



National Audit Office

Report

by the Comptroller
and Auditor General

Financial management of
the European Union budget
in 2014: a briefing for the
Committee of Public Accounts

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National Audit Office

Financial management of the European Union budget in 2014: a briefing for the Committee of Public Accounts

Report by the Comptroller and Auditor General

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Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

11 February 2016

This report provides an overview of the European Union (EU) budget, the framework within which it is managed, and associated oversight and accountability arrangements.

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Key facts

€143.9bn¹

EU revenue in 2014
(£116.0 billion)²

€142.5bn

EU payments in 2014
(£114.8 billion)

£11.4 billion
(€14.1 billion)

UK gross contribution to the EU budget in 2014 (taking into account the UK rebate³)

£5.7 billion
(€7.1 billion)

UK net contribution to the EU budget in 2014 (taking into account the UK rebate, and public- and private-sector receipts)

Since 2007

the European Court of Auditors has given a true and fair opinion on the accounts of the EU

Since 1994

the European Court of Auditors has given an adverse opinion on the legality and regularity of EU payments

4.4%

The European Court of Auditors' estimated level of error in EU payments during 2014, above its 2% materiality threshold

120

European Commission actions to reduce errors by simplifying processes, increasing accountability and increasing flexibility in how member states can spend public-sector receipts from the EU budget

1 All euro figures on this page are sourced from the European Commission.

2 All sterling figures are based on European Commission euro figures. We have calculated sterling figures using HM Treasury's annual average exchange rate for 2014 of £1 = €1.240977, rounded to 1 decimal place.

3 In 2014 the UK received a rebate of €6.1 billion. Calculating the UK rebate is complex, but it is broadly equivalent to 66% of the difference between the UK's contribution to the EU budget, and its receipts from the EU budget. The method for calculating the rebate is laid down in Council Decision 2007/436/EC, and in the supporting Council of the European Union document *Method for the calculation of the UK correction*.

Summary

1 The European Union (EU) operates a financial management regime that determines how it collects revenue in the form of contributions from member states, and how these are subsequently managed and accounted for.

2 In 2014 the EU budget received €143.9 billion in contributions from 28 member states and other sources,¹ and made €142.5 billion in payments.² The UK made a gross contribution (post-rebate³) of €14.1 billion (£11.4 billion), and received EU public- and private-sector receipts of €7.0 billion (£5.6 billion). It therefore made a net contribution of €7.1 billion (£5.7 billion).⁴ This was the third-largest net contribution to the EU budget.

3 On 10 November 2015 the European Court of Auditors (ECA) published the results of its audit of the EU budget in 2014. These are the most up-to-date audited financial results of the EU budget.⁵

4 This briefing on financial management of the EU budget has been prepared for the UK Committee of Public Accounts, drawing exclusively from published material. It includes:

- an overview of the EU financial framework;
- the opinions and findings of the ECA with respect to the EU budget in 2014; and
- the use made of EU monies in the UK, including oversight arrangements and information on the extent to which these monies have been managed in line with EU requirements.

¹ Member states contributed approximately €134 billion. Other sources contributed approximately €10 billion.

² Member states received approximately €129 billion in payments from the EU budget.

³ In 2014 the UK received a rebate of €6.1 billion. Calculating the UK rebate is complex, but it is broadly equivalent to 66% of the difference between the UK's contribution to the EU budget, and its receipts from the EU budget. The method for calculating the rebate is laid down in Council Decision 2007/436/EC, and in the supporting Council of the European Union document *Method for the calculation of the UK correction*.

⁴ Throughout this briefing, sterling figures have been calculated using HM Treasury's annual average exchange rate for 2014 of £1 = €1.240977, and rounded to 1 decimal place.

⁵ The EU financial year is based on the calendar year of 1 January to 31 December, whereas the UK financial year runs from 1 April to 31 March.

Key points

The EU budget

- The EU budget is agreed annually by the European Parliament and the Council of the European Union (the Council), within the terms of a seven-year agreement known as a multiannual financial framework (MFF). The current MFF covers the period 2014 to 2020.
- The current MFF allows the EU to make up to €960.0 billion in commitments (legal pledges to finance specific activities), and €908.4 billion in payments (money to be paid from the EU budget to beneficiaries). Respectively these are 3.4% and 3.7% less (in 2011 prices) than under the previous (2007–2013) MFF.

Audit results

- The ECA concluded that the 2014 EU accounts were true and fair. They have been true and fair since 2007.
- The ECA reached an adverse opinion on the regularity and legality of EU **payments**. The estimated level of error for 2014 was 4.4%, above the ECA's materiality threshold of 2%. Errors relating to payments in 2014 mean that this threshold has now been breached for the last 21 years. The ECA reported that **revenue** in 2014 was legal and regular.
- The ECA's estimated level of error represents money that was not used, or administered, in accordance with EU regulations and national rules. In 2014, the principal sources of errors included ineligible costs included in cost claims, serious errors in public procurement, and incorrect declarations of area by farmers. The ECA's estimated level of error is not an estimate of fraud.

Action to address errors

- The UK Committee of Public Accounts recommended in 2005 and 2009 that EU rules should be simplified to reduce errors.
- The ECA has recommended improvements in control systems at member state and EU levels, and further simplification of the rules, to reduce errors and enhance the results achieved from EU spending.
- In 2014 the European Commission (the Commission) and member states took corrective action to reduce the occurrence of errors by applying corrective measures in cases of irregular expenditure. If such corrections had not been applied, the ECA's overall estimated level of error would have been 5.5% rather than 4.4%.
- The Commission has an action plan to pursue simplification, increase accountability and improve flexibility, as well as focus on results achieved from EU spending.
- A mid-term review of the current MFF is scheduled for the end of 2016. This will enable EU institutions to reassess priorities for the remaining years of the current MFF.

The EU budget and the UK

- In 2014 the UK made a net contribution to the EU budget of £5.7 billion. It received public-sector receipts worth £4.6 billion. £3.2 billion of public-sector receipts contributed to the EU's objective *Sustainable growth: natural resources*, which includes support for rural development, and environmental measures. In addition, £1.4 billion of public-sector receipts to the UK contributed to the EU's objective of *Smart and inclusive growth*: promoting competitiveness to increase growth and jobs, and also supporting economic, social and territorial cohesion. Public-sector receipts do not include EU grant receipts secured by UK organisations through competitions.
- In common with all EU member states, the UK has adopted a structure whereby specific organisations manage, pay, certify, and audit the EU monies the UK receives.

Part One

The European Union budget

1.1 This part provides an overview of the European Union (EU) budget, the framework within which it is managed, and associated oversight and accountability arrangements.

An overview of the EU financial framework

1.2 The EU budget is set annually by the EU institutions within the terms of a seven-year agreement known as a multiannual financial framework (MFF). The current MFF was agreed by the Council of the European Union (the Council) and European Parliament in November 2013 and covers the period 2014 to 2020. The principal institutions of the EU and their roles in establishing a new budget are set out in Appendix Two.

1.3 When negotiating the budget, the EU institutions have to respect annual limits known as 'ceilings'. These ceilings set limits for both commitment appropriations (legal pledges to finance specific activities) and payment appropriations (money to be paid from the EU budget to beneficiaries), for each of the seven years.

1.4 The current (2014–2020) MFF divides the EU budget into six areas of expenditure ('policy areas/budget headings') corresponding to the different areas of expenditure. The six headings and their corresponding commitment appropriations are described in **Figure 1**. The MFF provides flexibility to allow the European Commission (the Commission) to react to unforeseen circumstances, for example to respond to the migration crisis.

1.5 A mid-term review of the current MFF is scheduled to take place by the end of 2016 to enable the Council, the European Parliament and the Commission to reassess priorities for the remaining years of the MFF.

Figure 1

EU policy area/budget heading, objective or purpose, and commitment appropriations for the 2014–2020 multiannual financial framework

EU policy area/budget heading	Objective or purpose	Commitment appropriations (€bn)	As a proportion of total commitment appropriations (%)
1 Smart and inclusive growth			
1a Competitiveness for growth and jobs	Supports research and innovation; education and training; trans-European energy, telecommunications and energy networks; social policy; enterprise development.	125.6	13
1b Economic, social and territorial cohesion	Supports regional policy intended to help the least developed EU countries and regions catch up with others, encouraging competitiveness and inter-regional cooperation.	325.2	34
2 Sustainable growth: natural resources	Supports rural development and environmental measures.	373.2	39
3 Security and citizenship	Supports justice and home affairs; border protection; immigration and asylum; public health; consumer protection; culture; youth; information and dialogue with citizens.	15.7	2
4 Global Europe	Supports international development and humanitarian assistance activities outside the EU.	58.7	6
5 Administration	Funds administrative expenditure of European institutions, pensions and European schools (schools primarily for the children of staff in EU institutions).	61.6	6
Total commitment appropriations		960.0	100

Notes

- 1 Commitment appropriations are given in 2011 prices, as this is when negotiations for the 2014–2020 multiannual financial framework commenced.
- 2 The commitment appropriations presented in this figure reflect the position as at December 2013. Delays finalising expenditure plans in 2014 mean that these commitment appropriations have since been amended.
- 3 The table does not include budget heading 6: *Compensation*. This heading has €27 million commitment appropriations (0.003% of total commitment appropriations), and is to fund temporary payments to ensure Croatia does not contribute more to the EU budget than it receives from it, in its first year following accession (Croatia joined on 1 July 2013).

