in the accounts (see note 2.8) which are subject to a high degree of estimation. At year-end 2017, the Commission estimated that eligible expenses incurred but not yet reported by beneficiaries amounted to 4 653 million euros (year-end 2016: 3 903 million euros).

IX. We examined the calculation of these accrual estimates and reviewed a sample of 36 individual contracts to address the risk that the accrual was misstated. The work performed led us to conclude that the accrued charges recognised in the final accounts were appropriate.

Potential impact on the 2017 EDF accounts of the United Kingdom's withdrawal from the European Union

X. On 29 March 2017, the United Kingdom (UK) formally notified the European Council of its intention to leave the European Union (EU). On 19 March 2018 the Commission published a draft withdrawal agreement that outlined the progress made in the negotiations with the UK. This draft withdrawal agreement states that the UK will remain party to the EDF until the closure of the 11th EDF and all previous unclosed EDFs, and will assume the same obligations as the Member States under the internal agreement by which the 11th EDF was set up, as well as the obligations arising from previous EDFs until their closure.

XI. The draft withdrawal agreement also states that, where the amounts from projects under the 10th EDF or from previous EDFs have not been committed or have been decommitted on the date of entry into force of this agreement, the UK's share of those amounts will not be reused. The same applies to the UK's share of funds not committed or decommitted under the 11th EDF after 31 December 2020. The negotiations on the UK's withdrawal from the European Union are still ongoing and, so the final text of the agreement has not yet been confirmed.

XII. Based on this, we conclude that the accounts at 31 December 2017 correctly reflect the situation at hand, subject to the outcome of the withdrawal process.

Responsibilities of management

XIII. In accordance with Articles 310 to 325 of the TFEU and with the 11th EDF Financial Regulation, management is responsible for preparing and presenting the EDF annual accounts on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the underlying transactions. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. The Commission is ultimately responsible for the legality and regularity of the transactions underlying the EDF accounts.

XIV. When preparing the EDF accounts, the Commission is responsible for assessing the EDFs' ability to continue as a going concern, disclosing any relevant matters and using the going concern basis of accounting unless it either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

XV. The Commission is responsible for overseeing the EDFs' financial reporting process.

Auditor's responsibilities for the audit of the EDF accounts and underlying transactions

XVI. Our objectives are to obtain reasonable assurance as to whether the EDF accounts are free from material misstatement and the underlying transactions are legal and regular and to provide, on the basis of our audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the transactions underlying them. Reasonable assurance is a high level of assurance, but it is not a guarantee that the audit has necessarily detected all instances of a material misstatement or non-compliance that may exist. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions taken by users on the basis of these EDF accounts.

XVII. As part of an audit in accordance with ISAs and ISSAIs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the EDF accounts and of material non-compliance of the underlying transactions with the requirements of the EDF legal framework, whether due to fraud or error. We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.
- Obtain an understanding of internal control relevant to the audit in order to design appropriate audit procedures, but not for the purpose of expressing an opinion on the effectiveness of the internal control.
- Evaluate the appropriateness of the accounting policies used by management and the reasonableness of management's accounting estimates and related disclosures.
- Conclude as to the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, as to whether material uncertainty exists owing to events or conditions that may cast significant doubt on the EDFs' ability to continue as a going concern. If we conclude that such material uncertainty exists, we are required to draw attention in our report to the related disclosures in the consolidated accounts or, if these disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the entity to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual accounts, including all disclosures, and assess whether the annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

XVIII. We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including findings of any significant deficiencies in internal control.

XIX. For revenue, we examine all contributions from Member States and a sample of other types of revenue transactions.

XX. For expenditure, we examine payment transactions once expenditure has been incurred, recorded and accepted. This examination covers all categories of payments (including those made for the purchase of assets) other than advances at the point they are made. Advance payments are examined once the *recipient* of funds has provided evidence of their proper use and the Institution or body has accepted that evidence by clearing the advance payment, whether in the same year or later.

XXI. Of the matters discussed with the Commission, we determine which were of most significance in the audit of the EDF accounts and are therefore the key audit matters for the current period. We describe these matters in our report unless law or regulation precludes public disclosure or, as happens extremely rarely, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh any public interest benefits.

12 July 2018

Klaus-Heiner LEHNE

President

European Court of Auditors

12, rue Alcide De Gasperi, Luxembourg, LUXEMBOURG

THE COURT'S OBSERVATIONS

Information in support of the statement of assurance*Audit scope and approach*

11. **Annex 1.1** of the Court's 2017 annual report on the implementation of the budget sets out our audit approach and methods. The following specific points should be noted in connection with this year's audit of the EDFs.

12. Our observations on the reliability of the EDF accounts are based on the financial statements⁽¹¹⁾ of the 8th, 9th, 10th and 11th EDFs, approved by the Commission in compliance with the EDF Financial Regulation⁽¹²⁾, together with the accounting officer's letter of representation received on 21 June 2018. We tested amounts and disclosures, and assessed the accounting principles used, as well as any significant estimates made by the Commission and the overall presentation of the accounts.

13. To audit the regularity of transactions, we took the following steps.

- (a) We examined all Member State contributions and a sample of other types of revenue transactions.
- (b) We examined a sample of 128 transactions representative of the full range of the payments within EDF, which comprised 100 payments authorised by 23 EU delegations⁽¹³⁾ and 28 payments approved by Commission headquarters⁽¹⁴⁾. As part of our audited population was covered by DG DEVCO's 2017 *residual error rate* (RER) study, we included in our sample 14 further transactions to which we applied, after adjustment, the results⁽¹⁵⁾ of this study. The total sample size was 142 which is in accordance with the Court's assurance model.

⁽¹¹⁾ See Article 44 of Regulation (EU) 2015/323.

⁽¹²⁾ See Article 43 of Regulation (EU) 2015/323.

