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EUROPEAN COURT OF AUDITORS

Landscape review

Making the best use of EU money: a landscape review of the risks to the financial management of the EU budget

2014

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Executive summary

I

Landscape reviews are a new product of the European Court of Auditors (the Court). They consider broad themes based on the Court's output and accumulated knowledge and experience. They are intended to serve as a basis for consultation and dialogue with the Court's stakeholders. They enable the Court to make observations on important matters which might not ordinarily be subject to audit. The first landscape review addresses issues of EU accountability and public audit arrangements. This second landscape review examines risks to the financial management of the EU budget.

II

Good public expenditure requires that taxpayers' money is spent on priorities decided as worthwhile and desirable by society (through their elected representatives), that it achieves its stated objectives in an efficient, effective and economic manner, and that checks and balances ensure proper democratic accountability and effective governance.

III

For too long the emphasis has largely been on spending the EU budget according to the rules established for its use, without paying sufficient attention to whether it provides value for money and results in EU added value, whereby clear and visible benefits arise for the EU and for its citizens which could not be achieved by spending only at the national, regional or local levels.

IV

This Executive Summary stems from a more detailed report which analyses the issues raised in more depth. Underpinning both documents is a series of fact sheets, providing more detailed information on the sources of EU revenues, on the different categories of budget expenditure (known as the multiannual financial framework (MFF) headings) and on the public procurement process.

V

The risks to good financial management are that the EU budget:

(a) is not spent as intended, for the purposes and according to the rules established by the budgetary authority (legality and regularity of expenditure);

(b) will not be accounted for properly in the annual financial accounts (reliability of accounts)[1];

(c) is not spent wisely, according to the principles of sound financial management (economy, efficiency and effectiveness); and

(d) EU spending may not add value and the expected benefits may not materialise (EU added value).

VI

Managing these risks well should result in good quality expenditure, i.e. effective and economic expenditure spent efficiently and in accordance with the rules. However, the Court has identified a number of key matters which merit specific mention and are developed in the following paragraphs:

Eligibility rules and other conditions for receiving EU support

VII

Most EU funds are provided to businesses or citizens who apply for grants and subsidies. The rules for paying out the money from the EU budget and the conditions for receiving it are set out in legislation, and often complemented by other eligibility criteria and conditions set by those managing EU funds in the Member States. These additional requirements may be unnecessary, and impose an administrative burden. Control systems at various levels may not be sufficient to check compliance with all the conditions.

1 As the Court has given a positive opinion on the reliability of the accounts since 2007, the landscape on financial management risks will not cover this topic.

VIII

Complex eligibility rules and other conditions can lead to poor targeting of EU funds and sub-optimal use of the EU budget: potential beneficiaries may be put off from applying for support from the EU budget; complex rules make it more difficult and costly for administrators to make sure both that the applications and payments are correct, and that all the conditions for receiving the support have been met.

IX

Although the Commission is taking steps to reduce and simplify legislation, Member States' authorities and other beneficiaries still face difficulties. In some budget areas there are too many layers of rules. This may lead to differing interpretations and thus inconsistent application of rules.

Application of public procurement rules and procedures

X

Public procurement is the purchasing of goods, services and works by public organisations. The EU public procurement directives aim to promote integration of the EU economy ('the internal market') by facilitating cross-border contracting and purchasing and making these processes transparent. Generally those public administrations receiving support from the EU budget have to follow public procurement rules and procedures, and apply the general rules of transparency (openness) and equal treatment of potential suppliers in their purchases. Not following these rules and procedures may result in higher costs to the public purse, poor competition, the rejection of legitimate bidders, or additional costs and delays due to cancellation of contracts.

XI

The results of the Court's audit work shows that many of the errors found by the Court relate to the poor application of procurement rules and procedures. This may occur deliberately, in order to favour some suppliers over others, or inadvertently because the rules are not well understood.

Capacity of Member States' authorities to manage and spend EU monies

XII

Member States' authorities have responsibility to ensure that subsidies and grants are paid to eligible beneficiaries and that undue payments are recovered appropriately. The costs of setting up the bodies and systems that administer EU monies are shared between Member States and the EU, with the former having some discretion as to how they are organised.

XIII

EU funds are spent via 28 national administrations and many regional and local authorities with unequal administrative capacity (skills and resources). This increases the risk of errors occurring, as well as the risk of poor quality spending. It may also slow down the implementation of EU-funded activities and projects, affect the quality of regulatory activities and hamper the exchange of information between the Commission and Member States.

Coordination of EU and national budgets, with pressure to spend EU funds

XIV

The annual nature of the EU budget can cause problems with the funding of actions that are carried out over a number of years. It takes time to translate funding decisions into concrete priorities and actions. Moreover, the EU and national budgetary processes are separate: they are carried out by different actors with different priorities, and follow different cycles. This may lead to duplications, gaps or contradictions between the EU and national budgets.

XV
Many activities and projects are financed from both the EU and national budgets ('co-financed expenditure'), on condition that both the EU budget and national budget are available. Austerity measures in Member States may result in national funds being significantly reduced or not being available at all to carry out the actions. Furthermore, the sustainability of EU-funded actions may also be problematic once EU funds are no longer available.

XVI
Because there is so much emphasis on spending the EU budget ('the input-orientated approach'), those managing the activities and projects often focus on compliance with the conditions for getting and using the money, regardless of the results achieved.

Impact of annual EU budgets on activities and cash flow management

XVII
Member States' authorities, other intermediaries and beneficiaries may receive cash advances ('pre-financing') to start up their activities. Unnecessarily long periods of pre-financing can increase the possibility of error and loss, and make it especially difficult to reorientate activities to achieve objectives. As there are long time limits for submitting cost claims, problems are only apparent in later years when it may be too late to correct them.

XVIII
Member States will be required to contribute 1 234 billion euro in the future to cover disbursements of commitments. This amount consists of 908 billion euro agreed for the MFF 2014–20 (payments), and an additional 326 billion euro, being disbursements for commitments under previous MFFs which may affect the Commission's ability to meet all requests for payments in the year in which the requests are made.

Benefits from spending from the EU budget — 'EU added value'

XIX
Expenditure from the European Union budget within the Union should offer clear and visible benefits for the EU and for its citizens which could not be achieved by spending only at national, regional or local level.

XX
However, in some cases, the EU budget may do no more than simply increase total funds available, without adding a particular EU dimension; EU funds may be used for activities that would have been carried out by the Member States and other beneficiaries anyway ('deadweight'); or these funds may be insufficient to achieve the intended outcomes.

Quality of data and information

XXI
The Commission coordinates many actors involved in spending the budget, and cannot always impose standardised processes and management systems. The challenge is to ensure that the right data is collected from intermediaries on a timely basis and that it can be checked effectively.

XXII
Furthermore, the Commission's monitoring, financial and performance management is often based on limited, incomplete or unreliable information.

Expenditure not chargeable to the EU budget, and audits

XXIII
Expenditure that is not chargeable to the EU budget should generally be clawed back ('recovered') from the beneficiaries. The Commission can also apply 'corrections' to the expenditure claimed from the EU budget by Member States, in effect rejecting that spending as chargeable to the EU budget, so that it has to be borne by the national budget. However, such corrections are complicated to administer and provide little incentive to Member States to address weaknesses in their systems. In some categories of spending, notably the cohesion policy, Member States may substitute rejected expenditure with eligible spending.

XXIV
The Commission cannot directly and systematically check all parts of the EU budget spent by Member States, other countries, international organisations, nor the expenditure declared by beneficiaries. It relies on independent auditors to certify the expenditure concerned, and on the limited checks and inspections carried out by its own operational staff and auditors.

XXV
However, the certification of expenditure by independent auditors may be affected by the quality and timeliness of their work, or their independence. The Commission's own checks may be affected by weaknesses in its control strategy.

What are the opportunities and what needs to be done?

XXVI
Both the Commission and the Member States are responsible for ensuring that EU funds are spent well and wisely and in recent years, both have already successfully undertaken many measures to ensure this.

XXVII
Nevertheless, the start of the new financial framework in 2014, the introduction of related implementing legislation and the new financial regulation, together with the Commission's commitment to ensure that the budget is more performance oriented, all provide opportunities for simplifying and improving the financial management of the EU budget.

XXVIII
In order to benefit from the opportunities mentioned above, all actors dealing with the EU budget in their respective domains should focus on:

— results and EU added value;

— performance management;

— budgetary management;

— control arrangements and the work of others; and

— mid-term review of the MFF.

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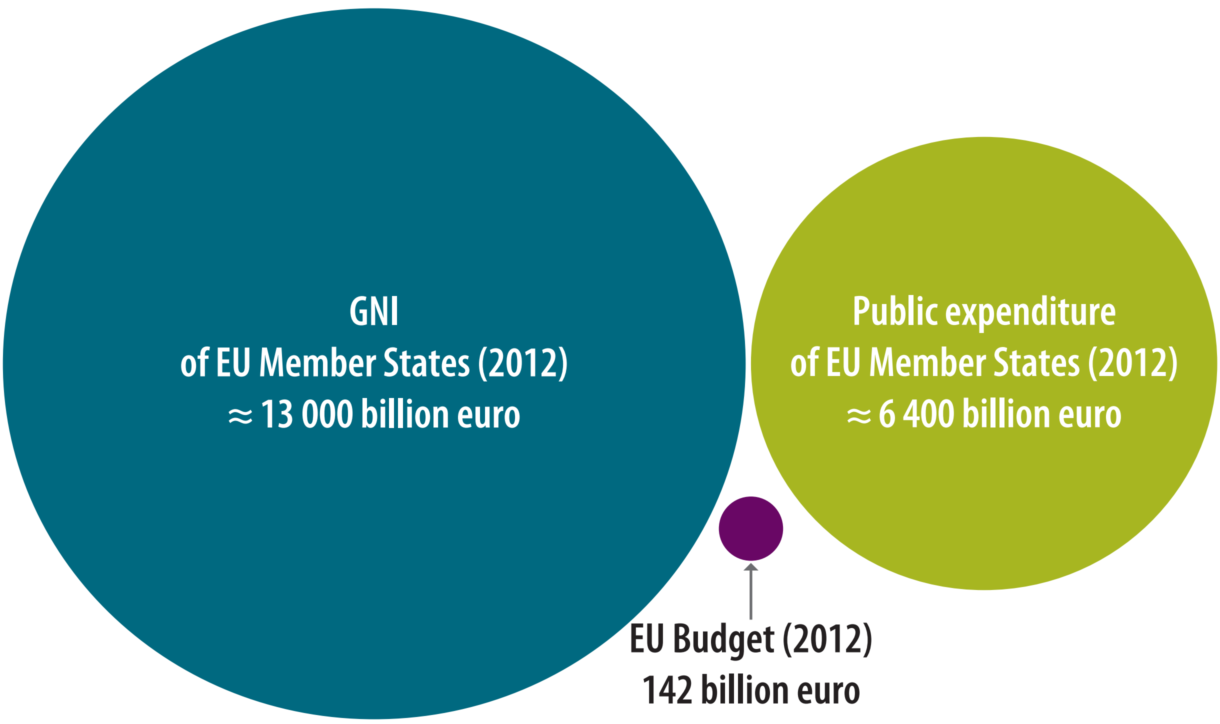
Introduction

01

Member States' contributions to the EU general budget (EU budget) are pooled and used to promote programmes and actions that support and further EU policy objectives. The budget complements legislative action taken by the European Commission (Commission) and other European institutions to promote the Treaty and EU objectives. The annual EU budget is small in comparison with the total revenues and public expenditures of the Member States: it represents just over 1 % of their combined gross national income (GNI), and is approximately 2 % of their total public expenditure (see ***Diagram 1***). It is also a fraction of the support that has been put forward for the financial and sovereign debt crises.

Diagram 1

The EU budget is a small part of Member States' resources and public expenditure (2012)



Source: Eurostat.

02

The financial crisis and the sovereign debt crisis have raised challenging questions about the role and development of the EU, and what it means to be part of the EU. The lengthy discussions before the approval of the 2014–20 multiannual financial framework (MFF) (see ***Box 1***)[1], the Member States' reluctance to increase the budget for payments[2], have shown that there is little appetite for EU funding that is perceived to promote the 'European project' over national exigencies.

03

The governments of the Member States and the European Parliament expect a high degree of transparency from the EU budget. The European Court of Auditors (Court)'s negative Statement of Assurance (DAS) opinion (see ***Box 2***) on EU spending for each of the last 19 years poses a problem for the EU. In particular, the negative opinion can inadvertently promote the perception that the errors reported indicate that the spending of the EU budget is seriously affected by fraud and corruption, adversely affecting public confidence in the EU institutions[3].

04

The governments and taxpayers of the Member States want to see better value being achieved for the funds they contribute to the EU budget: they want to see that it is spent properly and is well managed, that it is used for the purposes approved by the European Parliament and Council, and that it results in the desired outcomes.

05

Drawing on its 35 years' experience of auditing EU revenue and expenditure, this landscape review on the risks to financial management of the EU budget provides an overview of EU financial flows, and gives a summary of issues to be addressed to ensure that, among other things, the EU taxpayer gets better value for money from the EU budget. It is presented in three parts:

(a) an executive summary which gives an overview of the main issues;

(b) this detailed report which sets the context, and provides information on the EU budget, the actors involved in spending the EU monies and other financial flows;

(c) individual fact sheets for each of the main MFF headings, of sources of EU revenue, and public procurement which summarise the main characteristics and issues.

1 Agreement of the 2014–20 MFF took 2 ½ years. It was approved by the European Parliament on 19 November 2013, and adopted by the Council on 2 December 2013.

2 See Annual Report concerning the financial year 2012, paragraphs 1.51 to 1.53 (OJ C 331, 14.11.2013).

3 See Opinion No 1/2010 Improving the financial management of the EU Budget: risks and challenges (http://eca.europa.eu); and the Court's response to the Commission's communication 'Reforming the Budget, Changing Europe'.

Box 1

The multiannual financial framework

The multiannual financial framework (MFF) translates the Union's political priorities into financial terms for at least 5 years (Article 312 of the Lisbon Treaty). The MFF sets out the annual maximum amounts (ceilings) for EU expenditure as a whole and for the main categories of expenditure (headings). It is not as detailed as an annual budget. By specifying the spending limits for each category of expenditure, the MFF imposes budgetary discipline and ensures that the EU's expenditure develops within the limits of the EU budget own resources and in line with the EU's policy objectives. In addition, this system ensures a predictable inflow of resources for the EU's long-term priorities and gives greater certainty to beneficiaries of EU funds. The MFF 2014–20 sets the maximum budget commitments for the period at 960 billion euro and payments at 908 billion euro (at 2011 prices).

Box 2

Statement of assurance (DAS)

DAS — statement of assurance on the reliability of the EU financial accounts, and on the legality and regularity of the underlying transactions. The TFEU (Article 287) requires the Court to examine whether all revenue has been received and all expenditure incurred in a lawful manner and whether the financial management has been sound.

The DAS type audit opinion on both the reliability of the accounts and the legality and regularity of underlying transactions is rare. Few countries require their national auditors to give such an opinion, and in all likelihood, Member States' own auditors would not be in a position to issue a positive DAS type opinion on their own government's budget. For example, the UK's National Audit Office provides qualifications to their audit opinion on the reliability of whole of the government financial accounts, but it does not give a legality and regularity type opinion. Similarly, the US Government Accountability Office states that it is not in a position to give an opinion on the USA government's financial statements.

What are EU finances and how are they administered?

EU budget

06

Annual EU budgets are based on the MFF, which sets the EU's spending priorities in five broad policy categories ('headings') for a given period (*see* ***Table 1*** *and* ***Diagram 2***):

(a) For each year of the given period, the MFF sets the maximum annual amount for each heading, and fixes an overall annual ceiling on the amounts that the Commission can commit and pay (commitment and payment appropriations). The payment budget de facto sets the maximum amount that the Commission can request from Member States in order to meet its cash disbursements.

(b) As agreed in the MFF negotiations, the annual EU budget reserves national envelopes for each Member State in the expenditure areas of rural development, fisheries, and cohesion policy ('pre-allocations'). Similarly, EU budget ceilings for agricultural expenditure reserve the total annual subsidies that can be paid for each Member State. In this manner, 80 % of the MFF available for the benefit of Member States and the annual EU budget is already pre-allocated to the Member States.

Table 1

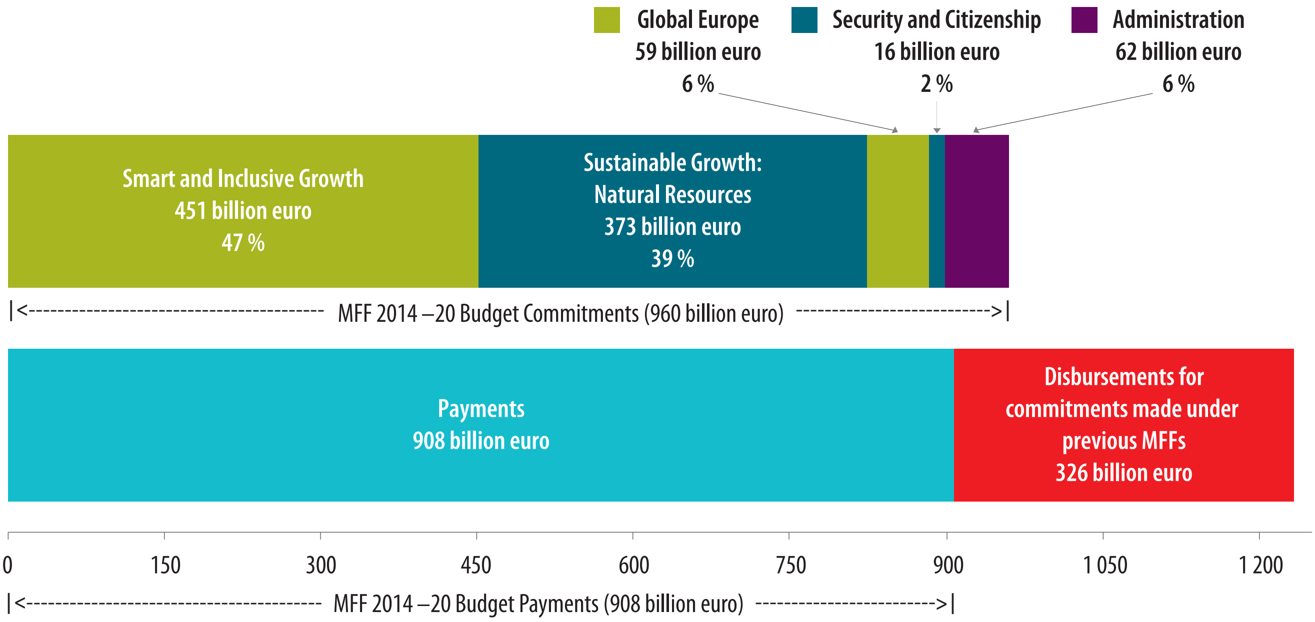
MFF 2014–20

(billion euro)

MFF Heading	Commitments	Pre-allocations and national ceilings	%
1. Smart and inclusive growth	450,8	322,3	71
2. Sustainable growth: natural resources	373,2	353,2	95
3. Security and citizenship	15,7		
4. Global Europe	58,7		
5. Administration	61,6		
Total MFF	**960,0**	**675,5**	**70**
Of which available for Member States	**839,7**	**675,5**	**80**
Reserves	10,0		
EDF	30,5		
Total outside MFF	**40,5**		
Total MFF and outside	**1 000,5**	**675,5**	**68**

Diagram 2

The multiannual budget (MFF) for 2014–20



Source: ECA figures based on Commission information.

