



Council of the
European Union

013275/EU XXVI. GP
Eingelangt am 02/03/18

Brussels, 2 March 2018
(OR. en)

6744/18

FIN 187

COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	1 March 2018
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	COM(2018) 117 final
Subject:	Report from the Commission to the European Court of Auditors, the Council and the European Parliament: Member States' Replies to the European Court of Auditors' 2016 Annual Report

Delegations will find attached document COM(2018) 117 final.

Encl.: COM(2018) 117 final



Brussels, 28.2.2018
COM(2018) 117 final

**REPORT FROM THE COMMISSION TO THE EUROPEAN COURT OF
AUDITORS, THE COUNCIL AND THE EUROPEAN PARLIAMENT**

Member States' Replies to the European Court of Auditors' 2016 Annual Report

{SWD(2018) 61 final}

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REPORT FROM THE COMMISSION TO THE EUROPEAN COURT OF AUDITORS, THE COUNCIL AND THE EUROPEAN PARLIAMENT

MEMBER STATES' REPLIES TO THE COURT OF AUDITORS' 2016 ANNUAL REPORT

1 INTRODUCTION

When the European Court of Auditors (ECA) published its 2016 Annual report on 28 September 2017¹, the Commission in accordance with the Financial Regulation² immediately informed Member States of the details of the report which relate to the management of funds for which they are responsible.

Member States were also invited to reply to a questionnaire focusing on three main themes: (1) Compliance with rules and regulations (2) Reporting on performance (3) Follow-up of ECA recommendations.

This report provides a summary of the Member States' replies. It is accompanied by a Staff Working Document (SWD) which presents the Member States' replies in more detail.

2 KEY FEATURES OF THE ECA 2016 REPORT

For the first time since 1994, ECA issued a qualified (rather than an adverse) opinion on the regularity of the transactions underlying the 2016 accounts. This reflects an important improvement in the management of EU finances.

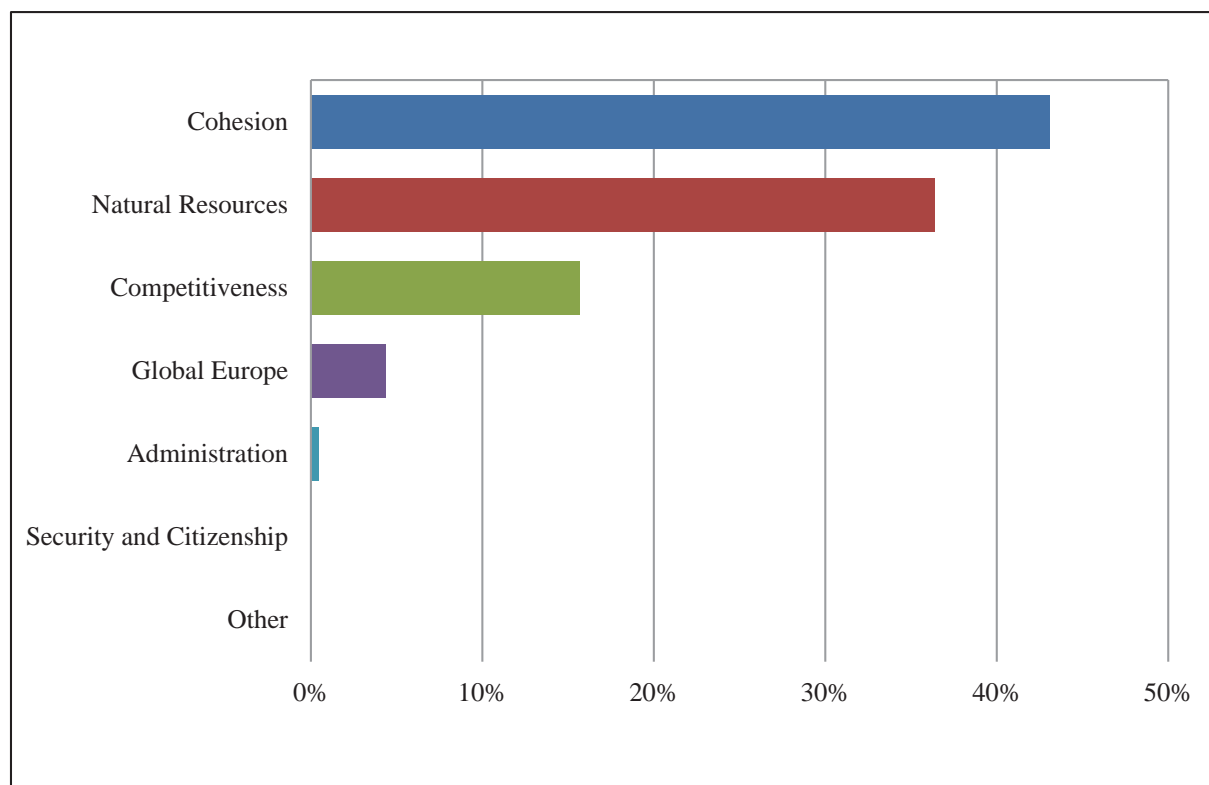
A significant part of the 2016 expenditure audited by the ECA was not affected by a material level of error and there was a sustained improvement in the estimated level of error in payments made from the EU budget over the past three years: from 4.4 % in 2014, to 3.8 % in 2015 and 3.1 % in 2016. While, apart from MFF headings 5 (Administration) and 3 (Security and Citizenship), expenditure for all remaining headings were still affected by a material level of error, all these individual rates show a decrease from 2015 to 2016. Cohesion remained the biggest contributor to the overall error rate followed by Natural Resources, Competiveness and Global Europe. The contribution to the 2016 overall estimated level of error by MFF heading is presented in Figure 1.