Source: European Commission

EU expenditure

1.6 The current MFF allows the EU to make up to €960.0 billion in commitments and €908.4 billion in payments over seven years. Respectively, this is 3.4% and 3.7% less (in 2011 prices) than under the previous (2007–2013) MFF period.

1.7 The current MFF marks a shift in EU priorities towards boosting growth and creating jobs as part of the *Europe 2020* strategy (**Figure 2**).⁶ Expenditure heading 1a: *Competitiveness for growth and jobs*, which includes, for example, research and innovation, increased by 37% compared to the previous MFF. Heading 2: *Sustainable growth: natural resources*, and heading 1b: *Economic, social and territorial cohesion* remain the EU's biggest budget items (respectively 38.9% and 33.9%); however, their combined budgets have reduced by 19.7%. Heading 5: *Administration* commitments have increased by 8%.

Figure 2

Comparison of current (2014–2020) and previous (2007–2013) EU multiannual financial frameworks (MFFs), in 2011 prices

Commitment appropriations for policy area/budget heading	Current MFF	Previous MFF	Comparison: current versus previous	
	(€bn)	(€bn)	(€bn)	(%)
1 Smart and inclusive growth				
1a Competitiveness for growth and jobs	125.6	91.5	+34.1	+37.3
1b Economic, social and territorial cohesion	325.2	354.8	-29.7	-8.4
2 Sustainable growth: natural resources	373.2	420.7	-47.5	-11.3
3 Security and citizenship	15.7	12.4	+3.3	+26.8
4 Global Europe	58.7	56.8	+1.9	+3.3
5 Administration	61.6	57.1	+4.5	+8.0
Total commitment appropriations	960.0¹	994.2²	-34.2	-3.4
Total payment appropriations	908.4	942.8	-34.4	-3.7

Notes

- This does not include commitment appropriations of €27 million in respect of budget heading 6: *Compensation*. This is to fund temporary payments to ensure Croatia does not contribute more to the EU budget than it receives from it in its first year following accession (Croatia joined on 1 July 2013).
- This does not include commitment appropriations of €0.9 billion in respect of budget heading 6: *Compensation*. This was to fund preparations for the accession of Croatia.
- Figures are given in 2011 prices, as this is when negotiations for the 2014–2020 multiannual financial framework commenced.
- Figures may not sum exactly due to rounding.

Source: European Council and Council of the European Union

⁶ *Europe 2020* is the EU's ten-year jobs and growth strategy, launched in 2010.

Allocation of EU expenditure

1.8 The EU budget is used to finance a number of funds, which are allocated to member states. The seven principal funds and their associated objectives are described in **Figure 3**. These seven funds account for nearly 80% of the EU budget, and are managed in partnership between the Commission and member states under a system referred to as 'shared management'.

1.9 Except for the European Agricultural Guarantee Fund (EAGF), almost all EU funds must be co-financed by the beneficiary. Co-financing requirements vary as a proportion of project costs and can come from national or local funders, including the private sector. Co-financing must comply with eligibility requirements of relevant EU and national-level rules.

Figure 3

EU policy areas, funds and fund objective or purpose

EU policy area	Fund	Shortened to	Objective or purpose
1 Smart and inclusive growth	European Regional Development Fund	ERDF	Strengthens economic and social cohesion in the EU by correcting imbalances between its regions.
	European Social Fund	ESF	Improves employment and education opportunities across the EU, and improve the situation of the most vulnerable at risk of poverty.
	Cohesion Fund	CF	Reduces economic and social disparities and promote sustainable development.
	Youth Employment Initiative	YEI	Provides extra support to young people under 25 living in regions where youth unemployment was more than 25% in 2012.
2 Sustainable growth: natural resources	European Maritime and Fisheries Fund	EMFF	Ensures fishing and aquaculture are environmentally, economically and socially sustainable.
	European Agricultural Guarantee Fund	EAGF	Finances direct payments to farmers, and finances measures to regulate agricultural markets.
	European Agricultural Fund for Rural Development	EAFRD	Helps rural areas meet economic, environmental and social challenges: sustainability of rural communities, environmental protection and food security.

Source: European Commission

1.10 The remaining 20% of the EU budget is managed directly or indirectly by the Commission. Directly managed funds include grants secured through competition. Member states, public or private organisations are required to bid for funding – there is no allocated share for member states. Examples of these competitive funds include:

- nearly €80 billion for *Horizon 2020*, to enhance EU competitiveness;
- €30.4 billion for *Connecting Europe*, to support trans-European networks and infrastructure in the areas of transport, telecommunications and energy; and
- €2.3 billion for *Competitiveness of Enterprises and SMEs* (small and medium-sized enterprises), to support the competitiveness, growth and sustainability of enterprises, in particular SMEs.

1.11 Directly managed funds also include the Commission's own administration costs. Indirectly managed funds include the administration costs of other EU institutions, and also heading 4: *Global Europe*.

1.12 All EU budget expenditure should focus on EU added value: objectives that can be achieved better through spending at EU level rather than at the level of the individual member states.

Financing the EU budget

1.13 The EU budget is financed almost exclusively by contributions from member states through a system of 'own resources'.⁷ Member states make contributions based on their:

- gross national income (approximately 70% of member states' contribution to the budget);
- customs duties and sugar levies (approximately 11%); and
- VAT receipts (approximately 12%).

1.14 The UK receives an abatement, or rebate, on its contribution through a mechanism designed to correct contributions by certain member states deemed excessive as compared to their national wealth.⁸ The cost of the UK rebate is divided among the other EU member states. The UK contribution to the EU budget is considered further in Part Three.

The EU budget in 2014

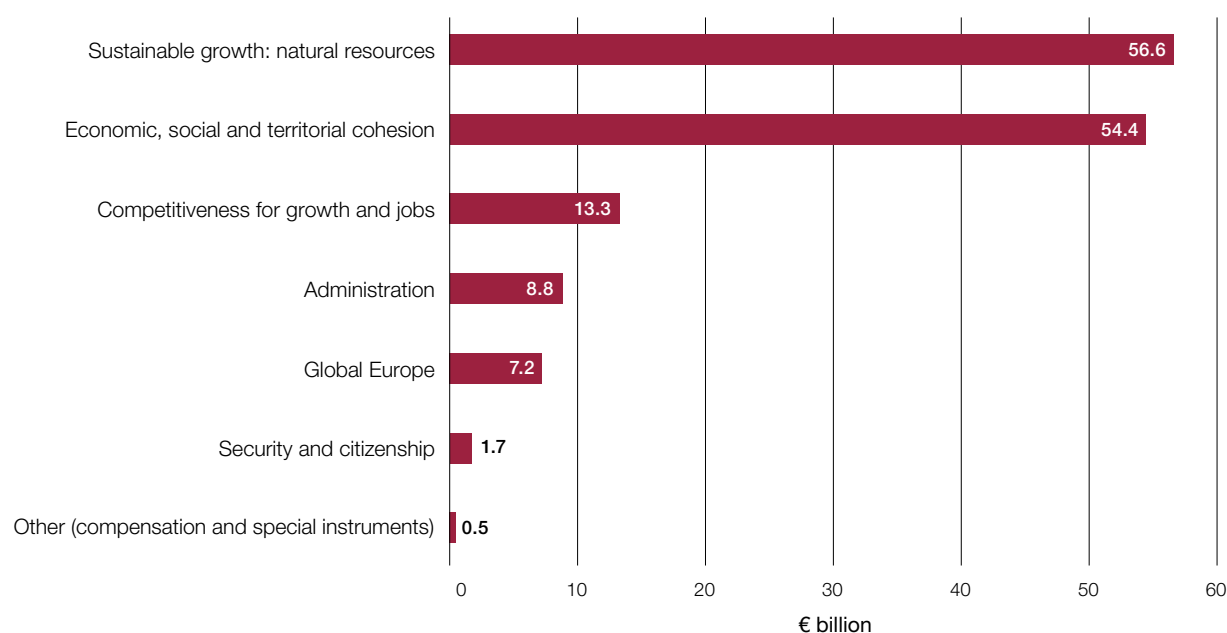
1.15 The EU budget in 2014 received €143.9 billion in contributions from 28 member states and other sources. It provided for payments of €142.5 billion (see **Figure 4**).

⁷ Approximately 92% of EU revenue comes from member states' contributions. The remaining amount is from other sources, including fines on companies breaching EU competition law. The own resources decision is agreed unanimously by all member states. In the UK this requires an Act of Parliament.

⁸ See footnote 3.

