



COMMISSION OF THE EUROPEAN COMMUNITIES

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**REPORT FROM THE COMMISSION TO THE COUNCIL**

**on the follow-up to 2004 Discharge Decisions  
(Summary) - Council Recommendations**

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## PREAMBLE

According to Article 276 of the EC Treaty and Article 180b of the Euratom Treaty, the “Commission shall take all appropriate steps to act on the observations in the decisions giving discharge and on other observations by the European Parliament relating to the execution of expenditure, as well as on comments accompanying the recommendations on discharge adopted by the Council. At the request of the European Parliament or the Council, the Commission shall report on the measures taken in the light of these observations and comments and in particular on the instructions given to the departments which are responsible for the implementation of the budget. These reports shall also be forwarded to the Court of Auditors”<sup>1</sup>

The Commission has accordingly prepared Follow-up Reports, which relate to the Council recommendation of 14 March 2006 and the Resolutions voted by the European Parliament on 27 April 2006. The present Follow-Up Report deals with the recommendations made by the Council in relation to the 2004 Discharges. A separate Follow-up report deals with the recommendations made by Parliament in relation to the Discharges given for the 2004 financial year<sup>2</sup>.

The summary Follow-up Reports, which are published in all EU official languages, are complemented by Commission working documents giving detailed answers to each specific recommendation of both Council and Parliament. The replies indicate actions that the Commission intends to take or has already taken and also the recommendations that the Commission will not or is not able to follow up. Due to translation constraints the detailed working documents are published in English, French and German. Each chapter of the summary reports includes cross-references to the relevant recommendation numbers in the working documents.

In the context of the 2004 discharge, the Commission has identified a total of 79 recommendations made by the Council to the Commission. The Commission considers that for 38 recommendations the required action has already been taken. For another 39 recommendations the Commission agrees to take the action recommended by Council. Finally, the Commission cannot accept 2 recommendations and will therefore not be taking the requested action<sup>3</sup>.

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<sup>1</sup> See also Article 147 of the Financial Regulation

<sup>2</sup> 2004 General Budget Discharge, 2004 EDF Discharge, 2004 Agencies Discharge

<sup>3</sup> See recommendations 24 and 61.

## I. COUNCIL RECOMMENDATION ON THE GENERAL BUDGET

### A) Introduction (Commission working document, points 1-5)

Like Council, the Commission regrets that in 2004 the Court of Auditors was again unable to give a Statement of Assurance (DAS) in relation to most of the expenditure. For this reason, the Commission has launched its “Action plan towards an Integrated Internal Control Framework” (COM(2006) 9). The objective of the Action Plan is to ensure that supervisory systems and controls are in place to keep the risk of illegality or irregularity in underlying transactions within reasonable limits and to provide the Court of Auditors with reasonable assurance to that effect.

The Action Plan includes 16 actions under four broad themes aimed at simplifying and harmonising control practices, via information sharing and the use of a ‘single-audit’ approach to better target the limited control resources available. At this stage, priority actions have been launched, while others which depend on the results of prior actions will be developed during 2007. Sufficient progress is expected to be made by the beginning of 2009. The first half-yearly progress report to Parliament and Council was issued on 19 July 2006 (SEC(2006) 1001).

### B) The statement of assurance (DAS) and supporting information (Commission working document, points 6-12)

The Commission's “Action Plan towards an Integrated Internal Control Framework” sets simplification as a goal for the next programming period. The Commission’s proposal for the Rules for Participation for the 7th Framework Programme foresees that greater recourse would be made to the use of flat rates (including scale of unit costs) and lump sums within the terms of the Financial Regulation. As regards low-value contracts and grants, the Commission proposes to let the authorising officer decide on the need to verify exclusion criteria depending on his/her risk assessment. The legislative authority should pay the necessary attention to the feasibility of expected controls and their cost/benefit, so that the correct application of controls is as straightforward as possible.

In the 2005 Synthesis of the annual activity reports the Commission welcomed the overall improvement in the annual activity reports (AAR), which were generally more focused and explicit. This is the result of improved guidance to increase accountability through explicit declarations and an appraisal of the inherent nature and characteristics of the management, risk and control environment in which Directorates-General operate, and of the elements and results of the management and control system which support the assurances required in the declaration.

