Official Journal of the European Union

C 322

English edition

Information and Notices

Volume 60

28 September 2017

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Court of Auditors

EN

IV

(Notices)

NOTICES FROM EUROPEAN UNION INSTITUTIONS, BODIES, OFFICES AND AGENCIES

COURT OF AUDITORS

In accordance with the provisions of Article 287(1) and (4) of the TFEU and Articles 148(1) and 162(1) of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 and Articles 43, 48 and 60 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund, as amended by Regulation (EU) No 567/2014

the Court of Auditors of the European Union, at its meeting of 13 July 2017, adopted its

ANNUAL REPORTS

concerning the financial year 2016

The reports, together with the institutions' replies to the Court's observations, were transmitted to the authorities responsible for giving discharge and to the other institutions.

The Members of the Court of Auditors are:

Klaus-Heiner LEHNE (President), Karel PINXTEN, Henri GRETHEN, Ladislav BALKO, Lazaros S. LAZAROU, Hans Gustaf WESSBERG, Pietro RUSSO, Ville ITÄLÄ, Kevin CARDIFF, Baudilio TOMÉ MUGURUZA, Iliana IVANOVA, George PUFAN, Neven MATES, Alex BRENNINKMEIJER, Danièle LAMARQUE, Nikolaos MILIONIS, Phil WYNN OWEN, Oskar HERICS, Bettina JAKOBSEN, Janusz WOJCIECHOWSKI, Samo JEREB, Jan GREGOR, Mihails KOZLOVS, Rimantas ŠADŽIUS, Leo BRINCAT, João FIGUEIREDO, Juhan PARTS, Ildikó GÁLL-PELCZ.

ANNUAL REPORT ON THE IMPLEMENTATION OF THE BUDGET

(2017/C 322/01)

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GENERAL INTRODUCTION

0.1. The European Court of Auditors was established by the Treaty on the Functioning of the European Union [1] as the external auditor of the EU's finances. In this capacity we act as the independent guardian of the financial interests of all EU citizens, notably by helping to improve the EU's financial management. More information on our work can be found in our activity report, our special reports, our landscape reviews and our opinions on new or updated EU laws or other decisions with financial management implications [2].

0.2. This annual report, our 40th on the implementation of the EU budget, covers the 2016 financial year. A separate annual report covers the European Development Funds.

0.3. The EU's general budget is approved annually by the Council and the European Parliament. Our annual report, together with our special reports, provides a basis for the discharge procedure in which the Parliament, acting on a recommendation from the Council, decides whether the Commission has satisfactorily met its budgetary responsibilities. On publication we forward it to national parliaments, the European Parliament and the Council.

0.4. The central part of our annual report is the statement of assurance on the reliability of the EU consolidated accounts and the legality and regularity of transactions ('*regularity of transactions*'). This statement is supplemented by specific assessments for each major area of EU activity.

0.5. Our report this year is structured as follows:

— chapter 1 contains the *statement of assurance* and a summary of the results of our audit on the reliability of accounts and the regularity of transactions;

— chapter 2 presents our analysis of budgetary and financial management;

— chapter 3 focuses this year on the Commission's performance reporting framework, presents significant results from our 2016 special reports on performance, and analyses the Commission's implementation of the recommendations we made in a selection of special reports from previous years;

— chapter 4 presents our findings on EU revenue;

— chapters 5 to 10 show, for the main headings of the current *multiannual financial framework (MFF)* [3], the results of our testing of the regularity of transactions and our examination of annual activity reports, other elements of internal control systems and other governance arrangements.

0.6. As there are no separate financial statements for individual MFF headings, the conclusions to each chapter do not constitute an audit opinion. Instead, the chapters describe significant issues specific to each MFF heading.

0.7. We aim to present our observations in a clear and concise way. We cannot always avoid using terms specific to the EU, its policies and budget, and to accounting and auditing. On our website we have published a glossary with definitions and explanations of most of these specific terms [4]. The terms defined in the glossary appear in *italics* upon first usage in each chapter.

0.8. The Commission's replies to our observations (or, where appropriate, the replies of other EU institutions and bodies) are presented with this report and should be taken into consideration alongside it. However, it is our responsibility, as external auditor, to report our audit findings and draw the necessary conclusions so as to provide an independent and impartial assessment of the reliability of the accounts and the regularity of transactions.

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(1) Articles 285 to 287 (OJ C 326, 26.10.2012, pp. 169-171).
(2) Available on our website: www.eca.europa.eu.
(3) Chapter 8 covers heading 3 ('Security and citizenship'). The analysis of heading 3 does not include an estimated level of error. We do not provide a specific assessment for spending under heading 6 ('Compensations') or for expenditure outside the MFF.
(4) http://www.eca.europa.eu/Lists/ECADocuments/GLOSSARY_AR_2016/GLOSSARY_AR_2016_EN.pdf

CHAPTER 1

Statement of assurance and supporting information

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THE COURT'S STATEMENT OF ASSURANCE PROVIDED TO THE EUROPEAN PARLIAMENT AND THE COUNCIL — INDEPENDENT AUDITOR'S REPORT

Opinion

I. We have audited:

(a) the *consolidated accounts of the European Union*, which comprise the consolidated financial statements ([1]) and the budgetary implementation reports ([2]) for the financial year ended 31 December 2016, approved by the Commission on 26 June 2017, and

(b) the legality and *regularity* of the *transactions* underlying those accounts, as required by Article 287 of the Treaty on the Functioning of the European Union (TFEU).

Reliability of the accounts

Opinion on the reliability of the accounts

II. In our opinion, the consolidated accounts of the European Union (EU) for the year ended 31 December 2016 present fairly, in all material respects, the financial position of the Union as at 31 December 2016, the *results* of its operations, its cash flows, and the changes in net assets for the year then ended, in accordance with the *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, the revenue underlying the accounts for the year ended 31 December 2016 is legal and regular in all material respects

Payments

Qualified opinion on the legality and regularity of payments underlying the accounts

IV. In our opinion, except for the effects of the matter described in the basis for qualified opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2016 are legal and regular in all material respects.

([1]) The consolidated financial statements comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets, and a summary of significant accounting policies and other explanatory notes (including segment reporting).

([2]) The budgetary implementation reports comprise also the explanatory notes.

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' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit, and we have fulfilled our other ethical responsibilities in accordance with these 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 qualified opinion on the legality and regularity of payments underlying the accounts

VI. Expenditure recorded in 2016 covering spending on a reimbursement basis ([3]) is materially affected by *error*. Our *estimated level of error* for payments made on a reimbursement basis is 4,8 %. Our overall estimated level of error (3,1 %) is still above our *materiality threshold*, but it is not pervasive. Payments made on an entitlement basis are not affected by a material level of error ([4]). Our overall conclusion is corroborated by the Commission's analysis of amounts at risk presented in the annual management and *performance* report for the EU budget.

Key audit matters

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

We assessed the provision for pension and other employee benefits presented in the accounts

VIII. The EU balance sheet includes pension and other employee benefits amounting to 67,2 billion euro at the end of 2016. This is one of the most significant liabilities in the balance sheet, accounting for almost a third of the total 2016 liabilities of 234,8 billion euro.

IX. The majority of this *provision* for pension and other employee benefits (58,7 billion euro) relates to the Pension Scheme of Officials and Other Servants of the European Union (the 'PSEO'). This pension liability covers the 'defined benefit' guaranteed by Article 83 of the Staff Regulations of Officials of the European Communities (the 'Staff Regulations') and Article 4(3) of the Treaty on the European Union (the 'TEU'). The liability recorded in the accounts reflects the amount which would have been included in a pension fund had one been set up to pay existing retirement pension obligations ([5]). In addition to retirement pensions, it covers invalidity pensions and pensions paid to widows/orphans of EU officials. Under Article 83 of the Staff Regulations, the benefits paid under the pension scheme are charged to the EU budget, Member States jointly guarantee the payment of the benefits and officials contribute one third of the cost of financing the scheme.

([3]) 66,0 billion euro. We provide further information in paragraph 1.10 of our 2016 annual report.
([4]) 63,3 billion euro. We provide further information in paragraph 1.11 of our 2016 annual report.
([5]) See International Public Sector Accounting Standard (IPSAS) 25 — Employee benefits. For the PSEO, the defined benefit obligation reflects the present value of expected future payments that the EU will be required to make to settle the pension obligations resulting from employee service in the current and prior periods.

X. The PSEO is a mandatory occupational pension scheme for EU civil servants, under which contributions from staff and from the institutions and bodies that employ them are used to finance future pensions. It is designed, through adjustments to the rate of contribution to the scheme and to pensionable age, to be in actuarial balance by default. The number and variety of parameters used to calculate a long-term projection of pension costs underlines the actuarial nature of this calculation, which is ultimately performed by Eurostat on an annual basis.

XI. As part of our audit, we evaluated the actuarial assumptions and resulting valuation for the pension provision. We checked the numerical data, the actuarial parameters, the calculation of the provision as well as the presentation in the consolidated balance sheet and the notes to the consolidated financial statements. Our audit of the fair value of the provision detected some incompleteness and inaccuracies in the underlying primary database which do not have a material impact on the EU consolidated accounts. The Commission, as disclosed in note 2.9 to the consolidated financial statements, will take further steps to strengthen its processes used for calculating the employee benefits liability, which we will keep under review.

We assessed the accrued charges presented in the accounts

XII. At year-end 2016, the Commission estimated that incurred eligible expenses due to the *beneficiaries* but not yet reported amounted to 102 billion euro (year-end 2015: 106 billion euro). It recorded these as accrued expenses.

XIII. We examined the methodologies and control systems for year-end estimates applied in the main directorates-general. We drew samples of invoices and pre-financing payments and carried out work on these elements to address the risk of the accrual having been misstated. We sought additional explanation from the Commission’s accounting services for the general methods applied, and in particular for the new method applied for the 2014-2020 *programming period* in Cohesion.

XIV. The work we performed enables us to conclude that the estimate of the overall amount of accrued charges stated in the consolidated balance sheet is fair for the main directorates-general. However, in some smaller directorates-general we found systemic weaknesses in relation to the year-end entries. The Commission developed an action plan in this respect.

We sought additional information from the Commission to support the valuation of financial instruments under shared management

XV. Authorities in the Member States transfer a part of the funding advanced by the Commission to *financial instruments* in the form of loans, equity instruments or guarantees.

XVI. For the 2007-2013 *multiannual financial framework (MFF)*, EU law did not require these authorities to produce periodic reports on sums held in these instruments for the preparation of the accounts. The Commission therefore estimated the use made of advances, on the basis of the latest available report (in this case, from year-end 2015), assuming that funds would be used in full and evenly over the period of operation (initially up to 31 December 2015, but later extended to 31 March 2017). We note that even though we find the use of financial instruments in 2016 to be outside the eligibility period (see chapter 6, paragraphs 6.20 and 6.21), the Commission does not seek to recover these amounts. Therefore the presentation in the balance sheet and note 2.5 to the consolidated financial statements reflects this Commission position.

XVII. For the 2014-2020 MFF, authorities need to provide information in every cost claim on advances paid to financial instruments and disbursements made from them to final beneficiaries. On the basis of this information an estimated amount is calculated and recognised in the accounts for the period between the date of the last cost claim received and year-end.

XVIII. We examined the procedure put in place for recognising the related pre-financing, and we consider that the amount stated in the balance sheet is fair.

Other matters

XIX. Management is responsible for the other information. The other information comprises the *Financial Statement Discussion and Analysis*, but does not include the consolidated accounts and our auditor's report thereon. Our opinion on the consolidated accounts does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the consolidated accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated accounts or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management

XX. In accordance with Articles 310 to 325 of the TFEU and the Financial Regulation, management is responsible for the preparation and presentation of the consolidated accounts of the European Union on the basis of internationally accepted accounting standards for the public sector and for the legality and *regularity* of the transactions underlying them. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them. The Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the European Union (Article 317 of the TFEU).

XXI. In preparing the consolidated accounts, management is responsible for assessing the EU's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

XXII. The Commission is responsible for overseeing the EU's financial reporting process.

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

XXIII. Our objectives are to obtain reasonable assurance about whether the consolidated accounts of the European Union are free from material misstatement and the transactions underlying them 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 is not a guarantee that an audit will always detect a material misstatement or non-compliance when it exists. 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 of users taken on the basis of these consolidated accounts.

XXIV. For revenue, our examination of value added tax and *gross national income*-based *own resources* takes as its starting point the relevant macroeconomic aggregates on which these are calculated, and assesses the Commission's systems for processing these until the contributions of the Member States have been received and recorded in the consolidated accounts. For traditional own resources, we examine the accounts of the customs authorities and analyse the flow of duties until the amounts are received by the Commission and recorded in the accounts.

XXV. For expenditure, we examine payment transactions when 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 when the *recipient* of funds provides justification for their proper use and the Institution or body accepts the justification by clearing the advance payment, whether in the same year or later.

XXVI. 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 consolidated accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the European Union, whether due to fraud or error, 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. The risk of not detecting a material misstatement or non-compliance resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

— Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control.

— Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

— Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's 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 consolidated accounts, including the disclosures, and whether the consolidated accounts represent the underlying transactions and events in a manner that achieves fair presentation.

— Obtain sufficient appropriate audit evidence regarding the financial information of the entities within the European Union scope of consolidation to express an opinion on the consolidated accounts and transactions underlying them. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

XXVII. We communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

XXVIII. From the matters communicated with the Commission and other audited entities, we determine those matters that were of most significance in the audit of the consolidated accounts of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, 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 the public interest benefits of such communication.

13 July 2017

Klaus-Heiner LEHNE

President

European Court of Auditors

12, rue Alcide De Gasperi, Luxembourg, LUXEMBOURG

THE COURT'S OBSERVATIONS

INTRODUCTION

The role of the European Court of Auditors

1.1. We are the EU's independent auditor. In accordance with the Treaty on the Functioning of the European Union (TFEU), we:

— give our opinion on the EU's accounts;

— check whether the EU budget is used in accordance with applicable laws and regulations;

— report on whether EU spending is economic, efficient and effective [6]; and

— advise on proposed legislation with a financial impact.

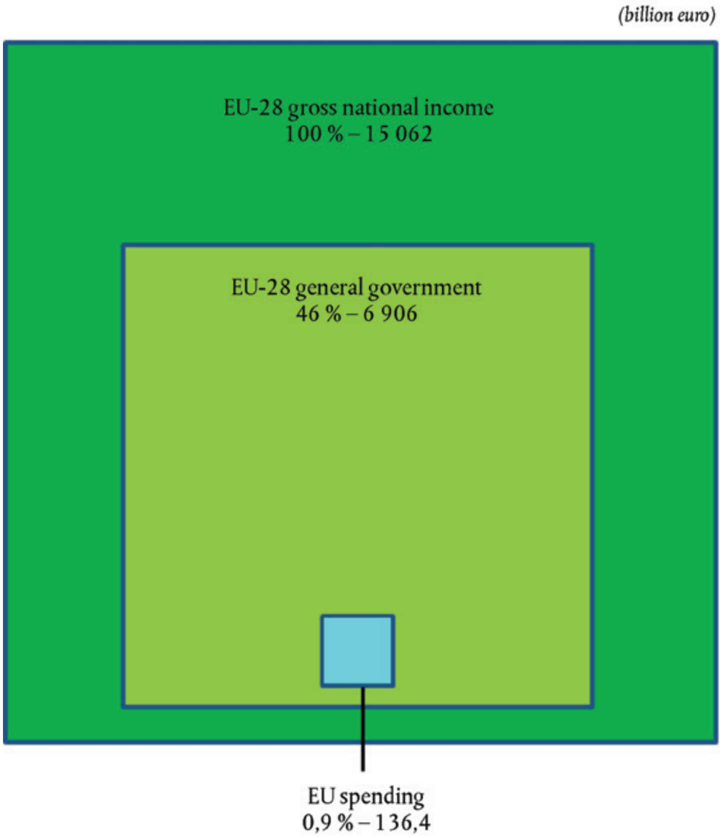
1.2. The work we do for the statement of assurance (explained in ***Annex 1.1***) directly fulfils the first and second of these objectives. In chapter 3 and some policy areas [7], the work we do for the annual report also addresses the economy, efficiency or effectiveness of spending. Taken together, our audit work also provides a key input into our opinions on proposed financial legislation.

EU spending is a significant tool for achieving policy objectives

1.3. European Union (EU) spending is an important — but not the only — means of achieving policy objectives. Other important means include the use of legislation and the freedom for goods, services, capital and people to move throughout the EU. In 2016, EU spending amounted to 136,4 billion euro [8], representing 2,0 % of EU Member States' total general government spending and 0,9 % of EU gross national income (***Box 1.1***).

(6) See glossary: *sound financial management*.
(7) See parts 2 of chapters 5, 6 and 7.
(8) See 2016 consolidated annual accounts of the EU, Budgetary implementation reports and explanatory notes, 4.3 MFF: Implementation of payment *appropriations*.

Box 1.1 — EU spending as a proportion of Member States' total general government spending and of gross national income



Source for Member States' GNI: Agreed set of forecasts of traditional own resources and VAT/GNI bases of 19.5.2016 (European Commission).

Source for Member States' general government spending: Eurostat — annual national accounts.

Source for EU spending: European Commission accounting data.

Compiled by ECA.

THE COURT'S OBSERVATIONS

RELIABILITY OF ACCOUNTS — AUDIT FINDINGS FOR THE 2016 FINANCIAL YEAR

The accounts were not affected by material misstatements

1.4. Our observations concern the European Union's consolidated accounts [9] (the 'accounts') for the 2016 financial year. We received them, together with the accounting officer's letter of representation, on 26 June 2017. The accounts are accompanied by a 'Financial Statement Discussion and Analysis' (FSDA) [10]. This analysis is not covered by our audit opinion. In accordance with the auditing standards, we have, however, assessed its consistency with information in the accounts.

1.5. The accounts published by the Commission show that, at 31 December 2016, total liabilities amounted to 234,8 billion euro compared to 162,7 billion euro of total assets. The *economic result* for 2016 amounted to 1,7 billion euro [11].

1.6. Our audit found that the accounts were free from material misstatements. We present our observations on the financial and budgetary management of EU funds in chapter 2.

(9) The consolidated accounts comprise:
(a) the consolidated financial statements consisting of the balance sheet (presenting the assets and liabilities at the end of the year), the statement of financial performance (recognising the income and expenses of the year), the cashflow statement (disclosing how changes in the accounts affect cash and cash equivalents) and the statement of changes in net assets as well as the related notes;
(b) the budgetary implementation reports on revenue and expenditure for the year as well as the related notes.

(10) See Recommended Practice Guideline 2 (RPG 2) 'Financial Statement Discussion and Analysis' of the International Public Sector Accounting Standards Board (IPSASB).

(11) See the statement of financial performance in 2016 consolidated annual accounts of the EU.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Key audit matters

1.7. Key audit matters [12] are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for 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. In accordance with International Standard of Supreme Audit Institutions (ISSAI) 1701, we report on key audit matters as part of our opinion (paragraphs VII to XVIII of our statement of assurance).

REGULARITY OF TRANSACTIONS: REVENUE AND AROUND HALF OF EXPENDITURE ARE FREE FROM MATERIAL ERROR

1.8. We examine EU revenue and expenditure [13] to assess whether it is in compliance with applicable laws and regulations. We present our audit results for revenue in chapter 4 and for expenditure in chapters 5 to 10 (***Box 1.2***). Our key findings were:

(a) Revenue was free from material error (paragraph 4.21).

(b) In expenditure, we continue to find a material level of error, but it is not pervasive. We estimate the level of error in expenditure as a whole at 3,1 %, but material error was confined mainly to reimbursement-based expenditure representing around half of the audited population (***Box 1.4***).

1.8 and 1.9. *The Commission notes with satisfaction that the results of this year represent a significant improvement to previous years' results.*

Regarding financial instruments for Cohesion policy (referred to in Box 1.2), the Commission considers the disbursements made to final recipients until end March 2017 in line with its closure guidelines to be within the set eligibility period (see Commission reply to paragraphs 6.20 and 6.21).

(12) Auditors are required to report on key audit matters as a result of the introduction in 2016 of ISSAI 1701 following the ISA 701.

(13) ***Annex 1.1***, paragraphs 7 to 10.

Box 1.2 — Summary of 2016 findings on regularity of transactions

Annual report chapter	MFF headings	Transactions subject to audit *(billion euro)*	Estimated level of error 2016 (%)	Confidence interval (%)		Estimated level of error 2015 (%)
				Lower error limit (LEL)	Upper error limit (UEL)	
5. Competitiveness	Heading 1a	15,2	4,1	2,1	6,1	4,4
6. Cohesion	Heading 1b	35,7	4,8 (1)	2,2	7,4	5,2
7. Natural resources	Heading 2	57,9	2,5	1,5	3,5	2,9
8. Security and citizenship	Heading 3	2,4	—	—	—	—
9. Global Europe	Heading 4	8,3	2,1	0,6	3,6	2,8
10. Administration	Heading 5	9,4	0,2	0,0	0,8	0,6
Other (2)	Heading 6 and other	0,4	—	—	—	—
Total		**129,3**	**3,1** (1)	**2,2**	**4,0**	**3,8**
Revenue		**144,7**	**0**	**0**	**0**	**0**

(1) The estimated level of error for cohesion does not include a quantification of 2016 disbursements to financial instruments, amounting to 2,5 billion euro, that we consider to be outside the eligibility period defined in Article 56(1) of Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25) (paragraphs 6.20 to 6.21). These disbursements would represent an estimated level of error of 2,0 % to overall EU expenditure.

(2) We do not provide a specific assessment for spending under MFF Heading 3 ('Security and citizenship'), MFF Heading 6 (Compensations), or for other spending (special instruments outside the 2014-2020 MFF such as the Emergency Aid Reserve, the European Globalisation Adjustment Fund, the European Union Solidarity Fund and the Flexibility Instrument). Work in these areas contributes, however, to our overall conclusion on spending for the year 2016.

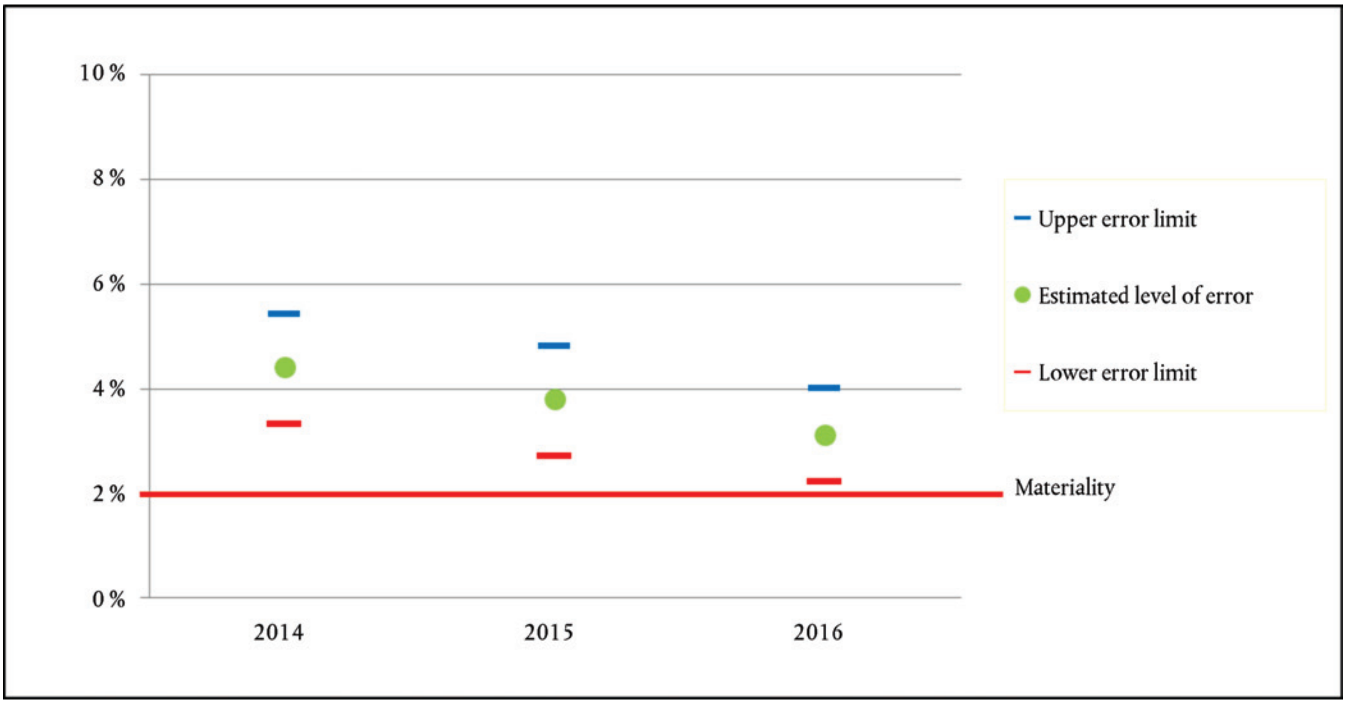
Source: ECA.

THE COURT'S OBSERVATIONS

Our 2016 audit results show an improvement

1.9. Our overall estimated level of error improved compared to that of recent years (***Box 1.3***), but it continues to exceed our benchmark for materiality of 2 %. Nevertheless, around half of 2016 expenditure was free from material error (***Box 1.4***).

Box 1.3 — The estimated level of error (most likely error, MLE) (2014 to 2016)



Source: ECA.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Results in different areas of expenditure show distinct patterns of error

1.10. We estimate the level of error in reimbursement-based expenditure at 4,8 % (2015: 5,2 %), which significantly exceeds the materiality threshold of 2 % (***Box 1.4***). In this type of expenditure, beneficiaries claim EU funds for eligible costs they have incurred. Such payments include research projects (chapter 5) and training schemes (chapter 6), as well as projects in regional and rural development (chapters 6 and 7) and development projects (chapter 9). In these schemes, *recipients* must provide information demonstrating that they are engaged in an activity eligible for support and showing incurred costs for which they may claim reimbursement. In doing so, they have to follow complicated rules regarding what can be claimed (eligibility) and how costs can be properly incurred (e.g. *public procurement* or *state aid* rules). This leads to errors which affect our conclusion for MFF headings 1a 'Competitiveness' (paragraphs 5.28-5.29), 1b 'Cohesion' (paragraphs 6.38-6.39), 2 'Natural resources' (overall — paragraphs 7.32-7.33), and 4 'Global Europe' (paragraphs 9.34-9.35).

1.10. *Simplification represents the most effective way of reducing the costs and burden of control and the risk of errors. Policy areas which are subject to sound management and control systems and less complex eligibility rules are also less error-prone.*

The ECA has confirmed that projects using Simplified Cost Options (SCOs) are less error-prone than the reimbursement of actual costs. For this reason, the Commission has been actively promoting their utilisation in Cohesion policy and rural development over the last few years. Furthermore, using SCOs reduces the administrative burden and improves the focus on results by Managing Authorities, Paying Agencies and beneficiaries, in particular when SCOs are based on the achievement of project outputs or results.

Public procurement and state aid rules are not specific to EU expenditure. To address the difficulties encountered in these areas, the Commission is implementing action plans with the Member States (see Commission reply to paragraphs 6.15 and 6.18).

In agriculture, rural development remains an area which merits close scrutiny, in particular for investment type measures. The Commission systematically requests Member States to design remedial action plans when control deficiencies are identified and supports their implementation. However, taking into account the need to balance legality and regularity with the achievement of policy objectives while bearing in mind the delivery (management and control) costs, it cannot be expected with any real certainty that an error rate for payments to beneficiaries below 2 % would be attainable with reasonable efforts. Nevertheless, the corrective capacity of Member States' recoveries and the Commission's financial corrections in the years following the year of expenditure enables the Commission to get assurance on the CAP expenditure.

See also Commission reply to paragraphs 1.12 and 6.7.

1.11. We estimate the level of error for entitlement-based expenditure (including administrative expenditure) at 1,3 % (2015: 1,9 %, ***Box 1.4***). In this type of expenditure, beneficiaries receive payment if they meet certain conditions. The payments concerned include student and research fellowships (chapter 5), *direct aid* for farmers and agri-environment measures (chapter 7) and salaries and pensions (chapter 10). We saw improvements in all areas of entitlement-based expenditure, and we conclude that the estimated level of error for direct aid to farmers was below materiality.

1.11. *The Commission welcomes the ECA assessment for entitlement-based expenditure.*

Box 1.4 — 2016 entitlement-based and administrative payments are free from material error

(billion euro)

Source: ECA.

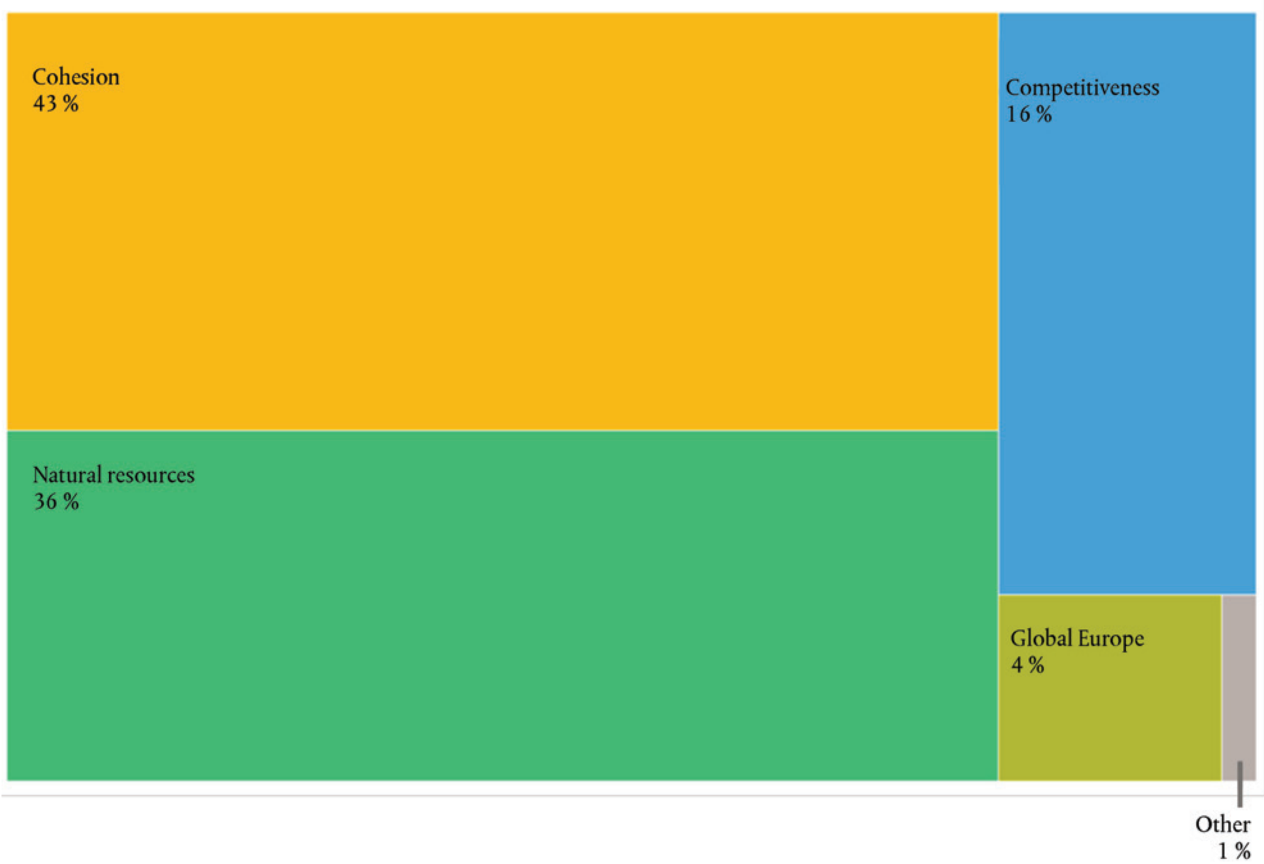
THE COURT'S OBSERVATIONS

1.12. As shown in ***Box 1.5***, 'Cohesion' was the biggest contributor to our estimated level of error for 2016, followed by 'Natural resources', 'Competitiveness' and 'Global Europe'. This distribution is in line with our findings for 2015.

THE COMMISSION'S REPLIES

1.12. *The Commission is constantly working with Member States to improve their management and control systems and will continue to strictly and timely use available legal supervisory tools to ensure that all material errors are corrected. Action plans addressing specific causes of errors are systematically being implemented where necessary.*

Box 1.5 — Contribution to the overall estimated level of error for 2016 by MFF heading



Source: ECA.

THE COURT'S OBSERVATIONS

1.13. 'Competitiveness' (chapter 5): the estimated level of error is 4,1 %, a decrease on 2015 (4,4 %). Much of the expenditure is made on a cost-reimbursement basis, and the errors here essentially reflect different categories of ineligible cost (in particular personnel costs, other direct costs, and *indirect costs*).

1.14. 'Cohesion' (chapter 6): the estimated level of error is 4,8 %, lower than the 2015 result (5,2 %). Expenditure in this area is dominated by cost reimbursements. Ineligible costs in expenditure declarations and ineligible projects account for 70 % of the error.

THE COMMISSION'S REPLIES

1.13. *The Commission refers to its common reply to paragraphs 5.9 and 5.10.*

1.14. *The Commission refers to its reply to paragraphs 1.10, 1.12, 6.7 and 6.11.*

THE COURT'S OBSERVATIONS

1.15. 'Natural resources' (chapter 7): the estimated level of error is 2,5 %, a decrease on 2015 (2,9 %). The European Agriculture Guarantee Fund (EAGF) accounts for more than three quarters of expenditure in this area and is free from material error (1,7 %), while in rural development we continue to find a high level of error (4,9 %), particularly for reimbursement expenditure. We did not find material error in entitlement-based expenditure on *direct support* to farmers, which has simplified land eligibility rules and an effective *ex ante* control system (*IACS*) that allows automated cross checks between different databases.

1.16. 'Global Europe' (chapter 9): the estimated level of error is 2,1 %, a decrease on the results in 2015 (2,8 %). Missing essential supporting documentation and overstated Commission interim [14] clearings account for two thirds of the total.

1.17. 'Administration' (chapter 10): this area is not affected by a material level of error. The estimated level of error is 0,2 %, a decrease compared to the 2015 results (0,6 %). Most expenditure in this area is on the salaries, pensions and allowances paid by EU institutions and bodies.

1.18. We do not estimate levels of error for other areas of expenditure, including MFF heading 3 (chapter 8). In total, expenditure covered by our statement of assurance in these areas amounted to 2,8 billion euro (2,2 % of the expenditure covered by our audit). Work performed in these areas continues to contribute to our overall conclusions on 2016.

1.19. Eligibility errors in cost reimbursement schemes continue to be the main contributor to the estimated level of error:

— ineligible costs included in cost claims; and

— ineligible projects, activities and beneficiaries (***Box 1.6***).

THE COMMISSION'S REPLIES

1.15. *Concerning EAGF, the Commission welcomes the ECA's assessment, in particular concerning the efficiency of the Integrated Administration and Control System (IACS), which makes a significant contribution to preventing and reducing levels of error (see paragraph 7.13). The Commission will continue to work with the Member States to maintain the quality of the Land Parcel Identification System and IACS in general.*

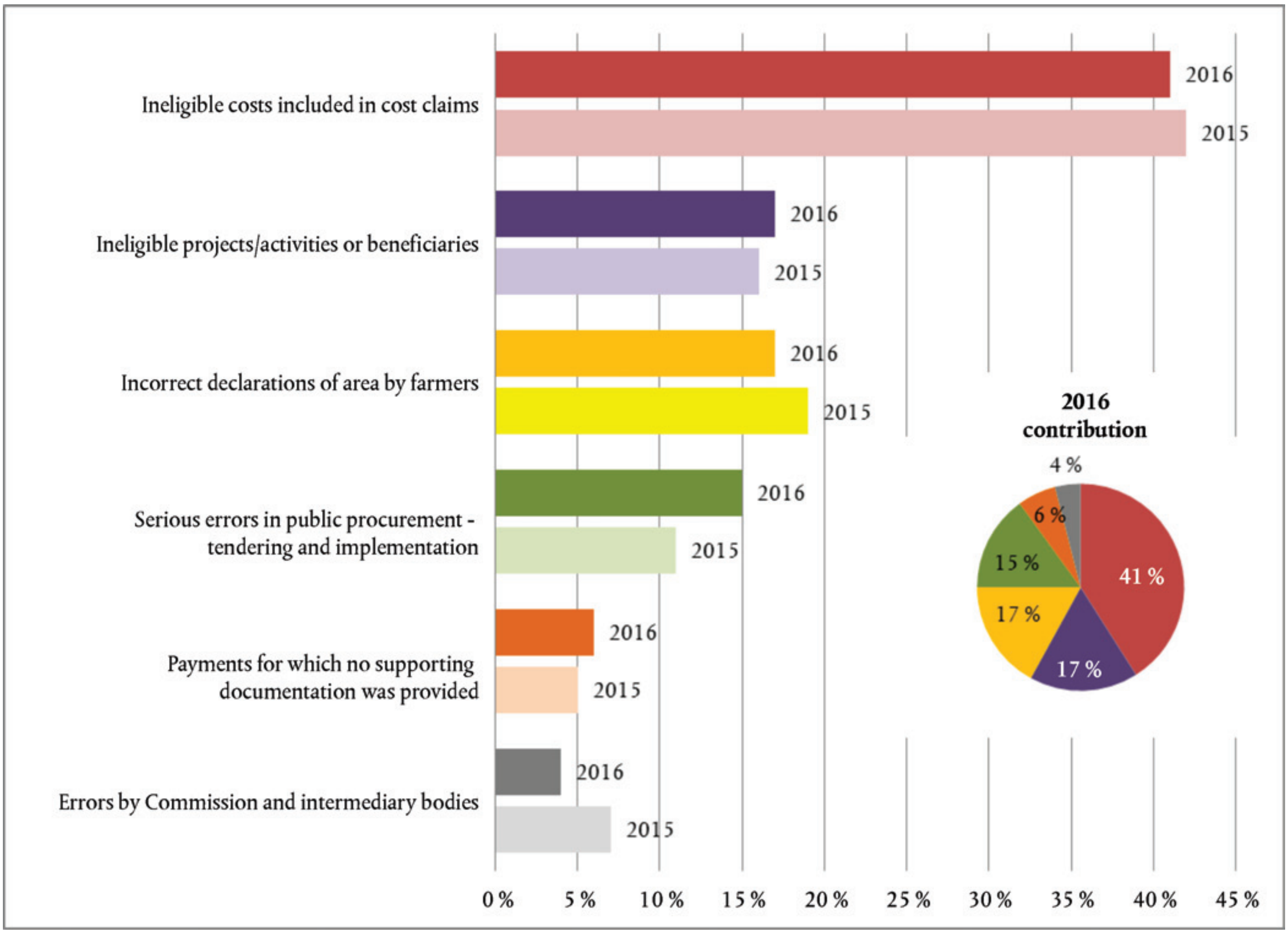
See also Commission reply to paragraphs 1.10 and 1.12.

1.19. *The Commission reaches the same conclusions about the nature and root causes of errors.*

Simplification represents the most effective way of reducing both the risk of errors as well as the cost and burden of control. For those programmes with persistently high levels of error, the Commission continuously takes actions, both preventive and corrective, to address their root causes and their impact. More details can be found in the Commission Communication 'Root causes of errors and actions taken (Article 32(5) of the Financial Regulation)' — COM(2017) 124 of 28.2.2017.

(14) A clearing transforms pre-financing into accepted expenditure. In an overstated clearing part of the amount booked to the accounts as expenditure is not justified by financial reports.

Box 1.6 — Breakdown of the overall estimated level of error by type of error



Source: ECA.

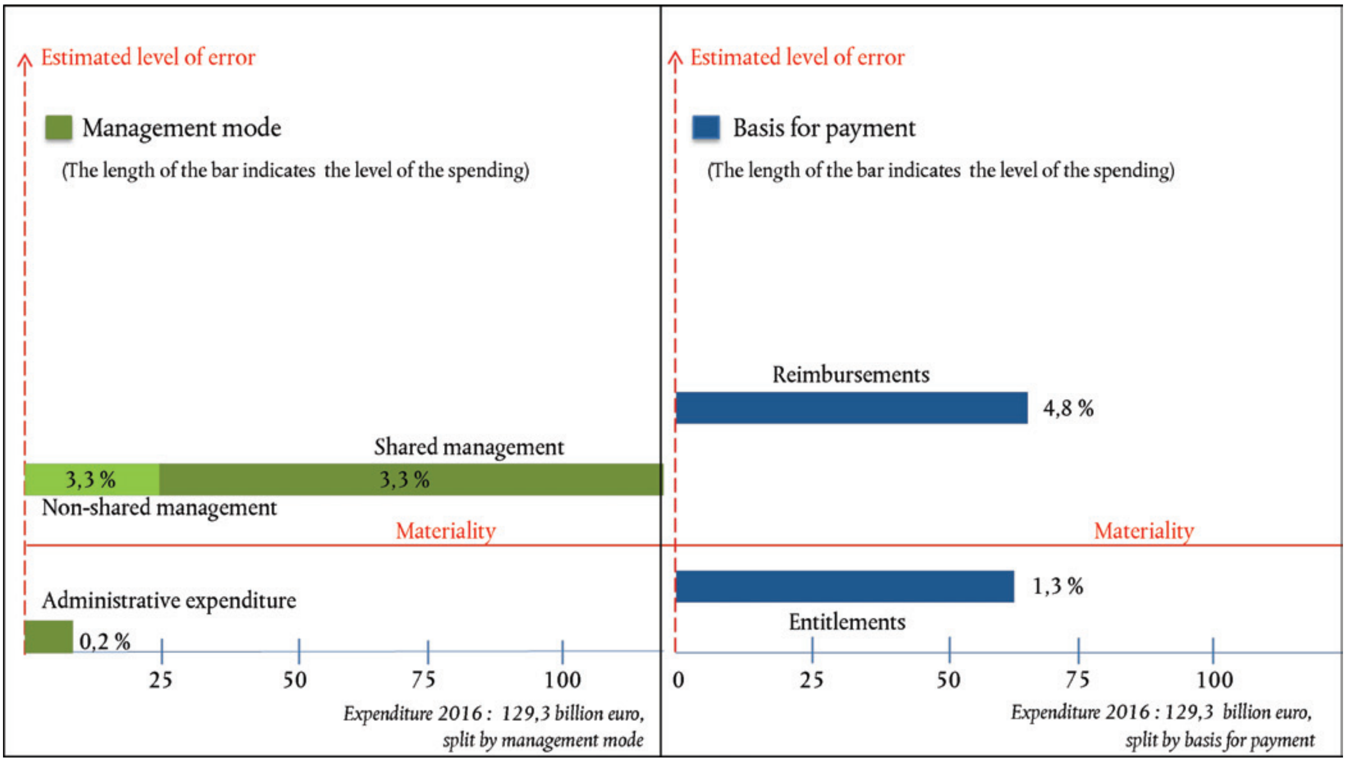
THE COURT'S OBSERVATIONS

Management mode has a limited impact on levels of error

1.20. Our estimated level of error in various areas of expenditure shows a much stronger correlation with the basis for payment (i.e. reimbursement or entitlement) than it does with the management mode [15]. We found the highest levels of error in 'Cohesion' (under shared management) and 'Competitiveness' (managed directly by the Commission and indirectly through entrusted entities). Reimbursement schemes dominate expenditure in both of these areas (***Box 1.7***).

[15] *Direct management* (budget implemented directly by the European Commission), indirect management (budget implementation entrusted to non-EU partner countries, international organisations, national agencies, the EIB group, etc.), *shared management* (budget implementation shared between the Commission and Member States).

Box 1.7 — Average estimated level of error by management mode and by basis for payment (2016)



Source: ECA.

THE COURT'S OBSERVATIONS

1.21. For 2016, the estimated level of error for shared management expenditure as a whole amounts to 3,3 % (2015: 4,3 %), and 3,3 % (2015: 4,2 %) for all other forms of operational expenditure [16]. The estimated level of error for administrative expenditure is 0,2 % (2015: 0,6 %).

The Commission's estimates of levels of error …

1.22. Each Commission directorate-general (DG) produces an *annual activity report (AAR)*. This includes a declaration in which the Director-General provides assurance that the report properly presents financial information and that transactions under his/her responsibility are legal and regular. The report also provides an account of the achievement of the key policy objectives (discussed in paragraphs 3.5 and 3.18 to 3.32) and a management report by the Director-General to the Commissioners.

THE COMMISSION'S REPLIES

1.22. *The annual activity report (AAR) is a report of the Director-General to the College of Commissioners on the performance of his/her duties. The annual activity reports provide an account of the achievement towards the general and specific objectives as set in the Directorate-General strategic and management plan. They also include the achievement in the field of financial management, internal control as well as organisational management.*

(16) Mainly expenditure covered by chapters 5 and 8, and also including parts of the expenditure covered by chapters 6 and 7 that are implemented under direct or indirect management. The extrapolated error for shared management expenditure is based on the examination of 560 transactions (drawn from a population of 94,5 billion euro); the extrapolation for other forms of operational expenditure is based on the examination of 321 transactions (drawn from a population of 25,4 billion euro).

THE COURT'S OBSERVATIONS

1.23. This year, for the first time, all DGs estimated a level of error in 'relevant expenditure'. The definition of relevant expenditure ([17]) is in line with our definition of underlying transactions (***Annex 1.1***, paragraph 10).

Box 1.8 — The ECA's 2016 audit results compared with the Commission's estimates of amounts at risk at payment in its 2016 annual activity reports

Annual report chapter	Estimated level of error (%) ([1])	Confidence interval (%)		Commission annual activity reports directorate general ([2]) ([3])	Estimated overall amount at risk at payment (%) ([5]) ([6])	
		Lower error limit (LEL)	Upper error limit (UEL)		Lowest value	Highest value
Chapter 5 — Competitiveness for growth and jobs	**4,1**	**2,1**	**6,1**	CNECT, EAC, EACEA, EASME, ECFIN, ENER, ERCEA, FISMA, GROW, INEA, JRC, MOVE, REA, RTD and TAXUD	**2,0**	**2,4**
Chapter 6 — Economic, social and territorial cohesion	**4,8**	**2,2**	**7,4**	EMPL and REGIO	**2,2**	**3,6**
Chapter 7 — Natural resources	**2,5**	**1,5**	**3,5**	AGRI, MARE, ENV and CLIMA	**2,5**	**2,5**
Chapter 9 — Global Europe	**2,1**	**0,6**	**3,6**	DEVCO, NEAR, ECHO, FPI, TRADE, AGRI, EMPL, REGIO, EACEA and ECFIN	**1,3**	**1,4**
Chapter 10 — Administration	**0,2**	**0,0**	**0,8**	Administration ([4])	**0,2**	**0,2**
Total	**3,1**	**2,2**	**4,0**	**Total**	**2,1**	**2,6**
Source: ECA.				*Source:* ECA based on Commission annual activity reports.		

([1]) Estimated level of error: see ***Box 1.2*** and footnotes.
([2]) Some DGs manage expenditure allocated under more than one MFF heading (AGRI, EACEA, ECFIN, EMPL and REGIO).
([3]) The (full) names of the Commission DGs and executive agencies abbreviated in this box can be found in section 9.6 of the inter-institutional style guide (http://publications.europa.eu/code/en/en-390600.htm).
([4]) BUDG, COMP, DGT, DIGIT, EPSC, EPSO/EUSA, ESTAT, HR, IAS, OIB, OIL, OLAF, OP, PMO, SCIC, SG, SJ and SRSS.
([5]) Percentage of expenditure that may not comply with the regulatory and contractual requirements applicable at the time of payment.
([6]) Most DGs disclosed the amount at risk as one figure. Some disclosed a range from minimum to maximum (ECFIN, FISMA, CNECT, RTD, REA, OIB and INEA) while DG REGIO presented a range from average to maximum.

([17]) Payments made, less new pre-financing, but including previous pre-financing actually cleared during the financial year (2016 AMPR COM(2017) 351 final, Annex 3, p. 16).

THE COURT'S OBSERVATIONS

1.24. Following the introduction of the concept 'amount at risk at closure' in the 2015 annual management and performance report (AMPR), DGs included this information in their AARs. The Commission focused on the impact of multiannual corrective mechanisms, which will reduce its own estimated level of error.

…are, in most cases, broadly in line with our own findings

1.25. As regards legality and regularity indicators, the figures disclosed in the AARs for amounts at risk at payment are, in most cases, broadly in line with our estimates of the level of error (***Box 1.8***) ([18]).

1.26. We found that DGs within the same MFF heading took different approaches to presenting error rates and amounts at risk ([19]). We also found that there were methodological risks in the work done by *audit authorities* for 2014-2020 expenditure ([20]). We also found that significant adjustments had to be made by the Commission to the control statistics presented by *paying agencies* ([21]).

THE COMMISSION'S REPLIES

1.24. *The concept 'amount at risk at closure' completes the global picture of the multiannual programmes as it gives additional information on the amount at risk that remains once all corrective actions are taken into account, including the 'corrective capacity', i.e. a best estimate of the corrections that will be made in the years following the expenditure.*

1.25. *Concerning the estimated overall amount at risk at payment (mentioned in Box 1.8), it should be noted that the figures in the 2016 AARs and Annual Management and Performance Report (AMPR) duly cover expenditure for programmes of both the 2007-2013 and 2014-2020 programming periods. In the case of Cohesion, the 2007-2013 related figures reported are 2,6 % to 4,2 %. However, the Commission considers that current Cohesion programmes are lower risk by design, as illustrated by the 2014-2020 related figures for which the Commission reports 0,9 % to 1,7 %.*

1.26. *The Commission has a sound methodology for estimating the level of error in the transactions. The Commission services apply this methodology taking into account the requirements of their specific legal framework and management mode. Therefore, each Director-General is applying the approach best suited to provide a realistic estimation of the level of error for the policy areas under his/her responsibility, taking into account the inherent risk characteristics of the programmes (e.g. higher risk in SME and lower risk in Marie Curie programmes) and the control results available for different expenditure areas (e.g. availability of sufficient* ex post *results, the quality of the reporting from the entrusted entities).*

Please see also Commission reply to paragraphs 6.33 and 6.34.

([18]) We reviewed the AARs of BUDG and ESTAT (paragraph 4.20); RTD, EAC and MOVE (paragraph 5.20); REGIO and EMPL paragraph 6.26); AGRI (paragraph 7.28); MARE, ENV and CLIMA (paragraph 7.31); NEAR (paragraph 9.29); HR, DIGIT, OIB, OIL, OP and PMO (paragraph 10.7) and DEVCO (AR EDFs paragraph 33).

([19]) MFF heading 1a 'Competitiveness' (see paragraph 5.21).

([20]) MFF heading 1b 'Cohesion' (see paragraph 6.34).

([21]) MFF heading 2 'Natural resources' (see paragraph 7.29).

THE COURT'S OBSERVATIONS

1.27. The overall error rate at payment calculated by the Commission for 2016 in the AMPR was material, being between 2,1 % and 2,6 % (compared with 2,3 % and 3,1 % for 2015). Our estimated level of error is 3,1 % (2015: 3,8 %).

The Commission provided figures on corrections and recoveries …

1.28. The 2016 FSDA reports total implemented financial corrections and recoveries of 3,4 billion euro. ***Box 1.9*** shows the distribution of the reported amounts by spending area and the stage in the spending cycle at which the Commission applied the corrective actions (declaration/acceptance of expenditure/payment from the budget).

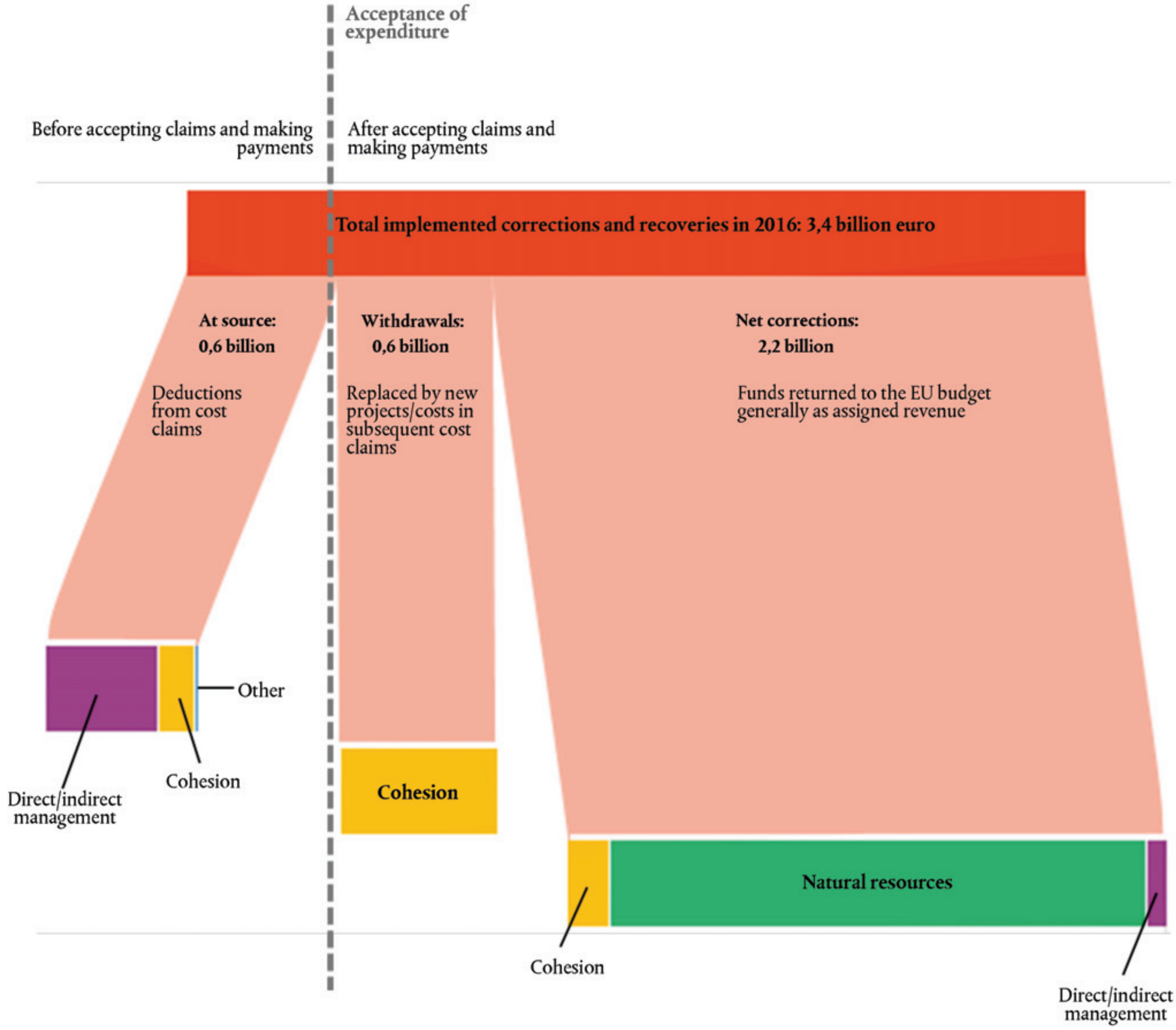
THE COMMISSION'S REPLIES

1.27. *The Commission has made progress on limiting the overall error rate at payment. The overall amount at risk at closure for 2016 presented in the AMPR is estimated to be less than 2 % of total relevant expenditure after taking into account estimated future corrections.*

1.28. *Detailed information on financial corrections and recoveries is provided in the annex to part II of the AMPR* [1]*.*

(1) *2016 AMPR (COM(2017) 351 final), part II.*

Box 1.9 — 2016 corrective measures: how were they implemented in different spending areas?



Source: ECA, based on the FSDA of the 2016 consolidated accounts of the EU and underlying data.

THE COURT'S OBSERVATIONS

1.29. In 2016, the Commission recorded 0,6 billion euro of corrections and recoveries at source before accepting expenditure. These take the form of deductions of ineligible amounts from claims before the corresponding payments are made from the EU budget (i.e. amounts deducted are not subsequently included in our audited population, since the transactions we select for testing are taken from payments accepted by the Commission). Such recoveries (0,4 billion euro) represented more than four fifths of all corrective activity in direct and indirect management areas in 2016.

1.30. The remaining 2,8 billion euro related to claims that the Commission had already accepted (and so were included in the population of payments we audited). Of this amount:

(a) For 'Natural resources', around 2 billion euro concerned agriculture *conformity decisions* that the Commission recorded as *assigned revenue* available to fund agricultural spending.

(b) For 'Cohesion', around 0,6 billion euro represented withdrawals by Member States of previously accepted claims for reimbursement of projects/expenditure and their replacement with new projects/expenditure. Such withdrawals do not result in the return of funds to the EU budget ([22]).

(c) For direct and indirect management areas (mainly 'Competitiveness' and 'Global Europe'), around 0,1 billion euro related to amounts recovered after payment.

Corrections and recoveries are triggered in a variety of ways

1.31. The Commission and the Member States may apply corrections and recoveries in a variety of ways, following the order set out in the Financial Regulation ([23]):

(a) Money unduly spent: basing corrections on the value of the erroneous transactions (individual corrections).

(b) Systematic errors within a representative sample of transactions: by extrapolating the results to the whole population (extrapolated corrections).

THE COMMISSION'S REPLIES

1.29. *The amounts of corrections and recoveries at source demonstrate that the Commission focusses on preventive measures to protect the EU budget before accepting expenditure.*

1.30.

(b) *The legislation foresees the possibility for Member States to withdraw irregular expenditure and replace it by new, regular one. This protects the EU budget, in conformity with the principle that in shared management, Member States are responsible in the first instance for detecting irregularities and making financial corrections where needed.*

1.31.

([22]) See special report No 4/2017.

([23]) Article 80(4) of the Financial Regulation states that 'The Commission shall base its financial corrections on the identification of amounts unduly spent, and the financial implications for the budget. Where such amounts cannot be identified precisely, the Commission may apply extrapolated or flat-rate corrections in accordance with the sector-specific rules'.

THE COURT'S OBSERVATIONS

(c) System weaknesses where it is not possible to precisely calculate the financial implications for the budget: by applying the rates defined in sector-specific guidelines for each situation ('flat rate corrections').

1.32. In our estimate of the level of error, we do not quantify many situations in which the Commission and the Member States apply and report corrections and recoveries:

(a) Flat-rate corrections are applied in order to redress system weaknesses rather than to eliminate individual *irregularities*. System weaknesses indicate a risk of irregular expenditure, but it is not always possible to identify a link between these weaknesses and any irregular payment we find and quantify in our estimate of the level of error.

(b) Some cases which the Commission assesses as errors leading to corrections are not (quantifiable) errors for us. For example, missed deadlines, lack of publicity and *cross-compliance* infringements are not taken into account in our estimate of the level of error.

In certain circumstances we take corrective action into account when estimating the level of error

1.33. We seek to take account of corrective measures taken by the Member States and the Commission where these precede our examination. We check whether these corrections (including recoveries of money unduly paid to beneficiaries and corrections at project level) have been applied and adjust the level of error estimate whenever appropriate. However, the impact of corrective measures varies significantly between different areas of spending and different corrective measures.

THE COMMISSION'S REPLIES

(c) *Flat-rate corrections are used when there is a substantiated risk that the system weaknesses established have had a financial impact on the EU budget but it is not possible, with proportionate effort, to identify more precisely the financial damage. They are applied to address system weaknesses and the associated risks they generate for the EU budget, and, as a consequence, they also redress individual irregularities.*

An important component of the systems-based audit approach usually applied in shared management, the flat rate corrections represent the way forward in the current context of the simplification of the EU legislation. Flat rate corrections are a strong incentive for the Member States to improve their management and control systems and, thereby, contribute to the legality and regularity of the individual underlying transactions.

Therefore, the Commission considers that flat-rate corrections are of high relevance when analysing the level of error of a policy area.

1.32.

(a) *The Commission protects the EU budget from expenditure incurred in breach of law. Where the exact amounts cannot be identified precisely with proportionate effort, the Commission may apply extrapolated or flat-rate corrections in order to fulfil this obligation. Flat rate corrections are a strong incentive for the Member States to improve their management and control systems.*

See also Commission reply to paragraph 1.31(c) and Commission replies to ECA Special Report No 4/2017 'Protecting the EU budget from irregular spending'.

(b) *The Commission notes that corrections from cross-compliance infringements are not included in its estimate of corrective capacity.*

THE COURT'S OBSERVATIONS

1.34. For 41 transactions sampled in 2016, the Commission and Member State authorities had applied corrective measures that directly affected the transaction and were relevant for our calculations. These measures reduced our estimated level of error by 1,2 percentage points (2015: 0,5 percentage points). Changes in the number of transactions affected and in the measures' impact on our estimated level of error do not indicate that corrective action has become any more or less effective, as these measures concern a relatively small share of our sample and some fluctuation is to be expected from one year to the next.

WE REPORT SUSPECTED FRAUD TO OLAF

1.35. We report cases of suspected fraud, whether identified during our audit (including our work on performance) or on the basis of information provided directly to us to the European Anti-Fraud Office (OLAF) for preliminary analysis and possible investigation. We cannot comment on individual cases or on OLAF's response to these. In 2016:

— we assessed the legality and regularity of some 1 000 transactions for our audit work on the annual report and, in addition, produced 36 special reports;

— we reported to OLAF eleven instances of suspected fraud found during our audits (2015: 27), as well as five cases based on information provided by the public (2015:15);

— the suspected fraud most frequently concerned the artificial creation of conditions to meet eligibility criteria, the non-delivery of goods/services, and the declaration of costs not meeting the eligibility criteria, followed by conflicts of interest and other procurement irregularities.

1.36. As at 31 December 2016, the cases of suspected fraud we had reported to OLAF between 2010 and 2016 had resulted in 67 investigations, of which 16 were still ongoing. Of the 51 investigations it had completed and closed, OLAF informed us that 28 had either concluded with recommendations to recover money and consider judicial proceedings or were closed because action had already been taken by the Commission or the national authorities. As at 31 December 2016, OLAF reported recommendations for recoveries from these cases totalling 247 million euro. Where OLAF closed a case without making recommendations for further action, OLAF's most common conclusion was that there was no evidence of fraud affecting the EU's financial or other interests.

THE COMMISSION'S REPLIES

1.34. *The Commission will continue to exercise its supervisory role by implementing financial corrections and recoveries at the level that corresponds to the level of irregularities and deficiencies identified.*

THE COURT'S OBSERVATIONS

CONCLUSIONS

1.37. The key function of this chapter is to support the audit opinion presented in the statement of assurance.

Audit results

1.38. Our audit results show improvements over the last few years. We conclude that entitlement-based expenditure is free from material error and that reimbursement-based expenditure is affected by material error. Based on this, we conclude that the error is not pervasive.

ANNEX 1.1

AUDIT APPROACH AND METHODOLOGY

1. Our audit approach is set out in the Financial and Compliance Audit Manual available on our website. We use an assurance model to plan our work. In our planning, we consider the risk of errors occurring (inherent risk) and the risk of errors not being prevented or detected and corrected (control risk).

PART 1 — Audit approach and methodology for the reliability of accounts

2. We examine the EU's consolidated accounts to determine their reliability. These consist of:

(a) the consolidated financial statements; and

(b) the budgetary implementation reports.

3. The consolidated accounts should properly present, in all material respects:

(a) the financial position of the European Union at year end;

(b) the results of its operations and cash flows; and

(c) the changes in net assets for the year ended.

4. In our audit, we:

(a) evaluate the accounting control environment;

(b) check the functioning of key accounting procedures and the year-end closure process;

(c) analyse the main accounting data for consistency and reasonableness;

(d) analyse and reconcile accounts and/or balances;

(e) perform substantive tests of *commitments*, payments and specific balance sheet items, based on representative samples;

(f) use the work of other auditors where possible, in accordance with international standards on auditing, particularly when auditing borrowing and lending activities managed by the Commission for which external audit certificates are available.

PART 2 — Audit approach and methodology for the regularity of transactions

5. Auditing the transactions underlying the accounts for regularity involves testing whether they comply with the relevant rules and regulations (***Box 1.2***).

6. In our audit work we consider whether we can make efficient use of the checks on regularity already performed by others. If we want to use the results of these checks, in line with audit standards, we assess the independence and competence of the other party and the scope and adequacy of its work.

How we test transactions

7. Under each MFF heading (chapters 5 to 10), we test a representative sample of transactions in order to estimate the share of irregular transactions in the overall population.

8. For each selected transaction, we determine whether or not the claim or payment was made for the purpose approved in the budget and specified in legislation. We examine how the amount of the claim or payment was calculated (for larger claims: based on a selection representative of all items in the transaction). This involves tracing the transaction from the budgetary accounts to the final recipient (e.g. a farmer, or the organiser of a training course or development aid project), testing compliance at each level.

9. When testing revenue transactions, our examination of value added tax and GNI-based own resources takes as a starting point the macroeconomic aggregates based on which these are calculated. We examine the Commission's controls on these Member State contributions up to the point they were received and recorded in the consolidated accounts. For traditional own resources, we examine the customs authorities' accounts and the flow of duties — again up to the point they were received and recorded by the Commission.

10. On the expenditure side, we examine payments once expenditure has been incurred, recorded and accepted. This applies to all categories of payments (including those made to purchase assets). We do not examine advances at the point they were made, but rather once:

(a) the final recipient of EU funds (e.g. a farmer, a research institute, a company providing publicly procured works or services) has provided evidence of their use; and

(b) the Commission (or other institution or body managing EU funds) has accepted the final use of the funds by clearing the advance.

11. Our audit sample is designed to provide an estimate of the level of error for the expenditure as a whole rather than for individual transactions (e.g. a particular project). We use *monetary unit sampling* to select claims or payments and, at a lower level, individual items within a transaction (e.g. project invoices, parcels in a claim by a farmer). The error rates reported for these items should not be seen as a conclusion on their respective transactions, but rather contribute directly to the overall level of error for EU expenditure as a whole.

12. We do not examine transactions in every Member State, beneficiary state and region in any given year. While we may name certain Member States, beneficiary states and/or regions, this does not mean that the examples do not occur elsewhere. The illustrative examples presented in this report do not form a basis for conclusions to be drawn on the specific Member States, beneficiary states and/or regions concerned.

13. Our approach is not designed to gather data on the frequency of error in the whole population. Therefore, figures presented on the number of errors detected in an MFF heading, in expenditure managed by a DG or in spending in a particular Member State are not an indication of the frequency of error in EU-funded transactions or in individual Member States. Our sampling approach applies different weightings to different transactions, according to the value of the expenditure concerned and the intensity of our audit work. This weighting is removed in frequency information which gives as much weight to rural development as to direct support for natural resources, and to European Social Fund expenditure as to regional and cohesion payments.

How we evaluate and present the results of transaction testing

14. An error may concern all or part of the amount involved in an individual transaction. We consider whether errors are quantifiable or non-quantifiable, i.e. whether or not it is possible to measure how much of the amount examined was affected by the error. Errors detected and corrected prior to and independently of our checks are excluded from the calculation and frequency of error, since their detection and correction demonstrate that the control systems have worked effectively.

15. Our criteria for the quantification of public procurement errors are described in the document 'Non-compliance with the rules on public procurement — types of irregularities and basis for quantification' ([1]).

16. Our quantification may differ from that used by the Commission or Member States when deciding how to respond to the misapplication of the public procurement rules.

Estimated level of error

17. What we estimate is the 'most likely error' rate (MLE). We do this for most MFF headings and for overall budget spending. The MLE takes account of quantifiable errors only and is expressed as a percentage. Examples of errors are quantifiable breaches of applicable regulations, rules, and contract and *grant* conditions. We also set the lower error limit (LEL) and the upper error limit (UEL).

18. We use the level of 2 % as materiality threshold for our opinion. We also take account of the nature, amount and context of errors.

([1]) http://www.eca.europa.eu/Lists/ECADocuments/Guideline_procurement/Quantification_of_public_procurement_errors.pdf

How we examine systems and report the results

19. The Commission, other EU institutions and bodies, Member State authorities, beneficiary countries and regions establish systems for managing the risks to the budget and overseeing/ensuring the regularity of transactions. It is helpful to examine these systems in order to identify areas for improvement.

20. Each MFF heading, including revenue, involves many individual systems. We select a sample of systems each year and present the results together with recommendations for improvement.

How we arrive at our opinions in the statement of assurance

21. The work reported in chapters 4 to 10 forms the basis for our opinion on the regularity of transactions underlying the EU's consolidated accounts. Our opinion is set out in the statement of assurance. Our work allows us to arrive at an informed opinion as to whether errors in the population exceed or fall within the materiality limits.

22. Where we find a material level of error and determine its impact on the audit opinion, we must determine whether or not the errors, or the absence of audit evidence, are 'pervasive'. In doing so, we apply the guidance contained in ISSAI 1705 (extending this guidance to apply to issues of legality and regularity, in accordance with our mandate). Where errors are material and pervasive, we present an adverse opinion.

23. An error or an absence of audit evidence are deemed 'pervasive' if, in the auditor's judgment, they are not confined to specific elements, accounts or items of the financial statements (i.e. they are spread throughout the accounts or transactions tested), or, if they are so confined, they represent or could represent a substantial proportion of the financial statements, or relate to disclosures which are fundamental to users' understanding of the financial statements.

24. Our best estimate of the level of error for overall spending in 2016 is 3,1 %. We did not assess this error as pervasive, as it is confined to a specific type of spending in only some spending areas. The estimated level of error found for the different MFF headings varies, as described in chapters 5 to 7 and 9 and 10.

Suspected fraud

25. If we have reason to suspect that fraudulent activity has taken place, we report this to OLAF, the EU's anti-fraud office. OLAF is responsible for carrying out any resulting investigations. We report several cases per year to OLAF.

PART 3 — Link between the audit opinions on the reliability of accounts and on the regularity of transactions

26. We have issued:

(a) an audit opinion on the consolidated accounts of the European Union for the financial year ended; and

(b) audit opinions on the regularity of the revenue and payments underlying those accounts.

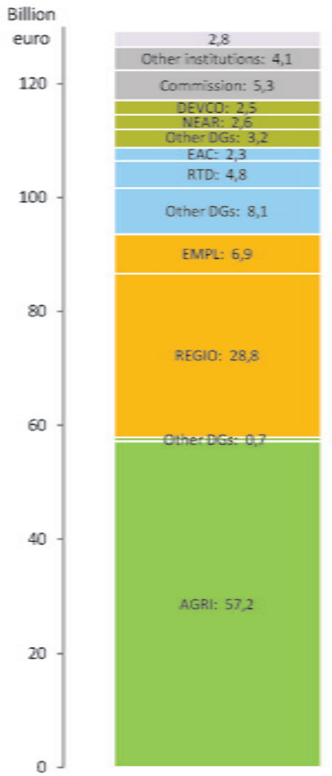
27. Our work and our opinions follow the IFAC's International Standards on Auditing and Codes of Ethics and INTOSAI's International Standards of Supreme Audit Institutions.

28. Where auditors issue audit opinions on both the reliability of accounts and the regularity of transactions underlying those accounts, these standards state that a modified opinion on the regularity of transactions does not, in itself, lead to a modified opinion on the reliability of accounts. The financial statements, on which we express an opinion, recognise that there is a material issue in relation to breaches of the rules governing expenses charged to the EU budget. Accordingly, we have decided that the existence of a material level of error affecting regularity is not, in itself, a reason to modify our separate opinion on the reliability of the accounts.

ANNEX 1.2

FREQUENCY OF DETECTED ERRORS IN AUDIT SAMPLING FOR THE YEAR 2016

Transactions subject to audit [1] per heading and Institution/DG [2]



Number of transactions affected

MFF heading 3/6/other

Transactions	HOME	JUST	SANTE	Others	Total
Error-free	6	2	2	1	11
Unquantified	0	0	0	0	0
errors quantified < 20 %	3	0	0	1	4
errors quantified ≥ 20 %	0	0	0	0	0
Total	9	2	2	2	15

MFF heading 5

Transactions	Commission	EP	EEAS	Council	CJEU	ECA	EESC	Total
Error-free	54	15	8	3	3	3	2	88
Unquantified	2	4	5	0	0	0	0	11
errors quantified < 20 %	0	0	0	0	0	0	0	0
errors quantified ≥ 20 %	0	1	0	0	0	0	0	1
Total	56	20	13	3	3	3	2	100

MFF heading 4

Transactions	DEVCO	NEAR	ECHO	FPI	Others	Total
Error-free	31	40	19	4	14	108
Unquantified	13	6	0	0	5	24
errors quantified < 20 %	8	2	5	2	0	17
errors quantified ≥ 20 %	4	1	0	2	0	7
Total	56	49	24	8	19	156

MFF heading 1a

Transactions	RTD	EAC	CNECT	ENER	GROW	MOVE	Others	Total
Error-free	21	14	7	11	8	4	11	76
Unquantified	14	0	4	2	2	2	2	26
errors quantified < 20 %	19	8	8	1	2	3	1	42
errors quantified ≥ 20 %	2	0	2	0	0	0	2	6
Total	56	22	21	14	12	9	16	150

MFF heading 1b

Transactions	REGIO	EMPL	Total
Error-free	69	24	93
Unquantified	54	8	62
errors quantified < 20 %	7	5	12
errors quantified ≥ 20 %	9	4	13
Total	139	41	180

MFF heading 2

Transactions	AGRI	MARE	ENV	CLIMA	Total
Error-free	258	3	1	1	263
Unquantified	20	1	1	0	22
errors quantified < 20 %	80	1	1	0	82
errors quantified ≥ 20 %	12	0	0	1	13
Total	370	5	3	2	380

[1] This annex complements the information included in this chapter. Our approach is not, however, designed to gather data on the frequency of error in the population (see paragraph 13 *of* ***Annex 1.1***). We take account of corrective measures and their impact on the individual findings included in the table (see also paragraphs 1.33 and 1.34), and this also affects the frequency of error.