Figure 4
EU expenditure in 2014

Total EU expenditure in 2014 was €142.5 billion



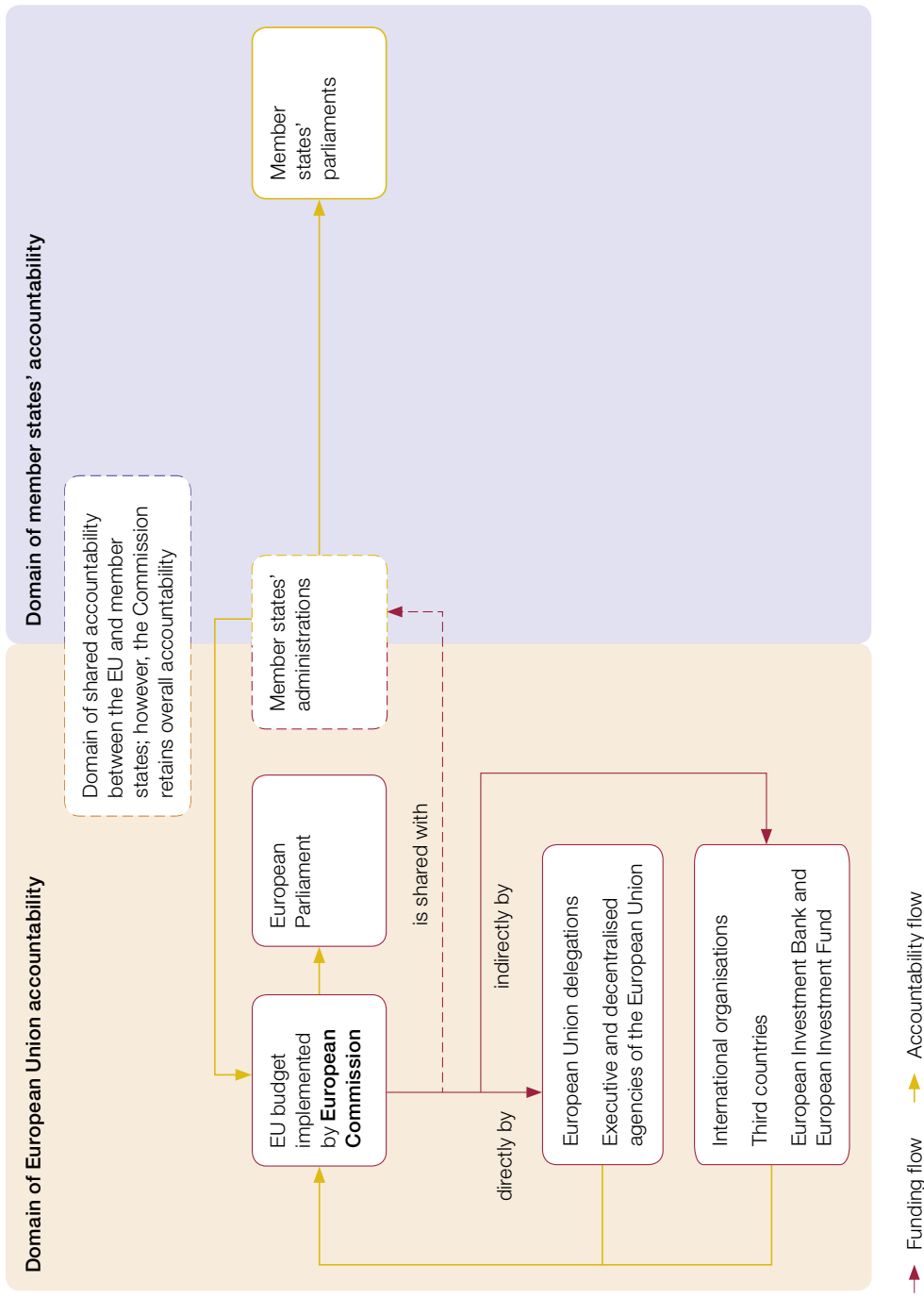
Source: European Court of Auditors

Managing the EU budget

1.16 Once the budget is adopted, it is managed directly by the Commission and other EU institutions, indirectly by other international organisations or third countries, or implementation is shared between the Commission and member states (see **Figure 5** overleaf). The Commission has a common set of rules that determine how the EU budget can be spent;⁹ however, the Commission retains overall accountability for the implementation of the budget.

⁹ European Commission, *Financial Regulation applicable to the general budget of the Union and its rules of application*, March 2014.

Figure 5 Organisations involved in the implementation of the EU budget, and corresponding accountability flows



Notes

1 Estimated levels of error in both domains was 4.6%. Estimated level of error in domain of EU accountability does not include the estimated level of error relating to heading 5: Administration of 0.5% (see figure 8).

Source: European Commission and European Court of Auditors

1.17 For the 80% of EU expenditure administered through shared management arrangements with national, regional and local authorities within member states, the Commission is responsible for:

- negotiating and approving EU partnership agreements proposed by member states, and allocating resources (partnership agreements should incorporate a focus on performance);¹⁰
- supervising the arrangements governing the management and control frameworks of EU programmes; and
- protecting the EU budget by making financial corrections and imposing recoveries, where necessary.

Member states are responsible for:

- managing EU programmes, and a simplification of rules;¹¹
- executing payments to beneficiaries and taking all necessary measures (legislative, regulatory and administrative) to ensure payments are legal and regular, and to detect and correct irregularities; and
- setting up management and control systems that comply with EU requirements.

Protecting the EU budget from financial irregularity and fraud

1.18 The Commission supervises member states' management of EU programmes. If a member state fails to meet certain procedural and other requirements, it must make efforts to rectify these through a financial recovery, or the Commission may make a financial correction (see paragraph 3.22). The process of identifying and rectifying errors can take a considerable time, and it can be several years before corrections are implemented. This is because corrections and recoveries normally result from inspections and audits, sometimes as part of the formal closure of a multi-year programme.

Fraud and irregularity and the work of OLAF

1.19 The role of the European Anti-Fraud Office (OLAF – from the French *Office de Lutte Anti-Fraude*) is to fight fraud, corruption, and other illegal activity that affects the financial interests of the EU. It is administratively part of the Commission, but is autonomous in its investigative role. OLAF reports annually on the number and value of irregularities and suspected frauds notified by member states, and on the results of its investigations.

¹⁰ Partnership Agreements are drawn up by member states and approved by the Commission following negotiation. They set out how the European Structural and Investment Funds (ESIF) will be used by the member states. ESIF comprises: the Cohesion Fund (CF), the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Youth Employment Initiative (YEI), the European Maritime and Fisheries Fund (EMFF) and the European Agricultural Fund for Rural Development (EAFRD).

¹¹ EU regulations: Common Provision Regulation (EU 1303/2013), governing the ESIF: Horizontal Regulation (EU 1306/2013), governing the financing, management and monitoring of the European Agricultural Guarantee Fund and the European Agricultural Fund for Rural Development.

1.20 It is important to distinguish between fraud and irregularity. An irregular transaction is one that has not complied with all of the regulations that govern EU revenue and payments. Fraud is an irregularity that is committed intentionally and constitutes a criminal act.

1.21 Member states are required to notify the Commission of irregularities, including those that may be fraudulent. In 2014, member states reported 16,473 irregularities to the Commission made up of:

- 14,824 irregularities not reported as fraudulent, involving €2.7 billion; and
- 1,649 irregularities reported as fraudulent (suspected and established) involving €538.2 million.

1.22 If OLAF recommends that EU monies should be recovered, it is up to competent authorities in member states to decide on the action to be taken: OLAF does not have the power to prosecute.¹² In 2014, OLAF recommended financial recoveries totalling €901 million. This was unusually high due to the conclusion of some significant investigations relating to European Structural and Investment Funds (ESIF), external aid and customs. Customs represented the single largest recommended recovery at €132.2 million (15% of the total recommended for recovery in 2014). As a result of OLAF investigations, €206 million was recovered for the EU budget in 2014. The average duration for investigations concluded during 2014, or ongoing at the end of 2014, was 21 months.

1.23 Between January 2007 and December 2014, OLAF made 16 recommendations to UK competent authorities to recover EU monies. Eleven of these recommendations were dismissed. The remaining 5 recommendations led to an indictment (representing an indictment rate of 31%, compared with the EU member state average of 53%).

The EU budget discharge procedure

1.24 The annual budget cycle is closed when the European Parliament 'discharges' the Commission from its responsibility for the fiscal year in question. The Council makes a discharge recommendation to the European Parliament, which is the opportunity for member states to express their views on the implementation of the budget. However, only the European Parliament has authority to grant, refuse, or postpone discharge (see Appendix Three).

1.25 The European Parliament's discharge decision is informed by:

- the EU accounts;
- reports from the European Court of Auditors (ECA), in particular its annual report;
- the recommendation of the Council; and
- the Commission's responses to questions posed by the European Parliament (answering specific questions and providing further information requested).

¹² In the UK, this includes the prosecuting authorities.