Funds in the cohesion and the agriculture headings are mainly implemented in shared management mode and are therefore the focus of the questions posed to the Member States.

¹ <https://www.eca.europa.eu/Lists/ECADocuments/annualreports-2016/annualreports-2016-EN.pdf>

² Article 162(5) of Regulation (EU, Euratom) No 966/2012.

Figure 1 - Contribution to the 2016 overall estimated level of error by MFF heading



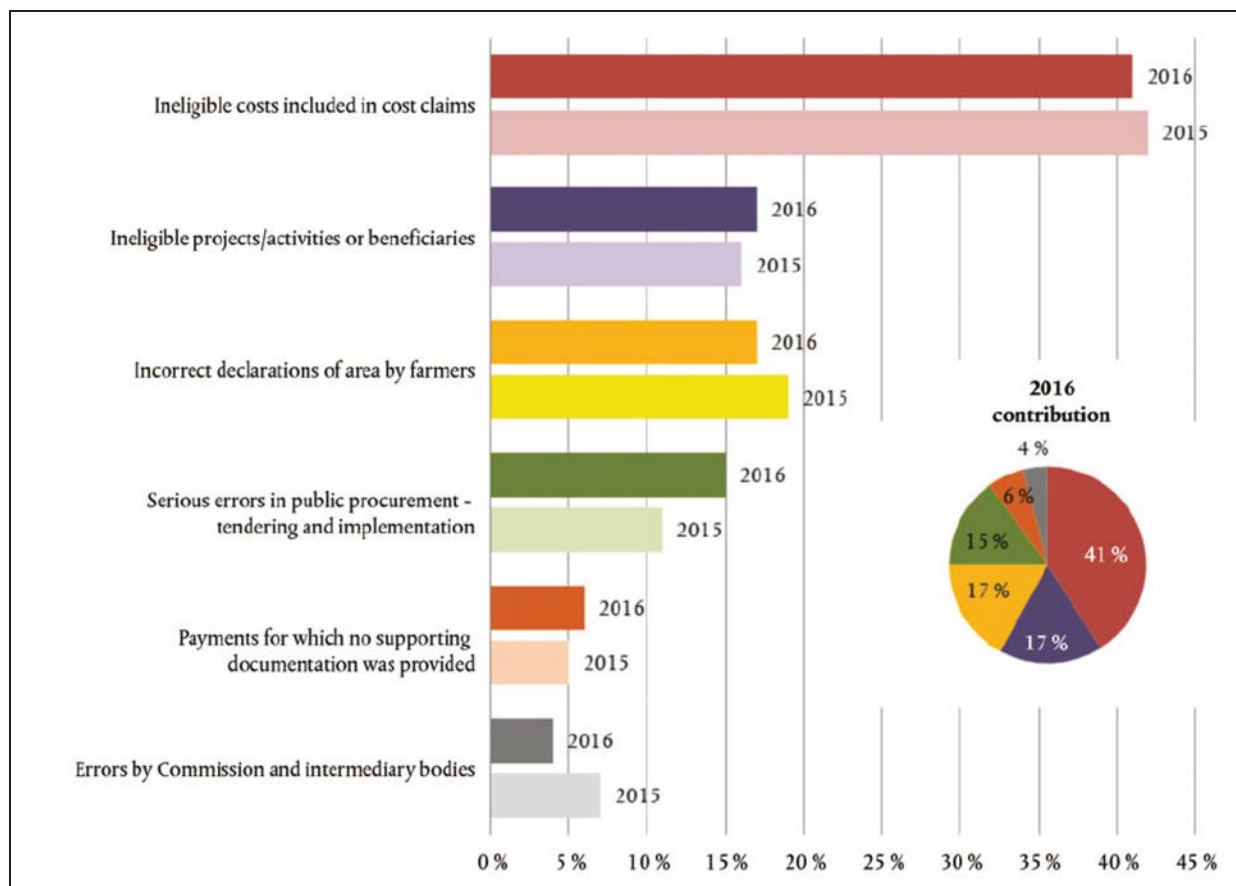
Source: ECA Annual report 2016

The results of ECA's audit for 2016 also showed that the accounts were not affected by material misstatements and it therefore issued a clean opinion on the reliability of the accounts, as it has done since 2007.

The ECA report also identified two types of expenditure programmes - entitlement programmes and cost reimbursement schemes - which involve distinct patterns of risks. According to the report, eligibility errors in cost reimbursement schemes dominated the errors detected for 2016. Errors in the category included mostly ineligible costs included in cost claims and ineligible projects, activities and beneficiaries. For entitlement programmes one of the most typical error type was the incorrect declarations of area by farmers. At the same time, the ECA found that eligible areas have been more accurately determined than in previous years. The result was the important development in 2016 that ECA did not find material error in entitlement-based expenditure on direct support to farmers. Figure 2 shows the breakdown of the overall estimated level of error by the types of error as applied by ECA.

Concerning performance, the Court found that the Commission produces a vast quantity of information in comparison to Member States or international organisations. The Commission accepted a recommendation to provide more information on the source and quality of data where available.

Figure 2 - Breakdown of the 2016 overall estimated level of error by the types of error