[2] This graph includes abbreviations of EU institutions and Commission directorates-general and services. The full and official names can be found in the inter-institutional style guide sections 9.5.1 (http://publications.europa.eu/code/en/en-390500.htm) and 9.6 (http://publications.europa.eu/code/en/en-390600.htm) respectively.

CHAPTER 2

Budgetary and financial management

TABLE OF CONTENTS

THE COURT'S OBSERVATIONS

INTRODUCTION

2.1. This chapter presents our observations on EU budgetary and financial management in 2016 and identifies a number of key risks and challenges for future budgets.

2.2. The budget for a given year must adhere to the *ceilings* for *commitment* and payment *appropriations* set out in the 2014-2020 *multiannual financial framework (MFF)* ([1]), which states that the EU can, in current prices, commit up to 1 087,2 billion euro and make payments of up to 1 025,4 billion euro between 2014 and 2020 ([2]). Commitment and payment appropriations ([3]) for the year must fall within the limits established by the Own Resources Decision ([4]) (ORD).

2.3. The Commission presented a *mid-term review* of the implementation of the current MFF, which was accompanied by legislative proposals. Part of this chapter builds on views we have previously expressed on those legislative proposals that are relevant to the proposal for the next MFF ([5]).

([1]) Council Regulation (EU, Euratom) No 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014-2020 (the 'MFF Regulation') (OJ L 347, 20.12.2013, p. 884).

([2]) These figures correspond to appropriations for commitment of 1,04 % of EU GNI and appropriations for payment of 0,98 % of EU GNI for 2014-2020 as set out in the latest Technical adjustment to the MFF — COM(2016) 311 final of 30 June 2016: 'Communication from the Commission to the Council and the European Parliament: Technical adjustment of the financial framework for 2017 in line with movements in GNI and adjustments of cohesion policy envelopes (Article 6 and 7 of Regulation (EU, Euratom) No 1311/2013 laying down the multiannual financial framework for the years 2014-2020)' ('2017 technical adjustment').

([3]) Additional payment appropriations above the *own resources* limit can be made from income other than own resources income.

([4]) Council Decision 2014/335/EU, Euratom of 26 May 2014 on the system of own resources of the European Union (OJ L 168, 7.6.2014, p. 105) sets a limit of appropriations for commitment of 1,26 % of EU GNI and for appropriations for payment of 1,20 % of EU GNI.

([5]) A briefing paper on the Commission's communication, 'EU budget: time to reform? A briefing paper on the mid-term review of the Multiannual Financial Framework 2014-2020', an opinion on the proposal to extend and expand the *European Fund for Strategic Investments (EFSI)*, Opinion No 2/2016 (OJ C 465, 13.12.2016), and an opinion on the proposal to revise the *Financial Regulation*, Opinion No 1/2017 (OJ C 91, 23.3.2017).

THE COURT'S OBSERVATIONS

BUDGETARY MANAGEMENT IN 2016

Payments were well within the limits set by the annual budget

2.4. Payments made against budget appropriations were 13,7 billion euro lower than the appropriations available in the initial adopted budget (130,2 billion euro out of a possible 143,9 billion euro [6], or 90,5 % of the available total) (see ***Box 2.1***).

2.5. The low level of payments mainly resulted from authorities in the Member States submitting lower than anticipated claims for *European Structural and Investment (ESI) funds*. This was due to delays in implementing programmes in the first years of the current MFF. The Commission has given the following explanations [7] for these delays:

(a) the consequence of significant delays in the implementation of the 2007-2013 programmes;

(b) the EU's late adoption of the legal bases for the 2014-2020 programmes [8];

(c) delays in Member States setting up and notifying the EU of the national authorities responsible for managing EU funds;

(d) the time needed to adjust to changes in the rules for programmes and projects for new period;

(e) the granting of an extra year in the 2014-2020 period for Member States to make payments against commitments (the 'n+3 rule') [9].

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(6) Excluding *carryovers* and assigned revenue.

(7) For these delays see pages 45 and 46 of the 'Report on Budgetary and Financial Management of the European Commission — Financial year 2016' and Annex 6 'Payment forecast' — Section 3, third paragraph of document SWD(2016)299 final of 14 September 2016 'Commission staff working document accompanying document "Communication from the Commission to the European Parliament and the Council: Mid-term review/revision of the multiannual financial framework 2014-2020 (COM (2016) 603 final)"'.

(8) Reasons for the length of the adoption procedure of the legal bases for 2014-2020 programmes are set out in paragraphs 11 and 36 of our special report No 2/2017 (http://eca.europa.eu).

(9) Special report No 36/2016 (http://eca.europa.eu).

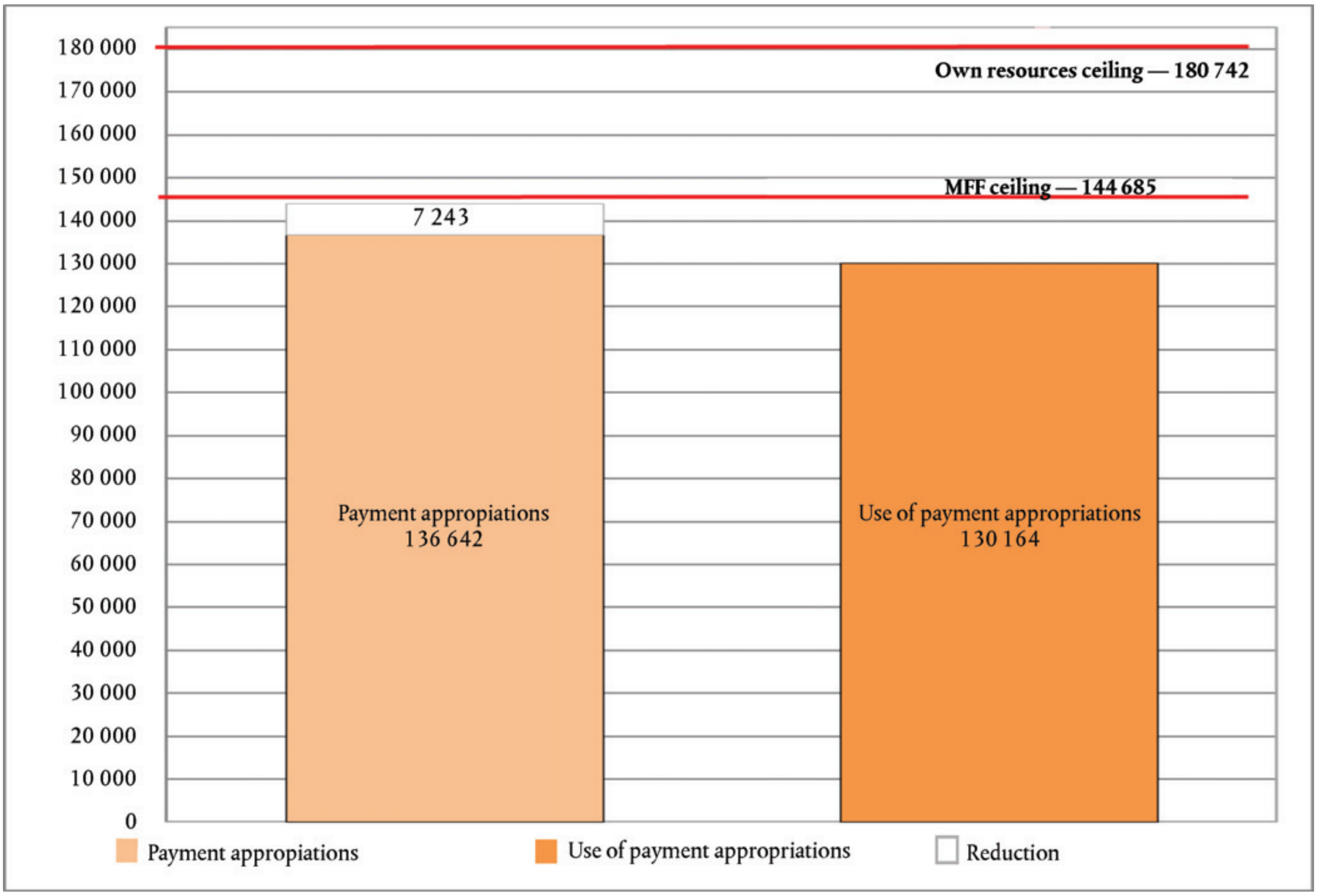
THE COURT'S OBSERVATIONS

2.6. As the Commission noted ([10]), delays in implementing ESI Fund programmes during the first three years of the 2014-2020 MFF exceeded those experienced at the start of the 2007-2013 period on structural and cohesion fund programmes.

2.7. In light of the low level of payment requests received during the year, the budgetary authorities amended the 2016 budget to decrease payment appropriations by 7,3 billion euro ([11]). Even with this reduction, the low number of payment requests led to the highest surplus since 2002: 6,4 billion euro ([12]) (2015: 1,3 billion euro).

Box 2.1 — The budget in 2016

(million euro)



Source: Consolidated annual accounts of the European Union — Financial year 2016, 'Aggregated reports on the implementation of the budget and explanatory notes', tables 4.1 and 4.3.

([10]) Annex 6 'Payment forecast' — Section 3, third paragraph — SWD(2016)299 final.

([11]) *Amending budget* No 4. This and other amending budgets increased commitment appropriations by 273 million euro and payment appropriations by 31 million euro.

([12]) See the 'EU Budget result' page in the 'Budgetary implementation reports and explanatory notes' section of the 'Consolidated annual accounts of the EU — Financial year 2016' ('2016 EU accounts').

THE COURT'S OBSERVATIONS

Extensive use of special instruments and margins leaves little flexibility to respond to unforeseen events

2.8. The 2014-2020 MFF has a number of instruments to facilitate the operation of the budget and hold funds in reserve. The most important of these are:

(a) The Global Margin for Payments (GMP), which, as set out in Article 5 of the MFF Regulation, makes it possible to transfer unused payment appropriations to future years, provided the MFF ceiling is not exceeded. Thus, the unused 13,7 billion euro from 2016 referred to in paragraph 2.4 can be carried forward for use in future years. The limit, stated in 2011 prices, for the transfer of unused payment appropriations provided in the MFF for years 2018-2020, is 31 billion euro (2018: 7 billion euro; 2019: 11 billion euro; 2020: 13 billion euro).

(b) Four 'special instruments' ([13]) to react to unforeseen events and changing priorities. According to the Commission's mid-term review in 2016 ([14]), the total amount still available up to 2020 was 7,4 billion euro. According to a Council statement ([15]) issued at the time of the mid-term revision of the MFF, it remains open to the budgetary authority to decide on a case-by-case basis whether payments relating to special instruments can be counted above the payment ceiling.

(c) contingency margin ([16]) of up to 0,03 % of GNI, (around 4,5 billion euro) making it possible, as a last resort, to transfer appropriations between years and headings in response to unforeseen circumstances, provided the MFF ceilings are not exceeded. This margin was used for payment appropriations in 2014, to be offset against 2017-2020. For commitment appropriations, the contingency margin was used to transfer 2,1 billion euro to MFF headings 3 and 4 from other headings in 2016 and 2017 in response to the refugee crisis ([17]).

([13]) The Emergency Aid Reserve, the European Union Solidarity Fund, the European Globalisation Adjustment Fund and the Flexibility Instrument. See Articles 9-12 of the MFF Regulation.

([14]) Annex 6 'Payment forecast', Section 6 of document SWD(2016) 299 final.

([15]) See Council document 7031/17 ADD 1.

([16]) Article 13 of the MFF Regulation.

([17]) Decisions (EU) 2017/339 and (EU) 2017/344 of the European Parliament and Council of 14 December 2016 on the mobilisation of the contingency margin (OJ L 50, 28.2.2017).

THE COURT'S OBSERVATIONS

(d) The Global Margin for Commitments (GMC) ([18]), which makes it possible to transfer unused commitment appropriations to future years, but only to be used for growth and employment, in particular youth unemployment. Almost all of the GMC for 2014 and 2015 (1,8 billion euro out of 2,0 billion euro ([19])) has been allocated to the EFSI.

2.9. These instruments have been put in place to deal with emergency situations and provide some flexibility in the context of an EU budget system designed to provide predictable funding to long-term EU expenditure programmes. However as EU expenditure programmes were delayed in the first years of MFF 2014-2020 and are expected to pick up in the years up to 2020, there may not be sufficient flexibility remaining within the MFF ceilings to fund the EU's response to any unexpected events that may still occur before the end of the current MFF.

2.10. In addition to making use of the margins described above, the Council may by unanimous decision amend the MFF regulation itself to change the ceilings for appropriations ([20]).

Outstanding commitments reached an all-time high

2.11. In 2016, the EU committed 155,2 billion euro out of a possible 156,1 billion euro, 99,4 % of the total available ([21]) excluding *assigned revenue*.

2.12. As a result of the almost full use of commitment appropriations and the lower than planned payments, outstanding commitments firstly fell in 2014 and then rose again in 2015 and 2016, reaching an all-time high of 238,8 billion euro (see ***Box 2.9***). They are also set to rise further in 2017, as the 2017 budget provides for commitment appropriations of 157,9 billion euro and payment appropriations of 134,4 billion euro, implying an increase in outstanding commitments of up to 23,5 billion euro.

2.13. This stock of outstanding commitments represents the cumulative difference between commitments and the payments made on them to date, less *de-commitments*. De-commitments represented a relatively small proportion of commitments made in the period 2007-2016 (27 billion euro out of a total of 1 446 billion euro or 1,9 %).

THE COMMISSION'S REPLIES

2.9. *More flexibility for the remaining years of the 2014-2020 MFF is provided in the mid-term revision for the MFF (see Council Regulation (EU, Euratom) 2017/1123).*

([18]) Article 14 of the MFF Regulation.
([19]) Based on the 2017 technical adjustment.
([20]) Article 17 of the MFF Regulation.
([21]) A 'commitment' has a different basis in different areas of the budget — see paragraph 2.5 and Figure 2.1 of our 2015 annual report.

THE COURT'S OBSERVATIONS

2.14. The vast majority of outstanding commitments are for multiannual spending programmes, where the time lag between a commitment and its corresponding payment may be more than a year, and often up to three years. Based on 2016 figures, outstanding commitments at year-end were 72 % higher than in 2007 and were equivalent to 2,9 years [22] of payments, compared to 2,2 years in 2007. This rise in outstanding commitments risks creating funding problems in future (see paragraphs 2.32 to 2.39).

THE COMMISSION'S REPLIES

2.14. *The increase in the level of outstanding commitments for the ESI Funds in the third year of the programming period is part of the normal cycle of implementation observed previously for these funds. The smooth annual profile of the commitment appropriations over the 2014-2020 period, the introduction of the n+3 rule and the slow implementation led to a significant increase in outstanding commitments.*

FINANCIAL MANAGEMENT ISSUES RELATED TO THE 2016 BUDGET

The EU budget's financial exposure is significant

2.15. In addition to outstanding commitments, the EU had a number of significant long-term liabilities, guarantees and legal obligations still outstanding at the end of 2016.

2.16. The EU's single biggest long-term liability is the 67,2 billion euro for staff pensions (2015: 63,8 billion euro). Although EU employees contribute to their pensions, these contributions are treated as general revenue of the EU budget and the liability is not offset by any specific asset.

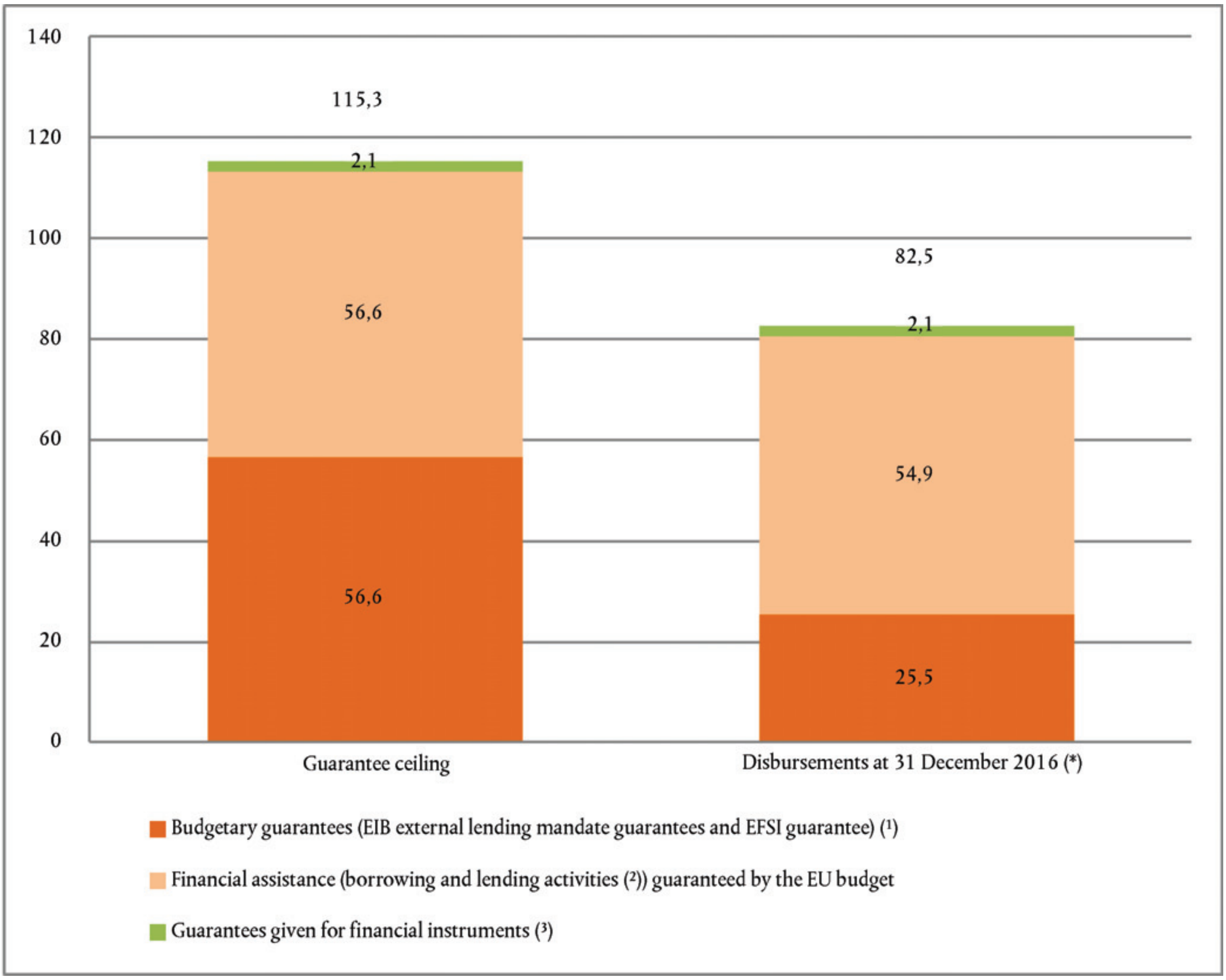
2.17. In recent years, the EU has made increasing use of the budget to back guarantees for loans and *financial instruments* (see ***Box 2.2***). These are *contingent liabilities* disclosed in the EU accounts [23]. A margin must be maintained between the level of payment appropriations in the budget and the maximum level allowable under the ORD in order to cover these guarantees should the need arise.

[22] To arrive at the figure, we divide outstanding commitments (2016: 238,3 billion euro; 2007: 138,4 billion euro) by differentiated payments made, i.e. payments that were made on multiannual commitments during the year (2016: 81,5 billion euro; 2007: 63,3 billion euro).

[23] See note 4 of the 2016 EU accounts.

Box 2.2 — Exposure to guarantees

(billion euro)



(*) The exposure at 31 December 2016 only includes disbursed amounts to final *beneficiaries*. A further 17,5 billion euro had been contracted but not yet disbursed at the end of 2016 (9,0 billion euro under the external lending mandate guarantee, 6,9 billion euro under the EFSI guarantee and 1,6 billion euro under financial assistance on MFA and Euratom loans).

(1) See note 4.1.1 of the 'Consolidated annual accounts of the EU — Financial year 2016' ('2016 EU accounts').

(2) See note 4.1.2 of the 2016 EU accounts.

(3) See note 4.1.3 of the 2016 EU accounts.

Source: 2016 EU accounts, Notes 4.1.1-3 to the Financial Statements.

THE COURT'S OBSERVATIONS

2.18. The EU budget has two funds to back the budgetary guarantees: the Guarantee Fund for external actions, with an asset value of 2,3 billion euro, and the EFSI Guarantee Fund, with an asset value of 1,0 billion euro at the end of 2016 ([24]) that will rise to 8 billion euro by 2022. It also maintains a *provision* against expected losses on guarantees, which stood at 0,9 billion euro at the end of 2016 ([25]) after provisions of 0,5 billion euro were added during the year, including for loans to Syria. For the guarantees relating to financial assistance to Member States, any liability arising can be covered by appropriations over and above the MFF ceiling ([26]) but must be paid through the EU budget.

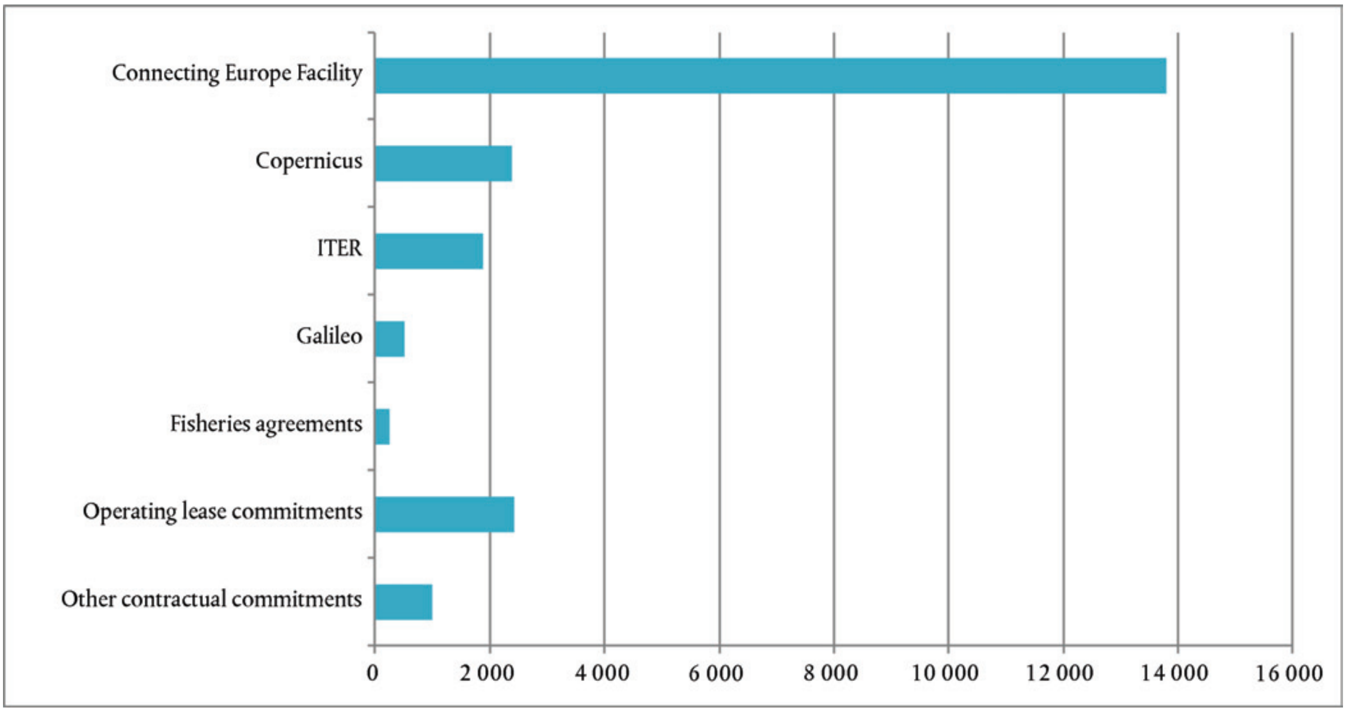
2.19. The Commission has proposed establishing a common provisioning fund to cover the financial liabilities arising from financial instruments, budgetary guarantees and financial assistance ([27]).

2.20. There were also significant long-term legal obligations not covered by outstanding budgetary commitments, totalling 22 billion euro ([28]) at year-end (see ***Box 2.3***), which will be paid out from future annual budgets.

([24]) See note 2.4.1 of the 2016 EU accounts.
([25]) See note 2.10 of the 2016 EU accounts.
([26]) Article 3(3) of the MFF Regulation.
([27]) We made a recommendation in our Opinion No 1/2017 on the proposal.
([28]) See note 5.3 of the 2016 EU accounts.

Box 2.3 — Other long-term legal obligations at end 2016

(million euro)



Source: 2016 EU accounts, Note 5.3 to the Financial Statements.

THE COURT'S OBSERVATIONS

The EU is making increasing use of financial instruments

2.21. Financial instruments benefiting from EU budgetary support have been increasing (see ***Box 2.4***) and are projected to continue to do so up to 2020. Careful management is necessary to ensure the effective, efficient and economical use of available funds, and that any changes are made only after a careful *impact* assessment.

THE COMMISSION'S REPLIES

2.21. *The Commission has implemented measures which ensure transparency and sound financial management when using the available funds.*

Whenever changes are foreseen, the ex ante *assessment should include an analysis of lessons learnt in previous similar instruments.*

For centrally managed instruments the relevant legal bases foresee mid-term reviews or evaluations.

For all such future mid-term reviews of financial instruments, the Commission will ensure that they cover the lessons learnt and the effect of any major socio-economic changes on the rationale of the instrument and the corresponding contribution from the EU budget.

Box 2.4 — Financial instruments benefiting from EU budgetary support

(billion euro)

	Programming period 2007-2013 (*)	Programming period 2014-2020
Under *shared management*		
ERDF, ESF ([1]), and Rural Development ([2]) for the 2007-2013 period/ESI Funds for the 2014-2020 period	12,0	21,5
of which SME Initiative	0	1,2 (**)
Under *direct/indirect management* and budgetary guarantees		
Financial instruments in indirect management	3,8 ([3])	7,4 (***)
EFSI — maximum EU budget guarantee, of which:	0	16
— Provisioning of the Guarantee Fund		8
— Unfunded liability to the current and future EU budgets		8
Total	**16,1**	**45,6**
Proposed increase in funding ([4])		10
Total after proposed increase		**55,6**

(*) Based on the latest available implementation reports.
(**) Based on maximum amounts of operating programme allocations at 31 December 2016.
(***) For the 2014-2020 programming period, we estimated the indicative budget for the financial instruments in indirect management to be 7,4 billion euro (2015 annual report, Figure 2.10).
([1]) For ERDF and ESF financial instruments, the total corresponding EU contribution paid at 31 December 2015 amounted to 11,6 billion euro, of which only 8,5 billion euro (73 %) reached the final beneficiaries. These amounts correspond to a nine year implementation period (2007-2015) (Commission document EGESIF_16-0011-00, Summary of data on the progress made in financing and implementing financial engineering instruments reported by the *managing authorities* in accordance with Article 67(2)(j) of Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25), p. 66).
([2]) Special report No 5/2015 (http://eca.europa.eu).
([3]) At 31 December 2014, the EU's overall contribution to 2007-2013 programming period for financial instruments in indirect management amounted to almost 3,8 billion euro (excluding blending facilities).
([4]) See paragraph 2.22 and footnote 35.

THE COURT'S OBSERVATIONS

2.22. The EFSI will continue to grow and is becoming a major source of funding ([29]). By the end of 2016, the EIB Group had signed contracts worth 21,3 billion euro for the EFSI ([30]). The investment period of EFSI is not yet over, ***Box 2.5*** shows the distribution of EFSI funding by Member State to the end of 2016.

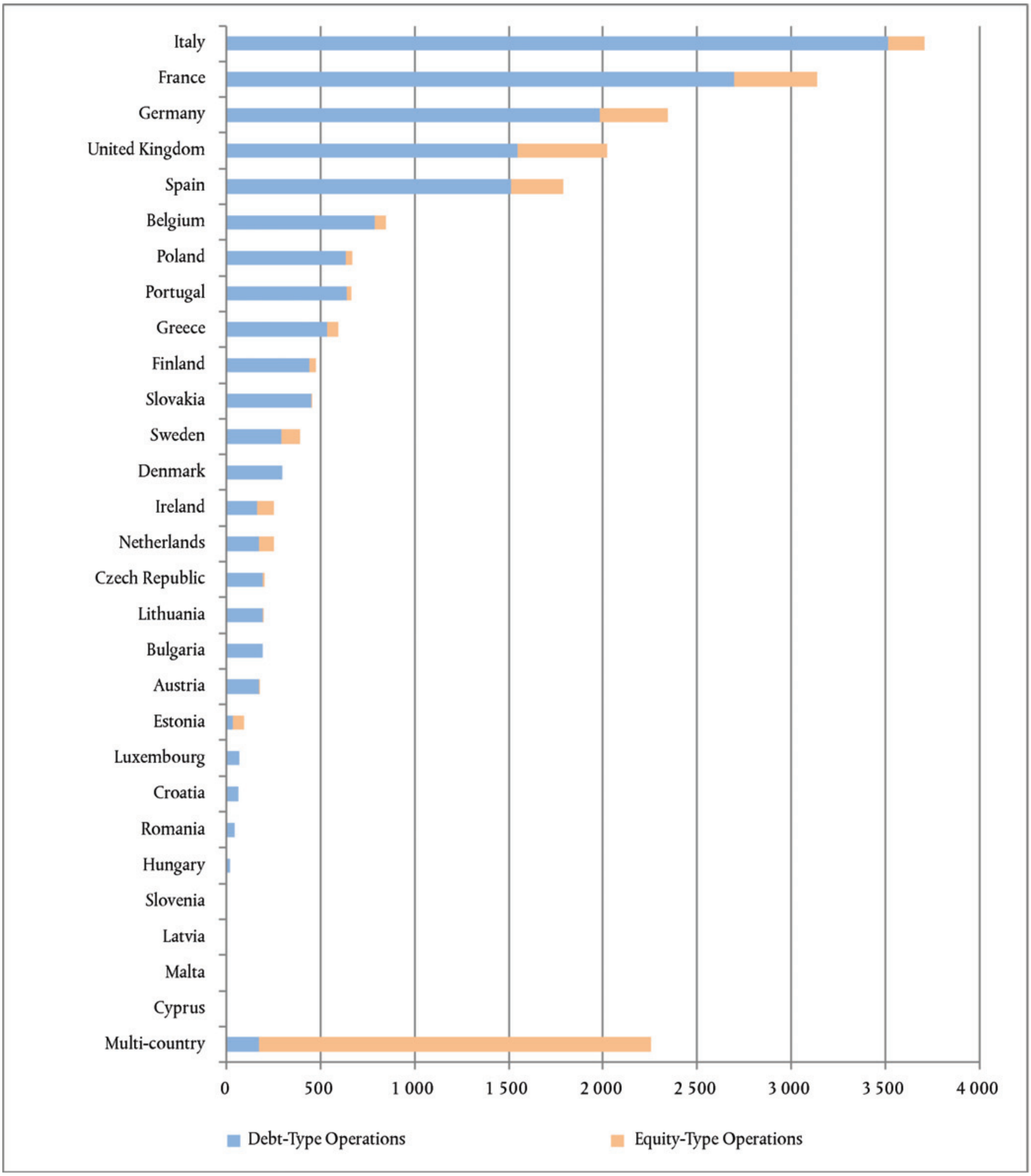
THE COMMISSION'S REPLIES

2.22. *The Commission considers that, in order to give a full picture of the dimension of EFSI funding in the different Member States, Box 2.5 should not only present amounts of EFSI interventions by Member States, but also the ratio of EFSI investments to the GDP and per capita of the respective countries.*

([29]) The Commission submitted a proposal to the budgetary authority to increase the size of the EFSI. We published Opinion No 2/2016 on the proposal.
([30]) EIB end-year operational report 'European Fund for Strategic Investments — IIW and SMEW. Schedule II of the EFSI Agreement' — reporting date: 31 December 2016. The EFSI guarantee covers 11,2 billion euro.

Box 2.5 — EFSI funding by Member State

(million euro)



Source: EIB end-year operational report 'European Fund for Strategic Investments — IIW and SMEW. Schedule II of the EFSI Agreement' — reporting date: 31 December 2016.

THE COURT'S OBSERVATIONS

2.23. The EFSI is a new centralised innovative instrument for Member States to support investment within the EU. Under the EFSI's governance arrangements, implementation powers are delegated to the EIB, with more limited public scrutiny than for other instruments supported by the EU budget, as illustrated in ***Box 2.8***.

Member States may face challenges in using the available EU funds

2.24. Given that ESI funds represent a significant proportion of some Member States' general government expenditure, it is important to note that, in nine Member States, outstanding commitments on ESI funds represent more than 15 % of general government spending in 2016 (see ***Box 2.6***).

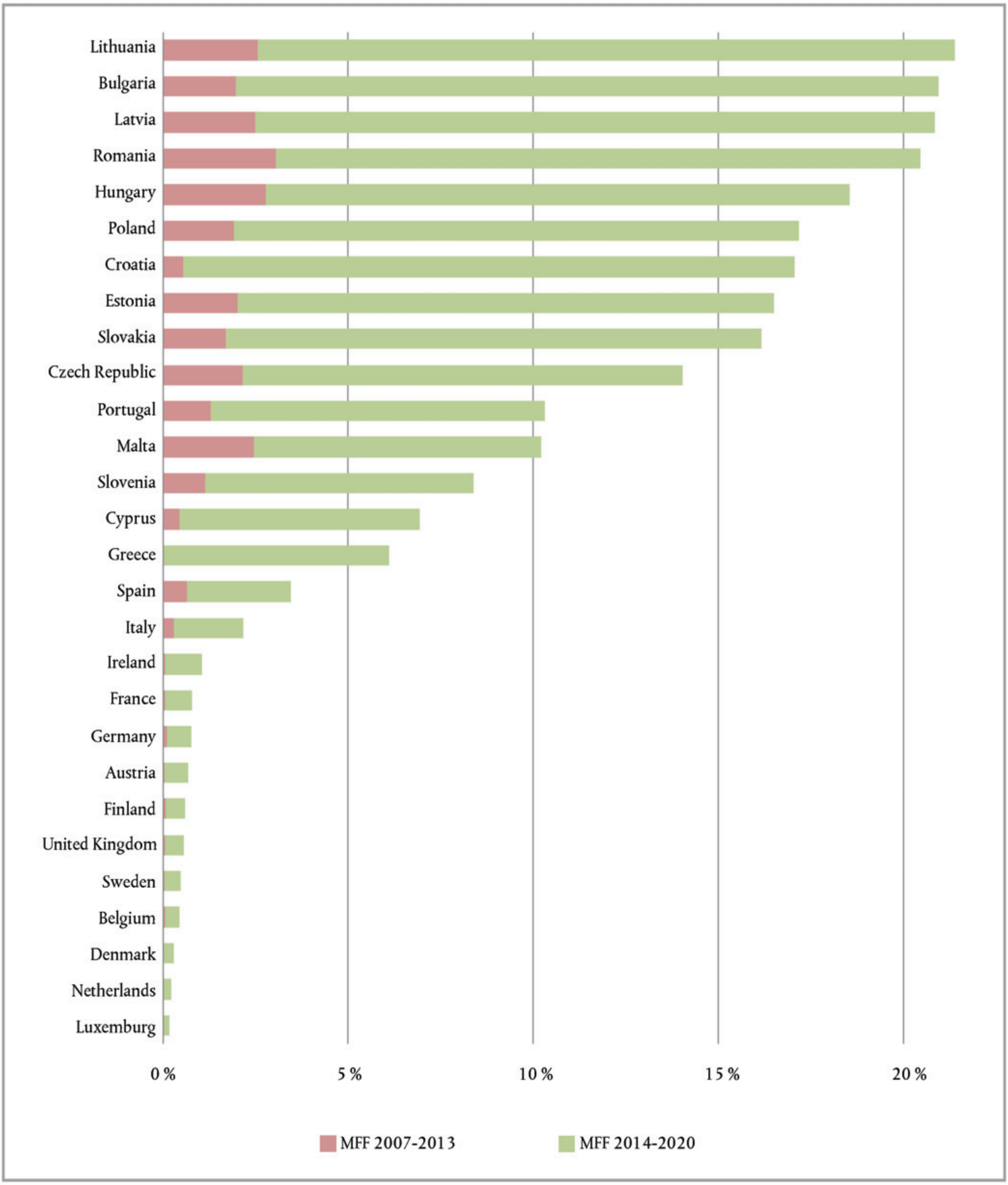
2.25. Given the sizeable commitment appropriations still available under the 2014-2020 MFF, Member States where ESI funds represent significant percentage of general government expenditure may find it challenging to identify sufficient high-quality projects on which to spend the available EU funds or to provide co-financing.

THE COMMISSION'S REPLIES

2.23. *The Commission considers that the EFSI is subject to appropriate public scrutiny.*

2.25. *The Commission considers that it is too early in the 2014-2020 MFF to prejudge the capacity of the Member States concerned to absorb the funds foreseen for them.*

Box 2.6 — Outstanding commitments of ESI Funds at 31 December 2016 as a percentage of 2016 general government expenditure by Member State

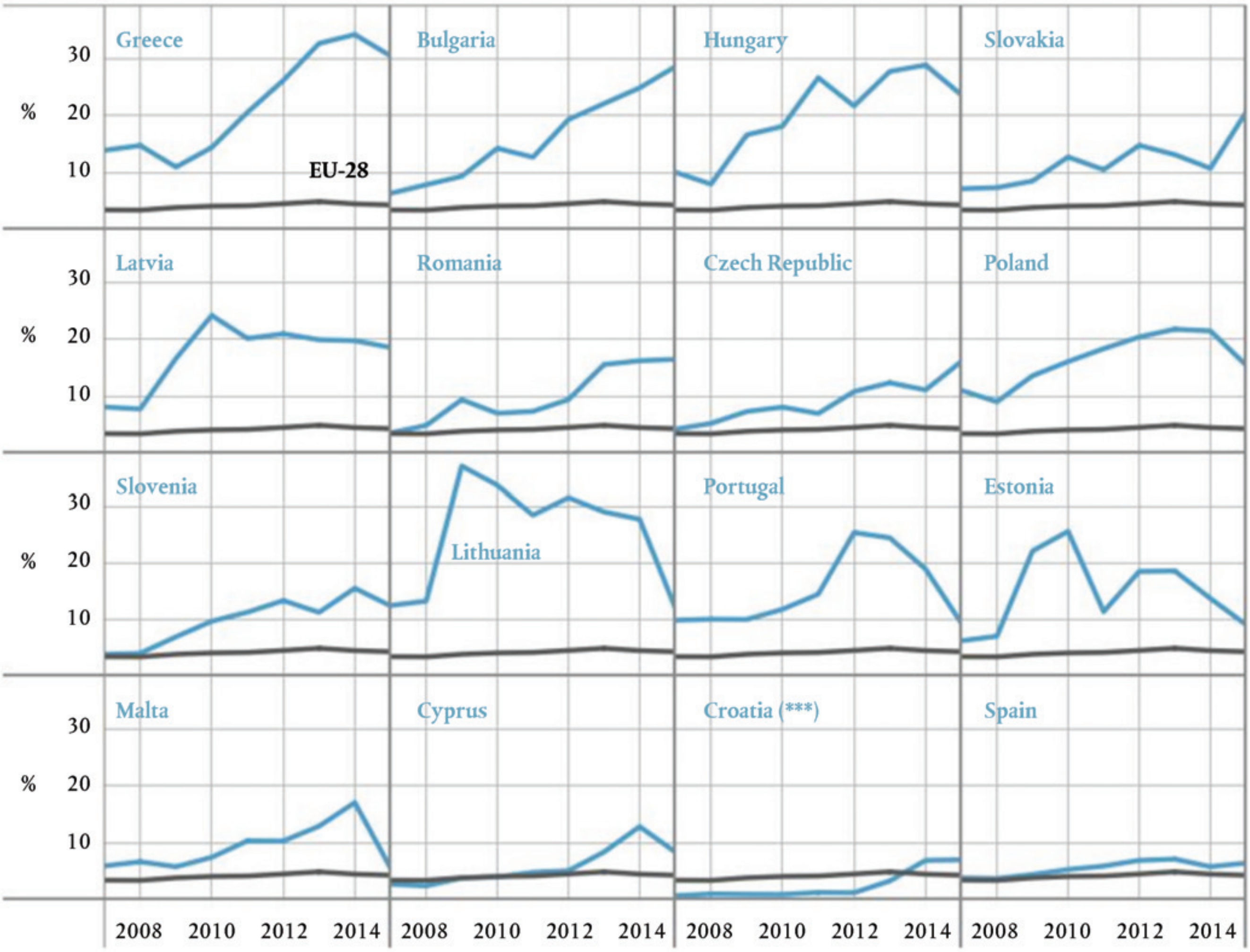


Source: European Court of Auditors based on information from the Commission. Eurostat data on general government expenditure for 2016; April 2017.

THE COURT'S OBSERVATIONS

2.26. Receipts from the EU budget make up a significant proportion of some Member States' capital investment in any given year. This means that the size and timing of such receipts can have significant macro-economic effects such as on investment, growth and jobs, which need to be sufficiently taken into account when planning future expenditure in the EU budget (see ***Box 2.7***) ([31]).

Box 2.7 — EU funds (*) **as a proportion of Member States' Gross Fixed Capital Formation** (**)



(*) EU funds do not include MFF Heading 5 'Administration'.

(**) Member States where EU funds were greater than 5 % of Gross Fixed Capital Formation (GFCF) on average during the period 2007-2015. GFCF consists of resident producers' acquisitions, less disposals of fixed tangible or intangible assets.

(***) Croatia joined the EU in 2013.

Source: European Court of Auditors based on information from the Commission. Eurostat data on Gross Fixed Capital Formation (Investments).

([31]) GFCF is often considered by economists to be an important indicator of longer-term economic growth and productivity.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Overall reporting on spending on migration and the refugee crisis needs to be more coherent and comprehensive

2.27. A key financial management challenge in 2016 was mobilising resources to deal with the refugee crisis and the integration of migrants, including emergency support within the EU. The EU's financial response has involved increasing funding in some existing areas, setting up new funding instruments and encouraging additional contributions from third parties ([32]).

2.28. The overall amount of funds mobilised for the refugee and migration crisis was not reported by the Commission in 2016 and is difficult to estimate. As in many cases, these funds make up only part of the allocated budgetary appropriations in the policy areas concerned. Although the Commission reports on each individual instrument, in order to be able to report the overall figure it would need to establish a specific reporting structure.

2.28. *As interventions on the refugee and migration crisis can take different forms over time, it is difficult to define this topic exhaustively beforehand and the underlying content and implicit definition of the information presented might vary over time. The Commission requires the OECD to adapt its DAC codes in order to have a commonly accepted definition of migration.*

The Commission will analyse possible consolidation of its existing reporting in order to produce comprehensive information on refugee and migration expenditure.

([32]) Measures taken so far included:
- establishing the refugee facility for Turkey (FRT); setting up an emergency trust fund for the Central African Republic (EUTF Bêkou);
- reinforcing the trust fund for Syria (EUTF Madad);
- increasing funding to the Asylum, Migration and Integration Fund (AMIF) and the Internal Security Fund (ISF);
- transferring funds to a new budget line for providing emergency support within the EU and
- reinforcing the budgets of relevant agencies, FRONTEX, EUROPOL, the European Asylum Support Office and the European Migrant Smuggling Centre.

THE COURT'S OBSERVATIONS

EU funding arrangements continue to increase in complexity

2.29. The EU budget has evolved greatly over the years, and a number of other mechanisms for funding EU policies have been added. This development has been driven by the need to find additional funds to respond to new challenges, such as the financial crisis, climate action, migration and refugees, and to use available funds more efficiently and innovatively, such as for loans, guarantees and *equity investment*.

2.30. As a result, the number of entities and instruments involved in financing the implementation of EU policies has increased considerably, creating a complex web of arrangements around the EU budget (see ***Box 2.8***).

2.31. The EU budget is a single mechanism subject to specific rules. This helps to provide accountability and transparency to our stakeholders, including the European Parliament and the Council. The increasing use of other financial mechanisms to deliver EU policies alongside the EU budget risks undermining this level of accountability and transparency, as reporting, audit and public scrutiny arrangements are not aligned. For example we audit and report on only some of the financial mechanisms, which limits public scrutiny. In our view, the current arrangements make it difficult to manage, audit, scrutinise and report effectively and to provide an adequate overview of the cost and benefits of the EU for citizens.

THE COMMISSION'S REPLIES

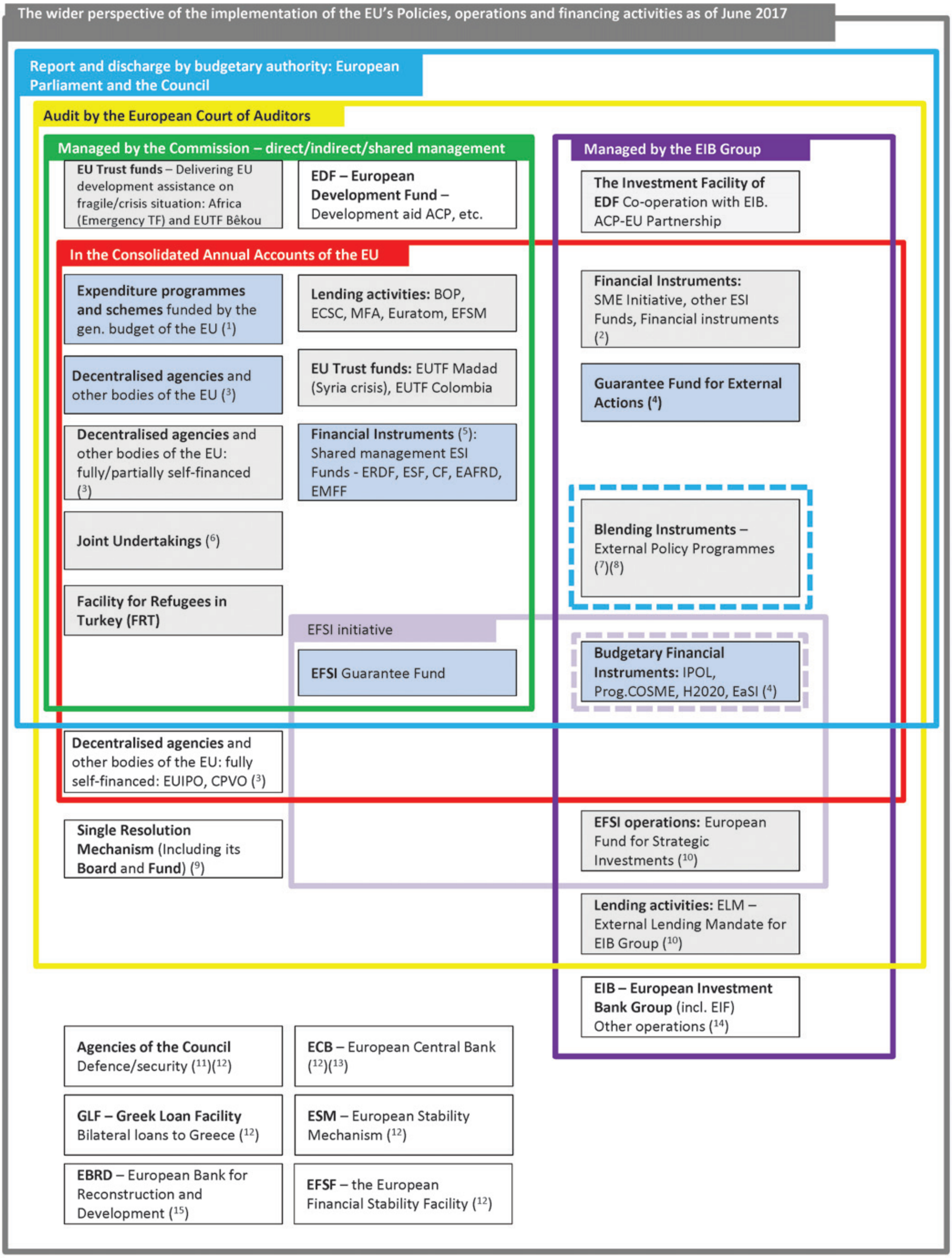
2.29-2.31.

The current EU financial architecture has made it possible to mobilise funds for new priorities and to do more with less. The EU budget is not the only tool to finance the EU policies. However, the EU accounts include all instruments and consolidate all agencies with an impact on the EU budget. The EU accounts are audited by the ECA. Some mechanisms were created to respond to the Euro area crisis and are of an inter-governmental nature. For this reason, they are outside the framework of the EU budget. Other instruments such as EFSI and the European Investment Fund complement the more traditional delivery mechanisms of the EU budget, enhancing its outreach and leverage effect.

Concerning the new financial mechanisms, all bodies managing them provide yearly accountability reports and an opinion by an external auditor. Moreover, for reasons of accountability and transparency, specific reports such as on financial instruments, trust funds and the Facility for Refugees in Turkey are also provided.

The Commission adopted a reflection paper on the future of the EU finances, in which the current EU financial architecture is explained. This subject will be a key element of the next MFF.

Box 2.8 — Entities and instruments involved in financing and implementation of EU policies



Legend:

	The wider perspective of the implementation of the EU's Policies, operations and financing activities as of June 2017
	Report and *discharge* by budgetary authority: European Parliament and the Council
	To some extent report and discharge by budgetary authority: EP and Council
	Audit by the European Court of Auditors
	Managed by the Commission — direct/shared management
	Managed by the EIB Group
	EFSI initiative
	To some extent EFSI initiative
	In the Consolidated Annual Accounts of the EU

Fund sources indicated by the colour of the boxes:

Financed by the general budget of the EU

Partially financed and/or guaranteed by the general budget of the EU

Not financed by the general budget of the EU

Footnotes:

(1) Including legal commitments not yet covered by budgetary commitments appropriations: Connecting Europe Facility (CEF), Copernicus, ITER, Galileo, fishery agreements and others.

(2) SME Initiative managed by the EIB on behalf of the Member States by shared management with the Commission; other financial instruments managed by the EIB on behalf of the Commission as an entrusted entity.

(3) Governing/management board with members from each Member State as decision-making body.

(4) Managed by the EIB on behalf of the Commission as an entrusted entity.

(5) Funds and operations are implemented by the Member States.

(6) Governing/Management board with members from Member States and other stakeholders as decision-making body. Not all Member States are represented in every Board.

(7) Only the part of the Blending Instruments funded by the General Budget of the EU is discharged by the budgetary authorities.

(8) Development Cooperation Instruments (DCI): Neighbourhood Investment Facility (NIF); Investment Facility for Central Asia (IFCA) and Asian Investment Facility (AIF); Latin America Investment Facility (LAIF).

(9) Financed by commercial banks. Management Board consists of members from each Member State.

(10) Only operations guaranteed by the general budget of the EU are audited by the ECA.

(11) Budget implementation report sent to Council — Discharge by the agencies' management boards. The Commission may participate on behalf of the EU in the agencies' projects. The Member States of each agency provides funding. The High Representative of the Union for Foreign Affairs and Security Policies is responsible for the agencies' overall organisation and functioning.

(12) Intergovernmental entity.

(13) The ECA's audit powers are limited to examining the operational efficiency of the ECB's management.

(14) Only the EU mandate of the EIB is audited by the European Court of Auditors. EIF is a part of the EIB Group.

(15) Shareholders are EU Member States, other countries, the EU and the EIB.

Acronyms and abbreviation used

ACP-EU	The Countries of Africa, the Caribbean and the Pacific and European Union Partnership	EMFF	European Maritime and Fisheries Fund
Approp.	Appropriations	EP	European Parliament
BOP	Balance of payments	ERDF	European Regional Development Fund
CF	Cohesion Fund	ESF	European Social Fund
Copernicus	The European Earth Observation Programme	ESIF	European Structural and Investment Fund
COSME	Competitiveness of enterprises and SMEs (COSME)	ESM	European Stability Mechanism
CPVO	Community Plant Variety Office	EUIPO	European Union Intellectual Property Office
EAFRD	European Agricultural Fund for Rural Development	EUTF Bêkou	Emergency Trust Fund for the Central African Republic
EaSI	The Employment and Social Innovation (EaSI) programme	EUTF Colombia	Trust Fund for Colombia
EBRD	European Bank for the Reconstruction and Development	EUTF Madad	EU Regional Trust Fund in Response to the Syrian Crisis
ECB	European Central Bank	FRT	Facility for Refugees in Turkey
ECSC	European Coal and Steel Community	Galileo	The European Union's Global Satellite Navigation System (GNSS)
EDF	European Development Fund	GLF	Greek Loan Facility
EFSF	European Financial Stability Facility	H2020	Horizon 2020 EU Research and Innovation
EFSI	European Fund for Strategic Investments	IPOL	Internal Policies
EFSM	European Financial Stabilisation Mechanism	ITER	International Thermonuclear Experimental Reactor (agreement and organisation)
EIB	European Investment Bank	MFA	Macro-financial assistance
EIF	European Investment Fund	Prog.	Programme
ELM	External Lending Mandate	SME Initiative	Small and medium-sized enterprise initiative

Source: European Court of Auditors.

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RISKS AND CHALLENGES FOR THE FUTURE

Avoiding another backlog of unpaid claims

2.32. There is a risk that a backlog of unpaid claims similar to the one in 2013-2015 may be created in the final years of the current MFF and the early years of the next. This is because the payment appropriations approved under the current MFF may not be adequate to pay all claims submitted for payment until 2020 ([33]).

2.32. *The risk of backlog does not only depend on the available MFF ceilings but also on the amounts granted by Council and Parliament in the annual budgets, and on the actual payment profile of the programmes. The Global Margin for Payments available in this MFF should ensure that the full payment ceiling is available.*

2.33. The Commission concluded in its forecast to the end of 2020 in the mid-term review ([34]) that 'the overall payments ceilings of the 2014-2020 MFF should be just sufficient, avoiding any new abnormal backlog of unpaid claims at the end of the period.' However, this was conditional upon special instruments being counted over and above the MFF ceilings and the removal of the maximum amounts for the use of the global margin for payments in 2018-2020 set out in the MFF regulation. Following the revision of the MFF regulation ([35]), it is not certain whether special instruments will in fact be counted over and above the ceilings (see paragraph 2.8(b)), and maximum amounts on the global margin for payments remain (see paragraph 2.8(a)). Moreover, a higher than anticipated amount of payment claims may be submitted by Member States.

2.33. *The Commission always proposes to count the payments for special instruments over and above the ceilings. However, the final decision will be taken by the Budgetary Authority on a case-by-case basis in line with the statement attached to the mid-term revision of the MFF. As regards the use of the Global Margin of Payments, more flexibility for the remaining years of the 2014-2020 MFF is provided in the mid-term revision for the MFF.*

([33]) See paragraphs 1.46 and 1.52 of our 2012 annual report.

([34]) Conclusions to Annex 6 of document SWD(2016)299 final.

([35]) Council Regulation (EU, Euratom) 2017/1123 (OJ L 163, 24.6.2017, p. 1).

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Financing the new MFF

2.34. If existing trends continue [36], we project that outstanding commitments (see ***Box 2.9***) will reach a record 262 billion euro by 2020, which is close to the Commission's projection in the mid-term review [37].

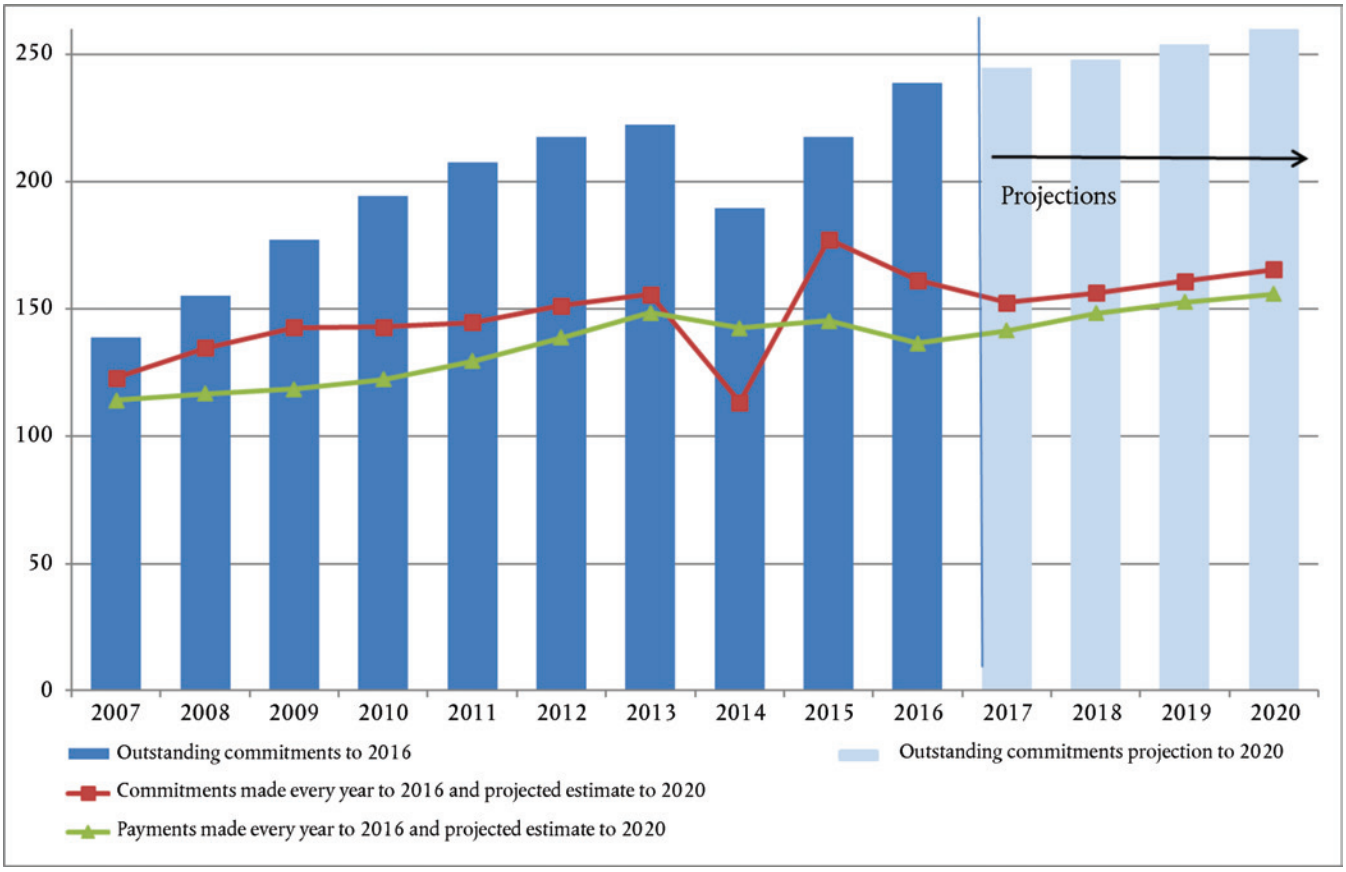
2.35. These outstanding commitments will need to be paid off using payment appropriations from the next MFF, mainly during the first three years of the next MFF.

(36) Based on existing results at end 2016 and on the MFF, including the 2017 technical adjustment, we have made the conservative assumption that 98 % of commitments appropriations will be converted to commitments. We have taken the estimate of decommitments calculated by the Commission in the mid-term review, and we have assumed that 99 % of payment appropriations will become payments excluding payments related to special instruments as per the Commission's assumption. Assigned revenue and carryovers have not been included in the 2017-2020 projections due to the difficulty in calculating them and their minimal impact on the projections.

(37) Annex 6 to document SWD(2016)299 final gives a figure of 254 billion euro. Our projection is based on an estimated use of 648,1 billion euro of commitment appropriations and 604,3 billion euro payment appropriations available in the MFF for the years 2017-2020 (based on the 2017 technical adjustment).

Box 2.9 — Commitments and payments projections to the end of the MFF in 2020

(billion euro)



Source: For financial years 2007-2016: Consolidated annual accounts of the European Union; for projections on financial years 2017-2020: MFF Regulation and 2017 technical adjustment.

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2.36. Clearing this increase in outstanding commitments, and thus addressing the additional exposure and the risk of backlogs being created, could be achieved by including sufficient additional payment appropriations over and above those required to cover new programmes of the next MFF and/or reducing commitment appropriations for new programmes under the next MFF to leave enough payment appropriations to cover these outstanding commitments.

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2.37. This would be preferable to using any delays in the implementation of programmes under the new MFF to generate enough payment appropriations to cover the outstanding commitments, as happened unintentionally in the early years of the current MFF, since this would simply postpone the problem again.

2.38. Article 323 of the TFEU provides that the '… European Parliament, the Council and the Commission shall ensure that the financial means are made available to allow the Union to fulfil its legal obligations in respect of third parties'. The Own Resources Decision of the Council ([38]) requires that 'an orderly ratio between appropriations for commitments and appropriations for payments shall be maintained to guarantee their compatibility …'.

2.39. The Commission will have the opportunity to address this issue when presenting its proposals for the new MFF ([39]) on the basis of a forecast for spending needs in the period after 2020 ([40]), as recommended in our annual reports in recent years ([41]).

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

2.40. The delays in the implementation of programmes in the first three years of the current MFF led to the transfer of commitment appropriations from 2014, mainly to 2015 and 2016, and low payments in 2016 (paragraphs 2.4 to 2.10).

2.41. Special instruments and margins were used extensively, but the amounts left may not be sufficient to fund unexpected events that may still occur before 2020 (paragraphs 2.8 to 2.10).

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2.41. *More flexibility for the remaining years of the 2014-2020 MFF is provided in the mid-term revision for the MFF.*

([38]) Article 3(2), second subparagraph of Decision 2014/335/EU, Euratom.

([39]) Article 25 of the MFF Regulation.

([40]) Article 9 of the Interinstitutional Agreement of 2 December 2013, between the European Parliament, the Council and the Commission on budgetary discipline, on cooperation in budgetary matters and on *sound financial management*.

([41]) See paragraph 2.47, Recommendation 2 of our 2015 annual report.

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2.42. A record level of outstanding commitments has been created, 72 % higher than in 2007. This has increased the amounts owed by the EU and thus the financial exposure of the EU budget (paragraphs 2.11 to 2.14). The overall financial exposure of the EU budget has grown, with significant long-term liabilities, guarantees and legal obligations (paragraphs 2.15 to 2.20) implying that careful management needs to be applied in the future.

2.42. *There is and will be a close monitoring of the outstanding commitments in the current and future MFFs.*

2.43. The EU is making increasing use of financial instruments. The establishment of EFSI creates new governance arrangements with more limited public scrutiny than for other instruments supported by the EU budget (paragraphs 2.21 to 2.23).

2.43. *The Commission considers that it has shown all related information in the 2016 financial statements and disclosure notes in a comprehensive, clear and transparent manner and that the EFSI is subject to appropriate public scrutiny.*

2.44. EU funds form a significant share of some Member States' expenditure, and the volume of funds and timing of their receipt can have a considerable macro-economic impact such as on investment, growth and jobs (paragraphs 2.24 to 2.26).

2.45. The Commission mobilised various resources to deal with the refugee and migration crisis, but it did not establish a reporting structure to enable it to report comprehensively on the use of the funds involved (paragraphs 2.27 and 2.28).

2.45. *As interventions on the refugee and migration crisis can take different forms over time, it is difficult to define this topic exhaustively beforehand and the underlying content and implicit definition of the information presented might vary over time. The Commission requires the OECD to adapt its DAC codes in order to have a commonly accepted definition of migration.*

The Commission will analyse possible consolidation of its existing reporting in order to produce comprehensive information on refugee and migration expenditure.

2.46. The mechanisms for funding EU policies have become increasingly complex, which risks weakening accountability and transparency (paragraphs 2.29 to 2.31).

2.46. *The Commission adopted a reflection paper on the future of the EU finances, in which the current EU financial architecture is explained. This subject will be a key element of the next MFF.*

2.47. A backlog of payments may develop towards the end of the current MFF and in the first few years of the next MFF, and financing the new MFF will require realistic budgetary appropriations to cover projected outstanding commitments (paragraphs 2.32 to 2.39).

2.47. *The functioning of the Global Margin for Payments should prevent a new abnormal backlog at the end of the MFF.*

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Recommendations

2.48. We recommend that the Commission:

— **Recommendation 1:** take into account the growth in outstanding commitments in its forecast of payment appropriations for the next MFF in order to help ensure an orderly balance between commitment and payment appropriations.

— **Recommendation 2:** together with the European Parliament and the Council, ensure a consistent approach to the issue of whether or not special instruments are counted within the ceilings for payment appropriations in the MFF.

— **Recommendation 3:** for management and reporting purposes, establish a way of recording EU budgetary expenditure that will make it possible to report on all funding related to the refugee and migration crisis.

— **Recommendation 4:** invite the European Parliament and the Council, in the context of the debate on the future of Europe, to consider how the EU budgetary system could be reformed to provide a better balance between predictability and the responsiveness as well as how best to ensure overall funding arrangements are no more complex than necessary to meet EU policy objectives and guarantee accountability, transparency and auditability.

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The Commission accepts this recommendation.

The Commission will ensure in its proposals an orderly balance between commitments and payments. However, the Commission notes that the final decisions are made by the co-legislators.

The Commission partially accepts the recommendation.

The Commission always proposes to count the payments for special instruments over and above the ceilings. However, the final decision will be taken by the budgetary authority on a case-by-case basis.

The Commission accepts the recommendation.

The Commission will analyse possible consolidation of its existing reporting in order to produce comprehensive information on refugee and migration expenditure.

The Commission accepts the recommendation.

The White Paper on the Future of Europe in 2025 launched an overall debate and reflection process preceding the next MFF preparations. In this context, the Commission adopted a reflection paper on the future of EU finances in June 2017. The EU financial architecture and other issues such as duration, flexibility and predictability will form part of the overall reflection process to prepare the next MFF.

CHAPTER 3

Getting results from the EU budget

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THE COMMISSION'S REPLIES

INTRODUCTION

3.1. Each year, in this chapter, we analyse a number of aspects relating to performance: the *results* achieved by the EU budget, which is implemented by the Commission in cooperation with the Member States [1]. This year we have looked specifically at:

(i) the *performance* reporting framework applied by the Commission,

(ii) significant results from our 2016 special reports on performance,

(iii) the Commission's implementation of our recommendations in a selection of earlier special reports.

PART 1 — PERFORMANCE REPORTING: HOW DOES THE COMMISSION'S APPROACH COMPARE WITH GOOD PRACTICE?

3.2. Most large and complex organisations have procedures for performance measurement and reporting to provide an indication of the success of operations and highlight where improvements should be made. In paragraphs 3.3-3.12, we provide an overview of the performance reporting framework. In paragraphs 3.13-3.51, we compare it with standards and good practices applied elsewhere.

Section 1 — The performance reporting framework

3.3. The Commission has introduced several changes in this area in recent years — notably by heading up the 'budget focused on results' (BFOR) initiative [2]. Performance reporting is at the heart of the initiative, which aims to find ways of improving the openness, timeliness and efficiency of communication about the results of the EU budget.

3.3. *The performance of the EU budget and related reporting have been reinforced in the current Multi-Annual Financial Framework (MFF). Since the launch of the EU Budget Focused on Results initiative, the Commission has significantly enhanced and streamlined its performance reporting. For example, the Commission produced for the first time in 2016 an Integrated Financial Reporting Package providing detailed information on revenue, expenditure, management and performance of the EU budget in line with the best practices in the fields of transparency and accountability.*

(1) Article 317 TFEU.

(2) The initiative is structured around four key questions: 'Where do we spend? How do we spend? How are we assessed? How do we communicate?' http://ec.europa.eu/budget/budget4results/index_en.cfm

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3.4. ***Box 3.1*** gives an overview of the performance reporting framework. It reflects the distinction made by the Commission between its own performance and that of the EU budget. In this section we describe the main reports shown in the box.

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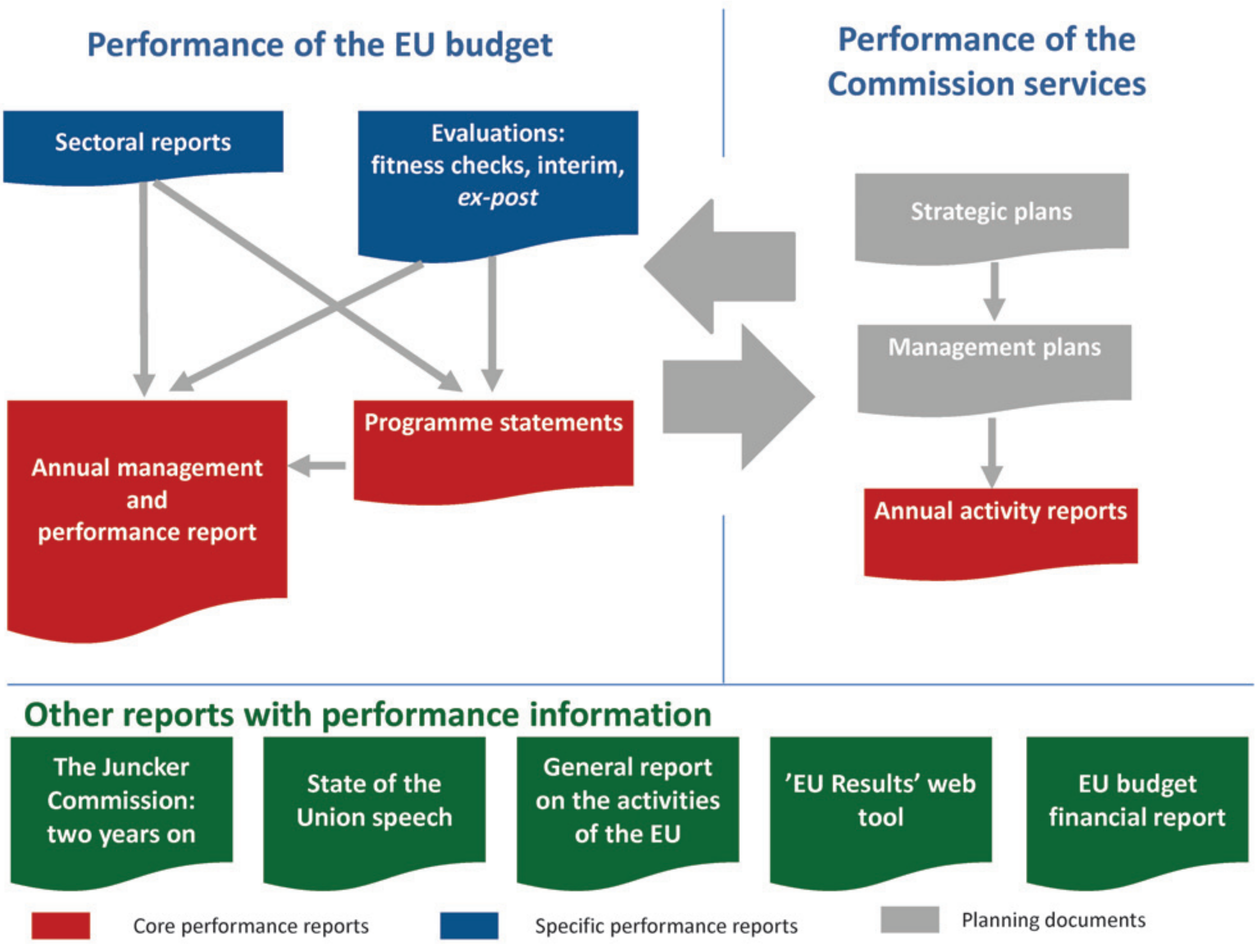
3.4. *At corporate level, the performance reporting of the EU budget encompasses two key reports: the programme statements and the Annual Management and Performance Report. The programme statements accompanying the draft budget are the instrument through which the Commission justifies the allocations of financial resources to the budgetary authority and enables it to take performance information into account. The Annual Management and Performance Report provides to the discharge authorities a high level summary of how the EU budget has supported the European Union's political priorities and of the results achieved with the EU budget, and reports on the Commission's management of the budget.*

Box 3.1 — The performance reporting framework applied by the Commission



Source: ECA, based on Commission information.

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A. *Programme statements*

3.5. The *Financial Regulation* requires the Commission to prepare 'programme statements' [3] to justify the funding requested for EU programmes in the draft budget. For each programme, the statements include an update on implementation, together with key financial and performance information [4], using indicators that will apply throughout the seven-year *multiannual financial framework* (see ***Box 3.2***). This approach enables the budgetary authority to take performance into account during the budgetary procedure.

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3.5. *The box relates to the 2017 programme statements published in June 2016. They include more than 700 indicators used to monitor the performance of the programmes during their life-cycle. Hence, for a certain number of indicators, data was not yet available. In the 2018 programme statements [1], data is available in relation to more than 80 % of the indicators, which represents an increase of more than 20 % compared to the previous year. Performance data will continue to increase with the implementation of the programmes co-financed by the EU budget.*

Box 3.2 — 2017 Programme statements: objectives and indicators

	Number of general objectives	**Number of specific objectives**	**Number of indicators used**	**Indicators removed for lack of data**	**2016 Payment Budget *(billion euro)***	**Number of indicators per billion euro**
Heading 1a — Competitiveness for growth and jobs	25	90	154	93	17,4	14
Heading 1b — Economic, social and territorial cohesion	3	21	8	76	48,8	2
Heading 2 — Sustainable growth: natural resources	6	28	29	69	55,1	2
Heading 3 — Security and citizenship	13	48	148	28	3,0	59
Heading 4 — Global Europe	14	44	97	5	10,2	10
Special instruments	0	2	2	0	0,4	5
GRAND TOTAL	**61**	**233**	**438**	**271**	**134,9**	**5**
	294 objectives		**709 indicators**			

Source: ECA, based on 'Draft general budget of the European Union for the financial year 2017 — Programme statements of operational expenditure' (COM(2016) 300 — June 2016).

