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**REPORT FROM THE COMMISSION**

**Member States' Replies to the Court of Auditors' 2010 Annual Report**

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# REPORT FROM THE COMMISSION

## MEMBER STATES' REPLIES TO THE COURT OF AUDITORS' 2010 ANNUAL REPORT

### 1. SCOPE OF THE REPORT

The Financial Regulation applicable to the General Budget of the European Union states in article 143(6) that as soon as the Court of Auditors (the Court) has transmitted the Annual Report, the Commission shall inform the Member States concerned immediately of the details of that report which relate to management of the funds for which they are responsible, under the rules applicable. Member States should reply to the Commission within sixty days and the Commission transmits a summary of the replies to the Court of Auditors, the European Parliament and the Council before 28 February<sup>1</sup> of the following year.

Following publication on 10 November 2011 of the Court's Annual Report for the budgetary year 2010, the Commission duly informed Member States of details of the report. This information was presented in the form of a letter and three questionnaires (presented as annexes) which Member States were required to complete : Annex I was a questionnaire on the paragraphs in the report referring to individual Member States; Annex II was a questionnaire on the audit findings which refer to each individual Member State and Annex III was a questionnaire on general findings related to the policies and programmes under shared management.

This report is an analysis of the Member States' replies and is accompanied by a Staff Working Document (SWD) which comprises the Member States' replies to Annex I and Annex III.

### 2. PRESENTATION OF THE REPORT AND DAS 2010 FINDINGS

#### 2.1 PRESENTATION OF THE COURT'S 2010 REPORT

In its 2010 report, the Court made further changes to the presentation. Firstly, there have been modifications to the policy groups and corresponding chapters, and a new chapter on performance issues (Chapter 8) which reflects the importance of the economy, efficiency and effectiveness of EU spending, has also been introduced.

Secondly, the Court has further highlighted recommendations, by reporting in detail on the follow up to its previous recommendations for each policy group. Finally, the results of transaction testing have been reported with greater clarity and the estimated error rates for each policy group, as well as for the budget as a whole have been provided by the Court.

Concerning the error rates, in its audit methodology for DAS year 2010, the Court has provided a clear definition of the terminology used:

"The **MLE (most likely error rate)** is the weighted average of the percentage error rates found in the sample. The Court also estimates, again using standard statistical

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<sup>1</sup> OJ L 390, 30/12/2006 - Financial Régulation Article 143.6

techniques, the range within which it is 95 % confident that the rate of error for the population lies in each specific assessment (and for spending as whole). This is the range between the **lower error limit (LEL)** and the **upper error limit (UEL)**<sup>2</sup>".

Table 1 below provides details of the **MLE**, **LEL**, and **UEL** per chapter for the DAS year 2010.

**Table 1.2 - 2010 Summary of findings on regularity of transactions**

Policy Group	Payments (million euro)	Most likely error (MLE) (%)	Confidence interval (%)		Frequency of errors <sup>(1)</sup> (%)	Assessment of supervisory and control systems <sup>(2)</sup>
			Lower error limit (LEL)	Upper error limit (UEL)		
Agriculture and Natural Resources	55 990 <sup>(3)</sup>	2,3	0,8	3,8	37	Partially effective
Cohesion, Energy and Transport	37 556 <sup>(4)</sup>	7,7	4,7	10,7	49	Partially effective
External Aid, Development and Enlargement	6.543	1,7	0,1	3,3	23	Partially effective
Research and other Internal Policies	8.953	1,4	0,6	2,1	39	Partially effective
Administrative and other expenditure	9.264	0,4	0,0	1,1	7	Effective
<b>Overall audited population</b>	<b>118 306<sup>(5)</sup></b>	<b>3,7</b>	<b>2,6</b>	<b>4,8</b>	<b>36</b>	<b>Partially effective</b>
Revenue	127.795	0,0	N/A	N/A	N/A	Effective

<sup>(1)</sup> The frequency of errors represents the proportion of the sample affected by quantifiable and non-quantifiable errors;

<sup>(2)</sup> Systems are classified as 'partially effective' where some control arrangements have been judged to work adequately whilst others have not. Consequently, taken as a whole, they might not succeed in restricting errors in the underlying transactions to an acceptable level. For details see the section "Audit scope and approach" in Chapters 2 to 7.

<sup>(3)</sup> Reimbursed expenditure (see paragraph 3.16).