Source: ECA Annual report 2016

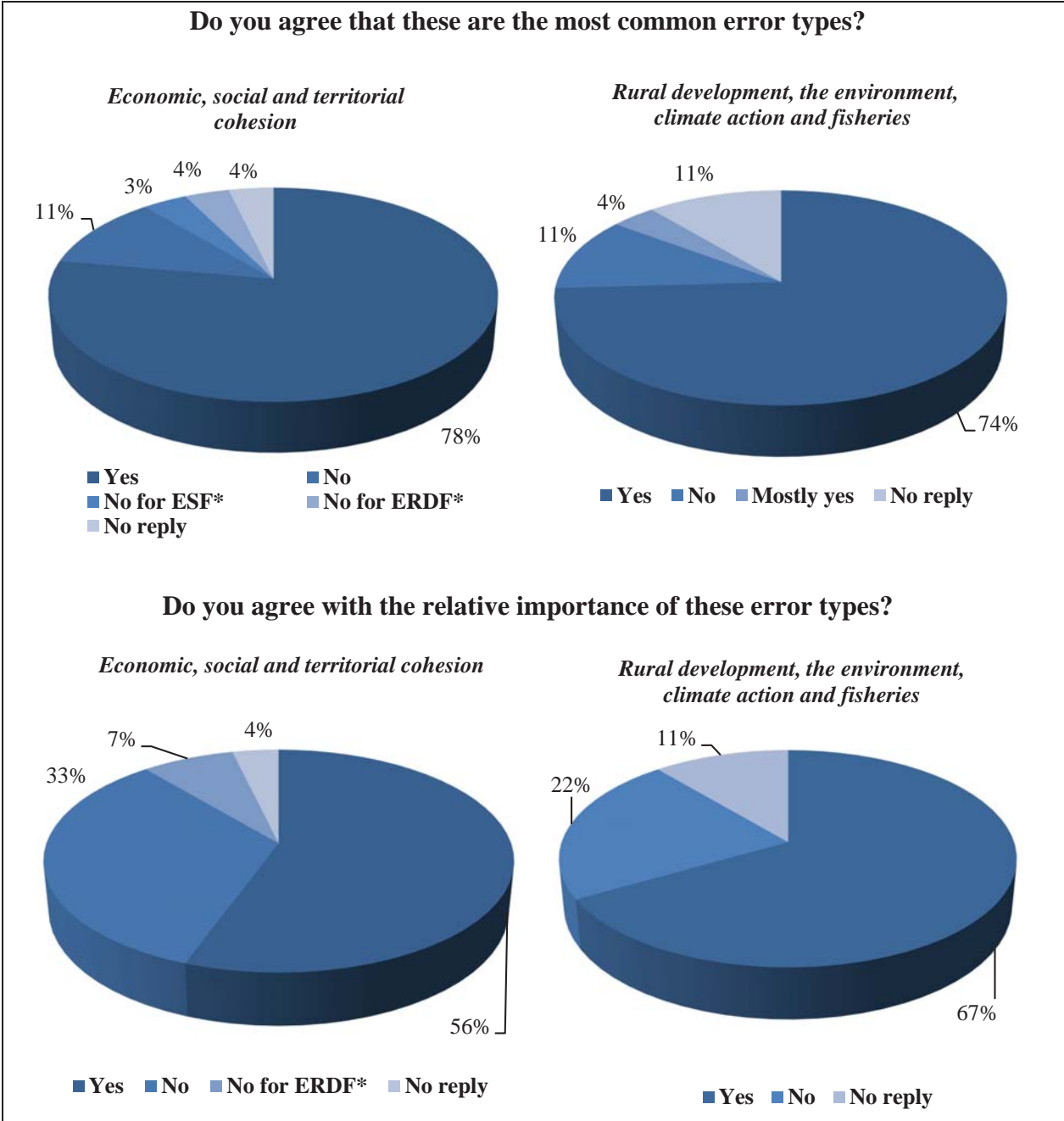
3 SUMMARY OF THE MEMBER STATES' REPLIES

3.1 Compliance with rules and regulations

The ECA 2016 Annual report identifies the main error types (based on their audits) in the two major EU shared management spending areas (common agricultural policy and economic, social and territorial cohesion policy). The questions aimed to assess whether Member States agree with the ECA's conclusion concerning the **error types and their relative importance** in these spending areas, and to what extent they have taken measures to prevent such errors from occurring.

The replies indicated that the vast majority of the Member States – around three-quarters of them - agreed with the most common error classes identified by ECA in both policy areas. They also mostly confirmed the relative importance of error types identified by ECA; the lower rate of agreement observed in cohesion (56%) as opposed to rural development (67%) in this respect can be explained by the somewhat more divergent error typologies characterizing the former policy area. Figure 3 gives details of the Member States' replies.

Figure 3 - Member States' perceptions of the Court's conclusion on the most common error types



* Some Member States provided separate replies with regards to ERDF and ESF.

Some Member States also indicated other types of error they frequently encounter in these policy fields. For cohesion, Estonia underlined that State aid-related irregularities tend to have a high financial impact, while Finland mentioned cost overruns. Hungary listed three additional categories, namely the failure to provide

evidence of compliance with the market price, double financing of projects and the breach of sound financial management. As regards rural development, Austria highlighted the risk of failure to comply with conditions governing the assistance and multiannual commitments.

Concerning the relative importance of error categories, many Member States (e.g. Bulgaria, Czech Republic, Estonia, Ireland) reported that infringements of public procurement rules continue to be the most important deficiency type.

A few Member States also supplied detailed descriptions of the measures in place to prevent these errors. Descriptions indicated that checks are performed and controls are in place at the level of managing authorities, certifying authorities in compliance with the relevant sectoral legislations governing the use of the instruments. The replies frequently state that managing authorities have developed manuals containing rules of procedure which operate the internal control systems for the implementation and management of operational programmes which are in line with these rules. Audit authorities adopted strategies focusing on on-the-spot checks of operations and systems audits to detect errors in the management of operations implemented under the European Structural and Investment Funds (ESIF).