The results of Action 3a of the Commission’s action plan (specification of control components) will be considered for the AAR circular with a view to improving the information on key elements of internal control and the management of risks in the 2006 AARs. The ongoing work on materiality criteria will also contribute to improved reporting. In addition, work is proceeding on the 2004 Synthesis action on objectives and indicators for the legality and regularity of operations.

As regards the Commission’s new accounting system, which became operational in January 2005, the Commission established its opening balance sheet and it was included as part of the 2005 provisional annual accounts. These accounts were presented on time to the Court of Auditors on 31 March 2006, as required by the Financial Regulation.

### **c) Budgetary management (Commission working document, points 13-16)**

The Commission notes Council's satisfaction with the overall progress in the Commission's budgetary management. The Commission always aims to provide accurate and realistic budget estimates, on the basis of the best available information. In 2005, more accurate budget estimates were reflected in a significant improvement in the implementation rate of payment appropriations, which rose to 98% (100% for structural operations).

The Commission regularly updates its analysis of outstanding budgetary commitments for Structural Funds and will continue to do so. The analyses take into account the latest available implementation data and expected developments. In its latest assessment the Commission has given due regard to the switch to a new programming period. An extensive analysis of the outstanding budgetary commitments for the Structural Funds is published every year in a Commission Staff Working Paper (DG Budget) "Analysis of the budgetary implementation of the Structural Funds". The analysis for 2005 was published in May 2006 and also includes an analysis on the operation of the n+2 rule. In the present programme period the n+2 rule provides a powerful incentive to Member States to ensure that implementation proceeds at a sufficiently high rate, as funds not implemented in good time are decommitted. Member States and the Commission are aware that vigilance is needed to ensure that the switch between programme cycles is made smoothly, both in terms of ensuring programme implementation, and of tackling the additional workload related to the establishment of new programmes.

### **d) Revenue (Commission working document, points 17-20)**

Like Council, the Commission is pleased that the Court again in 2004 considered the overall results satisfactory concerning the reliability of the accounts and the legality and regularity of underlying transactions for revenue.

Moreover, the Commission has taken or is taking the actions recommended by Council as regards own resources. The Commission has requested Member States to improve their fall-back mechanisms for electronic customs clearance systems. In the longer -term action is also being taken as part of the project to introduce a modernised customs code by 2009. This new code will contain clearer provisions relating to the drawing up of rules for fallback procedures in the implementing provisions.

As regards the control mechanisms for sugar levies, audits have taken place in twelve Member States since 2004. No serious problems were found apart from in one Member State. The new sugar regime, effective from 1 July 2006, abolishes the production levies to be paid by the manufacturers for the quantities produced under quota. In the new implementing regulations, the Commission has strengthened the provisions on controls and sanctions in the event of infringements.

The Commission is in constant contact with Member States with a view to lifting reservations on Member States' VAT statements as rapidly as possible. However, the pace of this work depends on the ability of national administrations to find and use better data, indeed any data at all in certain cases, or a suitable or more suitable methodology. The Commission provides regular advice to Member States on these matters.

As regards the GNI resources, the Commission will discuss the issue of supervisory and control systems related to national accounts with the Member States in the GNI Committee in 2006. The Commission will then make suggestions for promoting best practices in 2007.

#### **E) The Common Agricultural Policy (Commission working document, points 21-28)**

The Commission is committed to addressing the remaining shortcomings in the control system in the different areas of the CAP that are not checked through IACS. The CAP reforms of 2003 and, for Mediterranean products, of 2004 reduce the overall risk by extending the expenditure covered by IACS to 89% by 2013.