(3) Article 38(3)(e). Until the end of 2017, the Financial Regulation uses the term 'activity statement'.

(4) As of 2017, the structure and content of the statements was modified. This description reflects the modified statements.

(1) *http://ec.europa.eu/budget/library/biblio/documents/2018/DB2018_WD01_en.pdf*

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B. *Sectoral reports*

3.6. In some areas of spending, the TFEU, the Financial Regulation or sector-specific rules require the Commission to prepare sectoral reports. Since the aim, structure and content of these reports vary according to the different requirements, their focus on performance aspects also varies. Some sectoral reports provide wide-ranging, quantified performance information. The Commission monitors some sector-specific performance data online and frequently updates information.

C. *Strategic plans, management plans and annual activity reports*

3.7. Commission directorates-general (DGs) have prepared multiannual (2016-2020) 'strategic plans', which set goals giving medium-term direction to operational activities. In 'management plans', DGs break down their multiannual strategy and objectives into annual *outputs*, actions and interventions. Each DG's *annual activity report* (AAR) contains results by reference to the objectives set and an assessment of the extent to which operational expenditure has contributed to policy achievements ([5]). The AARs also include financial and management information, such as the results of checks on legality and *regularity*.

D. *Evaluations*

3.8. In its Better Regulation Guidelines (BRGs) ([6]), the Commission defines an *evaluation* as an evidence-based judgment of the extent to which an intervention is:

— effective and efficient,

— relevant given the needs and its objectives,

— coherent both internally and with other EU policy interventions, and

— achieving EU added value.

([5]) Article 66(9) of the Financial Regulation.
([6]) Commission Staff Working Document, Better Regulation Guidelines, SWD(2015)111 final, 19.5.2015, p. 49.

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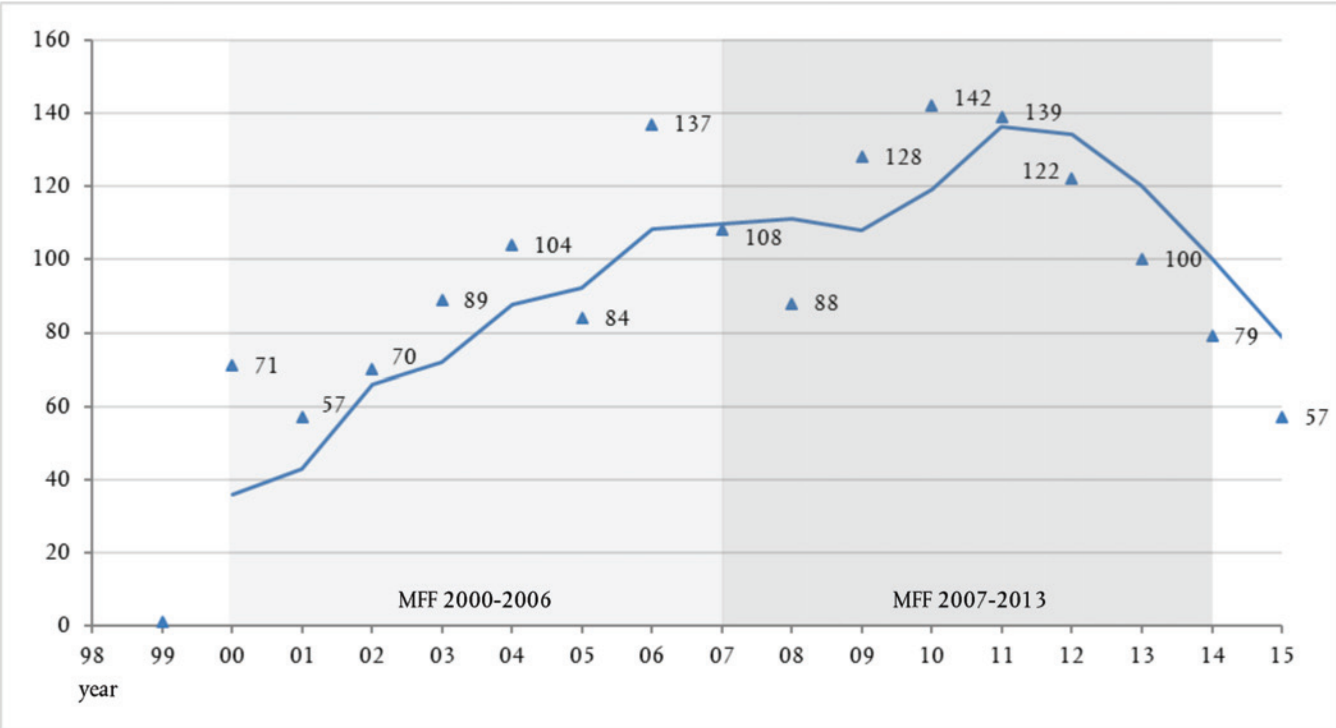
3.9. The BRGs commit the Commission to evaluating, in a proportionate way, all EU spending and non-spending activities intended to have a social or economic *impact*. Each DG is responsible for evaluating its own activities. Evaluations may be fully centralised in a horizontal unit, fully delegated to operational units or, in a hybrid model, decentralised for operational management purposes but supported by a central evaluation unit.

3.10. Until the end of 2015, the Commission maintained an evaluations database ([7]) with records of nearly 1 600 evaluations carried out between 1999 and 2015, an average of 100 each year (see ***Box 3.3***). The total cost of evaluations in 2016 was more than 60 million euro (210 million euro if studies ([8]) are included). The Commission has since discontinued the public evaluations database and introduced a 'studies database'. According to the Commission, the main purpose of the latter is to allow evaluation findings to be shared between the different EU institutions, whereas the public platform for sharing all evaluations and study information is the EU Bookshop.

Box 3.3 — Number of evaluations at the Commission between 2000 and 2015 (three-year rolling average line and annual figures)



Source: Commission's evaluations database (2000-2015).

([7]) http://ec.europa.eu/smart-regulation/evaluation/search/search.do

([8]) According to the BRGs, the requirement to provide judgements can be a critical factor distinguishing an evaluation from a study.

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E. *Annual management and performance report (AMPR)*

3.11. The AMPR constitutes a response to the requirements in both Article 318 TFEU (for a results-based evaluation of the EU's finances) and Article 66(9) of the Financial Regulation (for a summary of annual activity reports). By combining two previously separate reports, the Commission aimed to produce a single document for the *discharge* authority covering both the management of the EU budget and its evaluation of the results obtained.

F. *Other reports with performance information*

3.12. There are other Commission reports, both regular and occasional, that include information on objectives and performance indicators, as well as project benefits or achievements.

(i) The annual general report on the activities of the European Union ([9]), published in March, gives details of the previous year's major events, initiatives and decisions grouped by the Commission's ten priorities.

(ii) The annual EU budget financial report ([10]), published in July as part of the Commission's integrated financial reporting package, deals with budgetary management in the previous year.

(iii) 'The Juncker Commission two years on' ([11]) was a set of presentations published in November 2016 to provide an overview of the progress made on the Commission's ten priorities in the two years since it took office.

(iv) The President's annual 'State of the Union' ([12]) speech to the European Parliament in September, for which supporting documents are published.

(v) The 'EU Results' web tool ([13]), an online collection of EU-funded projects, each with a statement of results and, sometimes, numerical data.

THE COMMISSION'S REPLIES

3.11. *With the publication of the 2015 Annual Management and Performance Report, the Commission has continued to streamline and enhance the performance reporting for the EU budget. The 2016 Annual Management and Performance Report represents further progress in this regard.*

([9]) https://ec.europa.eu/commission/news/eu-2016-general-report-activities-european-union_en

([10]) http://ec.europa.eu/budget/financialreport/2015/foreword/index_en.html

([11]) http://europa.eu/rapid/press-release_AC-16-3892_en.htm?locale=FR

([12]) https://ec.europa.eu/commission/state-union-2016_en

([13]) https://ec.europa.eu/budget/euprojects/search-projects_en

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Section 2 — Comparison with good performance reporting practices elsewhere

A. *Introduction*

3.13. To identify good practices in performance reporting we:

(i) consulted relevant international standards, such as IPSASB Recommended Practice Guideline 3 — 'Reporting Service Performance Information' ([14]);

(ii) carried out a survey on performance reporting; in addition to a comprehensive reply from the Commission, we considered 17 replies from EU Member States, other national governments and other international organisations;

(iii) reviewed publicly available performance information for a selection of 14 governments and international organisations ([15]);

(iv) examined the assessment reports issued by the Multilateral Organisation Performance Assessment Network (MOPAN) ([16]) between 2011 and 2016; these always included elements of organisations' performance reporting.

3.14. While there are important differences between the EU and other international organisations and governments, the latter also have to comply with legal requirements and are subject to specific operating constraints. Other international organisations are no less exposed to complications in establishing a link between their actions and ultimate impact/performance. We identified six areas (B to G below) in which the good practices we observed could help the Commission to further develop its performance reporting.

3.14. *As part of the EU Budget Focused on Results initiative, the Commission has launched a dialogue on performance frameworks with relevant experts from national administrations and other international organisations, including the OECD, in order to gather lessons learned and identify good practices. Representatives from the European Parliament and the Council have also participated in this dialogue, which has covered a broad range of issues, e.g. performance, evaluation and EU Added Value. The discussions have clarified that a performance framework should develop gradually and that it cannot be based on a 'one-size-fits-all' approach. The Commission is continuing this dialogue with experts and stakeholders and will take the results into account when preparing the performance framework for the next MFF.*

([14]) Issued by the International Public Sector Accounting Standards Board (IPSASB) in March 2015.

([15]) Governments: Australia, Canada, France, the Netherlands, the UK and the USA. Other international organisations: the Council of Europe, the Food and Agriculture Organisation of the United Nations (FAO); the International Committee of the Red Cross (ICRC); the OECD; UNESCO; the UN General Secretariat; the World Bank and the World Health Organisation (WHO).

([16]) MOPAN is a network of like-minded donor countries for monitoring the performance of multilateral development organisations at country level. See http://www.mopanonline.org/

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B. *Scope for improving the performance framework*

(a) **The Commission uses two sets of objectives and indicators to measure the performance, respectively, of its services and of spending programmes**

Good practices

3.15. In Australia, government departments produce three core documents as part of the performance framework: portfolio budget statements quantifying programme budgets, corporate plans setting out the purposes and activities of public entities, and annual reports with feedback on results. Entities must ensure coherence (a 'clear read') between these documents ([17]). The performance criteria in each document must be reported collectively in a single annual performance statement (placed in annual reports at the end of the financial year).

3.16. In France, the state budget is subdivided into 'missions'. Each of the 31 missions in the budget comprises several programmes (118 in 2017). Each programme has a strategy, objectives and quantified performance indicators, and the most important indicators are also identified as mission indicators. The use of identical indicators ensures coherence between missions and programmes. The indicators cover both programme performance and the performance of government departments.

3.17. In Canada, all federal organisations receiving budget *appropriations* must plan and manage their operations and report their performance against a set of 16 government-wide outcome areas. This framework establishes a clear, straightforward relationship between financial allocations, programme activities and national outcomes.

([17]) Department of Finance, Resource management guide 131-137 http://www.finance.gov.au/resource-management/performance/

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Situation at the Commission

3.18. Before the start of the 2014-2020 *MFF*, the Commission instructed its services to 'deepen the performance framework' ([18]). To achieve this, it set as an internal rule ([19]) that the new programme objectives and indicators must feature clearly in programme statements, management plans and AARs. This was done for the first time in 2014, enabling the Commission to present a coherent performance narrative: targets for which money was allocated in the budget became part of the planning process in the relevant DG's management plan, and the results were reported in its AAR.

3.19. Since 2016, however, the Commission has no longer applied this approach. Instead, it has created a new planning document, the five-year strategic plan, in which DGs are expected to set new organisational objectives and indicators that are aligned with the priorities of the Commission but are distinct from the objectives and indicators already existing for programmes. AARs now report on the performance framework set in the strategic and management plans and should refer to the programme statements for the results of programmes. However, out of the six 2016 AARs we reviewed, only one used cross-references to the performance reported in programme statements. This hampers comparability between the different types of performance documents and does not reflect the fact that the Commission is ultimately responsible for implementation of the budget with regard to the principles of *sound financial management*.

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3.18. *The Commission's Internal Audit Service (IAS) work also brings additional added-value and scrutiny to the Commission's and the various Directorates-General's (DGs) performance frameworks and measurement systems.*

3.19. *The ECA observed in its 2015 Annual Report that many of the objectives in the Commission's management plans were not set at the right level of accountability. The Commission has since reviewed its Strategic Planning and Programming cycle. The objective was to provide a clearer framework for the Commission's/Directorates-General's accountability and to make the planning documents more streamlined and centred on the priorities of the Commission and the competencies of the Directorate-General. The objectives and indicators selected for the strategic plans are now tailored to their specific competences and reflect the fact that the responsibilities of Commission departments are broader than budget execution and programme management.*

For this reason, aligning objectives and indicators in the performance framework of the Commission services with those defined in the legal bases of programmes is no longer required. However, the Commission services are invited to make reference to programme statements when describing their activities in relation to the programmes. This helps to limit duplication of information and ensure consistency of data and will be reinforced in the future.

The Commission considers that its responsibility for implementing the budget is clear. Each Director-General signs in his/her Annual Activity Report a declaration of assurance stating that the resources have been used for the intended purpose and in accordance with the principle of sound financial management and that the underlying transactions are legal and regular. At corporate level, the College takes overall political responsibility for the management of the EU budget by adopting each year the Annual Management and Performance Report for the EU budget.

([18]) See 2012 synthesis report, COM(2013) 334 final, p. 3.
([19]) See 'Standing Instructions for 2013 annual activity reports', p. 3, and 'Instructions for the 2014 Management Plans', p. 9.

THE COURT'S OBSERVATIONS

3.20. The Commission uses a different reporting breakdown for spending and performance. AARs report on DGs' annual payments by type of activity/spending programme, but on performance by the achievement of general and specific objectives with no indication of the corresponding expenditure. As a consequence, it is not possible to assess how much was spent on pursuing the set objectives. The AMPR similarly does not include information on expenditure relating to the performance of programmes broken down by general and specific objectives.

(b) **The Commission has a large number of objectives and indicators**

Good practices

3.21. In 2016 the OECD carried out a performance budgeting survey in OECD countries and at the Commission. The chart in ***Box 3.4*** compares the existence, use and consequences ([20]) of performance frameworks in the various jurisdictions. The OECD considered the Commission's performance framework to be the most extensive, which may partly be explained by the volume of legal requirements in the EU. However, the OECD chart indicates that the use and consequences of the framework for decision-making do not reflect this higher level of specification.

THE COMMISSION'S REPLIES

3.20. *The Commission considers that the structure of its reporting in the AARs is appropriate to its institutional and organisational context. General and specific objectives cover not only the management of spending programmes but also non-spending activities (such as policymaking or regulatory activities).*

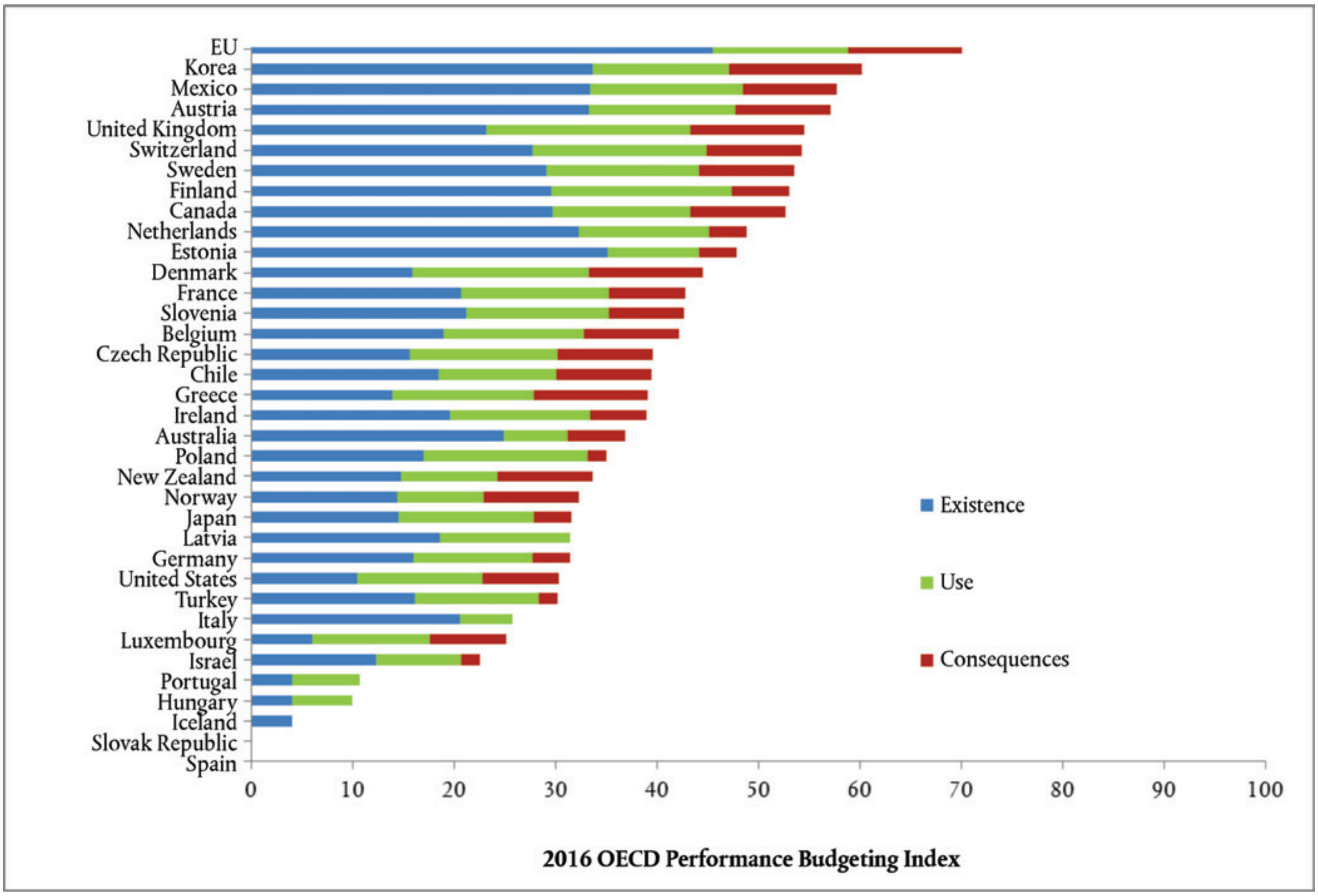
3.21. *The performance framework of the EU budget has been developed both to fulfil the legal requirements and to respond to the demands from stakeholders and the Commission's own needs.*

Performance information on the spending programmes is used by the Commission for (a) monitoring programme progress, (b) accountability and transparency, (c) informing decision-making about the management of a programme; (d) justifying or proposing adjustment of the allocation of funds to the budgetary authorities; (e) developing proposals for changes to the legal basis or for future programmes.

The Commission notes however that while performance information is taken into account during the annual budgetary procedure, it is not the only factor driving budgetary decisions.

([20]) Existence = breadth of performance information available; use = extent to which performance information is used in budgetary decision-making; consequences = impact on management and/or the budget.

Box 3.4 — 2016 OECD Performance budgeting survey results



Source: OECD presentation at the 12th annual meeting of OECD senior budget officials, performance and results network, 25 November 2016.

THE COURT'S OBSERVATIONS

3.22. Some countries have progressively reduced the complexity of their performance framework and the number of objectives and indicators.

(i) In August 2001 the French Parliament passed legislation [21] establishing new rules for preparing and implementing the state budget. Between 2014 and 2017, this involved the Ministry of Economy and Finance reducing the number of objectives and indicators by 20 % and 24 % respectively.

(21) *'Loi organique relative aux lois de finance'*.

THE COURT'S OBSERVATIONS

(ii) In 2012 and 2013, the Netherlands introduced an 'accountable budgeting' reform which set stricter conditions for the government's use of policy information (performance indicators and texts explaining policy objectives). The number of performance indicators in budget documents was halved.

Situation at the Commission

3.23. The programme statements for the EU's 2017 draft general budget contain 294 objectives and 709 indicators (see ***Box 3.2***). They are particularly highly concentrated under MFF headings 1a, 3 and 4. Through the BFOR initiative, the Commission is currently undertaking a review of its indicators to provide *input* for the next generation of spending programmes. ***Box 3.5*** illustrates the progress the Commission could be aiming for, though account should also be taken of certain factors specific to the institution.

THE COMMISSION'S REPLIES

3.23. *More than 700 indicators are included in the legal bases of the 2014-2020 programmes to help monitor their performance during their life-cycle. They are the outcome of the legislative process and therefore reflect the expectations of the co-legislators as regards the type and level of granularity of information required to track performance. Reporting on these indicators in the programme statements enables the budgetary authority to take performance information into account during the budgetary process. Under the EU Budget Focused on Results initiative, the Commission is reviewing the indicators for the spending programmes as established in the legal basis with a view to drawing lessons for the preparation of the next generation of spending programmes.*

The comparison made by the ECA does not take account of key contextual factors such as the number and nature of interventions, policy areas covered or the mode of implementation, nor does it measure the quality or relevance of the indicators.

The Commission also notes that the number of objectives and indicators used in the strategic plans for the Commission services has been reduced significantly with the recent reform. The number of general objectives has been reduced from 84 to 11, of impact indicators from 187 to 37, of specific objectives from 426 to 386, and result indicators from 969 to 825.

Box 3.5 — The EU has more objectives and indicators (per billion euro) than France or the Netherlands

	Objectives per billion euro	Indicators per billion euro
France — Net expenses of the State General Budget	1,0	2,0
Netherlands — State Budget	0,6	2,5
EU — Payment appropriations	2,0	5,0

Source: ECA, based on EU and national budget information.

THE COURT'S OBSERVATIONS

C. *Performance reporting is not exhaustive*

(a) **Performance reporting is not well balanced, as it provides limited information about challenges and failures**

Good practices

3.24. Other governments and international organisations have taken steps to ensure balanced performance reporting as recommended by international standards ([22]).

(i) In the USA, annual performance reports should provide a clear picture of performance results, show trends over time, link to the source of the performance information and discuss progress and shortfalls.

(ii) The WHO 'end of biennium assessment' for 2014-2015 included an 'Overview of major achievements and challenges' for each programme area ([23]). In the foreword to the WHO's main performance report for 2014-2015 ([24]), the Director-General remarked that 'Failures as well as successes are frankly presented'. In line with this, the text systematically described the challenges together with the results.

([22]) See for instance IPSASB Recommended Practice Guideline 3.
([23]) http://extranet.who.int/programmebudget/Biennium2014/Programme/Overview/12
([24]) http://www.who.int/about/finances-accountability/reports/en/

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

(iii) The World Bank assessed [25] the adequacy of its monitoring and evaluation to provide input into the ongoing efforts to enhance its effectiveness and promote a culture for developing solutions and evidence-based decision-making. It identified significant shortcomings in the design and use of its systems.

(iv) MOPAN's 2015-2016 assessment of the Inter-American Development Bank [26] noted a new section in the bank's Development Effectiveness Overview called 'learning from failure'.

Situation at the Commission

3.25. While the 2016 AAR instructions [27] do not explicitly mention the principle of balanced reporting, they do state that 'the executive summary brings together, in a realistic perspective, the main messages as far as policy achievements are concerned and the conclusions on financial management and internal control'.

3.25. *The principle of balanced reporting is further explained in the template for the 2016 Annual Activity Report that accompanied the 2016 Annual Activity Reports instructions [2].*

3.26. Notwithstanding the above, the AARs we reviewed contained limited information on the performance shortfalls and challenges relating to the DGs' objectives. It is also difficult to identify these shortfalls and challenges because no space is specifically set aside for them in the AARs.

3.26. *The template for the 2016 Annual Activity Report that accompanied the 2016 Annual Activity Reports instructions requests the Directorates-General to be exhaustive in reporting on all objectives, indicators and outputs (including those whose results show important deviations from set planned values) announced in their 2016-2020 Strategic Plans and 2016 Management Plans.*

3.27. With the 2015 AMPR, the Commission set out to provide a comprehensive overview of performance based on an EU budget focused on results. However, the AMPR did not provide comprehensive coverage of performance and was overly positive, the only shortfalls to which it refers being implementation delays. The report also:

3.27. *The Annual Management and Performance Report is a high level summary of how the EU budget has supported the European Union's political priorities and the key results that have been achieved with the EU budget. It is not designed to be an exhaustive and detailed report on the performance of the EU budget. The report refers to other performance reports where more detailed performance information can be found (evaluations, programme statements, Annual Activity Reports, etc.).*

(25) Independent Evaluation Group: Behind the mirror — A report on the self-evaluation systems of the World Bank Group (2016).

(26) http://www.mopanonline.org/assessments/iadb2015-16/index.htm

(27) Ref. Ares(2016)6517649 — 21/11/2016.

(2) *'Flexibility is offered to DGs while selecting the key general and specific objectives they want to report on in the narrative of section 1. The performance story should be based on a selection and description of the "key" results (positive or negative) in view of achieving the "key" general and specific objectives. Not all objectives and achievements need to be covered, but only:*
- *those which are of such importance that the reader would expect them to be reported in an AAR (because omission would lead to a distorted opinion as regards the performance of the DG; or because the deviations from the targets are remarkable; or because certain activities attracted major media-attention, …) even if the DG considers that they have no actual impact on assurance, and;*
- *those whose results shown in the performance tables in annex show important deviations from set planned values.'*

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

The 2015 Annual Management and Performance Report refers to a number of shortfalls and problems to be addressed. Section 1 of the report refers not only to challenges affecting the timely implementation of programmes but also to limitations in the assessment of programme performance (e.g. references to the evaluations on the 2007-2013 Health programme and programmes in budget heading 4 pointing to constraints in assessing the overall performance of these programmes).

— provided limited insight into the results of the *Europe 2020 strategy*, whereas this was requested by the European Parliament in its 2014 discharge decision,

— *The Annual Management and Performance Report is not a specific report on Europe 2020* [3]*. Nevertheless, the report includes a summary account of progress on Europe 2020 headline targets and relevant indicators and covers both the state of implementation of the 2014-2020 programmes and the results from the 2007-2013 programmes structured around the Europe 2020 priorities of smart, sustainable and inclusive growth.*

The Commission monitors and reports on the Europe 2020 strategy through the European Semester process. Detailed and comprehensive reporting on Member State performance towards their national Europe 2020 strategy targets is included in the Country Reports as part of the European Semester, as well as in the yearly updates on the Europe 2020 indicators published by Eurostat. The programme statements also provide a link between expenditure and the Europe 2020 strategy. They show the estimated contribution of programmes to the headline targets (theoretical link) and to the Europe 2020 priorities.

— did not always clearly explain the influence of external factors on results,

— *The 2015 Annual Management and Performance Report describes the operating context by referring in the introduction to the major political and economic challenges of the year. It clearly states that the EU budget is only one instrument, used in conjunction with others (i.e. national budgets and other policy and regulatory tools at EU and Member State levels) to deliver policy results and that 80 % of the EU budget is spent with the Member States. The report concludes under its section 1 on performance and results that '…There are limits to the degree to which indicators can capture a precise picture of performance…In addition, contextual factors have an important influence on final results, and indicators cannot eliminate or adjust for these factors' and that 'performance is a shared responsibility: responsibility for delivering on the Europe 2020 strategy as well as on the objectives of the financial frameworks is shared to a large extent with Member States'.*

(3) *The Staff Working Document attached to the Commission's report on the follow-up to the 2014 Discharge sets out the approach for reporting results on the Europe 2020 Strategy.*

THE COURT'S OBSERVATIONS

— was published too late to be reviewed in our annual report [28].

THE COMMISSION'S REPLIES

— *The deadline for adopting the report under the Financial Regulation is 15 June. The Commission relies on financial data from Member States in relation to shared management programmes which only becomes available in the course of March. It is therefore not possible to adopt the report significantly earlier.*

(b) **Limited information on performance data quality affects transparency**

Good practices

3.28. In the Netherlands, the measurement and reporting of indicators is subject to audit. Annual ministerial reports contain a mandatory feedback section on the reliability of performance information.

3.29. In the US, all government agencies publish a 'Fiscal Year Annual Performance Report and Fiscal Year n+2 Annual Performance Plan'. This document describes how the agencies will ensure the accuracy and reliability of the data used to measure progress towards their performance goals.

3.30. In Australia, the 2017 Report on Government Services supports the use of imperfect data for the sake of more comprehensive reporting [29]. To make up for this deficiency, every indicator in the report contains an assessment of the comparability and completeness of the underlying figures.

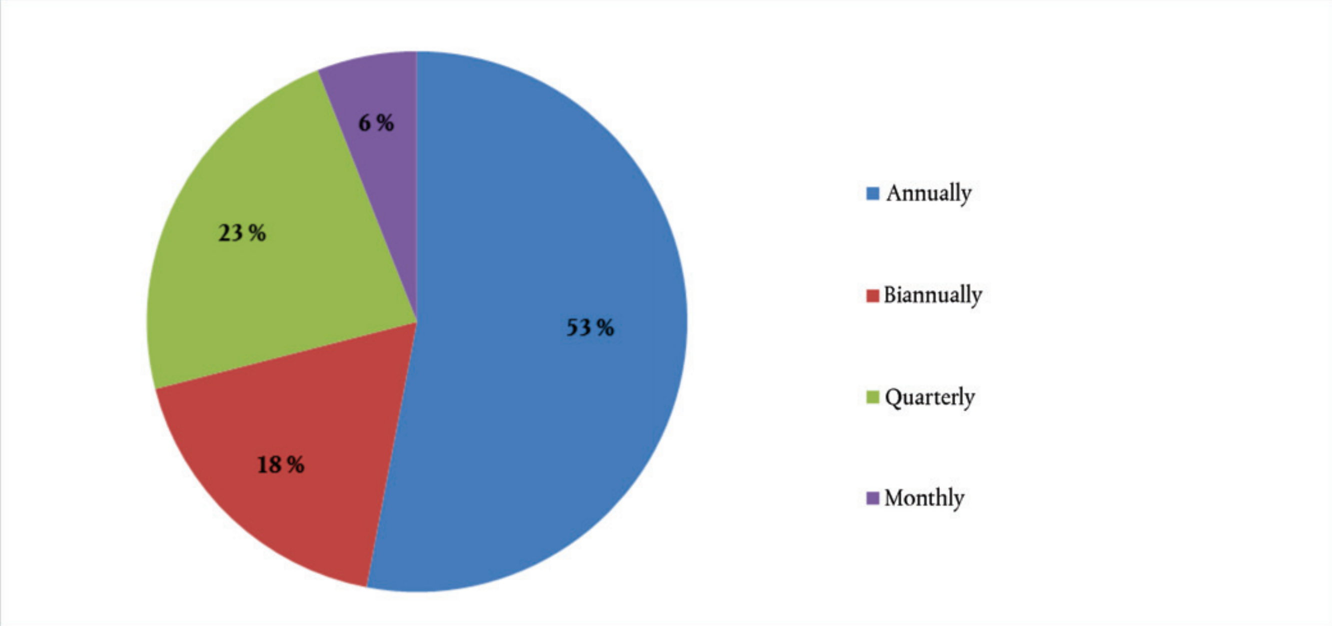
3.31. Another aspect of data quality is timeliness. Recent MOPAN assessment reports have described interesting trends in real-time reporting at the Vaccine Alliance, UNAIDS and the World Bank. Our survey [30] also showed that close to half of the respondents report on performance more frequently than once a year (see ***Box 3.6***).

(28) Opinion No 1/2017 concerning the proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union, paragraph 97.

(29) The approach is explained here: http://www.pc.gov.au/research/ongoing/report-on-government-services/2017/approach/performance-measurement

(30) See paragraph 3.13(ii).

Box 3.6 — Reporting frequency to monitor ongoing performance



Source: ECA, based on survey on performance reporting.

THE COURT'S OBSERVATIONS

Situation at the Commission

3.32. Currently, the Commission's performance documents do not systematically include an assessment on the quality of the data used. Deficiencies in data quality may be revealed, but there is no obligation to do so. Performance reports identify data sources, but they do not have a specific section disclosing matters of data accuracy and reliability. According to the Better Regulation toolbox ([31]), external evaluators can be asked to comment on the quality of data and provide recommendations on how to obtain better data, but this is not a rule.

THE COMMISSION'S REPLIES

3.32. *The Internal Control Framework put in place by each Commission service is designed to provide reasonable assurance with regard to, inter alia, the reliability of financial reporting. Each Directorate-General reports on this aspect under part 2 of its Annual Activity Report, and section 2 of the Annual Management and Performance Report summarises and reports on the assessment by the Directorates-General on the functioning of the internal control systems of the Commission's services.*

As to evaluations, the Better Regulation Toolbox stipulates that evaluation Staff Working Documents prepared by the Commission services at the end of an evaluation must contain a clear summary of any insufficiencies in the data used to support the conclusions and the robustness of the results. Moreover, the Better Regulation Guidelines stipulate that any limitations to the evidence used and the methodology applied, particularly in terms of their ability to support the conclusions, must be clearly explained in the evaluation reports. This is further strengthened in the Better Regulation Guidelines/Toolbox revision (SWD(2017) 350 final of 7 July 2017).

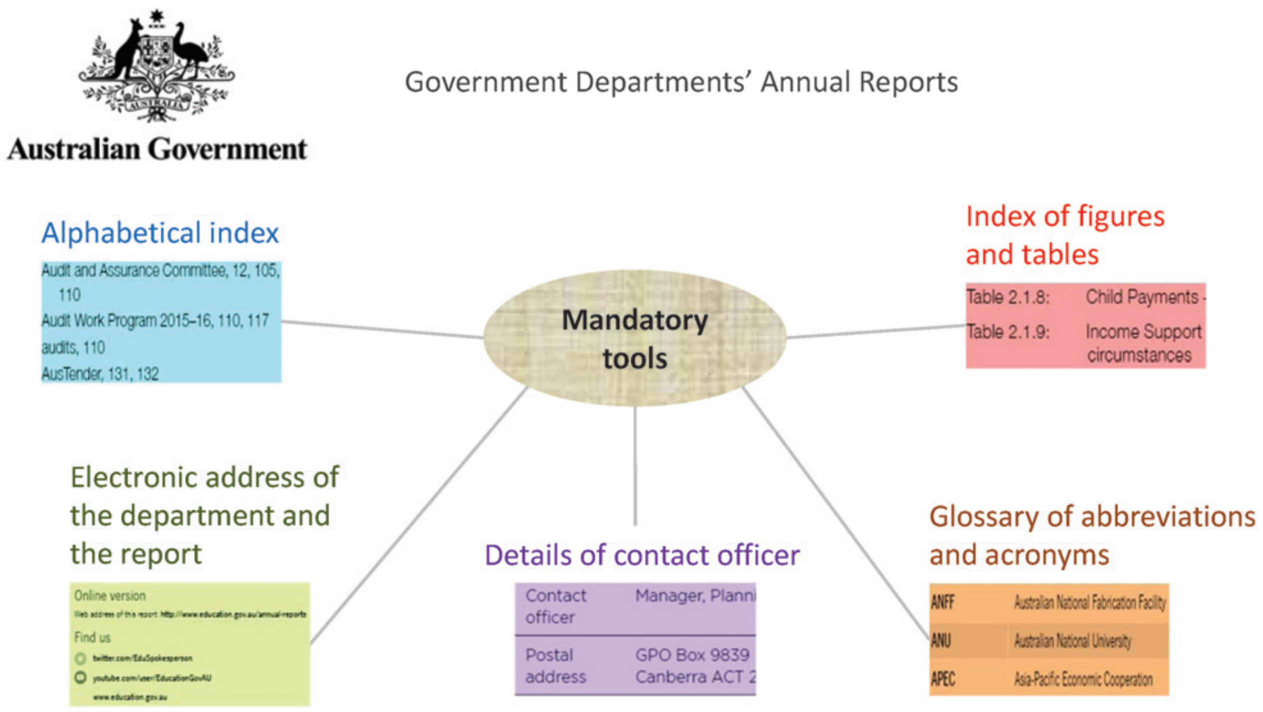
([31]) The toolbox complements the Better Regulation Guidelines, which apply to impact assessments, evaluations and fitness checks. See http://ec.europa.eu/smart-regulation/guidelines/toc_tool_en.htm, p. 287 and p. 290.

D. *Performance reports are rather narrative and could make better use of visual and navigation aids*

Good practices

3.33. Good practices in Australia, in France and at the World Bank are illustrated below.

Box 3.7 — Australia: departmental reports must include tools to help readers navigate

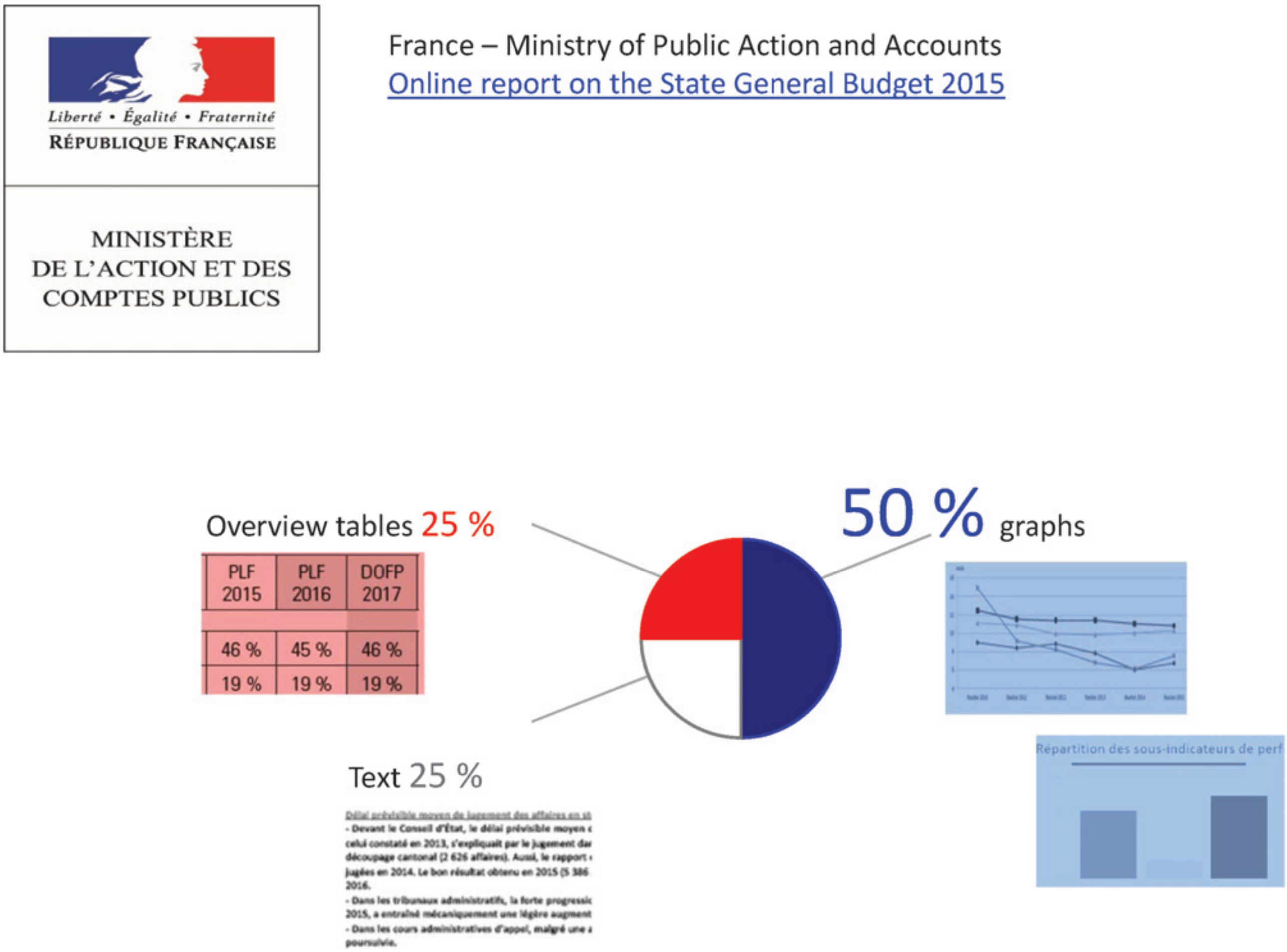


Source Australian Department of Social Services, Annual Report 2015-2016 ([32]) (pp. 253 and 258) and Department of Education and Training, Annual Report 2015-2016 ([33]) (pp. 225 and 238).

([32]) https://www.dss.gov.au/about-the-department/publications-articles/corporate-publications/annual-reports/dss-annual-report-2015-16-0

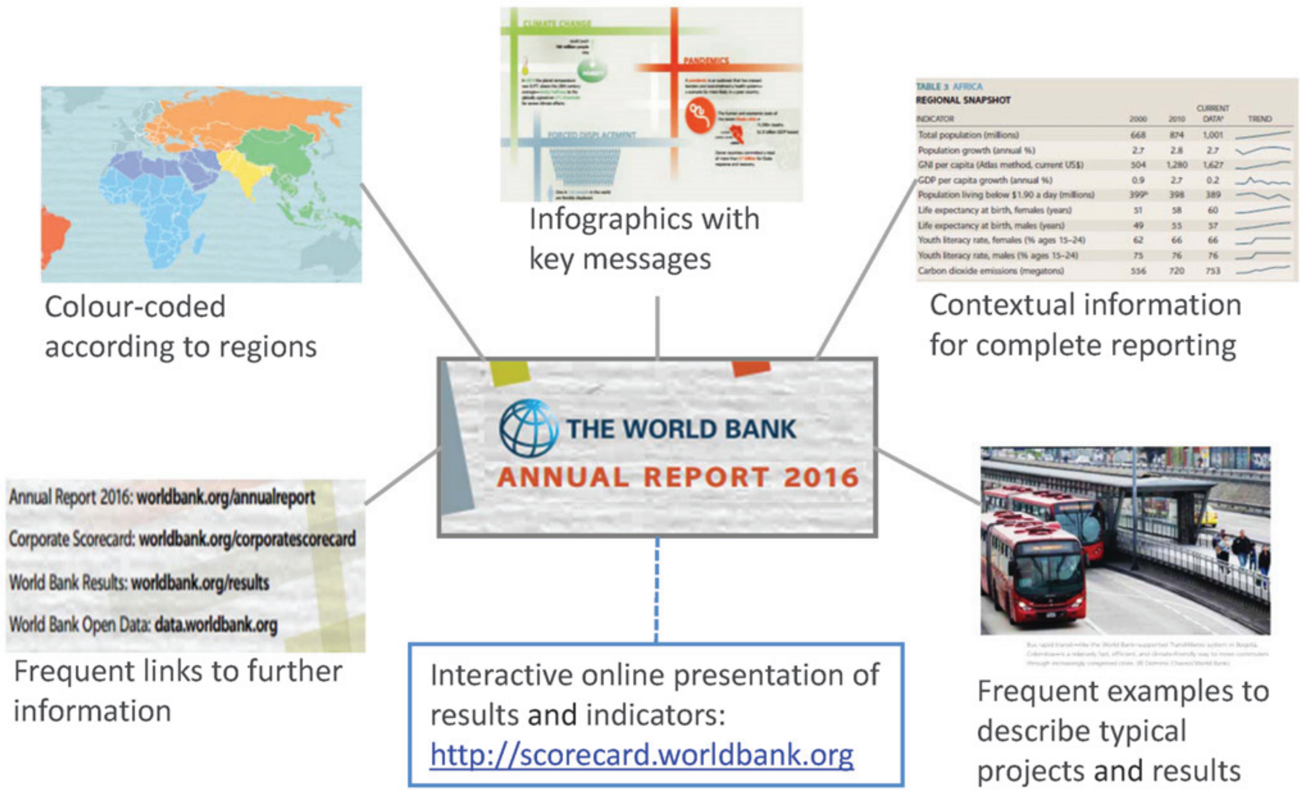
([33]) https://docs.education.gov.au/documents/department-education-and-training-annual-report-2015-16

Box 3.8 — France: State General Budget results report uses pictures rather than text



Source: ECA, based on the Report on the State General Budget 2015.

Box 3.9 — World Bank: 2016 annual report uses many tools to enhance accessibility



Source: ECA, based on the World Bank's Annual Report 2016.

'World Bank. 2016. The World Bank Annual Report 2016. Washington, DC. © World Bank. https://openknowledge.worldbank.org/handle/10986/24985 License: CC BY 3.0 IGO.'

THE COURT'S OBSERVATIONS

Situation at the Commission

3.34. The Commission uses quantitative and qualitative data to present performance information through a combination of graphics and narrative descriptions. ***Box 3.10*** shows that — for a selection of reports — although charts, graphs and tables are common, textual information predominates. The Better Regulation toolbox has a section on the use of visual aids, but this is limited to only three types (problem trees, objective trees and *intervention logic* diagrams). Other, more general tools for enhancing visual presentation — such as colour-coding or infographics — are not discussed.

3.35. Navigation aids — for example glossaries, lists of abbreviations and alphabetical indexes — are almost never used. The Commission has not adopted the practice of producing interactive online versions of key performance reports.

THE COMMISSION'S REPLIES

3.34. *The Commission recognises the importance of using visual aids in its various performance reports and has made improvements in this area. For example, the 2015 version of the Annual Management and Performance Report uses textboxes to make key messages and examples more visible and facilitate reading of the report. The 2016 edition of the Annual Management and Performance Report has further improved the presentation using graphics, charts and images and including an Executive Summary. This and other reports in the Integrated Financial Reporting Package are accompanied by one-page fact sheets which provide an easily accessible summary of the key information for the reader. Moreover, the instructions for the Annual Activity Reports invite the Directorates-General to use visual elements in the Annual Activity Reports to make those documents more easily readable.*

The Better Regulation Toolbox includes a dedicated tool on visual aids. This tool aims at presenting some examples of instruments that are considered particularly relevant for policy interventions as a way to raise awareness among Commission services of the added value of such aids. It is by no means meant to bring together all existing visual aids.

Box 3.10 — Use of visual and navigation aids in the Commission's performance reports

	Number of pages	**Number of graphs and charts**	**Number of tables**	**Colour coding**	**Interactive online version**	**Visual summary of core messages**	**Glossary**	**Alphabetical index**
2015 AMPR	58	8	2	No	No	No	No	No
DG ENER 2015 AAR (without annexes)	99	27	19	No	No	No	No	No
DG HOME 2015 AAR (without annexes)	64	6	18	No	No	No	No	No
DG MOVE 2015 AAR (without annexes)	123	13	23	No	No	No	No	No
DG TRADE 2015 AAR (without annexes)	38	3	5	No	No	No	No	No
The EU in 2016	95	18	0	Yes	No	Yes	No	No

Source: ECA, based on Commission reports.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

E. *The Commission does not demonstrate that it systematically uses evaluation results*

(a) **Recommendations not always made**

Good practices

3.36. The UNESCO evaluations we reviewed put forward recommendations together with 'strategic options for consideration'. All recommendations follow the same pattern: they define a goal and the means for achieving it, followed by a list of actionable suggestions for implementation.

3.37. A recent WHO evaluation ([34]) assesses the reach, usefulness and use of a sample of approximately 15 000 publications over 10 years. The evaluation makes six strategic recommendations and presents specific actions side-by-side with the text of each recommendation to explain what they entail and promote follow-up.

Situation at the Commission

3.38. The BRGs do not require evaluators to make recommendations for consideration by the Commission; we consider that this should be the basis for a well-functioning follow-up system including action plans addressing weaknesses. The practice on making recommendations varied among the twelve evaluations we reviewed:

— six evaluations contained recommendations and proposed implementing actions;

— four evaluations contained general recommendations but proposed no concrete actions to improve the situation;

— two evaluations contained no recommendations.

3.38. *The Better Regulation Guidelines provide that all evaluation Staff Working Documents include findings and conclusions which are the basis for possible follow-up action by the Commission. They also include requirements for the dissemination of evaluation findings and the identification of appropriate follow-up actions. A formal report to the legislator typically sets out follow-up actions under consideration by the Commission.*

3.39. The Commission has not carried out a study on its use of evaluation results, or had one made, since 2005.

3.39. *In the 2015 Better Regulation package the Commission committed to assess the functioning of the system before the end of 2019. Preparatory work for this assessment is now starting.*

([34]) http://www.who.int/about/finances-accountability/evaluation/evaluation-report-nov2016.pdf

THE COURT'S OBSERVATIONS

(b) **The Commission does not demonstrate that evaluation recommendations are systematically followed up**

Good practices

3.40. We found several good practices in the follow-up of evaluations and how it is reported:

(i) The World Bank tracks and reports progress on the implementation of evaluation recommendations, including management responses and action plans with indicators, targets, deadlines and responsible entities, through the Management and Action Record ([35]). This allows aggregate conclusions to be drawn concerning the typology and implementation of recommendations ([36]).

(ii) United Nations agencies react to evaluation recommendations by providing management responses and timed action plans identifying responsible units.

(iii) Canada's policy on results ([37]) requires evaluation reports to contain management responses and action plans. The three evaluations we reviewed did this, and also designated responsible bodies, set a completion date and defined deliverables.

Situation at the Commission

3.41. The Commission has no documented institutional system for the regular follow-up of evaluations. Since 2015, the BRGs ([38]) have required a staff working document summarising and presenting the final results of the evaluation process to be prepared for all evaluations. The Commission has not yet fully implemented this new requirement.

THE COMMISSION'S REPLIES

3.41. *Follow-up to evaluations is an intrinsic part of the Better Regulation system in the Commission whereby evaluation results feed into impact assessments, which are publicly available documents, and the annual programming and planning of Commission activities.*

The Commission follows up on the results of its evaluations in the framework of the Commission Work Programme. In planning the work programme, the Commission systematically reviews evaluation results and determines their follow-up. The follow-up to some evaluation findings are also set out in the REFIT scoreboard which is updated annually and in Commission reports to the legislator accompanying evaluations.

([35]) https://ieg.worldbankgroup.org/managementactionrecord
([36]) Chapter 3 of the overview report 'Results and performance of the World Bank Group 2015'.
([37]) http://www.tbs-sct.gc.ca/pol/doc-eng.aspx?id=31300
([38]) SWD(2015)111 final, Chapter VI 'Guidelines on evaluation and fitness checks'.

THE COURT'S OBSERVATIONS

3.42. The BRGs specify that management plans should record the action taken to follow up evaluations, whatever form these may take [39]. However, this is not a requirement in the relevant instructions, and in practice the 2016 management plans established no basis for monitoring such action. As the Commission does not have an overview of the conclusions, recommendations or action plans resulting from its evaluations, or track their implementation at institutional or DG level, it cannot inform stakeholders about the positive impact of evaluations.

THE COMMISSION'S REPLIES

3.42. *The instructions for the 2018 Management Plans will include explicit reference to the relevant section of the Better Regulation Guidelines.*

The results of some evaluations and their follow-up in the legislative cycle are presented in the REFIT scoreboard. The scope of REFIT has been extended considerably in 2017. Stakeholders are invited to provide feedback on the results of evaluations and on follow-up through the Better Regulation Portal. It is foreseen to fully integrate the REFIT scoreboard into this Portal in future.

F. *Core performance reports do not include a declaration or information on the quality of performance information*

Good practices

3.43. Performance statements are given in different forms and at different levels of responsibility. In terms of scope and/or level of responsibility, the practice of some governments goes beyond the declaration(s) given at the Commission:

(i) Section 39 of Australia's Public Governance, Performance and Accountability Act of 2013 [40] stipulates that 'The accountable authority of a Commonwealth entity must prepare annual performance statements…'.

(ii) In the USA, performance declarations vary. The Department of Education 2015 Annual Performance Report and 2017 Annual Performance Plan include the following declaration by the Secretary of Education: 'To the best of my knowledge, the data verification and validation process and the data sources used provide, to the extent possible, complete and reliable performance data pertaining to goals and objectives in our FY 2014-18 Strategic Plan. …'.

(iii) In the UK, the Accountability report which is part of the Annual Report and Accounts presented by departments includes a statement of the accounting officer's responsibilities. The relevant paragraph of this statement reads as follows: 'I also confirm that this annual report as a whole is fair, balanced and understandable, and I take personal responsibility for the annual report and accounts and the judgments required for determining that it is fair, balanced and understandable'.

([39]) Impact assessment, guidance, further monitoring…
([40]) http://www.finance.gov.au/resource-management/pgpa-act/

THE COURT'S OBSERVATIONS

Situation at the Commission

3.44. In each AAR, the Director-General declares that the information in the report gives a true and fair view [41]. However, it is not made clear in the declaration that this assurance does not extend to the information on the results achieved [42].

3.45. Because AARs do not include a declaration on the quality of the reported performance data, a similar approach is taken in the AMPR. In adopting the latter, the College of Commissioners takes overall political responsibility for the management of the EU budget [43] but not for the information on 'Performance and results' [44].

G. *Performance information provided by the Commission is not easily accessible*

Good practices

3.46. In the Netherlands, the Ministry of Finance has a single website [45] that carries all official Dutch budget documents with information on the planning and achievement of results, lessons from evaluations and major policy changes. Documents are sorted by type and year (and other relevant sub-categories) to help navigation. Brief descriptions give an overview of the purpose and content of the various document types.

THE COMMISSION'S REPLIES

3.44 and 3.45. *The overarching principles of the chain of accountability are enshrined in the EU treaties. Within the Commission, following the White Paper on governance, the accountability chain has been defined with a prominent role for the Authorising Officers by Delegation within a decentralised system operating under the political responsibility of the College as Authorising Officer. This is particularly true for the organisation of financial management. At the end of the reporting cycle, the College adopts the Annual Management and Performance Report for the EU Budget and takes overall political responsibility for the management of the EU Budget based on the annual declarations of the Authorising Officers by Delegation.*

The Commission statement about the responsibility for the management of the EU budget is included to make it clear that the Commission has the ultimate financial responsibility for the management of the EU budget, whereas the responsibility for the results achieved with the EU budget is shared with a wide range of actors at European and national level.

See also Commission reply to paragraph 3.32.

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(41) 'True and fair view in this context means a reliable, complete and correct view on the state of affairs in the DG'.

(42) We also referred to this issue in our opinion No 1/2017, paragraph 95.

(43) The Commission explained its overall political responsibility for the management of the EU budget in reply to paragraph 21 of our special report No 27/2016: 'The Commission considers that this encompasses accountability for the work of its services.'.

(44) http://ec.europa.eu/info/files/2015-annual-management-and-performance-report-eu-budget-com-2016-446-final_en, pp. 5 and 58.

(45) http://www.rijksbegroting.nl/

THE COURT'S OBSERVATIONS

3.47. The US Government operates a website (www.performance.gov) to inform the public about the progress of major federal agencies towards their shared and individual objectives. Results are presented by agency, goals, management initiatives and programmes.

3.48. The UK Government tracks the performance of government services through a 'performance platform' (https://www.gov.uk/performance). The platform is part of the central government website, which also includes a database of government publications [46]. The database has a user-friendly search interface and several useful filters (publication type, policy area, department, official document status, world location, and publication date).

3.49. The World Bank has a central hub [47] for locating information on the performance of the Bank and the development areas in which it operates. To make results more accessible, they are grouped into simple categories and often presented as links to graphs on other websites. Accessibility is also enhanced by the fact that readers can choose the desired level of detail — see for example the site of the President's Delivery Unit [48].

Situation at the Commission

3.50. There is no central performance website with information from all Commission departments on every area of the EU budget. The 'Publications' website [49] serves as an access portal for various information sources, but it lacks a map to explain what is available where, for what purpose, and how the different elements fit together. The website is also incomplete: the list of strategic documents does not include programme statements (see paragraph 3.5) or sectoral and other performance reports.

3.51. Among its 110 000 titles, the EU Bookshop includes Commission studies and evaluations. The bookshop has no dedicated section for these documents (in the same way as for 'authors', 'themes' or 'e-books'), so the only way to find a study or an evaluation is through an advanced search function. Although the search function has filters for studies or evaluations, hits are not presented in a user-friendly manner (e.g. documents supplementing studies or evaluations are shown as separate hits).

THE COMMISSION'S REPLIES

3.50. *Under the EU Budget Focused on Results initiative, a specific EU Results website has been developed. The website is a database which aims to become the single entry point to all EU funded projects — via direct, indirect and shared management. By the end of May 2017, the database has hosted about 1 600 EU funded projects in the EU and outside.*

3.51. *The Commission is continuously working to improve the presentation of studies and evaluations on the EU Bookshop webpage with the aim of making the content clearer and more easily accessible for the external reader. The current version of the EU Bookshop will soon be phased out to be replaced by a new improved platform.*

(46) https://www.gov.uk/government/publications
(47) http://www.worldbank.org/en/results
(48) http://pdu.worldbankgroup.org/
(49) https://europa.eu/european-union/documents-publications_en

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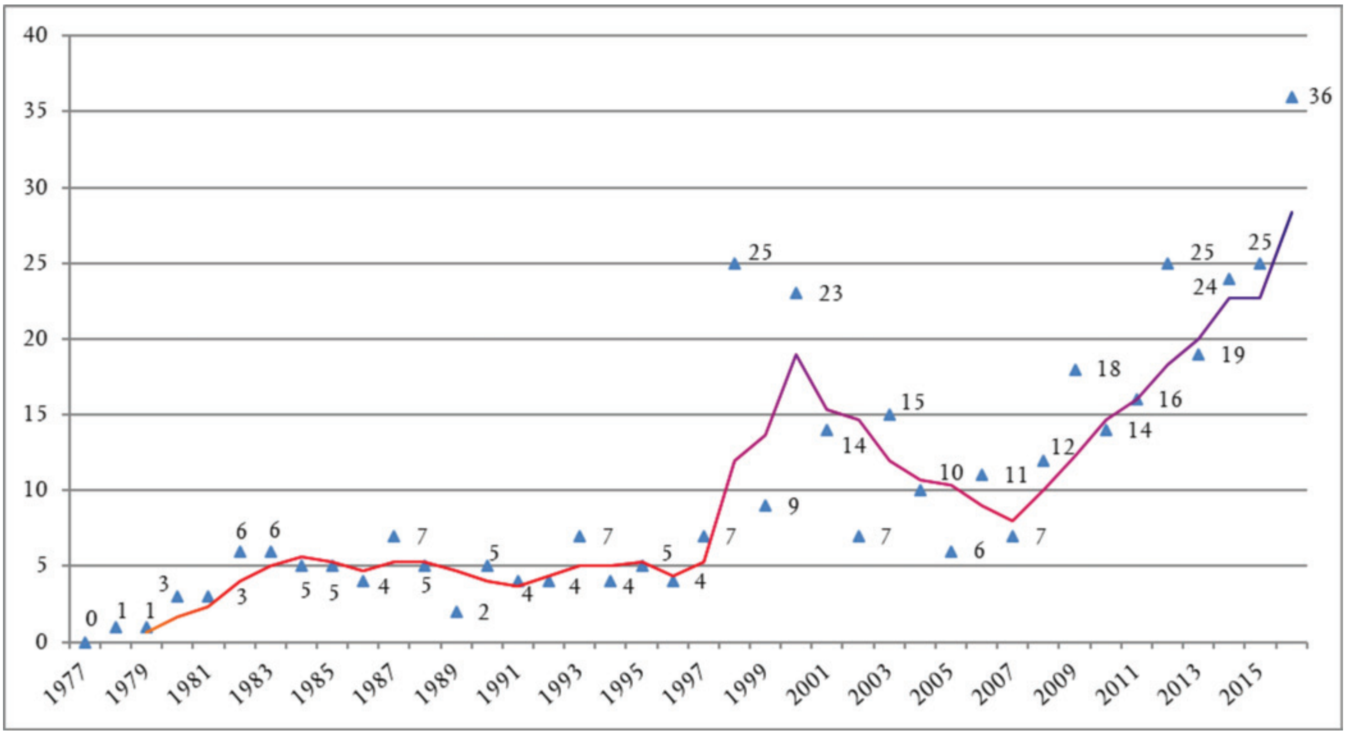
PART 2 — RESULTS OF THE COURT'S PERFORMANCE AUDITS: COMMON CHALLENGES IDENTIFIED IN SOME 2016 SPECIAL REPORTS

Introduction

3.52. Each year we produce a number of special reports in which we examine how well the principles of *sound financial management* are applied when implementing the EU budget. In 2016 we adopted 36 special reports ([50]) — more than in any other year so far (see ***Box 3.11***). They covered all MFF headings ([51]) (***Box 3.12***) and contained a total of 337 recommendations (***Box 3.13***). Our 2016 special reports also included positive observations specific to each individual area examined. The published replies to our reports show that nearly three quarters of our recommendations were fully accepted by the auditee, which was usually the Commission (***Box 3.14***).

3.52. *The Commission notes that the ECA's overview of common challenges is based on the situation presented in the special reports at the time of their presentation and does not take into account action taken by the Commission since then. Some of the findings highlighted by the ECA in paragraphs 3.54-3.59 have therefore already been addressed.*

Box 3.11 — More special reports than ever before (three-year rolling average line and annual figures)

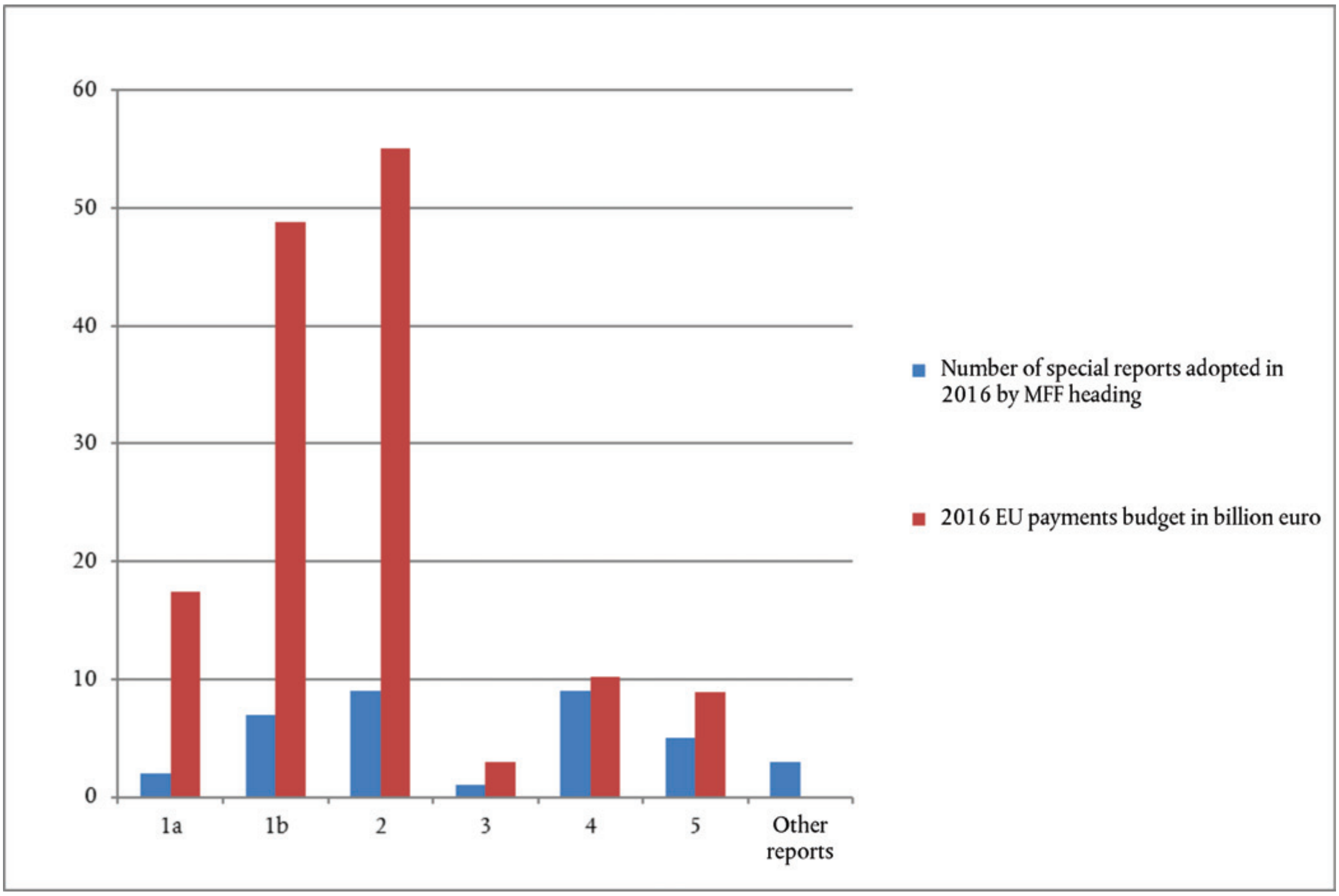


Source: ECA.

([50]) http://www.eca.europa.eu/en/Pages/AuditReportsOpinions.aspx?ty=Special%20report&tab=tab4

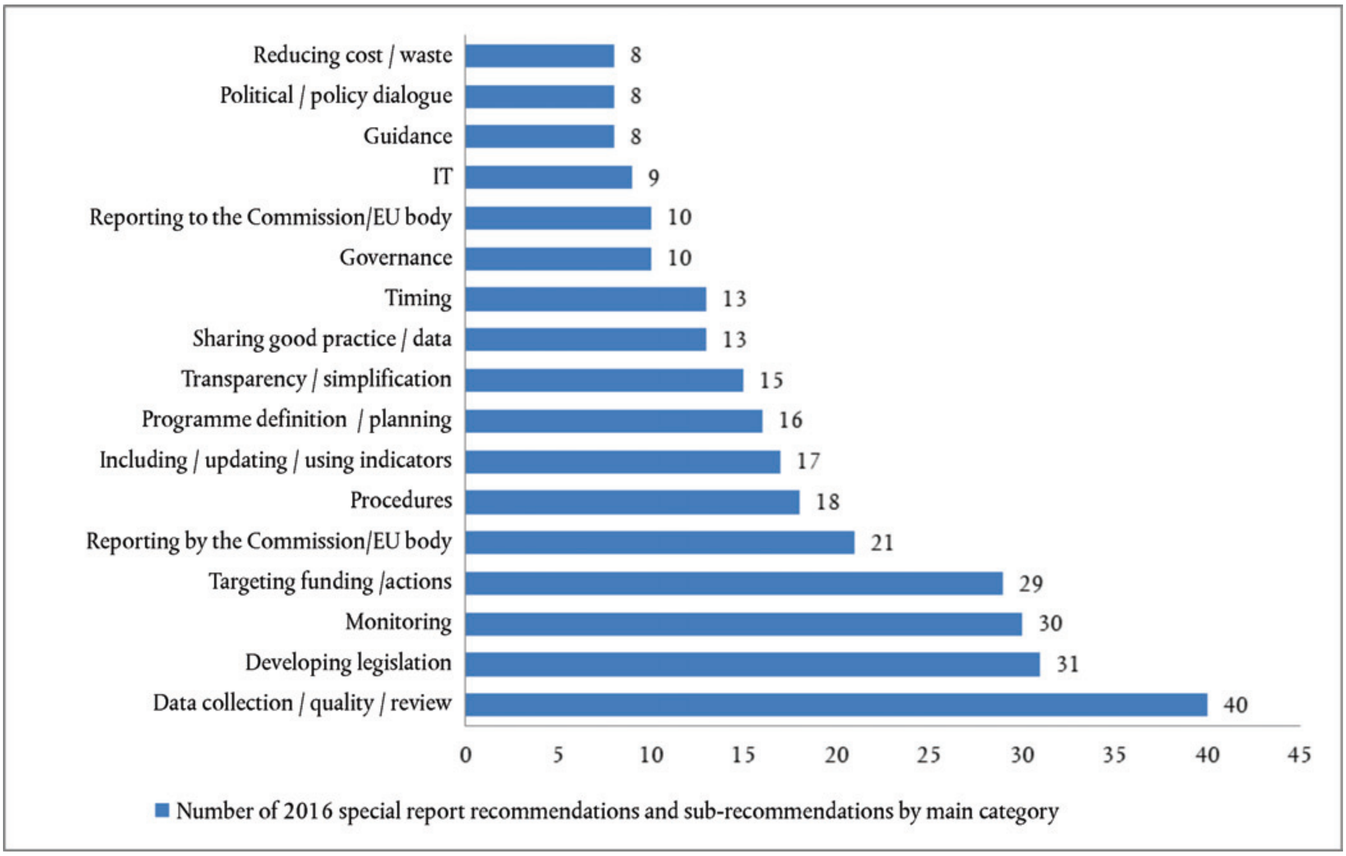
([51]) 1a ('Competitiveness for growth and jobs'), 1b ('Economic, social and territorial cohesion'), 2 ('Sustainable growth: natural resources'), 3 ('Security and citizenship'), 4 ('Global Europe'), 5 ('Administration').

Box 3.12 — Our special reports cover all MFF headings and more



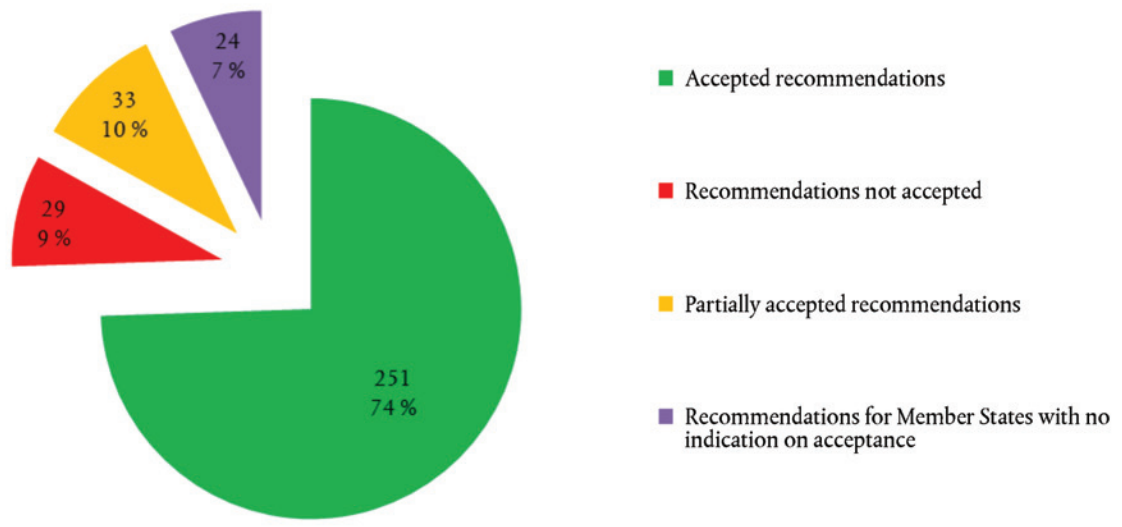
Source: ECA.

Box 3.13 — Recommendations cover a wide range of topics



Source: ECA.

Box 3.14 — How persuasive are we?



Source: ECA.

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3.53. The priorities established by the Court in its 2013-2017 strategy for focusing its work are: (i) sustainability of public finances, (ii) the environment and climate change and (iii) added value and growth. In the following paragraphs we draw attention to a selection of special reports that relate to these priorities. The chosen reports represent about one third of the 36 reports for 2016. From these reports, we present a selection of common challenges that led to recommendations, without attempting to reiterate the overall conclusions. ***Boxes 3.15***, ***3.16*** and ***3.17*** give an overview highlighting these challenges for each priority of the 2013-2017 strategy.

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3.53. *The Commission underlines that for some of the special reports selected in Boxes 3.15, 3.16 and 3.17, the ECA has also identified good results and achievements for example:*

— *In SR 19/2016, the ECA identified that with regard to management costs and fees, the legislation was significantly improved, providing ceilings on cumulative amounts which are below those applicable during the 2007-2013 programme period.*

— *In SR 10/2016, the ECA identified that in the recent years, the Commission has made commendable efforts to improve transparency.*

— *In the SR 31/2016, the ECA identified that ambitious work was underway and that, overall, progress had been made towards reaching the target. The implementation of the target has led to more, and better-focused, climate action funding in the European Regional Development Fund and the Cohesion Fund.*

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— *In SR 4/2016, the ECA identified that thanks to the European Institute of Innovation and Technology (EIT), the three Knowledge and Innovation Communities (KICs) launched in 2010 have brought more than 500 partners together across disciplines, countries and sectors. KICs are autonomous, an EIT feature particularly valued by the KIC partners. Through the EIT, the KICs have offered new opportunities to carry out innovative activities and have promoted an entrepreneurial culture. The ECA welcomed the EIT's decision to review its indicators in 2015 by implementing a new key performance indicator management system.*

Sustainability of public finances

3.54. Three special reports adopted in 2016 dealt with the sustainability of public finances. Although focusing on different instruments designed to safeguard the EU's or Member States' budgets, they identified some common implementation weaknesses. Two elements of our findings (concerns over the quality of data and over transparency) are issues we identified in many subject areas.

3.54. *The Commission highlights the following in relation to 'guidance' and 'data quality' mentioned for the SR 19/2016 in Box 3.15:*

At the moment of publication, the Commission was providing extensive guidance, manuals and possibilities for exchange of experience. These are all available under https://www.fi-compass.eu/resources/ec. Topics covered include inter alia ex ante *assessment, payment modalities, management costs and fees, combination of ESIF and EFSI, selection of bodies implementing financial instruments. The topics were selected based on the need for guidance expressed by the Member States.*

The cases mentioned in the ECA report, except the guidance on preferential treatment (presented to Member States in October 2015), are linked to recommendations for the Commission to provide additional guidance to Member States to make use of economies of scale, respect the tax provisions or to take appropriate measures to maintain the revolving nature of the funds during the required eight-year period after end of the eligibility period for the 2014-2020 programming period. The only reference in SR 19/2016 with regard to the quality of data is in relation to the management costs and fees reported by the managing authorities. For a number of financial instruments, the ECA report indicates that data on management costs and fees was either not reported at all or was not plausible. A mandatory reporting on the management costs and fees incurred and paid was legally foreseen only at closure, by March 2017.