Many Member States referred to the simplification of rules related to aid schemes and the use of simplified cost options as means to address the frequent appearance of errors. Almost all respondents stressed the usefulness of organizing training events for intermediate bodies and for beneficiaries when launching calls in order to raise awareness of legal requirements. In Spain, the managing authorities assess the capacities of the intermediate bodies before allocating tasks to them.

Many measures were cited in cohesion policy targeted at reducing errors in public procurement. Croatia, France and Slovakia mentioned that they set up online networking platforms for experts to discuss problems and for beneficiaries to easily access information. In Croatia, Latvia and Slovakia, the national authorities publish overviews of the most frequently occurring errors in procurement procedures. Lithuania has created a Public Procurement Office *"which is responsible for implementing a public procurement policy and enforcing national legislation on public procurement, as well as for prevention, for giving advice on public procurement matters and for administering the Central Public Procurement Information System."*

In the field of agriculture, Poland and Latvia introduced an electronic application system that facilitates for applicants the indication of a correct land area. Describing similar procedures involving also automated checks, Sweden stated that the approach has led to substantially fewer errors than manual processing. Many respondents (e.g. Cyprus, Czech Republic and Greece) mentioned the usefulness of cross-referencing computer-held information between various (internal and external) sources. Malta maintains and regularly reviews a risk register. Taking a pragmatic approach, Ireland reminds aid scheme participants of deadlines by SMS.

Coordination at a central level was also identified as a key element in the management and control systems. In France, *"(..) coordinating authorities are at the disposal of the managing authorities and certifying authorities to answer any*

questions on eligibility and public procurement." In Germany, *"interpretation of legislative provisions and implementation issues are discussed at regular meetings with the ERDF managing authorities."* Poland holds regular trainings in the area of public procurement for regional governments.

3.2 Performance of the EU budget

In Chapter 3 of its 2016 Annual report the ECA stressed the importance of the quality of information provided on performance. The Commission pledged to provide information on the source and quality of data where available. Given that a significant amount of performance data concerning programmes financed by the EU budget is provided by Member States, the Member States were asked in the questionnaire for information on the quality of performance data at national level.

In some cases, Member States referred in their replies to not only data concerning the achievement of policy objectives but also data concerning the results of compliance checks. It is therefore not possible to draw conclusions on just one of these two types of data on the basis of the Member States' replies to the questionnaire.

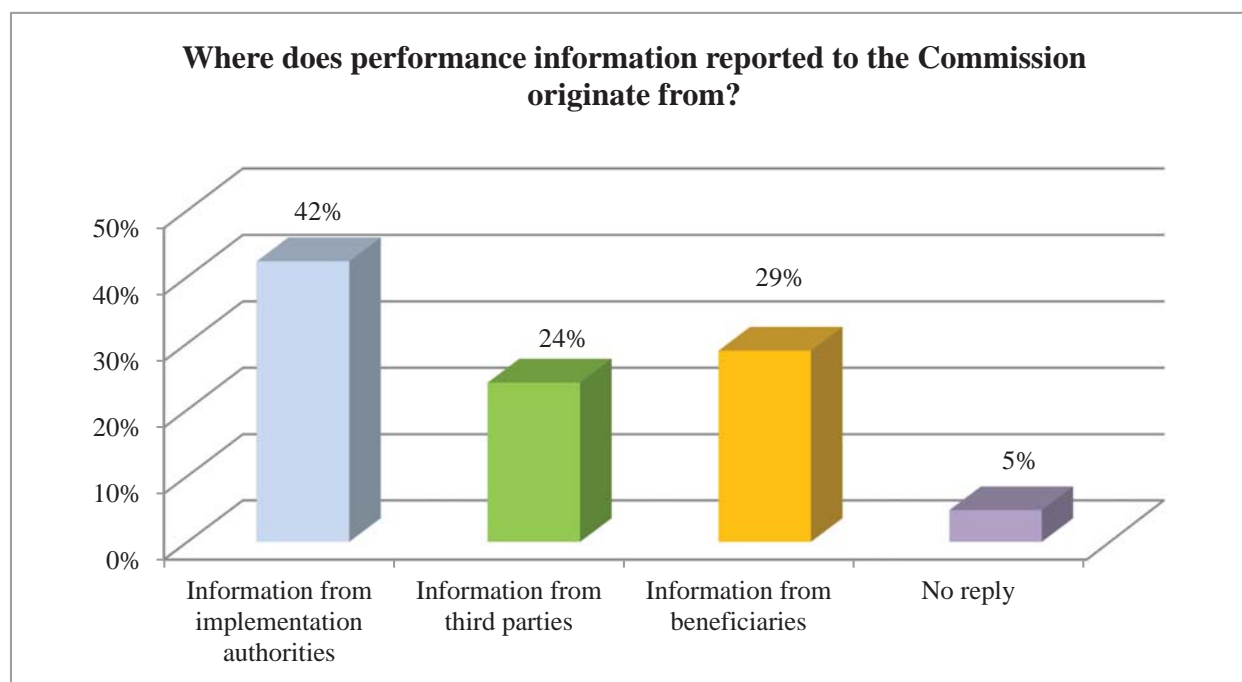
The replies of the Member States indicated that performance data may come from a number of sources which can be grouped into one of the following categories:

- Information held with national implementing bodies. In the case of cohesion, these were mainly the managing authorities (also in rural development), certifying authorities and intermediate bodies. In agriculture, this category represented paying agencies.
- Information coming from third parties. These can be national or international authorities, or agencies not involved in the management of projects or programmes concerned.
- Information originating from beneficiaries.

Several Member States provide performance data in cooperation with their national statistical offices which apply their own quality procedures.

While there can be apparent overlaps and interdependencies among the above categories (for instance, information held with national implementing authorities may originate from either of the other two sources), the questions and the analysis aimed to appraise Member States's own perceptions from the way they formulated the replies. Figure 4 shows the share of each category in the total number of error source citations in the replies.

Figure 4 – Share of information source categories mentioned in the replies of Member States



Note: 25 Member States replied to the question

Almost all Member States mentioned a national IT system operated by the implementing authorities for the management of operational programmes under shared management. In agriculture, the Land Parcel Identification System (LPIS) operated by the paying agencies was mentioned most frequently in this category.

Concerning third party-generated information, Eurostat and national statistics offices were often cited as corroborating sources used to verify indicator data; Romania also gathered information from independent national surveys for this purpose. Hungary mentioned it used information originating from the National Tax and Customs Administration and the National Bank, while Poland referred to consumer data from public utility companies.

The means and channels of gathering performance information from beneficiaries also proved to be versatile. Most Member States made reference to standardized progress reports which are collected and checked at the level of intermediate bodies or directly by the managing authorities in the field of cohesion (Bulgaria, Romania, Slovenia or Latvia). Documentation generated when applying for funding was also identified as an important performance information source especially in the field of agriculture.

Another question asked for information about the various actions, procedures and systems designed to ensure the quality of the reported performance data. Few Member States provided detailed replies with respect to the initial definition, identification and collection of performance data. Respondents rather focused on the