⁽¹³⁾ African Union, Angola, Barbados, Burkina Faso, Democratic Republic of Congo, Ethiopia, Fiji, Haiti, Jamaica, Kenya, Madagascar, Malawi, Mali, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, South Sudan, Sudan, Tanzania, Zambia, Zimbabwe.

⁽¹⁴⁾ DG DEVCO: 19 payments; ECHO: 9 payments for humanitarian aid.

⁽¹⁵⁾ As a result of our review on RER studies we have found that the methodology behind the RER study foresees a very limited number of on-the-spot checks and a limited scope for examination of procurement procedures. Therefore, this year we adjusted the result of the RER study with proportions of error on compliance with public procurement rules. The basis for adjustment was the Court's SoA 2014-2016 findings for EDFs.

THE COURT'S OBSERVATIONS

- (c) Where errors had been detected in the transactions, we analysed the relevant systems to identify weaknesses.
- (d) We assessed systems used by DG DEVCO and the EU delegations, covering: (i) ex ante checks by Commission staff, external auditors or supervisors before payments were made, and (ii) monitoring and supervision, notably the follow-up of external audits and the RER study mentioned above.
- (e) We reviewed DG DEVCO's *annual activity report* (AAR).
- (f) We followed up our previous recommendations.

14. As stated in paragraph 4, DG DEVCO implements most of the external assistance instruments financed from both the general budget and the EDFs. Our observations on systems, the reliability of the AAR and the Director-General's declaration for 2017 relate to DG DEVCO's entire area of responsibility.

Reliability of accounts

15. In the previous two years we reported on recoveries of unspent prefinancing which had been incorrectly recorded as operational revenue. DG DEVCO's accounting tests and our review of a sample of recovery orders ⁽¹⁶⁾ also identified similar cases in 2017. Although corrections amounting to 5,1 million euros ⁽¹⁷⁾ were made in the final EDF accounts, it is likely that similar errors occurred in the untested population.

⁽¹⁶⁾ We tested 17 recovery orders (total value 16,7million euros) and found that 3 recovery orders (0,4 million euros) had been incorrectly recorded as revenue instead of the recovery of unspent prefinancing.

⁽¹⁷⁾ 1,1 million euros of corrections identified by DG DEVCO, 4 million euros subsequently identified by ECA auditors.

THE COURT'S OBSERVATIONS

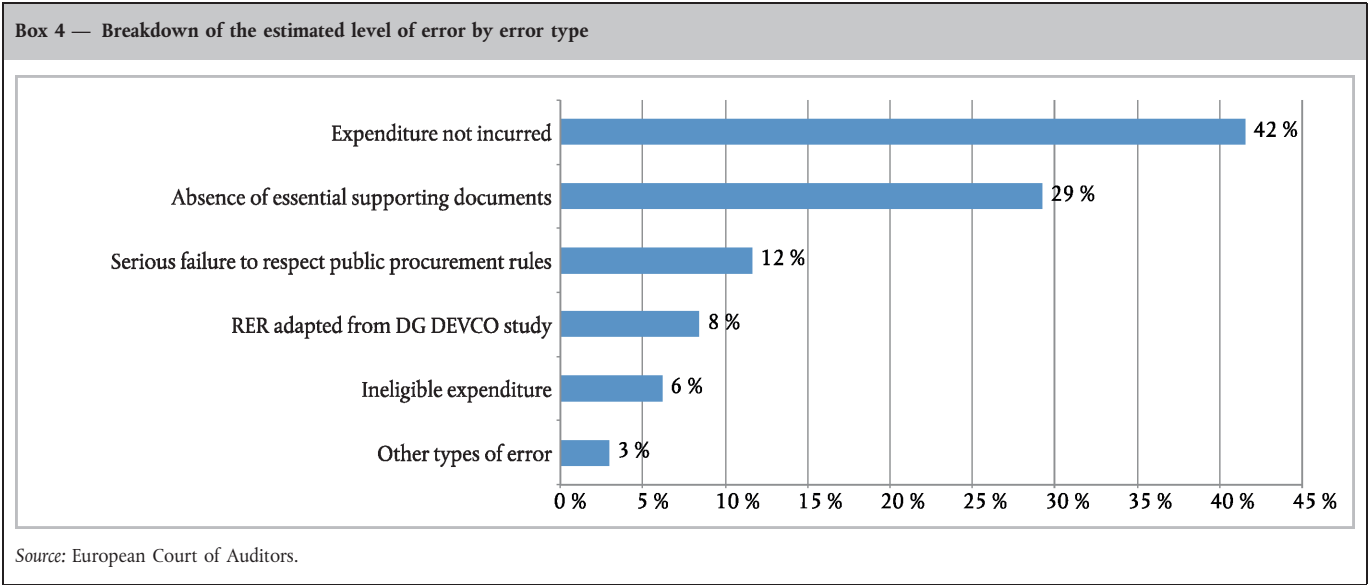
Regularity of transactions

Revenue

16. Revenue transactions did not contain a material level of error.

Payments

17. **Annex 1** provides an overview of the results of transaction testing. Of the 128 payment transactions examined, 37 (29 %) contained errors. On the basis of the 30 errors we have quantified, we estimate the level of error to be 4,5 % ⁽¹⁸⁾. This figure takes into account the adjusted results of RER 2017 study. **Box 4** gives a breakdown of our estimated level of error for 2017 by error type. **Box 5** presents examples of these errors.



⁽¹⁸⁾ We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the estimated level of error in the population lies between 1,2 % and 7,8 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

18. Of the 118 project-related ⁽¹⁹⁾ payment transactions that we examined, 37 (31 %) contained errors (30 quantifiable errors and 8 non-quantifiable). Of the 30 payment transactions containing quantifiable errors, 10 (33 %) were final transactions authorised once all ex ante checks had been carried out.