07

Under agreements, in the context of the financial crisis and the MFF 2014–20, the EU budget should be aligned with the EU policy priorities to boost growth and create jobs[4]. The Europe 2020 strategy defines five key targets for the EU to achieve by 2020, using funds from both the EU budget and national budgets. Namely:

(a) increase employment: 75 % of 20–64 year-olds to be employed;

(b) improve education levels: reduce drop-out rates to less than 10 % for early school leavers, and increase post-secondary education so that at least 40 % of 30–34 year-olds complete third level education;

(c) improve conditions for research and innovation: 3 % of the EU's gross domestic product (GDP) to be invested in R & D;

4 EU strategy for economic growth agreed by the European Council of 17 June 2010.

(d) promote social inclusion by reducing poverty: at least 20 million fewer people in or at risk of poverty and social exclusion; and

(e) reduce greenhouse emissions (climate/energy): greenhouse gas emissions 20 % (or even 30 %, if the conditions are right) lower than in 1990, 20 % of energy from renewables and a 20 % increase in energy efficiency.

08

In addition to the annual EU general budget, the Commission manages:

(a) The European Development Funds (EDFs) (approximately 3 billion euro for 2013, 27 billion euro for 2014–20). While Member States' contributions to the EDF budget are agreed in intergovernmental negotiations outside the EU general budget procedure, the EDF may be incorporated in the EU budget in the next MFF (see factsheet on global Europe). The Commission manages EDF-funded operations using resources allocated in the form of non-repayable aid. The European Investment Bank (EIB)[5] manages the Investment Facility and interest rate subsidies.

(b) lending and borrowing operations of approximately 57,2 billion euro at the end of 2013[6]. Under specific, authorised circumstances, the EU (represented by the Commission) can borrow funds in order to lend them to countries in order to fulfil its Treaty mandate.

(i) the funds borrowed are guaranteed by the 28 Member States. They are lent 'back to back' to the beneficiary country, with exactly the same conditions at which they were borrowed, so that the Commission does not incur any interest rate or foreign exchange risk;

(ii) there are three main instruments — the Balance of Payments facility (BoP, which provides financial assistance to non-euro countries, with loans of 11,6 billion euro at 31 December 2013 to Hungary, Latvia and Romania); the European Financial Stabilisation Mechanism (EFSM, which provided financial support to all Member States, with loans of 44,5 billion euro at 31 December 2013 to Ireland and Portugal. It now makes no new loans, its support activities being replaced by support from the EFSF and subsequently the ESM — see paragraph 10 below); and the Macro-financial assistance facility (MFA, which supports partner countries outside Europe but geographically close to it, with loans of 0,6 billion euro at 31 December 2013);

(iii) In addition, there are also Euratom loans made to Member and non-Member States to finance projects related to energy installations (0,4 billion euro at 31 December 2013) and European Coal and Steel Community (ESCS) promissory notes of 0,2 billion euro as at 31 December 2013).

5 The EIB is owned by the Member States, and finances capital projects which further EU objectives. Approximately 90 % of its loans are to Member States, and the remaining 10 % to 150 other countries. EIB loans may be combined with grants from the general budget and the EDF. The European Investment Fund is part of the EIB family, and provides venture capital and guarantees to SMEs.

6 See Provisional consolidated annual accounts of the European Union, financial year 2013, note 7.1 — financial support mechanisms, borrowing and lending activities managed by the Commission.

(c) long-term liabilities related mostly to pension and employee benefits (45,7 billion euro as at the end of 2013). While staff contribute one third of the expected cost of these benefits from their salaries, the Member States jointly guarantee the payment of these benefits, and will be called upon to finance them in the future.

(d) the Guarantee Fund for external actions, to cover defaults on loans made to non-EU countries by the EIB;

(e) special instruments falling outside the budget, for use in emergencies and exceptional circumstances for up to 1,4 billion euro each year (Emergency Aid Reserve, European Union Solidarity Fund, Flexibility Instrument and European Globalisation Adjustment Fund).

Specific actions in response to the financial and sovereign debt crisis

09

The Member States have greater coordination of economic policies within the European Semester (see ***Box 3***), and have to translate EU guidance and rules into their annual policy and budgetary choices.

10

In light of the sovereign debt crisis, the euro area countries set up intergovernmental financial stability mechanisms (the European Financial Stability Facility (EFSF[7]) and its successor the European Stability Mechanism (ESM[8])). The Commission is responsible for negotiating and monitoring compliance with the policy conditions set for the financial assistance under these mechanisms. However, these loans are not guaranteed by the EU budget and are not included in the EU accounts[9].

7 Under the EFSF 152,8 billion euro is loaned to three countries: Ireland, Portugal and Greece. The EFSF stopped making new loans after 1 July 2013. Euro countries in need of assistance will be able to borrow from the ESM, which has a lending capacity of 500 billion euro.

8 The ESM is set up and owned by the euro countries. Any euro country in need of assistance will be able to borrow from the ESM, which has a lending capacity of 500 billion euro.

9 In addition, the Commission manages the pooled bilateral loans from euro area countries to Greece. These have no impact on the EU budget, and are neither included nor mentioned in its financial statements.

Box 3

The European Semester

All Member States should reflect their commitment to achieve the Europe 2020 targets in their national targets and growth enhancing policies. The European Semester is a yearly cycle of economic policy coordination to ensure that individual efforts of Member States are coordinated and focused in order to have the desired impact on growth. Each year, the Commission undertakes a detailed analysis of the countries' economic and structural reform programmes, and provides country specific recommendations for the next 12–18 months. The Council discusses and formally adopts these recommendations, which are endorsed by the European Council. Policy advice is thus given to Member States before they finalise their national budgets for the next year. Policy warnings may be issued if the recommendations are not acted on within a given time frame.

11

The European Central Bank (ECB) is outside the EU budget:

(a) The ECB is owned by all the Member States' national central banks (NCBs), their respective shares being based on data provided by the Commission[10].

(b) During 2014, the ECB will take on responsibility for the single supervisory mechanism and will have the power to supervise and intervene in any credit institution in the participating Member States (the 18 euro countries, and non-euro area countries that have the right to opt in). In practice, the ECB will directly supervise the around 130 biggest banks in the euro area while others will remain under the remit of national authorities.

The complex EU budgetary system

12

The EU budget is spent in a complex environment (see ***Diagram 4***):

(a) There are over 30 policy areas, a wide range of objectives and many activities. Thousands of projects are funded using an array of instruments (grants, subsidies, loans, guarantees, direct budget support to countries outside the EU, and innovative financial instruments and other mechanisms to leverage EU funds). Final beneficiaries include individuals, companies, universities, public–private partnerships and government organisations.

(b) It involves actors from both within the Member States (at national, regional and local levels), countries outside the EU and international organisations, as well as various Commission departments (known as 'directorates-general'), agencies and other EU bodies (other EU institutions, the European Investment Bank (EIB), the European Investment Fund (EIF)), and organisations in which the EU participates (for example, the European Bank for Reconstruction and Development (EBRD)[11] and joint undertakings).

(c) Member States are responsible for spending approximately 80 % of the EU budget under shared management arrangements. Most of this 80 % is reserved for each country in national pre-allocations (see paragraph 6(b) and ***Table 1***). Except for agricultural expenditure, Member States must finance part of the costs of shared management activities themselves (co-financing).

(d) The management mode[12] and whether it is the sole provider of the funds for the actions carried out not only influences the extent to which the Commission can shape the activities undertaken, but also determines the control, audit and accountability arrangements put in place, as well as the information to which it has access.

10 The NCBs' shares in ECB capital are calculated using a key which reflects the respective country's share in the total population and gross domestic product of the EU. These two determinants have equal weighting. The ECB adjusts the shares every 5 years and whenever a new country joins the EU. The adjustment is made on the basis of data provided by the Commission.

11 The EBRD was set up in 1991 to promote entrepreneurship and foster transition towards open and democratic market economies. It works in 34 countries in central Europe, central Asia and the southern and eastern Mediterranean. Shareholders include 64 countries, the European Union and the European Investment Bank. The EU Member States, the EIB and the Commission own approximately 63 % of the EBRD shares.

12 Financial Regulation (applicable from 1 January 2013), chapter 2, methods of implementation (OJ L 298, 26.10.2012, p. 1). There are three management modes (before 2013 there were five). Under direct management, the Commission departments, executive agencies and heads of EU delegations oversee the use of funds; indirect implementation mostly concerns agencies, countries outside the EU and international organisations; under shared management, funds are managed through national implementing agencies, which are separately audited by certifying bodies. The Financial Regulation sets out the audit and control arrangements for each of these implementation modes.

(e) There are many separate programmes, projects and actions serving similar or complementary objectives, to which different management and control rules apply. Multiple funding sources occur across various policy areas (for example, research and innovation projects can be funded from three different sources of EU funding, each with different management and eligibility rules; for external actions, some actions can be funded from both the EU budget and from the European Development Fund (EDF) budget). This multi-funding also exists within individual policy areas[13]. Consequently, when programmes, projects and actions benefit from a range of funding from various sources (EU and national budgets, EIB and others), total costs may not be apparent. Moreover, each source of funding will have its own governance and reporting arrangement[14]. This has sound financial management implications for Member States providing monies through various channels.

(f) The EU budget is set annually, but many of the activities funded are carried out over a number of years. As a result:

(i) cash advances ('pre-financing') are paid to Member States, other intermediaries and beneficiaries when they first start implementing EU-funded programmes. At the end of 2013, the amount of pre-financing disbursed was 79,4 billion euro, most of it for shared management activities by Member States (see paragraph 40);

(ii) there is a substantial gap between the commitment and payment budgets, which has accumulated over the long term, affecting the Commission's ability to meet all requests for payments in the year in which the requests are made[15]. The legal funding commitments that are not disbursed until later (known as *'reste à liquider'* RAL) represented 222,4 billion euro at the end of 2013, most of it for commitments made for cohesion policy spending in the period 2010–14 (see ***Diagram 3***). Together with other liabilities (mostly for purchases and staff pensions) of 103,4 billion euro excluding borrowings, this will require future disbursement from the EU budget of some 326 billion euro in addition to the amounts agreed for the MFF 2014–20 (as at the end of 2013) (see ***Diagram 2***).

(g) In spending the budget, Member States must comply with the rules and regulations agreed for its use at the EU level — which means that there have to be effective mechanisms for these rules to be known or integrated at national, regional and local government levels.

(h) For indirect spending through countries outside the EU, international organisations or the EIB, agreements cover the manner in which the EU budget is spent, as well as reporting and verification rights.

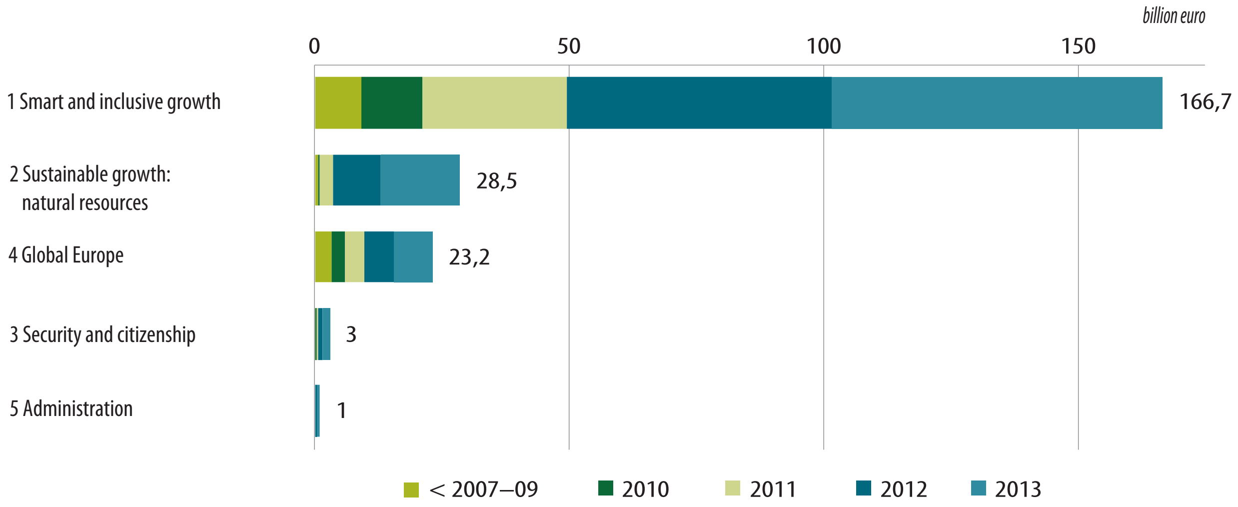
13 Commission staff working paper 'A Budget for Europe 2020: the current system of funding, the challenges ahead, the results of stakeholders consultation and different options on the main horizontal and sectoral issues', p. 9 and 17, under the heading 'A simpler and more transparent budget' (SEC(2011) 868 final, 29.6.11).

14 The implication of EIB and EBRD co-financing from the EU budget follow up study 2013 conclusions 3.3, 3.4 and 5 (report from European Parliament Directorate-General for internal policies, policy department, budgetary affairs D).

15 See Annual Report concerning the financial year 2012, paragraphs 1.51–1.53, 1.58–1.59 (OJ C 331, 14.11.2013).

Diagram 3

Commitments to be disbursed ('RAL') by MFF headings and by year



Source: ECA figures based on Commission information.

13

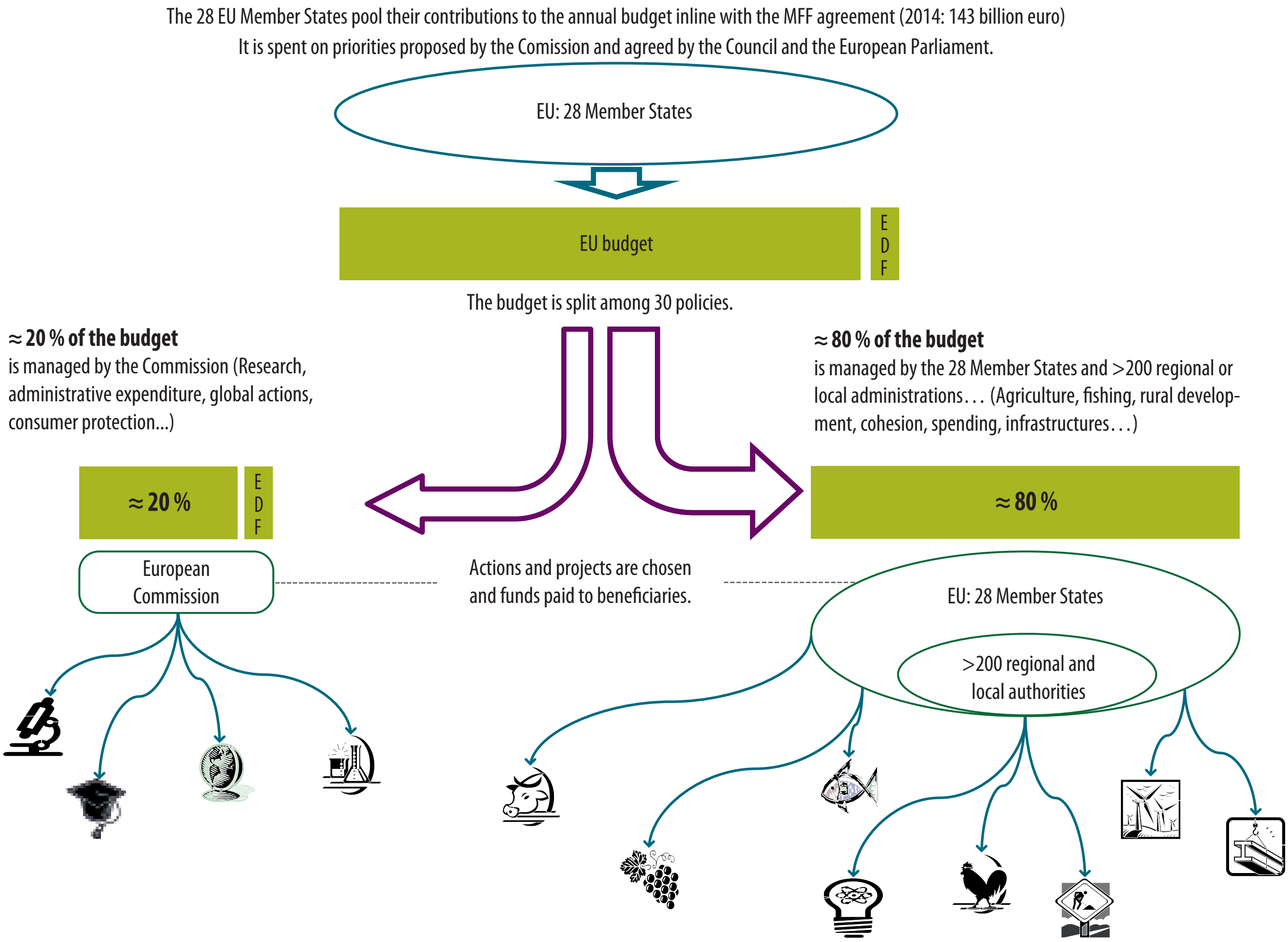
The Commission is ultimately responsible for supervising and implementing the EU budget. It may claw back monies from Member States and others if they are not spent on the agreed purposes and in a proper manner.

14

All these elements together require that roles and responsibilities are clear, that there is good coordination and good communication between the different actors, and that there are strong accountability and control mechanisms in place to ensure that the budget is spent properly and is effective.

Diagram 4

Spending of the EU budget



Source: ECA.

15
Diagram 5 shows the accountability model for spending the EU budget:

(a) The Council and the European Parliament establish the Union's annual budget in accordance with the Treaty provisions[16].

(b) The EU Treaty confers responsibility to the Commission for spending that budget[17]. While most of this budget is spent by the Member States, the Commission is ultimately responsible for the budgetary execution, and reports back to both the European Parliament and the Council on how the budget has been spent.

(c) The Court provides a Statement of Assurance ('DAS') and presents the results of performance audits to the European Parliament and Council[18], which use them as a basis for giving discharge to the Commission for collecting and spending the budget[19].

(d) A similar procedure is used to give discharge to the other EU institutions and agencies for the budget spent by them.

16 TFEU Article 314 'the EP and Council, acting in accordance with the special legislative procedure shall establish the Union's annual budget in accordance with the following provisions'. Article 314.2 'the Commission shall submit a proposal …' and articles 314.3–314.10 set out the adoption procedure.

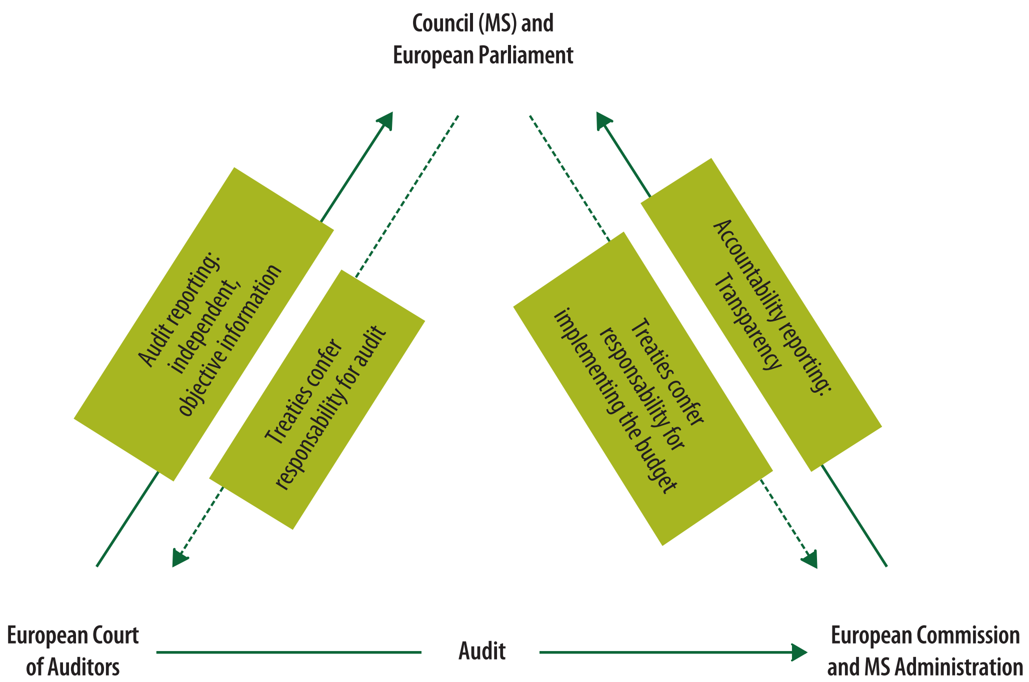
17 Article 17 of the Treaty on European Union; Article 317 TFEU 'The Commission shall implement the budget in cooperation with the Member States …'.