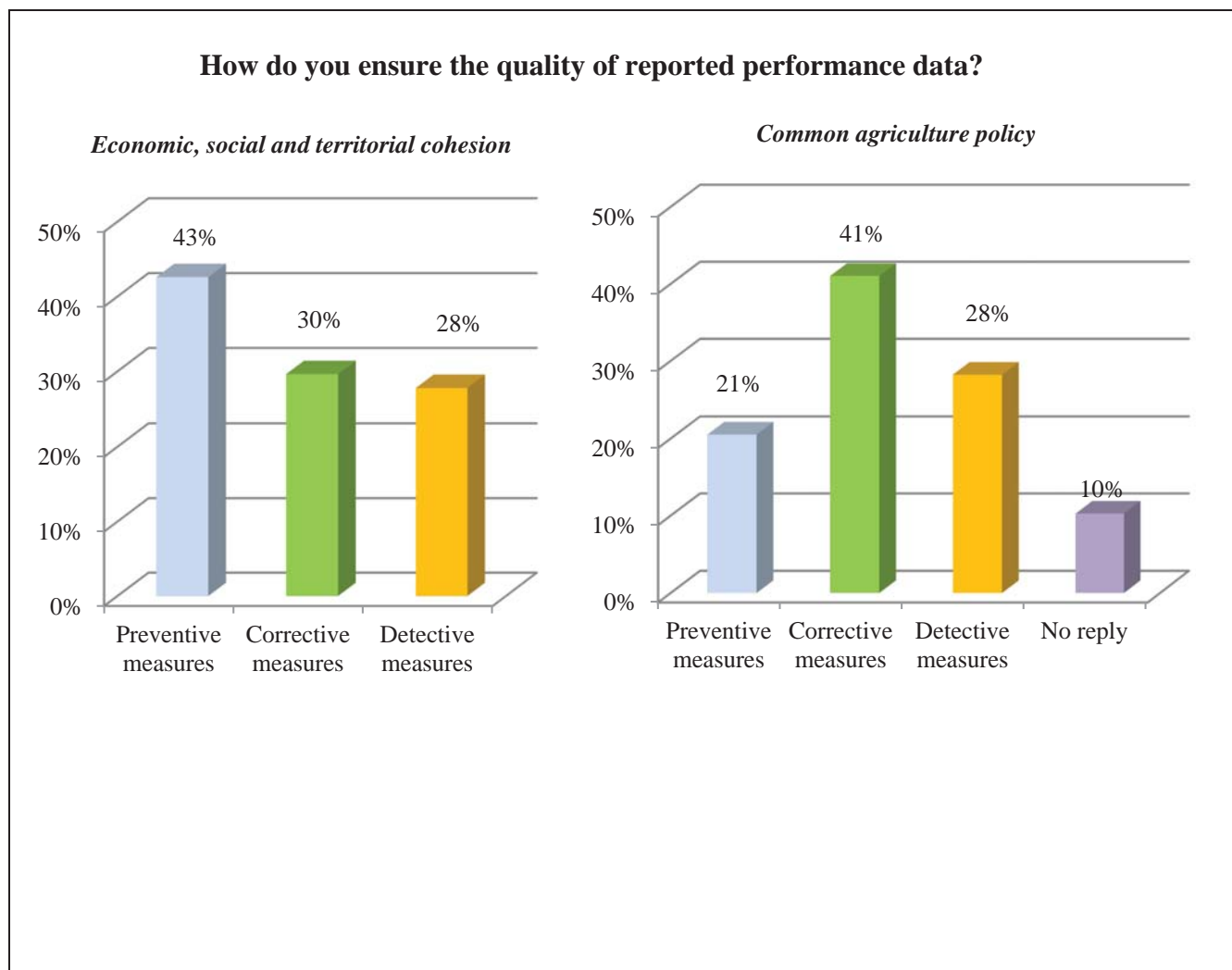
subsequent administrative cycles, i.e. those ranging from capturing performance data in the computerised systems to reporting.

In the analysis of the replies, such measures identified in the Member States' descriptions were grouped into the following categories:

- Preventive measures: Management actions intended to prevent deficiencies or errors to appear in the systems, procedures and processes which produce the indicators to be reported, resulting in an impairment of their quality.
- Corrective measures: Actions aiming to ensure that any error which may have still occurred are corrected before information is reported.
- Detective measures: Measures designed or are most effective to detect and correct any errors that may have impacted the quality of performance information reported to the Commission.

Similarly to the first set of groups above, possible overlaps and interdependences among the categories render a certain limitation to the conclusions provided by the analysis (for instance, information held with national implementing authorities may originate from either of the other two sources) As it was the case before, Member States' own perceptions assessed from the way the different actions and controls were formulated provided the yardstick for the categorisation. Figure 5 shows the share each of the above category represents in the Member States' replies.

Figure 5 - Share of measure types ensuring performance data quality



It transpired from the replies from many Member States that they envisage the establishment of an integrated electronic funds management system, compliant in design with the relevant EU and national legislations, as the most important preventive means to ensure data quality in both policy areas. Another such commonly mentioned preventive measure was the establishment of manuals for administrative checks to be conducted by managing authorities and intermediate bodies (Bulgaria, Croatia, Romania and Slovenia). Hungary published common methodologies on the establishment of common indicators and involved experts in defining them. In Bulgaria, in the field of cohesion, the certifying authority conducted quality checks of verification systems established by managing authorities for performance indicator monitoring. Some Member States (Bulgaria, Croatia and Greece) responded that they facilitated data supply by preparing standardized forms for beneficiaries to report on project implementation progress and the related indicators.