<sup>(4)</sup> Reimbursed expenditure (see paragraph 4.23).

<sup>(5)</sup> The difference between the payments in 2010 (122 231 million euro - see [Table 1.1](#)) and the total amount of the overall audited population in the context of the regularity of transactions corresponds to advances paid for the policy groups Agriculture and Natural Resources (851 million euro) and Cohesion, Energy and Transport (3 074 million euro) (see paragraphs 3.16 and 4.23).

Source: ECA Report 2010 - Table 1. 2 Summary of findings on regularity of transactions p 18

## 2.2 DAS 2010 FINDINGS FOR THE POLICY GROUPS

For the DAS year 2010, the Court found that the accounts presented fairly the financial position of the European Union, the results of its operations and its cash flows and that they were free from material error. With regard to Revenue (Chapter 2), the Court also noted that transactions were free of material error and control systems were effective. Commitments in all policy groups were also free from material error.<sup>3</sup>The Court concluded that payments for the policy area Administration and other expenditure (Chapter 7) were on the whole free of material error and that the systems were effective in ensuring the regularity of payments.

For Research and internal policies (Chapter 6), as well as External aid, development and enlargement (Chapter 5), the Court's audit stated that the two policy areas were overall free of material error and that control systems were partially effective in ensuring the regularity of payments. However, for Chapter 6, the Court noted that interim and final payments for the research FPs were subject to material error. Also in Chapter 5, interim and final payments were subject to material error<sup>4</sup>.

In Cohesion, energy and transport (Chapter 4) and Agriculture and natural resources (Chapter 3), the Court concluded that payments were materially affected by error, although in the case of policy area Agriculture and natural resources, direct payments to farmers covered by the IACS<sup>5</sup>, were free from material error. In both policy areas the systems were partially effective<sup>6</sup>.

<sup>2</sup> Annex 1.1, PART 2.13

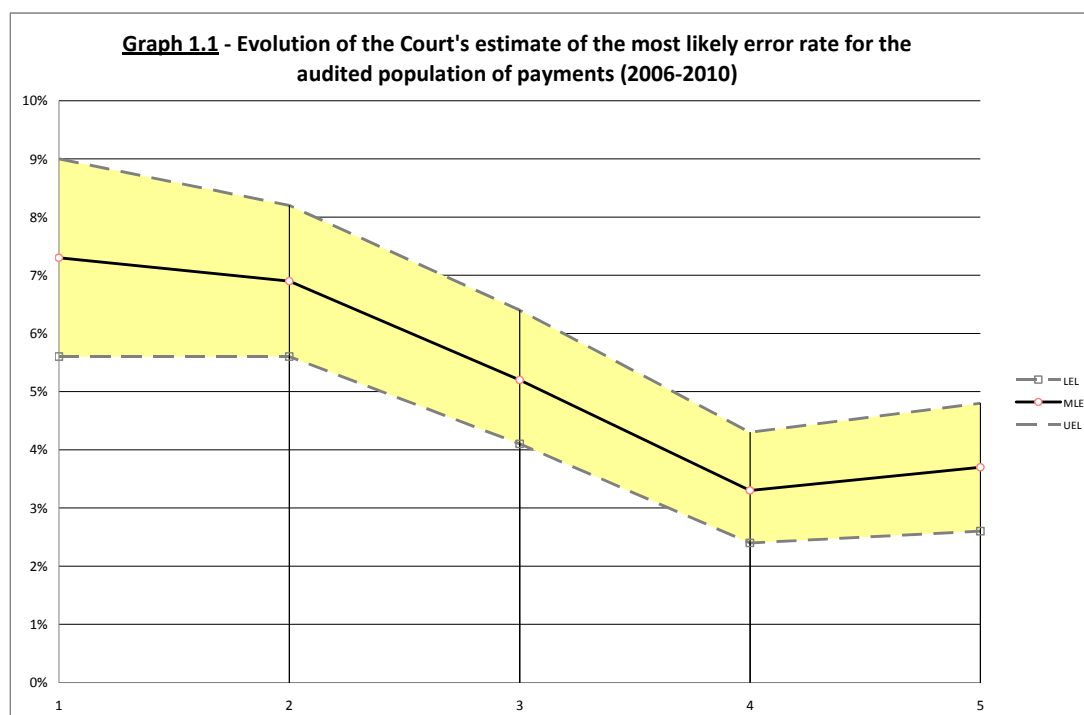
<sup>3</sup> ECA Report 2010 1.11 p 17

<sup>4</sup> ECA Report 2010 5.35 p 149 and 6.48 p 183

<sup>5</sup> Integrated Administration and Control System

<sup>6</sup> ECA Report 2010 1.13 p 17

Overall, as demonstrated in the Court's graph below, in the past five years the trend for the most likely error rate for the budget as a whole has been steadily downwards. However, for 2010, progress in a number of domains has not compensated for a moderate increase in Cohesion, thereby resulting in a small overall increase for the budget as a whole<sup>7</sup>.