The Commission also underlines that, building on the experience of the 2007-2013 period, requirements for the 2014-2020 period are much more detailed and a more structured provision of data is foreseen.

Box 3.15 — Common problems identified in reports on the sustainability of public finances

	Guidance	Data quality	Transparency
SR 10/2016 — Excessive deficit procedure (EDP)	X	X	X
SR 19/2016 — Implementing the EU budget through financial instruments	X	X	N/A
SR 29/2016 — Single Supervisory Mechanism (SSM)	X	X	X

Source: ECA.

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3.55. Examples of common findings in these reports

(i) Insufficiently developed guidance (SR 29/2016): to improve the decision-making process of the SSM Supervisory Board and ensure the efficiency and effectiveness of Board meetings, further guidance should be developed in the form of checklists, templates and flowcharts.

(ii) Data quality (SR 19/2016): the Commission did not have a comprehensive overview of the management costs and fees for implementing European Regional Development Fund and European Social Fund financial instruments. Similarly, the Commission lacked information on the additional overall administrative costs for each Member State of implementing the *European Structural and Investment Funds* through *grants* or *financial instruments* during 2014-2020.

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3.55.

(i) *Insufficiently developed guidance (SR 29/2016): The Commission notes that SR 29/2016 did not contain recommendations addressed to the Commission but to the ECB.*

(ii) *Data quality (SR 19/2016): For 2007-2013, the Commission monitors the management costs and fees through the summary of data for financial instruments based on the reporting from Member States. This requirement was introduced in 2011.*

For 2014-2020, the Commission will have a more complete and reliable set of data to monitor the whole financial instruments' implementation, including management costs and fees.

For both periods, the national authorities are responsible for ensuring the eligibility of the management costs and fees in line with the applicable rules and the principle of subsidiarity.

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(iii) Transparency (SR 10/2016): in general, the analyses underlying the Commission's proposals for EDP decisions and recommendations lacked transparency. We identified a need to balance the increased complexity and wider scope for economic judgement by enhancing transparency and thus facilitating public scrutiny. Eurostat did not report to the Economic and Financial Committee or make public all its *ex ante/ex post* bilateral advice to Member States. The reasons for Eurostat *reservations* and amendments, and the procedures underlying those reservations, could also be made more transparent.

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(iii) *Transparency (SR 10/2016): Eurostat has a procedure specifying the steps, timetable and role of each actor for the analysis of the notified EDP data. This includes regular meetings with senior management and with the Director-General. As an outcome of the ECA audit, Eurostat does in fact, since summer 2016, publish* ex ante *and* ex post *advice given to Member States on its web site, and they are reported to the EFC. They are available in the following section of the Eurostat's web site: http://ec.europa.eu/eurostat/web/government-finance-statistics/methodology/advice-to-member-states*

Concerning the reasons for Eurostat reservations and amendments, which are based on professional judgement, Eurostat has established procedures for setting reservations and amendments to the data, as an outcome of the ECA audit.

Environment, energy and climate change

3.56. In 2016 we published four reports on environment, energy and climate change. While these reports addressed different topics, they also raised some common issues. As in other areas, data quality and monitoring emerged as common areas of concern. Concerns over timeliness also emerged in this area.

3.56. *See Commission reply to paragraph 3.57.*

Box 3.16 — Common problems identified in reports on the environment, energy and climate change

	Data quality	Timely implementation	Monitoring and oversight
SR 3/2016 — Nutrient pollution in the Baltic	X	X	X
SR 18/2016 — Certification of biofuels	X	N/A	X
SR 22/2016 — Nuclear decommissioning in Lithuania, Bulgaria and Slovakia	N/A	X	X
SR 31/2016 — EU climate action	X	X	X

Source: ECA.

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3.57. Examples of common findings in these reports

(i) Data quality (SR 3/2016): the procedure for monitoring pollution from nutrient inputs in the Baltic Sea did not guarantee the reliability of data for the purposes of assessing compliance with HELCOM ([52]) targets.

(ii) Timeliness (SR 22/2016): nearly all key infrastructure projects in the three audited Member States had experienced delays. The longest delays were in Lithuania, where the decommissioning end-date had been postponed by nine years to 2038; (SR 31/2016): we found that ambitious work was underway to reach the target to spend at least 20 % of the EU budget for 2014-2020 on climate-related action, but there is a serious risk that this target will not be met. Overall, the Commission estimates that 18,9 % would be spent on climate action, thereby falling short of the 20 % objective.

(iii) Monitoring (SR 18/2016): the Commission was not supervising the operations of voluntary biofuel certification schemes and therefore could not be sure that these actually applied the standards for which they had been certified or detect infringements of the rules.

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3.57.

(ii) *Timeliness (SR 22/2016): The Commission noted that the decommissioning programmes are at different level of advancement and maturity in the three Member States. The Bohunice (SK) and Kozloduy (BG) programmes are the most advanced and scheduled for completion in 2025 and 2030 respectively. The latter programme was shortened by 5 years when it was revised in 2011.*

In Ignalina (LT), the decommissioning of the Chernobyl-type reactors is a first-of-a-kind process which actually entails the greatest challenges. Delays were incurred in the past multi-annual financial framework. Controls and management structures have subsequently been reinforced to mitigate the issues encountered.

Notwithstanding the progress already achieved, the Commission recognised the need for continuous improvement in the decommissioning programmes.

(iii) *Monitoring (SR 18/2016): The Commission noted that its 'supervisory power' regarding the implementation of all the operations was limited by the legislator. The Commission is supervising the voluntary schemes in line with the legal competences provided by the Renewable Energy Directive as amended by Directive (EU) 2015/1513 which requires voluntary schemes to report annually on their operation.*

The Commission agreed that supervision and transparency, including complaints procedures, could be strengthened.

Added value/cost reduction

3.58. The creation of added value is a recurrent theme in all our special reports, and we were led to make recommendations in many cases about the development of legislation or procedures or, more rarely, the reduction of costs. We identified common problems in this respect in four reports on EU institutions, bodies and agencies. Concerns over monitoring and transparency were also frequent in this subject area, as in many of our reports.

([52]) HELCOM is the governing body of the Helsinki Convention on the protection of the marine environment of the Baltic Sea Area.

Box 3.17 — Common problems identified in reports on EU institutions, bodies and agencies

	Added value/cost reduction	Monitoring	Transparency
SR 4/2016 — European Institute of Technology (EIT)	X	X	X
SR 7/2016 — European External Action Service (EEAS) buildings	X	X	N/A
SR 12/2016 — Agencies' use of grants	X	X	X
SR 17/2016 — EU institutions' procurement	N/A	X	X

Source: ECA.

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3.59. Examples of common findings in these reports

(i) Added value (SR 4/2016): despite a valid *raison d'être*, the EIT's complex operational framework and management problems were impeding its overall effectiveness and it should refocus its approach to delivering impact.

(ii) Monitoring (SR 7/2016): the EEAS did not take all relevant factors into account when monitoring the available space per person in its buildings, nor did it always ensure that the rents it paid for office and residential space were in line with market rates, or that charges passed on to other tenants recovered costs in full.

(iii) Transparency (SR 12/2016): we found shortcomings where the audited agencies applied specific expert selection and grant award procedures based on exemptions in the founding regulation; as a result there were risks to the principles of equal treatment and transparency, and potential conflict of interest issues had not been fully addressed; (SR 17/2016): the Internet visibility of the EU institutions' procurement activities was poor; information on the results of procurement was not accessible to effective monitoring by the discharge authority and the wider public to increase transparency and build confidence.

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3.59.

(i) *Added value (SR 4/2016): The EIT has adopted a series of measures to address shortcomings in effectiveness. The EIT has addressed the complexities in the operational framework through the Task Force for Simplification, the EIT monitoring strategy and the good governance and financial sustainability principles. Finally, the EIT has strengthened its leadership, management and governance structures.*

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PART 3 — FOLLOW-UP OF RECOMMENDATIONS

3.60. Our follow-up of the recommendations in our audit reports is an essential step in the performance audit cycle. As well as providing us and other stakeholders (chiefly the European Parliament and the Council) with feedback on the impact of our work, follow-up helps to encourage the Commission and Member States to implement our recommendations.

3.61. This section contains the results of our yearly review of the extent to which the Commission has taken corrective action related to our recommendations.

Scope and approach

3.62. This year we selected 13 reports that:

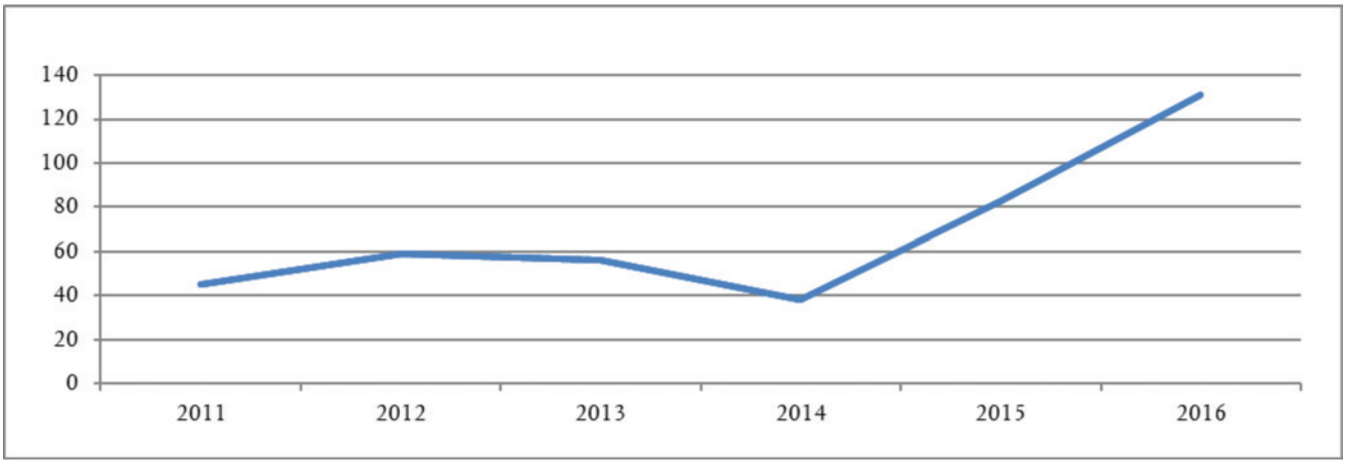
— we published at least three years ago,

— were still relevant, and

— we have not previously followed up in a special or an annual report.

The reports contained a total of 131 recommendations issued between 2010 and 2013 on a variety of topics (see ***Box 3.18***). Details on their implementation status are given in ***Annex 3.1***.

Box 3.18 — More recommendations followed up than in any previous year



Source: ECA.

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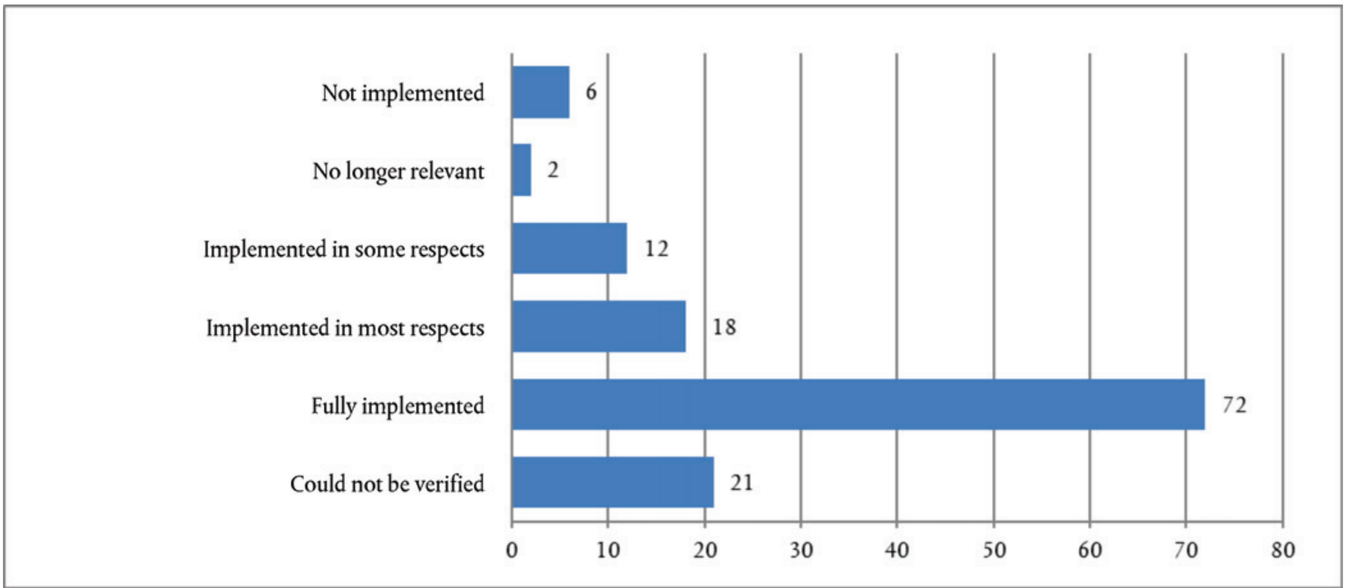
3.63. We carried out our follow-up on the basis of documentary review and interviews with Commission staff. To ensure a fair and balanced review, we then sent our findings to the Commission and took account of its replies in our final analysis. We concluded on the implementation of 108 recommendations. We could not conclude on the remaining 23 either because they did not directly address the Commission or because they were no longer relevant.

How has the Commission addressed our recommendations?

3.64. Of the 108 recommendations, we concluded that the Commission had fully implemented 72, while 18 were implemented in most respects, 12 in some respects, and six were not implemented (see ***Box 3.19***).

Box 3.19 — High number of recommendations implemented



Source: ECA.

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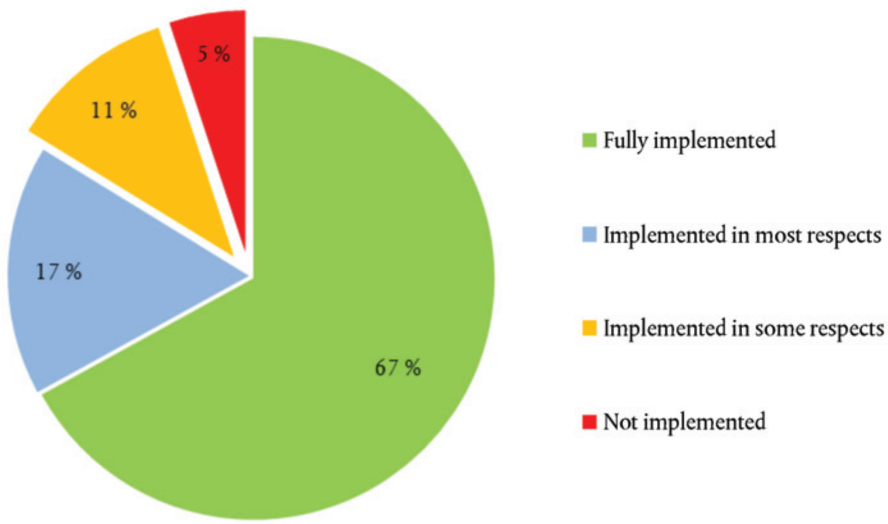
3.65. This outcome is broadly in line with previous years. However, the percentage of fully implemented recommendations was the highest since we started to publish consolidated figures.

3.66. Even where not fully implemented, our recommendations had frequently triggered corrective measures (see ***Box 3.20***). A large majority of these were in place within two years.

Box 3.20 — Recommendations frequently led to significant corrective action



Source: ECA.

3.67. We were unable to verify 21 recommendations (16 % of the overall total) because they were addressed solely to Member States ([53]).

3.68. The Commission stated that it would review significant issues with the Member States for specific cases in *shared management* where it had a supervisory role to play. A Court/Commission joint working group is currently discussing a possible mechanism for reporting and verifying these results. We also plan to work with the Contact Committee ([54]) and the Council to identify collaborative arrangements which might yield further useful information on Member States' implementation of recommendations.

([53]) In SR 20/2012 and SR 23/2012.
([54]) The Contact Committee is an assembly of the heads of EU SAIs, including the ECA.

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A mixed bag of results

3.69. Our follow-up shows that our recommendations led to several key improvements. Unresolved weaknesses are described in ***Annex 3.2***.

3.70. Six recommendations were not implemented (see report titles in ***Annex 3.1***):

— SR 20/2012 (paragraph 77(a)). The 2015 legislative proposals on waste did not take up our recommendation to set binding targets at EU level. This is because the Commission is moving from setting targets to supporting actions for the prevention of waste, such as food waste reduction and eco-design.

— SR 14/2012 (paragraph 54(b)). No evaluation of the impact of the EU funds allocated to the implementation of hygiene and food safety in slaughterhouses has yet been carried out.

— SR 14/2012 (paragraph 54(c)). Given that the evaluation referred to above has not been made, it was not possible to consider whether further action should be taken.

— SR 2/2013 (first part of recommendation 7, paragraph 104). The Commission had not implemented effective measures to guarantee the additionality of the successor to the Risk Sharing Finance Facility. This was confirmed in November 2016 by an independent evaluation which expressed concerns about the non-additionality of 28 % of projects and recommended establishing clear selection criteria to guarantee additionality.

3.70.

— *SR 20/2012. The Commission continues to legally and financially support waste prevention as the highest rank of the waste hierarchy through, for example, EU Cohesion funds. Whether or not the revised waste legislation will contain references to waste prevention (including reuse) targets cannot be predicted at this stage as the legislative process on the Commission's waste proposals is still ongoing (and will continue during the second half of 2017).*

— *SR 14/2012. If Member States have covered the food safety and hygiene standards in their* ex post *evaluation of the 2007-2013 Rural Development Programmes, the Commission will include the results of it in its summary evaluation. In any case, the measure has been discontinued in the current programming period.*

— *SR 14/2012. In the current programming period (2014-2020), the measure has been discontinued.*

— *SR 2/2013. It will always be difficult to ensure the additionality of every project* ex ante*, this assessment depends on a range of factors that are continually changing, and linked to changing economic conditions. However, 2014-2020 financial instruments were improved in terms of evaluation, monitoring and reporting requirements and the interim evaluation of INNOVFIN has been designed to provide answers to the concerns of the ECA. Difficult access to finance remains a concern for SMEs.*

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— SR 12/2012 (paragraph 108(d)). Contrary to our recommendation, the Director-General of Eurostat is still appointed without the prior involvement of the European Statistical Governance Advisory Board or the European Parliament and the Council.

— SR 23/2012 (paragraph 73(e)), last sentence). The Commission did not initially accept this recommendation, on following up the use of reimbursement clauses in grant decisions for regeneration projects, on the grounds that follow-up was the responsibility of Member States' *managing authorities*.

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— *SR 12/2012. An appropriate legal framework and necessary safeguards exist to ensure that appointment and dismissal procedures concerning Eurostat's Director-General are transparent, ensuring full compliance with the principle of independence as foreseen in Regulation (EC) No 223/2009 in this respect.*

The transparency has been confirmed by the recent procedure concerning the post of Director-General of Eurostat which was open to external applicants. In addition, ESGAB's independent reporting on the implementation of the Code of Practice by the Commission (Eurostat) is best served by it not being directly involved in the appointment of Eurostat's Director-General. Finally, the inter-institutional relations between the European Parliament, the Council and the Commission are well established, for instance as regards legislative procedure but also by making the Commission as a whole accountable before the Parliament. The annual statistical dialogue foreseen in Regulation (EC) No 223/2009 aims at ensuring appropriate involvement of, and information to, the Parliament on statistical matters, including by foreseeing that the newly appointed Director-General of Eurostat shall appear before the relevant committee of the Parliament immediately after appointment.

— *SR 23/2012. As mentioned in its reply to this recommendation, the Commission considers that the inclusion of a reimbursement clause in the grant letter issued by the managing authority is a case of good practice which can usefully be included by Member States in their national rules.*

However, under the principle of shared management, since the Managing Authorities issue the grant decisions, they should also monitor the application of the reimbursement clause as they monitor the implementation of projects.

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3.71. The Commission had initially not accepted 11 recommendations, nine of which concerned DG DEVCO (including six from SR 9/2013). Nevertheless, all but one were subsequently implemented partially or in full (see ***Box 3.21***).

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3.71. *After the 2015 reorganisation of the Commission, two of the nine initially rejected recommendations by the Directorate-General for International Cooperation and Development (DG DEVCO) fall under the remit of Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR).*

The rest of the seven initially rejected recommendations were covered by the 2016 follow-up exercise of the ECA:

— *one recommendation from the SR 13/2013, requiring the Commission and the European External Action Service (EEAS) to set up a new system for calculating and reporting on the overall administrative costs involved in delivering development assistance aid for the Central Asia was rejected being considered that a change to the existing ABB system should have been raised by the ECA at the Commission level and further agreed with the budgetary authority;*

— *in the SR 9/2013, DG DEVCO and the EEAS have not agreed with 6 out of 12 recommendations, due to the fact that most of the actions were considered as being already implemented as explained in the EEAS and Commission's joint responses to the ECA. Therefore this positive outcome should not be surprising.*

See Commission reply to paragraph 3.70 in relation to SR 12/2012.

Box 3.21 — Almost all recommendations not initially accepted were nevertheless implemented

SR number	Rejected and not implemented	Rejected and partially implemented	Rejected and fully implemented
SR 23/2012 Regeneration			The polluter-pays principle is now a condition for the funding of regeneration projects.
SR 14/2013 Palestine Authority		The Pegase programme of direct financial support to Palestine was initially provided without explicit conditionality; this changed with the introduction of a results-oriented approach.	

SR number	Rejected and not implemented	Rejected and partially implemented	Rejected and fully implemented
SR 13/2013 Central Asia		A new system for calculating and reporting on the overall administrative costs of delivering development assistance in Central Asia was not felt to be necessary because the existing activity-based budgeting system was sufficient.	
SR 9/2013 Democratic Republic of Congo		A standard timeframe was not agreed for governance projects in the Democratic Republic of the Congo because the Commission preferred to proceed on a best-knowledge basis and projects could be amended or extended. However, realistic time-bound indicators have generally been put in place.	Although our recommendation concerning the balance of aid in all provinces of the DRC was not accepted, we found a reasonably fair balance of aid between central and outlying regions.
		Rather than strengthen its use of conditionality and policy dialogue, the Commission said that it applied the principles agreed internationally for fragile states. We found nonetheless that conditionality and policy dialogue are in place, although they are not yet fully effective.	Measures to prevent and mitigate risks did not need to be established because the Commission and the EEAS would tailor these to the developing situation. We found that for the new programming period the Commission has taken greater account of the possible risks and intensified its mitigating measures accordingly.
			The Commission did not accept the need for further flexibility during programme implementation since programme amendments were part of normal practice. We found that programmes are now adjusted on the basis of regular evaluation, monitoring and audit.
			The Commission did not accept the need to encourage coordinated policy dialogue more than it was already doing. We found evidence of meetings at all levels, as well as joint statements.
SR 4/2013 Egypt			The Commission said that issues of public finance management and fraud in Egypt would be discussed through informal economic dialogue. We found that a national corruption committee had been set up in line with our recommendation.
SR 12/2012 ESTAT	The Commission believes that the necessary legal framework and safeguards are in place to ensure that Eurostat's appointment and dismissal procedures are transparent, ensuring full compliance with the principle of independence.		

Source: ECA and the Commission's recommendations, actions and discharge database.

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CONCLUSIONS AND RECOMMENDATIONS

Conclusions

3.72. Good performance measurement and reporting provides an indication of the success of operations and highlights where improvements should be made. The Commission applies a complex and diverse performance reporting framework consisting of various reporting channels (see paragraphs 3.3-3.12).

3.73. Like other governments and international organisations, the Commission is currently aiming to focus more on performance. We identified six areas of good practice by governments and international organisations around the world in which the Commission could consider improvements (see paragraphs 3.13-3.51):

1. **Scope for improving the performance framework (paragraphs 3.15-3.23)**

— The Commission's use of two sets of objectives and indicators, for programmes on the one hand and DGs on the other, does not reflect the fact that the Commission is ultimately responsible for implementation of the EU budget with regard to the principles of sound financial management We give examples of governments that have made efforts, by aligning the metrics used, to create a clear framework and increase insight into their performance. The Commission does not report information on expenditure broken down by general and specific objectives.

3.73.

— *The ECA observed in its 2015 Annual Report that many of the objectives in the Commission's management plans were not set at the right level of accountability. The Commission has since reviewed its Strategic Planning and Programming cycle. The objective was to provide a clearer framework for the Commission's/Directorates-General's accountability and to make the planning documents more streamlined and centred on the priorities of the Commission and the competencies of the Directorate-General. The objectives and indicators selected for the strategic plans are now tailored to their specific competences and reflect the fact that the responsibilities of Commission departments are broader than budget execution and programme management.*

For this reason, aligning objectives and indicators in the performance framework of the Commission services with those defined in the legal bases of programmes is no longer required. However, the Commission services are invited to make reference to programme statements when describing their activities in relation to the programmes. This helps to limit duplication of information and ensure consistency of data and will be reinforced in the future.

The Commission considers that its responsibility for implementing the budget is clear. Each Director-General signs in his/her Annual Activity Report a declaration of assurance stating that the resources have been used for the intended purpose and in accordance with the principle of sound financial management and that the underlying transactions are legal and regular. At corporate level, the College takes overall political responsibility for the management of the EU budget by adopting each year the Annual Management and Performance Report for the EU budget.

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— The Commission uses many different objectives and indicators. While it is undertaking a review under the BFOR initiative, other entities have already gone further towards simplifying their performance framework.

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— *The performance framework of the EU budget has been developed both to fulfil the legal requirements and to respond to the demands from stakeholders and the Commission's own needs.*

Performance information on the spending programmes is used by the Commission for (a) monitoring programme progress, (b) accountability and transparency, (c) informing decision-making about the management of a programme; (d) justifying or proposing adjustment of the allocation of funds to the budgetary authorities; (e) developing proposals for changes to the legal basis or for future programmes.

The Commission notes however that while performance information is taken into account during the annual budgetary procedure, it is not the only factor driving budgetary decisions.

More than 700 indicators are included in the legal bases of the 2014-2020 programmes to help monitor their performance during their life-cycle. They are the outcome of the legislative process and therefore reflect the expectations of the co-legislators as regards the type and level of granularity of information required to track performance. Reporting on these indicators in the programme statements enables the budgetary authority to take performance information into account during the budgetary process. Under the EU Budget Focused on Results initiative, the Commission is reviewing the indicators for the spending programmes as established in the legal basis with a view to drawing lessons for the preparation of the next generation of spending programmes.

The Commission notes that the number of objectives and indicators used in the strategic plans for the Commission services has been reduced significantly with the recent reform. The number of general objectives has been reduced from 84 to 11, of impact indicators from 187 to 37, of specific objectives from 426 to 386, and result indicators from 969 to 825.

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2. **Performance reporting is not exhaustive (paragraphs 3.24-3.32)**

— Compared with other entities, the Commission reports in a limited way on challenges and failures. Balanced reporting means more clearly analysing past performance in order to make better decisions for the future; it also reinforces the objectivity of the information obtained.

— *The Commission is committed to producing high-quality performance reports that describe results in a balanced manner.*

The Annual Management and Performance Report is a high level summary of how the EU budget has supported the European Union's political priorities and the key results that have been achieved with the EU budget. It is not designed to be an exhaustive and detailed report on the performance of the EU budget. The report refers to other performance reports where more detailed performance information can be found (evaluations, programme statements, Annual Activity Reports, etc.).

The 2015 Annual Management and Performance Report refers to a number of shortfalls and problems to be addressed. Section 1 of the report refers not only to challenges affecting the timely implementation of programmes but also to limitations in the assessment of programme performance (e.g. references to the evaluations on the 2007-2013 Health programme and programmes in budget heading 4 pointing to constraints in assessing the overall performance of these programmes).

— The limited information on data quality in the Commission's reports affects transparency. Other entities report more comprehensively on the reliability of performance information.

— *The Internal Control Framework put in place by each Commission service is designed to provide reasonable assurance with regard to, inter alia, the reliability of financial reporting. Each Directorate-General reports on this aspect under part 2 of its Annual Activity Report, and section 2 of the Annual Management and Performance Report summarises and reports on the assessment by the Directorates-General on the functioning of the internal control systems of the Commission's services.*

As to evaluations, the Better Regulation Toolbox stipulates that evaluation Staff Working Documents prepared by the Commission services at the end of an evaluation must contain a clear summary of any insufficiencies in the data used to support the conclusions and the robustness of the results. Moreover, the Better Regulation Guidelines stipulate that any limitations to the evidence used and the methodology applied, particularly in terms of their ability to support the conclusions, must be clearly explained in the evaluation reports. This is further strengthened in the Better Regulation Guidelines/Toolbox revision.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
3. **Performance reports are rather narrative and could make better use of visual and navigation tools (paragraphs 3.33-3.35)**	
— The Commission is making efforts to create reports that are more attractive to readers and stakeholders. Some other entities focus better on what is essential while making greater use of graphics, tables, colour-coding, infographics, interactive web-sites with navigation tools, etc.	— *The Commission recognises the importance of using visual aids in its various performance reports and has made improvements in this area. For example, the 2015 version of the AMPR uses textboxes to make key messages and examples more visible and facilitate reading of the report. The 2016 edition of the AMPR has further improved the presentation using graphics, charts and images and including an Executive Summary. This and other reports in the Integrated Financial Reporting Package are accompanied by one-page fact sheets which provide an easily accessible summary of the key information for the reader. Moreover, the instructions for the AARs invite the DGs to use visual elements in the AARs to make those documents more easily readable.* *The Better Regulation Toolbox includes a dedicated tool on visual aids. This tool aims at presenting some examples of instruments that are considered particularly relevant for policy interventions as a way to raise awareness among Commission services of the added value of such aids. It is by no means meant to bring together all existing visual aids.*
4. **The Commission does not demonstrate that it systematically uses evaluation results (paragraphs 3.36-3.42)**	
— Not all evaluations carried out by or for the Commission include recommendations and proposals for implementing actions, as is the case of the best examples from other international organisations and governments. The Commission has not carried out a study, or had one made, on its use of evaluation results since 2005.	— *The Better Regulation Guidelines foresee that all evaluation Staff Working Documents include findings and conclusions which are the basis for possible follow-up action by the Commission. They also include requirements for the dissemination of evaluation findings and the identification of appropriate follow-up actions. Evaluations by their legal character cannot commit the Commission to any actions directly. A formal report to the Legislator typically sets out follow-up actions under consideration by the Commission.* *In the 2015 Better Regulation package the Commission committed to assess the functioning of the system before the end of 2019. Preparatory work for this assessment is now starting.*

THE COURT'S OBSERVATIONS

— Unlike some other organisations and governments, the Commission does not have a documented institutional system in place for the regular follow-up of evaluation recommendations, action plans or management responses.

THE COMMISSION'S REPLIES

— *Follow-up to evaluations is an intrinsic part of the Better Regulation system in the Commission whereby evaluation results feed into impact assessments, which are publicly available documents, and the process of annual programming and planning of Commission activities. The Commission follows up on the results of its evaluations in the framework of the Commission Work Programme. In planning the work programme, the Commission systematically reviews evaluation results and determines their follow-up. The follow-up to some evaluation findings are set-out in the REFIT scoreboard which is updated annually and in Commission reports to the legislator accompanying evaluations.*

5. **Core performance reports do not include a declaration or information on the quality of performance information (paragraphs 3.43-3.45)**

— The College of Commissioners and Directors-General do not take responsibility for the performance information they provide.

— *The overarching principles of the chain of accountability are enshrined in the EU treaties. Within the Commission, following the White Paper on governance, the accountability chain has been defined with a prominent role for the Authorising Officers by Delegation within a decentralised system operating under the political responsibility of the College as Authorising Officer. This is particularly true for the organisation of financial management. At the end of the reporting cycle, the College adopts the Annual Management and Performance Report for the EU Budget and takes overall political responsibility for the management of the EU Budget based on the annual declarations of the Authorising Officers by Delegation.*

The Commission statement about the responsibility for the management of the EU budget is included to make it clear that the Commission has the ultimate financial responsibility for the management of the EU budget, whereas the responsibility for the results achieved with the EU budget is shared with a wide range of actors at European and national level.

6. **Performance information provided by the Commission is not easily accessible (paragraphs 3.46-3.51)**

— The Commission produces a vast quantity of performance information. Other governments and organisations group their performance information more rationally, for instance at a dedicated website with a well-developed search engine, user guides and other navigation tools.

— *Under the EU Budget Focused on Results initiative, a specific EU Results website has been developed. The website is a database which aims to become the single entry point to all EU funded projects — via direct, indirect and shared management. By the end of May 2017, the database has hosted about 1600 EU funded projects in the EU and outside.*

THE COURT'S OBSERVATIONS

3.74. In paragraphs 3.52-3.59, we present common challenges identified in some of our 2016 special reports.

3.75. This year's follow-up of past recommendations (see paragraphs 3.60-3.71) demonstrated that:

— the Commission accepts and implements a high proportion of recommendations within three years of our audits;

— recommendations that are initially not accepted may later be implemented partially or in full.

Recommendations

3.76. ***Annex 3.3*** shows the result of our review of the Commission's progress in addressing recommendations on performance issues in our 2013 annual report. That year chapter 10 contained three recommendations. Two were implemented in some respects and one was not implemented.

3.77. Based on our conclusions for 2016, we recommend that the Commission:

— **Recommendation 1:** *streamline performance reporting* ([55]) by

(a) further reducing the number of objectives and indicators it uses for its various performance reports and focusing on those which best measure the performance of the EU budget. In preparing the next multiannual financial framework, the Commission should propose less numerous and more appropriate indicators for the legal framework of the next generation of programmes. In this context, it should also consider the relevance of indicators for which information cannot be obtained until several years have elapsed;

([55]) See also our opinion No 1/2017 concerning the proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (paragraphs 90-99): http://www.eca.europa.eu/en/Pages/DocItem.aspx?did=40627

THE COMMISSION'S REPLIES

(a) *The Commission accepts the recommendation.*

The Commission is currently undertaking a review under the EU Budget Focused on results initiative on the indicators for the spending programmes as established in their legal basis. This will feed into the preparation of the proposals for the next MFF.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES

(b) presenting financial information in a manner which makes it comparable with performance information so that the link between spending and performance is clear;

(b) *The Commission accepts the recommendation.*

It considers that this recommendation is being implemented through the programme statements, which are the instrument through which the Commission justifies the financial resources for spending programmes in the draft budget. For the 2018 draft budget, these include information, for each programme, on financial programming and financial implementation alongside information on performance. It hence considers that the programme statements present information in a way that enable to link spending and performance.

(c) explaining and improving the overall coherence between its two sets of objectives and indicators for programmes on the one hand and DGs on the other.

(c) *The Commission accepts the recommendation.*

In the next Annual Activity Report exercises the Commission intends to reinforce this aspect by making greater use of the cross-reference in Annual Activity Reports to programme statements.

— **Recommendation 2:** *better balance performance reporting* by clearly presenting information, in its core performance reports, on the main challenges to achieving results.

The Commission accepts the recommendation.

The Commission is committed to producing high-quality performance reports that describe results in a balanced manner.

In the Annual Management and Performance Report the Commission reports on major management challenges in a separate dedicated section (under Section 2). Where problems were encountered in the course of the year the report describes how Commission departments tackled these challenges. In future the Commission will strive to give more information on the main challenges for achieving results in its core performance reports (Annual Activity Reports, Annual Management and Performance Report and programme statements).

— **Recommendation 3:** *further improve the user-friendliness of its performance reporting* by making greater use of methods and tools such as graphics, summary tables, colour-coding, infographics and interactive web-sites.

The Commission accepts the recommendation.

The Commission is committed to continuously improve the user-friendliness of its performance reporting. The 2016 Annual Management and Performance Report has already considerably improved with graphics, charts and images.

— **Recommendation 4:** *better demonstrate that evaluation results are well used* by:

(a) requiring evaluations always to include conclusions that can be acted upon, or recommendations, which the Commission should subsequently follow up;

(a) *The Commission accepts the recommendation.*

Evaluation conclusions and their follow-up are already an intrinsic part of the better regulation system in the Commission and the process of annual programming and planning of Commission activities. This system is further strengthened with the revision of the Better Regulation Guidelines and Toolbox.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
(b) carrying out a new study, or having one made, on the use and impact, including the timeliness, of evaluations at the institution.	**(b)** *The Commission accepts the recommendation.* *In the 2015 Better Regulation package the Commission committed to assess the functioning of the system, including evaluations, before the end of 2019. Preparatory work for this assessment has started.*
— **Recommendation 5:** indicate in core performance reports whether, to the best of their knowledge, the performance information provided is of sufficient quality.	*The Commission accepts the recommendation.* *In order to improve transparency, the Commission will provide information on the source and quality of data where available. Given that a significant amount of performance data is provided by Member States, the Commission will analyse to what extent they provide information on the quality of performance data.*
— **Recommendation 6:** *make performance information more easily accessible* by developing a dedicated web portal and search engine.	*The Commission partially accepts the recommendation.* *The Commission will strive to make performance information more easily accessible. It is committed to carrying out an assessment to appraise the feasibility, the costs and the potential benefits of such a web presence. The action as recommended would be implemented subject to the outcome of this assessment. In line with the Synergies and Efficiencies decision of the Commission from April 2016, a dedicated web portal and search engine should not be aimed at, but rather a relevant web presence using the corporate search engine of the Europa website.*

ANNEX 3.1

DETAILED STATUS OF RECOMMENDATIONS BY REPORT

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
1	SR 14/2010	The Commission's management of the system of veterinary checks for meat imports following the 2004 hygiene legislation reforms (Natural resources)	Par. 90 bullet 1	x					
			Par. 90 bullet 2	x					
			Par. 90 bullet 3	x					
			Par. 90 bullet 4		x				
			Par. 90 bullet 5		x				
			Par. 90 bullet 6	x					
			Par. 90 bullet 7	x					
			Par. 90 bullet 8	x					
			Par. 91	x					
2	SR 11/2012	Suckler cow and ewe and goat direct aids under partial implementation of SPS arrangements (Natural resources)	Par. 58	x					
			Par. 60	x					
			Par. 64	x					
			Par. 64			x			

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
3	SR 14/2012	Implementation of EU hygiene legislation in slaughterhouses of countries that joined the EU since 2004 (Natural resources)	Par. 52(a)	x					
			Par. 52(b)	x					
			Par. 52(c)	x					
			Par. 52(d)	x					
			Par. 53(a)	x					
			Par. 53(b)	x					
			Par. 53(c)	x					
			Par. 53(d)		x				
			Par. 54(a)	x					
			Par. 54(b)				x		
			Par. 54(c)				x		

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
4	SR 20/2012	Is structural measures funding for municipal waste management infrastructure projects effective in helping Member States achieve EU waste policy objectives? (Natural resources)	Par. 72(a)(i)						x
			Par. 72(a)(ii)						x
			Par. 72(a)(iii)						x
			Par. 72(b)			x			
			Par. 74(a)						x
			Par. 74(b)		x				
			Par. 74(c)	x					
			Par. 76(a)(i)						x
			Par. 76(a)(ii)						x
			Par. 76(a)(iii)						x
			Par. 76(b)(i)	x					
			Par. 76(b)(ii)			x			
			Par. 77(a)				x		
			Par. 77(b)	x					
			Par. 77(c)	x					
			Par. 77(d)					x	

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
5	SR 23/2012	Have EU structural measures successfully supported the regeneration of industrial and military brownfield sites? (Cohesion)	Par. 65(a) (MS)						x
			Par. 65(b) (MS)						x
			Par. 65(c) (MS)						x
			Par. 65(a) (COM)			x			
			Par. 65(b) (COM)	x					
			Par. 68(a) (MS)						x
			Par. 68(b) (MS)						x
			Par. 68(c) (MS)						x
			Par. 68(d) (MS)						x
			Par. 68(e) (MS)						x
			Par. 68(f) (MS)						x
			Par. 68(a) (COM and MS)	x					
			Par. 73(a) (MS)						x
			Par. 73(b) (MS)						x
			Par. 73(c) (MS)						x
			Par. 73(d) (MS)						x
			Par. 73(e) (MS)						x
			Par. 73(a) (COM)	x					
			Par. 73b (COM)	x					
			Par. 73(e) (MS last sentence)				x		

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
6	SR 5/2013	Are EU cohesion policy funds well spent on roads? (Cohesion)	Par. 55 Rec. 1			x			
			Par. 55 Rec. 2(a)	x					
			Par. 55 Rec. 2(b)		x				
			Par. 55 Rec. 2(c)	x					
			Par. 55 Rec. 3	x					
			Par. 55 Rec. 4			x			
7	SR 17/2013	EU climate finance in the context of external aid (External actions)	Par. 69 Rec. 1	x					
			Par. 69 Rec. 2	x					
			Par. 69 Rec. 3			x			
			Par. 69 Rec. 4		x				
			Par. 69 Rec. 5	x					

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
8	SR 14/2013	EU direct financial support to the Palestinian Authority (External actions)	Par. 81(a)	x					
			Par. 81(b)	x					
			Par. 81(c)	x					
			Par. 82(a)	x					
			Par. 82(b)	x					
			Par. 83		x				
			Par. 84		x				
			Par. 85			x			
9	SR 13/2013	EU development assistance to Central Asia (External actions)	Par. 87 First indent	x					
			Par. 87 Second indent	x					
			Par. 87 Third indent			x			
			Par. 87 Fourth indent	x					
			Par. 87 Fifth indent	x					
			Par. 87 Sixth indent		x				

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
10	SR 9/2013	EU support for governance in the Democratic Republic of the Congo (External actions)	Par. 94 Rec. 1(a)	x					
			Par. 94 Rec. 1(b)		x				
			Par. 94 Rec. 1(c)		x				
			Par. 94 Rec. 1(d)		x				
			Par. 94 Rec. 2(a)	x					
			Par. 94 Rec. 2(b)	x					
			Par. 94 Rec. 3(a)	x					
			Par. 94 Rec. 3(b)		x				
			Par. 94 Rec. 3(c)	x					
			Par. 94 Rec. 4(a)		x				
			Par. 94 Rec. 4(b)			x			
			Par. 94 Rec. 4(c)	x					

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
11	SR 4/2013	EU cooperation with Egypt in the field of Governance (External actions)	Par. 80(a)	x					
			Par. 80(b)	x					
			Par. 80(c)	x					
			Par. 80(d)	x					
			Par. 80(e)	x					
			Par. 81(a)	x					
			Par. 81(b)	x					
			Par. 81(c)	x					
			Par. 82	x					

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
12	SR 12/2012	Did the Commission and Eurostat improve the process for producing reliable and credible European statistics? (Others)	Par. 107			x			
			Par. 108(a)	x					
			Par. 108(b)	x					
			Par. 108(c)			x			
			Par. 108(d)				x		
			Par. 108(e)		x				
			Par. 108(f)	x					
			Par. 108(g)	x					
			Par. 109(a)	x					
			Par. 109(b)	x					
			Par. 109(c)	x					
			Par. 109(d)	x					
			Par. 109(e)		x				
			Par. 109(f)		x				
			Par. 109(g)	x					

No	SR	Report title	SR paragraph	Fully implemented	Implemented in most respects	Implemented in some respects	Not implemented	No longer relevant	Could not be verified
13	SR 2/2013	Has the Commission ensured efficient implementation of the seveth framework programme for research? (Smart and inclusive growth)	Par. 99 Rec. 1 second and third indents	x					
			Par. 99 Rec. 1 first and fourth indents	x					
			Par. 99 Rec. 2		x				
			Par. 100 Rec. 3 first indent	x					
			Par. 100 Rec. 3 second indent	x					
			Par. 101	x					
			Par. 102	x					
			Par. 103	x					
			Par. 104 first part				x		
			Par. 104 second part					x	
Total number of recommendations			**131**	**72**	**18**	**12**	**6**	**2**	**21**

The Commission's replies

SR 14/2012:

Reply to paragraph 54(c): The Commission considers that the recommendation is no longer relevant. In the current programming period (2014-2020), the measure has been discontinued.

ANNEX 3.2

KEY IMPROVEMENTS AND UNRESOLVED WEAKNESSES BY REPORT

No	SR	Report title	Improvements	Weaknesses
1	SR 14/2010	The Commission's management of the system of veterinary checks for meat imports following the 2004 hygiene legislation reforms	Commission proposal on import control activities has been adopted. It simplifies and clarifies regulatory framework. Harmonisation of rules for reinforced checks. Improvement of IT systems network. Development of guidance documents and training programmes. Improvement of the risk assessment model used for programming audits of the Directorate-General for Health and Food Safety. Member States take corrective action following recommendations by the Directorate-General for Health and Food Safety. EU animal welfare strategy included in international agreements on sanitary and phytosanitary measures.	Some international agreements on sanitary and phytosanitary measures are still under negotiation. Third countries (with some exceptions) still resist recognising the EU as a single entity. The new EU Regulation on official controls is expected to enter into application by the end of 2019. Implementing acts have yet to be adopted. Council and Parliament have not considered the article in the Commission proposal delegating powers to the Commission on laying down rules on performance indicators. Verification of the specific amount of fees for import checks is considered a low priority within the scope of the audits on imports of the Directorate-General for Health and Food Safety.
2	SR 11/2012	Suckler cow and ewe and goat direct aids under partial implementation of Single Payment Scheme arrangements	Targeting requirements added for voluntary coupled support. Member States now need to provide definition of specific type of production in justification of measures. The Commission has set up a common monitoring and evaluation framework, together with specific rules and indicators.	Despite some evaluation work already done or underway, no comprehensive Commission evaluation has yet been made of the schemes' impact.
3	SR 14/2012	Implementation of EU hygiene legislation in slaughterhouses of countries that joined the EU since 2004	Follow-up audits of DG SANTE's recommendations to the Member States are regularly carried out. Guidelines, training courses and workshops are available. Electronic database of national hygiene sectorial guides developed. A framework of standard operating procedures has been adopted to clarify the relationship responsibilities between DG SANCO and the Consumers, Health, Agriculture and Food Executive Agency.	There are no overview reports dealing with audit/analysis of the Member States' multiannual national control plans. No evaluation report on trends in the development of national guides or their quality. Lack of statistics on training addressed to food business operators by Member States. No evaluation on the impact of the EU funds used to implement hygiene and food safety standards.

No	SR	Report title	Improvements	Weaknesses
4	SR 20/2012	Is structural measures funding for municipal waste management infrastructure projects effective in helping Member States achieve EU waste policy objectives?	*Ex ante* conditionality ensures the existence of waste management plans and links EU support to achievements. Better definition of waste quantities. Guidance and information-sharing on waste plans. Steps made in waste prevention and recycling of products. Waste treatment clarified.	No assurance that the actions described in waste management plans ensure that waste is treated before disposal in landfills and that there is a focus on waste management infrastructures treating waste segregated at source. No assurance that waste monitoring systems and databases provide reliable data. Reduced rates of assistance not systematically applied. Waste prevention targets not set up.
5	SR 23/2012	Have EU structural measures successfully supported the regeneration of industrial and military brownfield sites?	Integrated sustainable urban development and regeneration are clearly promoted. The regeneration and decontamination of brownfield sites are a priority for 2014-2020. Definition and guidelines for the application of the polluter pays principle are in place. Compliance with EU State aid rules is checked and interim payments may be suspended in case of non-compliance. Further guidance has been issued to remind Member States of their obligation to determine the funding gap.	No EU standards for the definition of contaminated sites and the significance of the environmental and health risks they pose. No EU methodology for the definition of site-specific remediation standards. No follow-up on the application of reimbursement clauses.
6	SR 5/2013	Are EU cohesion policy funds well spent on roads?	New guide to cost/benefit analysis published in 2014 includes a case study of road projects with a breakdown of costs and main reasons for differences in unit costs. The main principles of the cost/benefit analyses are in legal acts and guidance is more detailed. Future co-financing of major road projects and Connecting Europe Facility projects is conditional upon a cost/benefit analysis, including a feasibility study, option analysis, demand analysis with traffic forecasts and modelling. Quality is checked by independent experts. There is an exchange of best practices related to traffic forecasts and specific assistance is provided to Member States (by JASPERS).	The unit cost calculation exercise is not yet fully completed. Concerns remain about non-major projects which are fully designed, selected and implemented at Member State level. No EU-wide database with cost benchmarks.

No	SR	Report title	Improvements	Weaknesses
7	SR 17/2013	EU climate finance in the context of external aid	The climate finance roadmap has been published. The Commission has issued guidelines for reporting and proposed a methodology for determining additionality. Commitment appropriations are displayed. An independent evaluation of the Global Climate Change Alliance is publicly available. The Climate Diplomacy Action Plan was adopted in 2015. Expert working groups have been set up and meet regularly.	No indication whether the EU's 20 % spending target for development aid in climate action is being met. Independent evaluation only briefly assessed why most Member States did not choose to co-finance the Global Climate Change Alliance.
8	SR 14/2013	EU direct financial support to the Palestinian Authority	Links identified between the EU and the Palestinian Authority's action plan and EU support to Palestine. EU support is programmed on multiannual basis. The Results-Oriented Framework includes specific and time-bound indicators. Competitive tenders were used. Decision taken to discontinue the funding of civil servants' salaries and pensions in Gaza. Specific issues related to EU support have been raised at technical meetings with the Israeli authorities.	Conditionality has not been applied systematically. No documentation on the implementation of the decision on salaries and pensions has yet been received. The Commission and EEAS have not prepared a detailed action plan of the steps Israel needs to take in order to enhance the effectiveness of EU support to Palestine, nor have they used the potential leverage offered by the framework of broader EU-Israeli cooperation.

No	SR	Report title	Improvements	Weaknesses
9	SR 13/2013	EU development assistance to Central Asia	EU values are promoted through a more pragmatic and flexible approach. The number of sectors has been reduced. Estimates of necessary human resources (in person-years) are prepared. Budget support conditions are applied. Public finance management is monitored, anti-corruption measures are implemented. New programmes have been developed. Key performance indicators are reported and monitored.	Reporting on administrative costs (human resources, equipment etc.) at regional or country level is lacking. Reporting is not available on actual versus planned spending and on objectives achieved at regional level.
10	SR 9/2013	EU support for governance in the Democratic Republic of the Congo	Improved programming focuses also on rural and infrastructure development. Local actors were involved in the development of the Environment programme, their needs are addressed. Political dialogue has been held. The EU has repeatedly stressed the importance of holding elections as required by the constitution. Improvements in the transparency of natural resources governance. Better governance, transparency and accountability have had positive effects on fraud and corruption. The Commission identifies main risks and proposes mitigating measures. The number of sectors targeted by EU aid is lower than in the previous period. Indicators are usually time-bound and more realistic. Programme adjustments are documented. Leaders have held meetings and issued joint statements.	Commission does not earmark aid to support the electoral process. The political dialogue on presidential and legislative elections is still ineffective. No support defined in the National Indicative Programme for enforcing the external audit process and national oversight institutions. Lack of well-defined corruption indicators. Enforcement of anti-corruption laws absent from the progamme. Many important thematic groups are inactive. They also generally lack information on their missions, objectives, strategies, budgets, responsibilities and coordination among members.

No	SR	Report title	Improvements	Weaknesses
11	SR 4/2013	EU cooperation with Egypt in the field of Governance	A limited number of human rights and democracy priorities identified, related dialogue resumed. Funding increased for the European Instrument for Democracy and Human Rights and the Civil Society Organisation. Coordination and proper distribution of funds between different instruments is ensured. A roadmap tailors Civil Society Organisation support, the Financial Regulation allows the procedure to be accelerated. Public Finance Management and the fight against corruption are emphasised in meetings. Conditionality has been applied: the Commission has suspended budget support operations in Egypt.	
12	SR 12/2012	Did the Commission and Eurostat improve the process for producing reliable and credible European statistics?	The system of European statistics has been strengthened. Regulatory framework has been amended, recognising the importance of the Code of Practice. European Statistical Governance Advisory Board was involved in peer reviews, which are now publicly available. Guidelines and procedures are established for the EU statistical programme. Priorities are reviewed. Progress on the implementation of modernisation projects is regularly reported. Staff costs have been analysed to increase efficiency. Guidelines for procurement enhance competition.	There is a need for transparent and objective procedures for recruiting and dismissing heads of statistical offices. Obstacles remain in the access to and effective use of data. Coordination of statistics and resources are areas of concern. Supervisory function has not been established to oversee verifications and inspections.

No	SR	Report title	Improvements	Weaknesses
13	SR 2/2013	Has the Commission ensured efficient implementation of the seveth framework programme for research?	Horizon 2020 has introduced more flexibility in the reporting of costs. Streamlined requirements for applicants. More coherence in Framework Programme 7 management via the Common Support Centre. Integrated IT workflows, indicators, common audit service. Joint Technology Initiatives framework is more flexible.	The EIT is not covered by the Common Support Centre and its rules are not consistently harmonised with the Horizon 2020 framework, which leads to inefficiency for its beneficiaries. The Commission has not implemented effective measures to guarantee the additionality of the successor to the Risk Sharing Finance Facility. This was confirmed in November 2016 by an independent evaluation which expressed concerns about the non-additionality of 28 % of projects and recommended establishing clear selection criteria to guarantee additionality.

The Commission's replies

SR 12/2012:

An appropriate legal framework and necessary safeguards exist to ensure that appointment and dismissal procedures concerning Eurostat's Director-General are transparent, ensuring full compliance with the principle of independence as foreseen in Regulation (EC) No 223/2009 in this respect.

The transparency has been confirmed by the recent procedure concerning the post of Director-General of Eurostat which was open to external applicants. In addition, ESGAB's independent reporting on the implementation of the Code of Practice by the Commission (Eurostat) is best served by it not being directly involved in the appointment of Eurostat's Director-General. Finally, the inter-institutional relations between the European Parliament, the Council and the Commission are well established, for instance as regards legislative procedure but also by making the Commission as a whole accountable before the Parliament. The annual statistical dialogue foreseen in Regulation (EC) No 223/2009 aims at ensuring appropriate involvement of, and information to, the Parliament on statistical matters, including by foreseeing that the newly appointed Director-General of Eurostat shall appear before the relevant committee of the Parliament immediately after appointment.

ANNEX 3.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR PERFORMANCE ISSUES

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				
2013	The Commission should: **Recommendation 1:** on the next occasion that the Financial Regulation is reviewed, rationalise its reporting framework for performance			X				
	Recommendation 2: ensure that the evaluation report presents a summary account that brings together all the information available on the progress towards Europe 2020 targets in order to provide the reader with a clear overview of the achievements made			X				
	Recommendation 3: further develop its performance managing and reporting system so that it allows the Commission to take responsibility for sound financial management as well as the EU budget's contribution to policy achievements in the annual declarations of assurance by the directors-general.				X			

CHAPTER 4

Revenue

TABLE OF CONTENTS

THE COURT'S OBSERVATIONS

INTRODUCTION

4.1. This chapter presents our findings for revenue, which comprises *own resources* and other revenue. ***Box 4.1*** gives a breakdown of revenue in 2016.

Box 4.1 — Revenue — 2016 Breakdown

(billion euro)

Total revenue 2016 ([1])	**144,7**

([1]) This amount represents the EU's budget revenue. The amounts in the statement of financial performance are presented differently, using the accrual-based system. As a result of using this system, the EU's revenue is stated to be 146,2 billion euro in the statement of financial performance.

Source: 2016 *consolidated accounts* of the European Union.

Brief description of revenue

4.2. Most revenue (91 %) comes from the three categories of own resources:

— The ***gross national income*-based (GNI-based) own resource** provides 66 % of the EU's revenue, and balances the EU budget after revenue from all other sources has been calculated. Each Member State contributes proportionally on the basis of its GNI ([1]).

([1]) The initial calculation is based upon forecast GNI. Differences between forecast and final GNI are adjusted in subsequent years, and affect the distribution of own resources between Member States rather than the total amount collected.

THE COURT'S OBSERVATIONS

- **Traditional own resources (TOR)** provide 14 % of the EU's revenue. They comprise customs duties on imports (20,0 billion euro), and sugar-production levies (0,1 billion euro). Both of these are collected by the Member States. The EU budget receives 80 % of the total amount; Member States retain the remaining 20 % to cover collection costs.
- The **value added tax-based (VAT-based) own resource** provides 11 % of the EU's revenue. Contributions under this own resource are calculated on the basis of a uniform rate applied to Member States' harmonised VAT assessment bases.

4.3. Revenue also includes amounts received from other sources. The most significant of these sources are contributions and refunds arising from Union agreements and programmes (5,9 billion euro — 4 % of EU's revenue), and fines and penalties (3,1 billion euro — 2 % of EU's revenue).

4.4. On 1 October 2016, a new decision on the EU's own-resources system (2014 ORD) ([2]) entered into force. Since it applied retroactively from 1 January 2014, the Commission recalculated the Member States' contributions for 2014 and 2015 retrospectively. It also adjusted their planned contributions for 2016 ([3]).

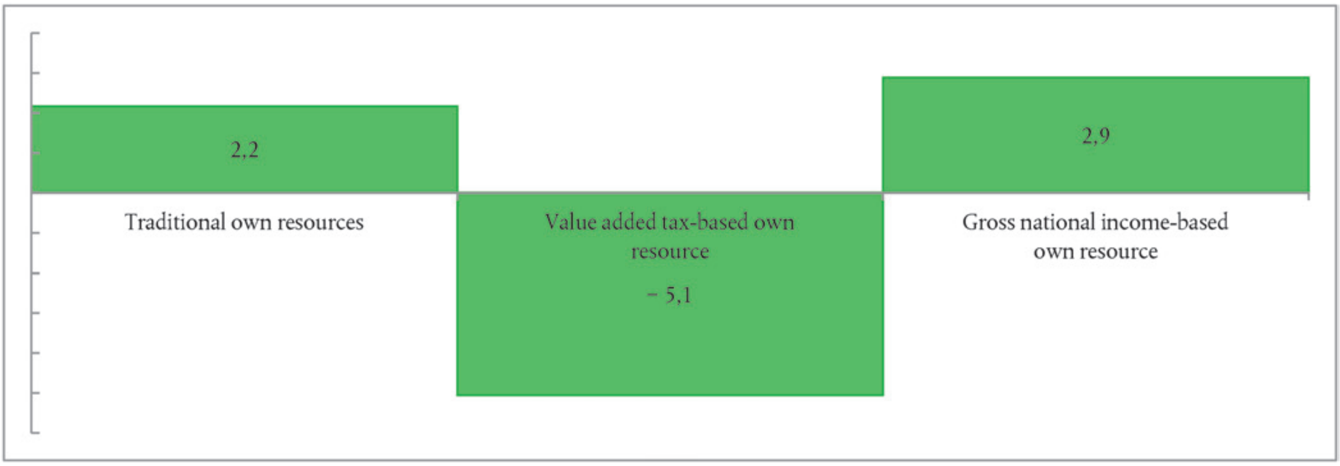
4.5. ***Box 4.2*** shows how the 2014 ORD recalculation affected the amount of revenue raised from own resources in 2014 and 2015 combined. ***Box 4.3*** shows the impact of the recalculation on individual Member States' contributions for 2014 and 2015 combined. This recalculation did not change the total amount of the EU's revenue.

([2]) Council Decision 2014/335/EU, Euratom of 26 May 2014 on the system of own resources of the EU (OJ L 168, 7.6.2014, p. 105).

([3]) The Member States' contributions were recalculated taking into account the following:
- A reduced VAT call rate of 0,15 % applies to Germany, the Netherlands, and Sweden, while the call rate for the other Member States remains 0,3 %.
- Lump-sum reductions in GNI-based payments were given to Austria, Denmark, the Netherlands and Sweden.
- The retention rate of the TOR collected was reduced to 20 % (from the previous rate of 25 %).
- For own-resources purposes, GNI is calculated according to ESA 2010 (previously, ESA 95 was used). See footnote 10.

Box 4.2 — Impact of the new own-resources decision on the amount raised from individual own resources in 2014 and 2015

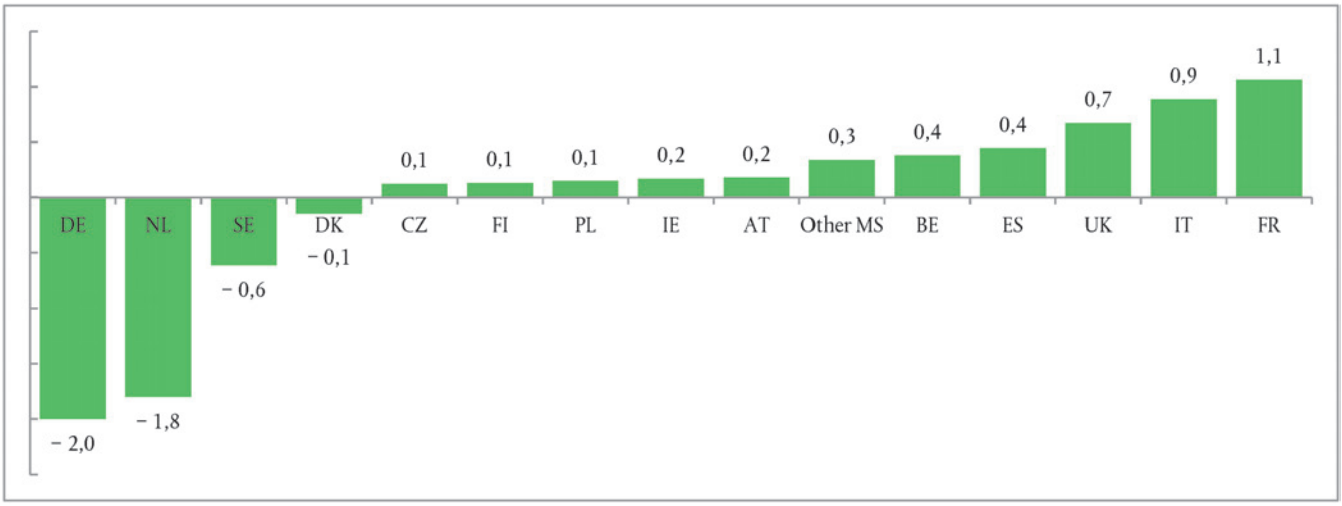
(billion euro)



Source: 2016 consolidated accounts of the European Union.

Box 4.3 — Impact of the new own-resources decision on individual Member States' contributions in 2014 and 2015

(billion euro)



Source: 2016 consolidated accounts of the European Union.

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Audit scope and approach

4.6. Applying the audit approach and methods set out in ***Annex 1.1***, in 2016 we examined the following for revenue:

(a) a sample of 55 Commission recovery orders ([4]) designed to be representative of all sources of revenue;

(b) whether the *annual activity reports* of Directorate-General for Budget (DG Budget) and Eurostat presented information on *regularity* of revenue that was broadly consistent with our results;

(c) the Commission's systems for:

(i) ensuring that the Member States' GNI and VAT data is an appropriate basis for calculating own-resources contributions, and its systems for calculating and collecting these contributions ([5]);

(ii) managing TOR, including procedures for monitoring the Member States' audits of customs duties after goods have been imported into the EU (post-clearance audits);

(iii) managing fines and penalties;

(iv) calculating the European Free Trade Association (EFTA) countries' contributions under the European Economic Area (EEA) agreement ([6]); the correction mechanisms; and the impact on Member States' contributions in 2014 and 2015 as a result of the entry into force of the 2014 ORD;

(d) the systems for TOR accounting ([7]), including post-clearance audits, in three selected Member States (Belgium, Bulgaria and Sweden) ([8]).

([4]) A recovery order is a document in which the Commission records amounts that are due to it.

([5]) Our starting point was the agreed GNI data and the harmonised VAT base prepared by the Member States. We did not directly test the statistics and data produced by the Commission and the Member States.

([6]) Iceland, Liechtenstein and Norway contribute to the EU budget under the EEA agreement. Switzerland also contributes to the EU budget under different agreements.

([7]) Our audit used data from the visited Member States' TOR accounting systems. We could not audit undeclared imports or those that had escaped customs surveillance.

([8]) These three Member States were selected on a rota basis, taking into consideration the size of their contribution.

REGULARITY OF TRANSACTIONS

4.7. ***Annex 4.1*** provides an overview of the results of *transaction* testing. Of the 55 transactions examined, none were affected by *errors*.

EXAMINATION OF ANNUAL ACTIVITY REPORTS AND OTHER ELEMENTS OF INTERNAL CONTROL SYSTEMS

4.8. As explained in paragraph 4.6, we selected and examined a number of systems. The comments which follow do not affect our overall opinion on EU revenue (see chapter 1), but they do highlight areas in which the calculation and collection of revenue could be further improved.

Overview of GNI and VAT reservations, and TOR open points

4.9. When the Commission identifies cases of potential non-compliance with the own-resources regulations ([9]), it marks the data as open and subject to amendments. For cases concerning GNI or VAT, this procedure is called setting a reservation; for TOR cases, the relevant procedure is called creating an open point. At the end of 2016, two GNI reservations were outstanding. The numbers of VAT reservations and TOR open points were similar to previous years. The numbers of outstanding GNI and VAT reservations and TOR open points for each Member State are given in ***Annex 4.2***. The impact of these reservations and open points is still to be determined, and could lead to changes in Member States' contributions.

([9]) Council Regulation (EU, Euratom) No 609/2014 of 26 May 2014 on the methods and procedure for making available the traditional, VAT and GNI-based own resources and on the measures to meet cash requirements (OJ L 168, 7.6.2014, p. 39) and Council Regulation (EU, Euratom) No 608/2014 of 26 May 2014 laying down implementing measures for the system of own resources of the European Union (OJ L 168, 7.6.2014, p. 29).

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The impact of globalisation on national accounts under ESA 2010

4.10. The 2014 ORD stipulates that, when compiling GNI for own-resources purposes, the ESA 2010 [10] accounting framework should be used instead of the ESA 95 framework [11]. One important difference between the two frameworks concerns how research and development (R&D) spending is dealt with. Under the ESA 95 framework, R&D was considered as current expenditure; under the ESA 2010 framework, it is treated as an investment [12]. Multinational companies can easily transfer R&D assets between countries for economic or fiscal reasons.

4.11. We compared forecast with provisional GNI data for all Member States. The differences were not generally significant. However, Ireland's reported GNI increased very significantly in 2015. This was a result of multinational companies relocating R&D assets to the country (see ***Box 4.4***).

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(10) ESA (European system of national and regional accounts) 2010 is the newest internationally compatible EU accounting framework. It is used to create a systematic and detailed description of an economy. See Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union (OJ L 174, 26.6.2013, p. 1).

(11) Council Regulation (EC) No 2223/1996 of 25 June 1996 on the European system of national and regional accounts in the Community (OJ L 310, 30.11.1996, p. 1).

(12) The change in the national accounts rules (from ESA 95 to ESA 2010) on the treatment of R&D led to an increase in Member States' GNI. According to a recent estimate made by the Commission, the average increase in stated GNI as a result of these changes was 2,0 %.

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Box 4.4 — Relocations of R&D assets: the impact on Ireland's national accounts

In September 2016, Ireland informed the Commission that its GNI had increased by 23,9 % (+ 39,4 billion euro) in 2015. This was caused by a small number of multinational companies transferring large amounts of intangible assets to Ireland. These mainly consisted of capitalised R&D expenditure, which is recorded in the balance sheet as intellectual property products (IPPs). The specifications which make up these IPPs are used as a basis for contract manufacturing in various countries of the world.

In addition, when R&D assets are relocated, the compilation of GNI is complicated by the following factors:

— The application of residency criteria. Under ESA 2010, the output related to these assets is recorded in the country where effective control of the assets is held.

— The valuation of the assets. In Ireland, the information was cross-checked with the companies' financial statements.

4.12. The Commission reacted promptly to the increase in GNI data submitted by Ireland, and verified the reasonableness of the methodology used for compiling Ireland's national accounts. The Commission also asked Member States to complete a questionnaire on R&D and other issues relating to multinational activities. The Member States' replies indicated that they had insufficient information in this regard. As a result, the Commission had only limited information about how these issues had been dealt with in the compilation of GNI.

4.13. It will therefore be necessary for the Commission to carry out additional work to ascertain the potential implications of multinational activities for national accounts, in terms both of methodology and of the verification process. Since the GNI data which will be used for the calculation of own resources for the period from 2010 is not yet final ([13]), the Member States' contributions are still subject to adjustment.

THE COMMISSION'S REPLIES

4.12. *Common reply to paragraphs 4.11, 4.12 and 4.13.*

This issue has a high priority and is currently being dealt with in the current verification round.

The Commission is currently investigating some more examples of the phenomenon. A high-level Task Force with representatives of the Member States has been set up and one of its first tasks has been to set up an 'early warning' procedure. The National Statistical Institutes will be expected to inform Eurostat as soon as an important restructuring case becomes known to them nationally and a case by case ad hoc task force of affected Member States will be established to agree the methodological and compilation aspects of the case.

The success of this initiative depends on the levels of co-operation between the multinational enterprises themselves and the National Statistical Institutes, on the one hand, and co-operation, in particular in sharing information, amongst the National Statistical Institutes in the different Member States.

([13]) This data is subject to revision for four years, after which it becomes time-barred, unless reservations are set by the Commission.

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Management of TOR

4.14. Each Member State sends the Commission a monthly statement of customs duties and sugar-production levies it has collected (the A accounts) and a quarterly statement of established duties which are not included in the A accounts (the B accounts).

4.15. We examined the collection of TOR in Belgium, Bulgaria and Sweden. We focused our analysis on: the compilation of the A accounts; the procedures for collecting the amounts registered in the B accounts; and post-clearance audits (see paragraph 4.6). We did not identify any significant problems in the compilation of the A accounts, but we noted recurrent shortcomings in the management of the B accounts ([14]).

4.15. *While national customs authorities need to diligently manage their B accounts, it is evident that, in an account of this nature, a repository of problematic cases, there always is a risk of shortcomings. That is why each inspection carried out by the Commission includes an examination of the B account for the customs office(s) inspected. The Commission will continue to follow up the shortcomings identified by the ECA with the Member States concerned.*

4.16. Goods may undergo customs checks after they have been cleared for free circulation within the EU (as opposed to being checked at the moment they are imported). This procedure is called a post-clearance control, a category which includes post-clearance audits.

4.17. As in previous years ([15]), we found weaknesses in how Member States identify and select importers to undergo post-clearance audits, and in how these audits are carried out. Sweden and Bulgaria had set out their framework of post-clearance controls in accordance with the Commission's customs audit guide. However, in Belgium post-clearance controls were selected based on the characteristics of individual transactions, not on the risk profiles of companies; and we observed that post-clearance audits were not generally carried out.

4.17. *In its traditional own resources inspections, the Commission always recommends to Member States that they follow the Commission's Customs Audit Guide including in the preparation and implementation of their post-clearance controls. It will continue to encourage Member States to do so. The lack of post–clearance audits in Belgium is being followed up with the national authorities.*

The Commission continues to work with the Member States on enhancing the common risk management framework for customs controls in relation to financial risks in line with the EU Strategy and Action Plan for customs risk management. Project groups have been established to develop EU common risk criteria and standards for financial risks, and to examine the possibility to establish further guidance on post-clearance audits regarding matters raised by the ECA. See also reply to paragraph 4.18.

([14]) See paragraph 4.18 of the 2015 annual report, paragraph 4.22 of the 2014 annual report, paragraph 2.16 of the 2013 annual report, and paragraphs 2.32 and 2.33 of the 2012 annual report.

([15]) See paragraphs 4.15 and 4.16 of the 2015 annual report, paragraph 4.19 of the 2014 annual report, paragraph 2.14 of the 2013 annual report, and paragraph 2.31 of the 2012 annual report.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

4.18. In July 2016 [16] the Commission noted that six Member States [17] either did not carry out any post-clearance audits or did not provide any information about these audits [18]. These Member States accounted for about 20 % of all customs duties collected in the EU.

4.18. *The Commission regularly provides methodological clarifications to all Member States, insists on accurate and reliable reporting and, when necessary, invites them to provide missing information and/or clarify the information provided. The Commission will continue to assess Member States' reports made under Article 6 of Council Regulation (EU, Euratom) No 608/2014 and will impress on them the need to perform proper controls, including post-clearance audits.*

The Commission will raise the new matters mentioned in observations 4.17 and 4.18 with the Member States in the context of the ongoing work referenced under 4.17.

The Commission's calculations of EEA/EFTA contributions and of Member States' contributions following the entry into force of the 2014 ORD

4.19. We found no significant problems with the recalculation of Member States' contributions following the entry into force of the 2014 ORD. However, we identified minor errors in the calculation of the 2016 EEA/EFTA contribution. The errors that we found are similar to those we found last year [19].

4.19. *An internal review system for the EEA/EFTA outturn calculation has been set up in April 2017 in order to prevent errors in future calls for funds.*

Annual activity reports and other governance arrangements

4.20. The information provided in the 2016 annual activity reports published by DG Budget and Eurostat corroborates our observations and conclusions. We note that DG Budget had made a *reservation* on TOR not collected by the United Kingdom. This was the result of an OLAF investigation into the valuation of imports of textiles and footwear from China; OLAF issued its final report and recommendations in March 2017. The amount of TOR concerned by the reservation is yet to be confirmed using information to be supplied by the United Kingdom.

(16) At the ACOR meeting held on 7 July 2016, the Commission presented information on the Member States' reports for 2015 under Article 17(5) of the own-resources Regulation (Council Regulation (EC, Euratom) No 1150/2000 of 22 May 2000 implementing Decision 94/728/EC, Euratom on the system of the Communities' own resources (OJ L 130, 31.5.2000, p. 1)).

(17) Belgium, Estonia, Italy, Portugal, Romania and Slovenia.

(18) We recommended in previous reports (see recommendations 3 and 4 of the 2013 annual report, and recommendation 3 of the 2014 annual report) that the Commission improve the existing guidance on post-clearance audits and encourage its implementation by Member States. Although the Commission has made some progress in this area, our recommendations have not yet been fully implemented.