1.26 The UK, together with the Netherlands and Sweden, has for the last four years voted against the Council's recommendation to the European Parliament to discharge the EU budget. Since 2010, these three countries have issued a joint statement to the European Parliament strongly regretting the adverse opinion on the legality and regularity of payments. In their most recent joint statement (February 2015, referring to the 2013 financial year) these three countries recommended that the Commission and member states should:

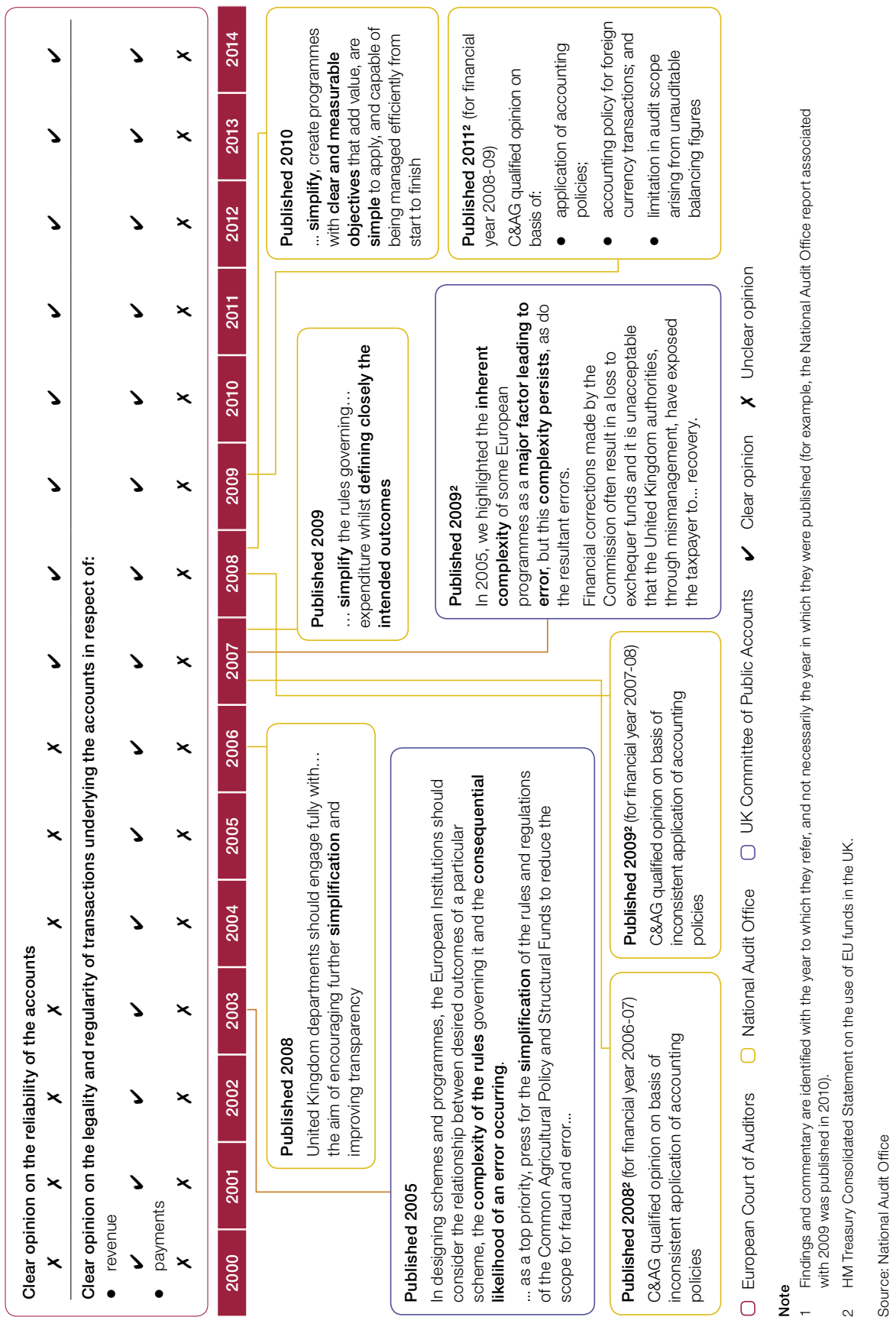
- identify more opportunities to simplify the complex rules and regulatory framework governing the EU budget; and
- give priority to improving the assessment and monitoring of EU programmes to ensure they achieve the desired outcomes and represent added value.

1.27 In its resolution discharging the Commission from the implementation of the 2013 EU budget, the European Parliament recommended that member states should continuously improve their management and control systems in order to achieve better financial management, and a reduction in error rates.

1.28 The problems associated with complex EU programmes have been evident for some years. Simplification was a theme advocated by the UK Committee of Public Accounts in its reports on financial management in the EU in both 2005 and 2009 (**Figure 6** overleaf). In 2005 and 2009 the Committee highlighted the inherent complexity of the rules governing EU expenditure as a major factor leading to error, but this complexity has persisted, as have the resultant errors. The conclusions and recommendations issued by the Committee in its 2009 report, together with developments to date, are set out in Appendix Five.

1.29 The discharge procedure for the 2014 budget is in progress, and is expected to conclude in April 2016.

Figure 6 Timeline of audit opinions from the European Court of Auditors and commentary from the National Audit Office and UK Committee of Public Accounts on the issue of error rates in EU expenditure, from 2000 to 2014



Part Two

The European Court of Auditors

2.1 This part:

- summarises the main conclusions of the European Court of Auditors' (ECA) annual report on the implementation of the European Union (EU) budget in 2014;¹³
- considers errors identified by the ECA, and action to address the build-up of financial commitments; and
- describes recent action to address weaknesses in financial management.

The role of the European Court of Auditors

2.2 The ECA is the independent external auditor of the EU. It is a collegiate body of 28 members, one from each member state. The ECA audits the consolidated financial statements of the EU, which are produced annually by the Commission's Directorate General for Budget.

2.3 The ECA audits the legality and regularity of EU revenue and expenditure, and conducts annual performance audits considering the economy, effectiveness and efficiency of EU spending.

Statement of assurance

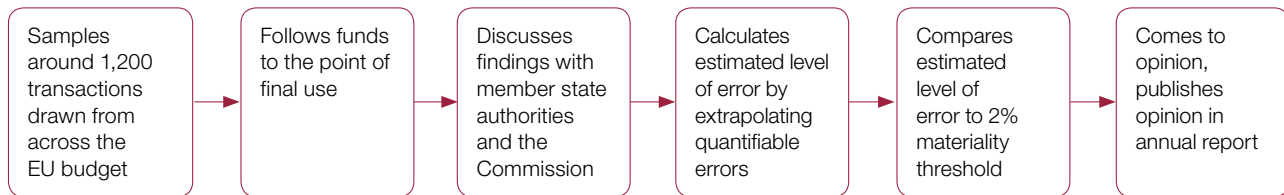
2.4 A key part of the ECA's report is the annual statement of assurance. The statement of assurance is an audit opinion of the reliability of the EU's accounts, and the legality and regularity of the transactions underlying them. The findings and conclusions supporting the opinion are published in the ECA's annual report. The President of the ECA communicates its annual report to the European Parliament and member states.

2.5 To assess legality and regularity, the ECA audits whether transactions conform to applicable laws and regulations. The ECA conducts detailed testing of a sample of transactions from across all policy areas/budget headings. The ECA uses the results to draw an opinion on the EU budget, and also to provide specific assessments of the different areas of the EU budget. The ECA's audit of the EU budget is based on international auditing standards. For an overview of the ECA's methodology for its statement of assurance, see **Figure 7** overleaf.

¹³ The EU financial year runs from 1 January to 31 December.

Figure 7

European Court of Auditors' 2014 methodology in respect of its statement of assurance (legality and regularity opinion)

The ECA

Source: National Audit Office based on information from the European Court of Auditors

2.6 The ECA's annual report on the EU budget does not attempt to draw conclusions in respect of individual member states, but on the EU budget and annual accounts as a whole. However, each year the ECA examines management systems in a number of member states, and individual member states are sometimes cited for illustrative purposes (see Appendix Four for references made to the UK in the ECA's 2014 annual report).

The ECA's statement of assurance on the 2014 EU budget

2.7 On 10 November 2015, the ECA published its annual report on the 2014 EU budget.

Key conclusions:

- **The EU accounts were reliable**

The EU accounts for 2014 were prepared in accordance with international public-sector accounting standards, and present a true and fair view of the EU's financial results for the year, and its assets and liabilities at the end of the year.¹⁴

- **Revenue was legal and regular**

The estimated level of error for revenue was zero.¹⁵

- **Adverse opinion in respect of payments**

The ECA did not provide a positive statement of assurance on the legality and regularity of EU payments because these were affected by material error. The estimated level of error at 4.4% was above the ECA's materiality threshold of 2%.¹⁶

¹⁴ The ECA has reported a true and fair opinion on the financial statements each year since 2007.

¹⁵ The ECA has reported that revenue was legal and regular since 1999.

¹⁶ The ECA has reported an adverse opinion on the legality and regularity of EU payments each year since 1994.

Analysis of errors identified by the ECA

2.8 The estimated levels of error recorded by the ECA were above the materiality level of 2% (the level below which it deems errors do not have a significant effect) for each of the main policy areas/budget headings except administration, which had an estimated level of error of 0.5% (**Figure 8**).

2.9 The ECA's estimated level of error represents monies not used or administered in accordance with applicable rules and regulations. It is not a measure of fraud. If the ECA suspects a transaction to be fraudulent, it is forwarded to OLAF, the EU's anti-fraud office, to investigate. Out of approximately 1,200 transactions assessed for legality and regularity in 2014, the ECA identified 22 instances of suspected fraud, which were forwarded to OLAF.

2.10 The main source of error in 2014 was 'ineligible costs included in cost claims', followed by 'errors in public procurement – tendering and implementation' and 'incorrect declarations of area by farmers' (**Figure 9** overleaf). Together, these three sources of error contributed almost 90% of all errors in 2014.