Source: ECA Report 2010 - Graph 1.1 Evolution of the Court's estimate of the most likely error rate for the audited population of payments (2006-2010)

### 3. IMPROVEMENTS MADE IN SHARED MANAGEMENT BY MEMBER STATES- REVENUE AND AGRICULTURE AND NATURAL RESOURCES.

As mentioned in the introduction, in addition to the letter, the Commission duly provided each Member State with three annexes: Annex I was a questionnaire on the paragraphs in the report referring to the individual Member States; Annex II was a questionnaire on audit findings which refer to the individual Member State and Annex III was a questionnaire on general findings related to shared management for DAS 2010. For Annexes I and II, the Member States were requested, where necessary, to provide details of actions taken to rectify the errors as well as the timing, content and expected outcome.

This section of the report provides an analysis of the replies given by Member States to Annex I and Annex II and also question 1 in Annex III which refers to policy area Agriculture and natural resources (Chapter 3).

Generally all replies from Member States were received within the scheduled timeline, and although the quality varied considerably from one Member State to another, in some cases replies were of a very high standard. In their replies this year, overall, nearly all Member States reported on and described initiatives for improvement already taken or to be taken in the future. They also indicated their

<sup>7</sup> ECA Report 2010 1.15-1.16 p 19

commitment to ensuring sound financial management<sup>8</sup>. Member States recognize their responsibility for improvement in EU fund management and there were proposals for a more transparent discharge procedure suggesting, for instance, that comprehensive information on best practices at Member States' level could be exchanged<sup>9</sup>.

### 3.1 REVENUE

In their replies to the Court's specific findings in policy area Revenue (Chapter 2), Member States indicated that remedial actions had been taken when necessary. For example, the Court identified certain weaknesses in the procedures and systems which affect the amounts included in the B accounts statements in three countries-UK, Italy and the Netherlands<sup>10</sup>. The UK stated that its authorities had accepted the Court's findings and that each specific finding had been addressed and the Court informed accordingly. The UK authorities stated further that they have rectified the B Account balance and established new procedures and guidance to prevent a recurrence<sup>11</sup>.

With regard to VAT based own resources, according to the Court's report: "longstanding reservations still exist but the backlog is being cleared<sup>12</sup>". As of 31/12/2010 there were 152 reservations for all Member States compared to 167 a year previously.

Seventeen Member States summarised in varying levels of detail the actions they and the Commission were undertaking to lift reservations. Eight of these Member States<sup>13</sup> (Cyprus, Finland, Austria, the Czech Republic, Poland, Spain, Lithuania and Latvia) noted that as a result of the activity undertaken since 2010, at least one reservation has been dropped for their Member State. Denmark, Malta, Poland, Lithuania, Italy, Greece, France and Finland all looked forward to the lifting of further reservations, either as a result of inspections during 2011 or from those scheduled for 2012.

### 3.2 AGRICULTURE AND NATURAL RESOURCES

In policy area Agriculture and natural resources (Chapter 3), the Court highlighted weaknesses of and reported findings on the Land Parcel Identification Scheme (LPIS)<sup>14</sup> - a database in which all the agricultural area (reference parcels) of the Member State is recorded, including the optional use of ortho-photos<sup>15</sup>. In Spain (Castilla-La-Mancha and Extremadura) Greece and Romania the Court observed cases of permanent pasture land recorded in the LPIS as 100% eligible although they were only partially eligible.

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<sup>8</sup> SWD Annex III Part B p 89

<sup>9</sup> SWD Annex III Part B p 90

<sup>10</sup> SWD p 6

<sup>11</sup> SWD p 6-7

<sup>12</sup> ECA Report 2010 2.22 p 49

<sup>13</sup> SWD p 11-21

<sup>14</sup> The Commission notes that most of the quantifiable errors found by the Court were relatively small in financial terms and mainly concerned small differences in the re-measurement of parcels carried out by the Court (ECA Report 2010 3.19 p 78).