19. As in previous years, the Commission and its implementing partners committed more errors in transactions relating to *programme estimates, grants, contribution agreements* with international organisations and *delegation agreements* with EU Member States' cooperation agencies than it did with other forms of support ⁽²⁰⁾. Of the 75 transactions of this type examined, 27 (36 %) contained quantifiable errors, which accounted for 70 % of the estimated level of error.

Box 5 — Examples of quantifiable and non-quantifiable errors in project transactions*(a) Expenditure not incurred (quantifiable error)*

For a natural resources management project in Sudan the Commission, by error, accepted 2 million euros more than the implementing partner, an international organisation (IO), had declared as expenditure.

When examining individual expenditure items, we found that three were affected by error as the declared amount had not actually been incurred in full. The error in the clearance and the identified ineligible costs resulted in an error rate of 51,57 % of the total costs tested.

(b) Absence of essential supporting documents (quantifiable error)

For a biodiversity project in Angola, implemented by an IO, we tested items related to construction contracts. The supporting documents were not sufficient to verify the expenditure; nor did they provide an audit trail to the amounts invoiced and the works carried out. Our on-the-spot checks showed significant discrepancies between the contract specifications and the completed works, in terms of size, design, and materials used. The ineligible costs resulted in an error rate of 28,83 % of the total costs tested.

⁽¹⁹⁾ Project related payments exclude budget support payments.

⁽²⁰⁾ Such as works/supply/service contracts.

THE COURT'S OBSERVATIONS

(c) Procurement error — Lack of documentation of the public procurement procedure (quantifiable error)

When testing the expenditure of a project implemented by an organisation to support private-sector development in ACP countries, we were unable to verify the eligibility of one procurement item due to lack of documentation. We requested documents, such as request for quotation, terms of reference, offers received, evaluation reports or an award notification, but we did not receive any. The ineligible costs resulted in an error rate of 10,00 % of the total costs tested.

(d) Ineligible expenditure (quantifiable error)

For spending on a trust fund administered by an international body we identified two items of ineligible costs. One item consisted of indirect costs reported as direct costs, and one item was not directly linked to the activities of the action or necessary to its completion. The ineligible costs resulted in an error rate of 20,00 % of the total costs tested.

(e) Ineligible expenditure (quantifiable error and non-quantifiable error)

For a project supporting development of local businesses in Tanzania, coordinated by a private entity, we identified three items affected by an error. One item included VAT, which is not eligible under the contract conditions, and was not fully supported by documents such as an invoice or a contract. The ineligible costs resulted in an error rate of 1,84 % of the total costs tested.

Another item, reported as salaries, was not based on actual gross salaries, but on an estimation. A cost can only be considered eligible if it has been incurred and is identifiable and verifiable. For the third item it was not possible to verify that the amount corresponds to fully paid salary costs and that the beneficiary did not retain a profit. These limitations resulted in a non-quantifiable error for both of the items.

THE COURT'S OBSERVATIONS

20. In eight cases of quantifiable error and three cases of non-quantifiable error, the Commission had sufficient information to prevent, or to detect and correct, the error before accepting the expenditure. Had the Commission made proper use of all the information at its disposal, the estimated level of error would have been 1,8 percentage points lower. We found two other transactions with errors which should have been detected by external auditors and supervisors. These cases contributed 0,1 percentage point to the estimated level of error ⁽²¹⁾.

21. In addition, a total of 15 transactions containing a quantifiable error ⁽²²⁾ were subjected to an audit or expenditure verification. The information provided in the audit/verification reports on the actual work done did not allow us to assess whether the errors could have been detected and corrected during these ex ante checks.

22. The African Infrastructure Trust Fund (AITF), managed by the European Investment Bank, is a trust fund to which the Commission contributes. DG DEVCO uses the fund's audited and unaudited financial statements as a basis for accepting incurred expenditure at least once per year. The financial statements of the fund are drawn up according to the IFRS ⁽²³⁾, and contain estimates ⁽²⁴⁾. Therefore, they do not include only actual incurred expenditure. In addition, the audit report used by DG DEVCO is of a financial audit intended to provide an audit opinion on the fund's financial statements. It is not designed to identify ineligible expenditure.

23. Our audit of AITF transactions found quantifiable and non-quantifiable errors linked to the use of estimations, or to a failure of certain ex ante controls to detect ineligible costs before they were accepted.

⁽²¹⁾ For 1,1 percentage points (9 cases) the Commission committed the error itself and for 0,8 percentage points (4 cases) the error was made by the beneficiaries.

⁽²²⁾ Contributing 1,7 percentage points to the estimated level of error.

⁽²³⁾ International Financial Reporting Standards.

⁽²⁴⁾ 'The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires EIB Management to exercise its judgment in the process of applying the Trust Fund's accounting policies.' Paragraph 2.2 — Significant accounting judgments and estimates of the AITF financial statements as at 31 December 2015.

THE COURT'S OBSERVATIONS

24. In two areas, payment conditions limited the extent to which transactions were prone to error. The first of these areas was budget support ⁽²⁵⁾. The second area comprised cases where the 'notional approach' had been applied in multi-donor projects implemented by international organisations ⁽²⁶⁾.

25. Budget support is a financial contribution either to a state's general budget, or to its budget for a specific policy or objective. We examined whether the Commission had complied with the conditions governing budget-support payments to partner countries, and whether it had verified that the general eligibility conditions (such as satisfactory improvements in public-sector financial management) were met before disbursement.

26. However, given the legal provisions' broad scope for interpretation, the Commission has considerable flexibility in deciding whether these general conditions have been met. Our regularity audit cannot go beyond the stage at which aid is paid to the partner country, since the funds are then merged with the recipient country's budget resources. Any weaknesses in its financial management leading to misuse at national level will not lead to errors in our audit ⁽²⁷⁾.