(19) See paragraph 4.20 of the 2015 annual report.

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CONCLUSION AND RECOMMENDATIONS

Conclusion

4.21. The overall audit evidence indicates that the level of error in revenue was not material. In our opinion, the revenue-related systems which we examined were, overall, effective. The key internal TOR controls we assessed in certain Member States were partially effective.

Recommendations

4.22. ***Annex 4.3*** shows the findings of our follow-up review of the five recommendations we made in our 2013 annual report ([20]). The Commission had implemented two recommendations in full, while three had been implemented in most respects.

4.23. Based on this review and our findings and conclusions for 2016, we recommend that the Commission:

— **Recommendation 1:** analyse, in cooperation with Member States, all the potential implications of multinational activities on the estimation of GNI, and provide guidance to them on how to deal with these activities when compiling national accounts.

The Commission accepts the recommendation. Work is already under way to encourage Member States to raise the priority of this work and, in particular, to profile large multinational enterprises. The Commission will provide guidance and, if necessary, reservations will be set. Please see also the common reply to paragraphs 4.11, 4.12 and 4.13.

— **Recommendation 2:** confirm, during the ongoing GNI verification cycle, that R&D assets have been correctly captured in Member States' national accounts, paying particular attention to the valuation of R&D assets and to residency criteria in cases where multinational activities have been relocated.

The Commission accepts the recommendation. R&D is given high attention in the current verification round. The implementation of the relevant ESA 2010 rules is being checked for all Member States in detail, including the impact of globalisation.

([20]) We chose our 2013 report for this year's follow-up exercise as, typically, enough time should have elapsed for the Commission to have implemented our recommendations.

ANNEX 4.1

RESULTS OF TRANSACTION TESTING FOR REVENUE

	2016	2015
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	**55**	55
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**0,0 %**	0,0 %
Upper error limit (UEL)	0,0 %	
Lower error limit (LEL)	0,0 %	

ANNEX 4.2

NUMBERS OF OUTSTANDING GNI RESERVATIONS, VAT RESERVATIONS AND TOR OPEN POINTS BY MEMBER STATE AT 31.12.2016

Member State	GNI reservations (situation at 31.12.2016)	VAT reservations (situation at 31.12.2016)	TOR 'open points' (situation at 31.12.2016)
Belgium	0	4	29
Bulgaria	0	2	4
Czech Republic	0	0	6
Denmark	0	3	19
Germany	0	8	8
Estonia	0	1	2
Ireland	0	12	12
Greece	2	8	26
Spain	0	1	26
France	0	5	26
Croatia	0	1	0
Italy	0	4	18
Cyprus	0	1	5
Latvia	0	2	2
Lithuania	0	0	0
Luxembourg	0	10	1
Hungary	0	1	8
Malta	0	0	2
Netherlands	0	5	46
Austria	0	10	6
Poland	0	4	8
Portugal	0	0	20
Romania	0	2	16
Slovenia	0	0	4
Slovakia	0	0	2
Finland	0	4	10
Sweden	0	3	7
United Kingdom	0	4	22
TOTAL 31.12.2016	**2**	**95**	**335**
TOTAL 31.12.2015	55	85	325

GNI process-specific reservations are not included in the table.
Source: European Court of Auditors.

ANNEX 4.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR REVENUE

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				
2013	**Recommendation 1:** The Commission should encourage Member States to provide more clarification on the methodologies they use for the compilation of data in the area of the non-observed economy and promote harmonisation between Member States in this area.	X						
	Recommendation 2: The Commission should put in place and closely monitor a detailed action plan with clear milestones to address the problems in the compilation of Greece's national accounts.	X						
	Recommendation 3: The Commission should establish minimum risk analysis standards for the customs post-clearance audits, including building upon the information in the existing database of imports, in order to allow Member States to better target risky importers.		X					
	Recommendation 4: The Commission should encourage Member States to use the existing guidance, and monitor, the implementation of Member States' post-clearance audits.		X					*The Commission will continue to assess Member States' reports made under Article 6 of Regulation (EU, Euratom) No 608/2014 and will impress on them the need to perform proper controls, including post-clearance audits. In its traditional own resources inspections, the Commission always recommends to Member States that they follow the Commission's Customs Audit Guide. In its inspections in 2017 the Commission has been requesting the Member States to confirm that they use the Guide in the preparation and implementation of their post clearance controls. The recommendation refers to a continuous process that the Commission keeps pursuing.*

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				
2013	**Recommendation 5:** The Commission should encourage Member States to correctly use A and B accounts and to ensure that they are demonstrably complete and correct.		X					*Under the current legal framework the carrying out of controls is a Member State competence. In its inspections the Commission encourages Member States to correctly use the A and B accounts, and will continue to do so. It will continue to examine the use of the A and B accounts in the course of its inspections and will request the Member States to ensure that they are complete and correct.*

CHAPTER 5

'Competitiveness for growth and jobs'

TABLE OF CONTENTS

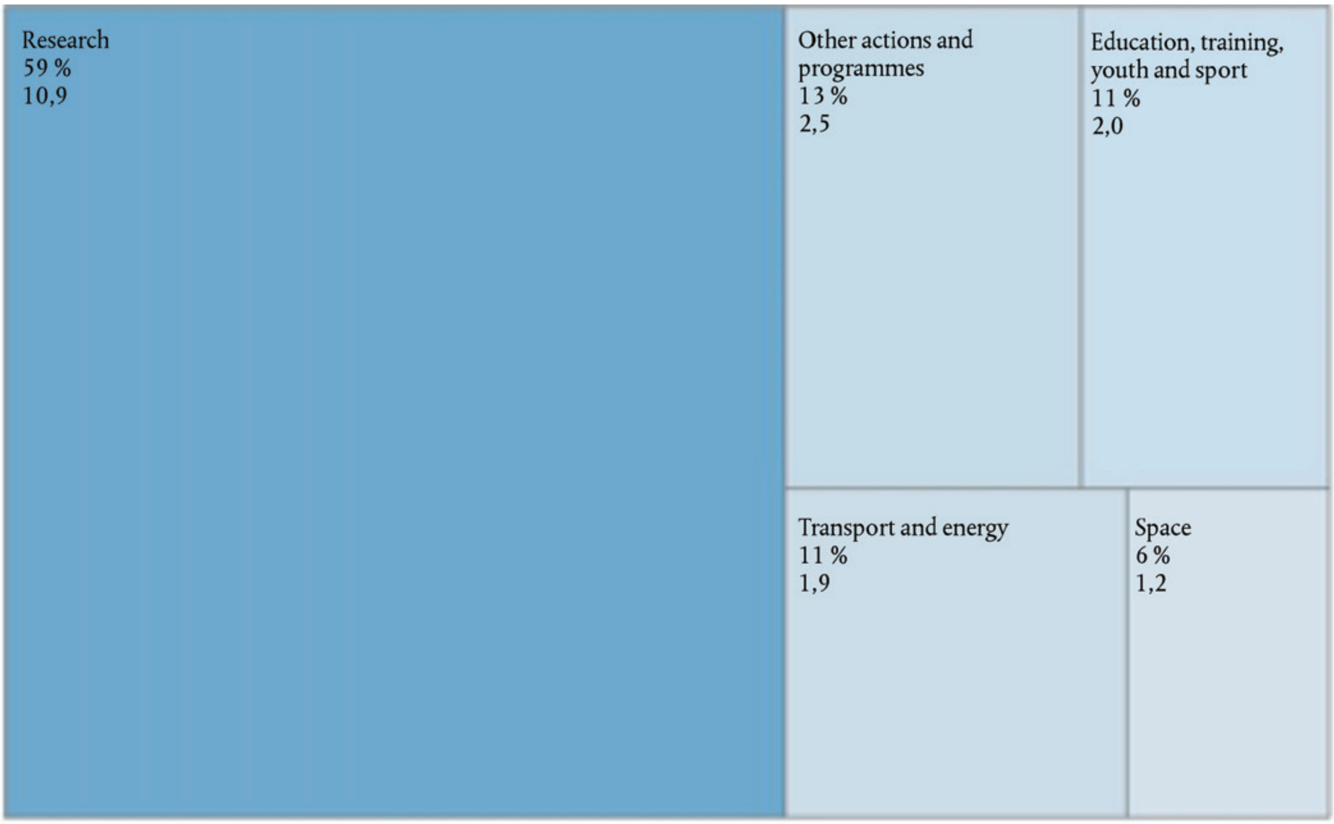
THE COURT'S OBSERVATIONS

INTRODUCTION

5.1. This chapter presents our findings for the *MFF* sub-heading 'Competitiveness for growth and jobs'. ***Box 5.1*** gives an overview of the main activities and spending under this sub-heading in 2016.

Box 5.1 — MFF sub-heading 1a — 'Competitiveness for growth and jobs' — 2016 breakdown

(billion euro)



Total payments for the year	18,5
- advances (1)	*12,2*
+ clearings of advances (1)	*8,9*
Audited population, total	**15,2**

(1) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 10).

Source: 2016 *consolidated accounts* of the European Union.

THE COURT'S OBSERVATIONS

Brief description of 'Competitiveness for growth and jobs'

5.2. Policy objectives under this sub-heading include improving research and innovation, enhancing education systems and promoting employment, ensuring a digital single market, promoting renewable energy and energy efficiency, modernising the transport sector and improving the business environment, especially for small and medium-sized enterprises (SMEs).

5.3. Research and innovation accounts for 59 % of spending, via the Seventh Framework Programme for Research and Technological Development 2007-2013 (the 'Seventh Research Framework Programme') and Horizon 2020 — the Framework Programme for Research and Innovation 2014-2020 ('Horizon 2020').

5.4. Most of the spending takes the form of *grants* to public or private *beneficiaries* participating in projects. The Commission provides advances to beneficiaries upon signature of a grant agreement or financing decision. The Commission reimburses the EU-funded costs reported by beneficiaries, deducting any advances paid.

5.5. The principal risk to the *regularity* of *transactions* is that beneficiaries declare ineligible costs which are neither detected nor corrected before the Commission reimburses them. This risk is particularly high for the Seventh Research Framework Programme, which has complex eligibility rules that are often misinterpreted by beneficiaries (especially those less familiar with the rules, such as SMEs, first-time participants and non-EU entities).

THE COURT'S OBSERVATIONS

Audit scope and approach

5.6. Applying the audit approach and methods set out in ***Annex 1.1***, in 2016 we examined the following for 'Competitiveness for growth and jobs':

(a) a sample of 150 transactions, in line with paragraph 7 of ***Annex 1.1***. The sample was designed to be representative of the full range of spending under this MFF sub-heading. It consisted of 92 transactions for research and innovation (79 for the Seventh Research Framework Programme and 13 for Horizon 2020) and 58 transactions for other programmes and activities;

(b) whether the *annual activity reports* of the Directorate-General for Research and Innovation (DG RTD), the Directorate-General for Education and Culture (DG EAC) and the Directorate-General for Mobility and Transport (DG MOVE) presented information on regularity of spending that was broadly consistent with our results ([1]);

(c) the audit performed in 2016 by the Commission's Internal Audit Service (IAS) of the progress made by the Commission in implementing its ex-post audits of research and innovation spending.

([1]) We also performed a limited review of the calculation of the error rates published in the annual activity reports of the Directorate-General for Communication Networks, Content and Technology (DG CNECT), the Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW), the European Research Council Executive Agency (ERCEA) and the Research Executive Agency (REA).

THE COURT'S OBSERVATIONS

PART 1 — REGULARITY OF TRANSACTIONS

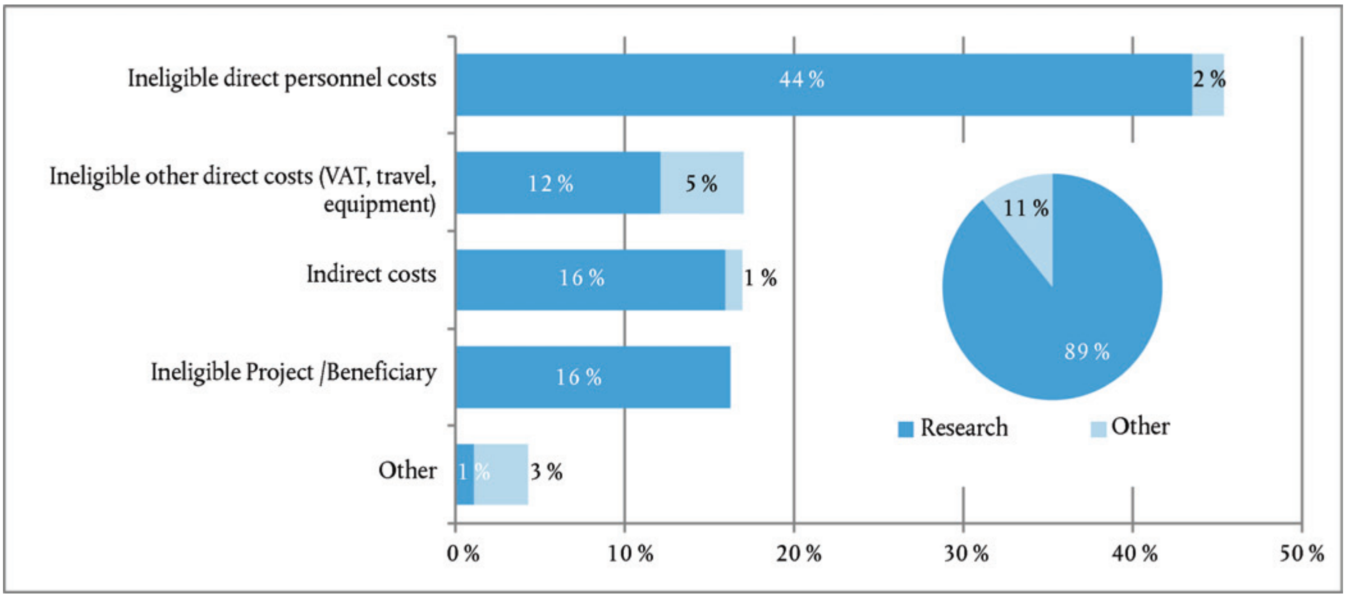
5.7. ***Annex 5.1*** provides an overview of the results of transaction testing. Of the 150 transactions examined, 74 (49 %) contained *errors*. On the basis of the 48 errors we have quantified, we estimate the level of error to be 4,1 % ([2]).

5.8. ***Box 5.2*** gives a breakdown of our *estimated level of error* for 2016. We detected quantifiable errors relating to ineligible costs in 37 of the 92 sampled research and innovation transactions, accounting for almost 90 % of our estimated level of error for 'Competitiveness for growth and jobs' in 2016.

THE COMMISSION'S REPLIES

5.7. *The estimated level of error reported by the ECA is one indicator of the effectiveness of the implementation of EU expenditure. However, the Commission has a multiannual control strategy. On this basis its services estimate a residual error rate, which takes account of recoveries, corrections and the effects of all their controls and audits over the period of implementation of the programme.*

Box 5.2 — Most errors occurred in research and innovation projects



Source: European Court of Auditors.

([2]) 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 2,1 % and 6,1 % (the lower and upper error limits respectively).

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The main source of quantifiable errors is the reimbursement of ineligible costs declared by beneficiaries

5.9. Six of the errors quantified exceeded 20 % of the corresponding transaction value (see ***Annex 5.2***). These six cases all concerned ineligible personnel costs declared by beneficiaries in projects under the Seventh Research Framework Programme.

5.10. Of the 58 transactions sampled for other programmes and activities, we detected quantifiable errors in eight. The errors related to breaches of eligibility rules by beneficiaries, such as incorrectly calculated personnel costs and the declaration either of costs without supporting evidence or costs incurred outside the period of the cost statement (3).

5.11. In 19 cases where quantifiable errors were made by beneficiaries, the Commission or independent auditors (4) had sufficient information to prevent, or to detect and correct the error before accepting the expenditure. Had the Commission or independent auditors made proper use of all the information at their disposal, the estimated level of error for this chapter would have been 1,2 percentage points lower (5).

(3) The errors ranged from 1 % to 20 % of the value examined and concerned projects under the Trans-European Networks-Transport programme (2 cases), the Competitiveness and Innovation Programme (2 cases), the Lifelong Learning Programme (2 cases), the Connecting Europe Facility (1 case), and an annual subsidy payment to the European Institute of Innovation and Technology (1 case).

(4) In certain cases, for example cost statements for Seventh Research Framework Programme projects where the EU contribution exceeds 375 000 euro, independent auditors must certify that the declared costs are eligible.

(5) Information included in supporting documentation and databases or emerging from standard cross-checks and (other) mandatory checks.

THE COMMISSION'S REPLIES

5.9. *Common reply to paragraphs 5.9 and 5.10.*

In research and innovation projects, personnel costs account for a large part of the project costs. In order to accommodate the diversity of cost structures in the European research landscape, a conscious policy choice has been made to reimburse these cost categories on the basis of real costs, rather than unit costs or flat rates. That explains why they are prone to error, which is reflected in Box 5.2. Horizon 2020 has been conceived to address, to the extent possible, these sources of error through the introduction of a number of simplifications (see paragraph 5.12).

5.11. *The Commission has a sound system of ex ante controls in place including detailed automated checklists, written guidance and continuous training. The improvement of this system without imposing additional administrative burdens on beneficiaries, and whilst ensuring that payments to researchers are made promptly, is a constant challenge. The ECA's findings have been and will be used to make further improvements to ex ante controls.*

As regards independent auditors certifying cost claims, which account for 15 of the 19 cases mentioned by the ECA, this is a well-known issue, addressed in previous reports. In order to follow up on the ECA's recommendations, the Commission has organised a series of meetings targeting beneficiaries and independent certifying auditors to raise awareness of the most common errors. In addition, feedback has been provided to certifying auditors who have made errors, and a more didactic template for audit certificates has been provided in Horizon 2020. For research, audit certificates are estimated to reduce the error rate by 50 % compared to uncertified claims. So while it is recognised that they do not identify every error, they are an important tool to reduce the overall error rate.

THE COURT'S OBSERVATIONS

Most non-quantifiable errors concerned research and innovation projects

5.12. Within the 150 transactions sampled, we also found 61 non-quantifiable errors relating to cases of non-compliance with funding rules [6]. These cases mostly concerned research and innovation projects and mainly related to weaknesses in beneficiaries' time recording systems and to delays in the distribution of the EU contribution by the project coordinator to the other project participants. Although in some cases there were understandable reasons for the delay, any such delays in the transfer of the EU contribution can have serious financial consequences for beneficiaries, especially SMEs [7].

Horizon 2020: continuing simplification but further efforts required

5.13. We have previously noted that Horizon 2020 was set up with simpler funding rules than the Seventh Research Framework Programme and that the Commission has invested considerable efforts in reducing administrative complexity [8].

5.14. Simplification is important because it reduces the administrative burden. In 2016, the Commission put forward further simplification measures: a new definition of additional remuneration for researchers; streamlining of the Horizon 2020 work programme for 2018-2020; targeted support for start-ups and innovators; and wider use of lump-sum funding for projects. These measures are an improvement compared with earlier framework programmes.

5.15. Simplification measures are intended to decrease the risks of legal uncertainty and inconsistent treatment of beneficiaries. This has been a recurrent issue in previous framework programmes and we see opportunities to further simplify the legal framework.

THE COMMISSION'S REPLIES

5.12. *The Commission considers it best that the transfer of funds between consortium members is managed within the consortium.*

The Commission has reminded coordinators of their obligation to promptly transfer funds and when a case of delayed distribution of funds is detected, or there is a complaint on this issue the Commission's standard practice is to follow up with the project coordinator on the reasons of this delay.

5.15. *Simplification is a continuous process. The creation of the Common Support Centre is a key action which aims to ensure legal certainty and consistent treatment of beneficiaries.*

(6) 25 transactions contained both quantifiable and non-quantifiable errors.

(7) See also the 2012 annual report, paragraph 8.18 and paragraph 8.42 (recommendation 2); and the 2013 annual report, paragraph 8.12.

(8) See the 2014 annual report, paragraph 5.12.

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5.16. The Commission published revised rules for the calculation of personnel costs in July 2016, but the principal source of guidance ('Annotated Model Grant Agreement') was not updated until November 2016. The revised rules include a complicated formula that may be used to calculate some personnel costs; this increases complexity for beneficiaries. We found that, in practice, the correct application of the formula could still result in beneficiaries declaring more costs than actually incurred.

THE COMMISSION'S REPLIES

5.16. *The new option to calculate personnel costs introduced in the Horizon 2020 grants was to satisfy repeated requests from participants, in particular to allow them to more easily use their usual cost accounting practices. There is also a simple option available to all beneficiaries. These calculations are subject to an additional safeguard, which is that beneficiaries must ensure that the total amount of personnel costs (per person/per year) declared in EU and Euratom grants is respected.*

The Commission published on 25 August 2016 on the Participant Portal FAQs with explanations and examples on how to apply the new option for personnel costs.

5.17. The rules have also been simplified in respect of the use of consultants, which has also been a source of error in the Seventh Research Framework Programme [9]. However, the change in the rules has resulted in less flexibility for beneficiaries: under the Seventh Research Framework Programme both natural persons and legal entities fit into the definition of in-house consultants, whereas under Horizon 2020 only natural persons may be considered in-house consultants.

5.17. *The Commission decided to limit the use of consultants to natural (physical) persons based on the FP7 experience. In FP7 some costs for consultants, claimed as direct personnel costs, were regularly found to be ineligible during audits.*

The Horizon 2020 rules on in-house consultants are simpler and clearer. They take into account, to a larger extent, the national specificities of the Member States. Legal entities providing consultancy services may be charged as sub-contracting costs.

5.18. The 'Annotated Model Grant Agreement' has evolved into a highly detailed document of more than 700 pages. For two Horizon 2020 projects, we found that the Commission approved grant agreements where some of the required clauses were either absent or incorrectly formulated, increasing legal uncertainty.

5.18. *The Annotated Grant Agreement (AGA) groups in one single document all the necessary explanations on the Horizon 2020 grant provisions. Under FP7 those explanations were spread throughout several documents amounting to more than 1000 pages. The AGA covers 24 different grants. However, beneficiaries do not need to read the whole document, but only refer to the Articles or parts relevant to their grant.*

The Commission accepts that there have been some minor errors in a small number of the first Horizon 2020 Grant Agreements. The Commission pays close attention to the practical aspects of the Horizon 2020 grant agreements implementation (IT processes, business processes etc.) and continuously updates the IT system and trains its personnel in order to aim to avoid errors when signing and implementing the grant agreements.

(9) See for example the 2015 annual report, paragraph 5.13.

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5.19. As we have previously observed, the European Institute of Innovation and Technology (EIT), despite implementing projects using Horizon 2020 funds, remains outside the Commission's common management and control framework for research and innovation spending ([10]). In some cases, the EIT applies conditions which diverge from Horizon 2020 rules. For example, under Horizon 2020 rules, beneficiaries may use an independent auditor of their choice to certify their declared costs, whereas the EIT appoints its own external auditor.

THE COMMISSION'S REPLIES

5.19. *The Grant Agreements between the EIT and Knowledge and Innovation Communities (KIC) are based on the Horizon 2020 model grant agreement. The EIT's management and control framework, supervised by the Commission, ensures compliance with those rules.*

The obligation to submit a certificate on financial statements is applied throughout the framework programme. The centralisation of the procurement of audit certificates is a practical solution appropriate to the particular situation of the EIT. It reduces the administrative burden on beneficiaries and can increase the assurance obtained at the same time, addressing previous audit recommendations of the ECA.

Annual activity reports corroborated our findings and conclusions, but we found different approaches in their presentation of error rates and amounts at risk

5.20. The annual activity reports we examined gave a fair assessment of these DGs' financial management in relation to the regularity of underlying transactions, and the information provided corroborated our findings and conclusions. For example, the reports of all DGs implementing research and innovation spending include a *reservation* on payments in reimbursement of cost claims under the Seventh Research Framework Programme.

5.20. *The Commission welcomes the assessment of the ECA.*

5.21. Although the information provided in the reports we examined corroborated our findings and conclusions, we found different approaches to calculating error rates for parts of the Seventh Research Framework Programme. For the space and security sub-programmes, DG GROW and DG Migration and Home Affairs calculated a combined *residual error rate*, whereas for the part of the budget of the same sub-programmes delegated to REA, the Executive Agency calculated specific residual error rates for each sub-programme.

5.21. *Each DG or service is required to estimate a residual error rate in its Annual Activity Report.*

REA manages three programmes, each with different inherent risk characteristics. It is therefore normal that it considers each sub-programme differently when considering the residual error rate in each of them.

5.22. For the 'Marie Curie' and 'Research for the benefit of SMEs' sub-programmes, the Commission used an error rate based not only on the results of its randomly selected ex-post audits, but also on the results of its targeted audits of the highest-funded beneficiaries. For the Marie Curie sub-programme, this approach yielded an error rate of 1,2 %, whereas the error rate based only on the randomly selected audits would have been 4,1 %.

5.22. *REA outlined in its Annual Activity Report why it included audits of major beneficiaries. Around 15 % of the highest ranked major beneficiaries (in terms of value of their participation) account for 80 % of the Marie-Curie Actions (MCA) budget. As a result, including the audits of these major beneficiaries is highly relevant when assessing the risk of errors in the total population of MCA grants.*

([10]) See the 2015 annual report, paragraph 5.23.

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5.23. As in 2014 [11], we also observed inconsistencies in the Commission's approaches to calculating the estimated overall amounts at risk. We identified the use of four different approaches for administrative expenditure [12]. For operational expenditure, the inconsistency concerned the use of different error rates for the parts of the research and innovation budget delegated to joint undertakings or managed via financial instruments.

THE COMMISSION'S REPLIES

5.23. *The Commission has taken steps to harmonise the presentation of the approach for the big expenditure items, especially for the Framework Programmes. However, it accepts that there have been some inconsistencies in some expenditure items like administrative costs. Different approaches can be justified, but where possible, the Commission will ensure harmonisation in the future.*

Common Audit Service: significant efforts needed to improve planning, monitoring and reporting processes for Horizon 2020

5.24. The Commission's ex-post audits of beneficiaries are a key control over the regularity of transactions. The audits provide essential input to the Commission's assessment of the regularity of transactions and form the basis for recovering funds which have been used to reimburse ineligible costs. Since 2014, the Commission's Common Audit Service for research and innovation spending has been responsible for implementing the Commission's ex-post audit strategies for the Seventh Research Framework Programme and Horizon 2020.

5.25. In 2016, the IAS audited the progress made by the Common Audit Service for research and innovation in meeting the objectives of the Commission's ex-post audit strategy for the Seventh Research Framework Programme.

5.25. *The Internal Audit Service is an important part of the Commission's overall control system and provides assurance to the institution about the operation of its internal systems. It has a multi-annual risk-based audit plan.*

5.26. The IAS recognised that the Common Audit Service had obtained good results in reaching the strategic annual targets for the number of audits closed in 2014 and 2015. Nevertheless, the IAS concluded that the Common Audit Service needed to make significant efforts to refine its internal processes, in order to achieve the overall objectives of the strategy and to be adequately prepared for the challenges of the Horizon 2020 ex-post audit strategy. The IAS stressed in particular the need to reduce the time taken to close audits and to improve internal processes for planning, monitoring and reporting on them. The Common Audit Service accepted all recommendations made by the IAS.

5.26. *The Common Audit Service (CAS) achieved its strategic annual targets for closing audits in 2016. The CAS submitted a detailed action plan which the IAS has considered to be satisfactory to mitigate the risks identified. The IAS is planning a follow-up audit in 2018 to assess the effective implementation of the recommendations.*

[11] The 2014 annual report, paragraphs 5.29 to 5.31.
[12] Minimum/maximum error rates of 0 %/0,5 %, 0 %/0,6 %, 0 %/1,99 % and 0 %/2 % respectively.

THE COURT'S OBSERVATIONS

5.27. We previously reported that the different implementing bodies had experienced difficulties in finding a common position on how to implement ex-post audit recommendations on recovering ineligible costs, thus increasing the risk of inconsistent treatment of beneficiaries and raising legal uncertainty [13]. The Commission was due, in April 2017, to define a common approach for implementing bodies to act upon audit results but has postponed this until January 2018.

THE COMMISSION'S REPLIES

5.27. *The Commission currently undertakes considerable ad hoc coordination efforts aiming to ensure that the identified risk is properly mitigated and that there is a harmonised treatment of beneficiaries. To increase effectiveness, the Common Support Service will take over this coordination from January 2018, in time for the implementation of the first Horizon 2020 audits.*

CONCLUSION AND RECOMMENDATIONS

Conclusion

5.28. The overall audit evidence indicates that the level of error in spending on 'Competitiveness for growth and jobs' was material.

5.29. For this MFF sub-heading, our testing of transactions produced an estimated overall level of error of 4,1 % (see ***Annex 5.1***).

Recommendations

5.30. ***Annex 5.3*** shows the findings of our follow-up review of the three recommendations we made in our 2013 annual report [14]. The Commission had implemented these recommendations in most respects.

5.31. Based on this review and our findings and conclusions for 2016, we recommend that the Commission:

— **Recommendation 1**: further streamline the Horizon 2020 rules and procedures to reduce legal uncertainty by further taking into account the *simplified cost options* in the revised *Financial Regulation* such as unit costs, lump sums, flat-rate financing and prizes.

The Commission accepts the recommendation. Some Simplified Cost Options (SCOs) are already in use in Horizon 2020, and the Commission is continually considering how they can be extended.

(13) See 2015 annual report, paragraph 5.26.
(14) We chose our 2013 report for this year's follow-up exercise as, typically, enough time should have elapsed for the Commission to have implemented our recommendations.

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— **Recommendation 2**: ensure that its services take a consistent approach towards the calculation of error rates and overall amounts at risk.

— **Recommendation 3**: promptly address the weaknesses in its ex-post audits identified by the IAS, by reducing the time taken to close ex-post audits and improving internal processes for planning, monitoring and reporting of audits.

PART 2 — PERFORMANCE ISSUES IN RESEARCH AND INNOVATION PROJECTS

5.32. We assessed *performance* for 60 of the sampled research and innovation projects ([15]). In 23 cases, these projects had already been completed. We did not directly assess the quality of the research undertaken or the projects' *impact* in terms of achieving the policy objective of improving research and innovation.

5.33. For each project, we reviewed the assessment report, which is completed by the Commission Project Officer as part of the checks before reimbursement of the declared costs. We checked whether the Project Officer found that:

— reported progress on *outputs* and *results* was in line with the objectives set out in the grant agreement;

— costs charged to the project were reasonable in relation to the reported progress;

— the outputs and results of the project had been disseminated in accordance with the requirements of the grant agreement.

THE COMMISSION'S REPLIES

The Commission accepts the recommendation.

The specific circumstances of each DG and each spending programme may always require some fine-tuning of the approach to calculating error rates. However, the Commission is continually working on increasing consistency in these calculations.

The Commission accepts the recommendation and has already set out an action plan which is being implemented.

([15]) We assessed performance of collaborative projects involving multiple participants and excluded transactions such as mobility payments to individual researchers.

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Most projects achieved their expected outputs and results

5.34. Based on the Commission's reports, we found that most projects achieved their expected output and results and in 12 cases, the Commission assessed that the projects had been exceptionally successful. However, the Commission's reports also revealed that several projects were affected by issues that detracted from their performance:

— in nine cases, reported progress was only partly in line with the objectives agreed with the Commission;

— in four cases [16], the Commission considered that the reported costs were not reasonable in relation to the progress achieved;

— in six cases [17], the project outputs and results had only been partly disseminated and in one case, no dissemination activities had taken place at all.

5.35. In general, we observed that difficulties in management and coordination increased when projects included a high number of participants.

THE COMMISSION'S REPLIES

5.34. *The aim of the monitoring process is to identify where projects are not fully successful, and to take appropriate action to resolve the problem.*

Depending on the situation the Commission may amend the contract (for example if scientific developments have rendered the original objectives obsolete), enter into discussion with the project partners to get the project back on track, reduce the payment or cancel the contract. The aim is to resolve the problem during the lifetime of the project to ensure that excellent research is produced at the end of it.

It should be noted that dissemination often occurs after the end of the project, for example due to the time required to publish/file a patent.

(16) In two of these four cases, reported progress was also only partly in line with the objectives.

(17) In one of these six cases, reported progress was also only partly in line with the objectives.

ANNEX 5.1

RESULTS OF TRANSACTION TESTING FOR 'COMPETITIVENESS FOR GROWTH AND JOBS'

	2016	2015
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	**150**	150
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**4,1 %**	4,4 %
Upper error limit (UEL)	6,1 %	
Lower error limit (LEL)	2,1 %	

ANNEX 5.2

OVERVIEW OF ERRORS WITH AN IMPACT OF AT LEAST 20 % FOR 'COMPETITIVENESS FOR GROWTH AND JOBS'

Introduction

Applying the general audit methodology set out in ***Annex 1.1***, we tested a representative sample of transactions to estimate the level of *irregularity* within the population for this MFF sub-heading. The errors we detected in testing do not constitute an exhaustive list — either of individual errors or of possible error types. The findings outlined below concerning errors with an impact of at least 20 % of the transaction value examined are presented by way of example ([1]). These errors were found in transactions worth between 155 000 euro and 1,3 million euro, with a median value ([2]) of 273 000 euro.

Examples of error

Seventh Research Framework Programme projects

Example 1 — declared costs not covered by grant agreement

The beneficiary (a non-EU public body participating in a project to develop protective coatings for ships) declared costs that were actually incurred by another entity which was not part of the grant agreement. The ineligible costs amounted to 100 % of the total costs examined.

Example 2 — excessive personnel costs declared

The amounts declared for reimbursement could not be reconciled to the accounts of the beneficiary (a non-profit research organisation participating in a collaborative project on the development of secure supply-chain systems), and the beneficiary was not able to provide all underlying calculations used to prepare the cost statement. We found that the hourly rate used to calculate salary costs was excessively high. The ineligible costs amounted to 81 % of the total costs examined.

Example 3 — ineligible indirect costs and bonus payments

The beneficiary (a public body participating in a project on the development of a cloud-based internet infrastructure for services) claimed personnel costs which included ineligible bonus payments. In addition, the beneficiary declared actual *indirect costs*, but did not satisfy the criterion of having an analytical accounting system identifying the project-related indirect costs. The ineligible costs amounted to 51 % of the total costs examined.

Example 4 — incorrectly calculated personnel costs and other ineligible costs

The beneficiary (a non-EU public body participating in a project in the field of biofuels technology) calculated personnel costs incorrectly and also charged costs without sufficient evidence of their relation to the project. The ineligible costs amounted to 38 % of the total costs examined.

Example 5 — excessive personnel costs

The beneficiary (an SME participating in a project to develop coordinated solutions to EU health emergencies) declared excessively high personnel costs and also charged amounts for personnel costs incurred outside the period of the cost statement. The ineligible costs amounted to 37 % of the total costs examined.

Example 6 — time recording discrepancies

We identified numerous discrepancies in the timesheets underlying the personnel costs declared by the beneficiary (a public body participating in a project to develop energy-efficient systems based on internet technologies). The ineligible costs amounted to 21 % of the total costs examined.

([1]) These errors account for more than half of the overall estimated level of error for 'Competitiveness for growth and jobs'.

([2]) I.e. half of all errors with an impact of at least 20 % were found in transactions worth less than 273 000 euro, and the remainder in transactions worth more than this amount.

ANNEX 5.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'COMPETITIVENESS FOR GROWTH AND JOBS'

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				
2013	The Commission should: **Recommendation 1:** extend and intensify its communication campaign to raise awareness among beneficiaries and independent auditors about the eligibility rules for research spending under FP7;		X					*The Communication campaign was initially related to FP7 and covered a full range of participants (around 4 500). The Commission is now focusing on providing guidance for Horizon 2020. Beneficiaries and their auditors are attending these meetings. Additionally, guidance related to all material aspects of the grant management is available to all stakeholders through the internet.*
	Recommendation 2: across the policy group, make its control activities more risk-driven, focusing checks on high-risk beneficiaries (for example entities with less experience of European funding) and reducing the burden of checks on less risky beneficiaries;		X					*The Commission's Control Strategies for the current funding programmes are designed to include more risk-based controls.*
	Recommendation 3: for the new 2014-2020 programmes for research and other internal policies, provide timely, consistent and clear guidance to beneficiaries and managing authorities in respect of the revised eligibility and control requirements.		X					*For the current funding programmes the Commission has provided considerable guidance to beneficiaries on all the important aspects related to the implementation of the programme. The information is being updated regularly by the Commission. It has been distributed via internet, but also during publicity campaigns, meetings with Member States and in ad hoc meetings with participants and their auditors.*

CHAPTER 6

'Economic, social and territorial cohesion'

CONTENTS

THE COURT'S OBSERVATIONS

INTRODUCTION

6.1. This chapter presents our findings for the *MFF* heading 'Economic, social and territorial cohesion'. ***Box 6.1*** gives an overview of the main activities and spending under this heading in 2016.

Box 6.1 — MFF sub-heading 1b 'Economic, social and territorial cohesion' — 2016 breakdown

(billion euro)

Total payments for the year		37,8
-	*advances* (1) (2)	*11,7*
+	*clearings of advances* (1)	*15*
+	*disbursements to final recipients from financial instruments under shared management*	*2,5*
-	*payments for the 2014-2020 MFF period*	*7,9*
Audited population, total		**35,7**

(1) In line with the harmonised definition of underlying *transactions* (for details see ***Annex 1.1***, paragraph 10).
(2) This figure includes contributions to *financial instruments* under *shared management*.

Source: 2016 *consolidated accounts* of the European Union.

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Brief description of 'Economic, social and territorial cohesion'

6.2. Spending under MFF sub-heading 1b — 'Economic, social and territorial cohesion' focuses on reducing development disparities between different Member States and regions, strengthening all regions' competitiveness and developing interregional cooperation ([1]). These objectives are implemented through the following funds/instruments:

— the European Regional Development Fund (ERDF, 56 % of 2016 payments), which aims to redress the main regional imbalances through financial support for the creation of infrastructure and productive job-creating investment, mainly for businesses;

— the Cohesion Fund (CF, 20 %), which finances environment and transport projects in Member States with a per capita GNI of less than 90 % of the EU average ([2]);

— the European Social Fund (ESF, 21 %), which aims to improve employment and job opportunities, encouraging a high level of employment and the creation of more and better jobs;

— other smaller instruments/funds (3 %), such as the European Neighbourhood Instrument (support for cross-border cooperation and political initiatives to strengthen ties between the EU and its neighbors) and the Fund for European Aid to the Most Deprived (FEAD — material assistance to help people out of poverty).

6.3. With a few exceptions, the ERDF, CF and ESF are governed by common rules. They are implemented through multiannual programmes, and management is shared between the Commission and the Member States. For each *programming period*, the Member States prepare *operational programmes (OPs)* for approval by the Commission ([3]). The projects to be financed from an OP are selected at Member State level. *Beneficiaries* claim their incurred costs from the responsible Member State authorities, which certify the expenditure and declare it to the Commission. This expenditure is audited by functionally independent audit authorities in the Member States. The Commission may also impose corrective measures.

([1]) These objectives are stated in Articles 174 to 178 of the Treaty on the Functioning of the European Union (TFEU).

([2]) For both the 2007-2013 and 2014-2020 programming periods, the CF is of relevance to Bulgaria, the Czech Republic, Estonia, Greece, Croatia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Portugal, Romania, Slovenia and Slovakia. Spain was also eligible during 2007-2013, but only for transitional support.

([3]) For the 2007-2013 programming period the Commission approved 440 OPs (322 ERDF/CF and 118 ESF); for 2014-2020 it approved 392 OPs (most covering more than one fund).

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6.4. 2016 was the last year for which all payments subject to our audit relate to the 2007-2013 programming period.

Audit scope and approach

6.5. Applying the audit approach and methods set out in ***Annex 1.1***, this year we examined the following for 'Economic, social and territorial cohesion':

(a) a sample of 180 transactions ([4]), in line with paragraph 7 of ***Annex 1.1***. The sample was designed to be representative of the full range of spending under this MFF heading. It consisted of transactions from 14 Member States, and included one European Territorial Cooperation (ETC) programme ([5]);

(b) a sample of 12 financial instruments under shared management, in eight Member States ([6]). Here we also reviewed disbursement rates (the share of funds reaching *final recipients*) and, in the case of guarantees, the multiplier ratio reported in the Commission's progress report for 2015;

(c) whether the *annual activity reports* of DG Regional and Urban Policy (DG REGIO) and DG Employment, Social Affairs and Inclusion (DG EMPL) presented information on *regularity* of spending that is broadly consistent with our results.

6.6. For part two of this chapter, which focuses on *performance*, we checked the Member States' systems for measuring the performance of physically completed projects (all transactions in our sample except for the 12 financial instruments under shared management).

([4]) The sample was drawn from all clearings and payments with the exception of advances. The 180 transactions came from 54 interim payments for 2007-2013, and related to 92 ERDF projects, 36 CF projects, 40 ESF projects, 11 ERDF financial instruments and one ESF financial instrument.

([5]) Bulgaria, the Czech Republic, Germany, Ireland, Greece, Spain, Italy, Hungary, Malta, Poland, Portugal, Romania, Slovakia, the United Kingdom and the Greece-Bulgaria ETC.

([6]) Bulgaria, Germany, Greece, Italy, Poland, Portugal, Slovakia and the United Kingdom.

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THE COMMISSION'S REPLIES

PART 1 — REGULARITY OF TRANSACTIONS

Results of transaction testing

6.7. ***Annex 6.1*** provides an overview of the results of transaction testing. Of the 180 transactions examined, 87 (48 %) contained *errors*. On the basis of the 25 errors we have quantified, we estimate the level of error to be 4,8 % ([7]).

6.7. *The Commission notes that the level of error reported by the ECA is an annual estimate which takes into account corrections of project expenditure or reimbursements affected by errors detected and recorded before the ECA's audit. The Commission underlines that it is bound by the Financial Regulation, which stipulates, in Article 32(2)(e), that its internal control system should ensure, among other things, 'adequate management of the risks relating to the legality and regularity of the underlying transactions, taking into account the multiannual character of programmes as well as the nature of the payments concerned'.*

Given the multiannual character of management and control systems under the 2007-2013 programming period for Cohesion policy, errors may be corrected up to closure. The Commission is currently scrutinising closure declarations to ensure that all necessary corrections have been applied and will not close any programme unless it has reasonable assurance that the residual risk for that programme is below materiality (2 %).

The Commission further notes that the most likely error rate calculated by the ECA has improved over the years.

This confirms that the error rate for the 2007-2013 programming period remains significantly below the rates reported for the 2000-2006 period. This development derives from the reinforced control provisions of the 2007-2013 period and the Commission's strict policy to interrupt/suspend payments when deficiencies are identified, as reported in the 2016 annual activity reports (AARs) of DG Regional and Urban Policy and DG Employment, Social affairs and Inclusion. The Commission continued in 2016 to focus its actions on the most risky programmes/Member States in view of preparation for closure and has implemented corrective measures when needed through a strict policy of interruptions and suspensions of payments up to closure.

([7]) 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 2,2 % and 7,4 % (the lower and upper error limits respectively).

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THE COMMISSION'S REPLIES

For the new 2014-2020 period, the overall corrective capacity is further strengthened by the possibility for the Commission to impose net financial corrections in case of serious deficiencies detected by the Commission or the ECA not previously identified by the Member State. This will be an important incentive for Member States to detect and correct serious irregularities before certifying annual accounts to the Commission, as suggested with the first set of annual accounts and assurance packages received by 15 February 2017.

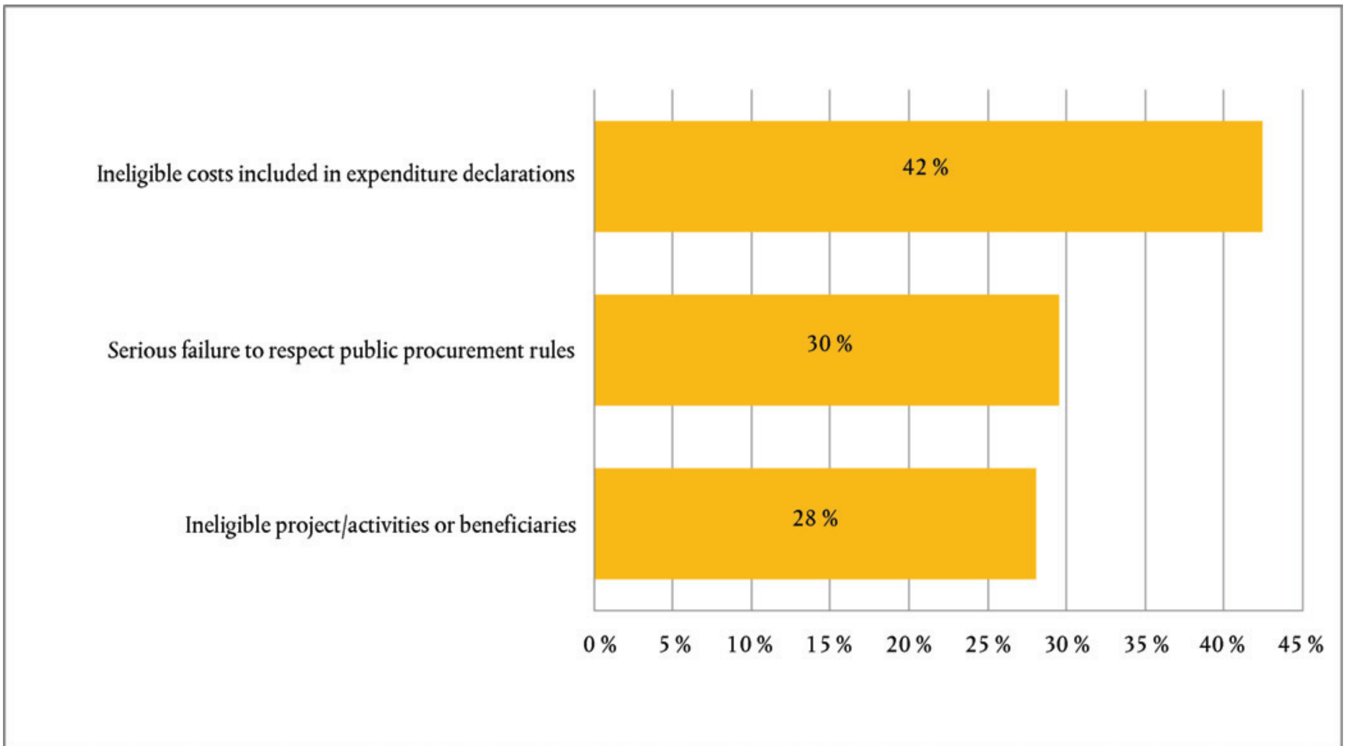
6.8. We note that there was also a key issue relating to the use of funds from financial instruments after the eligibility period ending 31 December 2015 (see paragraphs 6.20 to 6.21).

6.8. *The Commission refers to its position on this observation in its replies to the ECA's 2014 and 2015 Annual reports.*

See also Commission reply to paragraphs 6.20 and 6.21.

6.9. ***Box 6.2*** gives a breakdown of our *estimated level of error* for 2016. The main sources of error were the inclusion of ineligible costs in beneficiaries' declarations, infringements of internal market rules (EU and national *public procurement* legislation)and the selection of ineligible projects, activities or beneficiaries, .

Box 6.2 — 'Economic, social and territorial cohesion' — Breakdown of the estimated level of error



Source: European Court of Auditors.

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Ineligible expenditure

6.10. Ineligible costs had been declared in 10 % of all the transactions we examined (see ***Annex 6.3***, examples 1 to 6). These cases accounted for 72 % of all quantifiable errors, or approximately 2,0 percentage points of the estimated level of error.

6.11. The main causes of ineligible expenditure were breaches of national/EU eligibility rules. The majority of the rules breached were national. The most common errors were the absence of an audit trail to justify expenditure, ineligible salary costs, the incorrect calculation (or no calculation) of the funding gap for revenue-generating projects, the declaration of recoverable VAT, the incorrect application of financial corrections and non-compliance with other specific eligibility rules.

6.12. Over the last five years, 135 of the 1 437 transactions we have examined have used *simplified cost options* (SCOs) to declare costs. During this period, we did not quantify any errors, but identified ten non-quantifiable errors relating to the use of SCOs ([8]). This demonstrates that projects using SCOs are less error-prone than reimbursements of actual costs. During the 2014-2020 programming period, Member States are generally encouraged to make wider use of SCOs in Cohesion, and this is compulsory for all ESF projects worth under 50 000 euro ([9]).

THE COMMISSION'S REPLIES

6.10. *The Commission will follow up the cases identified by the ECA and will propose action as it deems necessary.*

6.11. *The Commission considers that its call to Member States for further simplification of rules at national level and for the increased use of simplified cost options should contribute to reducing errors linked to loss of the audit trail or ineligible expenditure.*

6.12. *The Commission also considers that simplified cost options are less prone to errors and therefore has actively worked with programme authorities since the introduction of the simplified cost options (SCOs) to progressively extend their use. This has already led to positive results.*

The Commission continues to actively promote the use of SCOs in the 2014-2020 programming period, where they have been significantly strengthened both in the Common Provisions Regulation and in the ESF specific regulation, in order to reduce the administrative burden on the beneficiaries, promote result-orientation and further reduce the risk of error.

Besides providing extensive guidance and direct support to Member States on the implementation of SCOs, DG Employment, Social Affairs and Inclusion has conducted numerous simplification seminars, with a particular focus on certain priority Member States which have experienced recurring high error rates in the 2007-2013 programming period and have not yet made sufficient use of SCOs.

In the context of the mid-term review of the Multi-Financial Framework, the Commission has made proposals in 2016 to offer further simplification measures and flexibility in the legislative framework for ESI funds. According to this proposal, the scope of the simplified cost options would be considerably expanded and their use made obligatory for ESIF operations below 100 000 euros.

([8]) See also the annual reports for 2012 (paragraph 6.23), 2013 (paragraph 6.16), 2014 (paragraph 6.29) and 2015 (paragraph 6.15).

([9]) Article 14(4) of Regulation (EU) No 1304/2013 of the European Parliament and of the Council of 17 December 2013 on the European Social Fund (OJ L 347, 20.12.2013, p. 470); Article 68 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (OJ L 347, 20.12.2013, p. 376).

THE COURT'S OBSERVATIONS

6.13. *Major projects* require approval by the Commission ([10]). Our sample included three major projects, for which the Member State authorities had not submitted the necessary application by the 31 March 2017 closure deadline. In the absence of a Commission decision approving the major projects, the expenditure declared is ineligible and should be recovered.

Ineligible projects

6.14. We identified three projects that did not comply with the eligibility rules in the regulation, and/or the eligibility criteria in the OP or the specific call for proposals. These projects accounted for 12 % of all quantifiable errors, or approximately 1,3 percentage points of the estimated level of error (see ***Annex 6.3***, examples 7 and 8).

THE COMMISSION'S REPLIES

6.13. *The Commission has carefully monitored all submissions of major projects or of amendments submitted by Member States and will take all required decisions up to closure. It will assess the eligibility of the concerned expenditure at closure on this basis. In case there are major projects for which no notification was made to the Commission in line with Article 40 of Regulation (EC) No 1083/2006, the Commission will either propose that Member States submit a major project application or apply a financial correction, where relevant. If a Member State submits an application the Commission could adopt a decision on the major project.*

6.14. *The Commission will follow up the cases identified by the ECA and will propose action as it deems necessary.*

([10]) See Articles 39 and 41 of Council Regulation (EC) No 1083/2006 (OJ L 210, 31.7.2006, p. 25). A major project is an operation comprising a series of works, activities or services, and which is intended by itself to accomplish an individual task of a precise economic or technical nature. It will also have clearly identified goals and a total cost exceeding 50 million euro.

THE COURT'S OBSERVATIONS

Infringements of internal market rules

Public procurement

6.15. This year we examined 121 contracting procedures for the works, services and supplies concerned by our transaction testing. The total estimated value was approximately 3 billion euro ([11]), and the vast majority of these contracts related to ERDF/CF projects ([12]).

6.16. We found elements of non-compliance with EU and/or national public procurement rules in 23 procedures. Four of these were serious infringements and were classified as quantifiable errors. They accounted for 16 % of all quantifiable errors, or approximately 1,4 percentage points of the estimated level of error (see ***Annex 6.3***, examples 9 to 11).

THE COMMISSION'S REPLIES

6.15 and 6.16. *Public procurement rules are applicable for all public spending in the Member States and are not specific to Cohesion policy. Non-compliance with EU or national public procurement rules has been a major source of errors in this policy area over years, in particular for regional and urban policy, mainly due to the types of projects co-financed. The Commission has therefore taken various preventive and corrective actions since the last programming periods in order to address weaknesses identified in that area.*

The Commission refers in particular to its Action Plan on public procurement set up in 2013 and endorsed by the Commission in December 2015 which aims at further improving the implementation of public procurement rules in the Member States through additional preventive measures such as guidance, training, sharing of good practices, compendium of errors to be avoided, integrity pacts (http://ec.europa.eu/regional_policy/en/policy/how/improving-investment/public-procurement/). The Action Plan on Public Procurement was updated in March 2017 to include new actions related to the transposition of the new Public Procurement directives and a stronger focus on strategic procurement and transparency.

The legal framework for ESI Funds 2014-2020 has also introduced a specific ex ante conditionality in relation to public procurement which together with simplified 2014 Directives should lead to further improvements in this area.

The Commission will follow up all public procurement errors reported by the ECA in accordance with Commission Decision C(2013)9527 final on the 'Setting out and approval of the guidelines for determining financial corrections to be made by the Commission for non-compliance with the rules on public procurement'.

([11]) This amount represents the total expenditure for the contracts awarded, part of which was certified by the expenditure declarations which we examined.

([12]) The contract value of around 49 % of the 121 procedures was above the threshold for application of the EU public procurement rules (enacted in national law), and 33 concerned the ERDF/CF and one the ESF.

THE COURT'S OBSERVATIONS

6.17. In 2014, the Council and the European Parliament adopted three directives aimed at simplifying public procurement procedures and making them more flexible [13]. Member States were given until April 2016 to transpose the new rules into national law (for e-procurement the deadline is October 2018). As at 2 June 2017, 17 Member States had done as required [14]. One year after the deadline, there has been insufficient progress since last year [15]. The Commission has sent reasoned opinions to a number of Member States. However, as of June 2017 the proceedings still need to progress and be referred to the European Court of Justice as soon as possible for the non-compliant Member States [16].

THE COMMISSION'S REPLIES

6.17. *As of June 2017, 17 Member States have completed the transposition process for all three Directives, four Member States have transposed the public procurement Directives but not the Directive on concessions and seven Member States have still not transposed any of the three Directives. The Commission does not find this situation satisfactory, in particular in view of the enhanced assistance it has provided and still continues to provide to Member States. Therefore, the Commission timely opened infringement procedures under Article 258 TFEU against all Member States failing to comply with their transposition obligations and sent 21 letters of formal notice in May 2016 and subsequently 15 reasoned opinions to Member States concerned in December 2016. Replies provided by the Member States and the latest developments are now being examined in view of the up-coming referrals to the Court of Justice. Following an in-depth examination of all details related to both already adopted and notified provisions, the Commission will assess for each case the need for imposition of proportionate financial penalties, as provided for by the Treaty.*

State aid

6.18. This year we identified 11 projects, in seven Member States [17], that infringed the EU *state aid* rules. The main cause of non-compliance was a failure to assess and/or notify state aid projects. However, we did not quantify any errors regarding state aid, as we assess that these cases of non-compliance had no impact on the level of public funding from the EU and/or Member States. ESF projects very often fall under the '*de minimis*' rule and therefore are less prone to infringements of the state aid rules than ERDF and CF projects.

6.18. *The Commission notes a decrease in the number of State aid cases with impact in the ECA's estimated error rate over years. However due to the risks that non-compliance with State aid rules entails for this policy area the Commission has taken preventive and corrective actions under an Action Plan on State aid set up in 2015 to further improve the implementation of State aid rules in the Member States. This includes also follow-up on the recommendations issued by the ECA in its Special Report 24/2016.*

The Commission will follow up the cases identified by the ECA and propose action as it deems necessary.

(13) Directives of 26 February 2014 on public procurement (2014/24/EU), the award of concession contracts (2014/23/EU) and procurement by entities operating in the water, energy, transport and postal services sectors (2014/25/EU) (OJ L 94, 28.3.2014).

(14) The Member States that had enacted all three directives by that date are the Czech Republic, Denmark, Germany, Greece, France, Italy, Ireland, Hungary, Cyprus, Latvia, Malta, the Netherlands, Poland, Romania, Slovakia, Sweden and the United Kingdom.

(15) 2015 annual report, paragraph 6.24. Eight Member States had transposed all three directives as of May 2016.

(16) See Article 258 TFEU.

(17) Nine ERDF/CF (including two JESSICA financial instruments) and two ESF (including one financial instrument).

THE COURT'S OBSERVATIONS

Information not always used appropriately

6.19. The Commission and, more significantly, the Member State authorities had applied corrective measures that directly affected nine of the transactions we sampled. These measures were relevant to our calculations, as they reduced our estimated level of error for this chapter by 3,3 percentage points. In 18 cases of quantifiable error, the Member States had sufficient information [18] to prevent, or to detect and correct, the error before declaring the expenditure to the Commission. Had the Member States made proper use of all the information at their disposal, the estimated level of error for this chapter would have been 3,7 percentage points lower.

THE COMMISSION'S REPLIES

6.19. *The Commission is strictly following up these cases and agrees that sound and timely management verifications must be in place in order to prevent irregularities occurring in the first place or being included in payment claims.*

Since 2010, the Commission has been carrying out targeted audits on management verifications of high-risk programmes where it has identified that deficiencies could remain undetected or not detected in a timely manner by the programme audit authority. The results of these audits conducted up to 2016 are presented in the 2016 AARs of DG Regional and Urban Policy and DG Employment, Social Affairs and Inclusion (see pages 61-64 and 65/66, respectively).

Under the 2014-2020 programming period, management verifications and controls (including on-the-spot checks) have to be carried out on time for the certification to the Commission of the annual programme accounts, the submission of management declarations and the calculation of reliable residual levels of error in the accounts as a result of all corrections made since the end of the accounting year. The Commission addressed updated guidance to Member States, drawing on the lessons learned from the previous programming period which, combined with the required use of SCOs, should contribute to improving the quality of management verifications.

The Commission considers that these reinforced control procedures should result in lasting reductions of the error rate, as illustrated with the assurance packages received in 2017.

(18) In the form of supporting documentation, including standard cross-checks, information in databases and the results of mandatory checks.

THE COURT'S OBSERVATIONS

Use of financial instruments in shared management in the 2007-2013 programming period

6.20. According to Article 56(1) of Regulation (EC) No 1083/2006, the final deadline for the eligibility of payments for 2007-2013 was 31 December 2015. In April 2015, the Commission provided its own interpretation in the closure guidelines that the eligibility period would run until 31 March 2017 [19], but without asking the Council and Parliament to amend the regulation.

6.21. As stated in our last two annual reports [20], we consider that this interpretation of the eligibility period does not respect the hierarchy of norms, by which a legal provision can only be modified by legislation of equal or superior legal value. On this basis, we consider all payments made or guarantees provided from financial instruments to final recipients after 31 December 2015 to be outside the eligibility period defined in Article 56(1) of Regulation No 1083/2006. We estimate that the value of payments made or guarantees provided to final recipients since 31 December 2015 amounts to 2,5 billion euro.

THE COMMISSION'S REPLIES

6.20 and 6.21. *The Commission considers that the modifications introduced in its closure guidelines were within the scope of Article 78 (6) of Regulation (EC) No 1083/2006, as amended, and therefore did not require an amendment of the legislative act.*

The Commission expressed its position on the same observation in its replies to the ECA's Annual Reports for the years 2014 and 2015. The Commission has acted in line with the European Council's recommendations of December 2014 and within the margin offered by the existing regulatory framework. Therefore, the Commission considers the disbursements made to final recipients until end March 2017 to be within the set eligibility period. The Commission will verify the corresponding amounts reported by Member States at closure and will confirm the concerned figures in its report planned to be issued by October 2017.

(19) Commission Decision C(2015) 2771.

(20) See the 2014 annual report, paragraph 6.52, and the 2015 annual report, paragraph 6.45.

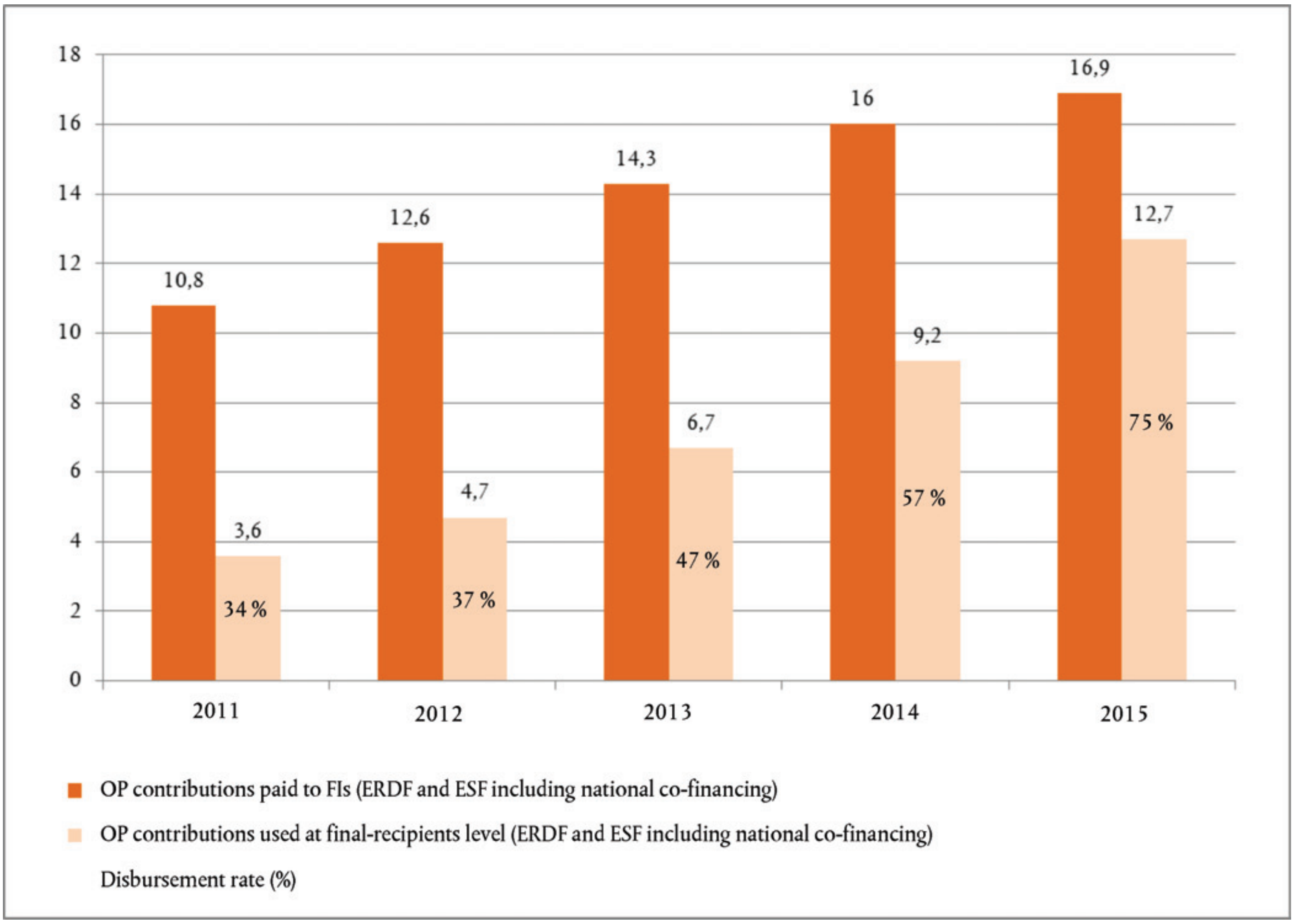
THE COURT'S OBSERVATIONS

Contributions were under-used and instruments did not achieve their full potential

6.22. The cumulative endowment to 2015 was around 16,9 billion euro ([21]). ***Box 6.3*** shows how this amount has been disbursed so far.

Box 6.3 — Cumulative disbursement rates for 2011-2015 in ERDF and ESF

(billion euro)



Source: European Court of Auditors based on the Commission's implementation report.

([21]) European Commission, 'Summary of data on the progress made in financing and implementing financial instruments reported by the *managing authorities* in accordance with Article 67(2)(j) of Regulation (EC) No 1083/2006, situation as at 31 December 2015', EGESIF 16-0011-00, 20 September 2016. The figures for 2016 will be published by 1 October 2017.

THE COURT'S OBSERVATIONS

6.23. By 31 December 2015, only 75 % of all funding through ERDF and ESF financial instruments had been used. As already pointed out in last year's report [22], this low level indicates that several Member States will be unable to make full use of their financial instrument endowment even with the extended eligibility period. A lower than 100 % disbursement rate does not fully exploit the potential of the instruments' 'revolving' architecture [23], which is one of their main advantages over *grants*.

6.24. ***Box 6.4*** presents the disbursement rates as at 31 December 2015 for financial instruments in Cohesion. The rates in four Member States (Spain, Italy, the Netherlands, and Slovakia) were significantly below the EU average of 75 %.

THE COMMISSION'S REPLIES

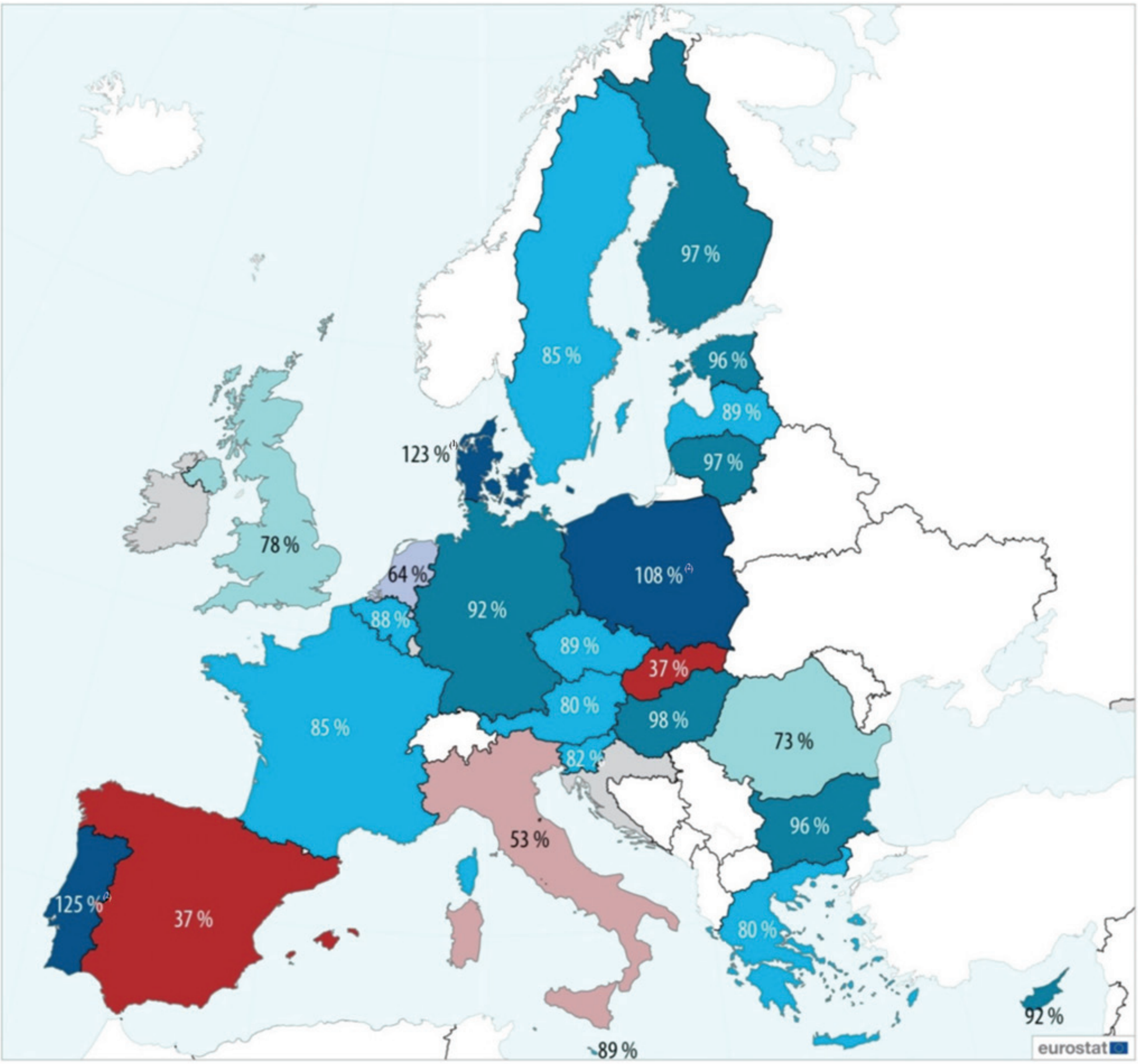
6.23 and 6.24. *The Commission underlines that the average disbursement rate of 75 % at end of 2015 — a substantial increased rate compared to 57 % at the end of 2014 — represents a very heterogeneous situation between Member States, depending on a number of factors including the financial crisis, the limited experience in some Member States and the late start of some instruments in the whole programming period. Taking into account the life cycle of the financial instruments, a substantial increase in the disbursement rates is still expected in the last year of implementation and it is only at closure that a final conclusion on the disbursement rates can be drawn.*

The Commission will report by 1 October 2017 on the situation at closure (end of March 2017) on the basis of data reported by Member States. Member States have to deduct at closure the remaining amounts in financial instruments not fully used in accordance with Article 78(6) of Regulation (EC) 1083/2006.

In the 2014-2020 programming period, the payments in tranches into financial instruments, subject to the actual level of disbursement to final recipients, will limit the risk of under-utilisation of financial instruments and of creating outstanding endowments during the implementation.

(22) 2015 annual report, paragraph 6.42.
(23) Financial instruments offer Member States the possibility of using the funds more than once — i.e. all returns on investments or loans, including profits, are ploughed back into the same activities.

Box 6.4 — Disbursement of financial instruments in Cohesion at 31 December 2015



Legend

Disbursement rate intervals for financial instruments financed by 'Economic, social and territorial cohesion'

- No instruments
- 30-39 %
- 40-49 %
- 50-59 %
- 60-69 %
- 70-79 %
- 80-89 %
- 90-100 %
- > 100 %

Administrative boundaries: © EuroGeographics © UN-FAO © Turkstat

Cartography: Eurostat — GISCO, 01/2015

0 200 400 600 800 km

([1]) In Denmark, financial intermediaries are not reimbursed until they have made payments to final recipients. Therefore the level of OP contributions to final recipients is greater than to financial instruments.

([2]) In Poland and Portugal, the reported payments to final recipients include profit and reflows. As these amounts are not OP resources, the total should not exceed 100 %.

Source: European Court of Auditors based on Commission's guidance note EGESIF_16-0011-00, 20 September 2016.

THE COURT'S OBSERVATIONS

Incomplete or inaccurate reporting on financial instruments by Member States

6.25. The information reported by the Commission on the implementation of ERDF and ESF financial instruments is based on data received directly from the Member States. Since 2011 the Commission has made substantial efforts to improve data quality, but in some cases the figures are still incomplete or inaccurate. This year we found inaccuracies in four of the 12 instruments we examined. These errors have the effect of overstating performance and, if not corrected, could artificially increase the declared amount of eligible expenditure at closure, especially in the case of guarantee funds.

Annual activity reports of the Commission and other governance issues

6.26. We examined the 2016 annual activity reports (AARs) and accompanying declarations of DG REGIO and DG EMPL [24]. In particular, we checked the consistency and accuracy of the Commission's calculation of the amounts at risk and whether the level of error was in line with our own estimate.

6.27. These AARs give provisional information on the amounts at risk and the residual risk [25], both for the closure of the 2007-2013 period and for the annual assurance package developed for the 2014-2020 period.

THE COMMISSION'S REPLIES

6.25. *At closure Member States have to certify the effective use of the funds in relation to financial instruments. This expenditure must have been checked by managing and audit authorities before submitting the closure package. Indeed, for a number of operational programmes, the audit authorities expressed limitations to their audit opinions due to the need to finalise their audit work in that respect. This ongoing audit work covers, among others areas, the disbursements at the level of final recipients. Therefore, the Commission will not close the relevant programmes until reasonable assurance on the amounts effectively disbursed and their eligibility is obtained or will apply the appropriate financial corrections.*

6.27. *At the time the 2016 AARs were issued, the Directorates General were not yet able to validate the information on the amounts at risk and residual risk rates as communicated by the audit authorities. This is due to the timing of the closure exercise (31 March 2017) and the legal time frame for both the submission of the 2014-2020 documents relating to the annual acceptance of accounts (by 1st of March) and the acceptance of accounts by the Commission (by 31 May 2017).*

Nevertheless, the Commission has fully used all information available at the time of the 2016 AAR, including data reported by audit authorities, with some limited adjustments.

(24) By the end of April of every year, each DG prepares an annual activity report for the previous year. This is submitted to the European Parliament and the Council and then published. The report is accompanied by a statement from the director-general indicating whether the budget under his or her responsibility has been implemented in a legal and regular way — essentially, whether the level of irregularities is below the Commission's 2 % *materiality threshold*. For OPs where this is not the case, the director-general may issue a full or partial *reservation*.

(25) In its AAR the Commission refers to the '*residual risk rate*' when dealing with the closure of the 2007-2013 programming period and to the 'residual total error rate' when dealing with the 2014-2020 programming period. These two rates are conceptually equal but apply to different time frames. In this chapter we refer to both as 'residual rate(s)'.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Commission's assurance for the 2007-2013 programming period

6.28. While the final deadline for the submission of closure documentation for the 2007-2013 period was 31 March 2017 ([26]), the Commission's assessment of the closure documentation was not due until 31 August 2017. If the Commission identified significant issues in its assessment, this deadline could be extended. The Commission will report the outcome of its assessment of the residual rates communicated by audit authorities in its 2017 AARs (April 2018).