18 Articles 285 and 287 of the TFEU.

19 Article 319 TFEU 'The European Parliament, acting on a recommendation from the Council, shall give discharge to the Commission in respect of the implementation of the budget …'.

Diagram 5

The accountability model for spending the EU budget



Source: ECA.

What are the risks to good financial management?

16
EU funds make a valuable and essential contribution to furthering the Treaty aims. They bolster legislation promoting the Treaty freedoms, the internal market, consumer health and protection, and they give visibility to the EU on the world stage. EU citizens, taxpayers, the governments of the Member States and the budgetary authority legitimately want to see that EU funds are spent properly, wisely and that they have a European added value. However, the EU's achievements go beyond funding. In the last two decades, the EU has met the challenges of integrating 16 new countries, introducing the euro and making a concerted response to the global financial crisis and the sovereign debt crisis in Europe. While some work remains to be done to deepen the internal market, it has been established with little budgetary spending. EU funds have also contributed to the creation and consolidation of structures and networks that bring EU citizens and organisations closer to each other, both physically and culturally, thus furthering European integration.

17
The risks to good financial management are that the EU budget:

(a) is not spent as intended, for the purposes and according to the rules established by the budgetary authority (legality and regularity of expenditure);

(b) will not be accounted for properly in the annual financial accounts (reliability of accounts)[20];

(c) is not spent wisely, according to the principles of sound financial management (economy, efficiency and effectiveness);

(d) EU spending may not add value and the expected benefits may not materialise (EU added value).

20 As the Court has given a positive opinion on the reliability of the accounts since 2007, the landscape on financial management risks will not cover this topic.

18
Managing these risks well should result in good quality expenditure, i.e. effective and economic expenditure spent efficiently and in accordance with the rules. ***Annex I*** provides a detailed list of the types of external, financial and activity risks that can occur in spending the EU budget. If they materialise, they may result in:

(a) failure to deliver on policy or to achieve the intended outcome because the wrong or inappropriate processes are used to get the desired results and impact;

(b) failure to add value, especially at the European level. EU funds may bring some benefits to EU citizens or other recipients, but this expenditure does not have a distinctive EU dimension. Or the results could have been achieved using other funds, or fewer EU funds;

(c) action or inaction damaging to the EU or the Commission's reputation;

(d) failure to use the appropriate management and operational methods to achieve the policy objectives, i.e. the results could have been achieved better, or better results could have been achieved by using other methods;

(e) failure to implement adequate internal control systems to achieve the objectives (taking account of risks related to management, operations, legality and regularity of expenditure, finance, procurement, fraud and other irregularities, use of IT, human resources, assets, health and safety, etc.), or to set performance management systems in place to monitor progress.

19
This landscape review does not cover the following aspects because of their exceptional nature:

(a) fraud and corruption which often imply sophisticated undertakings and collusion between fraudsters attracted by the high financial flows. The Court considers the risk of fraud when planning and carrying out its audits, but it does not systematically and actively search out fraud. This is the remit of the European Anti-Fraud Office (OLAF)[21];

(b) action or inaction that may harm the reputation of the EU or the Commission;

(c) specific actions in response to the financial and sovereign debt crisis, as ground breaking intergovernmental initiatives by Member States (see paragraphs 9 to 11) raise questions about accountability and public audit arrangements, which is the subject of another landscape review of the Court[22].

21 President's letter to the President of the European Parliament 'The European Court of Auditors' View on the Commission's Report on Anti-Corruption Measures' (http://eca.europa.eu).

22 See ECA report 'Gaps, Overlaps and Challenges: a landscape review of EU accountability and public audit arrangements' (http://eca.europa.eu).

Legality and regularity of EU expenditure: spending the money according to the rules

20

This section deals primarily with budgetary expenditure. Details about revenue, which should be guided by the overall objectives of simplicity, transparency and equity according to the European Council of February 2013, can be found in the fact sheet on revenue. The main issues concerning revenue are how the budget should be financed (sources) and the amount that each Member State contributes to the EU budget.

21

The Court gives a negative opinion on the regularity of budget spending (transactions) because the errors that it finds in all areas except revenue and administrative expenditure are material, that is, the level of error is above an acceptable level[23].

22

Errors arise when payments are neither legal nor regular, for example when claimed by ineligible beneficiaries, for expenditure that should not be financed by the EU, or when the conditions for receiving the aid are not followed. These problems (reported as errors) occur because:

(a) beneficiaries make incorrect declarations;

(b) beneficiaries do not comply with the conditions for getting and using the EU support. Complex and wide-ranging conditions can make it difficult both for beneficiaries to comply with, and for managers to establish compliance. Unclear conditions can be open to interpretation and lead to expenditure being accepted in a spending culture (i.e. where there is pressure to spend the budget available without regard to whether it meets genuine needs);

(c) checks and controls by the Commission, the Member States' managing bodies and other auditors certifying the expenditure fail to prevent, detect and correct erroneous expenditure declarations;

(d) Member States and others charged with spending the budget focus on using it (absorption of expenditure) within the required time period, at the expense of using it properly or effectively, rather than losing it. The annual envelopes earmarked for each Member State (see paragraph 6(b)) reinforce a culture which concentrates on net balances and the redistribution of the EU budget rather than on considering how common EU resources can be best invested and used for the common good.

23 Materiality is determined using professional judgement. Errors of more than 2 % of the expenditure category are considered material, as are facts and events that may change the perception of the reader of the accounts if disclosed. In the period 2009–12, the estimated most likely error rate affecting the EU budget has varied between 3,3–4,8 % of the total expenditure.

Sound financial management: getting results from the EU budget

23

Good performance can be considered as 'doing the right things (effectiveness) in the right way (efficiency)'. Effective and efficient administration requires that EU-financed activities are properly designed to address actual needs, and are implemented using appropriate methods. These activities should address well-defined objectives, and their performance should be properly monitored to allow the Commission and other managing bodies to gauge the achievement of those objectives.

24

The Court's performance audits[24] report on how the EU funds have been spent, and whether they have been effective.

25

Pressure to spend without sufficient regard to the achievement of expected results may result in poor value for money from the EU funds. ***Diagram 6*** shows the most common problems reported in our special reports. Poor value for money can result from weaknesses in the preparation, execution and monitoring of the actions funded if:

(a) the purpose of the funding is not clear, or there is no preliminary (*ex ante*) evaluation, or assessment of the actual funding needed;

(b) there are too many objectives, or unclear objectives that can be interpreted in different ways, making it difficult to establish priorities;

(c) the needs of potential beneficiaries are not adequately assessed, or the possible impact of EU funding is not properly considered;

(d) aid is not targeted at beneficiaries, areas and projects most in need, or the selection criteria for individual projects are insufficient;

(e) eligibility criteria are unclear or inconsistently applied by the bodies approving EU support (grants, loans, etc.);

(f) EU funds bring some benefits to the beneficiaries, but there is no special EU dimension to the actions over and above what is already funded by the Member States at national, regional and local levels. The EU added value may therefore be questionable;

(g) there is no assessment of the reasonability of costs charged to EU actions;

24 Chapter 7, Article 30 of the Financial Regulation requires that the EU budget should be used according to the principles of sound financial management (economy, efficiency and effectiveness). The results of the Court's performance audits are published in Special Reports, and are summarised in chapter 10 of the Annual Report 'getting results from the EU budget'.

(h) EU funds are used to purchase goods and services of unnecessary high quality;

(i) purchasing rules are not followed in the procurement of goods and services;

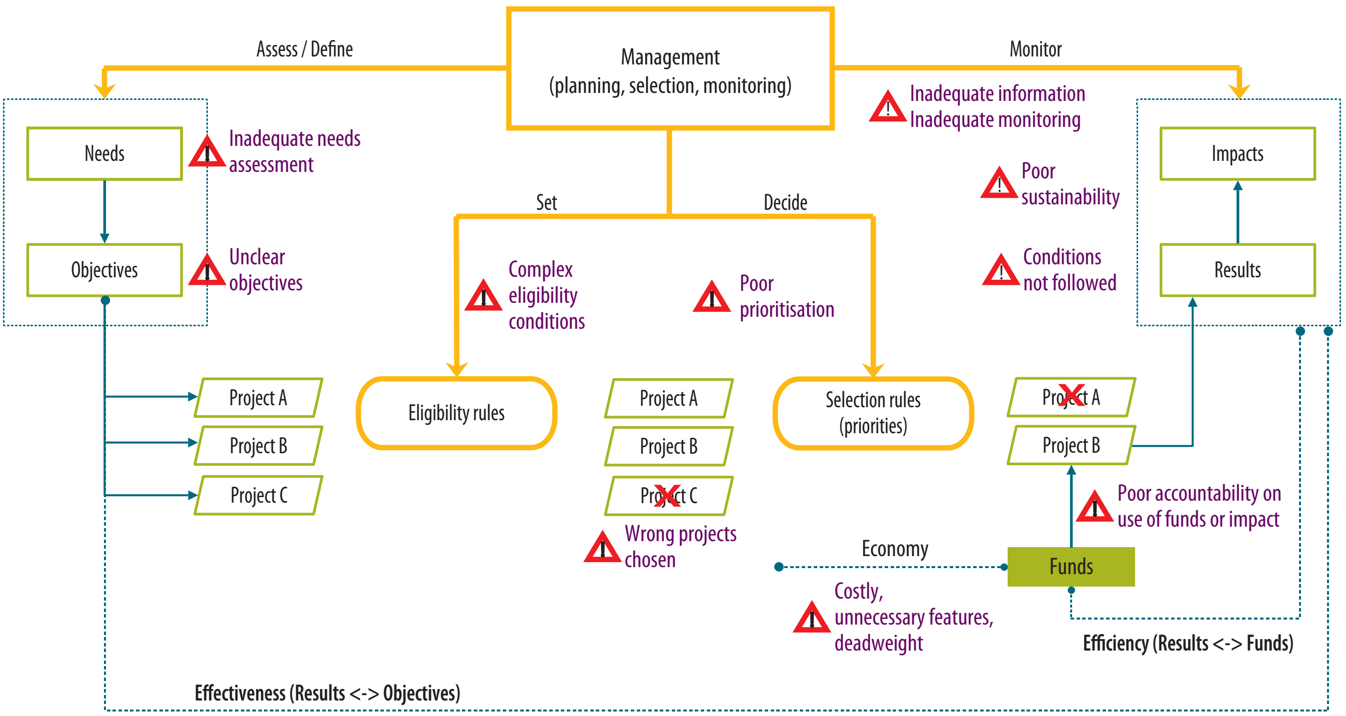
(j) it takes too long to carry out the actions;

(k) the EU budget may be used to fund actions and projects which are not self-sustaining or maintained once the EU funds are no longer available. The funds originally spent may therefore bring poor value;

(l) there is a lack of information about what was actually achieved and the benefits it brings. Partial information is sometimes available, for example, when individual countries set up reporting on activities in their territories (performance targets, evaluations, etc.). But this does not allow an overall picture of performance in the EU, nor allow comparisons to be made across the EU. As a result, the only consistent and comparable data available for the whole EU budget is about levels of funding, which can reinforce the spending culture.

Diagram 6

The most frequently reported problems in the Court's Special Reports



Source: ECA.

Some specific risk factors

26
Paragraphs 12 to 15 above give details about the complexity inherent in spending the EU budget. The complexity and multiplicity of programme structures (with different procedures) hamper the impact of EU spending, and create an administrative burden for applicants. Excessively complicated rules on spending or control requirements may delay implementation and contribute to a negative image of the EU. A number of key matters merit specific mention, and are developed in this section.

Eligibility rules and other conditions for receiving EU support

27
Complex eligibility rules and other conditions concerning the manner in which funds may be used can lead to poor targeting of these funds and sub-optimal use of the EU budget.

28
The Commission is taking steps to reduce and simplify legislation. However, the number of rules and their complexity still create difficulties for Member States' managing authorities, other intermediaries and beneficiaries:

(a) in some budget areas there are up to seven layers of rules, with conditions dispersed throughout many legal texts. This may lead to differing interpretations, and thus inconsistent application;

(b) the rules and perceived complexity may deter participants from applying for EU support, and also make it difficult for them to comply;

(c) the rules may not be known by all actors involved in collecting revenue or spending EU funds, especially when expenditure is co-financed by Member States' national budgets;

(d) Member States' authorities may not be able to take timely action to ensure that changes in EU rules are known and applied within their territories;

(e) Member States may also increase the complexity by adding other conditions through their national rules (for example on procurement) or other guidance, or by setting their own eligibility criteria (for example in the cohesion policy spending). These additional requirements may be unnecessary, and impose an unnecessary administrative burden and complexity on EU budget spending;

(f) control systems at any level may not be sufficient to check compliance with all the conditions.

Application of public procurement rules and procedures

29
Purchasing with public funds presents particular difficulties for managers responsible for spending: these funds must be used in a transparent, impartial and proper manner, and deliver value for money. The EU public procurement directives aim to open up the internal market by facilitating cross-border contracting and purchasing, and provide a legal framework for open and transparent purchases. Not following these rules may result in higher costs to the public purse (for example, over-priced public works), poor competition, the rejection of legitimate bidders, or additional costs and delays due to cancellation of contracts.

30
Many of the legality and regularity errors found by the Court relate to the poor application of procurement rules and procedures (see fact sheet on public procurement). This may occur deliberately in order to favour some suppliers over others, or inadvertently because the rules are complex and are not well understood.

Capacity of Member States' authorities to manage and spend EU monies

31
Relevant Member States' authorities and their auditors have primary responsibility to ensure that subsidies and grants are paid to eligible beneficiaries who comply with the required conditions, and that undue payments are recovered appropriately[25]. The costs of setting up the bodies and systems that administer EU monies are shared between Member States and the EU, with the former having some discretion as to how they organise their systems and controls at national, regional and local levels.

25 The new Financial Regulation (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 (OJ L 298, 26.10.2012, p. 1)) increases Member States' ownership and accountability for the EU budget that they spend.

32
Inherently, the fact of funds being spent through 28 national administrations, and many regional and local authorities with unequal administrative capacity, increases the risks of legality and regularity errors occurring, as well as the risks of poor quality spending. Inconsistencies in systems and checks for application of eligibility criteria, evaluation of reasonableness of costs, compliance with public purchasing rules, application of fines and recoveries of funds from those who received them unduly, on-the-spot inspections for grants and subsidies, checks on the implementation of legislation for environmental, health and food safety, the application of state aid rules, and the issuing of import authorisations or checks on imports may all be affected by insufficient administrative capacity of Member States' authorities.

33
Unequal absorption and administrative capacity may also slow the implementation of actions, regulatory activities and the exchange of information between the Commission and Member States.

34
Member States may also experience difficulties in addressing effectively and in a timely manner the weaknesses found by the Court and the Commission.

Coordination of EU and national budgets, with pressure to spend EU funds

35
The annual nature of the EU budget can cause problems with the funding of actions that are carried out over a number of years. It takes time to translate funding decisions into concrete priorities and actions at national, regional and local levels. There may be a considerable gap between political commitment and the resources allocated, the measures planned and implemented. Moreover, the EU and national budgetary processes are separate: they are carried out by different actors with different priorities, and follow different cycles.

36
Consequently, duplications, gaps or contradictions may occur between the EU budget and national spending, resulting in inefficiency and wasted resources. The greater coordination of economic policies within the European Semester (see ***Box 3***) may contribute positively to combat these issues.

37
This matters especially now because of the state of public finances in the Member States, and especially in those Member States where monies from the EU budget make a large difference to the government finances. For co-financed expenditure, austerity measures in Member States may result in national funds being significantly reduced or not being available to carry out the actions. Cut-backs in administrative expenditure and reduced staff resources also affect their ability to spend properly the EU budget. And the sustainability of EU-funded actions may also be problematic once EU funds are no longer available.

38
However, the input-orientated approach to EU budget spending means that management and control authorities focus on compliance, regardless of the results achieved. Financial management may largely focus on spending the budget available. For example, many of the measures to simplify programme implementation and to accelerate payments were aimed at spending the 2007–13 programmes (reprogramming, advance payments (front loading), extending the budget availability (closure deadlines), extending the scope of eligible expenditure, simplifying reimbursement by making greater use of flat-rate or lump-sum payments instead of reimbursing actual costs).

39
Member States may also feel pressure to use the EU budget without applying rigorous controls. Insufficient effort may be put into ensuring that the funds will be spent on the right programmes and projects from the outset. The availability of earmarked national envelopes may make the Commission unwilling to put a stop to proposals made by the Member States. For example, at the start of the new programming periods, the Commission may not use all its prerogatives to ensure that Member States' proposals are coherent with the EU objectives, and that the proposed action addresses sufficiently the specific needs identified by the Member States.

Impact of annual EU budgets on activities and cash flow management

40
As many of the activities funded by the annual EU budget are carried out over a number of years, Member States, other intermediaries and beneficiaries can receive cash advances (pre-financing) to start up their activities[26]. The use made of these cash advances is not known until much later, when the expenses ('cost claims') are submitted and checked. Budgetary accounts will show a better spending rate in early years because the amounts disbursed in pre-financing are shown as expenditure. But unnecessarily long periods of pre-financing can increase the possibility of error and loss, and make it especially difficult to reorientate activities to achieve objectives. As there are long time limits for submitting cost claims, problems are only apparent in later years when it may be too late to correct them, and tracking underlying documentation and information may be problematic. Error rates are consequently higher in later years when the cost claims are cleared[27].

41
The commitments that are not disbursed until later (RAL '*reste à liquider*') may mask budget amounts that cannot be spent (see ***Diagram 3*** above).

42
As indicated in paragraph 12(f)(ii) and ***Diagram 2*** above, the Member States will be required to contribute 1 234 billion euro in the future to cover disbursement of commitments.

Benefits from spending from the EU budget — 'EU-added value'

43
EU added value is the notion that spending at the EU level brings extra advantages compared to what can be achieved through national programmes. This concept has had a higher profile since the MFF negotiations raised questions about the costs and benefits of EU membership, and the political and economic implications of European integration. The concept provides a useful reference point to help ensure that the EU acts when Member States cannot, or where it can secure better results. It can help to shift the focus of discussion from how the EU budget is distributed among Member States to how common resources are best invested for shared purposes.

26 Advances are typically between 4–12 % of the expected activity costs. At the end of 2013, the amount of pre-financing disbursed was 79,4 billion euro, most of it for shared management activities by Member States.

27 For this reason the Court excludes pre-financing advances from the expenditure that it checks for legality and regularity.

44
The budget delivers EU added value when the spending is justified and makes an effective contribution to achieving the EU's policy goals efficiently, and contributes to building capacity and prosperity in the Member States. As well as providing funding in areas where the EU has sole competence, the EU budget can add value by creating networks (both physical and professional) that bring EU citizens and Member States closer to each other. It funds innovative actions, and availability of EU funds may induce governments to undertake actions which they may otherwise not consider.