<sup>15</sup> ECA Report 2010 3.31 p 83

In all three cases the Member States concerned provided replies. Spain reported that there was currently an action plan in place to improve LPIS-GIS updating including a new methodology for establishing the eligibility coefficient of pasture land<sup>16</sup>. Greece indicated that there were measures in place to ensure that only permanent pasture land was eligible for payments<sup>17</sup>. In response to the Court's observations, Romania replied that it had completed an action plan on the quality of LPIS. In addition, it stated that APIA - Agricultural Payments and Interventions Agency – now ensures that non agricultural areas are not included in the LPIS reference area and the isolated cases identified are the result of errors in photo interpretation. According to APIA, "where payments are made unduly they are recovered using the procedure in force<sup>18</sup>".

In five Member States - Bulgaria, Netherlands, Greece, Romania and Spain - the Court also identified specific weaknesses in keeping the LPIS up to date<sup>19</sup>. Four of the five mentioned by the Court reported that updating the database was an integral part of their maintenance programme, with Greece and Romania reporting regular annual updates<sup>20</sup>. In reply to a question in Annex III of the questionnaire on initiatives taken to improve the management and control systems for agricultural expenditure, notably in the area of Rural Development, other Member States highlighted the fact that improvements in LPIS remained a priority. Out of the 22 countries which replied to the question, 13 outlined concrete examples of initiatives taken for LPIS improvements. These countries included Ireland, Italy, UK, Portugal, Luxembourg and Poland.

In addition to improvements in the LPIS in several Member States, the majority of Member States replied that they had taken initiatives in the last year to further improve the management and control systems for agricultural expenditure and to enhance the effectiveness of checks carried out, notably in Rural Development. These improvements included development and enhancement of various IT systems in many countries. Slovenia for example stated that the Managing Authority for its Rural Development Programme for the period 2007-2013 devised the electronic filing "e-PRP" pilot project for measure 121 - Modernisation of agricultural holdings in 2010 aimed at speeding up and making more effective the management of applications. Applicants now make fewer mistakes when preparing their applications electronically and consequently less time is spent carrying out administrative checks, which in turn reduces the workload of the paying agency while ensuring effective controls<sup>21</sup>. Latvia also reported improvements in IT systems, for example a price catalogue was established within the Rural Development Programme Information System in order to help compare and assess prices between project applications submitted<sup>22</sup>.

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<sup>16</sup> SWD p 31  
<sup>17</sup> SWD p 31-32  
<sup>18</sup> SWD p 29  
<sup>19</sup> ECA Report 2010 3.32 p 84  
<sup>20</sup> SWD p 31-32  
<sup>21</sup> SWD Annex III p 83-84  
<sup>22</sup> SWD Annex III p 71-72

#### 4. IMPROVEMENTS MADE BY MEMBER STATES IN SHARED MANAGEMENT- COHESION, ENERGY AND TRANSPORT

##### 4.1 REINFORCED GUIDANCE AND TRAINING

Annex III of the questionnaire comprised mostly questions on Cohesion, energy and transport (Chapter 4) and this sub section of the report provides a detailed analysis of the Member States' replies to these questions.

The Court noted in its report that for Policy area Cohesion, energy and transport, Member States could have detected and corrected at least some of the errors (prior to certifying the expenditure to the Commission) for 58% of the transactions affected by error<sup>23</sup>. Member States were requested in Annex III to comment on this finding. Nearly all Member States commented and 63% of Member States replied that the most efficient means of preventing irregularities from occurring was with reinforced guidance to beneficiaries. Other means of improvement included reinforced documentary checks and increased on the spot verifications. Further suggestions offered by Member States included simplification and clarification of rules and regulations at both national and EU level (*see section 4.1 on Simplification for further analysis of simplification as proposed by Member States*). The table below provides details of the number of Member States selecting a particular option. Some Member States chose more than one option and there was a majority preference for a combination of (a) reinforced guidance to beneficiaries and (b) reinforced documentary checks.