6.28. *The Commission is carrying out its detailed assessment of the closure documents submitted by Member States which will be completed by the regulatory deadline of 31 August 2017. The outcome of this exercise will be indeed reported in the 2017 AAR.*

6.29. The Commission can only close a programme once the residual rate, taking account of all financial corrections, has been brought below 2 % ([27]). In a recently published special report on preparations for the closure of 2007-2013 programmes ([28]), we observed that the Commission had made adequate arrangements for Member States to close their Cohesion OPs. In another special report, on the financial corrections implemented by the Commission in Cohesion during the 2007-2013 programming period ([29]), we also concluded that the Commission had made effective use of the measures at its disposal to protect the EU budget from irregular expenditure.

([26]) Except for Croatia, which has until 31 March 2018.

([27]) Guidelines on the closure of the OPs, Commission Decision C (2015) 2771, Annex VI.

([28]) Special report No 36/2016: 'An assessment of the arrangements for closure of the 2007-2013 cohesion and rural development programmes'.

([29]) Special report No 4/2017: 'Protecting the EU budget from irregular spending: The Commission made increasing use of preventive measures and financial corrections in Cohesion during the 2007-2013 period'.

THE COURT'S OBSERVATIONS

Commission's assurance for the 2014-2020 programming period

Comments on the start of the 2014-2020 period

6.30. Three years after the start of the 2014-2020 period, the Member States have designated only 77 % of the programme authorities responsible for Cohesion policy funds [30]. As of 1 March 2017 the Commission received final accounts with expenditure covering just 0,7 % of the budget allocated for the entire programming period. As of mid-2017, the delays in budget implementation were greater than they were at the same point in the 2007-2013 period [31].

THE COMMISSION'S REPLIES

6.30. *The 77 % of the designated programme authorities are responsible for 88 % of the total Cohesion policy allocations. The Commission notes that designation is a Member States' responsibility. The Commission has repeatedly encouraged Member States on several occasions (in meetings and written communication) to speed up this process — while ensuring full respect of the designation criteria defined in the regulation — and provided clarifications and assistance where necessary.*

This has not yet translated into payment requests by Member States at levels similar to the 2007-2013 period but all conditions are now in place for absorption on the ground. The absorption rate at the end of 2016 is overall 3,7 % for ERDF/CF and 3,3 % for ESF/YEI projects, which reflects already a certain improvement compared with the figures available at mid-2016 based on the accounts received by 1 March 2017.

However, the Commission underlines that in these first years of implementation, the selection of projects to be co-financed is a key step towards a successful implementation of Cohesion policy. In that respect in 2016, the Commission notes that the rhythm of project selection has accelerated with an overall selection rate reaching 26 % for ERDF/CF projects and 32 % for ESF/YEI projects, as reported by Member States. This figure is similar to the same point in time in the 2007-2013 programming period.

Commission's new assurance model for Cohesion spending

6.31. Member States submit an 'assurance package' which includes the accounts after certification by the *certifying authorities*. With the package Member States confirm the effectiveness of the management systems and internal controls for an OP and the legality and regularity of the certified expenditure, and disclose the residual rates calculated by the audit authorities. The residual rate includes financial corrections applied and registered in the accounts to mitigate the risks identified by audits of operations.

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(30) ERDF, CF and ESF/YEI.

(31) We noted the issue of delays in special report No 2/2017: 'The Commission's negotiation of 2014-2020 *Partnership Agreements* and programmes in Cohesion'.

THE COURT'S OBSERVATIONS

6.32. The Commission has until 31 May to accept or reject the accounts and must pay the final balance within another month. Before accepting the accounts, it focuses mainly on administrative checks of completeness and accuracy. The Commission does not assess legality and regularity issues at this stage, but it may subsequently launch legality and regularity audits in the Member States to review the work of the audit authorities [32]. Therefore its conclusions on legality and regularity will be reported in the AARs for year n+1.

Comments on the information provided in the AARs for the 2014-2020 period

6.33. For the 2014-2020 period, 18 Member States submitted accounts with expenditure in respect of 71 of the 419 approved OPs [33], worth a total of 3,3 billion euro [34]. The Commission accepted 69 accounts by the regulatory deadline of 31 May 2017 [35]. As with the closure declaration for the previous period (see paragraph 6.29), the administrative acceptance of accounts took place after the AARs were adopted. Moreover, the Commission did not start verifying the legality and regularity of the 71 OPs until June 2017. The results will therefore not be published until the 2017 AARs in June 2018.

6.34. We detected a number of methodological risks which would need to be addressed to ensure the transparency and reliability of the reported residual rates:

— The AAR reporting period is not identical to that for the annual accounts submitted by Member States. DGs are required to report on the implementation of payments for calendar year n, but Member States report on expenditure declared to the Commission for the financial year from July n-1 to June n. This means that the Commission will provide assurance for a different period (calendar year) than is used by Member State authorities (financial year). Accordingly, each AAR should clearly indicate the outcome of the Commission's full assessment of the accounts initially presented in the AAR for the previous year.

THE COMMISSION'S REPLIES

6.32. *The Commission continues to carry out a thorough desk review of all documents received in the assurance packages; in particular, the reported error rates, residual risks and audit opinions issued by the audit authorities. In line with the Single Audit Strategy implemented by the concerned Directorate-Generals, this desk work is complemented with risk-based compliance audits. The main objective is to seek, via the review of the work of audit authorities after the acceptance of accounts, reasonable assurance that no serious deficiency in the management and control system remains undetected, unreported and therefore uncorrected.*

6.33. *Under the new set-up for programming period 2014-2020, the Commission will complement its desk assessment of the reported error rates by audit authorities with risk-based on-the-spot audits. Before confirming the reliability of the reported data in the subsequent annual activity reports, it will also be in a position to take account of observations that the ECA could have reported at this stage. This will allow strengthening the quality of data provided to discharge authorities in the respective annual activity reports.*

6.34.

— *The Commission uses all the information available at the time the AAR reporting, as it has been the case for several years.*

The Commission underlines that the Regulation for the 2014-2020 programming period and the timeframe set for the assurance package allows for a better alignment of reporting periods with programme authorities, compared to the 2007-2013 programming period. The Director-General needs to provide assurance on expenditure during calendar year by taking into account assurance provided by programme authority in their assurance package and the 10 % retention on each interim payment. The Commission agrees to provide in AAR the outcome of its full assessment on legality and regularity from the assurance packages submitted by Member States in the previous year (see Commission reply to paragraph 6.33).

[32] Article 139(5) of Regulation (EU) No 1303/2013.
[33] This includes 391 ESIF OPs and 28 FEAD OPs.
[34] Including 0,7 billion euro in up-front endowments to financial instruments.
[35] This includes 61 ESIF OPs and eight FEAD OPs.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
— Under Article 137(2) of the Common Provisions Regulation (CPR), Member States have to exclude from their accounts any amounts which have been previously included in a payment claim but for which there is an ongoing assessment of legality and regularity. Any part of such amounts that is subsequently found to be legal and regular may be included in a future payment claim. We came across one case in which the *audit authority* included amounts of this kind in the calculation of the residual rates. The Commission should again remind the audit authorities that Article 137(2) amounts must be clearly identifiable and not taken into account for the calculation of the residual rates.	— *The Commission has indeed already clarified to audit authorities in the Guidance Note on Annual Control Report and Audit Opinion* [1] *the criteria to compute a financial correction in the calculation of the residual risk rate. As the Court notes, the decisive factor is whether the financial correction intends to reduce the risk identified by the audit authorities as a result of the audit of operations (see ECA's observations in paragraph 6.32).* *The amounts under ongoing assessment following provisions of Article 137(2) which were deducted from the accounts provide further guarantees that all expenditure certified in annual accounts are legal and regular and should not have impact on the calculation of the residual risk rate by the audit authorities. The Commission will accordingly further clarify its guidance to Member States.*
— The reporting forms for the accounts do not include a detailed section for individual withdrawals and Article 137 (2) amounts. Although aggregated figures are given, only detailed information at the level of operations can ensure that there is a suitable audit trail for the acceptance of accounts. Making such information directly available in the common reporting system would enhance transparency and allow the necessary checks.	— *Amounts under ongoing assessment are to be disclosed globally in Appendix 8 of the accounts with an explanation by the certifying authority and the need for the audit authority to verify these explanations and potential discrepancies.* *The certifying authority needs to keep full and detailed accounting records in the programme monitoring system for individual movements and modifications made between interim payment claims and the amounts declared in the annual accounts to monitor the possibility given by Article 137(2) of a later declaration of these amounts. Such amounts, if later found legal and regular and introduced in payment claims in subsequent years will be subject to the same verification and control mechanism as for any other new expenditure.*

(1) *EGESIF_15-0002-03 of 09/10/2015.*

THE COURT'S OBSERVATIONS

Clarification required for the definition of the audit population of financial instruments and state aid advances

6.35. The Commission should clarify the rules covering how Member States' audit authorities are to define the audit populations of financial instruments ([36]). Payments to an instrument are made as soon as its legal structure is in place and are included in *interim payments* claims to the Commission ([37]). The regulation limits the definition of eligible expenditure to payments to final recipients, resources committed for guarantee contracts and the reimbursement of management costs and fees ([38]). Considering the audit population to be the initial endowment rather than the eligible expenditure disclosed in the annual accounts leads to an under estimate of the residual rate. The same issue affects state aid advances.

THE COMMISSION'S REPLIES

6.35. *The Commission commits to work jointly with the audit authorities and the ECA to ensure that a common understanding is applied for the error rates to be reported. In particular, in order to have a qualitative assessment of the error rate, the Commission has encouraged audit authorities to use the regulatory option to have specific stratum for financial instruments (Article 28(10) of Delegated Act 480/2014). Further guidance in this regard will be provided to audit authorities.*

Article 127 of the CPR applicable to the 2014-2020 period establishes that the audits are carried out on an appropriate sample of operations on the basis of declared expenditure.

The Commission underlines that payments in financial instruments under the 2014-2020 period will be made in tranches, subject to regulatory obligations in relation to the actual use of previous payment which will have to be included in the scope of the audits of operations carried out by the audit authorities. As per the first tranche, audit authorities have to verify that the applicable requirements (public procurement, ex ante assessment) are complied with and errors found have an impact on the error rate.

In relation to the State aid advances, as already done for closure 2007-2013, the Commission will clarify to the audit authorities that they have to carry out audit work (i.e. system audits) to confirm that the managing authorities have put in place a system ensuring that advances are properly justified within the regulatory deadline.

([36]) See also the 2015 annual report, paragraphs 6.60 to 6.63.
([37]) Article 41 of Regulation (EU) No 1303/2013.
([38]) Article 42(1) of Regulation (EU) No 1303/2013.

THE COURT'S OBSERVATIONS

Consistency between information in the AARs and our own findings

6.36. ***Box 6.5*** contains a summary of the information provided by the AARs on the 2007-2013 programming period.

Box 6.5 — Overview of information in the AARs for the 2007-2013 period

(billion euro)

Activity	Fund	Total relevant expenditure	2016 relevant expenditure	OPs	2016 error rate		Residual risk	Number of reservations
					Min	Max		
2007-2013 programming period	ERDF/CF	254,5	26,2	322	2,2 %	4,2 %	0,4 %	66
	ESF	70,2	6,4	118	3,9 %	4,3 %	0,7 %	23
	Total	**324,7**	**32,6**	**440**	**2,6 %**	**4,2 %**	**0,5 %**	**89**

Source: 2016 AARs of DG REGIO and DG EMPL.

6.37. Our estimated level of error is higher than the error rates which the Commission reported in its AARs on the basis of the audit authorities' results. However, these two sets of errors are not fully comparable, mainly for the following reasons:

— the residual rates reported in the AARs do not relate to the same period as those we publish [39];

— the residual rates calculated by the Commission are multiannual and take account of all financial corrections at EU and Member State level;

— our results are based on a statistically representative sample of transactions at EU level, while, although audit authorities generally apply statistical sampling, they may also select audits of operations on the basis of non-statistical samples.

THE COMMISSION'S REPLIES

6.37. *The Commission underlines that the assessment of the reliability of error rates reported by Member States each year is based on a thorough desk analysis of all available information completed by risk-based on-the-spot fact finding missions, also taking account of the overall assessment of the reliability of the work of audit authorities. When necessary, the Commission requests and obtains from the audit authorities any additional information required. See also Commission reply to paragraph 6.27.*

The Commission considers that for the 2016 annual report, as was the case for the last six years in a row for Directorate-General for Employment, Social Affairs and Inclusion and five years in a row for Directorate-General for Regional and Urban policy before this annual report, the result of the Commission's assessment is in line with the error rates calculated by the ECA (see pages 75 and 64 of the respective AARs).

(39) The error rates reported by audit authorities for year n relate to expenditure certified to the Commission in year n-1. The Court's error rates for year n relate to expenditure paid by the Commission in year n.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

CONCLUSION AND RECOMMENDATIONS

Conclusion

6.38. The overall audit evidence indicates that the level of error in spending on 'Economic, social and territorial cohesion' was material.

6.39. For this MFF heading, our testing of transactions produced an estimated overall level of error of 4,8 % (see ***Annex 6.1***).

6.38 and 6.39. *The Commission notes that the estimated level of error presented by the ECA has improved over the years and is in line with the error rates reported in the AARs of the respective Commission services.*

The Commission continued in 2016 to focus its audits and actions on the most risky programmes/Member States in view of preparation of closure and to implement corrective measures when needed through a strict policy of interruptions and suspensions of payments. It is applying a strict analysis and procedures at closure to exclude any remaining material risk of irregular expenditure.

The Commission further notes that given the multiannual character of the management and control systems under the 2007-2013 programming period for Cohesion policy, errors may be corrected up to closure as illustrated in section 2.1.3. of the respective 2016 AARs of DG Regional and Urban policy and DG Employment, Social Affairs and Inclusion.

To address the material error rates reported by the ECA under Cohesion policy, reinforced requirements on legality and regularity and accountability of programme authorities include under the 2014-2020 programming period the introduction of annual accounts which have to be free of material irregularities and a strengthening of the Commission's corrective capacity by the possibility to apply net financial corrections under certain conditions.

These requirements will be important incentives for Member States to detect, report and correct serious deficiencies before certifying annual accounts to the Commission and should contribute to a lasting reduction in the error rates to be reported by audit authorities, as illustrated by the first assurance packages received in 2017.

The Commission further refers to its replies provided under paragraphs 6.7 and 6.19.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Recommendations

6.40. ***Annex 6.4*** shows the findings of our follow-up review of the 11 recommendations we made in our 2013 annual report [40]. Of these, the Commission had implemented eight recommendations in full, while two had been implemented in most respects, and one had not been acted upon at all.

6.40. *The Commission notes that it had not accepted the recommendation reported under this paragraph as not implemented.*

6.41. Based on this review and our findings and conclusions for 2016, we recommend that the Commission:

— **Recommendation 1:** pay particular attention, when closing the 2007-2013 programmes, to areas in which there is a higher risk of ineligible expenditure or of the disclosure of inaccurate information that may lead to an over-reimbursement. In particular, the Commission should focus on:

  (a) ensuring that eligible amounts reported for financial instruments at closure are not artificially increased because of over-reporting of the amounts used at the level of final recipients. The risk is highest for guarantee funds, where an artificially low multiplier would mean an unjustified increase in eligible costs;

  (b) verifying that state aid advances were covered by real expenditure at project level, which is the only eligible expenditure. The Commission should ensure that the managing authorities have carried out sufficient verifications to allow for an appropriate audit trail for the clearance of advances and the deduction of unjustified amounts;

  (c) making sure that expenditure for all major projects is supported by a Commission decision approving the project, failing which the expenditure declared becomes ineligible. A particular risk arises where larger projects are split into smaller sections which are below the major project threshold.

The Commission accepts this recommendation and is already taking into account, among others, the particular areas pointed out by the Court concerning financial instruments, State Aid and major projects during its review of the 2007-2013 closure packages currently underway.

The Commission recalls that it is the responsibility of the Member States to notify major projects to the Commission.

(40) We chose our 2013 report for this year's follow-up exercise as, typically, enough time should have elapsed for the Commission to have implemented our recommendations.

THE COURT'S OBSERVATIONS

— **Recommendation 2:** address, for the 2014-2020 period, issues that may affect the reliable calculation of the residual rate, by introducing robust checks and guidance in relation to:

(a) the audit population of financial instruments and state aid advances. The population should take proper account, for financial instruments, of the amounts used at the level of final recipients and, for state aid, of the actual expenditure at project level as reported in the accounts;

(b) the audit coverage for financial instruments managed by the EIB. The Commission should make sure that the audit arrangements are adequate at the level of both financial intermediaries and final recipients. Final approval for the amendments to the existing legal basis which the Commission has proposed for the *Omnibus regulation* ([41]), as well as the obligation to audit at the level of the Member State, would be instrumental in this regard;

THE COMMISSION'S REPLIES

The Commission accepts this recommendation.

(a) *Against the background described in its replies to paragraph 6.36, and with a view to the provisions of the Regulation on eligible expenditure and audit population, the Commission commits to work jointly with the audit authorities and ECA to ensure that a common understanding is applied for the treatment of financial instruments and state aid advances in the audit population and corresponding audit work to be carried out in order to obtain the required reasonable assurance.*

(b) *The Commission has proposed in the Omnibus Regulation, which it has adopted in September 2016, to amend Article 40 of the CPR.*

The proposed amendment to Article 40, applicable to all financial instruments implemented by EIB and other International Financial Institutions (IFIs), clarifies the existence of two levels of controls/audits: 1) at the level of EIB/IFIs; 2) at the level of the bodies in the MS' jurisdictions.

For the first level, EIB Group or other IFIs will provide control reports accompanied by an annual audit report/opinion issued by the auditors designated in the Funding Agreement.

For the second level, Member States would carry out verifications by the managing authorities and audits by the audit authorities at the level of the financial intermediaries and for the audit authorities, when relevant, at the level of final recipients in their jurisdiction. These verifications and audits, taking into account of the risks identified, will cover the implementation of the instruments. The results of these verifications and audits will complement the reports received from EIB Group/IFIs.

([41]) Proposal for a Regulation (EC) on the financial rules applicable to the general budget of the Union, COM(2016) 605 final, 14.9.2016.

THE COURT'S OBSERVATIONS

(c) the exclusion of the amounts under ongoing assessment referred to in Article 137(2) of Regulation (EU) No 1303/2013 from the calculation of the residual rate as reported by the Member States, since including them has the effect of understating the residual rate and reduces the transparency and reliability of this key indicator.

— **Recommendation 3:** when reconsidering the design and delivery mechanism for the ESI funds post-2020, strengthen the programme focus on performance and simplify the mechanism for payments by encouraging, as appropriate, the introduction of further measures linking the level of payments to performance instead of simply reimbursing costs.

THE COMMISSION'S REPLIES

(c) *The Commission considers to have already taken action, but is willing to further clarify its current guidance to Member States.*

As explained in the Commission reply to paragraph 6.34, according to the 2014-2020 regulatory framework Member States have to exclude from their accounts certain amounts which have been previously included in a payment claim but for which there is an ongoing assessment of that expenditure's legality and regularity. Any or all of that expenditure that is subsequently found to be legal and regular may be included in a future payment claim.

Therefore the amounts under ongoing assessment following provisions of Article 137(2) have no impact on the calculation of the residual risk rate. The Commission has clarified to the audit authorities in the Guidance Note on Annual Control Report and Audit Opinion ([2]) the criteria to compute a financial correction in the residual risk rate. The possibility given by the regulation to include these amounts under ongoing assessment in a subsequent application for interim payment if they are found to be legal and regular is not relevant for the purposes of the residual error rate calculation and provides further guarantees that all expenditure certified in annual accounts is legal and regular.

The Commission accepts this recommendation, as it fully agrees to consider alternative design and delivery mechanisms including the one recommended by the ECA, but it cannot commit yet to a detailed position concerning its proposals for the post 2020 ESI funds. It also notes that the proposed amendment of the Common Provisions regulation presented and adopted by the Commission end of 2016 (so called Omnibus), if adopted by other institutions, would already allow under certain conditions to move away from the reimbursement of costs in favour of payments based on projects' performance.

The presentation of timely legislative proposals for Cohesion policy is a priority for the Commission. The timing, however, is dependent on the adoption of the proposal for the MFF Regulation. The Commission's proposal for the cohesion policy legislative package post 2020 will be presented subsequently.

The Commission will work closely with the co-legislators with a view to a timely adoption and entry into force of the legislative framework.

([2]) *EGESIF_15-0002-03 of 09/10/2015.*

THE COURT'S OBSERVATIONS

PART 2 — ASSESSMENT OF PROJECT PERFORMANCE

6.42. The principle of *sound financial management* in the implementation of the EU budget presupposes a focus not only on regulatory compliance but also on achieving the stated objectives ([42]).

6.43. In the last three years, in addition to checking regularity, where the projects we examine have been physically complete we have also assessed performance ([43]). This year, because the eligibility period ended on 31 December 2015, all 168 projects we examined (excluding financial instruments) should have been completed by the time of our audit. For all 168 we assessed:

— relevant aspects of performance system design (in particular whether OPs had *output* and *result* indicators that were relevant to their objectives, and whether the output and result objectives specified in project documents ([44]) corresponded to the OP objectives for each priority axis);

— project performance, i.e. whether projects had achieved their objectives and met the targets set for each indicator.

Assessment of performance system design

6.44. For the 2007-2013 programming period, beneficiaries were legally required to define and report on outputs. To assess a project's contribution to the OP objectives, Member States also had the option of defining result indicators linking project results to the corresponding indicators for the OP priority axis.

6.45. The regulatory provisions for the 2014-2020 period include some measures that, if adequately implemented, should contribute to the performance assessment of programmes. In one example, audit authorities are required to examine the reliability of performance data ([45]). In another, following its performance review the Commission may impose sanctions in cases where a priority axis has seriously under-achieved its financial and output indicators ([46]).

([42]) See the 2013 annual report, paragraph 10.10.
([43]) See also the 2014 annual report, paragraphs 6.80 to 6.86, and the 2015 annual report, paragraphs 6.77 to 6.89.
([44]) Project applications, grant agreements, contracts and/or co-financing decisions.
([45]) Article 22(6) and (7) and Article 127 of Regulation (EU) No 1303/2013.
([46]) Article 142(1) of Regulation (EU) No 1303/2013.

THE COURT'S OBSERVATIONS

One third of the projects examined were covered by a performance measurement system with output and result indicators linked to the OP objectives

6.46. We found that, for 63 of the 168 projects (38 %), a performance measurement system was in place linking project outputs and results to those in the OP objectives.

6.47. In 101 other cases (60 %), we found a number of weaknesses in the way Member State authorities had designed their performance systems at both OP and project level. The most frequent weaknesses were:

— in 70 cases (42 % of the 168), the authorities had not defined result indicators or set targets to measure performance at project level or the result indicators defined were not consistent with those of the OP. In these circumstances, it is not possible to determine whether these projects made any contribution to the overall programme objectives (see also paragraph 6.55);

— in 13 cases, the authorities had wrongly classified outputs as results, or *vice versa*, in the OP and/or the project approval documents;

— in 12 cases, the project output indicators were not consistent with those of the OP.

6.48. For the four remaining cases (2 %) ([47]), the authorities did not have a performance system defining and measuring outputs and results at project level. In these four cases we could not assess project performance.

6.49. While the regulations for both the 2007-2013 and the 2014-2020 programming period do not require Member States to set result indicators at project level, this was done for 90 (54 %) of the 168 projects we examined. It is good practice for managing authorities and intermediate bodies, wherever possible, to set result indicators of this sort, as it allows the specific contribution made by a project to the objectives of the corresponding priority axis to be measured.

THE COMMISSION'S REPLIES

6.47. *Although the structural funds legislative framework for 2007-2013 did not oblige programme authorities to define result indicators at project level, the Commission encouraged this whenever relevant. Some result indicators could indeed not be meaningfully measured at the level of a single project.*

6.49. *The Commission notes that there is a major improvement for 2014-2020 with a comprehensive system of obligatory indicators for outputs and results at programme level. The achievement of the objectives is measured by a result indicator (with a baseline — the starting point — and target). Programmes will systematically measure and report progress of result indicators. Projects within a programme are selected to deliver outputs and contribute towards the results to be achieved at programme level. Their progress is measured with output indicators. These are also mandatory.*

([47]) These four projects were in Ireland.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

6.50. We found projects without result indicators in 11 of the 14 Member States from which we sampled transactions ([48]). However, they were most common in Bulgaria, Spain and Italy for the ERDF/CF, and in Ireland and Spain for the ESF. In these countries, more than half of the completed projects we examined had no result indicators, or the indicators were not consistent with the OP.

Assessment of project performance

6.51. ***Box 6.6*** summarises the results of our assessment of project performance.

Box 6.6 — Assessment of project performance

Performance assessment	Number of projects for which we assessed:				
	Both output and result indicators	**Only output indicators (result indicators were not defined)**	**Neither output nor result indicators**	**Non-functioning projects**	**TOTALS**
Number of projects	**90 (100 %)**	**70 (100 %)**	**4 (100 %)**	**4 (100 %)**	**168 (100 %)**
— Fully achieved	43 (48 %)	54 (77 %)			**97 (58 %)**
— Partially achieved	45 (50 %)	12 (17 %)			**57 (34 %)**
— Not achieved	2 (2 %)	4 (6 %)		4 (100 %)	**10 (6 %)**
— Could not be assessed			4 (100 %)		**4 (2 %)**

Source: European Court of Auditors.

([48]) The Slovakian OP and the ETC OP for Greece/Bulgaria were the only two programmes in which project and OP output and result objectives were mutually consistent.

THE COURT'S OBSERVATIONS

88 of the 90 projects with both output and result indicators met their objectives at least partially

6.52. Of the 90 projects with a performance measurement system for outputs and results, 43 (48 %) fully achieved both the output and the result objectives set by the managing authorities.

6.53. Another 45 projects (50 %) partially achieved their output and result objectives. Of these, seven were ultimately phased over the two programming periods (2007-2013 and 2014-2020). These projects were in three OPs in three Member States (Hungary, Poland and Romania).

6.54. Finally, two projects did not achieve any of their objectives. In addition, four projects were 'non-functioning' according to the definition in the closure guidelines [49]. Managing authorities are explicitly required to report 'non-functioning' projects in the closure declaration for an OP.

66 of the 70 projects where only output indicators were defined and assessed met their output objectives at least partially

6.55. 54 of the 70 projects (77 %) had fully achieved the managing authorities' output objectives, another 12 (17 %) had partially achieved those objectives and the remaining four (6 %) had not achieved any of them.

THE COMMISSION'S REPLIES

6.52. *The Commission notes that, in the first place, it is the managing authorities that are required to ensure that projects with EU added value are selected and approved.*

As regards output indicators, the assessment of programme performance has been reinforced for the 2014-2020 period: as foreseen in the 2014-2020 regulatory framework (Article 22(6) and (7) of Regulation (EU) No 1303/2013), the Commission will be able to suspend interim payments or impose financial corrections to Member States in case of serious underachievement of a priority axis in a programme, respectively as a result of the performance review (Article 22(6) of Regulation (EU) No 1303/2013) and at closure (Article 22(7)).

6.53. *The Commission notes that the end of the eligibility period does not necessarily coincide with the final target date set to measure all performance indicators.*

6.54. *The Commission uses all possible measures at its disposal to ensure sound and efficient financial management in the use of EU funds. Moreover, it is only at the stage of the closure of the programme that the performance of projects financed by Operational Programmes will be evaluated.*

6.55. *The Commission notes that, in the first place, it is the managing authorities that are required to ensure that projects with EU added value are selected and approved.*

(49) Annex to the Commission Decision amending Decision C(2013) 1573 on the approval of the guidelines on the closure of operational projects, C(2015) 2771 final 30.4.2015, paragraph 3.5.

THE COURT'S OBSERVATIONS

Conclusion

6.56. Only one third of the projects examined had a performance measurement system with output and result indicators linked to the OP objectives. The majority of the projects met their output objectives at least partially. However, for 42 % of the projects it was not possible to identify and measure a specific contribution to the overall programme objectives, since no result indicators or targets were defined at project level.

6.57. The definition of indicators and the setting of targets simultaneously require a clear strategic approach in the *intervention logic* for an OP. Both our recent audit results and our opinion on the revision of the *Financial Regulation* ([50]) have highlighted that there are significant differences in the use of output and, even more so, result indicators, both between policy areas and between funds within the same policy area.

THE COMMISSION'S REPLIES

6.56. *Although the structural funds legislative framework for 2007-2013 did not oblige national authorities to define result indicators at project level, the Commission encouraged this whenever relevant. Some result indicators could indeed not be meaningfully measured at the level of a single project.*

6.57. *The Commission refers to its detailed replies provided in the ECA special report No 2/2017.*

([50]) See Special Report No 2/2017: 'The Commission's negotiation of 2014-2020 Partnership Agreements and programmes in Cohesion' (paragraphs 149 to 151); opinion No 1/2017 concerning the proposal for a revision of the 'Financial Regulation' (OJ C 91, 23.03.2017), paragraphs 147 and 148.

ANNEX 6.1

RESULTS OF TRANSACTION TESTING FOR 'ECONOMIC, SOCIAL AND TERRITORIAL COHESION'

	2016	2015
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	**180**	223
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**4,8 %**	5,2 %
Upper error limit (UEL)	7,4 %	
Lower error limit (LEL)	2,2 %	

ANNEX 6.2

OVERVIEW OF THE RESULTS OF TRANSACTION TESTING FOR EACH MEMBER STATE

Netherlands

No transactions examined for 2016

United Kingdom

Error-free transactions:	2
Unquantified errors:	6
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	1
Total:	9

Germany

Error-free transactions:	4
Unquantified errors:	0
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	0
Total:	5

Sweden

No transactions examined for 2016

Finland

No transactions examined for 2016

Latvia

No transactions examined for 2016

Lithuania

No transactions examined for 2016

Ireland

Error-free transactions:	3
Unquantified errors:	0
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	1
Total:	4

Denmark

No transactions examined for 2016

Estonia

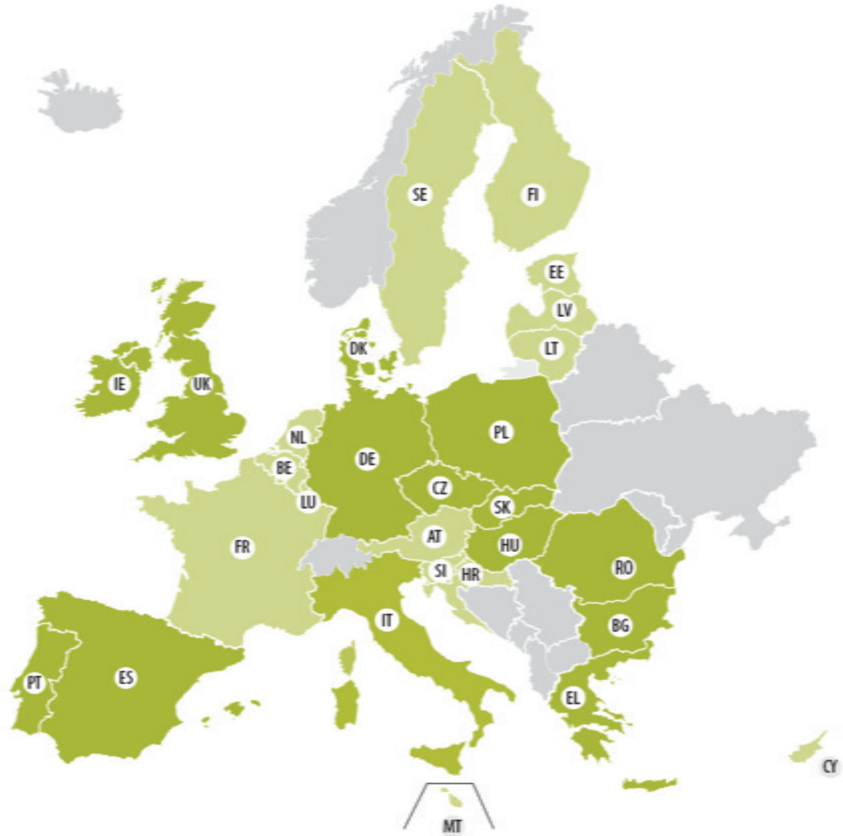
No transactions examined for 2016

Poland

Error-free transactions:	7
Unquantified errors:	5
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	1
Total:	13

Belgium

No transactions examined for 2016



Czech Republic

Error-free transactions:	14
Unquantified errors:	8
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	1
Total:	24

Luxembourg

No transactions examined for 2016

Slovakia

Error-free transactions:	9
Unquantified errors:	0
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	0
Total:	9

France

No transactions examined for 2016

Austria

No transactions examined for 2016

Portugal

Error-free transactions:	0
Unquantified errors:	1
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	0
Total:	1

Hungary

Error-free transactions:	7
Unquantified errors:	6
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	2
Total:	16

Spain

Error-free transactions:	9
Unquantified errors:	7
Errors quantified < 20 %:	3
Errors quantified ≥ 20 %:	5
Total:	24

Romania

Error-free transactions:	13
Unquantified errors:	7
Errors quantified < 20 %:	4
Errors quantified ≥ 20 %:	0
Total:	24

Italy

Error-free transactions:	15
Unquantified errors:	14
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	0
Total:	29

Slovenia

No transactions examined for 2016

Croatia

No transactions examined for 2016

Malta

Error-free transactions:	1
Unquantified errors:	2
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	1
Total:	4

Greece

Error-free transactions:	3
Unquantified errors:	2
Errors quantified < 20 %:	0
Errors quantified ≥ 20 %:	0
Total:	5

Cyprus

No transactions examined for 2016

Bulgaria

Error-free transactions:	6
Unquantified errors:	4
Errors quantified < 20 %:	2
Errors quantified ≥ 20 %:	1
Total:	13

Our audit work produces estimates of the likely level of error in the population as a whole. It is based on a probability-proportional-to-size sampling methodology and therefore provides no information on the frequency of error in the populations we audit (this would require the random selection of transactions). For these reasons, the above figures should not be understood as indicating the frequency of error, either in EU-funded transactions or in individual Member States, and the frequency of error in samples drawn from different Member States is no guide to the relative level of error in those Member States.

ANNEX 6.3

OVERVIEW OF ERRORS WITH AN IMPACT OF AT LEAST 20 % FOR 'ECONOMIC, SOCIAL AND TERRITORIAL COHESION'

THE COURT'S OBSERVATIONS

Introduction

Applying the general audit methodology set out in ***Annex 1.1***, we tested a representative sample of transactions to estimate the level of *irregularity* within the population for this MFF heading. The errors we detected in testing do not constitute an exhaustive list — either of individual errors or of possible error types. The findings outlined below concerning errors with an impact of at least 20 % of the transaction value examined are presented by way of example. These errors were found in transactions worth between 74 000 euro and 10,3 million euro, with a median of 0,9 million euro ([1]).

Examples of error

Ineligible expenditure

Example 1 — Several breaches of EU and national eligibility rules

The beneficiary for an ERDF-funded research project in Spain infringed several EU and national eligibility rules: direct costs were incorrectly included in the calculation of *indirect costs*, and recoverable VAT and an erroneous salary amount were wrongly declared for co-financing. Moreover, some expenditure was not substantiated by supporting documents.

We found similar cases (quantified up to or above 20 %) in three other ERDF projects in Spain.

Example 2 — Recoverable VAT declared as eligible for EU co-financing

In Poland, a local authority receiving CF funding for a tram project declared VAT as eligible expenditure. However, the VAT paid on new infrastructure which the public will be charged to use is in fact recoverable and thus ineligible for co-financing.

THE COMMISSION'S REPLIES

The Commission takes note of the ECA's comment in annex 6.2 that the overview of ECA transactions is not a guide to the relative level of error in the Member States in the sample. The Commission points out that detailed information on the Commission's and the Member States' audit results are presented for each Member State in the Annual Activity Reports and their technical annexes of the Commission departments implementing EU funds in shared management.

The Commission will follow up the cases identified by the ECA and will propose action as it deems necessary.

([1]) These errors account for more than three-quarters of the overall estimated level of error for 'Economic, social and territorial cohesion'.

THE COURT'S OBSERVATIONS

Example 3 — No calculation of the funding gap for revenue-generating projects, and ineligible VAT

A Bulgarian beneficiary received ERDF funding to purchase the equipment which it used for educational purposes. When calculating the amount of eligible expenditure, the beneficiary did not take account of revenue generated by services provided to the general public at these facilities. It also declared some amounts of recoverable VAT.

Example 4 — Financial correction wrongly applied

As a result of our audit for 2014 ([2]), the Commission imposed a 25 % financial correction on a CF project in Malta. However, instead of first certifying all eligible expenditure and then applying the correction, the Member State authorities certified expenditure up to 75 % of the project's initial budget. As a consequence, the non-certified part of the project expenditure, relating to costs not concerned by the financial correction, will, in principle, not be subject to audit.

Example 5 — Work-placement hours not documented and unjustified payment of the performance-related share of a contractor's fee

The beneficiary for an ESF project in Ireland to deliver training for unemployed job-seekers was unable to provide evidence in support of the hours charged for participants' work placements, as required by the national eligibility rules. In connection with the same project, the Member State authorities paid out the performance-related share of a contractor's fee for a training course even though the work-placement result was below the agreed target.

We found examples of errors of ineligible expenditure (quantified up to 20 %) in the Czech Republic, Spain, Hungary and Romania as well as the Greece-Bulgaria ETC OP.

Example 6 — Grant conditions not met

The beneficiary for an ERDF project in Spain did not comply with the requirement in the call for proposals to retain the co-financed equipment in the region for the agreed period. This made the equipment ineligible for co-financing.

THE COMMISSION'S REPLIES

The Commission will ask the beneficiary to provide a funding-gap calculation including all related revenues and operational costs and will conclude accordingly.

([2]) 2014 annual report, Box 6.1, example (a).

THE COURT'S OBSERVATIONS

Ineligible projects

Example 7 — Ineligible beneficiary

The call for proposals for an ERDF project in the Czech Republic specified that only SMEs were eligible. When verifying compliance with this requirement, the *managing authority* based its decision on the beneficiary's declaration and the information from its monitoring system. This was insufficient to ensure the proper status of the beneficiary. It resulted in funding going to a beneficiary that was not an SME.

Example 8 — Project partially ineligible

Priority Axis 3 of an ESF OP in Spain, which aims at increasing human capital, has three specific objectives. The relevant objective for a project examined within this OP was the development of human potential in the field of research and innovation. The Member State authorities retroactively declared for co-financing the salaries paid to medical professionals during specialised residential internships in 2014. While these internships had some ties to research activities, their main objective was to prepare specialised medical staff for the Spanish health system. It is therefore disproportionate to consider the whole project as primarily a research activity. Moreover, this training scheme is anyway compulsory for medical specialists under Spanish law. Part of the project was consequently ineligible and should not have been declared for co-financing.

We found a similar case in another ESF project in Spain.

THE COMMISSION'S REPLIES

The Commission considers that the training of health service professionals through the 'EIR' (resident interns in specialisation)) programme of postgraduate studies is eligible under Priority Axis 3 'Increase and improvement of human capital', since it contributes to the achievement of its objectives. Completing such postgraduate studies is a legal requirement in Spain to conduct clinical research. Furthermore, the Managing Authority has provided evidence of a total of 99 specific research activities for the 20 participants sampled by the Court, including scientific publications, participation in competitive research programmes with external funding and being part of highly qualified research groups.

Therefore, the Commission considers that the certified expenditure fully meets the eligibility criteria.

THE COURT'S OBSERVATIONS

Public procurement infringements

Example 9 — Wrong use of a secondary competition in a framework contract

The beneficiary for an ERDF project in the United Kingdom to erect a footbridge used a framework contract to award the works. The procedure chosen by the beneficiary for the secondary competition did not allow for identification of the most economically advantageous offer. In addition, the beneficiary incorrectly applied discount rates during negotiation with the contractor and awarded additional works directly to the same contractor. The procedure therefore infringed the principles of equal treatment and non-discrimination and departed from the procedure described in the framework agreement. As a result, the contract was unlawful and the related expenditure was ineligible for EU funding.

Example 10 — Unlawful amendment of contract

The beneficiary for a CF project in Hungary (extension of a sewage treatment plant) substantially modified the contract after signature without relaunching the procedure. Amendments of this sort are in breach of public procurement rules.

Example 11 — Unsuitable economic operators invited to tender

Only one of three companies invited to tender for an ESF language-training project in Hungary had a suitable profile to deliver the training. The effect of inviting two unsuitable candidates to participate was that the contract was awarded directly without due justification.

ANNEX 6.4

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'ECONOMIC, SOCIAL AND TERRITORIAL COHESION'

E = DG Employment, Social Affairs and Inclusion; R = DG Regional and Urban Policy; X = Common assessment for both DGs

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				
2013	Chapter 5, **recommendation 1:** require from the Member States in their management declarations (according to Article 59(5)(a) of the Financial Regulation) an explicit confirmation regarding the effectiveness of the first level checks performed by the managing and certifying authorities	R						
	Chapter 5, **recommendation 2:** carry out an assessment of the 'first level checks' performed during the 2007-2013 programme period in accordance with Article 32(5) of the Financial Regulation. Taking account of the weaknesses identified, the Commission should analyse the costs and benefits of possible corrective measures and take (or propose) appropriate action (such as the simplification of the applicable provisions, improvements in the control systems and re-design of the programme or delivery system)	R						
	Chapter 5, **recommendation 3:** analyse the underlying reasons for the high number of cases of non-compliance with EU state aid rules	R						
	Chapter 5, **recommendation 4:** analyse the reasons for the persistent delays in disbursement of EU funds through FEIs and take corrective measures accordingly	R ([1])						
	Chapter 5, **recommendation 5:** confirm in the annual activity report (AAR) of the Directorate-General for Regional and Urban Policy that the Commission's calculation of the 'residual error rate' is based on accurate, complete and reliable information on financial corrections. In order to do so, the Commission should request audit authorities to certify the accuracy of the data on financial corrections reported by certifying authorities for each OP whenever it deems such action necessary.	R ([1])						

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				
2013	Chapter 5, **recommendation 6** (also chapter 6): consistently disclose in its annual activity reports the reasons for not making reservations (or making reservations with a lower financial impact) in cases where this is due to exceptions to applicable Commission guidance or approved audit strategies	X ([1])						
	Chapter 6, **recommendation 1**: follow up with the Member States the weaknesses identified in DG EMPL's risk-based thematic audit of management verifications. This would require strengthening the checks related to compliance with public procurement rules and other relevant sources of errors (costs not linked to the project or with no added value).	E						
	Chapter 6, **recommendation 2**: confirm in its AARs that it has carried out appropriate checks to ensure that the *'residual error rate'* is based on accurate, complete and reliable information on financial corrections. In order to do so, the Commission should ask audit authorities to certify the accuracy of the data on financial corrections reported by certifying authorities for each OP, whenever it deems such an action necessary.	E ([1])						
	Chapter 6, **recommendation 3**: ensure that Articles 78 and 130 of the CPR for the 2014-2020 programme period are applied in a manner that precludes the accumulation of pre-financing in addition to the initial pre-financing payment				E ([2])			
	Chapter 6, **recommendation 4**: ensure that the Member State authorities in charge of managing structural funds address the issue of charging personnel costs at higher rates for EU projects compared to those financed by national funds		E ([3])					
	Chapter 6, **recommendation 5**: ensure, when approving the OPs for the new programme period, that Member States have considered all simplification possibilities allowed by the 2014-2020 *European Structural and Investment Funds* regulations		E ([4])					

([1]) Implementation should continue until closure.
([2]) Recommendation not accepted by the Commission (see the 2014 annual report, paragraph 6.79).
([3]) No systemic measures taken.
([4]) The new programming period is not yet sufficiently advanced for implementation to be fully assessed.

CHAPTER 7

‘Natural resources’

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INTRODUCTION

7.1. This chapter presents our findings for the *MFF* heading 'Natural resources'. This covers spending under the European Agricultural Guarantee Fund (EAGF) (in what is known as this chapter's 'first *specific assessment*'), and on rural development, the environment, climate action and fisheries (in this chapter's 'second specific assessment'). ***Box 7.1*** gives an overview of the main activities and spending under this heading in 2016.

Box 7.1 — MFF heading 2 'Natural resources' — 2016 breakdown

(billion euro)

Total payments for the year	57,4
- advances [1]	*1,5*
+ clearings of advances [1]	*2,0*
Audited population, total	**57,9**

[1] In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 10).

Source: 2016 consolidated accounts of the European Union.

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7.2. Aside from setting out our findings on *regularity*, this chapter also has a section examining the *performance* of a sample of rural development projects and of the new *greening* scheme (see paragraph 7.4).

Brief description of 'Natural resources'

7.3. The *common agricultural policy* (CAP) is the basis for EU spending on agriculture. The Commission, in particular the Directorate-General for Agriculture and Rural Development (DG AGRI), shares *management* of the CAP with *paying agencies* in the Member States. They pay *beneficiaries* mainly through two funds [1]: the EAGF, which fully finances EU *direct aid* and *market measures* [2], and the European Agricultural Fund for Rural Development (EAFRD), which co-finances rural development programmes together with the Member States.

7.4. The EAGF (77 % of 'Natural resources' spending) finances a series of direct aid schemes (40,8 billion euro in 2016) and intervention measures in agricultural markets [3] (3,2 billion euro in 2016). The 2013 CAP reform [4] introduced significant changes to direct aid schemes (see paragraphs 7.15 and 7.16), and 2016, the year covered by this report, was the first year when payments to final beneficiaries were made [5] on the basis of the new rules in force. The four main schemes, accounting for 91 % of all direct aid payments, are:

— two area-related schemes providing *decoupled* [6] *income support*, the '*basic payment scheme*' (BPS) (17,8 billion euro in 2016) [7] and the '*single area payment scheme*' (SAPS) (4 billion euro in 2016);

(1) Regulation (EU) No 1306/2013 of the European Parliament and of the Council of 17 December 2013 on the financing, management and monitoring of the common agricultural policy and repealing Council Regulations (EEC) No 352/78, (EC) No 165/94, (EC) No 2799/98, (EC) No 814/2000, (EC) No 1290/2005 and (EC) No 485/2008 (OJ L 347, 20.12.2013, p. 549).

(2) With the exception of certain co-financed measures, such as promotion measures and the school fruit scheme.

(3) Covering, in particular, support for the wine and fruit/vegetable sectors, and for school milk and fruit, as well as measures targeting the outermost regions of the EU.

(4) The European Parliament, the Council and the European Commission reached an agreement on the CAP reform in 2013. A number of legislative texts aimed at its practical implementation were approved thereafter.

(5) Based on aid applications submitted in 2015 (i.e. claim year 2015).

(6) Decoupled payments are granted for all eligible agricultural land, irrespective of whether it is used for production.

(7) We are currently examining the implementation of the BPS, with a view to publishing a special report (see our 2017 Work Programme; http://eca.europa.eu).

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— the payment for agricultural practices beneficial for the climate and the environment (known as the 'greening payment'; 11,7 billion euro in 2016);

— *coupled support*, linked to specific types of agricultural produce (e.g. beef and veal, milk or protein crops) which are particularly important for economic, social or environmental reasons and face certain difficulties (3,8 billion euro in 2016).

7.5. The EAFRD (21 % of 'Natural resources' spending) co-finances the rural development expenditure disbursed through Member States' rural development programmes. The expenditure covers both area-related measures [8] and non-area related measures [9]. In 2016, the EAFRD accounted for 12,4 billion euro of expenditure, of which 63 % related to rural development programmes for the 2014-2020 *programming period*, and 37 % to earlier programmes.

7.6. The MFF heading also covers the common fisheries policy and some of the EU spending on the environment and climate action [10] (2 % of 'Natural resources' spending).

THE COMMISSION'S REPLIES

7.5. *As to 37 % of payments disbursed in respect of commitments made in earlier programmes, it includes payments made in the very last quarter related to the 2007-2013 programmes as well as balance payments. Out of 92 Rural Development programmes for the period 2007-2013, 64 were already closed in 2016, with an average implementation rate of 99,1 % and a global balance payment of 2,7 billion euro.*

(8) Area-related measures are those where payment is linked to the number of hectares, such as agri-environment payments and compensatory payments to farmers in areas with natural handicaps.

(9) Non-area-related measures are typically investments to, for example, modernise farms or set up basic services for the rural economy and local population.

(10) Other EU spending areas beyond the MFF heading 'Natural resources' also provide funding for the environment and climate action.

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Audit scope and approach

7.7. Applying the audit approach and methods set out in ***Annex 1.1***, in 2016 we examined:

(a) Samples of 217 EAGF *transactions* and 163 transactions for rural development, the environment, climate action and fisheries, in line with paragraph 7 of ***Annex 1.1***. Both samples were designed to be representative of the range of spending under this MFF heading for each of the two *specific assessments* ([11]) . The EAGF sample consisted of transactions from 21 Member States ([12]). The sample for the second specific assessment consisted of 153 transactions for rural development and 10 other transactions (in areas covering the environment, climate action and fisheries) from 20 Member States ([13]).

(b) Whether the *annual activity reports* of DG AGRI, DG MARE and DG ENV/CLIMA ([14]) presented information on regularity of spending that was broadly consistent with our results.

([11]) Our approach is based on a number of randomly selected items (e.g. parcels or invoices) for each transaction. Therefore, a detected error does not necessarily reflect the overall level of error for the transaction in question.

([12]) Belgium (Wallonia and Flanders), Bulgaria, the Czech Republic, Denmark, Germany (Bavaria, Hamburg-Jonas, Mecklenburg-Vorpommern, North Rhine-Westphalia, Saxony-Anhalt, Schleswig Holstein), Ireland, Greece, Spain (the Basque Country, Andalusia, the Region of Murcia, the Valencian Community, Aragon, Castilla-La Mancha, Extremadura and Castile and León), France, Italy (AGEA, Calabria, Lombardy, Tuscany and Veneto), Latvia, Lithuania, Hungary, the Netherlands, Poland, Portugal, Romania, Slovakia, Finland, Sweden and the United Kingdom (England, Northern Ireland and Scotland). The sample also included one transaction under *direct management*.

([13]) Bulgaria, the Czech Republic, Denmark, Germany (Lower Saxony-Bremen, Saxony and Saxony-Anhalt), Estonia, Ireland, Greece, Spain (Andalusia, Castilla-La Mancha and Extremadura), France (Midi-Pyrénées and Rhône-Alpes), Croatia, Italy (Basilicata), Lithuania, Hungary, Austria, Poland, Portugal (Azores and mainland), Romania, Slovakia, Finland and the United Kingdom (England and Scotland). The sample included seven transactions under direct management, of which two concerned EU funds spent on fisheries partnership agreements outside the European Union.

([14]) DG ENV and DG CLIMA have a common financial resources directorate.

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7.8. For part two of this chapter, focused on performance, we reviewed:

(a) whether, for 193 investment projects that we had examined between 2014 and 2016, the beneficiaries had carried out the investment as planned and at a reasonable cost;

(b) whether 6 projects examined in 2016 and approved under the 2014-2020 rules would have been suitable for *simplified cost options*;

(c) certain performance issues relating to the new greening payment for 197 farms.

PART 1 — REGULARITY OF TRANSACTIONS

7.9. For 2016 we estimate a level of error below our *materiality threshold* of 2 % for spending on the EAGF, one of the two specific assessments we present in this chapter (see paragraph 7.11), representing more than three-quarters of spending under MFF heading 2. ***Annex 7.1*** provides an overview of the results of transaction testing for 'Natural resources' as a whole and for each of the two specific assessments. Of the 380 transactions examined, 112 (29 %) contained *errors*, of which 90 were quantifiable. We estimate the level of error for 'Natural resources' as a whole to be 2,5 % ([15]).

THE COMMISSION'S REPLIES

7.9. *The Commission is very satisfied with the ECA's finding that EAGF expenditure, representing 44 billion euro a year, is free of material error. The Commission is also pleased that the overall error rates reported by the ECA and for the CAP in DG AGRI's Annual Activity Report 2016 are very close.*

The Commission is of the view that net financial corrections resulting from multiannual conformity procedures, as well as recoveries from beneficiaries reimbursed to the EU budget, represent a corrective capacity that the Commission takes into account when assessing the final risk to the EU budget.

The Commission notes in particular that, as reported in the 2016 Annual Activity Report of the Directorate-General for Agriculture and Rural Development, its corrective capacity amounted in 2016 to 2,04 % of the relevant CAP expenditure.

([15]) 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 1,5 % and 3,5 % (the lower and upper error limits respectively).

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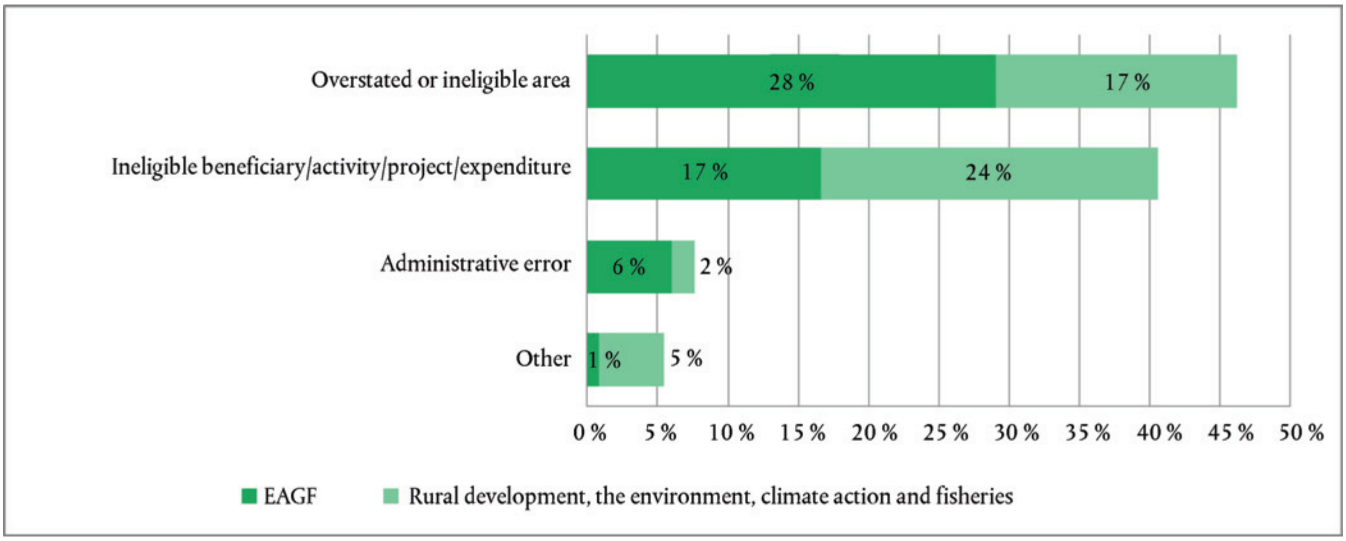
7.10. ***Box 7.2*** gives a breakdown of our overall *estimated level of error* for 2016, and of the nature and scale of errors affecting the EAGF and rural development, the environment, climate action and fisheries.

Box 7.2 — Breakdown of estimated level of error by error type — 'Natural resources'



Source: European Court of Auditors.

EAGF — Market and direct support

7.11. Overall, the results of transaction testing indicate that error was not material for this specific assessment. However, of the 217 EAGF transactions examined, 49 (23 %) contained errors, all of which were quantifiable. We estimate the level of error to be 1,7 % ([16]).

THE COMMISSION'S REPLIES

7.11. *The Commission is very pleased that the most likely error estimated by the ECA is below materiality and very close to the one reported in DG AGRI Annual Activity Report 2016. This confirms the effectiveness of remedial action plans implemented in previous years by Member States concerned, in particular with regards to improvements to their Land Parcel Identification Systems (LPIS) and their close monitoring by the Commission.*

([16]) 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 0,8 % and 2,6 % (the lower and upper error limits respectively).

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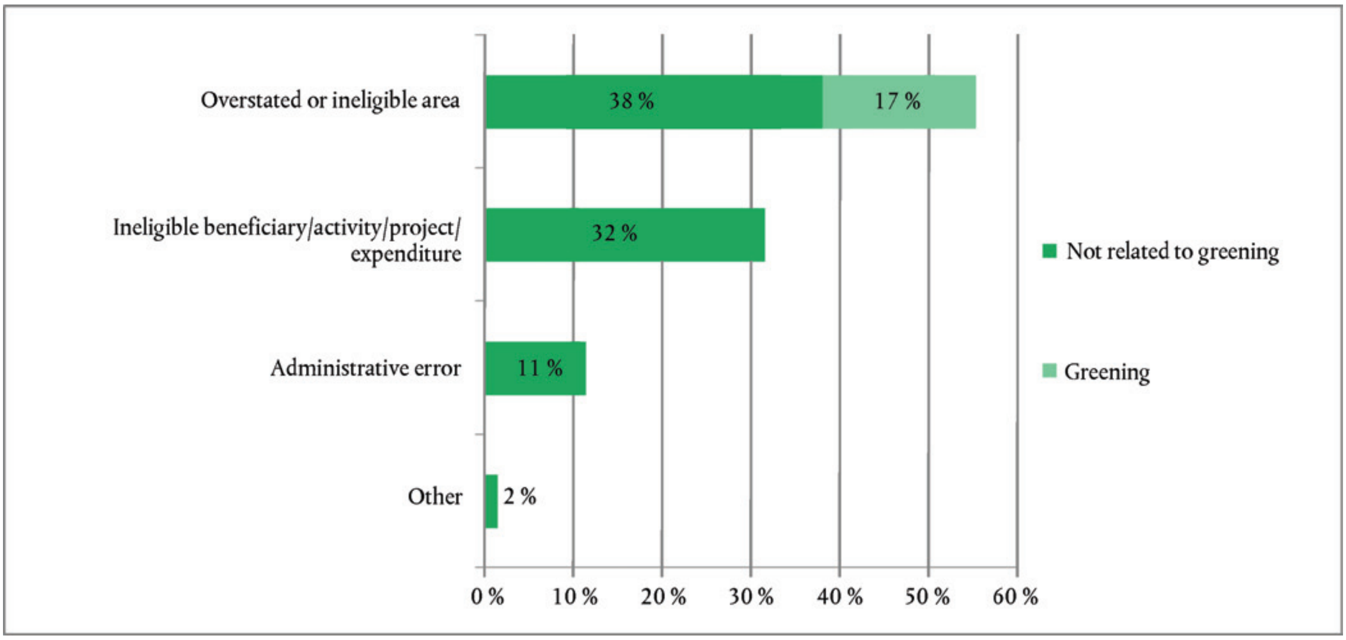
7.12. ***Box 7.3*** gives a breakdown of our estimated level of error for 2016 by error type.

Box 7.3 — Breakdown of estimated level of error by error type — EAGF



Source: European Court of Auditors.

7.13. Of the 217 EAGF transactions examined, 201 concerned direct aid schemes, and 16 intervention measures in agricultural markets and other items. The main management and control system for direct aid payments is the *Integrated Administration and Control System (IACS)*. As reported in the past, the IACS [17], and in particular the *Land Parcel Identification System (LPIS)* [18], makes a significant contribution to preventing and reducing levels of error.

THE COMMISSION'S REPLIES

7.13. *The Commission welcomes the opinion that IACS, in particular LPIS, makes a significant contribution to preventing and reducing levels of error. This confirms the Commission's view that IACS, including LPIS, is a crucial tool in the CAP assurance model. The Commission continues assisting the Member States in ensuring their appropriate quality and effectiveness, including for EAFRD concerned measures.*

(17) See paragraph 7.35 of our 2014 annual report.
(18) See paragraph 7.17 of our 2015 annual report.

THE COURT'S OBSERVATIONS

7.14. Member State authorities had applied corrective measures that directly affected 6 of the transactions we sampled. These measures were relevant for our calculations, as they reduced our estimate of error for this specific assessment by 0,7 percentage points. In 16 cases of quantifiable error, the national authorities had sufficient information [19] to prevent, or to detect and correct, the error before declaring the expenditure to the Commission. Had the national authorities made proper use of all the information at their disposal, the estimated level of error for this specific assessment would have been 0,5 percentage points lower.

Overstated or ineligible area, including for the new greening payment

7.15. We found eligible areas to have been more accurately determined than in previous years. The main reasons for this improvement are:

— the revised definition of *permanent grassland*, resulting from the 2013 CAP reform, has meant that some land which was previously ineligible has become eligible under the rules applicable from claim year 2015 onwards (see ***Box 7.4***);

— as we have noted in previous reports [20], the reliability of data on the eligibility of land contained in the LPIS continued to improve, as a result of the ongoing action plans being put into effect by Member States either at their own initiative or upon the Commission's request;

— use of the new geo-spatial aid application (GSAA) procedure [21] has reduced the number of area-related errors in aid applications. For aid applications filed in claim year 2015, over one-third of paying agencies already applied this useful tool. The GSAA is due to be fully rolled out by claim year 2018.

THE COMMISSION'S REPLIES

7.14. *The Commission welcomes the ECA's assessment on Member States' role and corrective actions and will continue to encourage and support Member States to take all necessary actions to prevent, detect and correct errors.*

In particular, the Commission will continue to work with the Member States to ensure their control and management systems are reliable, taking into account that resources of paying agencies to detect ineligible expenditure are limited and shall be in proportion to the risk.

7.15.

— *The Commission welcomes the ECA's assessment as to the effectiveness of the action plans in relation to LPIS.*

The Commission will continue to work with the Member States to maintain the quality of LPIS and IACS in general.

(19) Information included in supporting documentation and databases or emerging from standard cross-checks and other mandatory checks.

(20) See paragraph 7.17 of our 2015 annual report and paragraphs 60 to 64 of our special report No 25/2016 'The Land Parcel Identification System: a useful tool to determine the eligibility of agricultural land — but its management could be further improved' (http://eca.europa.eu).

(21) See also paragraphs 46 to 48 of our special report No 25/2016.

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Box 7.4 — New definition of permanent pasture helped reduce the error rate

In previous years ineligible permanent grassland was a key source of error [22]. Such errors have now significantly decreased in both number and scale due, in particular, to the new definition of permanent pasture under the reformed CAP.

While the former definition restricted eligibility to the portion of a parcel which was covered by grass or other herbaceous vegetation, the scope has now been extended to any vegetation suitable for grazing, including shrubs and trees, provided they are not predominant. Member States may also extend eligibility to land on which non-herbaceous vegetation is predominant, if it forms part of established local practices. The photos below illustrate the change in policy.

Image 1 — Non-herbaceous vegetation is now eligible if it can be grazed and is not predominant

Prior to the 2013 CAP reform, this parcel had an eligibility rate of 40 % corresponding to its grass cover. Under the new definition, the eligibility rate has increased to 60 %, to reflect other vegetation suitable for grazing (such as bushes and small trees).

Source: European Court of Auditors.

[22] See paragraph 7.20 of our 2015 annual report, paragraph 7.21 in our 2014 annual report, paragraph 3.9 in our 2013 annual report, paragraph 3.13 in our 2012 annual report, paragraph 3.12 in our 2011 annual report.

Image 2 — Non-herbaceous vegetation can also be predominant, if part of established local practices

Several Member States [23] have opted to admit, as eligible pastureland, land on which non-herbaceous vegetation suitable for grazing is predominant (e. g. grazable heathland).

Source: European Court of Auditors.

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7.16. The new greening payment creates additional requirements for farmers. The objective of the greening aid scheme is to make EU farms more environmentally friendly through three practices: crop diversification, the maintenance of existing permanent grassland and the establishment of ecological focus areas (EFAs) on arable land [24]. The three practices are described in paragraphs 7.44 to 7.46.

[23] Germany, Greece, Spain, France, Croatia, Italy, Portugal, Sweden and the United Kingdom.

[24] Only certain EFA eligible land uses can be on land other than arable land (e.g. short rotation coppice and afforested areas). Permanent features eligible as EFAs, such as landscape features and buffer strips, can be on land directly adjacent to arable land.

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7.17. We examined the greening payment for 63 farms ([25]). We found that all those subject to the crop diversification requirement were compliant. As regards the maintenance of existing permanent grassland, we found no infringements for parcels correctly recorded in the LPIS. However, not all permanent grassland had been properly recorded as such ([26]), and in one case this had led to a breach of the maintenance requirements on environmentally sensitive permanent grassland (ESPG; see paragraph 7.45). Most of the greening errors we found concerned compliance with EFA requirements.

7.18. Agricultural parcels are classified into three categories: arable land, permanent grassland and permanent crops (e.g. orchards and olive groves). EFAs must be located on (or adjacent to) arable land. We found that several paying agencies either did not have reliable information on the categories of land in their LPIS, or failed to use it to verify claims (see ***Box 7.5***).

7.18. *The Commission is aware of the deficiencies in some Member States. They arose during the first year of implementation of the new direct payments, they concern limited areas and remedial actions are being taken. Where necessary DG AGRI has opened conformity clearance procedures that will protect the EU financial interest.*

Box 7.5 — Correct classification of land is important for ensuring compliance with greening requirements

EU legislation states that arable land used to grow grasses becomes permanent pasture once it has been excluded from crop rotation for five consecutive years.

In the Czech Republic and Poland the LPIS database contained no information on historical land uses. In such situations, authorities cannot perform automated cross-checks to verify whether arable land used to grow grasses has become permanent grassland. This creates a risk that the authorities may not detect declared EFAs which are in fact on permanent grassland (i.e. not arable land).

We also found weaknesses in the classification of permanent grassland or the related cross-checks in Germany (Bavaria, Mecklenburg-Vorpommern, North Rhine-Westphalia, Saxony-Anhalt, Schleswig Holstein), France, Italy (Lombardy), Portugal and the United Kingdom (England).

Box 7.5 — Correct classification of land is important for ensuring compliance with greening requirements

DG AGRI is opening conformity clearance procedures that will protect the EU financial interest against this risk.

([25]) Not all the visited farms were subject to all three practices, some being exempt from one or more, mainly due to their small size.
([26]) See also paragraphs 37 and 38 of our special report No 25/2016.

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Ineligible beneficiary/expenditure

7.19. For three market measure cases in our sample, paying agencies had reimbursed costs that were partly ineligible. Although such measures represent a small part of overall EAGF spending, these errors form a significant source of overpayment for the fund in our sample.

Rural development, the environment, climate action and fisheries

7.20. ***Annex 7.1*** provides an overview of the results of transaction testing. For rural development, the environment, climate action and fisheries, of the 163 transactions examined, 63 (39 %) contained errors, of which 41 were quantifiable. We estimate the level of error to be 4,9 % ([27]). ***Annex 7.2*** provides an overview of the results of transaction testing by Member State for transactions under *shared management*, while ***Annex 7.3*** provides an overview of all errors with an impact of at least 20 % of the transaction value examined.

THE COMMISSION'S REPLIES

7.20. *The Commission takes note of the level of error estimated by the ECA, which is similar to the one reported in DG AGRI's Annual Activity Report 2016.*

Rural development remains an area which merits close scrutiny, in particular for investment type measures. The Commission systematically requests Member States to design remedial action plans when control deficiencies are identified and supports their implementation. The Commission also actively promotes the use of Simplified Cost Options in order to reduce both administrative costs and errors. However, taking into account the need to balance legality and regularity with the achievements of policy objectives while bearing in mind the delivery (management and control) costs, it cannot be expected with any real certainty that an error rate for payments to beneficiaries below 2 % for rural development would be attainable with reasonable efforts. Nevertheless, the corrective capacity of Member States' recoveries and Commission's financial corrections in the years following the year of expenditure enables the Commission to get assurance on CAP expenditure.

([27]) 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 2,1 % and 7,7 % (the lower and upper error limits respectively).

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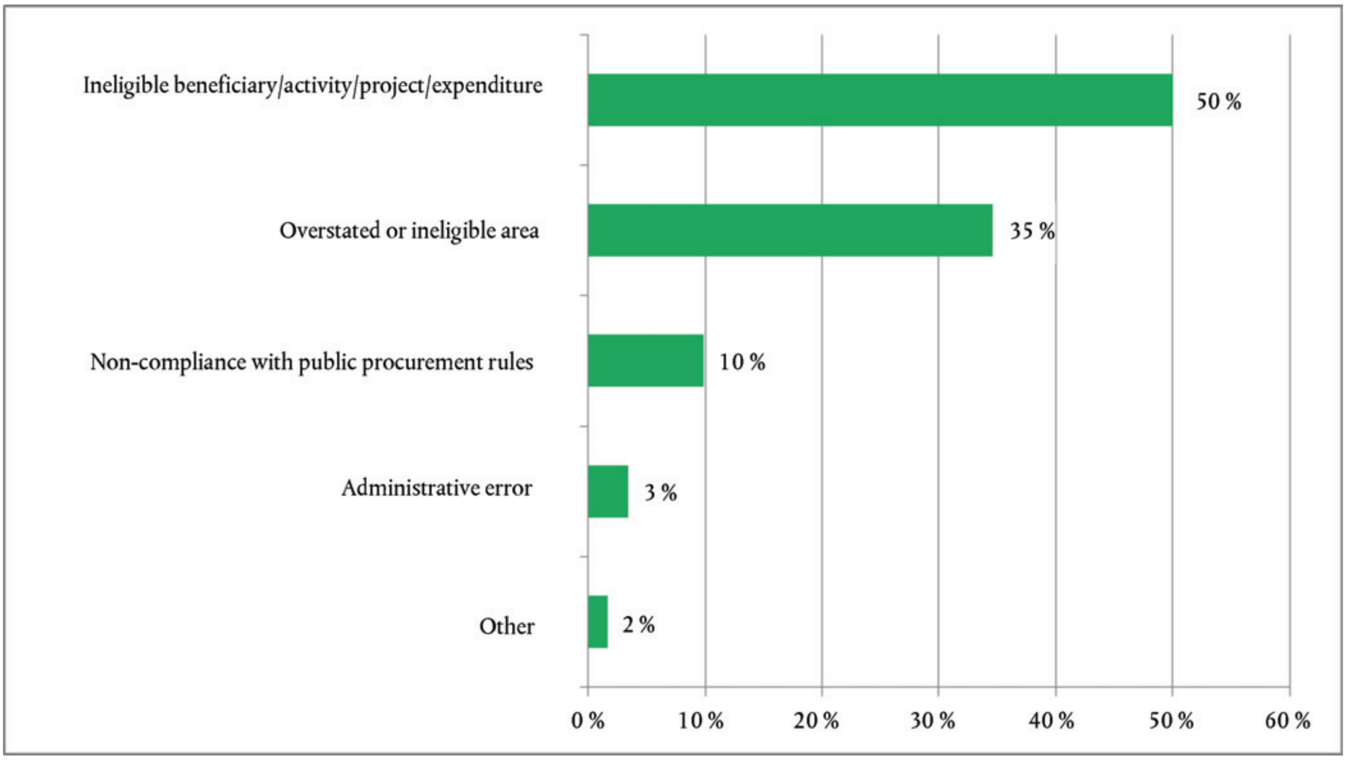
7.21. ***Box 7.6*** gives a breakdown of our estimated level of error for 2016 by error type.

Box 7.6 — Breakdown of the estimated level of error — Rural development, the environment, climate action and fisheries



Source: European Court of Auditors.

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7.22. For rural development, of the 153 transactions examined, 64 were area-related and 89 non-area related (typically investment projects). Of these 153 transactions, 58 (38 %) contained errors, of which 38 were quantifiable. As regards the 10 environment, climate action and fisheries transactions sampled, 5 (50 %) contained errors, three of which were quantifiable.

7.23. Member State authorities had applied corrective measures that directly affected 8 of the transactions we sampled. These measures were relevant for our calculations, as they reduced our estimate of error for this specific assessment by 0,4 percentage points. In 16 cases of quantifiable error, the national authorities had sufficient information ([28]) to prevent, or to detect and correct, the error before declaring the expenditure to the Commission. Had the national authorities made proper use of all the information at their disposal, the estimated level of error for this specific assessment would have been 1,5 percentage points lower.

7.24. The types of error are similar to those found in previous years and those identified in our special report analysing the causes of error in rural development spending ([29]). As in previous years, non-area related measures accounted for most (62 %) of the estimated level of error reported in paragraph 7.20.

7.25. For the non-area related transactions examined, the key cause of error was non-compliance with eligibility requirements. For the environment, climate action and fisheries, the three quantifiable errors also arose due to ineligible expenditure.

7.26. This year, three of the largest eligibility errors involved beneficiaries who did not disclose that they were controlled by, applying jointly with, or purchasing from linked companies, in breach of EU or national rules (see examples 1, 2 and 6 in ***Annex 7.3***).

THE COMMISSION'S REPLIES

7.22. *The Commission notes that 30 of the 38 quantifiable errors were below 20 %.*

7.23. *The Commission is aware that the national authorities could potentially have detected more of the errors found by the ECA for rural development. The CAP rules provide the Member States with all necessary instruments to mitigate most of the risk of errors.*

The Commission also considers that Member States efforts to scrutinise transactions shall be proportionate.

The Commission is vigilant and carries out conformity clearance audit missions which check the management and control systems in individual Paying Agencies in the Member States and provide valuable information on how effectively those systems protect the EU funds which they are responsible for disbursing.

In 2016, the Commission (DG AGRI) carried out 56 conformity audits covering EAFRD. Also the Certification Bodies in the Member States contribute to the prevention of the errors.

7.24. *The Commission pays particular attention to findings already detected in the previous years as well as to their proper follow-up and prevention of the similar errors in the other Member States.*

Besides, the implementation of action plans is also under close scrutiny by the Commission services. The Commission considers that the successful implementation of these action plans contribute to reducing errors.

([28]) Information included in supporting documentation and databases or emerging from standard cross-checks and other mandatory checks.