45
There are uncertainties though: the EU may do no more than bring additional funds and increase total funds available, but with no particular EU dimension to the budget spending; EU funds may be used for activities that would have been carried out by the Member States and other beneficiaries anyway ('deadweight'); or the funds may be insufficient, and without the necessary critical mass to achieve the intended results. Moreover, fragmentation and multiplicity of spending programmes (with different procedures) detract from EU added value, and can contribute to a perception of EU largesse, waste and bureaucracy.

46
The degree of Commission involvement in spending the EU budget varies with the three management modes (direct, shared and indirect (see footnote 12). These in turn affect its ability to determine and access management and performance information on a timely basis, to directly monitor the systems and controls put in place to achieve the objectives, to address weaknesses quickly, and to standardise control and audit arrangements.

Quality of data and information

47
The Commission coordinates multiple actors involved in spending the budget, and cannot impose standardised processes and management systems. The challenge is to ensure that the right data is collected from intermediaries on a timely basis and that it can be checked effectively.

48

Furthermore, its monitoring, financial and performance management is often based on limited, incomplete or unreliable information. For example:

(a) underlying information and supporting documents are often dispersed, geographically and in diverse systems;

(b) management information systems do not provide sufficient information on how funds were used, their impact and added value;

(c) reporting and accountability systems are not designed to measure outcome, or to monitor performance against plan;

(d) multiannual programmes lack milestones that allow the Commission to track the progress and direction of actions to ensure that goals are being reached;

(e) there may be a lack of indicators to measure the achievement of sound financial management (economy, efficiency and effectiveness), or the indicators are inappropriate and encourage the wrong behaviour;

(f) there may be poor or no evaluations.

Expenditure not chargeable to the EU budget, and audits

49

In shared management expenditure, 'clearance procedures'[28] are used to decide the amount chargeable to the EU budget. While the costs of financial corrections for agricultural spending are borne by the budget of the Member State concerned, in the structural funds, if the Member State agrees with the correction, it adjusts its expenditure declaration, and the amounts are available for reassignment within the same country. If the Member State disagrees with the correction, the Commission may take a formal decision to enforce it, resulting in a reduction of EU funding available to the country concerned. Consequently, there is no incentive for the Member States concerned to address weaknesses in their systems.

28 Clearance means that the accounts of expenditure submitted to the Commission for financing are correct and the expenditure recorded in them is used in accordance with the rules.

50

The Commission cannot directly and systematically check the parts of the EU budget spent by intermediaries (Member States, other countries, international organisations …), nor the expenditure presented for reimbursement (declared) by beneficiaries. It relies on independent auditors to certify the expenditure concerned, and on the limited checks and inspections carried out by its own operational staff and auditors. This situation presents certain difficulties:

(a) the certification of expenditure by independent auditors may be problematic due to issues about the quality and timeliness of their work[29], or their independence;

(b) the Commission's own checks may be affected by weaknesses in its control strategy;

(c) because the Commission does not have the resources to perform extensive, large-scale audits, it can lead to delays in the closure process, and acceptance of compliance of spending only through extensive, time-consuming financial corrections.

29 The Court has found that the quality of these auditors' work is not always sufficiently reliable.

What are the opportunities and what needs to be done?

51
Both the Commission and the Member States are responsible for ensuring that EU funds are spent well and wisely and in recent years, both have already successfully undertaken many measures to ensure this. Nevertheless, the start of the new multiannual financial framework in 2014, the introduction of related implementing legislation and the new financial regulation, together with the Commission's commitment to ensure that the budget is more performance oriented, all provide opportunities for simplifying and improving the financial management of the EU budget.

Focus on results and EU added value

52
The changes proposed for the shared management arrangements in the 2014–20 MFF remain fundamentally focused on expenditure rather than on the results achieved. Furthermore, their success will depend on how well they are implemented by both the Commission and the Member States.

53
The Commission, with the support of the European Parliament and the Council, should prioritise spending on activities where there is European added value, such as areas where the Commission has sole competence, cross border actions, projects promoting common interest and European networks. Budget areas characterised by the multiplicity and fragmentation of spending, or where commitments and national allocations are slowly utilised, or underused, all merit extra scrutiny, with a possible view to cancelling the funding.

Focussing on performance management

54
To promote performance management, the objectives of the EU budget should be formulated clearly, with robust indicators and milestones, and systematic monitoring and evaluation arrangements so that progress towards these objectives can be measured. This requires:

(a) a clear justification for why action is desirable and necessary at the EU level (impact assessment);

(b) a clear vision of what the EU policy, regulatory measures and the budget aim to achieve, a clear description of the programme's logic (the whys and wherefores), and the procedure for assessing its results and impacts. It also requires explicit clarification of roles and responsibilities of all those involved in the implementation of the budget;

(c) the establishment of a robust performance management and reporting system, with clearly defined performance indicators that are universally applied by the Commission, Member States, regions, and other actors. This will enable comparisons and aggregations to be made across the EU. Progress should be regularly monitored against a specific baseline and indicators should focus on outputs, outcomes and impacts. The Commission's recent efforts to build a performance management and reporting system should remain a priority;

(d) timely evaluations to establish whether objectives have been achieved efficiently and effectively.

Focussing on budgetary management

55

For budgetary management purposes, the Commission needs to improve and publish its long term cash flow forecast, in order to better anticipate the monies required from Member States and to ensure that the necessary payments can be met from approved annual (payment) budgets. This analysis should consider the extent to which the EU will need to make pre-financing advances, as well as the disbursement needs arising from liabilities already recorded in the Union's balance sheet.

56

The Commission should be more proactive in identifying instances of gold plating[30], and continued efforts should be made to simplify legislation, to establish realistic and clear eligibility conditions (especially at national level), and to make greater use of lump sum or flat rate payments based on results rather than on input costs.

57

Within its own departments, the Commission should identify best practices and mainstream activities that add value. It should also identify budget areas where different departments manage similar programmes and activities, and where potential intermediaries are the same, and take steps to ensure that its procedures and reporting requirements are coherent.

58

The Commission should also benchmark unit costs of activities and programmes that it co-finances across the Member States, allowing public bodies to better compare and monitor the value for money of their spending programmes.

30 See European Parliament study 'Gold-plating in the EAFRD: to what extent do national rules unnecessarily add to complexity and, as a result, increase the risk of errors?' (February 2014).

59
The Commission is also best placed to identify best practices in the Member States, and to promote these best practices and lessons learned across national borders and amongst Member States by supporting cross-border networks. It can strengthen administrations' and other intermediaries' institutional capacity by providing better guidance, explanatory information and checklists for spending the EU budget and implementing related legislation (for example, inter alia, on best procurement practices, on management declarations, on certification of expenditure by independent auditors, and on inspection methodology).

Control arrangements and the work of others

60
The Commission and Member States should both ensure that control arrangements are well implemented and effective:

(a) Member States' accreditation of national management and control bodies should ensure that all bodies involved in spending and controlling EU funds have the necessary administrative capacity and resources, and that they carry out their duties effectively.

(b) The Commission should be able to draw assurance from national management declarations on the functioning of the management and control systems, the legality and regularity of underlying transactions and the compliance of sound financial management principles by ensuring that these declarations are well founded.

Mid-term review

61
The mid-term review of the 2014–20 MFF may provide opportunities to reflect on priorities for EU budget spending, and the design of instruments to achieve this. Firstly, how to build on the opportunities presented in the TFEU (Article 311(3)) which allows for the creation of new sources of EU revenue and how to ensure that the part of the EU budget funded by Member States is done so in an equitable, transparent, cost-effective and simple way, based on each Member States' ability to contribute. Secondly, as long as the current system is driven by reserved national allocations rather than the results to be achieved, the effectiveness of EU spending cannot be assured. Based on the results of the mid-term review, the Commission should consider these two major issues in the context of future multiannual frameworks, which will require the political agreement of all the relevant stakeholders.

Risks that can occur in spending the EU budget[1]

External risks

Political

- Political decisions and priorities set by Member States outside the EU context
- Conflicting priorities between Member States
- Commission objectives suffer from low political support in Member States
- Imposition of unwanted responsibilities upon organisations, administrations or beneficiaries
- Partner countries outside the EU — governance issues/other political factors

Legal and regulatory

- Legal basis is uncertain/fragmented/complicated or subject to significant change

Financial risks

Budgetary

- Insufficient funds/resources to carry out desirable actions/cash unavailable to make payments
- Member State cannot co-finance due to their own budgetary restrictions
- Payments affected by errors (legality and regularity/DAS errors, spending is not in accordance with rules)
- Budgetary management issues (high proportion of commitments and payments made late in the financial year, commitments made but not used — RAL, and increased use of pre-financing)
- Activities funded by other sources, other EU instruments or co-financing (overlapping programmes)
- Ineligible costs paid

1 Inspired by Support for Improvement in Governance and Management (SIGMA, a joint initiative of OECD and EU) framework for risk identification.

Fraud, irregularities and corruption

- Low priority given to fraud prevention, detection and correction
- Lack of resources to fraud proof budget
- Activities involve large amounts of cash or high value goods
- Loss of assets
- Difficulty in identifying final beneficiary

Procurement

- Complex procurement or contractual rules
- EU procurement procedures are not followed (splitting to avoid thresholds for competition requirements, advertising, award criteria, contract terms and signature ...)
- Inappropriate tendering procedures used (contracts frequently awarded without competition, contracts for additional works ...)

Activity risks

Policy

- Significant degree of change in the policy environment
- Incoherent management within Commission services — different policy objectives (and resulting programme implementation and performance measures)

Programme design/operations

- Complexity in programme delivery method/activities
- Unsuitable implementation mechanism
- New initiatives set up in haste/urgent operations
- Rapid implementation of the programme after the decision on the legal basis
- Activities in which auditee has no or limited experience (for e.g. new instruments to deal with financial and sovereign debt crisis)
- Slow programme implementation
- Operations involve large number of transactions
- Cumbersome operational procedures

Organisation structure

- Complex organisation (e.g. cross-border operations, involving linguistic, political or geographical issues, several administrative levels, etc.)
- Geographically dispersed organisation

Organisation responsibilities

- Imposition of unwanted responsibilities and costs upon organisations, administrations or beneficiaries
- Unclear division of responsibilities between Commission and Member States
- Poor coordination of activities, especially in decentralised or shared management system
- Unclear division of responsibilities/overlapping responsibilities within EU institutions/bodies

Organisation resources

- Absence of common supportive administrative structure
- IT that is obsolete, highly complex or includes many different and/or incompatible computer systems

Operational objective setting

- Inadequate assessment of needs
- Lack of/unclear/inadequate or unquantified objectives for economy, efficiency and effectiveness
- Objectives do not include legality, regularity, accuracy and reliability of accounts, safeguarding of assets
- Contradictory or incompatible objectives, either in EU policy or programme, or between EU and national priorities
- Priorities unclear, or objectives are not prioritised
- Inadequate procedures to prioritise and select programmes and projects to ensure maximum impact from Community funds

Operationalising the objectives

- No clear links between objectives and activities
- Eligibility/selection criteria are unclear or too inconsistent with objectives (too wide, too restrictive or not relevant)
- Critical factors that could endanger the achievement of objectives are not assessed regularly

Control systems

- Lack of internal control systems to monitor the 3 Es (economy, effectiveness and efficiency)
- Weaknesses in design or performance of control systems, supervision and control systems are non-existent or unsuitable
- Complex control systems (ineffective or costly)
- Differences in control systems among beneficiaries/Member States
- Operations are not fully subject to usual controls
- On-the-spot inspections or monitoring rights are not taken up or are infrequently used

Financial control systems

- Beneficiaries' accounting systems are incompatible with Union systems
- Excessive costs in the programme, or costs beyond expectations, or budget targets are missed to a significant degree
- Difficulty in determining costs of inputs
- Lack of accounting system/poor audit trail

Audit and evaluation

- Inadequate audit system (coverage, quality, reporting, follow-up)
- Past audit findings not acted upon
- Poor evaluations/no follow-up of evaluation results

Information

- Lack of, or poor management information system
- Management and financial information poor, not used properly or misused

Performance measurement

- Reporting and accountability systems are not designed to measure outcome, or lack of system to monitor actual performance against plan
- Lack of indicators to measure achievement of economy, efficiency and effectiveness
- Indicators used are inappropriate or encourage wrong behaviour
- Different key performance measures are used by the Commission and Member States

Performance

- Results/impacts not achieved
- Delays in implementation due to poor performance by intermediaries/contractors
- Evidence of poor performance (high level of complaints, low user satisfaction, disparities in performance compared to similar organisations, poor performance of contracted out services)

Added value

- Lack of EU added value — programmes replace national government expenditure, or no added value (NB additionality and subsidiarity)
- Poor sustainability — no ownership; projects set up without a proper dialogue with beneficiaries; beneficiary is highly dependent on the EU; project does not continue/is not maintained after EU support ends
- Deadweight (action would have been carried out regardless of EU support)
- Gold plating (EU support used to implement costly actions and projects over and above what is necessary)

Reputation

- Actions/inactions that damage the EU/Commission’s name

Management

- Ethical values/poorly established integrity (tolerance of irregularities, no code of conduct)
- Strong pressure on management to achieve unrealistic objectives or meet unrealistic deadlines (i.e. high commitment rates)
- Political and other pressure to perform in a particular way
- Evidence of poor management performance (e.g. poor mismanagement in the past in areas/countries, significant cost and time overruns, inadequate planning, lack of supervision and monitoring)

Personnel

- Insufficient, under-qualified, inexperienced or poorly motivated staff and/or inadequate recruiting procedures
- Large number of sub-contractors
- Lack of job descriptions
- No policy for staff rotation

Making the best use of EU money: a landscape review of the risks to the financial management of the EU budget

Individual fact sheets

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Revenue

01

The EU general budget (EU budget) is a balanced budget. The European Commission (Commission) cannot borrow monies to fund EU spending, and expenditure must match its revenues. According to the European Council of February 2013, revenue should be guided by objectives of simplicity, transparency and equity.

02

The Commission proposes to simplify the contributions from Member States[1] (by abolishing the current value added tax (VAT) based resource, by introducing new own resources (a financial transaction tax and a new simplified VAT resource) and by replacing the current correction mechanism with lump sum corrections). The overall impact of the proposal would be to alter the composition of the resources as well as the share paid by individual Member States to the EU budget. Until the proposal is unanimously adopted by the Member States, the current system will apply. Member States may also decide to apply the new system retroactively.

What it covers

03

Revenue consists of mainly own resources (approximately 92 %). The total amount of own resources cannot exceed 1,23 % of the gross national income (GNI) of the EU Member States. Other income consists of fines, recoveries of expenditures, interest on late payments and fines, revenue from administrative operations (staff pension contributions and taxes on income) and budgetary adjustments.

04

Own resources consist of:

(a) traditional own resources (TOR — approximately 12 %), and comprise customs duties based on the Common Customs tariff and sugar levies paid by sugar producers. Member States retain 25 % of the TOR collected as a contribution towards their collection costs.

(b) VAT-based resources (approximately 10 %), whereby a rate is levied on Member States' harmonised VAT bases. The harmonised VAT base is capped at 50 % of each Member State's GNI. All Member States[2] pay a uniform rate of 0,3 % of the harmonised VAT base.

1 COM(2011) 739 final of 9 November 2011 — Amended proposal for a Council decision on the system for own resources for the EU.

2 Except Germany, the Netherlands, Austria and Sweden which pay a reduced rate.

(c) GNI-based resources (approximately 70 %), are the balancing resources. Based on Member States' compilation of GNI data.

(i) The UK receives a rebate on its GNI contribution, based on the budgetary imbalance correction mechanism. This correction is financed by the other Member States, with four Member States (Germany, the Netherlands, Austria and Sweden) paying a contribution restricted to 25 % of their share of their correction.

(ii) Until 2013, two Member States (the Netherlands and Sweden) each benefited from a gross reduction of 150 million euro[3] to their annual GNI-based contribution.

(iii) Balances and adjustments can be made to the GNI and VAT bases (and thus to contributions) for a particular year for up to 4 years, after which they are time barred unless a reservation is made by the Commission.

What we found

05

The current budget financing system is complex and lacks transparency:

(a) TOR revenue collection is complex. It is an area prone to irregularities (with changing rules, with millions of importers with variable value of transactions, prone to tax avoidance and undeclared imports) and affected by Member States' differing capacity and systems (with frequent changes in collection organisation, obsolete or missing IT systems, problems with implementing key procedures and complicated cross-border management affected by differing administrative capacity). The Commission's checks in Member States are assessed as partially effective.

(b) Three Commission directorate-generals, Budget, Taxation and Customs Union and Eurostat, are all involved in checking the VAT base, which entails the verification of complex statistical aggregates as well as the assessment of Member States' tax collection systems. VAT evasion is a serious problem in the EU, causing estimated losses of up to 20 % of VAT revenue. Member State audit authorities also check this area because of the impact on their national tax revenues.

(c) GNI-based contributions are based on GNI data compiled by Member States, which is verified by Eurostat. The Commission's verification of the GNI is affected by weaknesses, and is only partially effective. GNI data is complex, and there is always a certain degree of inaccuracy as it relies on estimates. The Commission does not assess the supervisory and control system for GNI compilation in the Member States, although supreme audit institutions will be required to pronounce on this in the future.

(d) The UK rebate is politically sensitive and the calculation is complex. Material errors were found in the calculations in 2009 and 2010[4].

3 Measured in 2004 prices, and adjusted to current prices when annual contributions were calculated.

4 The 2009 calculation error was found by the Commission too late to be corrected in financial year concerned. The 2010 calculation error was found by the Court in the context of its DAS.

Is the 2012 revenue received correct and complete, and is it well managed?

- Affected by material error? → NO

High risk factors

06
Incorrect TOR collection and weaknesses in VAT systems in Member States reduce the revenue available from these resources, and result in higher balancing GNI contributions being required.

07
Any overstatement (or understatement) of GNI of a particular Member State does not affect the overall GNI-based own resources, but results in decreasing (or increasing) the contributions from other Member States.

Way forward

08
The Commission should carry out a more structured and formal analysis of the GNI data, and report in a more complete, transparent and consistent manner on the Member State's GNI data and on the management of GNI-based resources. It should shorten the duration of its verification cycle.

09
Member States should strengthen their customs supervision in order to maximise the TOR collected. Similarly, VAT reporting and collection systems should ensure that VAT receipts are correctly reported and evasion is minimised.

10
Member State audit authorities have an important role in ensuring that systems and controls in all three areas of own resources are implemented correctly.

Useful reading/ECA reports and opinions

- Court Opinion No 2/2012:

  on an amended proposal for a Council Decision on the system of own resources of the European Union — COM(2011) 739,

  on an amended proposal for a Council Regulation laying down implementing measures for the system of own resources of the European Union — COM(2011) 740,

  on an amended proposal for a Council Regulation on the methods and procedure for making available the traditional and GNI-based own resources and on the measures to meet cash requirements — COM(2011) 742,

  on a proposal for a Council Regulation on the methods and procedure for making available the own resource based on the value added tax — COM(2011) 737,

  on a proposal for a Council Regulation on the methods and procedure for making available the own resource based on the financial transaction tax — COM(2011) 738

Legality and regularity issues

- ECA 2012 Annual Report, chapter 2 (Revenue)

Performance audits

- Special Report No 11/2013 'Getting the Gross National Income (GNI) data right: a more structured and better-focussed approach would improve the effectiveness of the Commission's verification'
- Special Report No 13/2011 'Does the control of customs procedure 42 prevent and detect VAT evasion?'
- Special Report No 1/2010 'Are simplified customs procedures for imports effectively controlled?'

Need more information?

Contact the Court's Press Officer:
E-mail: press@eca.europa.eu

MFF 1 — Smart and inclusive growth

(million euro) (commitments)

	2014–20 MFF[1]
MFF 1 — Smart and Inclusive growth	**508 921**
1a. Competitiveness for growth and jobs	142 130
1b. Economic, social and territorial cohesion	366 791
% of total heading which is pre-allocations to Member States	72

Note: This expenditure can be broken down over 13 major themes (transport, research and innovation, environment, human capital, labour market, SME and business support, social infrastructure, IT services, capacity building, energy, social inclusion, urban and territorial dimension, and culture, heritage and tourism).

