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"Tolerable risk of error"

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¹ A "working document" is a preparatory document. It is not a final document in as far as it has not gone through the traditional parliamentary process: presentation, exchange of views, amendments, vote. Therefore, opinions and considerations expressed in a working document represent the rapporteur's initial and personal points of views and not a final committee position.

Introduction

1. The notion "tolerable risk of error" was introduced by the European Court of Auditors' Opinion 2/2004 on "a Community internal control framework".
2. The European Parliament made comments on the Court's important strategic considerations in its 2003, 2004 and 2005 discharge reports and arranged also a workshop to discuss the issue on 12 July 2006.
3. The Commission produced a follow up to the Court's Opinion in two separate communications. First the "Roadmap to an Integrated Internal Control Framework" from June 2005¹ and then the "Action Plan towards an Integrated Internal Control Framework"² from January 2006.
4. The Council stated in a "conclusion" adopted on 8 November 2005 that "it should reach an understanding with the European Parliament regarding the risks to be tolerated in the underlying transactions, having regard to the cost and benefits of controls for the different policy areas and the value of the expenditure concerned"³.
5. As of today your rapporteur has not seen any initiatives from the Council in order to reach this "understanding" with Parliament and wonders when the Council will act on its own decision?

What is it about?

6. "Tolerable risk of error" is an expression of two basic facts:
 - the first is that internal control of EU expenditure has its price;
 - the second is that aiming at zero risk is extremely expensive and therefore not realistic.

Thus, it needs to be made explicit what risk of error can be tolerated.

7. It follows, so say the Court and the Commission that it is important to find an **appropriate *balance* between the *cost* of controlling and the *benefit* of such controls.**
8. The idea is that above a certain level it is uneconomical to put further resources into the control system, since the additional resources begin to outweigh the benefit.
9. The question then arises: ***who tolerates?*** In other words: which institution should decide on the tolerable level of error? The Court of Auditors suggests that the

¹ COM(2005) 252 of 15.6.2005.

² COM(2006) 9 of 17.1.2006.

³ Press release 2688th Council meeting Economic and Financial Affairs, paragraph 17, at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/86877.pdf.

budgetary authorities (Parliament and Council) should approve the "tolerable risk of error".

10. Why should Parliament participate in this exercise? Is it "tolerable" that a parliamentarian accepts that the use of public money can imply a risk? Would it not - particularly for a parliamentarian wishing to be re-elected - be wiser to forcefully underline the need for *absolute* assurance and *zero* risk?
11. The guiding principle in the public sector has traditionally been "no risk". If you ask taxpayers what they expect of public servants - and politicians - the answer will most probably be "compliance with the rules" rather than "innovation", "creativity" or "risk taking".
12. However, the "no risk" approach implies an enormous rise of control costs and thus - *taxes*. Therefore, parliamentarians have a duty to help find a balance and to explain to the taxpayers that they are better off that way.
13. The introduction of the concept "tolerable risk of error" allows us to move away from the "no risk" tradition in the public sector and towards a more open and transparent attitude on the risk profiles of the different EU policies and the cost of managing or containing that risk.

Possible main elements of an agreement

14. If we move towards a situation in which less than absolute assurance is politically acceptable what might then be the main elements of an agreement on "tolerable risk of error"?

Differentiation

15. There should probably be different levels in different policy areas. As of today the European Court of Auditors operates within a 2 % materiality level for all policy areas. However, it could be that some of the European Union's policies are of such a nature that a 2 % materiality level is out of reach *at a reasonable cost*.
16. An example: The need for humanitarian aid after a natural disaster is urgent and the surrounding chaos overwhelming. In that situation it would seem not only exaggerated but also irresponsible to aim for less than 2 % of errors. If humanitarian aid were delivered only on the basis of this condition the policy would be prohibitively expensive and administratively suffocating making it ultimately useless.
17. On the other hand we have "Administrative expenditure" where the error rate could and should be kept well below 2 %. Would 0.5 % be reasonable?

The rules

18. Risks are to a certain extent a result of rules which themselves result from the need to achieve policies. Complex rules are by nature more prone to errors than simple ones although complex rules are sometimes needed for targeted policy achievement.

Definition of "error"

19. There should be no discussion of what constitutes an error. The Court should be ultimately responsible for the definition of errors, and this definition should be made clear to all stakeholders.