As regards the Annual Activity Report of the Director-General the Commission does not intend to indicate separately in the Director-General's declaration verified expenditure and expenditure subject to further checks. Given the multi-annual nature of the conformity clearance process, such a distinction would be largely arbitrary; it would also prejudice the Member States' right of defence in the context of the clearance of accounts procedure. In their 2004 and 2005 AARs DGs clearly set out the basis for the Director General's annual declaration of assurance. The entire chain of controls and in the DG AGRI's AAR the clearance of accounts procedures were presented in detail, showing how these elements contribute to the overall assurance, which is built on all sources of information at the disposal of the Director-General. Furthermore, in the 2005 AAR, DG AGRI gives an indication of the level of financial corrections likely to be imposed on Member States for the 1999-2005 period. The same is true of the annual accounts, where the Commission makes the necessary disclosure of the amounts it still expects to be recovered through the clearance of accounts process.

The weaknesses identified by the Court of Auditors in the area of spending on animal premiums do not concern the effectiveness of the IACS control system in itself. Indeed the direct testing performed by the Court did not reveal any significant errors. The problem identified consists mainly in high percentages of errors identified at farmers' level by the IACS inspections, particularly in certain Member States. The Commission will continue to identify more precisely the reasons why IACS statistics show high rates of mis-declaration or over-declaration of animals for certain Member States and will recommend appropriate actions.

Although the use of the prefinancing system has become economically insignificant, with the exception of the beef sector, predominantly for its control function, the Commission is working on the necessary steps to abolish the system of prefinancing export refunds, while for the beef sector an alternative production and storage control system will be introduced. These measures should be in place by the end of 2006.

#### **F) Structural measures (Commission working document, points 29-37)**

A review of the control systems for the Structural Funds was carried out in 2005 in preparation for the Action Plan. A number of the actions in the Action Plan seek to improve the effectiveness, economy and efficiency of systems. Of particular importance for systems in the Structural Funds are the analysis of the quality of existing controls and declarations (action 13), to be completed by the end of 2006, and the survey of the costs of controls (action 10), to be completed by September 2007. In early 2006 the Commission issued notes on good practices in day-to-day checks by management and in paying authorities' work before certifying payment claims, which by setting benchmarks should help Member States to make the controls more effective and avoid overlap. The work being undertaken to coordinate audit standards (action 16) and intensify the sharing of audit results (action 9) should also foster economy and efficiency as well as helping to make the control system function more effectively.

Moreover, the Commission's audit work, monitoring of the audit results of national audit bodies, and dissemination of good practice are all designed to bring about the necessary improvements in systems so that the objective of financial control - that the expenditure reimbursed is as free of error and irregularity as reasonably possible - is achieved.

The closure of the 2000-2006 programmes has been prepared by the Commission and Member States and the Commission has issued a detailed guidance document.

#### **G) Internal Policies, including research (Commission working document, points 38-42)**

The Commission is continuously working on the development and adaptation of its internal control system in order to manage the risks linked to its environment. Major steps were taken in 2005 to introduce a systematic approach for risk analysis, assessment and management.

A risk framework was developed in 2005. A comprehensive strategic risk analysis was conducted, and is currently being implemented in the annual management plan 2006.

Simplification of the procedures with a growing use of IT tools has also been implemented.

The services concerned used the audit results also to evaluate the control environment in which the programmes are being managed. In this context, the issue of the frequency of errors in cost claims has been taken into account to improve the controls in FP6 (e.g. the introduction of audit certificates and penalties contributes to reduce the number of errors in the declarations of costs presented by the beneficiaries) and to simplify the upcoming FP7 (e.g. more use of lump sums and flat rates).

Following the 2005 Gap Assessment exercise, the services are contributing to the Commission's Action Plan with a set of specific measures. The main areas of work will be ex-post control strategy, the use of audit results to develop management and control systems, the financial circuits, the overall system of supervision put in place in the financial domain and the monitoring and reporting systems.

#### **H) External actions (Commission working document, points 43-45)**

The Commission has continued its efforts to improve its supervisory and control systems in the field of external actions and, in particular, it has further strengthened external audits as recommended by Council. Clear instructions to the external auditors are established in terms of reference and audit results are monitored and followed up.