([29]) See special report No 23/2014 'Errors in rural development spending: what are the causes, and how are they being addressed?' (http://eca.europa.eu).

THE COURT'S OBSERVATIONS

7.27. Among the 64 area-related transactions, we found 22 cases (34 %) where the land was ineligible or the area declared had been overstated (see examples 7 and 8 in ***Annex 7.3***).

THE COMMISSION'S REPLIES

7.27. *The CAP reform and the implementation of the Rural Development Programmes 2014-2020 triggered also changes in the land eligibility rules and consequently in the LPIS. See also Commission reply to paragraph 7.13.*

Annual activity reports and other governance arrangements

DG AGRI's annual activity report

7.28. In its 2016 AAR, DG AGRI presents an overall adjusted error rate (AER) for CAP expenditure of 2,5 %. This figure is consistent with our audit conclusion that the level of error for this spending area is material.

7.29. Based on their paying agencies' control statistics, Member States reported an overall level of error of 1,2 % ([30]). Subsequently, DG AGRI made adjustments mainly using the results of their and our own audits from the last three years and, to a lesser extent, the *certification bodies*' opinions on legality and regularity for the 2016 financial year ([31]).

7.30. This year we published a special report assessing whether a new framework set up in 2015 by the Commission enabled the certification bodies to form their opinions in line with EU regulations and international audit standards. Although the introduction of the framework was a positive step towards a single audit model, we found it to have significant weaknesses ([32]). We made a number of recommendations for improvements to be included in the new Commission guidelines applicable from the 2018 financial year onwards.

7.30. *The Commission fully accepted 5 of 7 recommendations and confirmed that they are considered already implemented in the certification body guidelines for financial year 2018 and onwards. The Commission did not accept the recommendation that using the opinion of certifications would be possible only once the work is carried out as defined in recommendations, but on the contrary considered that, whereas the guidelines for financial year 2015 can be improved, where they are correctly applied they already in their current form enable the certification bodies to give an opinion on legality and regularity in compliance with applicable rules and standards.*

([30]) The average level of error reported by Member States is 1,09 % for the EAGF and 1,78 % for the EAFRD.

([31]) Certification bodies are required to ascertain, on the basis of a representative sample, the legality and regularity of the expenditure for which the paying agencies have requested reimbursement from the Commission. The certification bodies issued their first opinions on regularity for the 2015 financial year.

([32]) For details see special report No 7/2017 'The certification bodies' new role on CAP expenditure: a positive step towards a single audit model but with significant weaknesses to be addressed' (http://eca.europa.eu).

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DG MARE, DG ENV and DG CLIMA annual activity reports

7.31. The AARs were prepared in line with the DG BUDG instructions, and the methods used to calculate the error rates do not point to any methodological problems. The number of transactions that we audited in 2016 in the areas of fisheries, the environment and climate action is statistically too small for us to be able to compare the information on regularity of spending reported by these three DGs with our audit results.

Conclusion and recommendations

Conclusion

7.32. The overall evidence indicates that the level of error in spending on 'Natural resources' and in the area subject to a specific assessment covering rural development, the environment, climate action and fisheries (see paragraphs 7.9 and 7.20) was material. However, for the EAGF (representing more than three-quarters of spending under MFF heading 2), our estimated level of error in 2016 is below materiality (see paragraphs 7.9 and 7.11).

7.32. *The Commission is very appreciative of the ECA's assessment of the level of error for EAGF as being below materiality, which the Commission considers is a reflection of the management and control systems in place, in particular IACS.*

The Commission would like to draw the attention to the corrective capacity of DG AGRI's audits and Member States controls (see Commission reply to paragraph 7.9), which enables having assurance on CAP expenditure as a whole.

7.33. For this MFF heading, our testing of transactions produced an estimated overall level of error of 2,5 % (see ***Annex 7.1***).

7.33. *The Commission welcomes the level of error estimated by the ECA which is very close to the error rate reported in DG AGRI annual report 2016.*

Recommendations

7.34. ***Annex 7.4*** shows the findings of our follow-up review of the 10 recommendations we made in our 2013 annual report [33]. Of these, one was no longer applicable. The Commission and the Member States had implemented five recommendations in full, while two had been implemented in most respects and two in some respects.

(33) We chose our 2013 report for this year's follow-up exercise as, typically, enough time should have elapsed for implementation of our recommendations.

THE COURT'S OBSERVATIONS

7.35. Based on this review and our findings and conclusions for 2016, we recommend that the Commission:

— **Recommendation 1:** review the approach taken by paying agencies to classify and update land categories in their LPISs and to perform the required cross-checks, in order to reduce the risk of error in the greening payment (see paragraphs 7.17 and 7.18, as well as ***Box 7.5***).

— **Recommendation 2:** provide guidance and disseminate best practices (e.g. the use of new IT technology) among national authorities to ensure that their checks identify links between applicants and other stakeholders involved in the supported projects (see paragraph 7.26).

PART 2 — PERFORMANCE

7.36. This part reports on the performance of selected rural development transactions ([34]) and of the new greening payment.

Performance assessment of rural development projects

7.37. Over the last three years (2014-2016), we have examined selected performance issues for 193 projects investing in tangible assets. We found that:

— 95 % of the investments that had been completed at the time of our audit visit had been carried out as planned;

— in 34 % of cases there was insufficient evidence that costs were reasonable.

THE COMMISSION'S REPLIES

The Commission accepts this recommendation.

Remedial actions are already ongoing in the Member States concerned, where necessary conformity clearance procedures will protect the EU budget.

The Commission accepts this recommendation.

During the audits in different Member States the best practices are shared, also in the form of recommendations given to improve the control and management system. The Commission organises on a regular basis seminars, conferences where the best practices are disseminated. IT solutions are also being explored.

([34]) See part 2 of chapter 7 of our 2014 and 2015 annual reports.

THE COURT'S OBSERVATIONS | THE COMMISSION'S REPLIES

Implementation of investment projects

7.38. Of the 193 investment projects we examined, 139 had been completed at the time of our audit visit. We checked whether these completed investment projects had been carried out as planned; 95 % of the investments satisfied this criterion.

Reasonableness of costs and the potential for increased use of simplified cost options

7.39. In 2014-2016 we analysed 193 investment projects to see whether there was sufficient evidence that costs were reasonable. We found sufficient evidence for 127 of the projects (66 %). However, there was insufficient evidence that costs were reasonable in 66 cases (34 %).

7.39. *The assessment of reasonableness of costs is the responsibility of the Member States (see article 48 of Regulation (EU) No 809/2014). The Commission protects the EU budget when weaknesses are identified through conformity procedures and issues guidance on how to improve the systems in place (see Guidance on rural development controls and sanctions, including a checklist for the assessment of reasonableness of costs).*

7.40. Almost all of the 193 projects used a system which reimbursed the costs incurred ([35]). In the 2014-2020 period Member States may, as an alternative, use a system of simplified cost options: standard scales of unit costs, lump sums and flat-rate financing ([36]). Where feasible, using simplified cost options effectively limits the risks of excessive prices — as long as they are set at the right level ([37]) ([38]).

([35]) Reimbursement of costs is associated with higher levels of error. On this topic, see also paragraphs 1.21 to 1.24 of the 2015 annual report.

([36]) Article 67(1) of Regulation (EU) No 1303/2013 of the European Parliament and of the Council (OJ L 347, 20.12.2013, p. 320). Certain forms of simplified cost options were already allowed in the 2007-2013 programming period for some rural development measures, but not for investment projects.

([37]) See paragraphs 58 to 63 of our special report No 22/2014 'Achieving economy: keeping the costs of EU-financed rural development project grants under control' (http://eca.europa.eu).

([38]) Our experience in auditing expenditure on economic, social and territorial cohesion also shows that projects implemented using simplified cost options are less error-prone. See paragraph 6.15 of the 2015 annual report.

THE COURT'S OBSERVATIONS

7.41. In 2016, most of the projects we examined were approved under the 2007-2013 rules, when simplified cost options could not yet be used for rural development investments. We reviewed 6 projects approved under the 2014-2020 rules and considered that 5 were suitable, but only one used simplified cost options (see ***Box 7.7***).

Box 7.7 — Simplified cost options can help ensure costs are reasonable

In the United Kingdom (England) we audited a project to build a new roof for a livestock-gathering area. The payment was based on a standard unit cost for roofs of 62 GBP per square metre, with a maximum available grant per farm of 10 000 GBP.

The standard unit cost for the roof came from a publication which is one of the most widely used independent sources of agricultural business information in the United Kingdom. The prices in the publication are updated every year.

7.42. We are currently working on an audit to analyse the use of simplified costs options in further detail, with a view to publishing a special report on the topic in 2018.

Assessment of greening performance

7.43. In 2016 we audited the first year of the greening payment. The objective of the new greening scheme is to make EU farms more environmentally friendly through three practices addressing both climate and environmental policy goals:

— crop diversification;

— maintenance of existing permanent grassland;

— establishment of ecological focus areas (EFAs).

THE COMMISSION'S REPLIES

7.41. *Under shared management, Member States are fully responsible for designing their programmes and measures. The Commission did and will continue to promote and support the use of simplified costs, as an efficient mean to reduce both administrative costs and errors.*

THE COURT'S OBSERVATIONS

7.44. **Crop diversification** aims in particular to improve soil quality ([39]). The practice is mandatory for farms with more than 10 ha of arable land, with additional requirements applicable to larger farms, as illustrated in ***Box 7.8***.

Box 7.8 — Crop diversification requirements

Ha of arable land on the farm	Minimum number of crops required	Limit for the main crop	Limit for the two main crops
Between 10 and 30	2	75 %	N/A
More than 30	3	75 %	95 %

7.45. The primary aim behind the **maintenance of existing permanent grassland** is to limit future carbon emissions from soils ([40]). Member States must ensure that the ratio of permanent grassland to the total agricultural area does not fall more than 5 % below a reference ratio. If it does, Member States must oblige farmers to maintain all their permanent grassland and to reconvert to permanent grassland any previously converted land. Member States must also designate areas of environmentally sensitive permanent grassland (ESPG), which farmers must not plough or convert to other land uses.

7.46. The main objective of **EFAs** is to safeguard and improve biodiversity ([41]). The EFA requirement dictates that aid applicants must designate an area corresponding to 5 % of their arable land as an EFA ([42]). Member States select eligible areas from a list contained in EU rules. The options include a series of permanent features (e.g. hedgerows, ditches, groups of trees, etc.) and certain temporary, environmentally friendly arable land uses (e.g. green cover, nitrogen-fixing crops, catch crops and land lying fallow).

([39]) Recital 41 of Regulation (EU) No 1307/2013 of the European Parliament and of the Council (OJ L 347, 20.12.2013, p. 608).
([40]) See Recital 42 of Regulation (EU) No 1307/2013.
([41]) Recital 44 of Regulation (EU) No 1307/2013.
([42]) Farms with less than 15 ha of arable land are exempt from the EFA requirement.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

7.47. In addition to our regularity work (see paragraphs 7.16 to 7.18), we assessed the extent of the changes in crop diversification and EFA practices since greening was introduced. We assessed this for 197 farms which received a greening payment. Below we present the results for each of the two practices.

7.48. We deal with the maintenance of existing permanent grassland in paragraph 7.17. We found no issues for parcels correctly recorded in the LPIS. However, not all permanent grassland had been properly recorded as such, and in one case this had led to a breach of the ESPG maintenance requirement.

Crop diversification

7.49. When comparing 2015 with 2014, the crop diversification requirements led to no changes on 89 % of the farms visited. There are two reasons for this high percentage. Firstly, around half of the farms already carried out crop diversification practices in the year before greening applied. Secondly, around one-third of the farms were exempt from crop diversification due to their small size. ***Box 7.9*** summarises our findings.

7.49. *Commission notes that prior to 2015 claim year in most Member States there was no obligation for farmers to record crops.*

THE COURT'S OBSERVATIONS

7.50. We found that 11 % of the farms visited had to increase the area under crop diversification in 2015 compared with 2014. For the farms sampled, we estimate that the introduction of crop diversification requirements under greening led to changes in land use on around 2 % of their arable land ([43]) ([44]).

THE COMMISSION'S REPLIES

7.50 and 7.51. *The Commission notes that prior to 2015 claim year in most Member States there was no obligation for farmers to record crops, which makes comparisons at individual farms level difficult. The Commission considers that the assessment of the impact of the greening requirements will require a more suitable approach (based on a proper counterfactual scenario) and also must be seen for more than 1 year of application. At this stage, it cannot be measured directly how much the environmental and climate performance was enhanced on the area where the crops changed. The Commission is closely following the impact of this new policy.*

Box 7.9 — Changes in crop diversification following the introduction of greening

Changes in crop diversification	**Farms**	**%**
No change (beneficiary already complied with crop diversification requirements)	107	54 %
No change (beneficiary not subject to crop diversification)	69	35 %
Change (more crop diversification)	21	11 %
TOTAL	**197**	**100 %**

([43]) Our estimate is based on the actual changes made by the farms which we sampled for EAGF payments. The greening requirement for crop diversification sets a limit for the first crop of 75 % of the total arable area for farms with more than 10 hectares of arable land. The maximum possible change attributable to greening is thus 25 % of the arable area of farms subject to this requirement (namely when a farm had a monoculture in 2014 and fulfilled the requirement in 2015). However, many farms already fulfilled the requirement in 2014: for these farms, we considered that no change occurred. Moreover, very few farms which had to adapt their crop diversification actually had monocultures in 2014.

([44]) The Commission's review of greening after one year concluded that 'the relocated area due to the diversification obligation' amounted to around 0,8 % of arable land. See Commission Staff Working Document 'Review of greening after one year' SWD (2016) 218, Annex 4, Section 5.2.2.

THE COURT'S OBSERVATIONS

7.51. We analysed the average size of the arable land in each of the three categories in the table above. The data shows that the average size of EAGF farms in our sample which already complied with crop diversification requirements in 2014 (438 hectares) was considerably larger than the average size of the farms which had to change their crop diversification in 2015 (87 hectares). This suggests that medium-sized farms have been more affected by the introduction of the new requirements, while larger farms were mainly already compliant, and smaller ones are exempt.

Ecological focus areas

7.52. When comparing 2015 with 2014, the EFA requirements led to no changes for 67 % of the farms audited. The same two reasons apply as for crop diversification: around one-quarter of the farms visited already had a sufficient area designated as an EFA the year before greening applied, and 42 % of the farms visited were exempt from the EFA practice due to their small size. ***Box 7.10*** summarises our findings.

7.53. We found that 32 % of the farms visited had to increase, sometimes significantly, their EFA in 2015 compared with 2014. For the farms sampled, we estimate that the introduction of the EFA requirements under greening led to changes in land use on around 1,5 % of their arable land ([45]).

THE COMMISSION'S REPLIES

7.52. *The Commission notes that prior to 2015 claim year EFA was not recorded, which makes comparisons at individual farms level difficult and not precise.*

7.53. *See also Commission reply to paragraphs 7.51 and 7.52.*

The Commission considers that at this stage, it cannot be measured directly how much the land use changed due to EFA requirements. EFAs are expected to have wider impacts.

([45]) Our estimate is based on the actual changes made by the farms which we sampled for EAGF payments. To comply with the EFA requirement, a farmer claiming more than 15 ha of arable land has to ensure that an area equivalent to 5 % of his total arable land is an EFA. The maximum possible change attributable to greening is thus 5 % of the arable area of farms subject to this requirement (namely when a farm had no EFA in 2014 and fulfilled the requirement in 2015). However, many farms already fulfilled the requirement in 2014, and most farms already had some proportion of EFA in 2014, even if not 5 %.

Box 7.10 — Changes in EFAs following the introduction of greening

Changes in ecological focus areas (EFAs)	Farms	%
No change (beneficiary already complied with EFA requirements)	49	25 %
No change (beneficiary not subject to EFA rules)	82	42 %
Change (increase of EFA)	64	32 %
Insufficient evidence	2	1 %
TOTAL	**197**	**100 %**

THE COURT'S OBSERVATIONS

7.54. We are analysing in detail the design and first-year implementation of greening, with a view to publishing a special report.

THE COMMISSION'S REPLIES

7.54. *The recent report from the Commission (March 2017) ([1]) took a further focus on the implementation of EFA. In 2015 8 million ha of land was declared as EFA, which accounted for 13 % of the arable land falling under the obligation and 10 % after the weighted factors.*

The report concludes that the EFA practice offers a wide potential. Some positive impact can be identified on biodiversity as preliminary results based on some JRC (Joint Research Centre) simulation and a review of selected literature. For instance, flower strips are expected to have beneficial environmental impacts beyond the area covered by flowers, through pollinator activity. In addition, EFA can have positive impact on some ecosystems services (e.g. water quality and pollinators). The introduction of EFA could also help farm climate resilience (e.g. by higher provision of landscape features) and enhance climate mitigation (e.g. by higher use of leguminous).

The analysis pointed out as well that the environmental benefits depend not only on the quantity but also on the quality which can be further improved by adjusting management conditions. The last amendments of Delegated Act (Delegated Regulation (EU) No 639/2014) which has been recently adopted by both co-legislators will go in this direction by imposing a ban of use of plant protection product on cultivated area qualified as EFA.

([1]) *COM(2017) 152 final.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Conclusions

7.55. Our examination of the performance of rural development investment projects showed that 95 % of investments had been carried out as planned, although there was insufficient evidence that costs were reasonable in 34 % of cases. Where feasible, using simplified cost options effectively limits the risks of excessive prices — as long as they are set at the right level. We are currently working on an audit to analyse the use of simplified cost options in further detail, with a view to publishing a special report on the topic in 2018.

7.55. *The assessment of reasonableness of costs is the responsibility of the Member States (see article 48 of Regulation (EU) No 809/2014). The Commission protects the EU budget when weaknesses are identified through conformity procedures and issues guidance on how to improve the systems in place (see Guidance on rural development controls and sanctions, including a checklist for the assessment of reasonableness of costs). Furthermore, trainings and sharing of good practices are organised by the European Network of Rural Development. Finally, the Commission is actively promoting the use of simplified cost options in the Member States.*

7.56. Our work on greening performance identified some positive changes in farming practices following the introduction of the scheme, especially in terms of EFAs. In our sample, the agricultural area on which we found positive changes amounted to around 3,5 % of arable land (see paragraphs 7.50 and 7.53).

7.56. *The Commission considers that after one or two years, it is too early to conclude on precise environmental outcomes. Indeed the methodology will be difficult to establish due to the lack of baseline in terms of biodiversity and soil quality before 2015. In addition other factors as greening contribute to the environmental performance of agriculture.*

Nevertheless, the Commission takes good note of the changes in farming practices following the introduction of greening and notes also that 11 % of the farms visited had to change their crop diversification practices and 32 % their EFA practices compared with 2014.

However it has to be recalled that the measure of the changes in crops and land use entailed by the greening is not sufficient to evaluate the environmental performance of the greening.

Based on the recent assessment (greening review after one year, the June 2016 Staff Working Document (SWD) and the Commission report on EFA issued in March 2017), green direct payment offer a wide potential in term of area coverage. 77 % of agricultural area are subjected to greening in 2016 and 69 % of arable land subject to EFA.

The Commission report (March 2017) on EFA assessed the potential environment effect of the EFA area as declared by farmers in 2015.

Preliminary results are promising especially for non-productive area such as landscape feature or field margin for biodiversity but also other area such leguminous for biodiversity and ecosystem services depending on their management.

Amendment of delegated act (Delegated Regulation (EU) No 639/2014) is an important step to further improve the environmental performance by the ban of use of plant protection products (PPP) on cultivated area qualified as EFA.

ANNEX 7.1

RESULTS OF TRANSACTION TESTING FOR 'NATURAL RESOURCES'

	2016	2015
SIZE AND STRUCTURE OF THE SAMPLE		
Agriculture: Market and direct support	**217**	180
Rural development, environment, climate action and fisheries	**163**	179
Total transactions 'Natural resources'	**380**	359
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error: Market and direct support	**1,7 %**	2,2 %
Estimated level of error: Rural development, environment, climate action and fisheries	**4,9 %**	5,3 %
Estimated level of error: 'Natural resources'	**2,5 %**	2,9 %
Upper error limit (UEL)	3,5 %	
Lower error limit (LEL)	1,5 %	

The lower and upper error limits for Agriculture: Market and direct support are: 0,8 and 2,6 %.
The lower and upper error limits for Rural development, environment, climate action and fisheries are: 2,1 and 7,7 %.

ANNEX 7.2

OVERVIEW OF THE RESULTS OF TRANSACTION TESTING FOR EACH MEMBER STATE FOR RURAL DEVELOPMENT, THE ENVIRONMENT, CLIMATE ACTION AND FISHERIES ([1])

Netherlands
No transactions examined for 2016

United Kingdom	
Error-free transactions:	7
Unquantified errors:	-
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	-
Total:	8

Germany	
Error-free transactions:	13
Unquantified errors:	1
Errors quantified < 20 %:	2
Errors quantified ≥ 20 %:	-
Total:	16

Sweden
No transactions examined for 2016

Finland	
Error-free transactions:	-
Unquantified errors:	-
Errors quantified < 20 %:	4
Errors quantified ≥ 20 %:	-
Total:	4

Latvia
No transactions examined for 2016

Lithuania	
Error-free transactions:	6
Unquantified errors:	1
Errors quantified < 20 %:	-
Errors quantified ≥ 20 %:	1
Total:	8

Ireland	
Error-free transactions:	4
Unquantified errors:	-
Errors quantified < 20 %:	-
Errors quantified ≥ 20 %:	-
Total:	4

Denmark	
Error-free transactions:	-
Unquantified errors:	-
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	-
Total:	1

Estonia	
Error-free transactions:	3
Unquantified errors:	-
Errors quantified < 20 %:	-
Errors quantified ≥ 20 %:	1
Total:	4

Poland	
Error-free transactions:	10
Unquantified errors:	-
Errors quantified < 20 %:	2
Errors quantified ≥ 20 %:	1
Total:	13

Belgium
No transactions examined for 2016

Czech Republic	
Error-free transactions:	8
Unquantified errors:	-
Errors quantified < 20 %:	4
Errors quantified ≥ 20 %:	-
Total:	12

Luxembourg
No transactions examined for 2016

Slovakia	
Error-free transactions:	2
Unquantified errors:	-
Errors quantified < 20 %:	2
Errors quantified ≥ 20 %:	-
Total:	4

France	
Error-free transactions:	7
Unquantified errors:	2
Errors quantified < 20 %:	3
Errors quantified ≥ 20 %:	-
Total:	12

Austria	
Error-free transactions:	4
Unquantified errors:	3
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	-
Total:	8

Portugal	
Error-free transactions:	4
Unquantified errors:	-
Errors quantified < 20 %:	3
Errors quantified ≥ 20 %:	1
Total:	8

Hungary	
Error-free transactions:	3
Unquantified errors:	-
Errors quantified < 20 %:	-
Errors quantified ≥ 20 %:	1
Total:	4

Spain	
Error-free transactions:	3
Unquantified errors:	4
Errors quantified < 20 %:	3
Errors quantified ≥ 20 %:	2
Total:	12

Romania	
Error-free transactions:	7
Unquantified errors:	5
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	-
Total:	13

Italy	
Error-free transactions:	1
Unquantified errors:	2
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	-
Total:	4

Slovenia
No transactions examined for 2016

Croatia	
Error-free transactions:	1
Unquantified errors:	-
Errors quantified < 20 %:	2
Errors quantified ≥ 20 %:	1
Total:	4

Malta
No transactions examined for 2016

Greece	
Error-free transactions:	4
Unquantified errors:	3
Errors quantified < 20 %:	1
Errors quantified ≥ 20 %:	-
Total:	8

Cyprus
No transactions examined for 2016

Bulgaria	
Error-free transactions:	9
Unquantified errors:	-
Errors quantified < 20 %:	-
Errors quantified ≥ 20 %:	-
Total:	9

Our audit work produces estimates of the likely level of error in the population as a whole. It is based on a probability-proportional-to-size sampling methodology and therefore provides no information on the frequency of error in the populations we audit (this would require the random selection of transactions). For these reasons, the above figures should not be understood as indicating the frequency of error, either in EU-funded transactions or in individual Member States, and the frequency of error in samples drawn from different Member States is no guide to the relative level of error in those Member States.

([1]) The seven examined transactions under direct management are not included in the map.

ANNEX 7.3

OVERVIEW OF ERRORS WITH AN IMPACT OF AT LEAST 20 % FOR RURAL DEVELOPMENT, THE ENVIRONMENT, CLIMATE ACTION AND FISHERIES

THE COURT'S OBSERVATIONS

Introduction

Applying the general audit methodology set out in ***Annex 1.1***, we tested a representative sample of transactions to estimate the level of *irregularity* within the population for this MFF heading. The errors we detected in testing do not constitute an exhaustive list — either of individual errors or of possible error types. The findings outlined below concerning errors with an impact of at least 20 % of the transaction value examined are presented by way of example for the specific assessment covering rural development, the environment, climate action and fisheries ([1]). These errors were found in transactions worth between 1 600 euro and 1 million euro, with a median value of just under 100 000 euro ([2]).

Examples of error

Rural development, the environment, climate action and fisheries

Ineligible beneficiary/expenditure

Example 1 — Support for micro, small and medium-sized enterprises granted to cooperative belonging to a large multinational company

In Lithuania we examined a payment made to a cooperative for investment support in the processing and marketing of agricultural produce. Under EU and national rules, such support is available only to micro, small and medium-sized enterprises, as determined by the number of employees, annual turnover and annual balance sheet total. Related enterprises, such as mother or daughter companies, have to be included in the calculation. We found that the cooperative concerned belonged to a large multinational company, and so did not qualify as a micro, small or medium-sized enterprise. The beneficiary was not eligible for support, leading to a 100 % error.

THE COMMISSION'S REPLIES

The Commission takes note of the ECA's comment in annex 7.2 that the overview of ECA transactions is not a guide to the relative level of error in the Member States in the sample. The Commission points out that detailed information on the Commission's and the Member States' audit results are presented for each Member State in the Annual Activity Reports and their technical annexes of the Commission departments implementing EU funds in shared management.

([1]) These errors account for more than three-quarters of the overall estimated level of error for this specific assessment.

([2]) I.e. half of all errors with an impact of at least 20 % were found in transactions worth less than 100 000 euro, and the remainder in transactions worth more than this amount.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Example 2 — Beneficiary purchased supported machinery from a related company

We examined a payment made to an agricultural company in Hungary for the purchase of machinery. We found conclusive evidence that the beneficiary had links with the company that supplied the machinery. Under national law this renders the whole payment ineligible, leading to a 100 % error.

Example 3 — Non-compliance with the LIFE programme's eligibility rules

We examined a payment for a directly managed environmental project financed by the LIFE programme. We identified several violations of the LIFE programme's eligibility rules on personnel costs; for example: contracts did not mention the LIFE programme, timesheets had not been certified and costs had not been charged on the basis of actual time worked. We reported an error of 60 % of the costs examined.

According to Article 25(1) of the LIFE Common Provisions (based on Article 126 of the FR) eligible costs must be based on actual costs incurred, therefore, costs cannot be based on a budgeted daily rate.

The time personnel worked for the project should be documented through appropriate means (timesheets). It should be noted, however, that reported time up to 2 days per month per calendar year is accepted without timesheets. Furthermore, if time worked for the project can be documented through alternative sources (e.g. extracts from an analytical accountancy system), the Commission would consider the related costs eligible.

While it is not a condition that the project should specifically be mentioned in the contract of the employee, the project should be mentioned in the timesheets or other means for time registration. Furthermore, if the time worked for the project can be documented through alternative sources than timesheets, such as extracts from an analytical accountancy system, the related costs would be considered to be eligible.

If timesheets are not signed by the employee and validated by a supervisor, they are not of an acceptable standard and the related costs are deemed ineligible. However, such timesheets are only considered ineligible in case they are systematically not signed and validated. Timesheets which only randomly are not signed and validated, are considered to be a clerical error, and are usually not disregarded.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Examples 4 and 5 — Regional government received EU funding for works calculated on basis of inflated costs

We examined two sets of works paid for by the regional government of Andalusia in Spain: one for the reconstruction of a rural road and the other for a rural house with an adjacent farm building. In both cases, we found that the works had been directly awarded to a company at inflated prices. We reported errors of 33 % and 41 % of the costs examined respectively.

Example 6 — Joint aid application was not permitted

We examined a payment made to an agricultural company in Estonia for the purchase of machinery. The project application was filed together with another company. According to the national rules, joint applications qualify for higher aid amounts, but are only permitted if neither applicant has, directly or indirectly, a dominant influence over the other. However, we found that this condition was not met, leading to a 32 % error.

We found errors due to ineligible beneficiaries/expenditure (quantified up to 20 %) in Denmark, Germany, Greece, Portugal (mainland), Italy (Basilicata), Austria and Poland.

Overstated or ineligible area

Example 7 — Support for conservation of traditional orchards paid for area with too few traditional trees

In Portugal we examined a payment made to a farmer under the rural development measure 'agri-environment-climate' for the conservation of the Azores' traditional orchards. One national prerequisite for receiving the payment was an orchard with at least one variety which is traditional in the Azores and which, if grown with other trees, should constitute at least 80 % of the tree population. We visited the two parcels claimed, and found that they did not contain enough eligible trees. The parcels did not comply with the eligibility rule, leading to a 100 % error.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Example 8 — Support paid for areas with no agricultural activity

The rural development measure 'Payments to areas facing natural or other specific constraints' supports farms in certain designated areas such as mountainous areas. Payments are made annually per hectare of eligible land to compensate farmers for all or some of the additional costs incurred and income foregone on account of the agricultural production constraints faced in such areas. Farmers must perform an agricultural activity in the designated areas to be eligible.

In Croatia we visited a farm which had received a 'mountain areas' compensation payment. We inspected a sample of three parcels, which the beneficiary had claimed as pastureland. On one of the parcels we found no sign of any agricultural activity, e.g. grazing. The parcel was therefore ineligible for compensation. There were ineligible areas on the two other parcels, due to the presence of thick forestation. We note that the paying agency had identified similar problems and has subsequently initiated recovery. On the basis of our sample, we estimated a 91 % error.

The Commission understands that the Croatian Authorities identified the potential ineligibility of the land as a result of the LPIS Quality Assessment and strove to follow it up with a view to correcting the error.

The Commission understands that the Croatian Authorities updated the LPIS after the rapid field visit and instigated the recovery of the support within the deadlines set by EU law; hence there will be no financial impact from the over-declaration.

We found errors due to overstated or ineligible area (quantified up to 20 %) in the Czech Republic, Germany (Saxony), Spain (Extremadura), France (Rhône-Alpes), Croatia, Portugal (Azores and mainland), Slovakia, Finland and the United Kingdom (England).

Non-compliance with public procurement rules

Example 9 — Public body unduly excluded lowest offer for execution of works

In Poland we examined a payment made to a public body for the reconstruction of an embankment to protect agricultural land against river flooding. Construction works represented 97 % of the audited costs. We reviewed the *public procurement* procedure used to select the company which carried out the construction works, and found that the lowest offer had been excluded without valid reason. Therefore, the costs concerned were not eligible, leading to a 97 % error.

The Commission understands that the decision to exclude the lowest offer was challenged by the unsuccessful bidder. However, the National Appeal Body (KIO) competent for the matter rejected this appeal. The Paying Agency followed the decision of the National Appeal Body.

ANNEX 7.4

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'NATURAL RESOURCES'

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2013	3.46. *Following this review and the findings and conclusions for 2013, the Court recommends that:*							
	Recommendation 1: the Commission and Member States take the necessary measures to ensure that the IACS is used to its full potential. This comprises particular efforts in ensuring that: — the eligibility and size of agricultural parcels, in particular of permanent pasture, are correctly assessed and recorded by the Member States on the basis of the applicable EU criteria by way of comprehensive analysis of the most recent ortho-images (see paragraphs 3.9, 3.10 and 3.20); — immediate remedial action is taken by the Member States where the IACS is found to be affected by systemic especially as regards incorrect administrative treatment of aid applications (see paragraph 3.15 and Box 3.5); — the debtors ledgers of the Member States contain full and reliable information on the amounts and nature of debts and that effective recovery/enforcement procedures are applied without any undue delay (see paragraphs 3.24 and 3.25);		X					
	Recommendation 2: the Commission ensures that the reinforcement of assurance procedure is effectively applied in order to enhance the quality and comparability of the work performed by the audit bodies and that remedial action is taken in respect of the unjustified reduction by the Italian authorities of the on-the-spot inspection rate (see paragraphs 3.30 to 3.35);					X		

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2013	**Recommendation 3:** the Commission actively monitors the application of remedial actions with regard to the deficiencies in the control system applicable to EU aid for producer groups in Poland (see paragraphs 3.36 to 3.38).	X						
	4.37. *Following this review and the findings and conclusions for 2013, the Court recommends in the area of rural development that:*							
	Recommendation 1: the Member States carry out their existing administrative checks better, by using all relevant information available to the paying agencies, as this has the potential to detect and correct the majority of errors (see paragraphs 4.8 and 4.20). In particular for investment measures, administrative checks should use all available information to confirm the eligibility of the expenditure, project and beneficiary (including all ultimate shareholders) and compliance of public procurement procedures with the applicable EU and/or national rules;			X				
	Recommendation 2: the Commission ensures that all cases where the Court detected errors are followed up appropriately (as identified in paragraphs 4.14, 4.20 and 4.21, as well as in paragraph 4.16 for environment).			X				*The Commission understands that it has provided to the ECA evidence that all cases have been followed up appropriately. Individual transactions described under paragraphs 4.14 and 4.21 were covered by dedicated Commission audits. Systemic weaknesses described under paragraph 4.20 concern the same issues as those detected by the Commission auditors and as such are included in the risk assessment when the annual working programme is devised.* *In addition, concerning paragraph 4.16, as the beneficiary confirmed in writing during the evaluation of the final report, that he cannot recover VAT, the Commission had no reason to put this written confirmation in question.*
	Recommendation 3: the Member States ensure that action plans to address the high error rate in rural development are complete, by including all regions and addressing all measures, particularly investment measures, and take the Commission's and Court's audit findings into account (see paragraph 4.30).		X					

Year	Court Recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented		Not implemented	No longer applicable	Insufficient evidence	
			In most respects	In some respects				
2013	*and for the CAP as a whole that:*							
	Recommendation 4: the Commission documents how it calculates the expenditure covered by its conformity audits (see paragraph 4.24).	X						
	Recommendation 5: the Commission takes steps to further reduce the backlog of open audit files, so as to enable all audits carried out prior to 2012 to be closed by the end of 2015 (see paragraph 4.27).	X						
	Recommendation 6: the Commission further develops its approach to calculating the RER by ensuring that it takes into account all expenditure and paying agencies (see paragraph 4.29).	X						
	4.38. *Furthermore, the Court recommends that:*							
	Recommendation 7: financial corrections to Member States concerning the European Fisheries Fund are supported by evidence of their validation (see paragraph 4.34).	X						

CHAPTER 8

‘Security and citizenship’

CONTENTS

THE COURT'S OBSERVATIONS

INTRODUCTION

8.1. This chapter presents our findings for the *multiannual financial framework* (MFF) heading 'Security and citizenship'. ***Box 8.1*** gives an overview of the main activities and spending under this heading in 2016.

Box 8.1 — MFF heading 3 — 2016 breakdown

(billion euro)

Total payments for the year	3,1
- *advances* (2)	*2,2*
+ *clearings of advances* (2)	*1,5*
Audited population, total	**2,4**

(1) Includes expenditure on consumers, justice, rights, equality and citizenship.
(2) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 10).

Source: 2016 *consolidated accounts* of the European Union.

THE COURT'S OBSERVATIONS

Brief description of the MFF heading

8.2. This is heading 3, which covers a range of policies whose common objective is to strengthen the concept of European citizenship by creating an area of freedom, justice and security without internal frontiers. As shown in ***Box 8.1***, the most significant area of expenditure is migration and security; funding is also provided for 'Food and feed' (covering nutrition, animal and plant health and animal welfare) and cultural and creative activities ('Creative Europe') as well as programmes covering justice, rights, equality and citizenship, and consumers and health. A significant share of payments is made through decentralised agencies ([1]).

Migration and security

8.3. Most migration and security spending comes from two funds — the Asylum, Migration and Integration Fund ([2]) (AMIF) and the Internal Security Fund (ISF). These run from 2014 to 2020 and replaced the SOLID programme ('Solidarity and Management of Migration Flows'), which consisted of four instruments ([3]) as well as the two programmes Prevention and Fight against Crime (ISEC) and Prevention, Preparedness and Consequence Management of Terrorism and other Security Related Risks (CIPS). Like SOLID, the management of most AMIF and ISF funding is shared between the Member States and the Commission (DG Migration and Home Affairs (DG HOME)). The objective of AMIF is to contribute to the effective management of migration flows and bring about a common EU approach to asylum and immigration. The ISF aims to achieve a high level of security in the EU. It has two instruments ([4]): ISF Borders and Visa and ISF Police. The first provides support for harmonised border management measures and the development of a common visa policy, while the second focuses on cooperation between law enforcement agencies and improving capacity to manage security-related risks and crises.

([1]) 12 such bodies are currently active in the different policy areas of this heading.
([2]) The legal act establishing AMIF can be found on the Eur-Lex website.
([3]) The legal acts establishing these instruments can be found on the Eur-Lex website: External Borders Fund, European Return Fund, European Refugee Fund, European Fund for the integration of third-country nationals.
([4]) The legal acts establishing these instruments can be found on the Eur-Lex website: ISF Borders and Visa, ISF Police.

Other areas

8.4. The main objective of the 'Food and feed' programme is to ensure human, animal and plant health at all stages of the food chain. The largest expenditure item covers the reimbursement of Member State expenses under Commission-approved programmes for certain animal diseases.

8.5. 'Creative Europe' is the EU framework programme of support for the culture and audio-visual sectors. Heading 3 also includes a number of programmes aimed at fulfilling the common objective of strengthening the security and citizenship area; in particular, the programmes on justice, consumers and the programme on rights, equality and citizenship.

Audit scope and approach

8.6. Applying the audit approach and methods set out in ***Annex 1.1***, in 2016 we examined the following for 'Security and citizenship':

(a) a sample of 15 *transactions*, in line with paragraph 7 of ***Annex 1.1***. The sample was designed to help us form a view on 2016 spending from the budget as a whole — not to be representative of the full range of spending under this MFF heading. This choice was motivated by the relatively low level of payments for this policy area in 2016 (around 2 % of the EU total). The sample consisted of five transactions under *shared management* with Member States [5], seven under *direct management* by the Commission, and three involving the clearing of advances to agencies;

(b) the main systems used by the Commission and the Member States to provide assurance for payments made under SOLID, AMIF and the ISF. We also performed additional testing of a sample of 35 transactions in support of systems work: 24 under the shared management of the Commission and Member States, and 11 under the Commission's direct management. The shared management sample focused on SOLID, as in 2016 most expenditure cleared by the Commission continued to be under that programme. We mainly examined those Member State systems which were assessed by the Commission as providing a reasonable level of assurance;

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(5) Germany, Spain, France, Italy and Lithuania.

THE COURT'S OBSERVATIONS

(c) whether the *annual activity reports* of DG HOME and DG Communication (DG COMM) presented information on *regularity* of spending that was broadly consistent with our results.

REGULARITY OF TRANSACTIONS

8.7. Of the 15 transactions examined, four were affected by quantifiable *error*, of which three were below 2 % of the transaction value examined. As this sample was not intended to be representative of spending under this MFF heading, an error rate is not calculated.

EXAMINATION OF SELECTED SYSTEMS

Shared management

AMIF and ISF

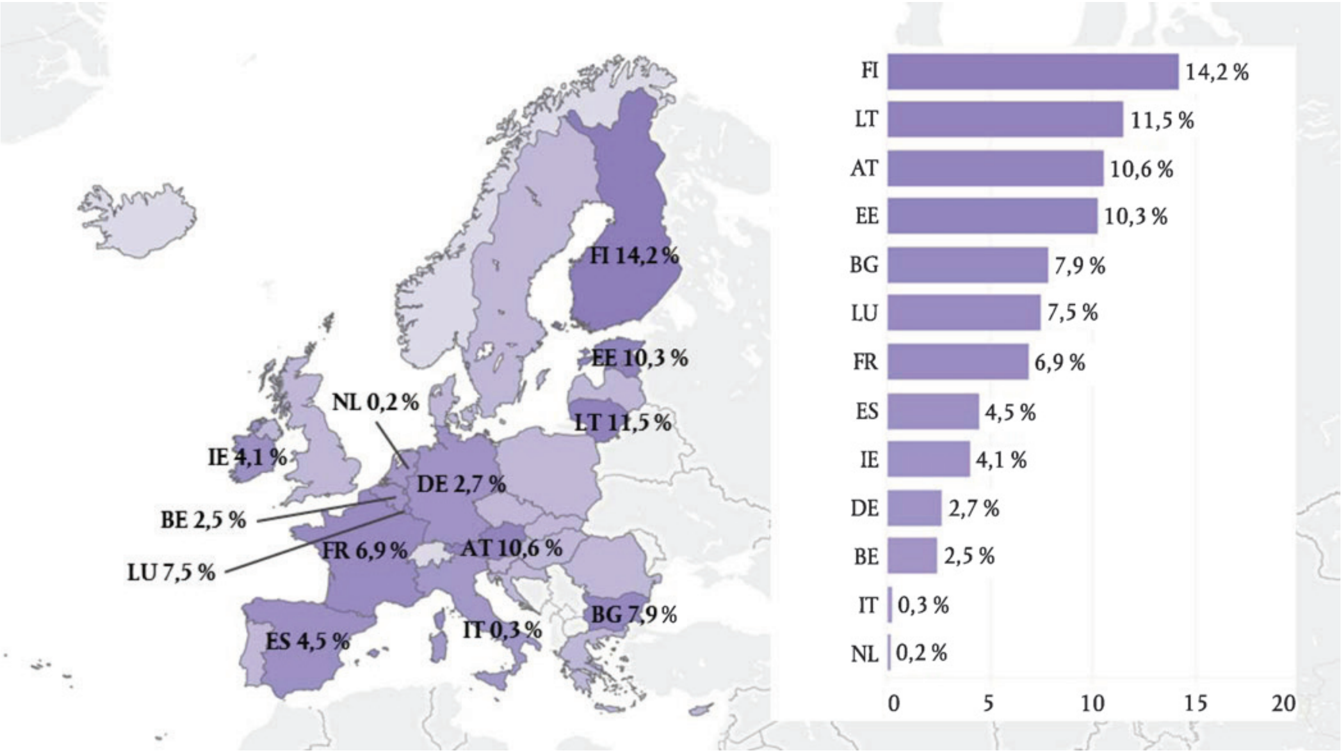
8.8. We examined the procedure leading to the Commission's approval of ten national programmes, its assessment of Member States' management and control systems, and the financial clearance of the AMIF and ISF accounts in 2016. We tested the same systems in visits to four Member States ([6]). As shown in ***Box 8.2***, two years into the seven-year *programming period*, progress in making shared-management AMIF and ISF payments was slow.

THE COMMISSION'S REPLIES

8.8. *Although the level of payments in the first accounts covering the financial years 2014 and 2015 was low, the Commission would like to underline that payments reported in 2017 (on 2016 accounts) increased by more than three times compared to 2014-2015 accounts. In addition, the amounts committed at Member State level have reached for AMIF 36 % and for ISF 40 % as per 2016 Annual Implementation Report. Therefore, it is expected that the increasing trend in payments will continue in the future.*

([6]) For AMIF in Spain and Austria and the ISF in Germany and France.

Box 8.2 — Implementation of AMIF and ISF up to the 2015 financial year was relatively slow



Note: The implementation rate compares spending under shared management in the 2014 and 2015 financial years to the total allocation for the 2014-2020 funding period for the 13 Member States for which the Commission had cleared expenditure for 2014 and 2015.

Source: Commission decision on the clearance of the annual accounts for national programmes concerning expenditure supported under the AMIF and ISF of the 2014 and 2015 financial years.

THE COURT'S OBSERVATIONS

8.9. We found several weaknesses at Commission (DG HOME) and at Member State level. ***Box 8.3*** illustrates the main system weaknesses and their effects.

SOLID

8.10. Our examination of the additional sample of transactions (see paragraph 8.6(b)) broadly confirmed the Commission's assessments of the level of assurance provided by Member State systems.

THE COMMISSION'S REPLIES

8.9. *The Commission underlines that its control system worked well and was consistent, thus allowing it to provide proper assurance as evidenced in the annual activity report.*

8.10. *The Commission welcomes the broad confirmation from the ECA of its assessment of the level of assurance provided by Member State systems for SOLID. The Commission considers that this shows the level of assurance is thus also reliable.*

Box 8.3 — System weaknesses relating to SOLID, AMIF and the ISF		
Weakness	**Effect**	**Commission reply**
Commission level		
1. There was a high number of draft AMIF/ISF Programmes (e.g. the German ISF programme had 10 versions and the UK's AMIF programme had nine) prepared by Member States and reviewed by the Commission prior to their approval.	Potentially delays implementation.	*The programming phase was an iterative process with the Member States necessary to ensure high quality of national programmes approved by the Commission for the 2014-2020 programming period.*
2. The Commission's assessment of Member States' systems for AMIF and ISF was often based on insufficiently detailed information, particularly in the area of audit strategies.	Limits the Commission's assessment of Member State systems.	*The Commission does not share the opinion of the ECA, particularly in the area of audit strategies based on the following assumptions.* *Despite the fact that the legal basis does not require the Audit Authorities to submit their system audit reports, the Commission requested systematically to Audit Authorities to submit such reports when needed. Based on the assurance model under shared management, it considered neither realistic nor efficient to review and analyse the entire content of all individual system audit reports.* *The Audit Authority audit reports are only one of the tools which allow the Audit Authority and subsequently the Commission to obtain assurance on the veracity of the three opinions expressed by the Audit Authority in the accounts. The assurance model under shared management approach is based on four other assurance pillars (Summary of audit strategy; Result of system audit work; Result of financial audit work; Re-performance, if applicable, and any other audits the Responsible Authority was subject to during the reference period; DG HOME own audit work, i.e. through desk reviews, system review meetings and system audits.).*
3. Outsourced audit work on SOLID programme:		
— Although Member States were prompt to reply, there were delays in the reporting of ex-post conformity audits (an average of 20 months to produce a final audit report).	Delays the correction of deficiencies in control systems by Member States.	*Even if the Commission acknowledges some past delays in the reporting of ex-post conformity audits, it does not agree that they delayed the correction of the deficiencies in control systems by Member States.* *The primary objective of an ex-post control is to determine the residual level of error in the audited programme(s); the Commission's assurance is also based on system audits throughout the entire programming period, which are the main opportunity for Member States to take corrective measures for system deficiencies.*

Weakness	Effect	Commission reply
— Insufficiently documented quality control procedures for outsourced audit work.	Risks the consistent quality of ex-post conformity audits.	*DG HOME made use of these external contractors for the implementation of the audits following the annual work plan.* *DG HOME bases its supervision of contractors on key elements which go beyond the systematic filling of checklists and its subsequent administrative burden (i.e. specific guidance on risks given to senior manager coordinating the review process, standard checklists for project audits developed to ensure consistent audit approach across Member States; meetings between the desk auditor and the external contractor to brief on the scope of the audit assignment, risks etc.).*
Member State level		
4. In Austria and Spain, on-the-spot checks carried out by the responsible authorities were not sufficiently documented, and in Spain, the samples for inspection were not drawn from the full population.	Increased risk to the eligibility, management and control of funded actions.	
5. Spain and France do not have a dedicated IT tool for the management and control of funds.		*As regards IT tools for managing the funds, France has put in place the PRESAGE system that was not fully operational at the time of the first accounts. The Responsible Authority committed itself to introduce all projects into the database by mid-2017. However, this did not have an impact on eligibility of costs and did not imply financial risks since only advance payments were made by the Responsible Authority.*
6. Weaknesses in audit activities performed by *audit authorities*: In Germany and Austria there was insufficient evidence that the responsible authority complied with the designation criteria. In France the sampling methodology did not take into account the differences between AMIF and ISF in terms of inherent risks. In Germany there was limited testing of administrative controls.		*As regards the sampling methodology used by the French Audit Authority, the Audit Authority has changed its approach.*

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Direct management

8.11. Concerning expenditure managed directly by the Commission, our examination of the sample of transactions showed that around half were free from error. The errors we detected were mainly not serious and related to the eligibility of costs and tendering procedures. A finding on EU funding for an emergency assistance project is illustrated in ***Box 8.4***.

8.11. *The Commission welcomes the confirmation from the ECA that the errors detected were mainly not serious.*

Box 8.4 — Example of a finding

We examined a payment by the Commission (DG Migration and Home Affairs) to Greece of emergency assistance to transport non-EU migrants from Greek islands to the Greek mainland between August and November 2015, at the peak of the refugee crisis.

The Greek authorities paid 8 million euro to charter vessels to be used to transport, accommodate and provide snacks to migrants. Under an agreement signed with the Greek authorities in November 2015, the Commission contributed a *grant* of 6 million euro to this action.

The selected shipping companies transported over 150 000 migrants, providing them with accommodation and snacks, and charged adult migrants 60 euro per ticket (children were charged up to 30 euro) for their passage, earning up to 9 million euro. The vessels carried no passengers on their trips from the mainland to collect migrants from the islands.

Box 8.4 — Example of a finding

The arrival of hundreds of thousands migrants in Greece required urgent and effective humanitarian response by the EU. The purpose of the action was to allow the transfer of migrants from the islands to the mainland to avoid a humanitarian catastrophe. For this, Greece concluded contracts with shipping companies to use boats that could therefore not be used for tourist activities or to provide regular services. The action was very urgent and extremely useful, and implemented in full respect of sound financial management.

The Greek authorities signed a contract in view to:

(1) assure that vessels, not already routed in regular itineraries, especially for tourists during the summer period, were available for the project in favour of migrants;

(2) assure that services to migrants would have been provided in terms of transport, accommodation, and food.

The call issued by the Greek authorities clearly stipulated that the contractor was called to deliver services beyond those normally foreseen in the cost of a ticket. This included provision of food, accommodation, etc., and the offers received also made clear, that the offer price took into account the fact that the boats had to make return journeys empty. The tender documents issued by the Greek authorities equally stipulated that the ticket price for such journeys could be charged by the contractor to the migrants. This was also reflected in the price of the offers submitted.

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES
The Commission was informed that the migrants were charged by the shipping companies. However, when assessing the proposed action in October 2015, and evaluating the *performance* of the action before paying the balance of the grant in March 2016, the Commission did not refer to the potential income from migrants. The contract documentation between the Greek authorities and the shipping companies referred to charging migrants but did not estimate these revenues. There is therefore a lack of transparency of the split of funding between public sources and the revenue from migrants, for this emergency action.	*The Commission does not share the assessment of the ECA and this finding.* *The financial implementation of the action fully corresponds with the Grant agreement with the Greek authorities and is implemented in accordance with the rules in force, and therefore is legal and regular.* *The ticket price cannot be considered as relevant revenue for the purpose of the contract given that the purpose of the contract was to provide services over and beyond those foreseen in the ticket price.* *As such, the Commission considers that the tendering, evaluation of offers, award of contract, performance of services and payment by the Greek authorities were legal, regular and fully transparent.*
The average market price in high season for a return ticket in economy class for the routes concerned was up to 90 euro. The income from migrants, of up to 60 euro per ticket, contributed to the revenues and consequently, to any profits of the shipping companies. EU legislation does not allow *beneficiaries* of EU grants to obtain profits from the implementation of a project, and indeed the Greek authorities, as grant beneficiary, did not make a profit.	*Considering also the fact that the migrants used all the facilities in the ship (including first class and cabins) and that there was no revenue from the shipping of vehicles or other services such as food to the shipping companies, the Commission considers that the Greek authorities paid a fair price for the shipping service.* *As already explained above, the contract was to provide services over and beyond those foreseen in the ticket price, and as such any potential revenue, or indeed profit if any, from the ticket is neither relevant for the grant agreement nor measurable.*
The Greek authorities' contracts with the shipping companies covered the use of vessels for periods of up to 20 days, at a cost of between 30 000 and 40 000 euro per day per ship, for a total of 228 shipping days. There were days on which ships were inactive in port, but the companies were paid as agreed in the contract. Three ships were inactive in port for 3, 4 and 5 days respectively, for which the shipping companies were paid 415 500 euro.	*The few days of inactivity of the vessels reported by the ECA were to be expected taking into account that they were obliged to be always on hand, based on the contract, to depart any time in the extreme emergency situation that Greece was facing during the grant period, towards any destination at any time. The Commission calculates that the days of inactivity were seven in total.*

Annual activity reports and other governance arrangements

8.12. The annual activity reports of DG HOME, and DG COMM were prepared in line with the instructions given by DG Budget and the methods used to calculate the error rates do not point to any methodological problems. The number of transactions that we audited in 2016 is statistically too small for us to be able to compare the information on the regularity of spending reported by these DGs with our audit results.

CHAPTER 9

'Global Europe'

TABLE OF CONTENTS

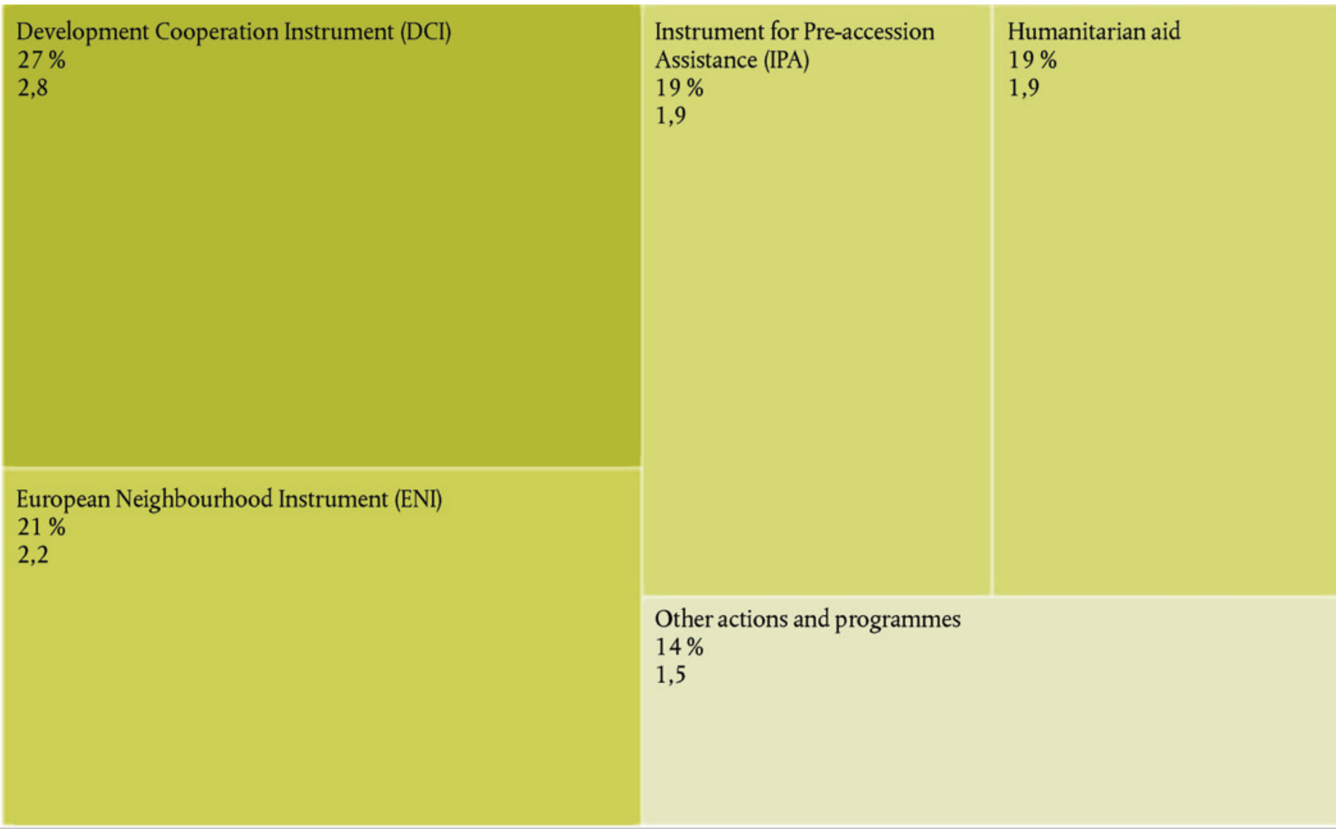
THE COURT'S OBSERVATIONS

INTRODUCTION

9.1. This chapter presents our findings for the *MFF* heading 'Global Europe'. ***Box 9.1*** gives an overview of the main activities and spending under this heading in 2016.

Box 9.1 — MFF heading 'Global Europe' — 2016 breakdown

(billion euro)



Total payments for the year	10,3
- *advances* (1) (2)	6,6
+ *clearings of advances* (1)	4,6
Audited population, total	**8,3**

(1) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 10).
(2) Including 0,3 billion euro payments to the Guarantee Fund for External Actions.

Source: 2016 consolidated accounts of the European Union.

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Brief description of 'Global Europe'

9.2. 'Global Europe' covers expenditure on all external action (foreign policy) funded by the EU general budget. Policies are aimed at:

— promoting EU values abroad, such as human rights, democracy and the rule of law;

— addressing major global challenges, such as climate change and biodiversity loss;

— increasing the impact of EU development cooperation, with the primary aim of helping to eradicate poverty;

— investing in the long-term prosperity and stability of the EU's neighbours, both through preparing candidate countries for membership and the neighbourhood policy;

— enhancing European solidarity following natural or man-made disasters;

— improving crisis prevention and resolution, preserving peace and strengthening international security.

9.3. The main directorates-general involved in implementing the external action budget are the Directorate-General for International Cooperation and Development (DG DEVCO), the Directorate-General for Neighbourhood and Enlargement Negotiations (DG NEAR), the Directorate-General for European Civil Protection and Humanitarian Aid Operations (ECHO) and the Service for Foreign Policy Instruments (FPI).

9.4. In 2016 payments for 'Global Europe' amounted to 10,3 billion euro and were disbursed using several instruments (see ***Box 9.1***) and delivery methods [1], in more than 150 countries.

(1) Such as, in particular, finance procurement contracts, grants, special loans, loan guarantees and financial assistance, budgetary support and other targeted forms of budgetary aid.

THE COURT'S OBSERVATIONS

Audit scope and approach

9.5. Applying the audit approach and methods set out in ***Annex 1.1***, in 2016 we examined the following for 'Global Europe':

(a) a sample of 156 *transactions*, in line with paragraph 7 of ***Annex 1.1***. The sample was designed to be representative of the full range of spending under this MFF heading. It consisted of 68 transactions approved by the EU Delegations in 12 *beneficiary* states, and 88 transactions approved by the Commission headquarters, of which 24 were implemented in humanitarian crisis areas through the ECHO partners;

(b) the relevant systems to identify system weaknesses, when *errors* had been detected;

(c) whether the *annual activity reports* of DG DEVCO and DG NEAR presented information on *regularity* of spending that was broadly consistent with our results.

REGULARITY OF TRANSACTIONS

9.6. ***Annex 9.1*** provides an overview of the results of transaction testing. Of the 156 transactions examined, 48 (31 %) contained errors [2]. On the basis of the 24 errors we have quantified, we estimate the level of error to be 2,1 % [3].

9.7. The Commission had applied corrective measures that directly affected 13 of the transactions we sampled. These measures were relevant for our calculations, as they reduced our estimate of error for this chapter by 0,3 percentage points.

(2) Some transactions contained more than one error. In total we reported 56 errors.

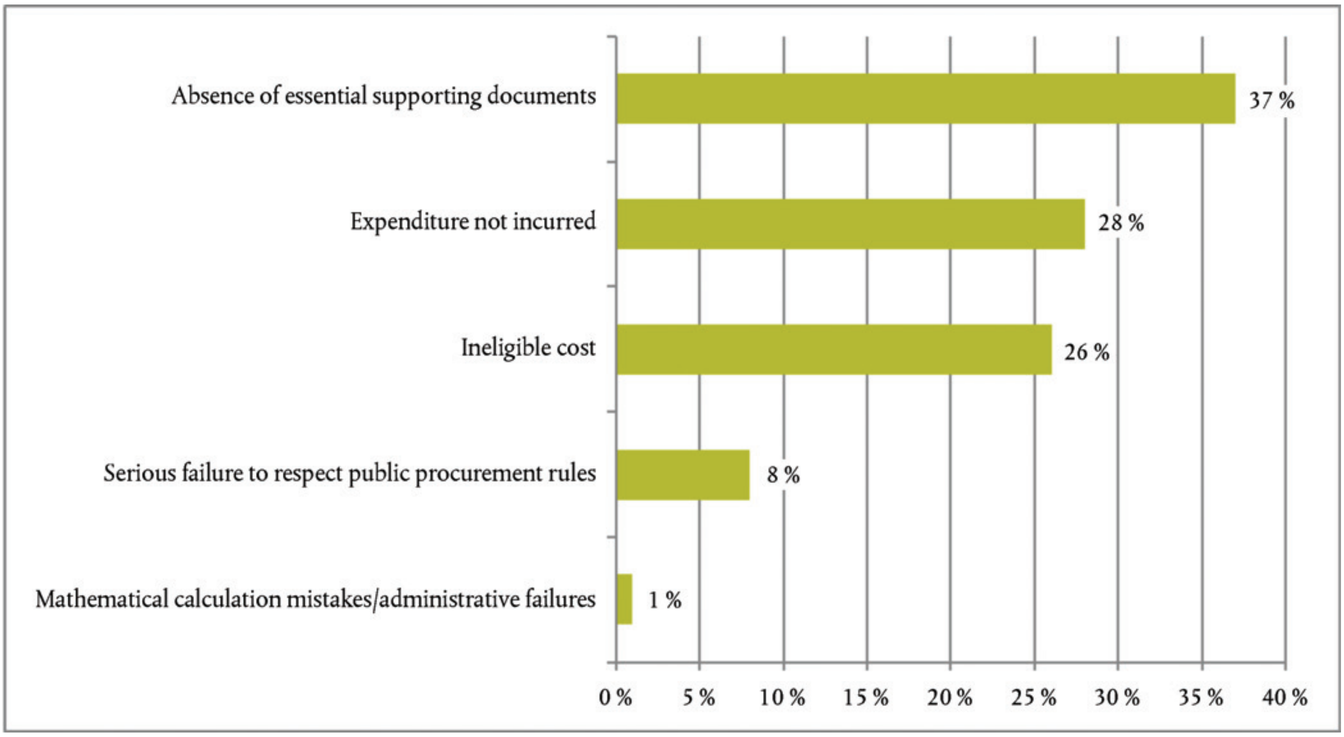
(3) We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % *confidence* that the estimated level of error in the population lies between 0,6 % and 3,6 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

9.8. In five cases of 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* for this chapter would have been 0,7 percentage points lower ([4]). We found six other transactions with errors which should have been detected by the beneficiary-appointed auditors. These cases contributed 0,2 percentage points to the estimated level of error.

9.9. ***Box 9.2*** gives a breakdown of our estimated level of error for 2016 by error type.

Box 9.2 — 'Global Europe' — Breakdown of estimated level of error



Source: European Court of Auditors.

([4]) The Commission itself committed errors (in two cases) accounting for 0,6 % of the error rate, while the beneficiaries committed errors (in three cases) accounting for 0,1 % of this rate.

THE COURT'S OBSERVATIONS

9.10. The payment conditions in two areas limit the extent to which transactions are prone to error. These areas are *budget support* ([5]) and those where the 'notional approach' is applied in multi-donor projects implemented by international organisations ([6]).

9.11. Budget support is a contribution to a state's general budget or 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 had verified that the general eligibility conditions (such as satisfactory progress in public sector finance management) had been met.

9.12. 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 ([7]).

9.13. When the Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of expenditure, the Commission assumes that EU eligibility rules are complied with as long as the pooled amount includes sufficient eligible expenditure to cover the EU contribution. This approach, as applied by the Commission, has also been taken into account in our substantive testing ([8]).

([5]) Budget support payments financed by the general budget in 2016 amounted to 1,1 billion euro.

([6]) Payments to international organisations from the general budget in 2016 amounted to 3,0 billion euro. We cannot state the proportion of this sum to which the notional approach applied, since the Commission does not monitor it separately.

([7]) 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 on 'EU assistance to Ukraine', SR 30/2016 on 'The effectiveness of EU support to priority sectors in Honduras' and SR 13/2016 on 'EU assistance for strengthening the public administration in Moldova' (http://eca.europa.eu).

([8]) 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.

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9.14. When excluding the 7 budget support and 17 notional approach transactions from the audited sample, the estimated level of error is 2,8 % ([9]).

9.15. 37 % of the estimated level of error is attributable to expenditure for which essential supporting documentation was not provided (see examples 1 to 3 in ***Annex 9.2***).

9.16. 28 % of the estimated level of error is accounted for by two cases for which the Commission accepted expenditure that had not actually been incurred (see example 4 in ***Annex 9.2***).

9.17. The most frequent type of error, representing 26 % of the estimated level of error, is ineligible expenditure. This includes expenditure relating to activities not covered by a contract or incurred outside the eligibility period, and also covers non-compliance with the rule of origin, ineligible taxes and the use of wrong exchange rates (see example 5 in ***Annex 9.2***).

9.18. The Commission and its implementing partners committed more errors in transactions relating to *grants*, as well as contribution agreements with international organisations, than it did with other forms of support. Of the 91 transactions of the two types examined, 19 (21 %) contained quantifiable errors.

9.19. In addition to the errors we have quantified, we identified 32 non-quantifiable errors relating to non-compliance with legal or contractual obligations.

9.20. The seven budget support transactions examined contained no errors.

9.21. Our transaction testing revealed some control weaknesses in the Commission's 'Global Europe' DGs' systems. As stated in paragraph 9.8 in some instances the beneficiary-appointed auditors failed to detect errors in expenditure, leading the Commission to accept ineligible costs ([10]).

([9]) 132 transactions: lower error limit = 1,1 % and upper error limit = 4,5 %, with 95 % confidence.

([10]) Of the six cases reported in paragraph 9.8, five concern DG DEVCO and one DG NEAR.

THE COURT'S OBSERVATIONS

9.22. We examined three transactions governed by twinning [11] contracts. Since the Commission's new rules on unit costs, lump sum and flat-rate costs under the twinning instrument had not been adopted at the time of the audit, the problems detected in 2015 persisted [12]. As twinning contracts are modelled on grant contracts, they are forbidden from generating a profit [13]. If *indirect cost* funding is not capped, implementing partners might generate a profit.

9.23. The majority of transactions, 108 (69 %) were free from errors.

ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

DG NEAR system assessment

Weaknesses in the audit authorities

9.24. When performing our review of DG NEAR system assessments, we found evidence that DG NEAR auditors had detected weaknesses in the indirect management of the second Instrument for Pre-accession Assistance (IPA II), more specifically at the audit authorities of three IPA II beneficiary countries (Albania, Turkey and Serbia). These weaknesses ranged from the lack of qualifications held by the heads of the audit authorities to important methodological shortcomings, as well as organisational issues such as a lack of proper supervision or weaknesses in staff planning, training and recruitment. While the Albanian and Serbian audit authorities have made changes aiming to solve the problems detected, there are some significant areas of the Turkish *audit authority*'s systems which might still limit the assurance it can provide to the Commission.

THE COMMISSION'S REPLIES

9.22. *The Commission has now introduced (in accordance with Article 124 of the Financial Regulation) a revised system of flat-rates and unit costs for the implementation of Twinning projects. It distinguishes between direct and indirect costs with the latter limited to 6 % of the total eligible costs. This new system applies to Twinning grants.*

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(11) Twinning is an EU institution-building instrument developed by the Commission and based on partnership cooperation between public administrations of EU Member States and a beneficiary country for the achievement of mandatory results jointly agreed with the Commission.

(12) Chapter 8 of the 2015 annual report, paragraphs 8.30 and 8.31.

(13) Non-profit principle laid down in Article 125(4) of Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council (OJ L 298, 26.10.2012, p. 1).

THE COURT'S OBSERVATIONS

2016 RER study

9.25. In 2016 DG NEAR carried out its second *residual error rate* (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.

9.26. The study examined a representative sample of transactions made under contracts closed between September 2015 and August 2016 and employed a methodology used by DG DEVCO since 2012. We assessed this methodology, finding it to be broadly fit-for-purpose and effective. Our review of the RER study found, nevertheless, that there was scope for improvement in a number of respects, particularly as regards the degree of judgement left to the auditors for error estimates for individual transactions.

9.27. The results of DG NEAR's 2016 RER are presented in its AAR ([14]). The study estimated the global RER for the DG to be 0,93 %, i.e. below the 2 % *materiality threshold* set by the Commission.

DG DEVCO system assessment

9.28. We also assessed DG DEVCO's systems. The results of our work are presented in detail in our annual report on the 8th, 9th, 10th and 11th European Development Funds (paragraphs 28 to 33).

([14]) See DG NEAR's 2016 annual activity report, p. 36 and 37.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Annual activity reports

9.29. For the current exercise, we reviewed DG NEAR's 2016 annual activity report.

9.30. DG NEAR estimated the total amount at risk at the time of payment [15] for expenditure accepted in 2016 (2 543 million euro) to be 29 million euro (1,14 % of 2016 expenditure). Of this amount, it estimated that 10 million euro (35 %) would be corrected by its checks in subsequent years [16]. The DG NEAR Director-General declared that, in view of the amount at risk at closure, the DG's financial exposure was below the materiality threshold of 2 %. Although we have identified a material level of error for the MFF heading 'Global Europe', the Director-General's statement does not contradict the results of our audit work, as only a minor part of our error rate relates to transactions under the responsibility of DG NEAR.

9.30. *The overall amount at risk at closure is derived from the RER study.*

9.31. In relation to DG NEAR's *corrective capacity*, we found, despite DG NEAR's efforts to exclude from the calculation recoveries on pre-financing, cancelled recovery orders and earned interest, that the 2016 figure (10 million euro) included some amounts that should have been excluded [17], resulting in an overstatement of the corrective capacity and, consequently, of the total amount at risk at payment. Though it is difficult to quantify the overall extent of this shortcoming, it does not affect the assurance provided by the Director-General.

(15) Best conservative estimate of the amount of expenditure authorised throughout the year but not compliant with the contractual and regulatory provisions applicable at the time payment is made.
(16) See DG NEAR's 2016 annual activity report, p. 51.
(17) During our review, we found errors in 6 out of a sample of 25 cases that had not been taken into account in the calculation.

THE COURT'S OBSERVATIONS

9.32. As the Director-General acknowledged, the positive assessment of the control procedures, largely based on the 2016 RER study, may mask difficulties in certain parts of the portfolio. DG NEAR has therefore devised internal control templates (ICT) to detect major weaknesses ([18]). However, risk indices to enhance the templates' usefulness have yet to be developed. The current ICT assessment is, therefore, limited to an analysis of the Court's *statement of assurance* and RER errors and needs to be further developed to allow for a measurement of the global impact of these errors. Furthermore, we note that the AAR does not properly disclose the limitations in the scope of the RER study compared with an audit engagement.

9.33. We have also examined DG DEVCO's 2016 annual activity report. The results are presented in our annual report on the 8th, 9th, 10th and 11th European Development Funds (paragraphs 34 to 37).

CONCLUSION AND RECOMMENDATIONS

Conclusion

9.34. The overall audit evidence indicates that the level of error in spending on 'Global Europe' was material.

9.35. For this MFF heading, our testing of transactions produced an estimated level of error of 2,1 % (see ***Annex 9.1***).

THE COMMISSION'S REPLIES

9.32. *The Commission would like to highlight that 2016 was the first year that the RER study covered all its operations.*

It will further elaborate its risk differentiated segmentation in 2017.

([18]) See DG NEAR's 2016 annual activity report, p. 38-48.

THE COURT'S OBSERVATIONS

Recommendations

9.36. ***Annex 9.3*** shows the findings of our follow-up review of the two recommendations we made in our 2013 annual report ([19]). Of these, the Commission had implemented one in full, while the other had been implemented in some respects.

9.37. Based on this review and our findings and conclusions for 2016, we recommend that DG NEAR:

— **Recommendation 1**: work together with the audit authorities in IPA II beneficiary countries to improve their competence, particularly by organising seminars, setting up networks and using the tools available, such as twinning or technical assistance.

— **Recommendation 2**: develop risk indices to improve the assessment based on the internal control templates, so as to better measure the impact of errors.

— **Recommendation 3:** properly disclose the scope of the RER study and the estimated lower and upper error limits in its next AAR.

— **Recommendation 4:** improve the calculation of the 2017 corrective capacity by addressing the shortcomings identified in this annual report.

([19]) We chose our 2013 report for this year's follow-up exercise as, typically, enough time should have elapsed for the Commission to have implemented our recommendations.

THE COMMISSION'S REPLIES

9.36. *The Commission would like to stress that the implementation of the recommendation assessed by the Court as 'implemented in some respects' is significantly advanced.*

As of the time of publication of this report five out of ten missions are declared compliant representing the most substantial part (75 % of payments made in 2016) of the CSDP operations (EULEX Kosovo, EUPOL Afghanistan, EUMM Georgia, EUPOL COPPS in the Occupied Palestinian Territories and EUAM Ukraine). Compliance for EUBAM Rafah will be formalised in the coming weeks.

The EUCAP Sahel Mali is currently being assessed with a view to being compliant by November 2017. The assessments of EUCAP Sahel Niger and EUCAP Nestor prior to 2016 were not compliant and a road map was established. Work is now advanced towards the compliance of these two missions which will be re-assessed in accordance with the roadmap in 2018.

The auditing of EUBAM Libya is planned for end 2017 (the mission has been relocated from Tripoli to Tunis and was downsized).

The Commission accepts this recommendation.

The Commission accepts this recommendation.

The Commission accepts this recommendation.