Sanctions and penalties

20. Consideration should be given to what happens in cases where the error rate in a Member State is higher than what had been agreed as "tolerable". Sanctions and penalties should be sufficient to assure prompt follow-up from the responsible actors. The follow-up should be that the control system is tightened the following year to better achieve the desired risk level.

The price of the actual control system as well as of additional control.

21. At present the cost of the current control systems is not known. Neither is it known how much a reduced level of errors would cost. And furthermore: Is there a direct relation between an increase in audit resources and fewer errors? It could be the case that instead of more controls we need *fewer and better* controls.

Complete and truthful reporting from the Commission

22. A fundamental condition for the introduction of a "tolerable risk of error" is *clear, unequivocal and complete* reporting from the Commission and the Member States. Based on the experiences with inadequate quality of some of the Directors-General Annual Activity Reports as identified by the Court of Auditors this very basic requirement could be a major challenge for the Commission.

Reservations

23. In principle your rapporteur would be in favour of making the "implicit explicit" as Mr Caldeira said in the workshop of 12 July 2006. But the following reservations cannot be neglected.

Avoid confusions

24. It should be recognised that:
- *the problem* is the reality of (too many) errors in the underlying transactions in some policy areas and this problem is mainly situated in the *Member States*;
 - *the objective* is to reduce the number of errors to a known and agreed level;
 - the Statement of Assurance shall continue to be based on the Court's *audit results* and *not* on wishful thinking.

Is cost/benefit a sufficient criterion?

25. The Court proposes that the 'tolerable risk of error' shall be set on the basis of "costs and benefits" (paragraph 50 in Opinion 2/2004). Is this an adequate criterion? Situations may arise where 'tolerable risk' cannot be defined exclusively on a *quantitative* basis. It must also be defined in *qualitative* terms in cases where we are dealing with so-called "*reputational risks*".

A 'reputational risk' is the risk of damage to reputation stemming from *any* incident of *any* kind of *any* amount which throws doubt on the integrity of an organisation as a whole. The question is to know how to establish the price of the *political damage* caused by deficient control systems?

26. It could be argued that parts of administrative expenditure - for instance representation costs of Members of institutions, private use of official cars and secretarial allowances for MEPs - are so sensitive that only zero tolerance is good enough to contain the risk to reputation.

Who should set the 'tolerable risk of error'?

27. As mentioned the Court proposes that "the budgetary authorities (Parliament and Council)"¹ should **approve** the cost/benefit balance, but it does not suggest which institution should **set** 'the tolerable risk of error'.

28. Your rapporteur takes the view that a proposal from the Commission concerning the tolerable risk of error for a given policy should be accompanied by a *cost calculation* concerning the cost of controls.

29. The quality of the cost calculation should be assessed by the European Court of Auditors who could then help the Council and Parliament to decide on what is deemed tolerable.

30. Independent assessment of the cost information is important. The Commission would maybe wish to stay on the safe side, and overestimate the resources needed, or it would maybe set the level a bit higher in order to be sure it can be attained with the available resources.

31. In order to be transparent and give the budgetary authorities a solid basis for decision the Commission could even present differing options indicating the control expenses for a 2% error rate, a 5 % error rate, etc as well as giving information on how much the control expenses may be reduced if the regulation governing a specific programme were to be amended in such and such a way.

Way forward

32. Your rapporteur would like to suggest that:
- political recognition of the calculated risks involved in EU actions be

¹ paragraph 55 in Opinion 2/2004

encouraged;

- the 'tolerable risk of error' be set on the basis of "what we want" (by decision) and not on the basis of "what we have" (by accident);
- precise and reliable information as regards the present situation be provided;
- on the basis of the present situation action plans be developed in view of a continuous reduction of errors over time until the agreed level, taking into account the costs, is reached.

Final remarks

33. A 'tolerable risk of error' should not be an isolated and narrow technical instrument. It should be an integrated element in the overall management of the budget. It should help the implementation of the budget in a more rational and flexible way by allowing a greater margin for those who implement it, and taking specific account of the cost of control, whether incurred by the Commission or the Member States.
34. This greater margin would of course have its price. Its name is *accountability*. Since about 80 % of the EU budget is implemented by implementing authorities within Member States, national accountability must be strengthened.
35. The Parliament has proposed 'national management declarations' as a tool with which to achieve this objective. It has also suggested that National Audit Institutions could play a role in ensuring that national management declarations give an honest assessment of the situation.
36. Your rapporteur invites the Commission to give due attention to these considerations in the new proposals following the Budget review.