

COMMISSION OF THE EUROPEAN COMMUNITIES

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# SYNTHESIS REPORT FROM THE COMMISSION

## Member States' replies to the Court of Auditors' 2003 Annual Report

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## 1. INTRODUCTION

Immediately after the Court of Auditors transmitted its *Annual report concerning the financial year 2003*[1] in November 2004, the Commission informed each of the Member States of the observations specific to them in the report. The Commission also invited Member States to reply to two general questions relating to the Court of Auditors' *Opinion no. 2/2004 on the 'single audit' model (and a proposal for a Community internal control framework)*[2] (hereafter "the CICF opinion").

The Financial Regulation requires the Commission to transmit a summary of the Member States' replies to the Court of Auditors, the Council and the European Parliament before 15 February[3]. Due to the late receipt of some replies, as well as the time needed for translation of the replies and of the report itself, this deadline was not met. The Commission did nevertheless present the main conclusions from the replies to the Council before the Council decided its recommendations to the European Parliament on the 2003 discharge[4].

19 Member States replied to both the two general questions and the specific observations concerning them. An additional three Member States replied to only the specific observations.

The aim of this report is to present a summary of Member States' replies. Section two summarizes the replies to the two general questions and the Court's specific observations on Member States. Section three considers the issue of DAS errors. Section four presents the conclusion.

## 2. SYNTHESIS OF MEMBER STATES REPLIES

### 2.1. Member States' views on a Community internal control framework

The Court of Auditors published its CICF opinion in April 2004 where it set out some general principles for a Community internal control framework, *cf. annex I*. The Court highlighted the opinion in the general introduction to its *2003 Annual Report*[5]. The Commission considers this opinion a very important and valuable contribution to the debate on how to further improve the Community internal control framework[6].

As Member States are involved in shared management of around 80 per cent of EU funds, the Commission considered that an appropriate follow-up to the Court's

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1 Cf. OJ C 293 of 30.11.2004.

2 Cf. OJ C 107 of 30.4.2004.

3 Cf. 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 June 2002 (OJ L 248 of 16.9.2002).

4 Letter of 15 February 2005 from Vice President Siim Kallas to President of the Council (ECOFIN) Jean-Claude Juncker.

5 Cf. point 0.5 in *Court of Auditors – Annual report concerning the financial year 2003*, OJ C 293 of 30.11.2004.

6 The Community internal control framework is defined as all actions taken into account by the Commission in its risk management. This comprises e.g. internal controls within the Commission itself, missions performed by the Commission itself, missions entrusted to external auditors as well as internal control and/or audit systems of Member States and/or National Audit Institutions. Thus, the Community internal control framework does not include external audit undertaken by the Court of Auditors.

opinion should be based on input from the Member States as well. The Commission therefore invited Member States to answer two general questions relating to issues raised in the Court's opinion.

Question no. 1

*In its opinion no. 2/2004 on the single audit model, the Court has included a proposal for a Community internal control framework. In the areas of shared management, the Court is proposing that a chain of tasks and responsibilities be developed, stretching from the immediate managers of the funds (primary controls) to the Commission (supervisory controls) via a central Member State control function. This model presupposes that each level can rely and use (i.e. has access to) the results of the other control bodies. Do you support this chain-based model in general and would you support the development of such a chain-based model in the areas where it does not already exist? What can be done in practice to improve the co-ordination of controls (e.g. do you support the contracts of confidence proposed by the Commission in the area of structural funds)?*

19 Member States have replied. None reject the idea of a Community internal control framework but several Member States express reservations/make comments:

- **Responsibilities** of all involved should be clearly defined. The Commission shall remain responsible for the implementation of the EU budget, in accordance with article 274 of the Treaty.
- Several Member States stress that **an internal control framework already exists** to some extent.
- **Common standards for financial control and internal audit** must exist at all levels for the control chain. Such standards should be developed in full cooperation between the Commission and Member States. They should be based on already existing international standards. Some Member States mention own resources as an area where the Commission and Member States cooperate effectively on harmonization of audit and control procedures.
- **Costs and benefits** must be reasonably balanced. Any changes to the Community internal control framework should make the system simpler and not increase the administrative burden. One Member State proposes that the EU budget should bear the costs of Member State controls. Another argues that support for audit and control activities within Structural Funds and the Cohesion Fund should continue to be financed under technical assistance measures. One Member State notes that accurate estimates of the costs of controls by national authorities are difficult to obtain because of the complex range of control activities for a given type of expenditure.
- Several Member States say that **differences in national administrative cultures and practices** must be taken into account.
- Some Member States indicate that **reporting** documents should be harmonized and pooled while others find that reports of national bodies cannot be considered the property of the Union. In a few cases, Member States foresee legal complications if such reports should be directly accessible to other control levels.
- Some Member States point out that **imprecise legislation and lack of guidelines** cause irregularities.