The Commission accepts this recommendation.

ANNEX 9.1

RESULTS OF TRANSACTION TESTING FOR 'GLOBAL EUROPE'

	2016	2015
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	**156**	156
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**2,1 %**	2,8 %
Upper error limit (UEL)	3,6 %	
Lower error limit (LEL)	0,6 %	

ANNEX 9.2

OVERVIEW OF ERRORS WITH AN IMPACT OF AT LEAST 20 % FOR 'GLOBAL EUROPE'

THE COURT'S OBSERVATIONS	THE COMMISSION'S REPLIES

Introduction

Applying the general audit methodology set out in ***Annex 1.1***, we tested a representative sample of transactions to estimate the level of *irregularity* within the population for this MFF heading. The errors we detected in testing do not constitute an exhaustive list — either of individual errors or of possible error types. The findings outlined below concerning errors with an impact of at least 20 % of the transaction value examined are presented by way of example ([1]). These errors were found in transactions worth between 281 000 euro and 19,0 million euro, with a median ([2]) value of over 1,3 million euro.

Examples of error

Absence of essential supporting documents

Example 1 — Unavailability of supporting documents

DG DEVCO — Indonesia

The recovery procedure is ongoing.

We examined expenditure accepted by the Commission for a contribution agreement signed with an international organisation working to improve the security capacity of local staff.

The beneficiary's partners were unable to provide (all or certain) supporting documents to justify several audited costs, in particular consultancy costs, travel expenses and other operational costs, which were therefore considered ineligible. Ineligible expenditure resulted in an error rate of 41 %.

([1]) These errors account for more than half of the overall estimated level of error for 'Global Europe'.

([2]) I.e. half of all errors with an impact of at least 20 % were found in transactions worth less than 1,3 million euro, and the remainder in transactions worth more than this amount.

THE COURT'S OBSERVATIONS

Example 2 — Unavailability of supporting documents

DG DEVCO — Niger

We examined expenditure accepted by the Commission for a grant awarded to an NGO working in the field of access to sexual and reproductive health services.

The beneficiary was unable to provide supporting documents to justify some of the audited costs, in particular staff salaries, insurance, national income tax, and vehicle and classroom hire. These costs were therefore considered ineligible. The related error rate was 50 %.

Example 3 — Unavailability of supporting documents

DG DEVCO

We examined expenditure accepted by the Commission for a contribution made to a trust fund managed by an international organisation working in the field of influenza pandemic preparedness in Asia.

The beneficiary was unable to provide supporting documents to justify some of the audited costs, in particular for medicines and medical equipment. These costs were therefore considered ineligible in the RER study, a conclusion that we accepted. The related error rate was 35 %.

THE COMMISSION'S REPLIES

The beneficiary has formally declared that the documents could not be supplied due to their loss during the move of their offices after the completion of the project. Therefore the Commission considers that this is not a case of bad management or refusal to give access. Nonetheless, the Commission has already launched the recovery of the amount concerned.

This transaction is part of the DEVCO RER study. After the conclusion of the study the international organisation provided the Commission with evidence regarding the reasons for the lack of availability of the documents.

As a consequence of a viral infection at a government building in Cambodia and of the ongoing works in another building which was partially destroyed in the Nepal 2015 earthquake, the beneficiary was unable to provide supporting documents to justify some of the audited costs, in particular for medicines and medical equipment.

THE COURT'S OBSERVATIONS / THE COMMISSION'S REPLIES

Expenditure not incurred

Example 4 — Clearing of pre-financing overstated

DG DEVCO

We examined expenditure accepted by the Commission for a contribution agreement signed with an international organisation for the conservation and sustainable use of animal genetic resources in Africa.

The Commission had accepted and booked an amount which was higher than the total amount of incurred expenditure declared by the beneficiary in the sole financial report available. The amount overstated and ineligible resulted in an error rate of 82 %.

Following the Court's desk review, the relevant clearings have been cancelled.

Ineligible expenditure

Example 5 — Origin of goods not proven

Foreign Policy Instruments — Niger

We examined expenditure accepted by the Commission for a contribution to a public entity working to strengthen the role of institutional peacekeepers in certain regions of the country.

The beneficiary had purchased motorcycles at the local market without sufficient proof that they had originated from an eligible country. Non-compliance with the 'rule of origin' makes the costs involved ineligible; in this case, though, the Commission incorrectly accepted them. We found two payments (advance payment of 40 % and the final payment of the balance for the same purchase) to be ineligible. The error rates for these two transactions were 27 % and 20 % respectively.

The Commission recognises the ineligibility of expenditure due to non-compliance with the rule of origin. The Commission will take the necessary measures in order to prevent, detect and correct these errors in the future. In particular, in order to enhance its supervision over the Delegations, the Commission will implement Regional Teams as of 2017. The Delegation in Niger is also included in the Supervision Mission plan of 2017.

The Commission is in the process of recovering the ineligible funds with a view to effectively protecting the financial interests of the EU.

THE COURT'S OBSERVATIONS

Serious failure to respect* public procurement *rules

Example 6 — Absence of competition

DG NEAR — Turkey

We examined expenditure accepted by the Commission for an agreement with a regional organisation providing capacity building in the field of the environment.

The beneficiary had not respected the procurement rules requiring that at least three providers be consulted to ensure a competitive bid. Ineligible expenditure resulted in an error rate of 20 %.

ANNEX 9.3

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'GLOBAL EUROPE'

Year	Court recommendation	Court's analysis of the progress made						Commission reply
		Fully implemented	Being implemented: In most respects	Being implemented: In some respects	Not implemented	Not applicable	Insufficient evidence	
2013	The Court recommends that: **Recommendation 1:** the Commission, and particularly DG ELARG, ensure that instructions to staff state that clearings should be made only on the basis of incurred expenditure and not be based on their own estimates;	X						
	Recommendation 2: FPI accredit all CFSP missions in accordance with the 'six-pillar assessment'.			X				

CHAPTER 10

'Administration'

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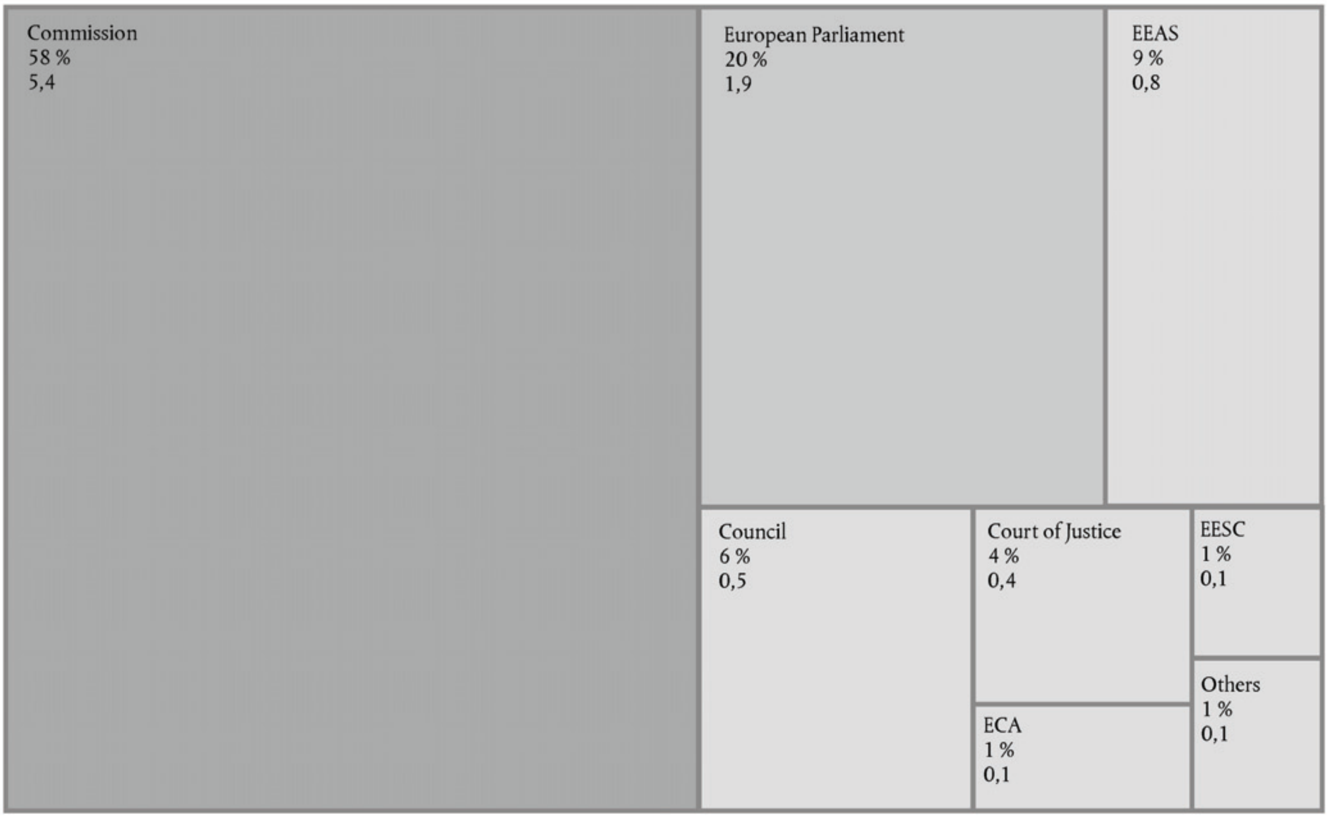
INTRODUCTION

10.1. This chapter presents our findings for *MFF* heading 5, 'Administration' ([1]). ***Box 10.1*** gives an overview of the spending per institution under this heading in 2016.

Box 10.1 — MFF heading 5 — 2016 breakdown

(billion euro)



Total payments for the year	9,3
- advances ([1])	*0,1*
+ clearings of advances ([1])	*0,2*
Audited population, total	**9,4**

([1]) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph 10).

Source: 2016 *consolidated accounts* of the European Union.

([1]) This includes the administrative expenditure of all the EU institutions, pensions and payments to the European Schools. For the latter, we issue a specific annual report which is submitted to the Board of Governors of the European Schools. A copy of this report is sent to the European Parliament, the Council and the European Commission.

THE COURT'S OBSERVATIONS

10.2. We report separately on the EU agencies and other bodies ([2]). Our mandate does not cover the financial audit of the European Central Bank.

Brief description of the MFF heading

10.3. Administrative expenditure comprises expenditure on human resources, which accounts for about 60 % of the total, as well as expenditure on buildings, equipment, energy, communications and information technology. Our work over many years indicates that this spending is low-risk.

Audit scope and approach

10.4. Applying the audit approach and methods set out in ***Annex 1.1***, we examined the following for MFF heading 5:

(a) a sample of 100 *transactions*, in line with paragraph 7 of ***Annex 1.1***. The sample was designed to be representative of the range of spending under this MFF heading (see ***Box 10.1*** and paragraph 10.3);

(b) a risk-based sample of 20 *commitments* ([3]) which had been approved close to the end of the financial year on the basis of *appropriations* from 2016 and which were automatically carried over to 2017, in order to check that the institutions had used the budget in line with the budgetary principle of annuality ([4]);

([2]) Our specific annual reports on agencies and other bodies are published in the Official Journal.

([3]) Three for the European Parliament, one for the Council, 12 for the European Commission, one for the European Court of Justice and three for the European External Action Service.

([4]) Based on Articles 9, 13, 202 and 203 of the Financial Regulation.

THE COURT'S OBSERVATIONS

(c) how the institutions and bodies had implemented the plan to reduce staff numbers by 5 % ([5]) by 2017 ([6]);

(d) whether the *annual activity reports* of all the EU's institutions and bodies, and among them of the European Commission's directorates-general (DGs) and offices primarily responsible for administrative expenditure ([7]), presented information on *regularity* of spending that was broadly consistent with our own results.

10.5. The European Court of Auditors' own spending is audited by an external firm ([8]). The results of its audit of our financial statements for the year ending 31 December 2016 are presented in paragraph 10.16.

REGULARITY OF TRANSACTIONS

10.6. ***Annex 10.1*** provides an overview of the results of transaction testing. Of the 100 transactions examined, 12 (12 %) contained *errors*. The error we have quantified (payments not covered by contracts resulting from a procurement procedure — see paragraph 10.15) led to an *estimated level of error* of 0,2 % ([9]).

([5]) The reduction aimed 'to neutralise the additional capacity built up by the increase of working time to 40 hours per week' and was to take place between 2013 and 2017 on the basis of the number of posts assigned to each institution — their 'establishment plan' at 1 January 2013. It was adopted in the Interinstitutional Agreement (IIA) of 2 December 2013 (paragraph 27 of the IIA of 2 December 2013 between the European Parliament, the Council and the Commission on budgetary discipline, on cooperation in budgetary matters and on *sound financial management* (OJ C 373 of 20.12.2013, p. 1)).

([6]) Our examination covered the European Parliament, the Council, the European Commission, the Court of Justice of the European Union, the European Court of Auditors, the European Economic and Social Committee, the Committee of the Regions and the European External Action Service. We did not include the European Ombudsman or the European Data Protection Supervisor because their establishment plans were too small.

([7]) DG for Human Resources and Security, Office for the Administration and Payment of Individual Entitlements (PMO), Offices for Infrastructure and Logistics in Brussels and in Luxembourg, Publications Office and DG for Informatics.

([8]) PricewaterhouseCoopers, Société à responsabilité limitée, Réviseur d'Entreprises.

([9]) 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 0,0 % and 0,8 % (the lower and upper error limits respectively).

THE COURT'S OBSERVATIONS

ANNUAL ACTIVITY REPORTS AND OTHER GOVERNANCE ARRANGEMENTS

10.7. The annual activity reports we reviewed did not identify material levels of error; this is consistent with our own audit results.

OBSERVATIONS ON INSTITUTIONS AND BODIES

Observations common to several institutions and bodies

Implementation of the budgetary principle of annuality

10.8. We examined 20 commitments that had been approved close to the end of the 2016 financial year. For 15 of them, the services concerned were to be provided entirely or mainly in 2017, and the related payments were to be made in that same year. The *provisions* of the *Financial Regulation* implementing the budgetary principle of annuality give flexibility to make such legal commitments before the end of the year with the delivery of goods and services and corresponding payments in the following year. We note, however, that such *carry-overs* should be understood as an exception to the principle of annuality and reflect actual needs rather than being used as a means to maximize the consumption of appropriations at year-end.

REPLY OF THE EUROPEAN EXTERNAL ACTION SERVICE

10.8. *The EEAS considers, as the ECA states, that the provisions of the Financial Regulation give flexibility to make such legal commitments before the end of the year with the delivery of goods and services and corresponding payments in the following year. The Financial Regulation does not contain any provisions which would cause the commitments concerned to be considered exceptional.*

THE COURT'S OBSERVATIONS

Implementation of the 5 % reduction in staff numbers

10.9. In 2013, in response to the increase in the number of hours worked each week by EU civil servants (from 37,5 to 40, a 6,6 % increase), the *budgetary authorities* agreed a target of reducing the number of posts in the establishment plan of EU institutions and bodies by 5 % over the period from 2013 to 2017. Achieving that target would, in principle, mean that the total number of hours worked would remain constant.

10.10. We found that the institutions ([10]) had collectively cut the number of posts in the establishment plan by 4,0 % over the period from 2013 to 2017 (from 39 649 to 38 072 posts). The institutions had reduced the number of staff (posts actually occupied by a staff member) by 1,4 % between 2013 and 2017 (from 37 153 to 36 657 posts — see ***Box 10.2***).

REPLY OF THE EUROPEAN PARLIAMENT

10.10. *Parliament remains fully committed to implement the agreed cuts. 60 posts will be deleted in 2018 and 59 in 2019, as specified in 2015 ([1]).*

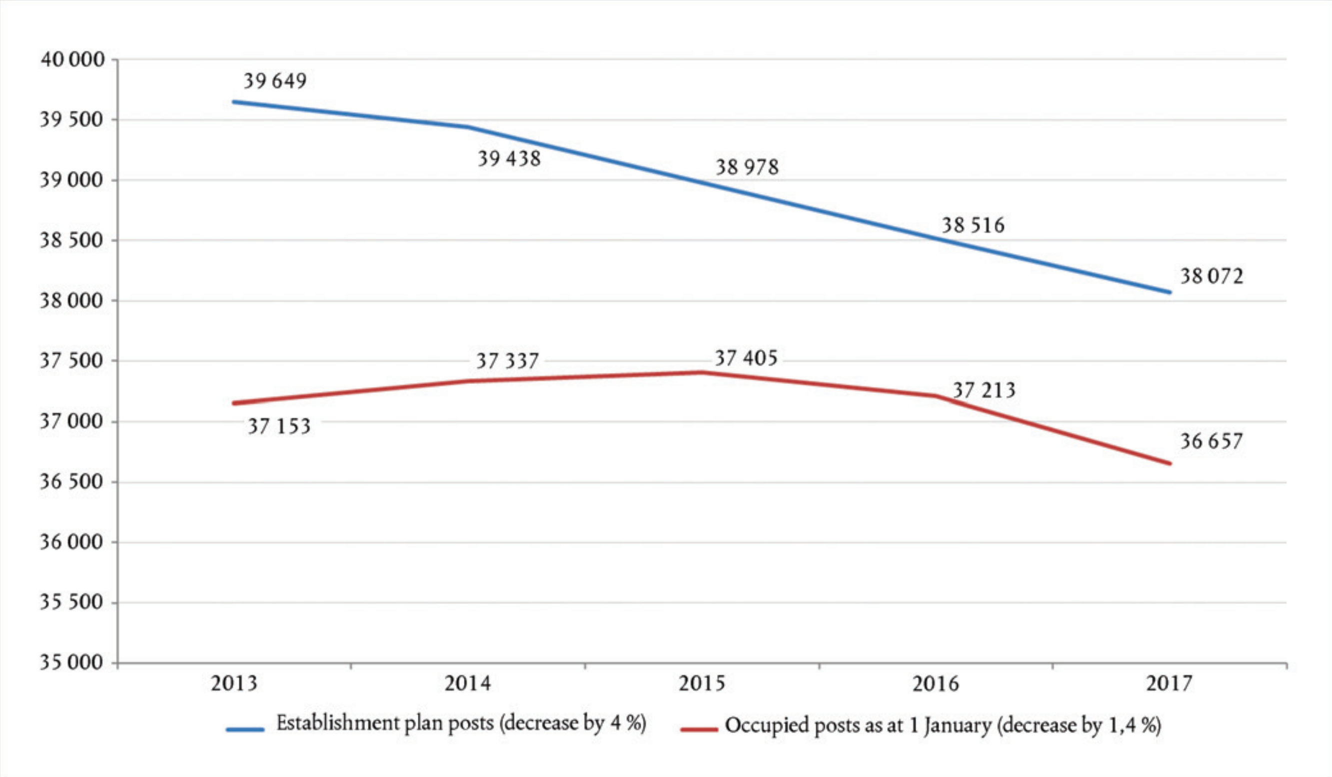
THE COMMISSION'S REPLY

10.10. *The Commission started the reduction of the number of staff from the beginning of 2012 and the process continued until 1.1.2017. In this 5-year period (1.1.2012-1.1.2017) the number of staff occupying posts in the Commission decreased by 4,0 % (from 24 016 to 23 045).*

([10]) The reduction of staff numbers for the European Ombudsman, for the European Data Protection Supervisor and in agencies is not covered by this annual report.

([1]) *See joint statement 3.3 in the European Parliament legislative resolution of 25 November 2015 on the joint text on the draft general budget of the European Union for the financial year 2016 approved by the Conciliation Committee under the budgetary procedure.*

Box 10.2 — Evolution of establishment plan posts and occupied posts between 2013 and 2017



Source: ECA, based on data supplied by the institutions.

THE COURT'S OBSERVATIONS

10.11. The key changes in the number of posts in the establishment plan are set out in ***Box 10.3***. In addition to the 5 % reduction in the number of posts ([11]) and the posts added as a result of Croatia's accession, the following changes explain most of the net decrease of 230 posts under 'Other additions and reductions'.

— The European Commission cut 359 posts to compensate for the increase in the number of posts and external staff in the executive agencies ([12]) and the increase in the number of staff at the European GNSS Agency.

— The European Parliament created 93 posts to perform new tasks and tasks previously carried out by external contractors and contract staff, and cut 76 posts to compensate for an increase in the number of posts assigned to political groups ([13]).

THE COMMISSION'S REPLY

10.11. *The number of actual cuts presented in Box 10.3 (1 844) is 54 higher than that presented by the Commission in its follow-up table for the 5 % staff reduction in all Institutions. This is due to the methodology applied by the Commission, according to which non-structural posts that had been granted to an Institution are considered as offsetting the progress towards the 5 % reduction target. Therefore, the remaining number of posts to be cut is 189 according to the Commission methodology.*

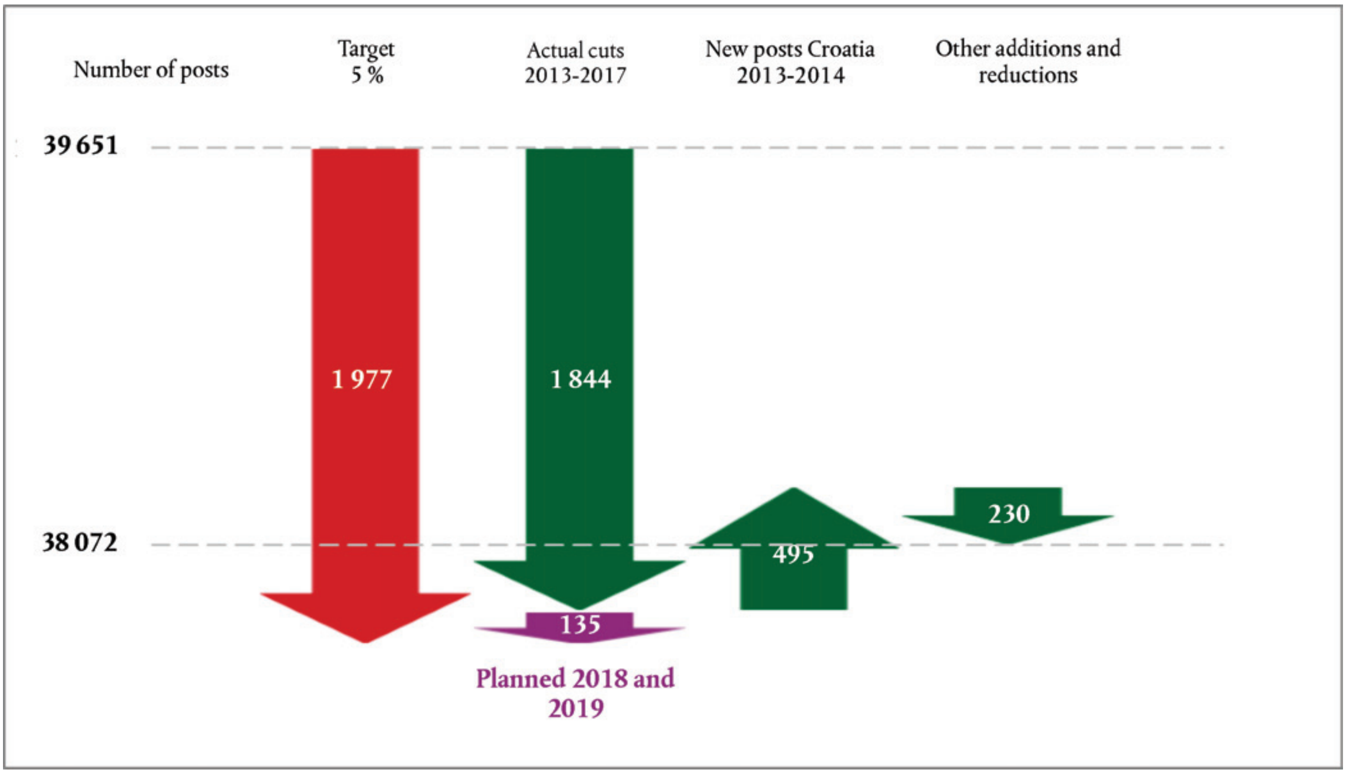
([11]) The planned reductions concern the EEAS (2018) and the European Parliament (2018 and 2019).
([12]) As a result of the delegation of tasks to the executive agencies.
([13]) The European Parliament has decided to exclude political groups from the scope of the 5 % staff cuts.

THE COURT'S OBSERVATIONS

— The Court of Justice of the European Union was assigned 137 more posts, mostly because of an increase in the number of judges and advocates-general.

— The institutions created 53 posts in connection with the phasing-out of the derogation for translation into the Irish language.

Box 10.3 — Implementation of the 5 % reduction in staff numbers (2013 to 2017)



Source: ECA, based on data supplied by the institutions.

10.12. We also examined how the budgeted number of contract staff had changed. This number rose from 4 517 to 5 417 between 2013 and 2017 — an increase of 19,9 %. Contract staff made up 11,4 % of the number of staff in the establishment plan in 2013, and 14,2 % in 2017. The European Parliament's use of contract staff to perform tasks previously carried out by external contractors accounts for most of this increase.

10.13. The institutions are achieving the 5 % reduction target ([14]) by eliminating vacant posts in the establishment plan and by not replacing staff members leaving upon retirement, illness or at the end of temporary contracts.

([14]) The target defined in the IIA was strictly limited to reducing staff numbers in the establishment plan.

THE COURT'S OBSERVATIONS

Observations on specific institutions and bodies

10.14. Other than the issues discussed in paragraphs 10.8 to 10.13, we did not identify any specific issues concerning the Council, the European Commission, the Court of Justice of the European Union, the European Economic and Social Committee, the Committee of the Regions, the European Ombudsman or the European Data Protection Supervisor. We found some weaknesses in procurement procedures organised by the EEAS in non-EU countries; we have brought these to the attention of the EEAS's management. We detected similar weaknesses in 2015 ([15]).

European Parliament

10.15. For one payment to a political group ([16]), we found weaknesses in checks on the authorisation and settlement of expenditure made in 2015 but cleared in 2016 ([17]). We also found that payments were made without being covered by contracts resulting from a procurement procedure (see also paragraph 10.6). We detected similar shortcomings in a transaction relating to another political group in 2015 ([18]).

REPLY OF THE EUROPEAN PARLIAMENT

10.15. *Parliament takes notes of the observation and has informed the political group concerned. According to Article 1.4 of the relevant rules adopted by the Bureau, 'political groups shall be responsible to the institution for the use of appropriations, within the limits of the powers conferred upon them by the Bureau for application of these rules. They shall ensure that the appropriations are used in accordance with these rules and they shall take appropriate action to prevent any expenditure which is not in accordance with these rules. The political group, represented by its chair, shall have authorising officer powers…'*

On the basis of the report of the group's external auditor, Parliament will decide whether to apply 2.7.4 of the above-mentioned Rules: in case the Bureau takes the view that the appropriations have not been used in accordance with these rules, the appropriations shall be repaid.

([15]) See the 2015 annual report, paragraph 9.14, and recommendation 4 in paragraph 9.18.
([16]) The applicable legal framework is the 'Rules on the use of appropriations from Budget Item 4 0 0, adopted by the Bureau on 30 June 2003' (last amended by Bureau decisions of 14 April 2014 and 27 April 2015). The political groups manage the funds allocated to them according to the principles of indirect management of funds in analogical application of Article 60 of the Financial Regulation, taking into account the specific requirements of the groups.
([17]) Expenditure in year n is cleared in year n+1 on the basis of a report on the accounts by an independent external audit. The Bureau of the Parliament may ask for appropriations to be repaid to the Parliament if the latter are deemed not to have been used in accordance with the Rules.
([18]) See the 2015 annual report, paragraph 9.11, and recommendation 1 in paragraph 9.18.

THE COURT'S OBSERVATIONS

European Court of Auditors

10.16. The external auditor's report [19] states that 'the financial statements give a true and fair view of the financial position of the European Court of Auditors as of 31 December 2016, and of its financial performance, its cash flows and the changes in net assets for the year then ended'.

CONCLUSION AND RECOMMENDATIONS

Conclusion

10.17. The overall audit evidence indicates that the level of error in spending on 'Administration' was not material. For this MFF heading, our testing of transactions produced an estimated overall level of error present of 0,2 % (see ***Annex 10.1***).

Recommendations

10.18. ***Annex 10.2*** shows the findings of our follow-up of the three recommendations we made in our 2013 annual report [20]. The institutions and bodies concerned had implemented two recommendations in most respects and one in some respects.

THE COMMISSION'S REPLY

10.18. *Regarding the recommendation on updating the personal situation of staff and management of family allowances, the Commission has already taken measures to improve its monitoring systems and it considers that full implementation of this recommendation will be achieved by end of 2017.*

10.19. Based on this review and our findings and conclusions for 2016, we recommend that:

— **Recommendation 1:** the European Parliament review its framework for monitoring the implementation of budget appropriations allocated to political groups. It should also provide better guidance to political groups and monitor more effectively how they apply the rules for authorising and settling expenditure, and how they carry out procurement procedures (see paragraph 10.15).

REPLY OF THE EUROPEAN PARLIAMENT

Parliament takes note of the recommendation and will aim for improvements while keeping the current set of rules.

The General Secretariat will continue the additional efforts it started in 2016 to assist the political groups in improving their internal financial management: In particular, training sessions on the general principles of budgetary management and on procurement have been organised in cooperation with the groups and a guidance note on tendering by political groups has been issued. The groups themselves are also undertaking efforts for further harmonisation and improvement.

(19) See the external auditor's report on the financial statements referred to in paragraph 10.5.

(20) We chose our 2013 report for this year's follow-up exercise as, typically, enough time should have elapsed for the institutions and bodies to have implemented our recommendations.

ANNEX 10.1

RESULTS OF TRANSACTION TESTING FOR 'ADMINISTRATION'

	2016	2015
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	**100**	151
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**0,2 %**	0,6 %
Upper error limit (UEL)	0,8 %	
Lower error imit (LEL)	0,0 %	

ANNEX 10.2

FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR 'ADMINISTRATION'

Year	Court recommendation	Court's analysis of the progress made						Institution's reply
		Fully implemented	Being implemented: In most respects	Being implemented: In some respects	Not implemented	Not applicable	Insufficient evidence	
2013	**Recommendation 1 (Commission):** *Updating of the personal situation and management of family allowances* The Commission should take further steps to ensure that staff provide documents confirming their personal situation on a regular basis, as well as to improve systems for the timely processing of those documents that have an impact on the calculation of family allowances (see the 2013 annual report, paragraphs 9.11 and 9.20).		X					
	Recommendation 2 (EEAS): *Updating of the personal situation and management of family allowances* The EEAS should take further steps to ensure that staff provide documents confirming their personal situation on a regular basis, as well as to improve systems for the timely processing of those documents that have an impact on the calculation of family allowances (see the 2013 annual report, paragraphs 9.13 and 9.20).		X					*With regard to the heading 'Updating of the personal situation and management of family allowances', EEAS staff are regularly reminded of their obligation to inform the Service without delay of any changes to their family situation, and unduly paid allowances are regularly recovered. The EEAS therefore considers that this recommendation is applied.*
	Recommendation 3 (EEAS): *Procurement* The EEAS should improve the design, coordination and conduct of procurement procedures by means of its Headquarters providing increased support and guidance to the Delegations (see the 2013 annual report, paragraphs 9.14, 9.15 and 9.20).			X				*With regard to 'Procurement' (and also paragraph 10.14), we are actively taking steps to apply this recommendation. The EEAS is continuing to invest in improving the training, support and advice provided to delegation staff responsible for procurement. In addition, useful lessons should be drawn in future from the pilot project on the regionalisation of administrative support (in the 27 delegations in the neighbouring countries).*

ANNUAL REPORT ON THE ACTIVITIES FUNDED BY THE 8TH, 9TH, 10TH AND 11TH EUROPEAN DEVELOPMENT FUNDS FOR THE FINANCIAL YEAR 2016

(2017/C 322/02)

Annual report on the activities funded by the 8th, 9th, 10th and 11th European Development Funds for the financial year 2016

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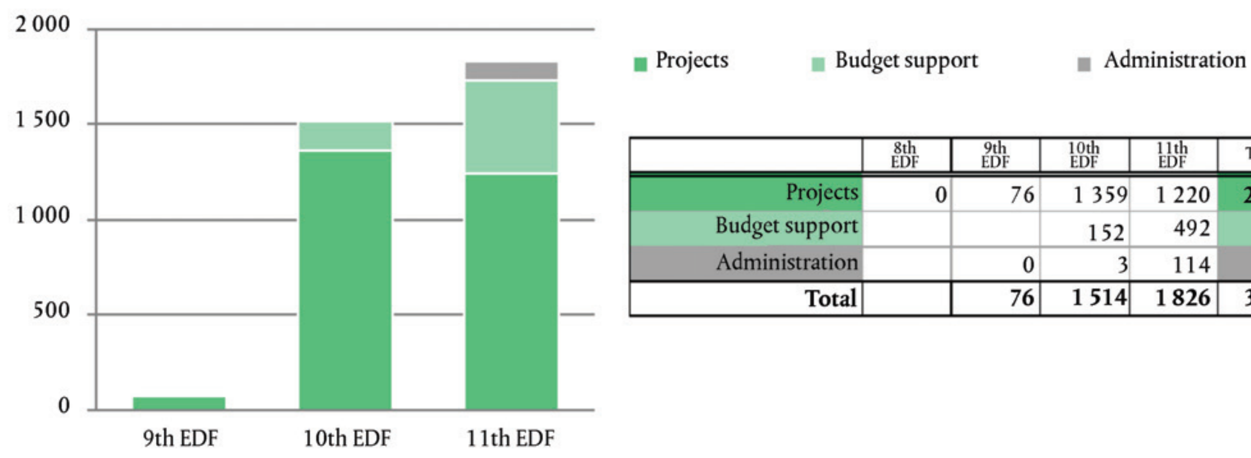
INTRODUCTION

1. This annual report presents our findings on the 8th, 9th, 10th and 11th European Development Funds (EDFs). ***Box 1*** gives an overview of the activities and spending for this area in 2016.

Box 1 — European Development Funds — 2016 financial overview

Million euro



	8th EDF	9th EDF	10th EDF	11th EDF	Total
Projects	0	76	1 359	1 220	**2 654**
Budget support			152	492	**644**
Administration		0	3	114	**117**
Total		**76**	**1 514**	**1 826**	**3 416**

Table 1 — European Development Funds — Key information 2016

(million euro)

Total operational payments (projects)	2 676
Total operational payments (budget support)	644
Total administrative payments ([1])	96
Total payments	**3 416**
- advances and EDF contributions to EU Trust Funds	*2 057*
+ clearings of advances and EU Trust Funds	*1 477*
Audited population	**2 836**
Total individual commitments ([2])	**4 234**
Total global commitments ([2])	**6 491**

([1]) Contribution from the EDFs to cover expenditure incurred both at the Commission and in EU Delegations for the administrative support needed to manage operations financed under the EDFs.

([2]) Global commitments relate to financing decisions. Individual commitments relate to individual contracts.

Source: European Court of Auditors, based on the 2016 consolidated accounts of the 8th, 9th, 10th and 11th EDFs.

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 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 (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 methods implemented in 79 countries. Rules and procedures are often complex, including those for tendering and awarding contracts.

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 euro, that of the 9th EDF (2000-2007) 13 800 million euro, and that of the 10th EDF (2008-2013) 22 682 million euro.

7. The Internal Agreement establishing the 11th EDF ([4]) (2015-2020) came into force on 1 March 2015. The 11th EDF holds 30 506 million euro ([5]), of which 29 089 million euro is allocated to the ACP countries and 364,5 million euro to the OCTs.

8. ***Box 2*** shows the use of EDF resources both in 2016 and cumulatively.

([3]) With the exception of the 3 % of the 2016 EDF expenditure managed by the Directorate-General for Humanitarian Aid and Civil Protection (ECHO).
([4]) OJ L 210, 6.8.2013, p. 1.
([5]) Including 1 139 million euro managed by the EIB.

Box 2 — Use of EDF resources at 31 December 2016

(million euro)

	Situation at end of 2015		Budgetary implementation during the 2016 financial year (net) [6]					Situation at end of 2016					
	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]	**76 880**		**- 20**	**- 163**	**223**	**- 24**	**16**	**10 392**	**15 467**	**21 607**	**29 430**	**76 896**	
B — USE													
1. **Global commitments** [4]	**53 607**	**69,7 %**	**- 13**	**- 104**	**- 80**	**6 688**	**6 491**	**10 391**	**15 429**	**21 058**	**13 220**	**60 097**	**78,2 %**
2. **Individual commitments** [5]	**48 797**	**63,5 %**	**- 6**	**- 46**	**541**	**3 745**	**4 234**	**10 378**	**15 309**	**19 576**	**7 769**	**53 032**	**69,0 %**
3. **Payments**	**41 989**	**54,6 %**	**0**	**68**	**1 466**	**1 816**	**3 350**	**10 376**	**15 053**	**16 476**	**3 435**	**45 339**	**59,0 %**
C — Outstanding commitments (B1 – B3)	**11 618**	**15,1 %**						**15**	**376**	**4 582**	**9 785**	**14 758**	**19,2 %**
D — Available balance (A – B1)	**23 273**	**30,3 %**						**1**	**38**	**549**	**16 210**	**16 799**	**21,8 %**

(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 2016 consolidated 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. Across its entire area of responsibility, in 2016 DG DEVCO continued its efforts to reduce old prefinancing payments and commitments, largely exceeding its targets ([6]). It also sought to bring down the number of open expired contracts ([7]). As in the last two years, DG DEVCO was close to meeting its 2016 target for the share of expired contracts in its portfolio as a whole ([8]), but progress was less satisfactory in respect of the EDFs ([9]).

THE COMMISSION'S REPLIES

9. *The main problems preventing the closure of expired contracts for EDF are recovery orders not cashed, legal cases and ongoing audit processes. Although these aspects are not entirely under its control, the Commission will pursue its efforts to speed up the closure of expired contracts.*

([6]) Reduction of old open prefinancing for the EDFs: 28 % achieved (25 % target); reduction of old unspent commitments for the EDFs: 36 % achieved (25 % target).

([7]) A contract is considered to have expired if it is still open more than 18 months after the end of its operational period. Delays in contract closure increase the risk of regularity errors as the supporting documentation might be difficult to retrieve if it has not been archived properly and key project staff have left. Late contract closure may also delay the recovery of unspent prefinancing and ineligible expenditure.

([8]) The share of expired contracts in DG DEVCO's portfolio fell from 18,62 % at the end of 2013 to 15,15 % at the end of 2016 (15 % target).

([9]) Of 1 896 expired contracts, 1 058 (56 %) concerned the EDFs. The ratio of expired contracts to all open EDF contracts was 19 %, compared with 12 % for the DG DEVCO portfolio as a whole. The operational period of 156 (323 million euro) of the 1 058 expired EDF contracts (14,7 % in number; 11,4 % in value) had expired more than 5 years ago.

CHAPTER II — THE COURT'S *STATEMENT OF ASSURANCE* ON THE EDFS

The Court's statement of assurance on 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 statement of cash flow, the statement of changes in net assets, and the report on financial implementation for the financial year ended 31 December 2016, approved by the Commission on 23 June 2017, 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 2016 present fairly, in all material respects, the financial position as at 31 December 2016, the results of their operations, their cash flows and the changes in 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, the revenue underlying the accounts for the year ended 31 December 2016 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 2016 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' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit, and we have fulfilled our other ethical responsibilities in accordance with these 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. Expenditure recorded in 2016 under the 8th, 9th, 10th and 11th EDFs is materially affected by error. Our *estimated level of error* for expenditure underlying the accounts is 3,3 %.

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 2.9) which are subject to a high degree of estimation. At year-end 2016, the Commission estimated that eligible expenses incurred but not yet reported by beneficiaries amounted to 3 903 million euro (year-end 2015: 3 797 million euro).

IX. We examined the calculation of these accrual estimates and reviewed a sample of 30 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 once the Commission had made all necessary corrections we identified.

Responsibilities of management

X. In accordance with Articles 310 to 325 of the TFEU and the 11th EDF Financial Regulation, management is responsible for the preparation and presentation of the annual accounts of the EDFs on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the transactions underlying them. This responsibility includes the design, implementation and maintenance of 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 bears the ultimate responsibility for the legality and regularity of the transactions underlying the EDF accounts.

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

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

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

XIII. Our objectives are to obtain reasonable assurance about whether the EDF accounts are free from material misstatement and the transactions underlying them 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 is not a guarantee that an audit will always detect a material misstatement or non-compliance when it exists. 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 of users taken on the basis of these EDF accounts.

XIV. 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, 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. The risk of not detecting a material misstatement or non-compliance resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

— Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the internal control.

— Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

— Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the EDFs' ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's 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 the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

XV. We communicate with those charged with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

XVII. For expenditure, we examine payment transactions when 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 when the *recipient* of funds provides justification for their proper use and the Institution or body accepts the justification by clearing the advance payment, whether in the same year or later.

XVIII. From the matters communicated with the Commission, we determine those matters that were of most significance in the audit of the EDF accounts of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, 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 the public interest benefits of such communication.

13 July 2017

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

10. Annex 1.1 to chapter 1 of the Court's 2016 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.

11. 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 27 June 2017. 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.

12. For the audit of the regularity of transactions, we:

(a) examined all Member State contributions and a sample of other types of revenue transactions;

(b) examined a sample of 143 transactions designed to be representative of the full range of payments within the EDFs and consisting of 108 payments authorised by 16 EU delegations [13] and 35 payments approved by the Commission headquarters [14];

(c) analysed the relevant systems where errors had been detected in the transactions, to identify the weaknesses involved;

(d) assessed systems at 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 DG DEVCO's 2016 *residual error rate* (RER) study;

(e) reviewed the *annual activity report (AAR)* of DG DEVCO;

(f) followed up our previous recommendations.

(11) See Article 44 of Regulation (EU) 2015/323.
(12) See Article 43 of Regulation (EU) 2015/323.
(13) Barbados, Benin, Burkina Faso, Cape Verde, Democratic Republic of the Congo, Fiji, Gambia, Ghana, Ivory Coast, Niger, Nigeria, Madagascar, Rwanda, Senegal, Tanzania and Zambia.
(14) DG DEVCO: 31 payments; ECHO: 4 payments for humanitarian aid.

Box 3 — Auditors examining the accuracy of road thickness measurements for a payment relating to a road project in Zambia

Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

13. 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 2016 relate to DG DEVCO's entire area of responsibility.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Reliability of accounts

14. Last year 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 ([15]) have also identified similar cases in 2016. Although corrections amounting to 3,2 million euro ([16]) were made in the final EDF accounts, it is likely that similar errors occurred in the untested population. At the end of 2016, DG DEVCO issued detailed instructions to its staff on the correct encoding of recovery orders of this type.

14. *Instructions produced by DEVCO on the encoding of recovery orders and corrections made by DEVCO on the basis of controls made on recovery orders issued in 2016 resulted in a significant reduction of errors in the encoding of recovery orders and/or recovery contexts (from 9,6 million euro detected by the Court in 2015 down to 3,2 million euro detected by DEVCO and/or the Court in 2016). DEVCO will pursue its efforts in 2017.*

Regularity of transactions

Revenue

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

Payments

16. ***Annex 1*** provides an overview of the results of transaction testing. Of the 143 payment transactions examined, 35 (24 %) contained errors. On the basis of the 26 errors we have quantified, we estimate the level of error to be 3,3 % ([17]).

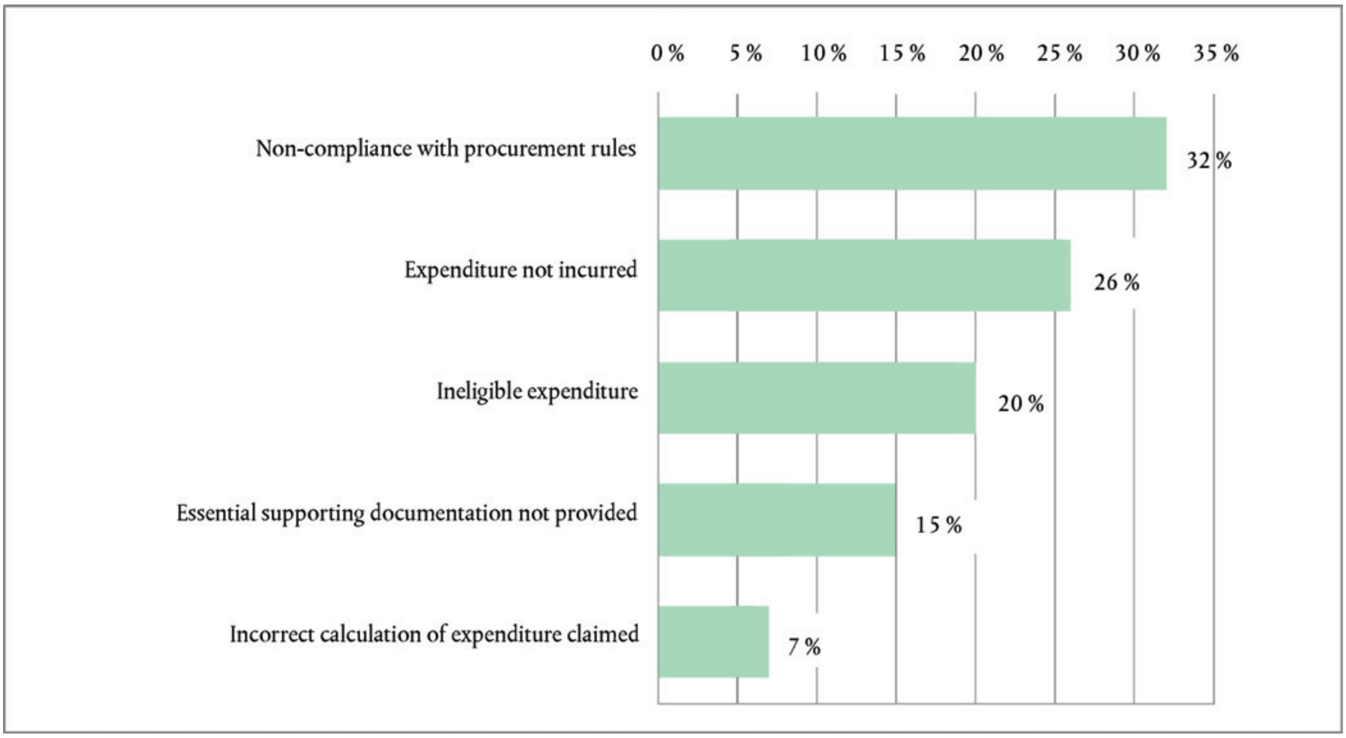
17. ***Box 4*** gives a breakdown of our estimated level of error for 2016 by error type.

([15]) We tested 15 recovery orders (total value 7,6 million euro) and found that 3 recovery orders (0,5 million euro) had been incorrectly recorded as revenue instead of the recovery of unspent prefinancing.

([16]) 2,7 million euro of corrections identified by DG DEVCO, 0,5 million euro subsequently identified by ECA auditors.

([17]) 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 1,0 % and 5,6 % (the lower and upper error limits respectively).

Box 4 — Breakdown of the estimated level of error



Source: European Court of Auditors.

THE COURT'S OBSERVATIONS

18. Of the 130 project-related payment transactions that we examined, 35 (27 %) contained errors. Of the 26 (74 %) payment transactions containing quantifiable errors, nine 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* and contribution agreements with international organisations than it did with other forms of support. Of the 67 transactions of this type examined, 23 (34 %) contained quantifiable errors, which accounted for 85 % of the estimated level of error.

THE COURT'S OBSERVATIONS

Box 5 — Examples of quantifiable errors in project transactions

Non-compliance by the beneficiary *with procurement rules*

We examined the Commission's clearance of 3 489 416 euro spent under a grant contract to support trade capacity development in ACP countries, implemented by an international organisation. Of the 10 expenditure items sampled, 6 were found to contain errors, including 5 in which fees and allowances were paid to trade advisors on the basis of service contracts. These contracts (total value 570 500 euro) were not awarded following a competitive selection procedure, as required by the grant agreement. Instead, the contracts were directly awarded to advisors who had previously worked on a predecessor project.

Ineligible expenditure — activities not covered by the contract

We examined the Commission's final clearance of 10 875 375 euro spent on the 2012 work programme of an international body providing assistance to enterprises in ACP countries. Of the 10 cost items sampled, 3 related to contracts sub-granted to third-party beneficiaries (value 147 990 euro). No *provision* was made for sub-granting under the special conditions of the grant, meaning the activities were in breach of contract. Furthermore, the sub-grants were directly awarded without a competitive selection procedure.

20. In two cases of 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 for this chapter would have been 0,7 % lower. We found five other transactions with errors which should have been detected by external auditors and supervisors. These cases contributed 0,1 % to the estimated level of error ([18]).

THE COMMISSION'S REPLIES

Box 5 — Examples of quantifiable errors in project transactions

Non-compliance by the beneficiary with procurement rules

The project consisted almost exclusively of the recruitment of regional and national trade advisors. Independently of the type of selection procedure, their recruitment was subject to standard operative processes for recruitment of international staff, including prior publication of the vacancy notice.

Ineligible expenditure — activities not covered by the contract

The Commission initiated the recovery procedure.

([18]) For 0,7 percentage points (one case) the Commission committed the error itself and for 0,2 percentage points (six cases) the error was made by the beneficiaries.

THE COURT'S OBSERVATIONS

21. In addition, a further 10 transactions containing a quantifiable error ([19]) 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. In two areas, the nature of the funding and the payment conditions limit the extent to which transactions are prone to error. These areas are *budget support* ([20]) and those where the 'notional approach' is applied in multidonor projects carried out by international organisations ([21]).

23. Budget support is a contribution to a state's general budget or 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 had verified that general eligibility conditions (such as satisfactory progress in public finance management) had been met.

24. However, given the legal provisions' broad scope for interpretation, the Commission has considerable flexibility in deciding whether the 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 of regularity ([22]).

([19]) Contributing 1,4 percentage points to the estimated level of error.

([20]) Budget support payments financed by the EDFs in 2016 amounted to 644 million euro.

([21]) EDF payments to multidonor projects carried out by international organisations in 2016 amounted to 914 million euro. We cannot state the proportion of this sum to which the notional approach applied, since the Commission does not monitor it separately.

([22]) Efficiency and effectiveness of budget support is addressed in the Court's special reports, the latest ones being SR 32/2016 on 'EU assistance to Ukraine', SR 30/2016 on 'The effectiveness of EU support to priority sectors in Honduras' and SR 13/2016 on 'EU assistance for strengthening the public administration in Moldova'.

THE COURT'S OBSERVATIONS

25. When the Commission's contributions to multi-donor projects are pooled with those of other donors and are not earmarked for specific identifiable items of expenditure, the Commission assumes that EU eligibility rules are complied with as long as the pooled amount includes sufficient eligible expenditure to cover the EU contribution. This approach, as applied by the Commission, has also been taken into account in our substantive testing ([23]).

26. When excluding the 13 budget support and 6 notional approach transactions (referred to in paragraphs 22 to 25) from the audited sample, the estimated level of error is 4,4 % ([24]).

Annual activity report and other governance arrangements

27. 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. ***Box 6*** shows the efforts made in the last four years.

Box 6 — DG DEVCO's efforts to improve the implementation of its control system

Last year we reported on the satisfactory progress achieved on the 2013 and 2014 action plans; 19 actions had been fully implemented, with the remaining 4 transferred to the 2015 action plan.

The design of the 2015 action plan was further improved with the inclusion of measures targeting high-risk areas: funds under indirect management via international organisations and grants under *direct management*. All actions were initially scheduled to be completed by June 2016. By the end of 2016, ten actions had been completed, five partially implemented and one was ongoing.

Four new targeted measures were added to the 2016 action plan, the progress of which will be assessed in our next annual report.

([23]) 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 laid between 75 % and 90 %, we assessed the need to perform checks on underlying items of expenditure on a case by case basis.

([24]) The figure quoted is the best estimate based on a representative sample of 124 transactions. We have 95 % confidence that the rate of error in the population lies between 1,8 % and 7,1 % (the lower and upper level error limits respectively).

THE COURT'S OBSERVATIONS

28. DG DEVCO's control system is centred around 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 — points to weaknesses in these checks.

29. In our 2014 and 2015 annual reports, we reported on the measures [25] which DG DEVCO had already taken to improve the quality of these audits and verifications [26]. DG DEVCO is currently revising the terms of reference of the audits and verifications to obtain information allowing for a quality assessment, as we recommended in last year's report. Although planned to be finalised by June 2017 [27], this critical revision has not yet been completed.

2016 RER study

30. In 2016 DG DEVCO carried out its fifth 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 [28]. The scope of the RER study and its limitations were disclosed in the AAR following our 2013 recommendation [29].

THE COMMISSION'S REPLIES

29. *Work on the revision of the Terms of Reference for Audits and Verifications is ongoing. The Commission expects the work to be completed, even if not fully operational, by the end of 2017.*

(25) (a) Risk analysis made compulsory for the preparation of annual audit plans by EU delegations and DG DEVCO departments; (b) grant contract templates revised so that DG DEVCO can select or contract auditors directly; (c) raising awareness of the most common types of error, training and strengthening the financial and control skills of DG DEVCO staff and beneficiaries; (d) quality grid to assess the quality of an audit or expenditure verification.

(26) In paragraph 41 of the 2015 annual report, we also reported on measures aimed at improving document management and procurement procedures for both the Commission and beneficiaries.

(27) By December 2016 for indirect management via international organisations and by June 2017 for grants under direct management, as set in the 2016 action plan.

(28) EDFs and the EU general budget.

(29) Footnote 24 of the 2016 AAR.

THE COURT'S OBSERVATIONS

31. The study examined a representative sample of transactions made under contracts closed between September 2015 and August 2016. We reviewed the 2016 RER study and found that it had been conducted in compliance with the RER methodology. All weaknesses reported in our 2013 report had been addressed, with the exception of the RER-specific estimation method, which still left too wide a margin for judgement when estimating individual error rates.

32. For the first time in 2016 the study estimated the RER to be within the 2 % *materiality threshold* set by the Commission ([30]). This result is attributable to a combination of the following main factors:

(a) DG DEVCO's efforts to improve the implementation of its internal control system (see paragraphs 27 to 29 and ***Box 6***);

(b) DG DEVCO's efforts to obtain supporting documents which resulted in the decrease in the number of estimates in the RER sample, since these contain higher residual error rates than the rest of the population due to their increased inherent risk ([31]);

(c) increase in the share of budget support transactions in the RER sample ([32]), for which the residual error rate is estimated to be 0 % (see also paragraphs 22 to 24).

THE COMMISSION'S REPLIES

31. *The number of estimations has decreased year-on-year from 43 in 2012 to 6 in 2016. Each estimation is reviewed at Director and Partner level to ensure consistency. This procedure restricts the margin for judgement when estimating individual error rates. Estimations are done when there is a legal or logistical reason for documentation not being available for the RER auditor before the deadline for completion of work at the end of the study. Those transactions where documentation has not been provided present an inherently enhanced risk of susceptibility to error and therefore estimations increase the level of error.*

32. *The Commission considers that the decrease in the error rate through the years is linked to a number of factors, the main one being the measures taken to reinforce the internal control system of DEVCO.*

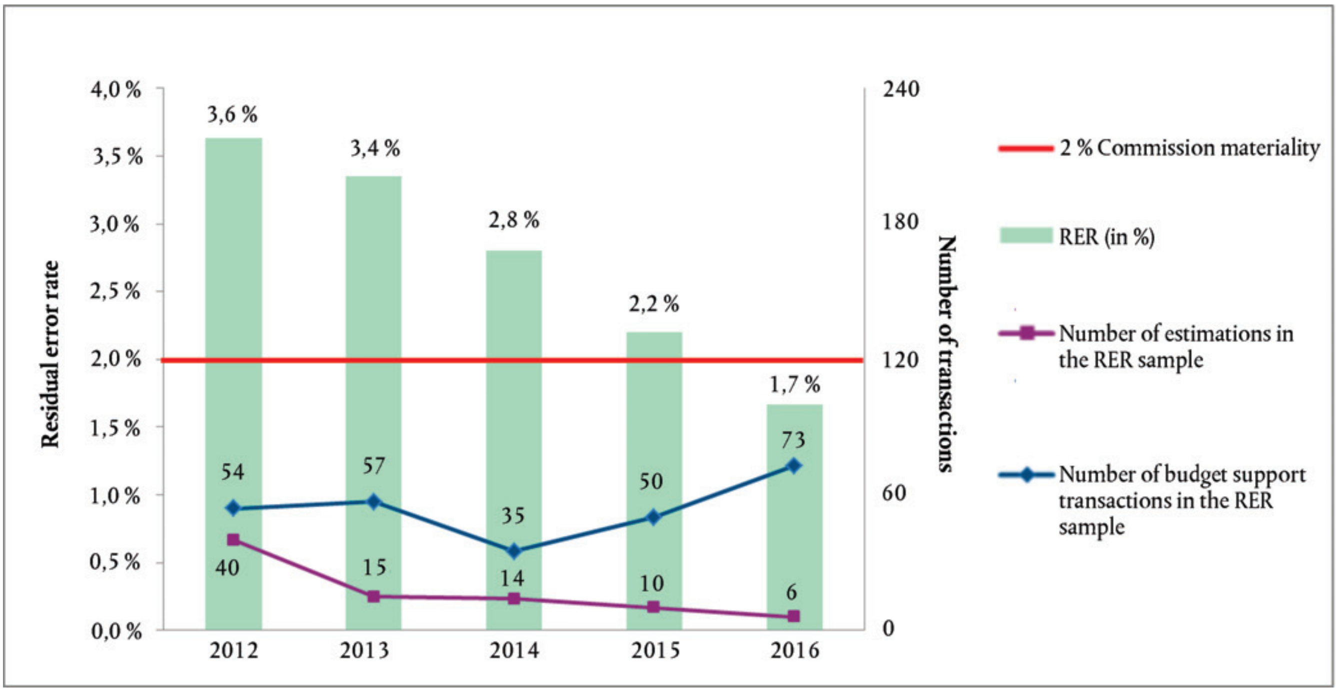
(c) *From the Commission's point of view, there is no direct correlation between the share of budget support transactions in the RER sample and the level of error rate. The number of Budget Support items in the sample is purely dependent on the monetary unit sampling applied. It is true that budget support contracts are hardly affected by errors, because of the substantial efforts the Commission has made to improve guidance and tackle the risks in line with your recommendations. However, the downward trend in the error rate has not been accompanied by a parallel increasing share in Budget Support transactions in the sample through the years. It can be argued that this may be one of the factors in the current situation of the error rate.*

([30]) 2014: 2,8 %; 2015: 2,2 %; 2016: 1,7 %.

([31]) 2014: 14 estimates; 2015: 10; 2016: 6. According to the RER methodology, estimates should only be used if there is a valid legal or logistical reason for documentation not being available before the deadline for completion of the RER work by the end of the study. Transactions for which documentation has not been provided present an inherently enhanced risk of susceptibility to error and the estimate should be calculated with this in mind.

([32]) 2014: 35 budget support transactions; 2015: 50; 2016: 73, sampled according to their respective weight in the population.

Box 7 — Evolution of DG DEVCO's RER from 2012 to 2016



Source: European Court of Auditors, based on the 2012-2016 RER studies.

THE COURT'S OBSERVATIONS

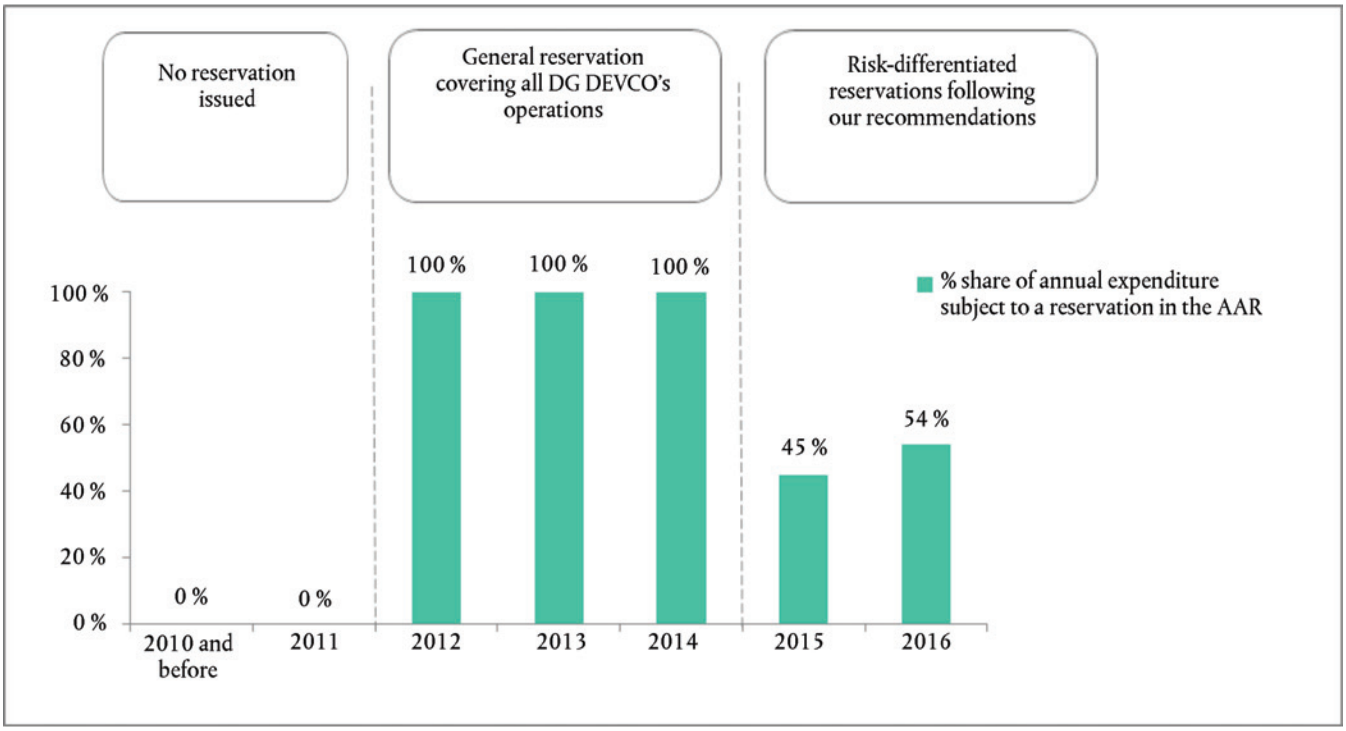
Review of the 2016 annual activity report

33. For the years 2012-2014, the Director-General issued a general reservation on the legality and regularity of transactions for all DG DEVCO's operations. For the first time in 2015, the Director-General made a risk-differentiated declaration of assurance and issued a reservation targeting two spending areas identified as high risk: (i) grants under direct management and (ii) indirect management via international organisations.

34. In 2016, DG DEVCO extended the reservation to grants and programme estimates under indirect management. Despite the 2016 RER being below the 2 % materiality threshold, this was done in consideration of all elements in the DG DEVCO's assurance-building process ([33]). The reservation issued is in line with our own recommendations and observations in both this and previous annual reports.

([33]) This includes a risk analysis of the past RER and ECA errors.

Box 8 — DG DEVCO's progress towards a risk-differentiated declaration of assurance



Source: European Court of Auditors, based on DG DEVCO's annual activity reports.

THE COURT'S OBSERVATIONS

35. DG DEVCO estimated the total amount at risk at the time of payment ([34]) for expenditure accepted in 2016 (5 393 million euro) to be 105 million euro (1,9 % of 2016 expenditure). Of this amount, it estimated that 25 million euro (24 %) would be corrected by its checks in subsequent years ([35]).

([34]) 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.

([35]) See DG DEVCO's 2016 annual activity report, p. 50.

THE COURT'S OBSERVATIONS

36. The 2016 figure ([36]) (25 million euro) was half the 2015 estimate due to DG DEVCO's efforts to exclude from the calculation recoveries on prefinancing, cancelled recovery orders and earned interest, as we recommended last year. Nevertheless, the reliability of the 2016 figure is still impaired (i) by detected errors that have not been fully extrapolated to the untested population of recovery orders in 2016 and in previous years ([37]); and (ii) because the calculation has not been reconciled with the EDF financial statements ([38]). It is difficult to quantify the overall extent of these shortcomings ([39]).

THE COMMISSION'S REPLIES

36. *Measures taken by DEVCO for preventing and correcting errors in the encoding of recovery context are presented in paragraph 14. These efforts will be pursued in 2017. Furthermore, DEVCO will make sure that potential errors still detected in the future will be fully extrapolated to the untested population of recovery orders taken into account in the estimation of the corrective capacity.*

The system bug which caused the recording of recovery orders without recovery context field (none or qualified) will be resolved during 2017 and thus was a one-off event. This will be achieved through a correct use of the recovery context functionality in accordance with the instructions issued (e.g. recovery context manual) and via the implementation of necessary business rule in the Commission's accounting system.

CONCLUSION AND RECOMMENDATIONS

Conclusion

37. The overall audit evidence indicates that the EDFs' accounts for the financial year ending 31 December 2016 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.

([36]) The 2016 corrective capacity was calculated as the average annual amount of recovery orders issued for errors and irregularities between 2010 and 2016.

([37]) DG DEVCO checked a large sample of 2016 recovery orders and concluded that approximately 50 % of all recovery orders affecting the corrective capacity had been wrongly booked. The 2010-2015 recovery orders used in the calculation were thus adjusted by the same percentage. During our review, we found other errors that had not been taken into account, which would increase the percentage of wrongly booked recoveries to at least 62 %.

([38]) The population of 2016 recovery orders did not include recovery orders without any recovery context due to a technical problem in the Commission's accounting system.

([39]) The maximum potential impact of these shortcomings does not affect our opinion on the reliability of the EDF accounts.

THE COURT'S OBSERVATIONS / THE COMMISSION'S REPLIES

38. The overall audit evidence indicates that, for the financial year ending 31 December 2016:

(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 16 to 26). Our testing of transactions produced an estimated level of error of 3,3 % (see ***Annex 1***).

Recommendations

39. ***Annex 3*** shows the findings of our follow-up review of the five recommendations we made in our 2013 annual report ([40]), all of which DG DEVCO had implemented in full ([41]).

40. Based on this review and our findings and conclusions for 2016, we recommend that DG DEVCO:

— **Recommendation 1:** strengthen the monitoring of old open expired EDF contracts in order to further reduce their number.

The Commission accepts the recommendation.

— **Recommendation 2:** complete the revision of the terms of reference for all its audits and expenditure verifications by the end of 2017.

The Commission accepts the recommendation. Work is already under way.

— **Recommendation 3:** extend the actions in its 2017 action plan to also cover grants and programme estimates under indirect management in the AAR reservation.

The Commission accepts the recommendation. The fact of issuing a reservation concerning those two areas implies already the definition of specific actions for them.

— **Recommendation 4:** consider reducing the extent of the RER substantive testing of individual low-risk budget support transactions and reallocating the saved resources to increase the substantive testing of project-related transactions.

The recommendation is accepted. The Commission will consider the approach proposed by the Court and, if relevant, introduce it into the RER methodology.

— **Recommendation 5:** further improve the calculation of the 2017 *corrective capacity* by addressing the shortcomings identified in this annual report.

The recommendation is accepted.

([40]) We chose our 2013 report for this year's follow-up exercise as, typically, enough time should have elapsed for the Commission to have implemented our recommendations.

([41]) 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.

ANNEX 1

RESULTS OF TRANSACTION TESTING FOR THE EUROPEAN DEVELOPMENT FUNDS

	2016	2015
SIZE AND STRUCTURE OF THE SAMPLE		
Total transactions	**143**	140
ESTIMATED IMPACT OF QUANTIFIABLE ERRORS		
Estimated level of error	**3,3 %**	3,8 %
Upper error limit (UEL)	5,6 %	
Lower error limit (LEL)	1,0 %	

ANNEX 2

OVERVIEW OF ERRORS WITH AN IMPACT OF AT LEAST 20 %

THE COURT'S OBSERVATIONS

Introduction

Applying the general audit methodology set out in Annex 1.1 to chapter 1 of the Court's 2016 annual report on the implementation of the budget, we tested a representative sample of transactions to estimate the level of *irregularity* within the population for the EDFs. The errors we detected in testing do not constitute an exhaustive list — either of individual errors or of possible error types. The findings outlined below concerning errors with an impact of at least 20 % of the transaction value examined are presented by way of example ([1]). These errors were found in transactions worth between 128 000 euro and 11,8 million euro, with a median ([2]) value of over 4,8 million euro.

Examples of error ([3])

Non-compliance with procurement rules

Example 1 — Incorrect evaluation of tender for constructions works

We examined the Commission's clearance of spending on construction works of a polyclinic in the Caribbean. The procurement for this project did not comply with the principles of transparency and equal treatment, nor did it follow the Commission's own procurement rules. Even though in our view the lowest bid fulfilled all selection criteria, it was rejected, because of concerns about the bidder's technical capacity to perform the work. We did not see proper justification for this decision. The notification letter gave the bidder the wrong reason for rejection. At the time of our examination, the Commission explained that the lowest bidder had not provided sufficient evidence of the minimum financing to carry out the work. However, the second lowest bidder, to whom the contract was awarded, also fell 10 % short of the minimum credit requirement. The evaluation committee gave the second lowest bidder the opportunity to provide more information on this selection criterion. This possibility was not given to the first bidder. Taken together, all these flaws constitute a serious *public procurement* error (quantification 100 %).

THE COMMISSION'S REPLIES

According to the conclusions of the evaluation report, the evaluation committee considered the lowest bid to be non-compliant, as it did not have sufficient technical capacity to execute the contract along with the other two contracts already awarded by the contracting authority. The lowest bid also fell short of the minimum credit requirement.

([1]) These errors account for more than half of the overall estimated level of error.

([2]) I.e. half of all errors with an impact of at least 20 % were found in transactions worth less than 4,8 million euro, and the remainder in transactions worth more than this amount.

([3]) Two further examples of error are presented in ***Box 5*** of the main text.

THE COURT'S OBSERVATIONS

THE COMMISSION'S REPLIES

Example 2 — Lack of documentation on the public procurement procedure

We examined the Commission's final clearance of spending on a project providing technical assistance to improve the administration of EU-funded projects in Grenada. The payment claim included several items relating to a consultancy service contract. We did not receive the full procurement files for this contract and were thus unable to verify that the procurement rules had been followed as laid down in the project's general conditions. The ineligible costs resulted in an error rate of 30 % of the total costs tested.

The Commission is following up on the ECA's finding.

Expenditure not incurred

Example 3 — Expenditure not incurred by the beneficiary

We examined the Commission's clearance of spending on a project implemented by an international organisation to support private sector development in ACP countries. When verifying the full amount of the accepted expenditure, we noticed that it consisted of letters of guarantee issued by the international organisation and management fees for the full duration of the contribution agreement. The bank guarantees had not been enforced by the investors, meaning the beneficiary incurred no actual costs. In addition, the contract's execution period is 20 years, and future management fees cannot be charged in advance. The ineligible costs resulted in an error rate of 98 % of the total costs tested.

The Commission has taken relevant remedial measures: the contested clearance has been cancelled.

Essential supporting documentation not provided

Example 4 — Insufficient supporting documentation

We examined the Commission's interim clearance of spending on a project supporting trade and agriculture in Tanzania. For the majority of the expenditure items tested, either we did not receive any supporting documentation or the documents provided were insufficient, for example they did not cover the full amount of the item. We were therefore unable to verify the eligibility of these items. The ineligible costs resulted in an error rate of 45 % of the total costs tested.

Following the Court's visit, the Commission is still in the process of obtaining additional documentation before the final amount due is established.

THE COURT'S OBSERVATIONS

Example 5 — Insufficient supporting documentation, ineligible costs

We examined the Commission's final clearance of spending under a grant agreement to provide financial services to rural areas, implemented by a non-profit organisation in Malawi. We noted several issues in the payment claim. Not all supporting documents (such as payslips or proof of payment) were provided for the audit of salary payments, and ineligible costs, namely import duties, had been included in the claim. In addition, in some cases the procurement procedure did not observe the principles of transparency and non-discrimination. The ineligible costs resulted in an error rate of 44 % of the total costs tested.

Incorrect calculation of expenditure claimed

Example 6 — Errors in the calculation of the fees charged

We examined the Commission's spending on a trust fund administered by an international body. The cost claim included technical consultant fees. The contract for these services specified that the consultancy company should convert daily working hours to months on the basis of a 30 working-day month. Instead, the company used a 21 working-day month, which resulted in an increase in the fees charged. In addition, travel time and overtime were charged, in breach of the contract terms. The ineligible costs resulted in an error rate of 25 % of the total costs tested.

THE COMMISSION'S REPLIES

The Commission will take the required actions in order to recover those amounts that are considered ineligible.

The Commission will take the required actions in order to recover the amounts that are considered ineligible.

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				
2013	**Recommendation 1:** EuropeAid should ensure that all authorising officers by sub-delegation recover interest generated by pre-financing over 750 000 euro annually (2013 annual report, paragraph 51, recommendation 1).	x						
	Recommendation 2: EuropeAid should, by the end of 2014, complete the development of the CRIS system to allow interest on pre-financing of between 250 000 and 750 000 euro to be recognised as financial revenue (2013 annual report, paragraph 51, recommendation 2).	x						
	Recommendation 3: EuropeAid should revise the quantification of benefits of controls implemented (2013 annual report, paragraph 51, recommendation 3).	x						
	Recommendation 4: EuropeAid should report in the AAR on progress in the implementation of the action plan to address weaknesses in the control system (2013 annual report, paragraph 51, recommendation 4).	x						
	Recommendation 5: EuropeAid should disclose in the AAR the scope of the RER study and the estimated lower and upper error limits (2013 annual report, paragraph 51, recommendation 5).	x						

ISSN 1977-091X (electronic edition)
ISSN 1725-2423 (paper edition)

Publications Office of the European Union
2985 Luxembourg
LUXEMBOURG

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