EuropeAid has introduced measures to improve the follow-up of audits and this year produced an analysis of audit reports finalised in 2005. Moreover, as regards CRIS-Audit, a specific module of EuropeAid's Common Relex Information System (CRIS), aiming at providing a database on audit information, the Commission intends to further improve its operation with a view to allowing a better exploitation of the system at both Headquarters and Delegations.

#### **I) Pre-accession aid (Commission working document, points 46-48)**

The Council welcomed the Court of Auditors' statement that supervisory and control systems at the level of the Commission's central services, Delegations and certifying authorities were basically sound and worked in practice for all pre-accession instruments (Phare, Turkey, ISPA and Sapard) and that no material errors in the underlying transactions tested were identified.

The Court invited the Commission to continue its efforts to ensure sound financial management of the pre-accession instruments. The Commission has already taken action on these recommendations, e.g. by drawing the attention of the national authorities to the need to take urgent corrective measures in relation to the present Decentralised Implementation System (DIS) with ex ante control on procurement and award decisions.

**J) Administrative expenditure (Commission working document, points 49-52)**

The Commission has taken due note of Council's recommendations concerning administrative expenditure. In particular as regards the implementation of the Internal Control Standards adopted in 2000, the Commission undertakes a yearly follow-up of the implementation of the related baseline requirements. According to self-assessments of the Commission's services, in 2005 95% of the baseline requirements were complied with compared to 93% in 2004, which – in an ever changing environment – could be considered as being practically fully implemented.

Under this heading Council has also included two recommendations concerning the regulatory agencies. The agencies are independent institutions and it is their responsibility to comply with the relevant rules and procedures for staff recruitment, public procurement and accounting. Nevertheless, the Commission gives guidance and support to the agencies, e.g. on accounting, procurement, staff policy and audit, and where the agencies request it, the Commission provides specific assistance, e.g. to help them to understand and interpret the rules<sup>4</sup>. The agencies should also be encouraged to further develop their inter-agency cooperation whenever appropriate in order to share costs and knowledge.

**K) Financial instruments and banking activities (Commission working document, points 53-54)**

As regards the European Investment Fund (EIF), the participation on the Board of Directors of senior officials from the three services with the greatest policy interest in the EIF activities is the best assurance of the protection of the Community interest. The introduction in mid 2005 of a Compliance Function in the EIF with a particular mandate to ensure appropriate compliance arrangements are in place with respect to EU policies and legislation further enhances this assurance. The Commission is working closely with the EIF to help ensure the effectiveness of this new function.

**II. RECOMMENDATIONS CONCERNING INDIVIDUAL AGENCIES (Commission working document, points 55-57)**

The Commission is taking the action recommended by Council. In particular as regards the Translation Centre for the Bodies of the European Union and the payment of employer's contributions in respect of its employees' pension rights, the Commission has repeatedly tried to arrive at a solution, proposing approaches to the Management Board of the Translation Centre, including offers for a negotiation on some periods under consideration. None of these was successful and the Commission has now decided to lodge a complaint before the Court of Justice.

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<sup>4</sup> See also the examples mentioned in points 49 and 50 of the annexed working document.



**III. CONCLUSIONS ON THE FOLLOW-UP OF THE 2003 DISCHARGE (Commission working document, points 58-63)**

The Commission is taking the recommended actions to follow up the conclusions on the 2003 discharge, for instance as regards the approach to risk management, the production of adequate indicators for activity-based management and the implementation of the new accounting system.

In line with Article 131 of the Financial Regulation, the Commission already provides a report on implementation of the budget to the Budget Authority three times a year, but does not in this report include a specific analysis of the cumulative state of implementation of major Community programmes as requested by Council. The Commission provides such an analysis annually in its Report on the budgetary and financial management.

**IV. COURT OF AUDITORS' SPECIAL REPORTS (Commission working document, points 64-79)**

The Commission will take the actions recommended by Council as regards the Court of Auditors' special reports on the devolution of EC external aid management to the Commission Delegations (SR 10/2004), the management of the European Anti-Fraud Office (OLAF) (SR 1/2005), the verification of agri-environment expenditure for rural development (SR 3/2005) and interpretation expenditure incurred by the Parliament, the Commission and the Council (SR 5/2005).

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