2.11 EU payments can be characterised by whether a recipient is 'entitled' to receive EU monies, or whether a recipient is being 'reimbursed' for costs incurred.¹⁷ The ECA's analysis suggested that errors relating to reimbursements dominated the errors detected in 2014 (**Figure 10** on page 23).

Figure 8

European Court of Auditors' estimated level of error by EU policy area/budget heading, and contribution to overall estimated level of error, 2014

EU policy area/budget heading	Estimated level of error	Contribution to overall estimated level of error by policy area/budget heading
	(%)	(%)
1a Competitiveness for growth and jobs	5.6	12
1b Economic, social and territorial cohesion	5.7	50
2 Sustainable growth: natural resources	3.6	33
4 Global Europe	2.7	5 ¹
5 Administration	0.5	
Overall	4.4	100

Notes

- 1 Together, 4: *Global Europe*, 5: *Administration* and an 'other' category contributed 5% of the overall estimated level of error.
- 2 The table does not include estimated levels of error for EU policy area/budget headings 3: *Security and citizenship* and 6: *Compensation*, as the European Court of Auditors does not provide a specific assessment of spending under these headings.

Source: European Court of Auditors

¹⁷ Those entitled to receive EU monies could include farmers and students. Those reimbursed for costs incurred could include, for example, construction companies contracted to build an airport or motorway.

Figure 9

Contributing factors to overall estimated level of error in EU budget expenditure, by error type, for 2013 and 2014

In 2014, nearly 90% of errors identified by the European Court of Auditors related to three error types

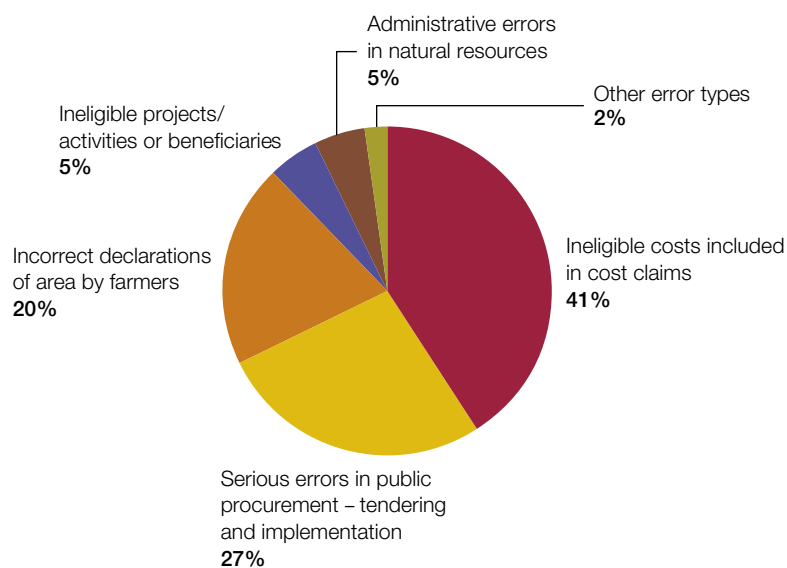
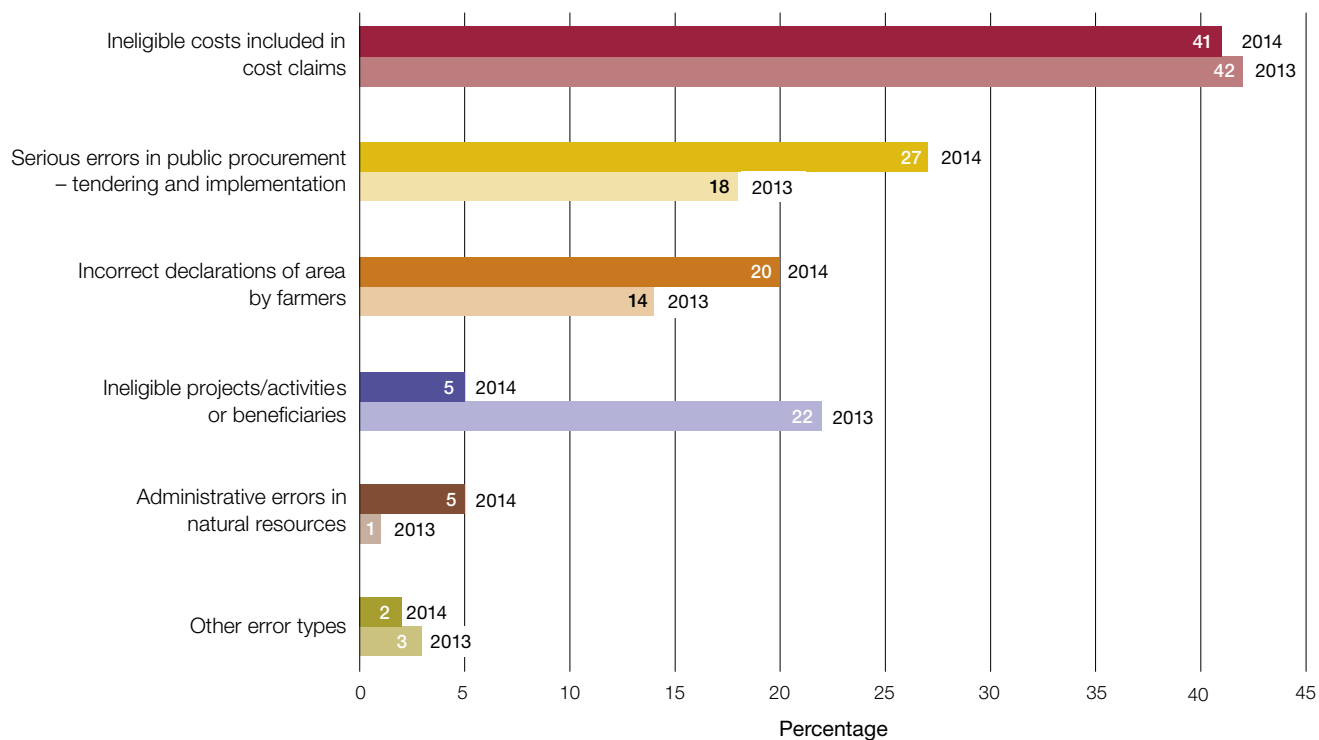
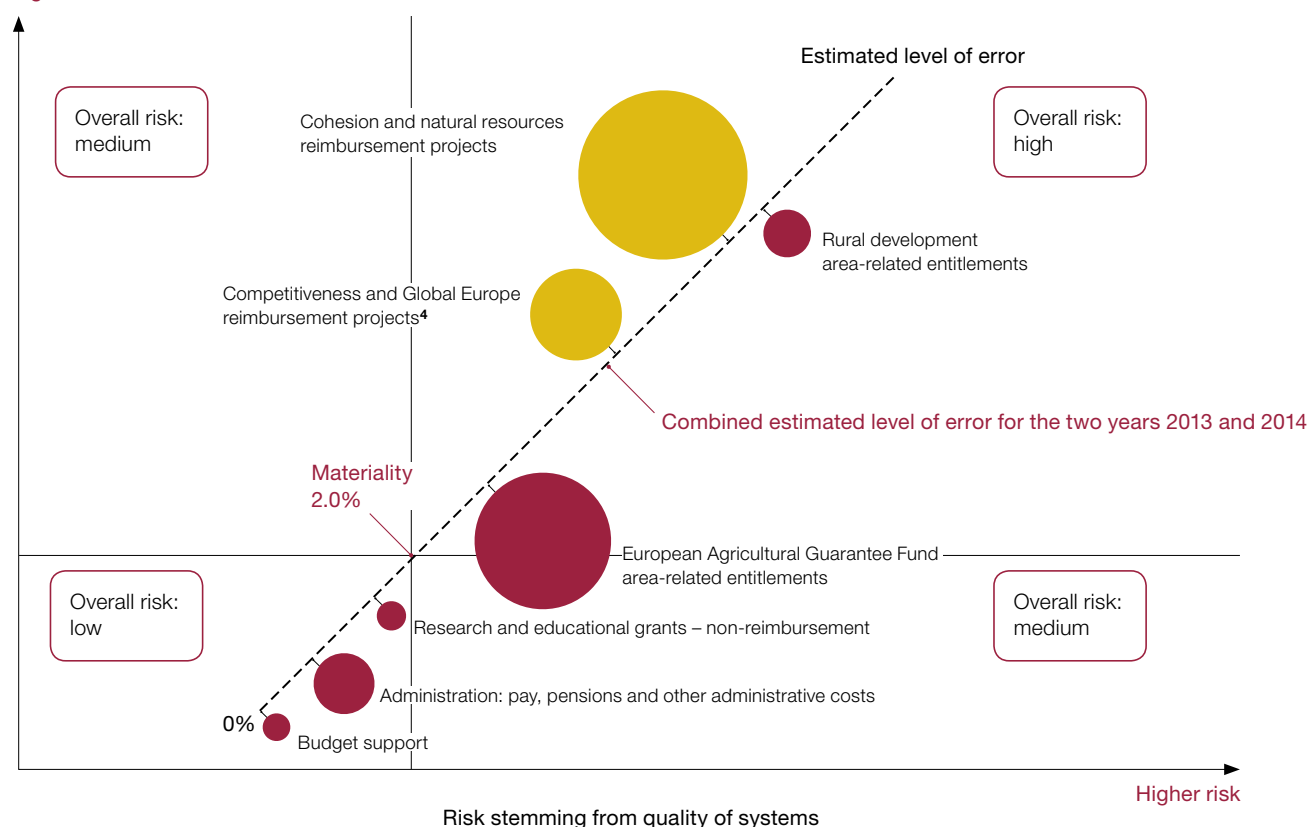


Figure 10

The relationship between entitlements, reimbursements, risk and estimated level of error in EU payments, based on audit testing in 2013 and 2014

Risk stemming from nature and complexity of transactions

Higher risk



- Entitlements
- Reimbursements

Notes

- 1 Reimbursements: eligible costs for eligible activities are reimbursed by the EU (for example, infrastructure such as new roads).
- 2 Entitlements: payments are made based on qualifying criteria (for example, enrolling as a student, being a farmer or being an employee of one of the EU institutions).
- 3 This figure is based on audit testing in 2013 and 2014. Expenditure is grouped according to its nature. The size of the circles are proportionate to overall spending, and their colour indicates whether expenditure is based on entitlements or reimbursements. The position of these circles along the 45° line indicates relative levels of estimated errors.
- 4 Reimbursements for 4: *Global Europe* include multi-donor projects, which in practice have many of the attributes of entitlement spending but are affected by lower levels of error.