<b>Q2 - Cohesion, Energy and Transport</b>		
	No. of Member States	% of Member States
In the Cohesion chapter (§4.25), the Court considers that sufficient information was available for the Member State authorities to have detected and corrected at least some of the errors (prior to certifying the expenditure to the Commission) for 58% of the transaction affected by error.		
<b>In your opinion, what can be done to improve the situation?</b>		
(a) reinforce guidance to beneficiaries to prevent irregularities from occurring	18	67%
(b) reinforce documentary checks on claims submitted by beneficiaries	15	56%
(c) increase on-the-spot verifications on operations before certification	11	41%
(d) any other suggestions	7	26%

In Cohesion the Court also found that wholly ineligible projects and ineligible costs accounted for 35% and 33 % respectively of the estimated error rate for the Chapter. In addition, the Court also noted that there had been serious failures to respect EU and national procurement rules and that these failures accounted for 22% of the estimated error rate<sup>24</sup>.

<sup>23</sup> ECA report 2010 Chapter 4.25 p 109

<sup>24</sup> ECA Report 2010 Chapter 4.20, 4.29, 4.26 p 107-109



Member States cited training programmes as the single best means of addressing these key issues. In the case of wholly ineligible projects, 78% of the Member States stated that more training for staff in national/regional/managing authorities and intermediate bodies was required and 56% of them underlined the necessity for the training to be targeted.

In its reply, Ireland further highlighted the importance of the issue by stating that the most efficient way to benefit from these training programmes would be by ensuring that they were: "targeted/tailored at the various levels in the financial management and control cascade with regular follow-up refresher courses<sup>25</sup>". In addition, Germany underlined the challenges of the training issue by stating that "covering all areas in training and guidance where infringements are possible may create considerable difficulties<sup>26</sup>".

Similarly for ineligible costs, a majority of Member States (78%) highlighted as a solution, guidance and training at the level of beneficiaries. For public procurement, an even greater number of countries (81%) selected training for staff of national/regional/managing authorities and intermediate bodies as the most effective means of improving the situation.

Both Latvia and France stated that they are currently taking initiatives to complement the training already provided.

Latvia stated in its reply that: "the institutions involved in the administration of EU funds work with the Public Procurement Bureau (PPB) and the State Treasury in order to arrange regular training for the beneficiaries on procurement matters. From 2012 on, pre-procurement verifications, apart from the PPB, will be carried out by the responsible institution/cooperation institution (RI/CI), reducing/preventing infringements in the area of public procurement<sup>27</sup>".

France proposed that starting from the first trimester of 2012 training programmes with specific themes (e.g. eligibility and expenditure) will be organised by the French Interior Ministry. These training programmes will be made available to staff from both national and regional managing authorities<sup>28</sup>.

In the Cohesion chapter the Court also highlights several weaknesses found in Audit Authorities in the Member States<sup>29</sup>.

Member States demonstrated a clear preference for two improvement measures (1) the use of detailed checklists which cover all risks to the regularity of expenditure and (2) specific guidance by the Commission on the scope of verifications and the extent of the audit checks to be undertaken, as well as the reporting of findings. The use of standard sampling methodology and re-structuring of training for the audit authorities were welcomed by only 7% of Member States.

Apart from the measures suggested in the questionnaire (Annex III) some additional comments on the subject were also provided by Member States. Some Member States expressed concerns with regard to the functioning of audit authorities. For

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<sup>25</sup> SWD Annex III p 70-71

<sup>26</sup> SWD Annex III p 65-66

<sup>27</sup> SWD Annex III p 71-72

<sup>28</sup> SWD Annex III p 65

<sup>29</sup> ECA Report 4.38 p 115

example in its reply, Germany highlighted the "exacting requirements" for audit authorities, but stated that at the same time there were some areas of uncertainty e.g.: sampling for small populations. The German authorities concluded that:

"the Commission should in particular work in partnership (with the audit authorities) and consider in more detail specific experiences of the audit authorities in terms of practice and context<sup>30</sup>".

Lithuanian authorities highlighted the staffing issue as an area of weakness for their audit authorities and stated that what was required was the "improvement of the level of qualifications of the audit institution and application of appropriate measures to ensure lower staff turnover<sup>31</sup>".

France, however, confirmed that weakness in its Audit Authorities was not a problematic issue<sup>32</sup>.

## 4.2 SIMPLIFICATION

On the subject of simplification, a significant number of Member States has already introduced initiatives addressed at simplifying the implementation of EU programmes during the current programming period 2007-2013. Estonia and Portugal have both acknowledged the importance of simplification in the context of the European Social Fund (ESF). Estonia stated that "twelve different rates for the reimbursement of expenditure from the ESF on the basis of standardised unit prices have been implemented in Estonia<sup>33</sup>". Portugal also pointed out that "the ESF Information System (SIIFSE) was a key instrument of simplification implemented in Portugal in this programming period<sup>34</sup>".