DG Regio is the main Commission department responsible for cohesion policy spending. It also manages the Instrument for pre-accession Assistance (IPA) included under MFF heading 4 global Europe. IPA helps candidate countries to develop transport networks and improve environmental infrastructure. It is available to candidate countries (Turkey and the former Yugoslav Republic of Macedonia) and potential candidate countries in the western Balkans (Albania, Bosnia-Herzegovina, Montenegro, Serbia, and Kosovo).

1 The MFF 2014–20 was agreed at 2011 prices (Council Regulation (EU, Euratom) No 1311/2013 of 2 December 2013 laying down the multiannual financial framework for the years 2014–20 (OJ L 347, 20.12.2013, p. 884)). The figures stated here are at current prices (from the DG Budget website).

MFF 1 — Smart and inclusive growth

52

(million euro) (commitments)

	2014–20 MFF[1]	2014 Budget (final)
TOTAL	508 921	63 973
Heading 1a — Competitiveness for growth and jobs	**142 130**	**16 560**
Large infrastructure projects	14 350	2 629
European satellite navigation systems EGNOS and Galileo	7 072	1 338
International thermonuclear experimental reactor ITER	2 986	728
Earth observation programme Copernicus	4 292	363
Nuclear safety and decommissioning (Bulgaria, Lithuania and Slovakia)	1 643	157
Common Strategic Framework (CSF) Research and Innovation	79 402	9 326
Horizon 2020	79 402	9 326
PM Euratom research and training		
Competitiveness of Enterprises and SMEs (COSME)	2 298	276
Education, Training, Youth and Sport (Erasmus for all)	14 775	1 556
Social Change and Innovation (PSCI)	920	119
Customs, Fiscalis and Anti-fraud	908	118
Connecting Europe Facility (CEF)	21 937	1 966
PM Plus Cohesion Fund contribution to transport	*11 306*	
Energy	5 850	410
Transport	14 945	1 482
ICT	1 142	74
Other programmes	2 003	264
European Statistical Programme (ESP)		
Standards for financial reporting and auditing		
Interoperability for European Public Administration (EPA)		
Decentralised agencies	2 293	243
Margin	2 078	106
Heading 1b — Economic, social and territorial cohesion	**366 791**	**47 413**
Investment for growth and jobs	278 418	35 609
Regional convergence (less developed regions)	185 374	23 635
Transition regions	35 701	4 802
Competitiveness (more developed regions)	55 780	7 503
Outermost and sparsely populated regions	1 563	210
PM including European aid to the most deprived (FEAD)	*3 500*	
Cohesion Fund (CF)	74 929	8 950
PM Including CF contribution to Connecting Europe Facility transport	*11 306*	983
European territorial cooperation	10 229	507
Youth employment initiative	3 211	1 804
Margin	4	1

1 The MFF 2014–20 was agreed at 2011 prices. The figures stated here are at current prices (from DG Budget website).

What it covers

Heading 1a — competitiveness for growth and jobs

01
MFF heading 1a mostly covers spending for policy areas which tackle major challenges facing European society in the near future, and funds actions that ensure that Europe remains competitive on the world stage, by investing in education, research and innovation, and by promoting actions that boost employment and encourage the development of European networks for research and innovation, ultimately with the aim of boosting economic growth.

02
Almost 15 % of heading 1 (80 billion euro) is reserved for research and innovation activities, under the Horizon 2020 instrument. Seven Commission directorates-general and two executive agencies manage activities and spending[1], with the two agencies carrying out a significant part of the day-to-day operations.

03
Most of the spending is by way of grants to beneficiaries. The two main risks in this area concern the selection of beneficiaries eligible to receive the grants, and the justification of the costs put forward by the beneficiaries for reimbursement from the EU budget. While the Commission has introduced measures to simplify rules and procedures and reduce the administrative burden for beneficiaries, the eligibility rules for ongoing programmes remain complex. Depending on the amount of the grant, independent auditors are required to certify the veracity of the cost claims submitted by beneficiaries. In addition, the Commission uses its own auditors and external auditors to carry out *ex post* audits of a sample of grants.

Heading 1b — economic, social and territorial cohesion

04
Economic and social development in the EU is diverse. Articles 174 to 175 TFEU sets out the EU's economic, social and territorial cohesion policy ('cohesion policy'), which contributes to the EU's overall economic performance by reducing disparities between regions and countries of the European Union.

1 Commission: DG Research and Innovation (RTD), DG Communications Networks, Content and technology (CNECT), Joint Research Centre (JRC), DG Education and Culture (EAC), DG Enterprise and Industry (ENTR), DG Mobility and Transport (MOVE) and DG Energy (ENER), Agencies: the Research Executive Agency (REA) and the European Research Council Executive Agency (ERCEA).

05

Approximately 72 % of the total MFF heading 1 budget (322,3 billion euro of 450,76 billion euro) is reserved ('pre-allocations') for Member States on the basis of GDP and GNI criteria, and negotiated in the context of the MFF agreement:

(a) These amounts are allocated without regard to the administrative capacity of Member States to absorb the funds i.e. to prepare programmes and projects, plan and select, implement correctly, effectively monitor public procurement and eligibility rules, etc. This may lead to significant volumes of funds being allocated to regions that do not possess the capacity to manage these funds soundly. Moreover, the use and evolution of these pre-allocations is not transparent.

(b) Most of the budget is spent over a number of years ('multiannual programmes'). Member States can receive pre-financing (cash advances) to start up the programmes. They lose the right to use the budget if it is not used within a given period ('n+3 rule').

(c) Budget spending is marked by a high degree of cash advances ('pre-financing') and legal commitments made for which payments have yet to be disbursed '*reste à liquider* (RAL)'. This is partly explained by the long-term nature of many of the activities to be financed. There are 455 programmes under the 2007–13 MFF.

06

Budget spending for cohesion policy is made through three main funds with programmes which run for the duration of the 7-year MFF budget cycle.

(a) The European Regional Development Fund (ERDF) operates in all Member States, in the regions with the lowest GDP per capita, with the aim of reducing imbalances between the regions. The fund co-finances national investments in companies (especially SMEs); infrastructures linked to research and innovation, telecommunications, environment, energy and transport; financial instruments (capital risk funds, local development funds, etc.) to support regional and local development and to foster cooperation between towns and regions; technical assistance.

(b) The Cohesion Fund (CF) co-finances national spending on transport and environment projects in Member States where the GNI per inhabitant is less than 90 % of the Union average. It aims to reduce their economic and social disparities, and to stabilise their economy. The Cohesion Fund concerns 15 Member States[2]. The financial assistance of the CF can be suspended by a Council decision (taken by qualified majority) if a Member State shows excessive public deficit and if it has not resolved the situation or has not taken the appropriate action to do so. The CF finances trans-European transport networks including projects related to energy or transport: energy efficiency, use of renewable energy, developing rail transport, supporting intermodality (by integrating different transport modes), strengthening public transport, etc.

2 The Member States covered by the Cohesion Fund are the new EU-12 Member States, plus Croatia, Greece and Portugal.

(c) The European Social Fund (ESF) aims to improve employment and job opportunities in the EU. It co-finances national expenditure aimed at: adapting workers and enterprises (lifelong learning schemes, designing and spreading innovative working organisations); improving access to employment for job seekers, the unemployed, women and migrants; social integration of disadvantaged people and combating discrimination in the job market; strengthening human capital by reforming education systems and setting up a network of teaching establishments.

(d) From 2014, common rules are established for the ERDF, the ESF, the CF, the European Agricultural Fund for Rural Development (EAFRD) and the European Maritime and Fisheries Fund (EMFF) which are included under MFF heading 2.

(e) To make the Cohesion policy more efficient and sustainable, the Commission has developed four initiatives jointly with the European Investment Bank (EIB) and other financial institutions. Two concern promotion of financial engineering instruments (Jeremie and Jessica) and two concern technical assistance facilities (Jaspers and Jasmine).

07

Approximately 72 % of the MFF heading 1 (heading 1.b mostly) budget is spent under shared management arrangements with the Member States. For the MFF 2014–20, partnership agreements between the Commission and each Member State will set out how the Member State intends to use the available EU funding for the period to achieve its objectives, with more details in the programmes. The EU budget will contribute between 50–85 % of the cost (co-financing) of the Commission approved spending programmes (operational programmes). The Commission has established a control and management framework to ensure that only expenditure that is spent in accordance with the rules is paid from the EU budget. It has also reintroduced a performance reserve of 6 % on the amounts that it will finance[3].

(a) Many different national, regional and local bodies are responsible for the management of all cohesion policy funds. The Member States bear most of the costs of the organisation and systems put in place to spend the EU budget. They are responsible for making sure that subsidies and grants are paid to eligible beneficiaries who comply with the conditions for receiving the support.

(b) Member States may receive cash advances for start-up costs. Generally, programme costs are borne by the Member States concerned, which are subsequently reimbursed by the Commission on the basis of expenditure declarations (cost claims) certified by their authorities.

(c) Audit authorities (AAs) in the Member States report to the Commission in annual control reports (ACRs) whether the management and control systems function effectively and on the regularity of the expenditure certified by each operational programme (OP).

3 A performance reserve existed in the MFF 2000–06, but the ECA concluded that it was used primarily to maximise spending rather than to concentrate spending on areas which were shown to be particularly effective. Under the 2014–20 MFF the Commission and Member States will agree at the start of the programming period on priorities which form the basis for the 6 % performance reserve (Council Regulation (EU) No 1303/2013 (OJ L 347, 20.12.2013, p. 320)). In 2019, based on implementation reports submitted by the Member States, the Commission will release the performance reserve if Member States have achieved the programme milestones for the chosen priorities. This 6 % reserve will remain as part of the national allocation, to be reallocated to other priorities if the Commission does not release it for the priorities initially agreed.

(d) The Commission may interrupt or suspend payments if it finds that a Member State fails to correct irregular expenditure, or if there are serious failings in the management and control systems. It may also suspend payments if macroeconomic conditions under the European Semester are not complied with.

(e) The Commission may apply financial corrections if the Member State does not withdraw the ineligible expenditure or remedy serious system failures. If the Member State concerned accepts the financial corrections, it can withdraw irregular expenditure and substitute it with eligible expenditure from other projects, i.e. the amounts are available again for their use. If these corrections are not accepted by it, the amounts are borne by the Member State's national budget. The correction system therefore does not have a dissuasive incentive to all those involved in spending the budget to get it right from the start.

What we found

Is the 2012 budget spent according to the rules? (Legality and regularity of expenditure)

- Affected by material error? → YES
- Estimated most likely error rate:

  Regional policy, energy and transport: → 6,8 %
  Employment and social affairs: → 3,2 %
  Research and innovation → 3,9 %

08
Errors occurred because of ineligible beneficiaries, failure to comply with public procurement rules, declaration of ineligible costs, non-compliance with state aid rules, and incorrect calculations of costs chargeable to the budget.

09
Management and control systems, especially in the Member States, are partially effective in preventing, detecting and correcting errors and irregularities.

10
Member States add unnecessary complication to the national eligibility rules required under the implementing regulations.

Is expenditure well managed and does it have an impact? (Sound financial management)

11

There is evidence of poor performance of programmes audited by the Court: the effectiveness of EU spending is reduced because there is inadequate assessment of needs, unclear objectives, contradictory or incompatible objectives and priorities, and inadequate selection procedures to prioritise projects that maximise impact.

12

For shared management expenditure:

(a) There may be conflict between EU and individual Member States' aims. In some thematic areas of the cohesion policy (for example energy), the EU targets and requirements are very demanding. Member States may not be prepared with technical, financial and regulatory expertise, nor have the necessary financial means. There may thus be a considerable gap between the political agreement and the measures adopted or planned, and the resources allocated.

(b) The Commission does not have complete information about the impact and achievements of the EU budget spending. Reporting systems are not designed to measure outcomes or to monitor performance, and there is a lack of indicators to measure performance. When information is available, it is patchy and does not allow comparisons between Member States.

(c) Results and impacts are not always achieved. There may be delays because sophisticated projects with complex environmental restrictions or technological requirements need time.

13

For research under FP7, rules for the eligibility of expenditure chargeable to the EU budget are complex. Certification by independent auditors of the expenditure chargeable to the EU budget is problematic, with the Court finding significant levels of error in cost claims certified as entirely eligible by the independent auditors.

High risk factors

14
Delays in the agreement of the MFF 2014–20 and adoption of related regulations will most probably have a knock on delay in the spending of the EU budget. Complex technical or infrastructure projects require lead time to prepare. Moreover, the total cost of such projects is opaque when multiple financing sources are used.

15
There are many actors involved in implementing the budget (Commission directorates-general: DGs Regional and Urban Policy, Employment, Social Affairs and Inclusion, Mobility and Transport, Energy for cohesion policy, seven other DGs for research and innovation, executive agencies and joint undertakings, Member States' management authorities, national, regional and local bodies, and financial intermediaries).

16
In the EU budget, there is a multiplicity and fragmentation of expenditure. Different procedures for applying for, reporting and control of payments are not efficient, and may lead to a negative perception of EU bureaucracy and reflect negatively on the EU.

17
The programmes, projects and actions may benefit from a range of funding from various sources (EU and national budgets, EIB family, EBRD, etc.). A full picture of total costs may not be apparent, and each source of funding will have its own governance and reporting arrangements.

18
Use of pre-financing (cash advances) for long periods of time increase the risk that problems may be discovered too late to take corrective action as regards achieving the objectives of the investment. While recovering funds may deter some activities, it still does not resolve the issues related to non-achievement of expected results.

19
Procurement: not all those receiving EU funds comply with the public purchasing (procurement) rules.

20
Administrative capacity of Member States: has an impact on their ability to spend the EU budget properly and well, to implement effective management and control systems, and to absorb timeously the EU monies made available.

21
Spending culture: Member States may be encouraged to spend the EU budget in order not to lose funds reserved for them in the regional policy national allocations, regardless of performance, especially when the Commission's co-financing rate is high. The overriding importance is that allocations are taken up in full ('use it or lose it'), that spending is in compliance with the rules, and only lastly by considerations of performance. The introduction of the performance reserve does not address the fundamental issues related to national allocations (see footnote 3).

22
However, RAL, legal commitments that have as yet to be disbursed, may mask amounts that cannot be used. Information on RAL by Member State is not published.

23
There may be conflict between EU and individual Member States' aims. In some thematic areas of the cohesion policy (for example energy), the EU targets and requirements are very demanding. Member States may not possess the technical, financial and regulatory expertise, nor have the necessary financial means. There may thus be a considerable gap between the political agreement and the measures adopted or planned, and the resources allocated.

24
Member States may add to the complexity by defining national eligibility rules which are sometimes more demanding than the EU conditions[4]. In addition, disparate national actors have to comply with extensive EU legal and organisational standards to ensure the day-to-day management and control of projects financed.

25
EU funds may be used for activities that would have been funded anyway by the Member States (deadweight), or when projects are substituted in the context of correction procedures.

4 See European Parliament study 'Gold plating in the EAFRD: to what extent do national rules unnecessarily add to complexity and, as a result, increase the risk of errors?' (February 2014).

26

Inadequate needs assessments may result in funding costly programmes and projects, which include features over and above what was necessary.

27

The Commission's supervisory role is affected by:

(a) the lack of timely, reliable and comparable management information, and by a poor performance culture, especially for co-financed expenditure. Decisions to commit and pay out funds are based on limited, often incomplete and unreliable information provided by Member States[5]. Underlying information and supporting documentation is dispersed in the Member States;

(b) the quality and timeliness of audits by other auditors (audit authorities) certifying the expenditure may not be sufficient to guarantee that the budget expenditure is used legally and regularly;

(c) weaknesses in the Commission's risk assessment and control strategy, together with pressure on resources, may mean that the riskiest areas of budget expenditure are not systematically checked, and problems may be identified too late.

28

The correction system allows the Member States to substitute eligible expenditure for any ineligible expenditure found. If they accept the Commission's proposed corrections, the budget is available for them to use for other eligible projects. There is therefore little incentive to get things right.

Way forward

29

The Commission:

(a) takes steps to foster and introduce a performance culture in the spending of the EU budget, and justify the European added value of all activities funded;

(b) is more proactive in building capacity in Member States, by bringing together networks of (Member State) administrative bodies responsible for spending the budget in this area, to enable them to learn from each other and to foster best practice. The Commission can also provide better guidance to Member State bodies;

5 The high error rates found by the ECA are an indication of the unreliability of information from Member States. Many of the errors could have been identified by the managing authorities and other intermediate Member State bodies. See Annual Report concerning the financial year 2012, paragraphs 5.27 to 5.28, and 6.12.

(c) makes greater use of lump sum and flat rate payments, and consider payment by results rather than input costs. It should gather comparative information on actual costs in Member States to allow the latter to better benchmark their costs and to monitor the value for money for their spending programmes;

(d) provides information by Member State on the utilisation of the pre-allocations, pre-financing and RAL (‘*reste à liquider*’), with the aim of better budgetary management and cash flow planning. It should also take more dissuasive action on corrections.

30

Member States:

(a) make proposals for funding of programmes that are realistic, that meet real needs and focus on achieving maximum performance from EU funding;

(b) ensure that those involved in the management and spending of the EU budget have the capacity and resources available to do so, and are aware of the rules by which the monies have to be spent, as well as other legislative requirements. The Member States should foster better cooperation and coordination between national and regional actors;

(c) ensure that the programme logic model is applied: that the programme results and outcomes are clear and realisable; that proper needs analysis has been undertaken; that projects are chosen for funding using relevant and realistic criteria, and that national rules are not gold plating requirements;

(d) ensure that proper procurement procedures have been followed;

(e) ensure that control arrangements are well implemented and effective, and take the appropriate and timely action to address weaknesses found by the Commission and the ECA audits.

Useful reading/ECA reports and opinions

General

- Opinion No 7/2011 on the proposal for a Regulation of the European Parliament and of the Council laying down common provisions for the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development, the European Maritime and Fisheries Fund covered by the Common Strategic Framework and laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund.
- Commission DG Regional and Urban Policy, DG Employment, Social Affairs and Inclusion websites
- Meta-study on lessons from existing evaluations as an input to the review of EU spending for the period 2000–06, January 2008.
- A Study on EU Spending Commissioned by the European Commission, Directorate-General for Budget (Contract No 30-CE-0121821/00-57) by ECORYS Nederland BV.

Legality and regularity issues

- ECA 2012 annual report, chapter 5 (Regional policy, transport and energy)
- ECA 2012 annual report, chapter 6 (Employment and social affairs)

Cross cutting themes

- Special Report No 16/2013 'Taking stock of the 'single audit' and the Commission's reliance on the work of the national audit authorities in cohesion'.
- Special Report No 3/2012 'Structural funds: did the Commission successfully deal with deficiencies identified in the Member States' management and control systems?'
- Special Report No 3/2010 'Impact Assessments in the EU institutions: do they support decision-making?'