27. Under the 'notional approach', when the Commission's and other donors' contributions to multi-donor projects are pooled and are not earmarked for specific, identifiable items of expenditure, the Commission assumes that EU eligibility rules have been complied with as long as the total pooled amount includes sufficient eligible expenditure to cover the EU's contribution. We took this approach, as applied by the Commission, into account in our substantive testing ⁽²⁸⁾.

⁽²⁵⁾ Budget support payments financed by the EDFs in 2017 amounted to 880 million euros.

⁽²⁶⁾ EDF payments to multidonor projects carried out by international organisations in 2017 amounted to 812 million euros. We cannot state the proportion of this sum to which the notional approach applied, since the Commission does not monitor it separately.

⁽²⁷⁾ The efficiency and effectiveness of budget support is addressed in a number of the Court's special reports, the latest ones being SR 32/2016 'EU assistance to Ukraine', SR 30/2016 'The effectiveness of EU support to priority sectors in Honduras'.

⁽²⁸⁾ We did not perform checks on underlying items of expenditure if the Commission's contribution was below 75 % of the action's budget. In cases where such contributions lay between 75 % and 90 %, we assessed the need to perform checks on underlying items of expenditure on a case by case basis.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

28. The 15 multi-donor transactions where the 'notional approach' was applied and the 10 budget-support transactions we examined contained no errors. When excluding these transactions from the audited sample, the estimated level of error is 6,5 % ⁽²⁹⁾.

Annual activity report and other governance arrangements

29. In every annual activity report since 2012, DG DEVCO has issued a reservation on the regularity of underlying transactions. An action plan has then been adopted to address the weaknesses in the implementation of DG DEVCO's control system.

30. Last year we reported on the satisfactory progress achieved on the 2015 action plan. Ten actions had been completed, five had been partially implemented, and one was ongoing.

31. In its action plan for 2016, DG DEVCO continued to address high-risk areas: funds under indirect management by international organisations, and grants under direct management. By March 2018, ten actions had been completed, two had been partially implemented ⁽³⁰⁾, and two were ongoing.

32. Six new targeted measures were added to the 2017 action plan. These measures are intended to, for example, reduce errors arising from programme estimates. They also included amendments to be made to the contract templates for the delegation agreements and the pillar assessments, to reflect the changes in the new Financial Regulation.

33. DG DEVCO's control system is based on ex ante checks conducted before the expenditure claimed by beneficiaries is accepted. In this year too, the frequency of the errors found — including some contained in final claims which had been subjected to ex ante external audits and expenditure verifications, continues to point to weaknesses in these checks.

33. *Revised terms of reference (ToR) for expenditure verifications were adopted at the end of March 2018, that are expected to contribute to improved performance of ex-ante checks.*

⁽²⁹⁾ The figure quoted is the best estimate based on a representative sample of 117 transactions. We have 95 % confidence that the rate of error in the population lies between 2,8 % and 10,2 % (the lower and upper level error limits respectively).

⁽³⁰⁾ Informing beneficiaries on the possibility of DG DEVCO requesting detailed supporting documents before approving the expenditure; establishing a focal point unit to coordinate relations with International Organisations.

THE COURT'S OBSERVATIONS

2017 RER study

34. In 2017 DG DEVCO carried out its sixth RER study to estimate the level of error which had evaded all management checks to prevent, detect and correct errors across its entire area of responsibility⁽³¹⁾. For the second year in a row, the study estimated the RER to be within the 2 % materiality threshold set by the Commission⁽³²⁾.

35. In its 2017 AAR, DG DEVCO has removed the section drawing attention to the limitation of the RER study on the scope of examination of procurement procedures, even though the limitation remains.

36. In the 2017 RER study, the number of transactions where no substantive testing had been performed due to full reliance being placed on previous control work (previous control work) was far higher (67 % of the transactions) than in previous studies (see **Box 6**), even though the RER manual allows full reliance on previous control work to be used 'only in rare circumstances'⁽³³⁾. For most of the RER transactions sampled for our review⁽³⁴⁾, we concluded that the full reliance had been placed on previous control work incorrectly or without proper justification. Furthermore, the errors identified by previous control work were not extrapolated to the untested population, and therefore the study assumes that the untested population is free of error. This has an impact on the residual error rate.

THE COMMISSION'S REPLIES

35. In the Commission's view pointing to the scope of examination of procurement procedures as a major difference was somewhat exaggerated as RER contractors do examine parts of the procurement procedures: they check the basic supporting documentation (such as the procurement notice, tender opening reports, evaluation reports, award decision, etc.), but the RER methodology does not prescribe re-performing the selection process (either at the level of the Commission or at the level of the beneficiary). In some cases, contractors may, based on professional experience and a risk analysis, decide to analyse the procurement process in full detail.

36. In the delivery of the RER 2017 exercise professional judgement was exercised where interpretation was allowed or required.

Following this experience the Commission will consider evolving the methodology towards reliance on previous audit work in more than exceptional circumstances where international standards applied.

⁽³¹⁾ EDFs and the EU general budget.

⁽³²⁾ 2015: 2,2 %; 2016: 1,7 % and 2017: 1,18 %.

⁽³³⁾ DEVCO Residual Error Rate: Instruction Manual for Annual Measurement Exercise, p. 26.

⁽³⁴⁾ Our review concluded that 26 out of the 41 transactions reviewed, full reliance should not have been placed on previous control work.

THE COURT'S OBSERVATIONS

37. In addition to the significant increase of placing full reliance on previous control work, our review also identified errors and inconsistencies in the calculation and extrapolation of individual errors. These errors are similar to the ones we have reported in our annual report on the EDFs 2014 ⁽³⁵⁾.