- Finally, some Member States argue that a change in the role of Member States in the internal control framework should be counterbalanced by a different **approach in the audit and control acitivities of the Court of Auditors and the Commission**, such as by reducing control activities in Member States in general and focusing on systems audits instead of doing on-the-spot controls.

Question no. 2

*Until 2001, the Court of Auditors based its statements of assurance on the errors found in a limited sample of payments charged to a year's EU budget, and has considered that the level of irregularity found in funds managed in partnership was too high. However, a certain level of irregularity is unavoidable as the control systems are not designed to detect every irregular payment, but to limit the risk to the EU budget:*

*- through dissuasive sanctions applied when irregularities are found in the 5 per cent of claims checked on the spot under the IACS system in agriculture*

*- through recoveries in a later financial year when a final claim is submitted under a grant, or when an ex-post audit detects an irregularity*

*The Court is now moving towards basing its statement of assurance on its assessment of the supervisory and control systems put into place to manage the risk of irregularity in claims, rather than on individual errors found during its audits.*

*How can Member States best provide evidence that supervisory and control systems are in place which keep the risk of irregularity in EU funds to within reasonable limits?*

19 Member States have replied. The content of the replies varies as some Member States have described the current control framework in place in the Member State while others have commented on the role of Member States in general terms.

Very few Member States have presented ideas on how the Member States at an operational level should provide evidence that the risk of irregularity in EU funds is within reasonable limits. One proposes that each Member State should have a central coordination body carrying out effective and constant supervision. Another proposes to introduce a principle of one audit authority for each Member State. And a third proposes that each Member States should provide the Commission with an annual report and a declaration, based on the same model as is used by the Commission internally.

All Directors-General in the Commission must present an Annual Activity Report and sign a declaration each year as to whether funds managed by the Directorate-General have been used for the intended purpose in accordance with the principles of sound financial management and that the control procedures in place give the necessary guarantees concerning legality and regularity of the underlyings transactions.

### 2.2. Member States' views on specific observations made by the Court of Auditors

22 Member States have replied to the Court's specific observations. Almost all provide feedback on a majority of the specific observations where a reply is expected. In more than one in four cases, Member States indicate that they either disagree with the observations of the Court or they consider the issue still open for discussion.

Disagreements between the Court and the Member States do vary in nature, but among the recurring issues are a) the eligibility of expenditure, b) the structure of checks (i.e. sampling methods, risk analysis and extrapolation) and c) the estimated effect on the Community budget when taking into account that corrections have been made or will be made in later payments.

Several Member States point out that the Court has not taken their replies into account in the *2003 Annual Report*. Two find that they were not duly notified of observations before they appeared in the *2003 Annual Report*.

Some point out, that the Court's observations are based on findings in individual transactions and do not necessarily indicate systematic irregularities within e.g. a Structural Funds programme. One stresses that the current procedure makes it impossible for Member States to profit from the exercise. Instead, the Court should present a qualitative examination of the systems it has examined as such input would be of more value to the Member States.

Another proposes that the Court includes a brief summary of specific recommendations for clearly identified Commission follow-up actions, together with deadlines. This would reinforce the multi-annual aspect of the Commission's work and provide a baseline for subsequent reports.

## 3. DAS ERRORS

The Court of Auditors bases its statement of assurance on four elements:

- an examination of the way in which the supervisory systems and controls set up in both the Community institutions and in the Member States and third countries work;
- an examination of samples of transactions for each major area by carrying out checks down to the final beneficiary level;
- an analysis of the annual activity reports and declarations of the Directors-General and of the procedures applied in drawing them up;
- where necessary, an examination of the work of other auditors who are independent of Community management procedures.