Energy efficiency

- Special Report No 21/2012 'Cost-effectiveness of Cohesion Policy Investments in Energy efficiency'

Entrepreneurship

- Special Report No 2/2012 'Financial instruments for SMEs co-financed by the European Regional Development Fund'
- Special Report No 9/2011 'Have the e-Government projects supported by ERDF been effective?'
- Special Report No 4/2011 'The audit of the SME Guarantee facility'

Environment

- Special Report No 20/2012 'Is structural measures funding for municipal waste management infrastructure projects effective in helping Member States achieve EU waste policy objectives?'
- Special Report No 9/2010 'Is EU Structural Measures spending on the supply of water for domestic consumption used to best effect?'
- Special Report No 3/2009 'The effectiveness of Structural measures spending on waste water treatment for the 1994–99 and 2000–06 programme periods'

Human Capital

- Special Report No 7/2013 'Has the European Globalisation Adjustment Fund delivered EU added value in reintegrating redundant workers?'
- Special Report No 25/2012 'Are tools in place to monitor the effectiveness of European Social Fund spending on older workers?'
- Special Report No 4/2010 'Is the design and management of the mobility scheme of the Leonardo da Vinci programme likely to lead to effective results?'
- Special Report No 17/2009 concerning vocational training actions for women co-financed by the European Social Fund

Nuclear decommissioning

- Special Report No 16/2011 'EU Financial assistance for the decommissioning of nuclear plants in Bulgaria, Lithuania and Slovakia: Achievements and Future Challenges'

Research and Innovation

- Special Report No 2/2013 Has the Commission ensured efficient implementation of the Seventh Framework Programme for Research?
- Special Report No 2/2010 'The effectiveness of the Design Studies and Construction of New Infrastructures support schemes under the Sixth Framework Programme for Research'
- Special Report No 8/2009 'Networks of excellence and Integrated projects in Community Research policy: did they achieve their objectives?'
- Special Report No 7/2009 'The management of the Galileo programme's development and validation phase'

Social infrastrucutre

- Special Report No 2/2009 'The European Union's Public Health Programme (2003–07): an effective way to improve health?'

Solidarity Funds

- Special Report No 24/2012 'The European Union Solidarity Fund's response to the 2009 Abruzzi earthquake: The relevance and cost of operations'

Tourism and Culture

- Special Report No 6/2011 'Were ERDF co-financed tourism projects effective?'

Transport

- Special Report No 5/2013 'Are EU Cohesion policy funds well spent on roads?'
- Special Report No 3/2013 'Have the Marco Polo programmes been effective in shifting traffic off the road?'
- Special Report No 4/2012 'Using Structural and Cohesion Funds to co-finance transport infrastructures in seaports: an effective investment?'
- Special Report No 8/2010 'Improving transport performance on trans-European rail axes: Have EU rail infrastructure investments been effective?'

Urban and rural regeneration

- Special Report No 23/2012 'Have EU Structural Measures successfully supported the regeneration of industrial and military brownfield sites?'

Need more information?

Contact the Court's Press Officer:
E-mail: press@eca.europa.eu

MFF 2 — Natural resources

(million euro) (commitments)

	2014–20 MFF[1]	2014 Budget (final)
MFF 2 — Natural Resources	**420 034**	**59 303**
European Agricultural Guarantee Fund (EAGF) — market-related expenditure and direct payments (decoupled SAPS and SPS, production-related subsidies)	312 735	44 130
European Agricultural Fund for Rural development (EAFRD)	95 577	13 652
Maritime and fisheries	7 405	1 017
European Maritime Fisheries Fund (EMFF)		866
Regional Fisheries Management Organisations (RFMOs) and Sustainable Fisheries Agreements (SFAs)		151
Environment and climate	3 457	405
Decentralised agencies	388	52
Margin	473	47

Note: Health and consumer protection falls under MFF 3 Security and Citizenship.

1 The MFF 2014–20 was agreed at 2011 prices (Council Regulation (EU, Euratom) No 1311/2013). The figures stated here are at current prices (from the DG Budget website).

What it covers

01
Articles 38 to 44 TFEU set out the aims of the common agricultural policy (CAP) and the common fisheries policy (CFP), and replace the need for 28 different national policies. The CAP aims to increase agricultural productivity, ensure a fair standard of living for the agricultural community, to stabilise markets, to assure the availability of supplies and to ensure that supplies reach consumers at reasonable prices. The CFP has similar objectives for those involved in fishing, and also the aim of managing fishing fleets and conserving stocks. Rural development policy takes account of the wider rural community, and should be complementary to the structural funds.

02
The EU is the world's second largest exporter of agricultural products after the USA. It is also the leading importer of agricultural products and foodstuffs. The Commission negotiates in the World Trade Organisation on behalf of the EU-28. It also negotiates separately the bilateral international fishery agreements between the EU and other countries.

03
There is a marked diversity in the EU agriculture and rural landscape. The MFF 2014–20 gives Member States more possibilities to choose options that suit their particular conditions.

04

There are 12 million farmers in the EU. It is a mostly ageing population (with almost a third over 65 years of age), as farming and agriculture does not attract young people (only 6 % of farmers are under 35 years of age).

05

The structure and size of agricultural holdings varies enormously across the EU. This has an impact on the EU support they receive. The 2013 CAP reforms will allow Member States to take more account of their national agricultural characteristics in paying subsidies.

06

Less than 2 % of EU producers receive 31 % of the direct payments. Under the 2013 reforms, those not involved in agriculture as their main activity will be excluded from receiving support, there will be a reduction of 5 % of payments over 150 000 euro, and Member States may opt to cap subsidies to large producers.

07

The EU budget is underpinned by extensive legislation with strong links to agriculture and food production. These rules aim to protect human, animal and plant health. They contribute to the functioning of the internal market, and give confidence to consumers of EU products. Member States must ensure that this legislation is observed in their territory, and are responsible for checking that it is the case. Fraud in the food production chain can impact negatively on the demand for EU food products (for example, the horse meat scandal from early 2013 reduced the demand for meat and consumption is still down).

08

The European Agricultural Guarantee Fund (EAGF) fully funds the direct support to farmers and market measures[1], without the need for national funding:

(a) It provides direct income support to farmers. Most of this support is not related to what and how much is produced, i.e. 'decoupled'. Aid is calculated on the size (acreage) of the farms, and the payment entitlements held by the farmers. It is reduced if farmers do not respect cross-compliance requirements for environmental, animal, plant and human health and food safety, and do not maintain their land in good agricultural and environmental condition (GAEC). National ceilings for subsidies that can be paid in each country limit the budget available for that country, in effect reserving the budget for it.

(b) Market measures (including intervention storage costs and export refunds paid to exporters when EU prices for certain commodities are higher than the world price) are being phased out, and all the different Common Market Organisations (CMOs) will be replaced by a single CMO.

1 Except for certain measures totalling less than 100 million euro for promotion measures and school fruit schemes, which are co-financed.

09

The European Agricultural Fund for Rural Development (EAFRD) pays part of the cost of each country's rural development strategy, i.e. it 'co-finances' measures chosen by the Member State in their strategy to address the needs in rural areas in line with EU priorities. The amount available to each country to spend ('national allocations') is decided in the MFF negotiations:

(a) Farmers may apply for area (acreage) based support for agri-environmental purposes, and for support to modernise and diversify their holdings. The EAFRD also pays extra to farmers in areas with natural handicaps.

(b) Others in the rural economy are supported through measures aimed at improving the economy and quality of life in rural areas, by setting up basic services and diversifying activities.

10

Most of the MFF 2 budget is spent by Member States under shared management arrangements:

(a) Member States bear most of the costs of the organisation and systems put in place to spend the EU budget. They set up designated paying agencies (there are 81 at the beginning of 2014) which are responsible for making sure that subsidies and grants are paid to eligible beneficiaries who comply with the conditions for receiving the support. The Member States also appoint independent auditors ('certifying bodies') to examine the accounts and payment records of the paying agencies.

(b) The Commission reimburses Member States for expenditure declared by them. It accepts the expenditure chargeable to the EU budget through its clearance of accounts procedure. The Commission relies partly on the independent auditors ('certifying bodies') who check and report on certain matters designated by it, and on its own audits on the spot.

(c) Financial 'corrections' are made by the Commission to claw back expenditure that is not spent in accordance with the EU rules and regulations. The expenditure that is not accepted is borne by the Member States' national budgets.

What we found

Is the 2012 budget spent according to the rules? (Legality and regularity of expenditure)

- Affected by material error? → YES
- Estimated most likely error rate:

  Agriculture: direct and market support: → 3,8 %
  Rural development, environment, fisheries and health: → 7,9 %

11
The rural development expenditure which is co-financed by Member States national budgets is more problematic because of the complex legislation and the administrative capacity of the Member States. The fully funded CAP direct payments have better established, though not perfect, management and control systems (IACS — Integrated administrative and control system).

Is expenditure well managed and does it have an impact? (Sound financial management)

12
Direct support (Single Area Payment Scheme and Single Payment Scheme, approximately 41 billion euro for the period 2014–20) to farmers may not necessarily reach the intended beneficiaries. There is some evidence that it is absorbed by higher land rentals and land prices.

13
There is evidence of poor performance in the programmes and schemes audited by the ECA:

(a) Spending in the Member States is not always well targeted at those people or areas in need of support. This reduces the effectiveness of EU spending.

(b) The Commission does not have complete information about the impact and achievements of the EU budget spending. Reporting systems are not designed to measure outcomes or to monitor performance, and there is a lack of indicators to measure performance. When information is available, it is patchy and does not allow comparisons between Member States.

High risk factors

14
Delays in the adoption of the 2013 CAP reforms, the MFF 2014–20 and related regulations will have a knock on delay in the spending of the EU budget, especially for the rural development where Member States have to prepare their spending plans, and on the implementation of control systems designed to check compliance with new conditions.

15
New conditions and adaptation of control systems to the 2013 CAP reform requirements may increase the risk of errors occurring in the early years of the current MFF, especially:

(a) linking payments to new, more stringent environmental conditions;

(b) the integrated and administrative control systems (IACS), which are only partially effective, will have to be updated to reflect the environmental conditions, and take account of the introduction of geo-spatial aid applications.

16
For direct payments, there are a large number of small beneficiaries, most of them with low value payments. The IACS control system is designed to carry out automated checks on applications, but is only partially effective.

17
For co-financed expenditure: timely, reliable and comparable management information is not easily available to enable the Commission to play its role effectively.

18
Complex aid delivery mechanisms: there are many actors (Directorate-General (DG) Agriculture and Rural Development mostly, but also DGs Maritime Affairs and Fisheries, Climate Action, Environment and Health and Consumers, Member States' management authorities and 81 paying agencies). There is multiple and fragmented expenditure, with a risk of some overlap with Member States' own programmes, especially in rural development. EU added value of some schemes may therefore be questionable.

19
Complicated legislation on eligibility and other conditions: there are up to seven layers of rules on spending the budget. The many statutory requirements for cross compliance are dispersed throughout different texts, and the Member States' own definitions of good agricultural and environmental conditions are not sufficiently robust to have an environmental impact. 2013 CAP reforms for 'greening' introduce more conditionality for environmental compliance.

20
Procurement: those receiving EU funds may not comply with the public purchasing (procurement) rules.

21
Administrative and technical capacity of Member States: has an impact on Member States' ability to spend the EU budget properly and well, to implement effective management and control systems, and to absorb the EU funds made available to them in a timely manner.

22
Spending culture: Member States may be encouraged to spend the EU budget in order not to lose funds reserved for them in the rural development and fisheries national allocations.

23
The Commission's supervisory role is affected by:

(a) The lack of timely and reliable management information. Spending under this MFF heading remains fundamentally input based, so the focus is on compliance rather than performance.

(b) The quality and timeliness of audits by other auditors certifying the expenditure, which may not be sufficient to guarantee that the budget is used legally and regularly.

(c) Potential weaknesses in its risk assessment and control strategy, together with the pressure on resources, may mean that the riskiest areas of budget expenditure may not be systematically checked. Problems may be identified too late to allow corrective action.

Way forward

24

The Commission:

(a) takes steps to foster and introduce a performance culture in the spending of the EU budget, and justify the EU added value of all activities funded;

(b) takes a more systematic approach to rationalise and simplify the legislative requirements;

(c) addresses weaknesses in its risk assessments and control strategy, and to reduce the persistent problem of delays in its conformity audits;

(d) is more proactive in bringing together networks of Member State administrative bodies responsible for spending the budget in this area, to enable them to learn from each other and to foster best practice.

25

Member States (managing authorities, paying agencies):

(a) ensure that those involved in the management and spending of the EU budget are aware of the rules by which the monies have to be spent, as well as other legislative requirements;

(b) take appropriate and timely action to address weaknesses found by the Commission and the ECA audits;

(c) increase and speed up their efforts to ensure that IACS databases are reliable and up to date;

(d) improve the quality of the inspections on the spot;

(e) better define the environmental conditions linked to payment of subsidies in order to have a better environmental impact.

Useful reading/ECA reports and opinions

General

- Opinion No 1/2012 on certain proposals for regulations relating to the common agricultural policy for the period 2014–20
- Commission DG Agriculture and Rural Development website
- Meta-study on lessons from existing evaluations as an input to the review of EU spending for the period 2000–06, January 2008

Legality and regularity issues

- ECA 2012 annual report, chapter 3 (Agriculture: market and direct support)
- ECA 2012 annual report, chapter 4 (Rural development, environment, fisheries and health)
- Special Report No 7/2010 'Audit of the clearance of accounts procedure'
- Special Report No 8/2011 'Recovery of undue payments made under the common agricultural policy'

Direct aids

- Special Report No 10/2013 'Common agricultural policy: Is the specific support provided under article 68 of Council Regulation (EC) No 73/2009 well designed and implemented?'
- Commission Report on the distribution of direct aids to agricultural producers (financial year 2011), published December 2012
- Special Report No 16/2012 'The effectiveness of the Single Area Payment Scheme as a transitional system for supporting farmers in the new Member States'
- Special Report No 11/2012 'Suckler cow and ewe and goat direct aids under partial implementation of SPS arrangements'
- Special Report No 7/2012 'The reform of the common organisation of the market in wine: Progress to date'

- Special Report No 10/2011 'Are the School Milk and School Fruit Schemes effective?'
- Special Report No 5/2011 'Single Payment Scheme (SPS): issues to be addressed to improve its sound financial management'
- Special Report No 10/2010 'Specific measures for agriculture in favour of the outermost regions of the Union and the smaller Aegean islands'
- Special Report No 6/2010 'Has the reform of the sugar market achieved its main objectives?'
- Special report No 14/2009 'Have the management instruments applied to the market in milk and milk products achieved their main objectives?'
- Special Report No 6/2009 'European Union food aid for deprived persons: an assessment of the objectives, the means and the methods employed'

Rural development

- Special Report No 12/2013 'Can the Commission and Member States show that the EU budget allocated to the rural development policy is well spent?'
- Special Report No 8/2013 'Support for the improvement of the economic value of forests from the European Agricultural Fund for Rural Development'
- Special Report No 6/2013 'Have the Member States and the Commission achieved value for money with the measures for diversifying the rural economy?'
- Special Report No 8/2012 'Targeting of aid for the modernisation of agricultural holdings'
- Special Report No 5/2010 'Implementation of the Leader approach for rural development'

Environmental and climate measures

- Special Report No 15/2013 'Has the Environment component of the LIFE programme been effective?'
- Special Report No 7/2011 'Is agri-environment support well designed and managed?'
- Special Report No 11/2009 'The sustainability and the Commission's management of the LIFE-Nature projects'

Fisheries

- Special Report No 12/2011 'Have EU measures contributed to adapting the capacity of the fishing fleets to available fishing opportunities?'

Food safety, production and labelling

- Special Report No 1/2013 'Has the EU support to the food-processing industry been effective and efficient in adding value to agricultural products?'
- Special Report No 14/2012 'Implementation of EU hygiene legislation in slaughterhouses of countries that joined the EU since 2004'
- Special Report No 9/2012 'Audit of the control system governing the production, processing, distribution and imports of organic products'
- Special Report No 11/2011 'Do the design and management of the geographical indications scheme allow it to be effective?'
- Special Report No 14/2010 'The Commission's management of the system of veterinary checks for meat imports following the 2004 hygiene legislation reforms'
- Special Report No 10/2009 'Information provision and promotion measures for agricultural products'

Need more information?

Contact the Court's Press Officer:
E-mail: press@eca.europa.eu

MFF 3 — Security and citizenship

(million euro) (commitments)

	2014–20 MFF[1]	2014 Budget (final)
MFF 3 — Security and citizenship	**17 725**	**2 179**
Asylum and Migration Fund (AMF)	3 137	403
Internal Security Fund (ISF)	3 764	403
IT Systems (Schengen Information System SIS and Visa Information System VIS)	139	19
Justice Programme	378	47
Rights and Citizenship programme	440	55
Union Civil Protection Mechanism — Member States	224	28
Food and Feed	1 892	253
Health for Growth Programme	449	59
Consumer Programme	189	24
Creative Europe Programme	1 463	179
Europe for Citizens	186	23
Agencies	4 003	535
Other	679	86
Margin	783	65

1 The MFF 2014–20 was agreed at 2011 prices (Council Regulation (EU, Euratom) No 1311/2013). The figures stated here are at current prices (from DG Budget website).

What it covers

01
MFF 3 covers a number of programmes of public interest, such as development of education and training, consumer protection, food and health policies, justice, judicial cooperation, rights and citizenship as well as protection of the EU's external borders.

02
Generally, the management of spending in this area is either delegated to agencies or shared with Member States. Activities are normally implemented in the form of multiannual programmes managed by European executive agencies[1], national agencies or similar management structures in Member States, which allocate grants and contracts to projects or measures carried out by private and public beneficiaries.

03
Support takes the form of schemes funding various thematic (policy) areas and types of project activities using grants for citizenship initiatives or for mobility in the education and training sectors. Projects are carried by higher education and training organisations, non-profit organisations, private firms and public administrations. The final beneficiaries are individuals, mostly EU citizens.

1 Education, Audiovisual and Culture Executive Agency (EACEA), Consumers, Health and Food Executive Agency (CHAFEA).

04
Management of some programmes, namely the External Borders Fund, the Integration Fund, the Return Fund and the European Refugee Fund is, however, mostly, shared with Member States.

What we found

Is the 2012 budget spent according to the rules? (Legality and regularity of expenditure)

- Affected by material error? → YES
- Estimated most likely error rate: → 2,3 %

(not officially published information from DAS 2009. There is no chapter for MFF 3 since)

05
The MFF 3 spending was last audited separately in the DAS 2009, where the error rate was narrowly above 2 %. No significant issues were identified. The heading itself only represents about 1,6 % of the total MFF 2014–20.

Is expenditure well managed and does it have an impact? (Sound financial management)

06
Though not fully satisfactory, no significant management issues were noted by the Court’s audits.

Risk concerns

07
For the most part, funding consists of cash advances (‘pre-financing’) to EU agencies and national agencies, to finance their activities, and quarterly contributions to their operating costs. Payments to national agencies are made on signature of a contract or acceptance of a work programme, or on the acceptance by the Commission of cost claims demonstrating that 70 % of the pre-financing funds have been disbursed to beneficiaries. There is a risk that the managing body or the Commission do not detect ineligible, overstated or unsubstantiated costs included in beneficiaries’ cost claims. However no significant issues were identified by the Court.

08

National agencies conclude grant agreements with participating organisations, and use the pre-financing to give them advances of between 80 % and 100 % of estimated costs. These projects are normally completed and closed within 3 years, after beneficiaries submit final reports to the national agency. The national agency submits an annual report to the Commission on all agreements. After it has approved the report, calculated and settled the final balance, the Commission closes the agreement with the agency. Such high pre-financing cash advances may not be needed to start up the activities, and they can also contribute to legality and regularity errors as organisations may want to justify expenditure of the cash made available to them. Given the long period between the advances being made and the closing of the projects, it may result in problems of recovering unused funds.

Way forward

09

The Commission should ensure that the spending in this area brings EU added value. It (the Commission) can play a significant role in promoting knowledge sharing and best practices between Member States, in order to bring a genuine European dimension for many of the policy issues dealt with under this heading.

Useful reading/ECA reports and opinions

General

- Special Report No 22/2012 'Do the European Integration Fund and European Refugee Fund contribute effectively to the integration of third-country nationals?'
- Special Report No 4/2010 'Is the design and management of the mobility scheme of the Leonardo da Vinci programme likely to lead to effective results?'
- Special Report No 2/2009 'The European Union's Public Health Programme (2003–07): An effective way to improve health?'