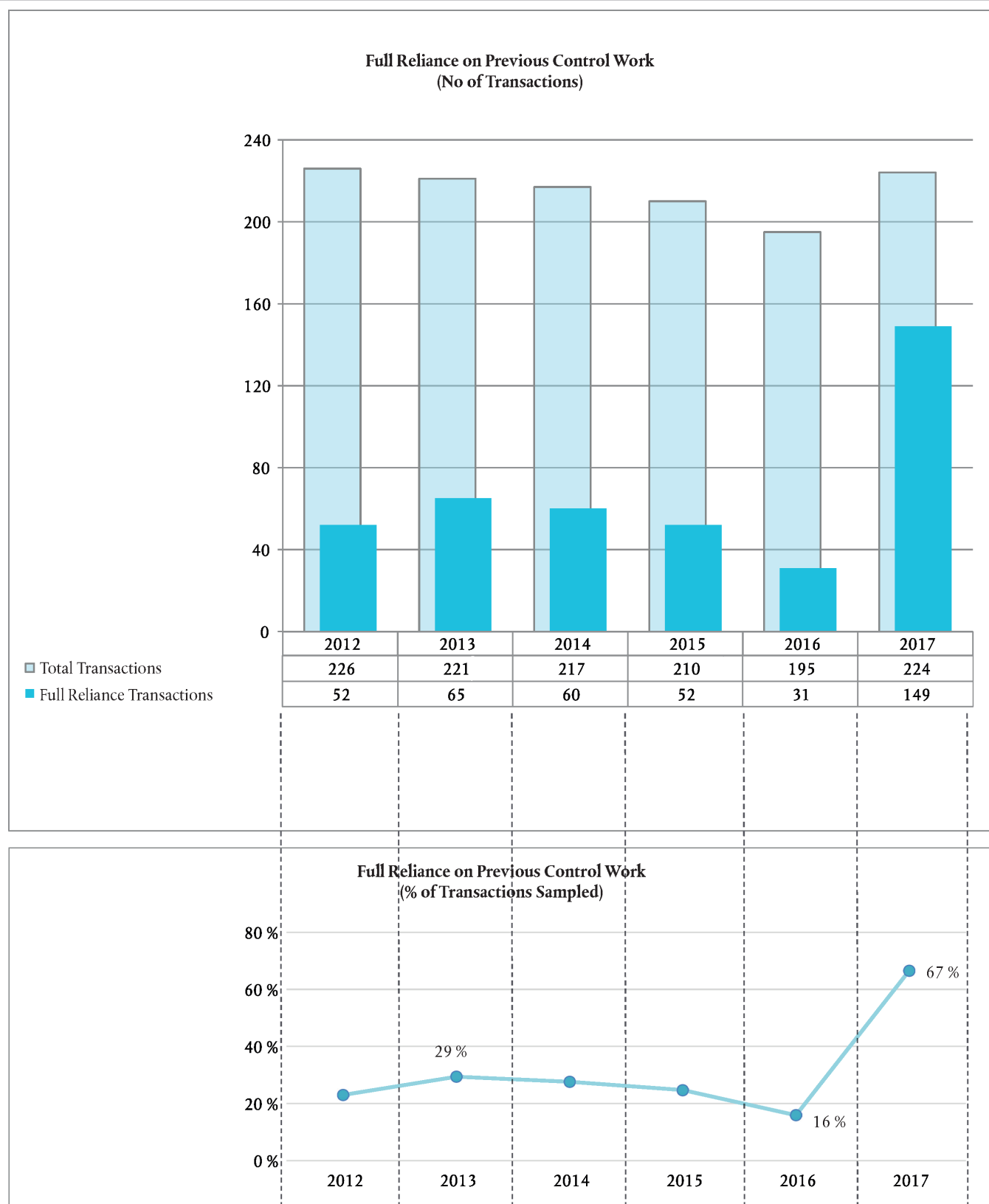
38. The Commission did not properly monitor the work carried out by the RER contractor and therefore could not prevent the problems from occurring.

THE COMMISSION'S REPLIES

38. *There were regular meetings monitoring the progress of the study in detail. The Commission provided the RER contractor with guidance within the limits set by the absolute need of its independence and professional judgement. Nevertheless, the Commission suggests to further improve its monitoring in order to follow-up more closely on more specific aspects such as the number of full reliance cases.*

⁽³⁵⁾ See paragraph 43 of our 2014 annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds (EDFs) (OJ C 373, 10.11.2015, p. 289).

Box 6 — Trend of the number of transactions with full reliance placed on previous control work, 2012-2017



Full reliance transactions peaked in 2017 both in relative (67 %) and absolute terms (149 transactions). The percentage of full reliance on previous control work has witnessed a substantial increase in 2017 versus 2016; it also surpassed by far the previous peak observed in 2013.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Review of the 2017 annual activity report

39. In 2016 DG DEVCO's Director-General's declaration of assurance included two reservations, of which one related to grants in direct and indirect management, indirect management with International Organisations, Development Agencies and programme estimates. The reservation included in the declaration of assurance in the 2017 AAR ⁽³⁶⁾ only includes grants in direct management.

40. This reservation is based on the results of the RER study. Had the RER study followed the same prudent approach of previous years, the outcome of the study, and therefore the declaration of assurance, would probably have been different.

41. DG DEVCO estimated the overall amount at risk at payment to be 82,96 million euros ⁽³⁷⁾. Of this amount, it is estimated that 13,08 million euros (16 %) would be corrected by its checks in subsequent years ⁽³⁸⁾.

CONCLUSION AND RECOMMENDATIONS**Conclusion**

42. The overall audit evidence indicates that the EDFs' accounts for the financial year ending 31 December 2017 present fairly, in all material respects, their financial position, the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the accounting officer.

40. *The reservation is not based on the result of this RER study alone. It is the result of a risk analysis based on the ECA DAS and RER exercises of the last three years. Therefore, it cannot be concluded that the approach followed in the RER exercise under scrutiny would have probably led to a different result in terms of reservations.*

Furthermore, the reservation in the 2017 AAR indeed related to grants in direct management only, whereas in previous years the combination of error rates and risk assessments led to reservations on more spending areas. However, this does not mean that control efforts were reduced. In the description of the reservation it is explained that although the reservation relates to grants in direct management only, the actions relating to the other spending areas, i.e. those from previous years, will also be continued.