Source: European Court of Auditors

2.12 The estimated level of error for reimbursements was 5.5% (2013: 5.6%). Typical errors included ‘ineligible costs in cost claims’; ‘ineligible projects, activities and beneficiaries’; and ‘infringement of public procurement rules’. The estimated level of error for entitlements was 2.7% (2013: 3.0%). Typical errors included ‘incorrect declarations of area by farmers’, and ‘administrative errors in natural resources’. The ECA considers that the quality of information provided by beneficiaries, and the inherent complexity of reimbursing costs, impacts the estimated levels of error identified in respect of reimbursement schemes.

2.13 As shown in Figure 5, EU expenditure can also be characterised by whether it is managed in partnership by the Commission and member states (approximately 80%), or directly or indirectly by the Commission (approximately 20%). The estimated level of error for expenditure in both of these categories was 4.6%.

2.14 The results of the ECA’s audit testing in 2014 reflects similar results in recent years (**Figure 11**), when the estimated level of error has also been consistently above the ECA’s materiality threshold of 2%. Due to changes in the spending headings and how errors are evaluated by the ECA it is not possible to comment conclusively on any long term trend. Estimated levels of error vary from one policy area to another, and from year to year, but have only been consistently below materiality in administrative spending.

Figure 11

European Court of Auditors’ estimated level of error by EU policy areas/budget headings, 2012 and 2013

EU policy area/budget heading ¹	Estimated level of error	
	2012 (%)	2013 (%)
Agriculture: market and direct support	3.8	3.6
Rural development, environment, fisheries and health	7.9	6.7
Regional policy, transport and energy	6.8	6.9
Employment and social affairs	3.2	3.1
External relations, aid and enlargement	3.3	2.6
Research and other internal policies	3.9	4.6
Administrative and related expenditure	0	1.0
Overall	4.5²	4.5²

Notes

- 1 EU policy area/budget heading categories changed between 2013 and 2014, and hence 2014 rates are presented in Figure 8.
- 2 The overall rates for estimated levels of error have been adjusted to reflect a revised approach to measuring error adopted by the European Court of Auditors for 2014.

Source: European Court of Auditors

Action by member states to reduce errors

2.15 As in previous years, the Commission and member states took action to reduce the occurrence of errors by applying corrective measures in cases of irregular expenditure. In 2014, if such corrections had not been applied, the ECA's overall estimated level of error would have been 5.5% rather than 4.4%.

2.16 In addition, the ECA has recommended improvements in control systems in member states and at EU level, and further simplification of rules to reduce levels of error. Despite efforts by member states, estimated levels of error have remained stable above materiality.

Action to improve financial management

2.17 The Commission and member states have acknowledged the need to address weaknesses in financial management. In February 2012, the Commission set out a simplification agenda for the current multiannual financial framework (MFF).¹⁸ The aim of the simplification agenda is to cut costs, reduce the scope for error and increase the efficiency of controls. In addition, the Commission envisages that greater online management of EU funds will help cut the administrative burden and reduce the number of errors.

2.18 The Commission's efforts to pursue simplification include 120 actions.¹⁹ These actions can be grouped into three themes:

- **Simplification:** this includes efforts to reduce unnecessary bureaucracy, speed up procedures and shift the focus to performance (for example, simplified methods to calculate costs such as lump sum payments, flat rates and standard scales of unit costs).
- **Increased accountability:** this includes measures to enhance sound financial management and the protection of the EU's financial interests. For example national authorities must sign and submit annual summaries (also referred to as annual declarations) certifying that EU monies have been used properly.
- **Increased flexibility:** this includes the introduction of financial mechanisms such as loans, equity or guarantees to enable the mobilisation of third-party funds.

2.19 The Commission has appointed a group of independent experts to report on the extent to which simplification measures are being incorporated in partnership agreements (see paragraph 1.17). This group will inform the forthcoming mid-term MFF review.

¹⁸ European Commission, *A simplification agenda for the MFF 2014–2020*, COM (2012) 42 final, February 2012; and European Commission, *Simplification and gold-plating in the European Social Fund*, November 2013.

¹⁹ European Commission, Press release, *Final "simplification scoreboard": 120 measures to cut red tape on EU funding*, 4 March 2014.

Action to address the build-up of financial commitments

2.20 The ECA has drawn attention to the growing level of financial commitments.

2.21 The EU budgeting system is different from that in the UK. The EU system operates with commitments (legal pledges to finance specific activities) and payments (money to be paid from the budget to beneficiaries). In some spending areas, this differentiation is of little consequence. With direct payments relating to agriculture, a commitment turns into a payment in the same year with no time lag. In other areas the differentiation is important.

2.22 With the European Structural and Investment Funds (which might include large infrastructure projects) there is a lag between commitments becoming payments, and some commitments never do. This could be due to member states' institutional capacity constraints, because projects take time to implement, or because co-financing from a member state is not available. In December 2013 the European Parliament and Council extended the time allowed for using commitments from two to three years.²⁰ Member states gained one more year in which to benefit from commitments before they lapse (are 'decommitted').

2.23 The stock of unspent commitments has been growing and stood at more than €222 billion at the end of 2013. Although unspent commitments fell to €189.6 billion in 2014, they are projected to increase again in 2015 and subsequent years. In some member states unspent commitments, together with required national co-financing, is equivalent to more than 15% of general government expenditure (see **Figure 12**). The ECA has highlighted that spending this money will be a challenge for some member states.

2.24 In March 2015, the Commission presented a payment plan intended to 'bring the EU budget back on a sustainable track'.²¹ The ECA has commented that the measures proposed by the Commission seek to improve shorter-term cash flow management; however, dealing with the high level of unspent commitments will require a longer-term strategy.

The ECA's assessment of performance and value for money

2.25 The ECA's 2014 annual report also emphasised the importance of achieving value for money from the EU budget. The ECA commented on the EU's long-term strategy, noting that:

- decision-makers must align the budget better with the EU's long-term strategic priorities, and make it more capable of responding in a crisis;
- legislators need to ensure that spending schemes are clear about the results to be achieved and the risks it is acceptable to take²²; and
- financial managers have to ensure that the money spent complies with the rules and achieves the intended results.

²⁰ Regulation (EU) No 1303/2013 of the European Parliament and the Council.