Need more information?

Contact the Court's Press Officer:
E-mail: press@eca.europa.eu

MFF 4 — Global Europe

(million euro) (commitments)

	2014–20 MFF
MFF 4 — Global Europe (EU general budget)[1]	**66 262**
European Development Fund (outside EU general budget)[2]	30 506
Total (general budget + outside budget)	**96 768**

1 The MFF 2014–20 was agreed at 2011 prices (Council Regulation (EU, Euratom) No 1311/2013. The figures stated here are at current prices (from the DG Budget website).

2 Internal agreement between the Representatives of the Governments of the Member States of the European Union, meeting within the Council, on the financing of European Union aid under the MFF for the period 2014 to 2020, in accordance with the ACP–EU Partnership Agreement, and on the allocation of financial assistance for the Overseas Countries and Territories to which Part Four of the Treaty on the Functioning of the European Union applies (OJ L 210, 6.8.2013, p. 1).

(million euro) (commitments)

	2014–20 MFF[1]	2014 budget (final)
MFF 4 — General budget	**66 262**	**8 335**
Instrument for Pre-accession assistance (IPA) (DG Regio, responsible for cohesion policy spending, manages the IPA.)	11 699	1 574
European Neighbourhood Instrument (ENI)	15 433	2 113
Development Cooperation Instrument (DCI)	19 662	2 310
Partnership Instrument with third countries (PI)	955	113
European Instrument for Democracy and Human Rights (EIDHR)	1 333	179
Instrument for Stability (IfS)	2 339	315
Humanitarian aid	6 622	905
Common Foreign and Security Policy (CFSP)	2 339	315
Instrument for Nuclear Safety Cooperation (INSC)	225	31
Macro-financial Assistance (MFA)	565	76
EU guarantees for lending operations	1 193	59
Civil Protection Mechanism (CPM) and European Emergency Response Centre (ERC)	145	20
European Voluntary Humanitarian Aid Corps EU Aid Volunteers (EUAV)	148	13
Other actions and programmes	1 167	151
Decentralised agencies	154	21
Margin	2 286	143

1 The MFF 2014–20 was agreed at 2011 prices (Council Regulation (EU, Euratom) No 1311/2013). The figures stated here are at current prices (from DG Budget website).

What it covers

01
EU Institutions alone are the second largest donor of development aid[1]. Together with the Member States, the EU is the largest official donor contributing more than half of total Official Development Aid (ODA)[2]. However, there are marked differences between what the EU ODA is used for as compared to the total OECD ODA, reflecting the EU's different priorities. While 54 % of OECD ODA is used for project-type interventions, the EU spends 17 % on this type of activity. OECD countries together contribute 8 % of their ODA to multilateral funding (through the UN agencies and international organisations), whereas the EU uses 25 % of its ODA towards such multilateral funding. And OECD countries together use 3 % of ODA to provide direct budget support to the government budgets of partner countries, while 22 % of EU ODA goes towards such support.

02
The Lisbon Treaty initiated three key modifications to the EU's external aid policy:

(a) It stated explicitly the primary objective of the EU development cooperation is to eradicate poverty[3].

(b) It created the function of the High Representative for Foreign Affairs and Security Policy.

(c) It established the principle of reinforced synergies in EU external actions, through the unity, consistency and effectiveness of action by the Union.

03
Article 209 TFEU places both the European Parliament and the Council on equal footing for implementing development cooperation policy ('acting in accordance with the ordinary legislative procedure').

04
The EU external aid is a shared competence between the Commission and the Member States, and it is organised via three main organs:

(a) the Commission,

(b) the European External Aid Services (EEAS) and

(c) the European Development Fund (EDF).

1 OECD data on ODA (Official Development Aid).

2 OECD data: EU institutions together with the 15 Member States that are Members of the DAC (Development Assistance Committee of the OECD) stand well above 55 % of total ODA.

3 Article 208 of the consolidated TFEU.

05

The Commission and the EEAS formulate jointly the EU external aid policy programming and strategic goals. Activities are funded from both the EU general budget and the EDF budget.

06

The Commission bears sole responsibility for the implementation of the development aid programmes and spending the funds

(a) **EuropeAid** is the main directorate-general (DG) in charge of the programming and implementation of the EU external aid. Four other DGs are responsible for specific areas of external actions[4].

(b) The **EEAS** was established by a Council decision of 26 July 2010[5] on a proposal by the High Representative[6], it became operational on January 2011. The EEAS is an independent EU institution with the legal responsibility to ensure its policies are consistent with other EU policies.

(c) Founded by the Treaty of Rome to grant assistance to historically associated African, Caribbean and Pacific countries, the **EDF** is funded by Member States separately from the general EU budget. The European Parliament has only an advisory role on the funding of the EDF, which is negotiated on an intergovernmental level between the Council and the Commission. The European Parliament has however obtained the right to question the Commission whenever it finds that proposals promote causes other than development (i.e. trade, fighting terrorism, etc.), or if it considers that the Commission is exceeding its legal mandate.

07

The Commission manages both the EU general budget and the EDF budget
Since the 10th EDF, there are minor differences in the financial regulations applicable to both funding streams. A decision on whether to merge the EDF budget into the general budget is expected to be taken before the end of the current EDF[7] in 2020, to coincide with the start of the next MFF period. Before the financial crisis, too many Member States were opposed to the merger.

08

There are advantages to a distinct EDF budget: under the Cotonou agreement, the EU and ACP countries established a model of joint ownership and accountability. Outside of the European Parliament remit, the EDF gives Member States more liberty to act on their own accord, in line with the Paris declaration[8]. 90 % of its funds reach low-income countries, compared to 40 % from the general budget. With its 7-year budget, the EDF funding is more predictable than the EU annual budget. Unless otherwise specified, this document addresses both budgets together.

4 DG ECHO (Humanitarian Aid and Civil Protection), DG ELARG (Enlargement), DG FPI (Service for Foreign Policy Instruments: Common Foreign and Security Policy (CFSP), Instrument for Stability (IfS), (crisis response and peace-building), Industrialised Countries Instrument (ICI), Election Observation Missions (EOMs) and Press and public diplomacy (PPD)) and DG Trade (EU trade and investment relations with non-EU countries through the EU's trade and investment policy).

5 Council Decision 2010/427/EU of 26 July 2010 establishing the organisation and functioning of the European External Action Service (OJ L 201, 3.8.2010, p. 30).

6 http://register.consilium.europa.eu/pdf/en/10/st08/st08029.en10.pdf

7 The 11th EDF will cover 7 years from 2014 to 2020, ending at the same time as the Cotonou partnership agreement.

8 Paris declaration on Aid effectiveness 2005: http://www.oecd.org/development/effectiveness/34428351.pdf

What we found

Is the 2012 budget spent according to the rules? (Legality and regularity of expenditure)

- Affected by material error? → YES
- Estimated most likely error rate:

  External relations, aid and enlargement: → 3,3 %
  European Development Fund (distinct budget): → 3,0 %

09
In most cases, quantifiable errors concerned ineligible costs such as costs incurred outside of the eligible period, funding of activities not provided for in the contract, and non-compliance with procurement procedures.

Is expenditure well managed and does it have an impact? (Sound financial management)

10
There is evidence of insufficient performance in the programmes and schemes audited by the ECA.

11
External aid actions are carried out in a complex environment, in many large regions with disparate levels of development and/or governance. Also, recent years have seen a development of international interest in gaining influence over the ACP regions; which adds a degree of competition amongst donors in an already complex environment. As in all EU programmes, financial instruments and management modes bear specific risks:

(a) overall this makes it difficult to manage spending in large regions, and meeting general objectives is precarious;

(b) establishing partnerships with, and fostering ownership, from the partner states may be problematic;

(c) achieving sustainable results in the partner countries often depends on the continued action and funding from external donors.

12

In this complex environment, the effectiveness (performance) of EU spending is primarily affected by complex programme designs, unclear objectives, inadequate assessment of needs and poor sustainability of projects due to lack of ownership, but also by:

(a) unsuitable and/or slow implementation mechanism due to programme design and organisation of projects,

(b) inadequate procedures to prioritise and select programmes and projects,

(c) governance issues and other political factors,

(d) incoherent management between Commission services with different policy objectives,

(e) poor coordination of activities, especially in decentralised or shared management,

(f) unclear priorities or lack of objectives prioritisation,

(g) unclear links between objectives and activities and

(h) lack of indicators to measure the achievement of economy, efficiency and effectiveness.

13

Insufficiently met objectives, disappointing results when compared to the funds provided may damage the credibility and reputation of the EU. Not least, this may jeopardise the EU's ability to deliver good value in future projects.

High risk factors

14
External aid activities cover more than 150 countries, are carried in a complex geopolitical environment. Many partner countries have weak institutional, administrative and financial capacities. Specific risks affect the geographical areas where actions are implemented:

Specific risks drivers for geographical areas

	Asia, Central Asia and Africa	The Mediterranean, Middle East, Gulf, Iran, Iraq and Yemen	Candidate and potential candidate countries
Low GNI per capita[1]	Generally an issue	N/A (generally)	N/A (generally)
Low human development index[2]	Generally an issue	N/A (generally)	N/A (generally)
Political instability[3] (and shortcomings in the political, economic and or social areas)	Generally an issue (and mostly in Africa and Central Asia)	Generally an issue (and area where the risk is most prominent)	Systemic shortcomings may have repercussions for Member States
Armed conflicts and historical conflicts[4] legacy (war crimes, inter-ethnic tensions, …),	In Asia and Africa some pockets of serious armed conflicts persist. Overall the area knows a moderate level of conflicts	Area where the risk is most prominent with several armed conflicts (increased by the Arab spring)	Historical conflict, which are a challenge to regional stability and explain a low political commitment to regional cooperation
High exposure to corruption[5-6]	Generally an issue	Generally an issue	Higher levels than most Member States with a risk of repercussions for Member States and poor results in fighting organised crime
Low commitment to institution building, weak administrative and financial capacities	Generally an issue	Generally an issue	Generally an issue
Faltering public support for the enlargement process due to a lack of transparency, coherence or credibility of the process	N/A	N/A	A major risk, particularly in a context where corruption and general society shortcomings exist and are not seen to be sufficiently addressed.
Aid absorption issues	N/A	N/A	Poor absorption of aid backlog in implementing pre-accession aid, under decentralised management and shortfalls in beneficiary countries' co-financing

Source: ECA.

1 http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?display=map
2 http://hdr.undp.org/en/countries.
3 http://viewswire.eiu.com/site_info.asp?info_name=instability_map&page=noads
4 http://www.nobelprize.org/educational/peace/conflictmap/index.html
5 http://cpi.transparency.org/cpi2013/results/
6 http://ec.europa.eu/dgs/home-affairs/doc_centre/crime/docs/study_on_links_between_organised_crime_and_corruption_en.pdf

15

Concerning purchases, beneficiaries are numerous, geographically dispersed and funded through different instruments. Whereas all beneficiaries are likely to use public procurement, they may also be less acquainted with EU spending rules than their own national purchasing rules. Thus monitoring of compliance with EU rules may be insufficient in comparison to the number and dispersion of controls to be implemented.

16

Spending under grant contracts should be certified by external auditors. The independence of such local auditors may be less certain than is the case in the EU.

17

The creation of the EEAS has added further complexity, requiring strong coordination and cooperation between the EEAS and the Commission:

(a) The EEAS and the Commission prepare different phases of the programming cycle:

(i) the EEAS is tasked with programming the EU budget and EDF funding, but this also remains under the responsibility of the Commission;

(ii) the EU delegations establish their budget forecast and different inter-services groups (EEAS, Commission departments) assess the proposals;

(iii) the final programmes are presented together by the Commission and the EEAS to the EU Council Committee;

(iv) the Parliament has a budget oversight on the approved proposal (except for the EDF, which is outside of the general budget).

(b) The EEAS also faces recruitment issues, partly due to its mandate:

(i) to foster synergies between the EU institutions and the Member States, 33 % of delegation staff should be seconded Member State nationals;

(ii) generally, the EU external aid resources are often stretched, and EU delegations face difficulties in recruiting and retaining qualified contractual staff;

(iii) Member States’ national diplomatic officials have tended to be recruited at higher (employment) grades than officials recruited under the EU Staff Regulations. Structural differences in pay and career prospects can threaten the service’s ability to deliver.

18

Financial mechanisms unique to the EU external aid exemplify the particular risks of external aid, such as the difficulty of striking the right balance between actions both targeted enough to address local needs and regional enough to foster global, sustainable progress.

(a) **Budget support** is managed under a direct centralised management mode and the Commission's payment authorisation depends on whether the partner country has met agreed preconditions. De minima, these require the existence of a well-defined policy strategy, a stable macroeconomic framework and a credible commitment to improving public financial management. Once paid out, funds are merged with the partner country's budget and are deemed to contribute to the objectives set.

(b) **Contribution agreements with international organisations** fall under a joint management mode. Funding depends on whether the organisation's financial procedures and administration meet internationally accepted standards. An independent auditor assesses this for the Commission, on a documentary basis. Funds are then made available for spending by the international organisation.

(c) **Programme estimates** follow a decentralised management mode. Funds are run by an independent administrative structure, the Programme Management Unit (PMU), nominated by the body representing the partner country. Activities of the programme estimates are submitted to the Commission, by the PMU, for prior endorsement under a decentralised management mode.

(d) In all three financial mechanisms, the primary issue for the EU budget is whether funds reach their intended purposes, and whether they meet the EU efficiency, effectiveness and economy requirements.

   (i) In budget support, the key risk factor is a combination of two: funds are fungible by nature and partner countries often have weak public financial management systems. Eligibility conditions attached to the funding are too general and open to flexible interpretation. However, once paid out, there are limited options to check whether funds are used adequately. One of the EU's primary objectives for budget support is to be a 'vector of change', but a financier, seemingly unconcerned with effectiveness, minimises his ability to promote such a goal.

(ii) Fungibility of EU funds contributed is also a major issue in contribution agreements with international organisations. Monies are usually pooled in multi-donors funds, but contributions are not earmarked. International organisations have a reputational advantage over EU institutions. As aid coordinators they are more likely to make a positive impression on beneficiaries. The contributions made by the EU (institutions and Member States together) are not coordinated, which gives the EU less leverage to negotiate contractual terms with the organisations. For instance, both reporting by the UN organisations and EU institutions' access to financial data is generally limited. Information available on actions is insufficient to assess whether implementation was efficient and the objectives achieved; the nature of administrative, indirect and support costs remains imprecise. Similarly, although EU contributions are usually significant, they may not get recognition and visibility comparable to other large donors such as the USA.

(iii) Less used now, programme estimates provide funds for more locally targeted activities, with the risk that they do not fulfil an adequate and relevant purpose. Funding is earmarked and thoroughly controlled: each expenditure item is checked and authorised at three levels[9], and an external auditor's report is required. While the risk on the use of fund use is limited, programmes financed may not be effective if they are not well designed or do not meet the needs.

(e) Finally the three financial mechanisms show differences in their spending rates: whereas budget support and contribution agreement normally meet all of their budget absorption targets (budget and timing), the total budget available for programme estimates are generally not used. Where funds are pooled in fungible budgets, the control and monitoring focus shifts from contractual allocation to the pace of budget execution.

9 The PMU, the beneficiary authority and the Commission (or its delegation) who receives a copy of all administrative documents and whose prior approval is required for significant expenditure.

Way forward

The Commission

19
Reinforced attention should be paid to ensuring that conditions attached to budget support are sufficient to ensure that funds are meeting their intended purpose.

20
The organisation between the EEAS and the Commission services should be further streamlined to facilitate coordination and avoid overlaps.

21
Defining needs and objectives well is an essential step, as is promoting ownership in partner states to ensure sustainable development. For the delivery of aid, the Court has regularly recommended that the use of conditions and policy dialogue be strengthened. The delivery of aid could also benefit from a balanced mix of project-oriented funding and global policy funding. With sufficient reporting requirements attached the coordination and monitoring of funds should improve but also reinforce transfer of administrative and management skills and support partner countries in owning their projects and in achieving the necessary reforms.

Useful reading/ECA reports and opinions

General

- Special report No 11/2010 'The Commission's management of General Budget Support in ACP, Latin American and Asian Countries'
- Special report No 15/2009 and No 3/2011 'EU assistance implemented through United Nations organisations: decision-making and monitoring' and 'The efficiency and effectiveness of EU contributions channelled through United Nations organisations in conflict-affected countries'
- Special report No 12/2010 'EU Development Assistance for Basic Education in Sub-Saharan Africa and South Asia'
- Special report No 4/2009 'The Commission's management of non-state actors' involvement in EC development cooperation'

Legality and regularity issues

- ECA 2012 annual report, chapter 7 (External relations, aid and enlargement)
- ECA 2012 annual report on the activities funded by the 8th, 9th and 10th European Development Funds (EDFs)

Performance audits

- Special Report No 17/2013 EU climate finance in the context of external aid
- Special Report No 14/2013 European Union direct financial support to the Palestinian Authority
- Special Report No 9/2013 EU support for governance in the Democratic Republic of the Congo
- Special Report No 4/2013 EU Cooperation with Egypt in the Field of Governance
- Special Report No 18/2012 'European Union assistance to Kosovo related to the rule of law'
- Special Report No 17/2012 'The European Development Fund (EDF) contribution to a sustainable road network in sub-Saharan Africa'
- Special Report No 13/2012 'European Union Development Assistance for Drinking-Water Supply and Basic Sanitation in Sub-Saharan Countries'

- Special Report No 6/2012 'European Union Assistance to the Turkish Cypriot Community'
- Special Report No 5/2012 'The Common External Relations Information System (CRIS)'
- Special Report No 1/2012 'Effectiveness of European Union development aid for food security in sub-Saharan Africa'
- Special Report No 14/2011 'Has EU assistance improved Croatia's capacity to manage post-accession funding?'
- Special Report No 3/2011 'The efficiency and effectiveness of EU contributions channelled through United Nations Organisations in conflict-affected countries'
- Special Report No 1/2011 'Has the devolution of the Commission's management of external assistance from its headquarters to its delegations led to improved aid delivery?'
- Special Report No 13/2010 'Is the new European Neighbourhood and Partnership Instrument successfully launched and achieving results in the Southern Caucasus (Armenia, Azerbaijan and Georgia)?'
- Special Report No 12/2010 'EU Development Assistance for Basic Education in Sub-Saharan Africa and South Asia'
- Special Report No 11/2010 'The Commission's management of General Budget Support in ACP, Latin American and Asian Countries'
- Special Report No 18/2009 'Effectiveness of EDF support for Regional Economic Integration in East Africa and West Africa'
- Special Report No 16/2009 'The European Commission's management of pre-accession assistance to Turkey'
- Special Report No 15/2009 'EU assistance implemented through United Nations organisations: decision-making and monitoring'
- Special Report No 12/2009 'The effectiveness of the Commission's projects in the area of Justice and Home Affairs for the western Balkans'
- Special Report No 4/2009 'The Commission's management of non-state actors' involvement in EC development cooperation'

Need more information?

Contact the Court's Press Officer:
E-mail: press@eca.europa.eu

MFF 5 — Administration

(million euro) (commitments)

	2014–20 MFF[1]	2014 Budget (final)
MFF 5 — Breakdown per Commission draft budget	**69 584**	**9 854**
Administrative expenditure of the institutions		8 226
European Parliament		1 756
European Council and Council of the European Union		534
European Commission		4 694
Court of Justice of the European Union		355
Court of Auditors		133
European External Action Service		519
European Economic and Social Committee		129
Committee of the Regions of the European Union		88
European Ombudsman		10
European Data Protection Supervisor		8
Pensions		1 450
European Schools		178
Costs of decentralised agencies' included under other MFF headings[1]	**6 838**	**851**
Heading 1a — smart and inclusive growth	2 293	243
Heading 2 — natural resources	388	52
Heading 3 — internal policies	4 003	535
Heading 4 — global Europe	154	21
Total administrative costs[1]	**76 422**	**10 705**

1 The MFF 2014–20 was agreed at 2011 prices. The figures stated here are at current prices (from DG Budget website).

What it covers

01
This heading covers the administrative expenditure of the EU institutions: staff costs (salaries, allowances and pensions), buildings, equipment, energy, communications and information technology.