⁽³⁶⁾ See chapter 2.1.5 of the AAR 2017.

⁽³⁷⁾ Best conservative estimate of the amount of expenditure authorised during the year but not compliant with the contractual and regulatory provisions applicable at the time payment is made.

⁽³⁸⁾ See DG DEVCO's 2017 annual activity report, p. 59.

THE COURT'S OBSERVATIONS

43. The overall audit evidence indicates that, for the financial year ending 31 December 2017:

- (a) the revenue of the EDFs was not affected by a material level of error;
- (b) EDF payment transactions were affected by a material level of error (see paragraphs 17 to 28). Our testing of transactions including imported adjusted RER results produced an estimated level of error of 4,5 % (see **Annex 1**).

44. As regards the RER study, considering the less prudent approach and the nature, relevance and volume of errors detected during our review, we conclude that the results of this year's study cannot be compared to the results obtained in previous years. The weaknesses found have an impact on the results of the 2017 residual error rate (see paragraphs 36 to 38).

45. Currently, there is an inconsistency between the budgetary process (EP is not involved) and the accountability process (EP is partly involved in the discharge) (see paragraph 3(c)). The possible future integration of the EDFs within the EU general budget could mitigate the risks associated with this inconsistency (artificial annual budgetary discharge and absence of budgetary power of the EP).

Recommendations

46. **Annex 3** shows the findings of our follow-up review of the four recommendations we made in our 2014 annual report⁽³⁹⁾, of which DG DEVCO had implemented⁽⁴⁰⁾ recommendations 1, 2 and 4 in full. In our opinion, recommendation 3 has not been implemented, on the basis of our review of the 2017 RER study (see paragraph 37).

THE COMMISSION'S REPLIES

44. *It cannot be concluded that a different approach would have automatically led to a different result in terms of the error rate.*

46. *The Commission considers the recommendation to be fully implemented: new versions of the RER methodology and manual were issued that address the points raised by the ECA.*

⁽³⁹⁾ We chose our 2014 report for this year's follow-up exercise as, typically, enough time should have elapsed for the Commission to have implemented our recommendations.

⁽⁴⁰⁾ The aim of this follow-up was to verify whether corrective measures had been introduced in response to our recommendations, and not to assess the effectiveness of their implementation.

THE COURT'S OBSERVATIONS

47. Based on this review and our findings and conclusions for 2017, we recommend that from 2019 onwards the Commission:

- **Recommendation 1:** monitor closely the implementation of the RER study, particularly that the full reliance decisions are fully in line with the methodology and justified (see paragraph 36);
- **Recommendation 2:** disclose again in the AAR the limitations of the RER study (see paragraph 35);
- **Recommendation 3:** take decisive steps to de facto enforce the guidance on accepting expenditure to avoid excess clearings (see **Box 5**);
- **Recommendation 4:** take measures to ensure that only incurred costs are accepted as expenditure for AITF transactions (see paragraph 22);
- **Recommendation 5:** set up a KPI to monitor the ageing of the advance contributions made to trust funds (see paragraph 10);
- **Recommendation 6:** propose a relevant solution to the EDFs budgetary and accountability inconsistencies as part of the current post-Cotonou studies (see paragraph 45).

THE COMMISSION'S REPLIES

The Commission accepts the recommendation

The Commission suggests to further improve its monitoring in order to follow-up closely on more specific aspects such as the number of full reliance cases.

The Commission accepts the recommendation

The Commission accepts the recommendation and will look into ways to clarify and enforce the relevant guidance.

The Commission accepts the recommendation

The Commission will take measures to prevent the acceptance as expenditure of estimates reported in the financial statements of the AITF.

The Commission does not accept this recommendation

According to the accounting rules, EDF contributions to the EU Trust Funds are presented in the EDF annual accounts. They are monitored and controlled on a yearly basis. Furthermore, the RAL absorption period of the EU Trust Funds which directly impacts the ageing of those contributions is monitored in real time through KPI 4 (RAL absorptions capacity). The Commission considers therefore that the ageing of EDF contributions to EU Trust Funds is duly monitored and that the creation of an additional KPI is not necessary.

The Commission accepts the recommendation

Since the Commission already made a proposal, it considers the recommendation to be implemented.