Most countries (20 in total) stated that the greatest potential for simplification lay with EU rules rather than with national rules. Nonetheless, a significant number (11 in total) agreed that there was also potential for simplification of national rules as well. Also, as indicated in their replies and illustrated in the graph which follows, most Member States would make at least minimal use of flat rates and lump sums.

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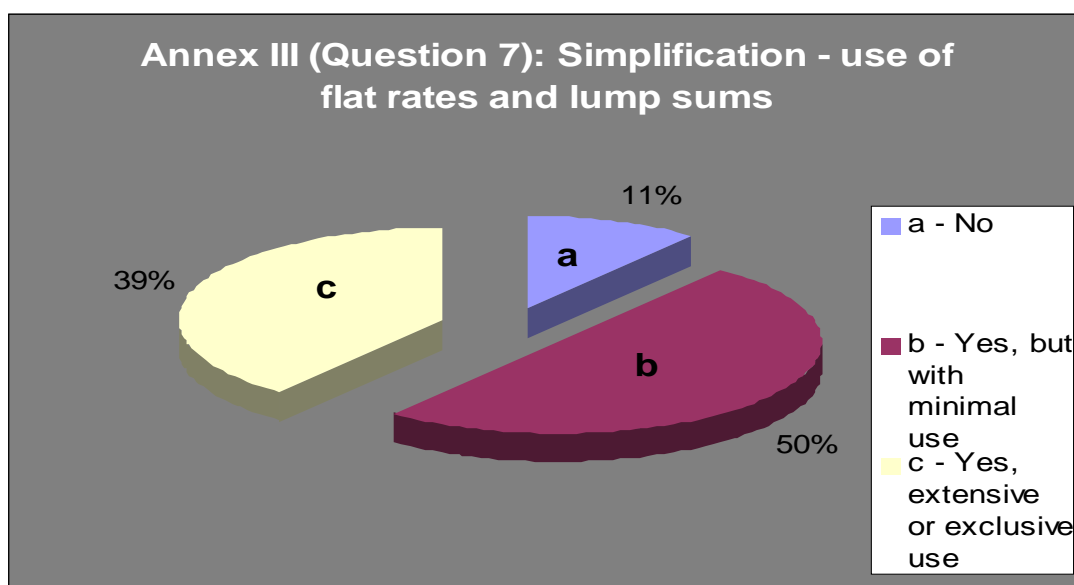
<sup>30</sup> SWD Annex III p 65-66

<sup>31</sup> SWD Annex III p 76-77

<sup>32</sup> SWD Annex III p 65

<sup>33</sup> SWD Annex III p 64

<sup>34</sup> SWD Annex III p 79-81



The challenges of simplification were outlined by some Member States in their replies. For example, Ireland stated that:

"A main part of any simplification for management and beneficiaries is allowing flexibility where possible. Therefore, all simplification proposals from the Commission rules should be optional and not mandatory. However, at Member State level a balance is required, as a more flexible approach to specific operations could be a simplification to the beneficiaries but, potentially, not a simplification for management because a higher staff management resource would be required than setting general national rules<sup>35</sup>".

## 5. CONCLUSION

The results of the Court's 2010 Annual Report indicate encouragingly that the overall most likely error rate for all EU spending is below 4%. The results are particularly positive for policies directly managed by the Commission. Policy areas such as Research and other internal policies, External Aid, development and enlargement as well as Administrative and other expenditure indicate continuous improvement.

In policy area Agriculture and natural resources, the situation remained relatively stable with a level of error close to the materiality threshold of 2%. In policy area Cohesion, energy and transport, it is important to emphasise that the error rate was still below the rates for DAS years 2006 - 2008. This is an indication that the management and control systems in the policy area, although still partially effective, are working more efficiently for the current programming period, as compared to the previous period.

Member States replies to the report indicate that there is a continuing trend towards improvement in the management of EU funds. They outlined several initiatives taken

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and also stated their commitment to even further improvements. Simplification and training at all levels remain a top priority. In addition, some Member States provided some complementary suggestions with regard to ensuring efficient management of EU funds and a more transparent discharge procedure.