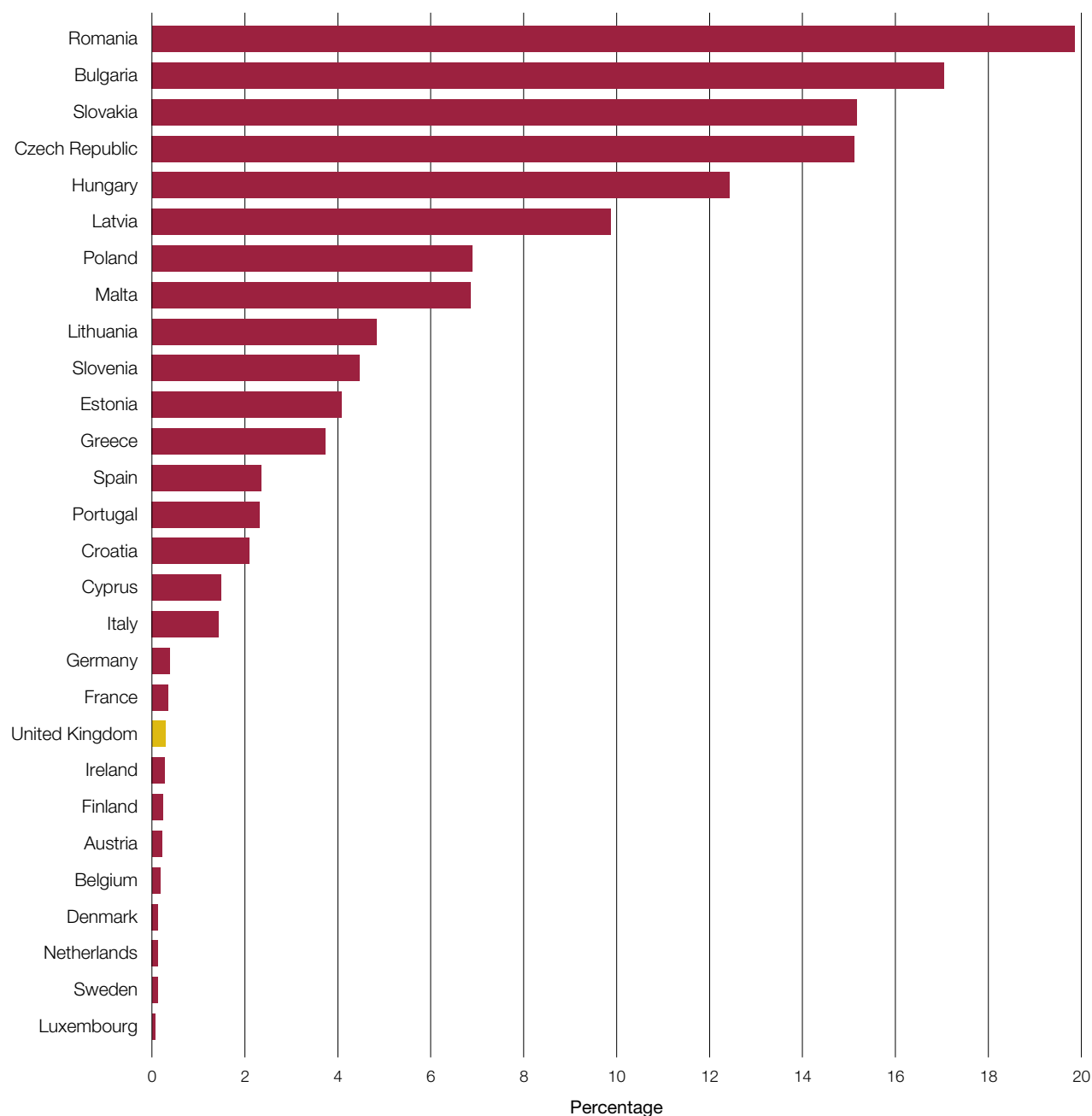
²¹ European Commission, *Elements for a payment plan to bring the EU budget back onto a sustainable track*, March 2015.

²² The European Parliament and the Council of the European Union.

Figure 12

Outstanding commitment appropriations of EU European Structural and Investment Funds (ESIF) at 31 December 2014 as a percentage of 2014 general government expenditure in the EU-28

In four member states the accumulated share that could be claimed from EU ESIF is equivalent to 15% or more of annual general government expenditure

**Notes**

- 1 EU ESIF includes the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Maritime and Fisheries Fund (EMFF) and the European Agricultural Fund for Rural Development (EAFRD).
- 2 EU-28: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, the United Kingdom.

Source: European Court of Auditors based on European Commission data

2.26 During 2014, the ECA published 24 special reports, which examined whether the principles of sound financial management had been applied to EU spending, and two landscape reviews. These are listed at Appendix Six. The ECA's work in 2014 identified a weak focus on results, and instances where projects likely to deliver best value for money were not always selected. In 2015 the ECA published 22 special reports, including one considering procurement.²³

2.27 During the current MFF, the Commission intends to place a greater emphasis on results from the EU budget. In 2015 the Commission launched the 'Budget Focused on Results' initiative; and in spring 2016 it will announce further proposals to strengthen its focus on performance.

2.28 The upcoming mid-term review of the current MFF is a crucial point in the management of EU spending. The ECA has recommended that the Commission analyses the areas of persistently high levels of error as soon as possible, and assesses opportunities for reducing these while strengthening the focus on performance in spending.

²³ European Court of Auditors, *Efforts to address problems with public procurement in EU cohesion expenditure should be intensified*, September 2015.

Part Three

The EU budget and the UK

3.1 This part identifies UK contributions to the European Union (EU) budget, and UK private- and public-sector receipts from the EU budget. It summarises the use made of EU monies in the UK, oversight arrangements and information on the extent to which these monies have been managed in line with EU and national rules.

Forecast UK contributions to the EU budget

3.2 **Figure 13** overleaf details Office for Budget Responsibility (OBR) figures for outturn and estimates for UK contributions to the EU budget, 2014-15 to 2020-21. These contributions do not include private-sector receipts: EU monies secured by UK organisations through competitions, including universities (see figure 19). **Figure 14** overleaf details OBR figures for outturn and estimates for public-sector receipts from the EU budget to the UK over the same period.²⁴

UK contribution to the EU budget in 2014

3.3 In 2014 the UK made a gross contribution (post-rebate²⁵) of €14.1 billion (£11.4 billion), and received EU public- and private-sector receipts of €7.0 billion (£5.6 billion). It therefore made a net contribution of €7.1 billion (£5.7 billion). This was the third-largest net contribution to the EU budget.

3.4 In 2014, based on data from the European Commission (the Commission), the UK was one of ten countries that made a net contribution to the EU budget. The others were Germany, France, Italy, the Netherlands, Sweden, Austria, Denmark, Finland and Ireland. The UK made the third-largest net contribution, accounting for 14.3% of the total net contribution of these ten countries (see **Figure 15** on page 31).

3.5 In 2014-15 the UK net contribution to the EU budget of £8.8 billion was equivalent to 1.4% of UK government total departmental expenditure of £620.6 billion (**Figure 16** on page 32).²⁶

²⁴ The EU financial year is based on the calendar year of 1 January to 31 December, whereas the UK financial year runs from 1 April to 31 March. Differences in the financial years used by the EU and UK authorities makes interpreting and comparing UK and EU data challenging.

²⁵ In 2014 the UK received a rebate of €6.1 billion. Calculating the UK rebate is complex, but it is broadly equivalent to 66% of the difference between the UK's contribution to the EU budget, and its receipts from the EU budget. The method for calculating the rebate is laid down in Council Decision 2007/436/EC, and in the supporting Council of the European Union document *Method for the calculation of the UK correction*.

²⁶ This net contribution figure considers the gross contribution and deductions resulting from the rebate and public-sector receipts only. It does not take into account private-sector receipts (see paragraphs 3.8 and 3.9).

Figure 13

UK contributions to the EU budget (taking into account UK rebates and public-sector receipts, but excluding private-sector receipts), 2014-15 to 2020-21

Year	Contribution (£bn)
2014-15	8.8 ¹
2015-16	10.8
2016-17	9.7
2017-18	8.4
2018-19	9.3
2019-20	9.6
2020-21	9.9

Notes

- 1 2014-15 represents an outturn, other years are forecasts.
- 2 Contributions in this figure do not include private-sector receipts: EU monies secured by UK organisations through competitions (including universities). Private-sector receipts are not forecast.

Source: Office for Budget Responsibility

Figure 14

Public-sector receipts to the UK from the EU budget, 2014-15 to 2020-21

Year	Public-sector receipts (£bn)
2014-15	4.6 ¹
2015-16	4.1
2016-17	4.2
2017-18	4.4
2018-19	4.7
2019-20	5.0
2020-21	5.2

Note

- 1 2014-15 represents an outturn, other years are forecasts.

Source: Office for Budget Responsibility

Figure 15

Net contributor countries to the EU budget, and net contribution/capita, 2014

Country	Net contribution to the EU budget (€bn)	Proportion of total net contribution (%)	Net contribution/capita (€)
Germany	17.7	36	219
France	7.5	15	114
UK	7.1	14	110
Netherlands	6.4	13	378
Italy	5.2	11	85
Sweden	2.6	5	270
Austria	1.3	3	152
Denmark	1.0	2	177
Finland	0.8	2	154
Ireland	0.1	<1	19
Total	49.7	100	