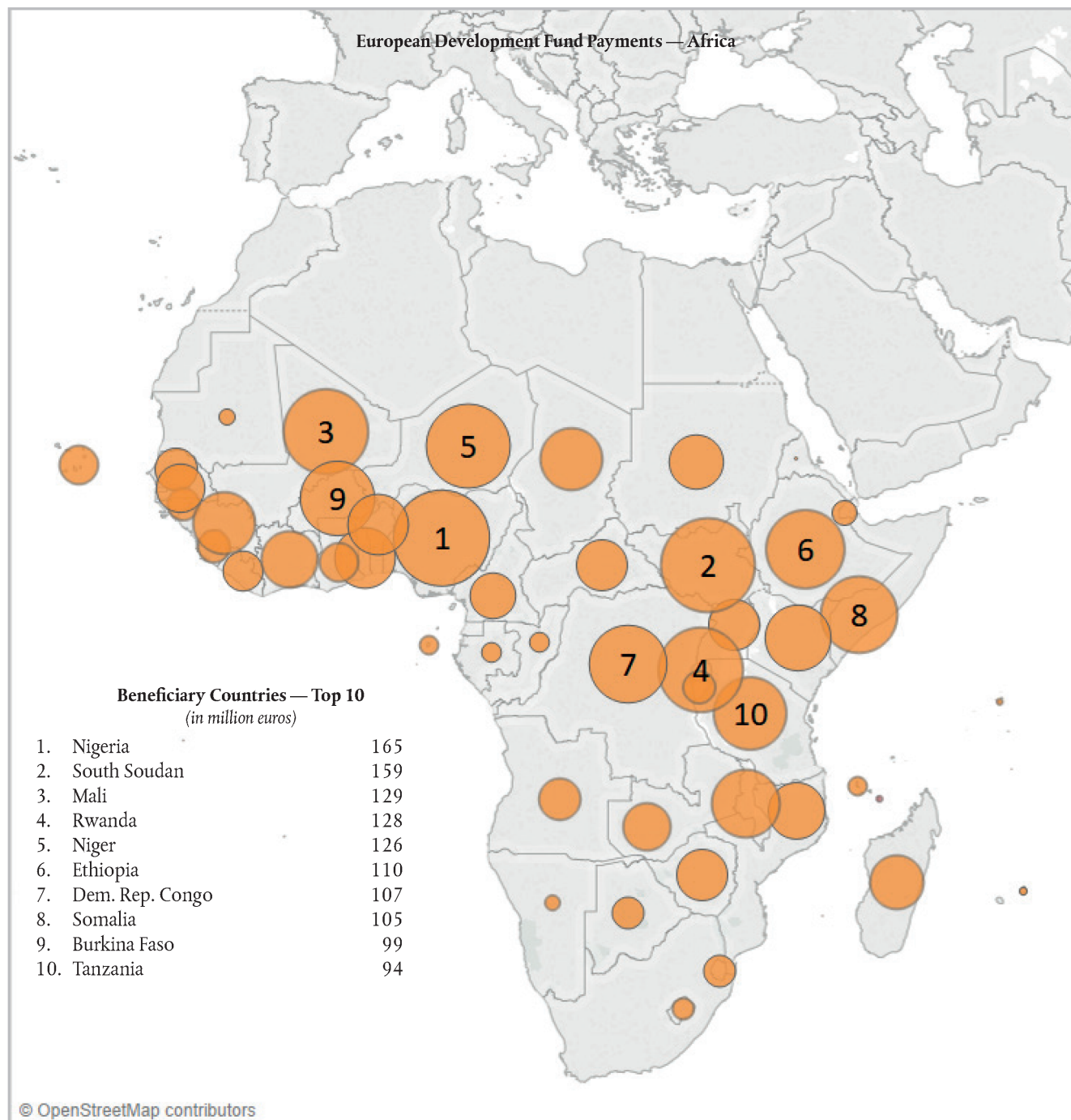
ANNEX 1

RESULTS OF TRANSACTION TESTING FOR THE EUROPEAN DEVELOPMENT FUNDS

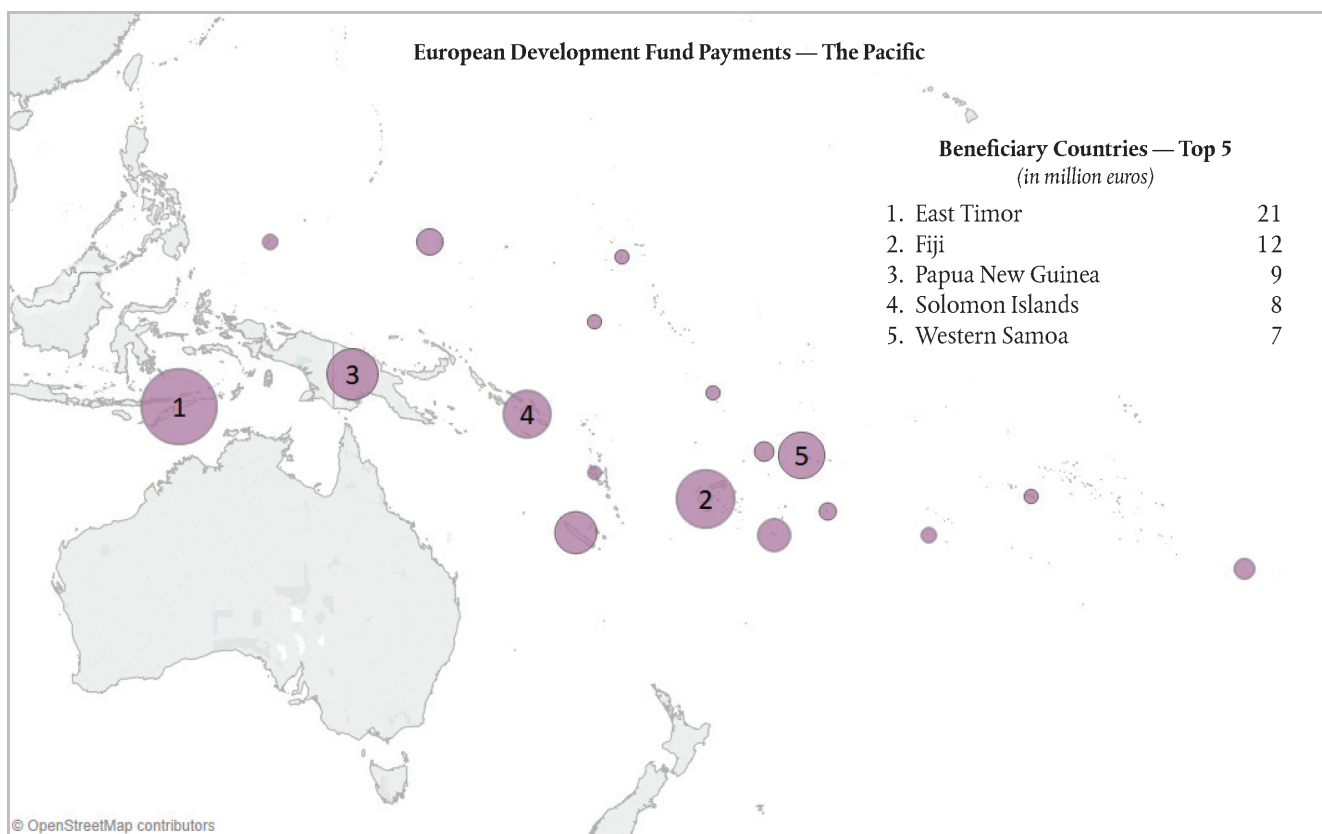
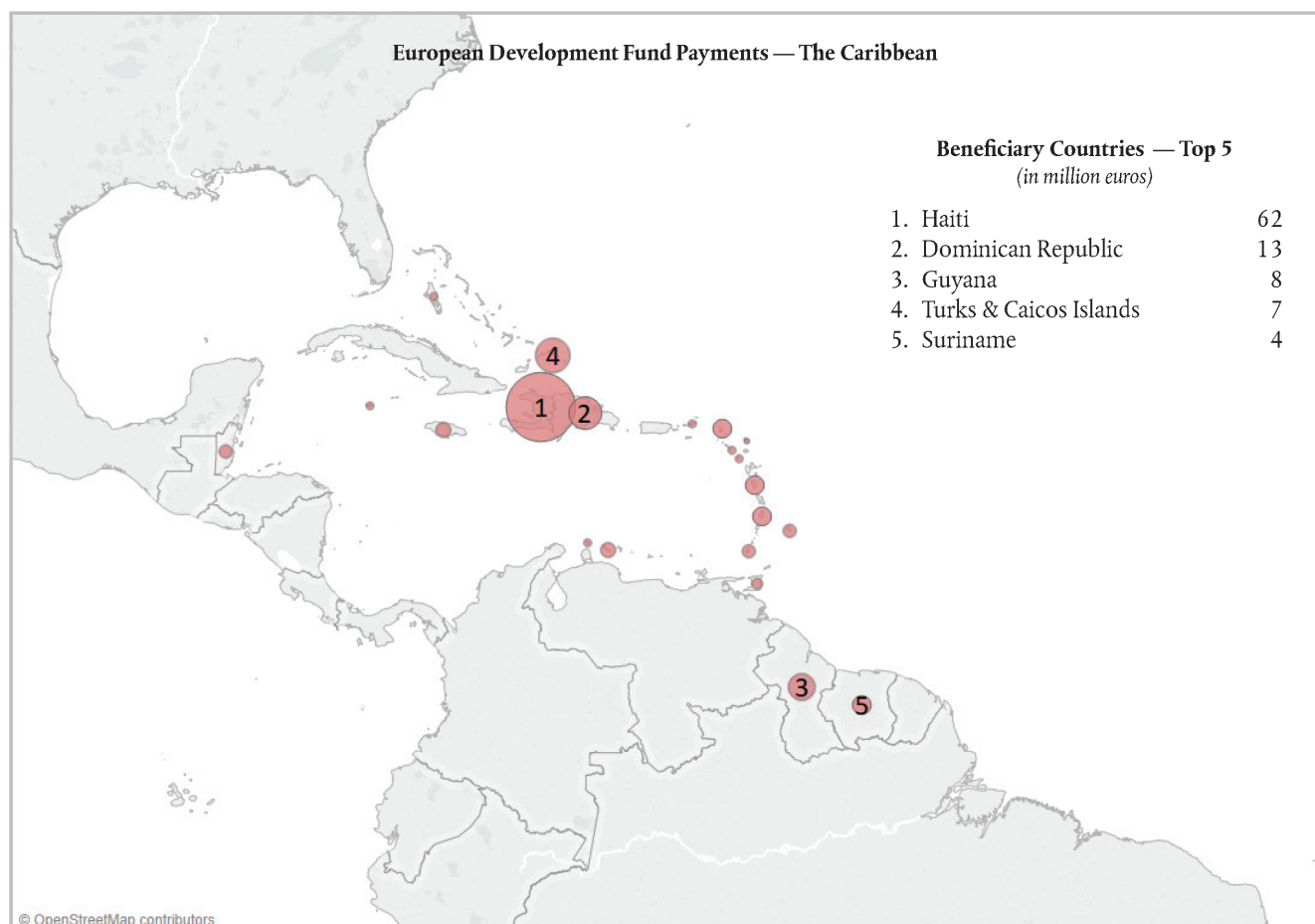
	2017	2016
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	142	143
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	4,5 %	3,3 %
Upper error limit (UEL)	7,8 %	
Lower error limit (LEL)	1,2 %	

ANNEX 2

EDF PAYMENTS IN 2017 BY MAIN REGION



Sources: Map background ©OpenStreetMap contributors licensed under the Creative Commons Attribution-ShareAlike 2.0 license (CC BY-SA) and European Court of Auditors, based on the 2017 consolidated annual accounts of the 8th, 9th, 10th and 11th EDFs.



Sources: Map background ©OpenStreetMap contributors licensed under the Creative Commons Attribution-ShareAlike 2.0 license (CC BY-SA) and European Court of Auditors, based on the 2017 consolidated annual accounts of the 8th, 9th, 10th and 11th EDFs.

ANNEX 3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR THE EUROPEAN DEVELOPMENT FUNDS

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	Not applicable	Insufficient evidence	
			In most respects	In some respects				
2014	Recommendation 1: EuropeAid should set up and implement internal control procedures to ensure that pre-financing is cleared on the basis of actual incurred expenditure not including legal commitments;	x						
	Recommendation 2: EuropeAid should, reinforce the systematic verification that partner countries use the correct exchange rate to convert budget support disbursements into their national currency;	x						
	Recommendation 3: EuropeAid should ensure together with the contractor in charge of the RER study that the issues that we have found are addressed;				x			
	Recommendation 4: EuropeAid should improve its indicators in respect of target values against which to assess the efficiency and cost-effectiveness of controls, its cost approach, and its procedures and management information systems to measure the benefits of controls.	x						