The Court identifies errors when it examines a sample of transactions (point b) above). Some are attributed to the Commission itself, others to the Member States. Errors are classified as either substantive or formal, with substantive errors having direct financial consequences and formal errors not.

About one third of the errors identified by the Court in 2003 were classified as substantive. Of these, almost one in three were cases with an error rate (i.e. the amount in error as a share of the total amount involved in the transaction) less than two per cent. In the cases with error rates higher than two per cent, more than 2/3 were attributed to areas of shared management. On the basis of the replies received, it is not possible to present a global estimate of how many errors the Member States accept or contest. However, the Commission follows up on all error findings made by the Court of Auditors in cooperation with the Member States concerned. If the Court's observations are confirmed, the necessary financial corrections and recoveries are made. Based on the results so far achieved in the follow-up, the Commission's analysis of the errors indicates that about half of the substantive errors with an error rate higher than two per cent can be accepted. For the remaining half, the errors are either rejected or it is not yet possible to accept/reject the error because the cases have not been closed yet.

In the vast majority of the cases with accepted errors, the Commission/Member States agree with the Court of Auditors on the amount which is considered to be in error. However, it should be noted that the amount in error (as a share of the total transaction amount) is usually in the lower range; thus, in more than 60 per cent of the cases, the amount in error is less than 10 per cent of the total transaction amount.

## 4. CONCLUSION

The Commission welcomes the Member States' replies which in many cases are full and comprehensive.

The follow-up to the European Court of Auditors' *Annual Report* is important as Member States in several cases do not agree with the specific observations of the Court. The exercise allows both the Member States and the Commission to have a global overview of Member States' position on both these observations and DAS errors. An analysis of the DAS errors show that at this point in time, only about half of substantive errors identified by the Court with error rates higher than two per cent can be accepted.

The 2003 exercise has also provided the Commission with valuable information on Member States' preliminary reactions to the Court of Auditors' CICF opinion. This issue is taken up in the *Communication on a roadmap to an integrated internal control framework* (COM(2005) 252). The two general questions were an innovation. Given the positive results, the Commission may put such horizontal questions in the 2004 exercise. The Commission will also continue to make further efforts along with the Court of Auditors to ensure that Member States can more easily identify and thereby comment on DAS errors. The Commission will also continue to make efforts to ensure that Member States' replies to the Court's observations are taken into account in the Court's annual report and in the discharge process but must acknowledge that this is often difficult due to the timing of the procedure.

**ANNEX I**

## General principles for a Community internal control framework set out by the Court in its opinion no. 2/2004

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|---|---|
| Objectives | • Should define scope, purpose, those involved, what it comprises, to what end, with what constraints, to what extent, how.<br>• Complete and timely corrective action must be ensured if errors in transactions and systems weaknesses appear. |
| Conditions | • The European Union should "own" all checks, i.e. all results, supporting documents etc. must be available to others in the control chain.<br>• Legislation must be simple and clear.<br>• Penalties and sanctions should cover all parts of the budget. |
| Structure | • At Member State level, someone must be responsible for providing assurance that the control work undertaken at the local level is to the required standard and quality.<br>• The Commission must ensure that control levels in Member States (or equivalent) are operating effectively and as intended.<br>• Claims for reimbursement or costs should be accompanied by audit certificate from independent external auditor. |
| Application | • The Commission should define minimum requirements for control systems at all levels.<br>• Common standards for controls must exist.<br>• Results must be accessible in a common format (perhaps in a database with access for others in the control chain).<br>• The issue of risk based versus random sampling must be addressed.<br>• Beneficiaries must be well informed of the risks if cheating. |
| Costs and benefits | • Should Member States' (or bodies undertaking controls) costs be borne by the EU budget?<br>• Benefits must be "measured" through estimates of illegality and irregularity.<br>• A trade-off must be struck between costs and benefits (tolerable risk of error/irregularity).<br>• Tolerable risk must be defined, e.g. by defining acceptable error rates and the intensity of checks. |
| Roles and responsibilities | • The Commission should be responsible for promoting internal control systems in partnership with the Member States, i.e. it shall define common characteristics of the system, monitor costs and evaluate benefits.<br>• The Parliament and the Council should approve the cost/benefit balance[7].<br>• The Court of Auditors should audit the internal control systems as external auditor. |

[7] The approval of costs may be implicit, in accepting a certain percentage of checks.