02
The EU has also set up a number of agencies over the years, to address specific topics[1]:

(a) There are six executive agencies[2]. Established for a fixed period, they are entrusted with the managing tasks related to the implementation of EU programmes, and are located at the seat of the European Commission in Brussels or Luxembourg.

(b) Decentralised agencies and bodies are independent legal entities under European public law, distinct from the EU institutions. Since 2012, they operate under a new common framework which aims to make them more coherent, effective and accountable (Common Approach). They are located in different Member States, and play a role in implementing EU policies, especially in tasks of a technical, scientific, operational and/or regulatory nature. There are 37 decentralised agencies, of which the Court audits 34[3]. All except five of the agencies are wholly funded from the EU budget[4].

(c) Euratom agencies and bodies support the aims of the European Atomic Energy Community Treaty (Euratom). They coordinate the Member States' research programmes for the peaceful use of nuclear energy, provide knowledge, infrastructure and funding of nuclear energy and ensure sufficiency and security of atomic energy supply.

(d) Joint undertakings constitute EU bodies (Article 208 of the Financial Regulation), set up in partnership with other countries and organisations. The Commission currently participates in nine joint undertakings, five of which were set up through the Seventh Framework Programme for Research as Joint Technology Initiatives.

1 A list of the agencies can be found at http://europa.eu/about-eu/agencies/

2 Established under Council Regulation (EC) No 58/2003 of 19 December 2002 laying down the statute for executive agencies to be entrusted with certain tasks in the management of Community programmes (OJ L 11, 16.1.2003, p. 1), the six Executive agencies are:

Education, Audiovisual and Culture Executive Agency (EACEA)
European Research Council Executive Agency (ERC Executive Agency)
Executive Agency for Competitiveness and Innovation (EACI), now replaced by Executive Agency for Small and Medium-sized enterprises (EASME)
Executive Agency for Health and Consumers (EAHC), now replaced by Consumers, Health and Food Executive Agency (Chafea)
Research Executive Agency (REA)
Trans-European Transport Network Executive Agency (TEN-T EA), now replaced by Innovation and Networks Executive Agency

3 Of the 37 decentralised agencies, three relate to the common security and defence policy, which are audited by a college of auditors nominated by the Member States.

4 Two agencies use the revenues generated from their activities (CPVO in Angers, OHIM in Alicante); the three other agencies are partly funded from the EU Budget (EASA in Cologne, EMA in London and CdT in Luxembourg).

What we found

Is the 2012 budget spent according to the rules? (Legality and regularity of expenditure)

- Affected by material error? → NO
- Estimated most likely error rate: → 0 %

03
This expenditure is generally considered to be a low risk area. The main risks concern incorrect application of procedures for all organisational activities, especially those related to procurement of goods, services, works; and recruitment of personnel and management of human resources.

Is expenditure well managed and does it have an impact? (Sound financial management)

04
Our audits (both DAS and performance audits) have not identified significant issues.

High risk concerns

05
Although the Court's reports do not identify significant issues in the management of the EU administrative budget, some issues are inherent to the nature of the activities. The main budget spending is on human resources, purchases (procurement) and cost of buildings. The risks are of over-spending or of questionable spending, with potential consequences for the reputation of the EU institutions.

06

Human resources:

It is essential that the EU institutions' human resources policies ensure that they can recruit and retain staff of the sufficient calibre to ensure an independent, qualified and motivated public civil service. The staff regulations governing the employment conditions of the EU civil servants bring rigidity in some respects:

(a) Officials (permanent civil servants) can only be recruited through public competitions which are highly selective (on average approximately 10 % of candidates are successful in the competitions to become European civil servants). Organisation of these competitions is complex, and is often a lengthy procedure as they have to be across all Member States and involve thousands of candidates. Due to the length and complexity of the recruitment process, as well as issues relating to the forecast of staffing needs, recruitment targets are often not met. Over the period 2003–06, only two thirds of recruitment needs were met, increasing the reliance on contractual and temporary staff. Increasing temporary staff risks that EU institutions lose experience and skills through lack of continuity. While the 2012 audit of the agencies found no cases of irregular recruitment, observations on the transparency of recruitment procedures and the equal treatment of applicants for employment were made for 17 of the 40 audited agencies.

(b) While public sector employment is often only attractive when economic times are difficult, the current salary scales and entry level conditions offered by the institutions may be less likely to be attractive to new staff. In particular, current entry level positions (AD5 or AST1/AST3) offer neither competitive salaries nor attractive career prospects to many EU-15 Member States' citizens, with the risk of geographical imbalance in the future. Moreover, agencies, the Council and EU delegations can recruit temporary civil servants at staff grades commensurate with their professional experience; which is not the case with the other institutions', which can currently only recruit staff at the lowest grade, irrespective of their experience, at an average age of 34 years.

(c) Provisions for dealing with poor performing staff are rarely used.

07

Concerning links between the public and private sector, and in particular, the employment of former senior officials by companies having an interest in EU affairs, although the new rules mark some progress[5] towards the revolving door policy of the Commission, they are open to interpretation. For example, the 12 month cooling-off period applies specifically to high ranked civil servants, whereas a two-year cooling-off period is the standard practice in the private sector. While the cooling-off period only applies to activities of permanent staff in the previous 3 years, the situation of temporary staff remains unspecified.

5 Whilst the 2013 Staff Regulation new regulation keeps the same 2-year notification period during which an official is required to notify new positions which could conflict with their previous occupation, it provides that high ranking officials will need to keep a 12 month cooling-off period. All institutions are required to publish annual information on the implementation of this rule, including a list of cases assessed.

08

Purchasing (Procurement):

(a) EU purchases should be made according to the applicable procurement rules. While no problems have been identified in the Court's audits of administrative expenditure to date, the main risks are that there may be poor planning, that procurement rules are circumvented, or that the correct procurement procedures are not applied. It may also be difficult to define the right selection and award criteria (e.g. in some projects such as building or IT projects, it is not uncommon that through development of unanticipated needs, the original price estimate may be too low).

(b) As a consequence of the difficulty in establishing the right procurement procedure and the most appropriate selection criteria, it may not always be feasible to achieve best value for money. Similarly, whereas the EU aims to open procurement procedures to the largest number of suppliers, the size of the institutions' purchases (large needs, wide geographical coverage) may prevent SMEs from being able to participate.

(c) The Commission's Internal Audit Service (IAS) have highlighted a need for improvements in the purchasing made by the institutions, to address: weaknesses in planning and control procedures; non-compliance with the financial regulation; problems in the evaluation of offers; and lack of uniformity of procedures.

09

Buildings policy: building costs represent one of the main components of the EU administrative budget. Since 1996, the institutions have given priority to purchasing buildings over long-term rentals as their experience shows that purchasing office space is 40 to 50 % cheaper than renting[6]. Because the EU could not borrow money to finance buildings projects until 2013, innovative solutions were required to fund them. The use of special purpose vehicles and other complex financing structures may have had an impact upon overall project costs and thus value for money. Building investments are long-term projects that require planning and realistic staff forecasts, which is complex at best in an annual budget context. Moreover, the concentration of EU institutions in the European quarter in Brussels and in Kirchberg in Luxembourg pushed office rental costs upwards, having a negative impact on the institutions' ability to negotiate good value for money on buildings in these areas.

6 See Special Report No 2/2007 concerning the institutions' expenditure on buildings (OJ C 148, 2.7.2007, p. 1).

10

Procedures in agencies: autonomous decentralised agencies may make coordination and monitoring by the Commission more complex:

(a) Weaknesses in the management of grants given by the agencies may result in irregular expenditure being accepted. *Ex ante* and *ex post* verifications related to grant management are frequently inadequate. Agencies do not always check the supporting documents to confirm the accuracy and eligibility of expenditure claimed by beneficiaries, and rely on certificates from auditors or national authorities. Purchasing (procurement) may also be problematic in some agencies.

(b) The Commission implements the budget indirectly through agencies[7]. Under the new requirements of the 2013 Financial Regulation, independent external auditors shall verify the annual accounts of the decentralised agencies, and the ECA should consider the results of the audits of these independent external auditors when preparing its specific annual reports on the agencies. The work of these external auditors may not be of a sufficient quality for the ECA to rely on.

11

European Schools provide education for the children of staff of the European institutions and bodies. They are an intergovernmental body, with governance assured by a governing board consisting of representatives from each of the Member States' ministries of education, the Commission (DG Human Resources and Security) and the Secretary-General of the European Schools. The main challenges concern the risks to providing effective education (affected by a disproportionate demand for education in the English section; staff employment conditions that make it difficult to recruit teaching staff; an administrative structure and organisation of schools that has not been updated to take account of changing needs; and outdated financial and internal control systems). The Internal Audit service (IAS) considers 20 of 35 identified processes to have high impact and a high residual risk.

12

Administrative expenditure — cash payments to visitor groups in the European Parliament: first reported in 2010[8], the practice of making cash payments and not requiring proof of expenditure for reimbursement of visitors' costs continues, resulting in a high reputational risk for the institution.

7 Article 58.1.c.(iv) and Article 208 of the Financial Regulation.

8 See paragraphs 7.13 to 7.14 of the Court's 2010 Annual Report.

Useful reading/ECA reports and opinions

Legality and regularity issues

- ECA 2012 Annual Report, chapter 9 (Administrative expenditure)
- ECA 2012 Specific Annual Reports of the EU agencies

Performance audits

- Special Report No 15/2012 'Management of conflict of interest in selected EU Agencies'
- Special Report No 12/2012 'Did the Commission and Eurostat improve the process for producing reliable and credible European statistics?'
- Special Report No 10/2012 'The effectiveness of staff development in the European Commission'
- Special Report No 2/2011 'Follow-up of Special Report No 1/2005 concerning the management of the European Anti-Fraud Office'
- Special Report No 13/2009 'Delegating implementing tasks to executive agencies: a successful option?'
- Special Report No 9/2009 'The efficiency and effectiveness of the personnel selection activities carried out by the European Personnel Selection Office'
- Special Report No 5/2009 'The Commission's Treasury Management'

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Public procurement

What it covers

01
EU public procurement is a key policy instrument in establishing the single market. Procurement rules aim, among other things, to ensure that the TFEU principles and fundamental freedoms are observed in the award of public contracts[1].

02
In 2011, the EU-27 public expenditure on works, good and services represented 19,7 % of their GDP (2 406 billion euro)[2]. Approximately 20 % of total public expenditure is subject to EU public procurement rules. In the same year, 42 billion euro was allocated to EU structural funds (ERDF, Cohesion Fund and ESF), of which a large share is implemented through public procurement[3]. In the period 2006–09, cross-border public procurement represented around 15 % of value of the contracts awarded within the EU[4].

03
In the EU over 250 000 contracting authorities (CAs) organise over 2 million procedures per year for the award of public contracts. The CAs can be public entities, or subject to certain conditions, also private undertakings.

04
The EU also supports opening up procurement through international competition: it is signatory to the World Trade Organisation's Government Procurement Agreement (GPA)[5], and has concluded provisions on government procurement in third countries through free trade agreements.

05
EU legislation seeks to ensure that companies from all Member States have the opportunity to compete for public contracts above given thresholds, to remove legal and administrative barriers to participation in cross-border tenders, to ensure equal treatment and to remove scope for discriminatory purchasing by ensuring transparency:

(a) two EU directives, (on public works, supply and service contracts[6] and utilities (water, energy, transport and postal services)[7]), regulate public contracts over a certain value in the EU and the European Economic Area (EEA). These will be replaced by revised directives and a new directive on the award of concessions[8] approved on 15 January 2014. Contracts for defence[9] and services of general interest[10] are covered by other rules.

(b) the EU directives impose rules to ensure transparency, regulate procedures in order to give all interested tenderers a fair chance and establish non-discriminatory technical specifications. The EU directives are transposed into the national procurement laws, thereby ensuring a harmonised legal framework throughout the EU;

1 Freedom of movement of goods (Article 28 TFEU) and services (Article 56), freedom of establishment (Article 49) and freedom to provide services, non-discrimination and equal treatment, proportionality, transparency and mutual recognition (Articles 18 and 53).

2 EU public procurement legislation: delivering results summary of evaluation report (a working document of the Commission Directorate-General Internal Market and Services, http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/executive-summary_en.pdf).

3 European Court of Auditors, Annual Reports concerning the financial year 2011, p. 120 and 152 (OJ C 344, 12.11.2012, p. 1). The exact amount allocated through public procurement is not available.

4 Direct cross-border procurement represents only 1,6 % of contracts awarded and roughly 3,5 % of value of contracts in the period 2006–09. Indirect cross-border procurement through foreign affiliates or subsidiaries represented 11,4 % of awards and 13,4 % by value in the same period.

5 GPA is a pluri-lateral agreement aimed at opening up international competition that confers rights and obligations to the signatories of the GPA.

6 Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts (OJ L134, 30.4.2004, p. 114).

7 Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sector (OJ L134, 30.4.2004, p. 1).

8 New procurement rules were approved by the European Parliament on 15 January 2014. Member

(c) European legislation seeks to guarantee bidders legal redress against CAs that do not comply with these rules[11], and there is considerable European Court of Justice case-law relating to the interpretation and application of EU directives, and of the general principles of equal treatment and transparency;

(d) for purchases below the threshold amounts, Member States may choose to apply the EU rules. However, Member States' freedom to design their own national procurement rules are restricted by the requirement to take account of the European Court of Justice case law on general principles of equal treatment and transparency.

06
Expenditure from the EU budget managed by EU institutions and agencies, are also subject to EU public procurement rules as set out in the Financial Regulation.

07
According to the OECD, public procurement is the government activity most vulnerable to waste, fraud and corruption due to its complexity, the size of the financial flows it generates and the close interaction between the public and the private sectors[12].

08
However, a transparent and open public procurement policy can be a significant tool for fighting corruption. DG Budget, DG Regio and the European Anti-Fraud Office have produced extensive guidance for managers carrying out and controlling procurement, seeking to ensure that public procurement rules have been followed correctly in both administrative and operational expenditure.

What we found

09
Public procurement is a risky area where unsound behaviours and practices, like conflicts of interest, favouritism, fraud and corruption, may occur at all stages, distort fair competition and discourage bidders.

10
Getting it right results in savings to the public purse and good governance in the use of those funds, by instilling discipline to encourage better use of resources, greater efficiency and reducing the risk of favouritism or corruption in public purchasing.

States have until April 2016 to implement the provisions of the new rules into national law. The new legislation overhauls the current EU public procurement rules and for the first time sets common EU standards on concession contracts to boost fair competition and ensure best value for money by introducing new award criteria that place more emphasis on environmental considerations, social aspects and innovation. The rate at which Member States adopt and implement the new directives in their national legislation will vary, with the result that procurement legislation will be especially more complicated in the period to January 2016, as different rules will be applicable. The new rules aim to simplify purchasing, and increase flexibility by allowing greater use of negotiation with prior publication. This may increase the risk of non-application of procedures concerning transparency and equal treatment.

9 Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC (OJ L 216, 20.8.2009, p. 76).

10 On contracts for services of general interest (energy, telecommunications, transport, radio and television, postal services, schools, health and social services), the EU has common rules to improve competitiveness while respecting the diversity in national systems.

11 The remedies directive: Directive 2007/66/EC of the European Parliament and of the Council of 11 December 2007 amending Council Directives 89/665/EEC and 92/13/EEC with regard to improving the effectiveness of review procedures concerning the award of public contracts (OJ L335, 20.12.2007, p. 31).

12 OECD Fighting corruption in the public sector: integrity in procurement (www.

11
In the Commission's own purchasing, the use of framework contracts may restrict the market access for SMEs, making it possible for only large organisations to provide the services required.

12
There is also a risk that successive purchases may be made for amounts just under the limits for public procurement rules to be applied.

13
In the Member States, the huge number of CAs, managing budgets of different sizes and with very different administrative capacities, carrying out procurement in a complex legal environment with EU, national and sometimes regional requirements, means that there is scope for errors to occur. Moreover, the legal framework may add a layer of rigidity for complex procurements, and entail higher administrative costs for purchasing.

14
The Court's compliance audits have revealed consistently high levels of error concerning compliance with public procurement in the Cohesion area. The Court has observed that the various errors which affect the management of these contracts represent a significant part of the estimated error rate for the Cohesion area. In 2012, for example, the quantifiable errors related to non-compliance with EU or national public procurement rules accounted for 52 % of the estimated error rate of the regional policy (the MLE was 6,8 %), and for 26 % of the estimated error rate of the employment and social affairs area (the MLE was 3,2 %)[13].

15
In the Court's experience, the most frequent infringements of procurement procedures are inter alia:

(a) unjustified direct awards, including direct award of additional works or services exceeding the limits laid down by EU and national rules;

(b) subdivision of contracts in order to circumvent public procurement rules;

(c) insufficient or no publicity of tenders and/or award decisions;

(d) use of inappropriate technical specifications and selection criteria restricting competition;

(e) use of irregular methods to evaluate offers;

oecd.org/gov/ethics/integrityinpublicprocurement.htm).

13 European Court of Auditors, Annual Reports concerning the financial year 2012, paragraphs 5.26, 5.33, 6.10 and 6.15.

(f) breach of the principle of equal treatment of bidders during the award procedure;

(g) substantial changes to contract conditions once the tender has been awarded; and

(h) weaknesses in documentation (tender documents, evaluation procedures).

What needs to be done/What the Court has recommended in the past

16

The Court's experience when auditing public procurement suggests that recurrent problems of non-compliance, which lead to significant errors affecting the legality and regularity of transactions, are related to weak implementation of existing rules and that there is still substantial room for improvement at implementing level.

17

Successive evaluations carried out on behalf of the Commission have called for simplification of the EU public procurement rules. However, the new directives (which will have to be implemented in the next 24 months)[14] introduce requirements for CAs to consider social and environmental matters in their purchasing policy. The new legislation simplifies the procedures for CAs, but may make it more difficult to establish if the principles of equal treatment and transparency are applied. It will also introduce an element of subjectivity and additional complexity in that application of the rules for social and environmental matters will rely on interpretation.

18

The Commission could have a role in collecting and disseminating good practices from both intra- and extra-EU territories, to allow policymakers in Member States to learn from others. It could facilitate networking and coordination between Member States on this subject.

14 December 2011 proposals were agreed by the Council in June 2013 and approved by the European Parliament on 15 January 2014. (Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC (OJ L 94, 28.3.2014, p. 65); Directive 2014/23/EU of the European Parliament and of the Council of 26 February 2014 on the award of concession contracts (OJ L 94, 28.3.2014, p. 1); Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 on procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC (OJ L 94, 28.3.2014, p. 243)).

Useful reading/ECA reports and opinions

- EU Anti-corruption Report, Section IV Public Procurement (Com(2014) 38 final of 3 February 2014)
- Opinion No 4/2011 on the Commission's Green Paper on Modernisation of the Public Procurement Policy
- EU public procurement legislation: delivering results summary of evaluation report (http://ec.europa.eu/internal_market/publicprocurement/docs/modernising_rules/executive-summary_en.pdf)
- DG Internal Market and Services website
- ECA Annual Report 2012, chapters 1, 5 and 6
- European Anti-Fraud Office: Red flags in public procurement/fraud schemes

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This Landscape Review was adopted by the Court of Auditors in Luxembourg at its meeting of 25 July 2014.

For the Court of Auditors

Vítor Manuel da SILVA CALDEIRA
President

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