Among corrective and detective measures cited, the most important type appeared to be the first level management verifications (involving a proper segregation of duties and the observance of the four-eyes principle). The Czech Republic in particular mentioned the importance of performing reasonableness checks of the reported indicator data with those in previously submitted reports. On-site checks performed by implementing authorities at beneficiaries to reconcile information in beneficiary reports with source documents were also frequently mentioned.

3.3 Follow-up of ECA recommendations

Each year ECA examines how the Commission follows up on the recommendations issued by ECA to the Commission. This year's analysis of 108 recommendations published between 2010 and 2013 showed that the Commission implemented 90 recommendations fully or in most respects. The ECA found that just six recommendations had not been implemented at all (of which one was not initially accepted by the Commission).

The ECA can address recommendations to specific Member State(s) or Member States in general. In the questionnaire Member States were therefore asked whether they follow up recommendations in both cases and, if yes, they were invited to briefly describe the related arrangements; if not, they were asked to explain why not.

Almost every respondent Member State stated that they follow up both types of recommendations.

Member States usually deal with specific recommendations by identifying the relevant implementing authorities and forwarding them (normally via the audit authority) the ECA reports or communications concerned. On top of it, several Member States make reference also to relevant monitoring procedures. In the case of agricultural policy in France, in Denmark and in Greece this is assumed by the relevant implementing authorities, while in the case of Hungary, such monitoring is carried out in a specific department of the Prime Minister's Office. Greece mentioned that they maintain a National Action Plan to reduce the error rate in EAFRD, and specific recommendations are assessed with a view to a possible updating of the document. Luxembourg and France organise regular follow-up meetings with beneficiaries and maintain and centrally monitor detailed and specific action plans. Germany added that the most frequent sources of error found, inter alia, by the ECA, and the corresponding measures identified, may give rise to setting up subject-specific Federation-Länder working parties to address the weaknesses identified.

Austria and Romania provided distinct replies with regards to cases where the recommendation is of a general nature, potentially on the assumption that these may reveal shortcomings in the design of the systems which may be more overarching. In Romania, for example, specific recommendations are dealt with by the implementing authority concerned or may give rise to the initiation of recovery proceedings at the level of the Member State on a case by case basis, and the underlying deficiency of the more general ones are assessed for possible improvement of the legislative framework for the next programming period. With a view to a possible follow-up, Denmark mentioned that it analyses the relevance of the recommendations for their

own management and control environment even where their projects and programmes did not form part of the audited population.

4 CONCLUSION

The ECA acknowledged that, this year for the first time, all Commission DGs estimated a level of error in 'relevant expenditure'. Furthermore, it stressed that the figures disclosed in the Annual Activity Reports (AARs) are, in most cases, broadly in line with its own estimates of the level of error. In this respect, the ECA also continues to take account of corrective measures applied by the Member States and the Commission where these are made prior to its examination. The ECA also indicated that management and control systems in place at the level of Member States and the Commission produced sufficient information to further prevent or detect and correct many errors. The President of the ECA stated that *"This means there is no need for additional controls, but the existing controls must be enforced properly."*³

This is corroborated by the replies received from the Member States this year. They demonstrate a continued commitment by Member States to sound financial management through the use of Simplified Cost Options (SCOs), improved management verifications and efforts to streamline administrative procedures, and strong willingness to follow up on deficiencies found by external auditors and endorsed by national authorities. In the area of public procurement, Member States tackled issues by offering tailor-made training programmes and the sharing of best practices using online networking facilities, and by making expert advice widely available.

The replies show that Member States are in line with the conclusions of the High Level Group on Simplification for the beneficiaries of the European Structural and Investment Funds (ESI Funds) which found that simplicity and flexibility are key to ensuring the success of ESI Funds investments in Europe and of Cohesion Policy after 2020.

In the area of performance management, the ECA has found that the Commission makes available a lot of information in comparison to other countries or international organisations.

The replies received from Member States demonstrated that they are aware of the need to have a performance framework in place in the 2014-2020 programming period to ensure that resources are allocated to priorities that bring an added value to actions financed through the EU budget. Member States replied that they rely on a wide range of data sources for performance information, including national statistical offices. The Commission will continue working with Member States to improve information on performance data.

³ Speech given by Klaus-Heiner Lehne, President of the European Court of Auditors during the plenary session of the European Parliament (Strasbourg, 4 October 2017).