Note

1 Figures may not sum exactly due to rounding.

Source: European Commission

Receipts from the EU budget to the UK

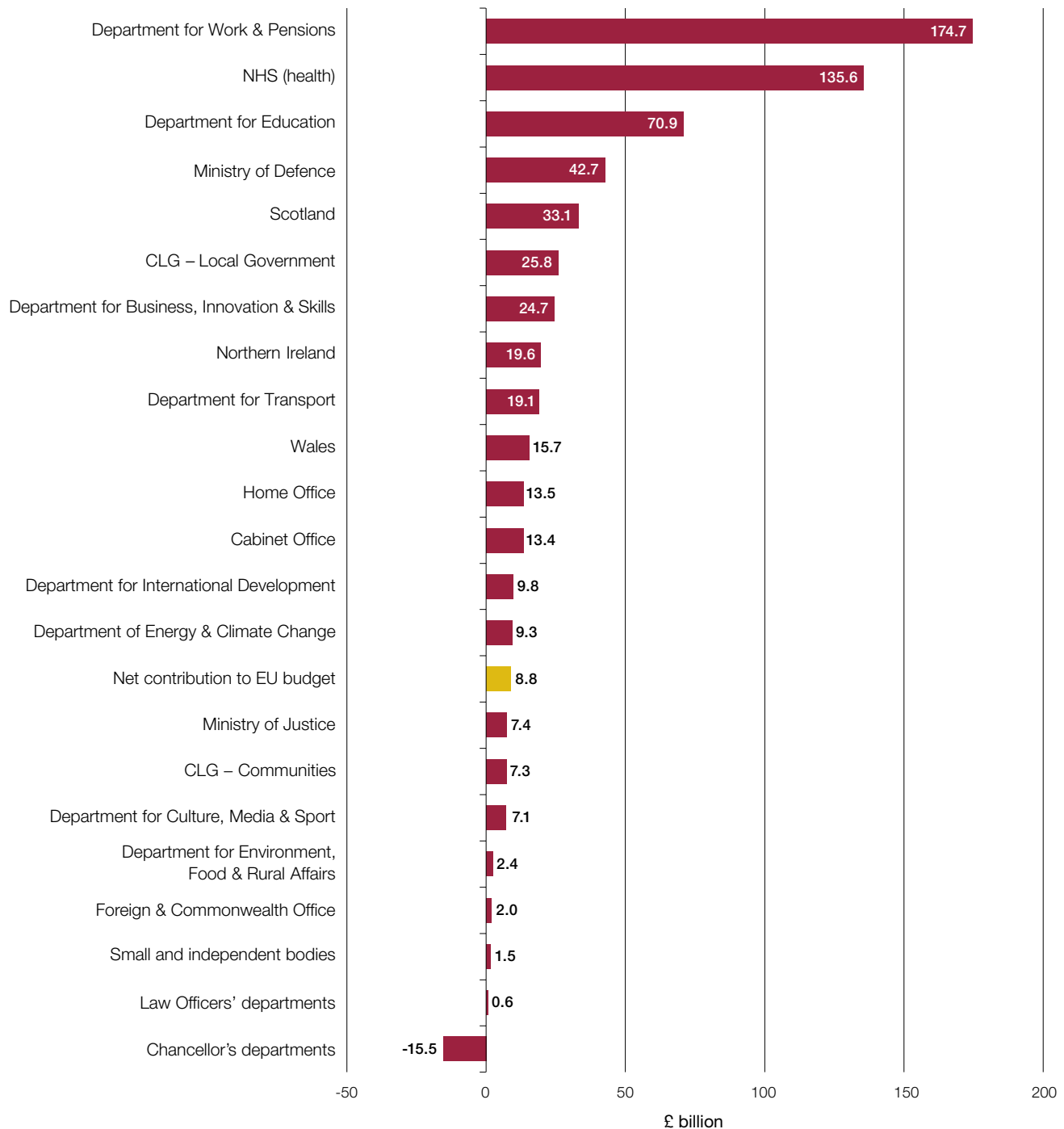
3.6 In 2014 the majority of EU payments to the UK (97%) related to activities in support of policy area 1a: *Competitiveness for growth and jobs*, 1b: *Economic, social and territorial cohesion*, and 2: *Sustainable growth: natural resources* (see **Figure 17** on page 33).

3.7 Over the seven years of the current MFF, the UK will receive approximately €39 billion in respect of six allocated funds: more than €22 billion from EAGF, and more than €16 billion from the European Structural and Investment Funds (ESIF). **Figure 18** on page 34 identifies how the latter will be allocated to the regions of the UK.

Figure 16

UK net contribution to the EU budget and UK total departmental expenditure in 2014-15

UK net contribution to the EU budget in 2014-15 was equal to 1.4% of UK total departmental expenditure in 2014-15

**Notes**

- 1 UK net contribution to the EU budget in 2014-15 was £8.8 billion. This considers the UK's gross contribution and deductions resulting from the rebate and public-sector receipts only. It does not take into account private-sector receipts. Total departmental expenditure in 2014-15 was £620.6 billion.
- 2 Net expenditure for Chancellor's departments was negative as income and other gains associated with financial sector interventions exceeded expenditure.

Source: National Audit Office analysis of HM Treasury and Public Expenditure Statistical Analyses data

Figure 17

EU policy areas, objective or purpose, and UK public- and private-sector receipts from the EU budget in 2014

EU policy area	Objective or purpose	UK receipts in 2014	As a proportion of total UK receipts in 2014
		£/€ billion	(%)
1 Smart and inclusive growth			
1a Competitiveness for growth and jobs	Supports research and innovation; education and training; trans-European energy, telecommunications and energy networks; social policy; enterprise development	£0.8 (€1.0)	15
1b Economic, social and territorial cohesion	Supports regional policy intended to help the least developed EU countries and regions catch up with others, encouraging competitiveness and inter-regional cooperation	£1.4 (€1.7)	25
2 Sustainable growth: natural resources	Supports rural development and environmental measures	£3.2 (€4.0)	57
Other		£0.2 (€0.3)	4
Total		£5.6 (€7.0)	100

Notes

- 1 Figures may not sum exactly due to rounding.
- 2 Other includes headings 3: *Security and citizenship*, 5: *Administration*. There were no public- or private-sector receipts from the EU budget in 2014 in relation to heading 4: *Global Europe*.

Source: National Audit Office analysis of European Commission data

Figure 18

EU public-sector receipts: fund allocations to UK regions, 2014 to 2020

Region	EU fund	Funding allocation (€m)
England	ERDF	3,628.3
	EAFRD	3,460.2
	ESF	3,308.9
	YEI	159.8
	EMFF	97.2
		10,654.4
Northern Ireland	ERDF	308.0
	EAFRD	227.4
	ESF	205.4
	EMFF	23.5
		764.3
Scotland	EAFRD	844.7
	ERDF	476.8
	ESF	417.8
	EMFF	107.7
	YEI	46.3
		1,893.3
Wales	ERDF	1,406.8
	ESF	1,005.7
	EAFRD	651.0
	EMFF	14.7
		3,078.2
Sub-total (regions)		16,390.2
UK-wide	EAGF	22,283
Total		38,673.2

Notes

- 1 EAGF: European Agricultural Guarantee Fund; ERDF: European Regional Development Fund; ESF: European Social Fund; EAFRD: European Agricultural Fund for Rural Development; EMFF: European Maritime and Fisheries Fund; YEI: Youth Employment Initiative.
- 2 The table does not include Gibraltar, which will receive €6 million in respect of ERDF, and €5 million in respect of ESF between 2014 and 2020.
- 3 The UK will not receive payments from the Cohesion Fund between 2014 and 2020, because UK GNI per capita is more than 90% of the EU average. Gibraltar, Northern Ireland and Wales will not receive payments in respect of the YEI during this period. Gibraltar will also not receive payments in respect of EAGF, EAFRD or EMFF during this period.

Source: European Commission, Department for Environment, Food & Rural Affairs, Department for Communities and Local Government, Department for Work & Pensions, and the devolved administrations for Northern Ireland, Scotland, Wales and Gibraltar

3.8 In addition to these six funds, in 2014 the UK received EU monies secured by public or private organisations through competitions (for example grants funded by *Horizon 2020*).²⁷ Over the seven years of the current MFF, *Horizon 2020* will provide nearly €80 billion to research and development projects. By December 2014 over 14,000 applications for funding had been received from the UK, more than from any other member state, accounting for more than 12% of applications from the entire EU. The UK has received the highest number of grants issued (approximately 15% under the programme). UK projects also received the second-largest amount of grant funding – just under 15% of the €5.5 billion issued in 2014 by *Horizon 2020* has gone to UK projects.

3.9 The UK benefited significantly from the previous seven-year research and development programme. Between 2007 and 2013 the UK won more grants from the European Research Council than any other member state (761 compared with Germany's 467) and received the second-highest share of overall funding (€6.9 billion/£5.8 billion). **Figure 19** identifies estimated private-sector receipts from the EU budget to the UK for all years for which data are available.

Financial oversight in the UK

3.10 Grants secured through competition are managed directly by the Commission, which has responsibility for their financial oversight. On the other hand, allocated funds are managed in partnership with UK national or regional authorities. The UK has devolved responsibility for implementing EU obligations, and hence the proper administration of EU funds in England, Northern Ireland, Scotland and Wales is a matter for the relevant administration.

Figure 19

Estimated private-sector receipts from the EU budget to the UK, 2010 to 2013

Year	Private-sector receipts (£bn)
2013	1.4
2012	1.5
2011	1.6
2010	1.0

Source: HM Treasury

²⁷ *Horizon 2020* is the EU's research and innovation programme.

3.11 Within the UK, departmental accounting officers have responsibility for the use made of EU monies within their budgets. There is no single point of responsibility for the use made of EU monies in the UK. However, following a recommendation from the UK Committee of Public Accounts, in 1980 HM Treasury started publishing an annual statement to the UK Parliament providing information on the EU budget. This statement is intended to support greater scrutiny of the UK's management of public-sector receipts from the EU budget, and of the financial relationship between the UK and the EU.²⁸ The most recent statement was published in December 2015.

3.12 HM Treasury produced a consolidated statement on the use of EU funds in the UK for each of the UK financial years 2006-07, 2007-08, and 2008-09, which the National Audit Office (NAO) was invited to audit. The preparation, audit and publication of these statements was designed to strengthen parliamentary scrutiny of the UK government's management of EU monies, and help detect weaknesses in controls. The Comptroller and Auditor General (C&AG) qualified his opinion for each year. HM Treasury published the consolidated statement for 2008-09 in 2011, and has not published any further statements since. In July 2012, HM Treasury committed to help the UK Parliament strengthen its scrutiny of the financial relationship between the EU and the UK government by improving the consolidated statement.²⁹

3.13 The arrangements for overseeing the management of allocated funds are complex. EU regulations governing these funds require member states to designate:

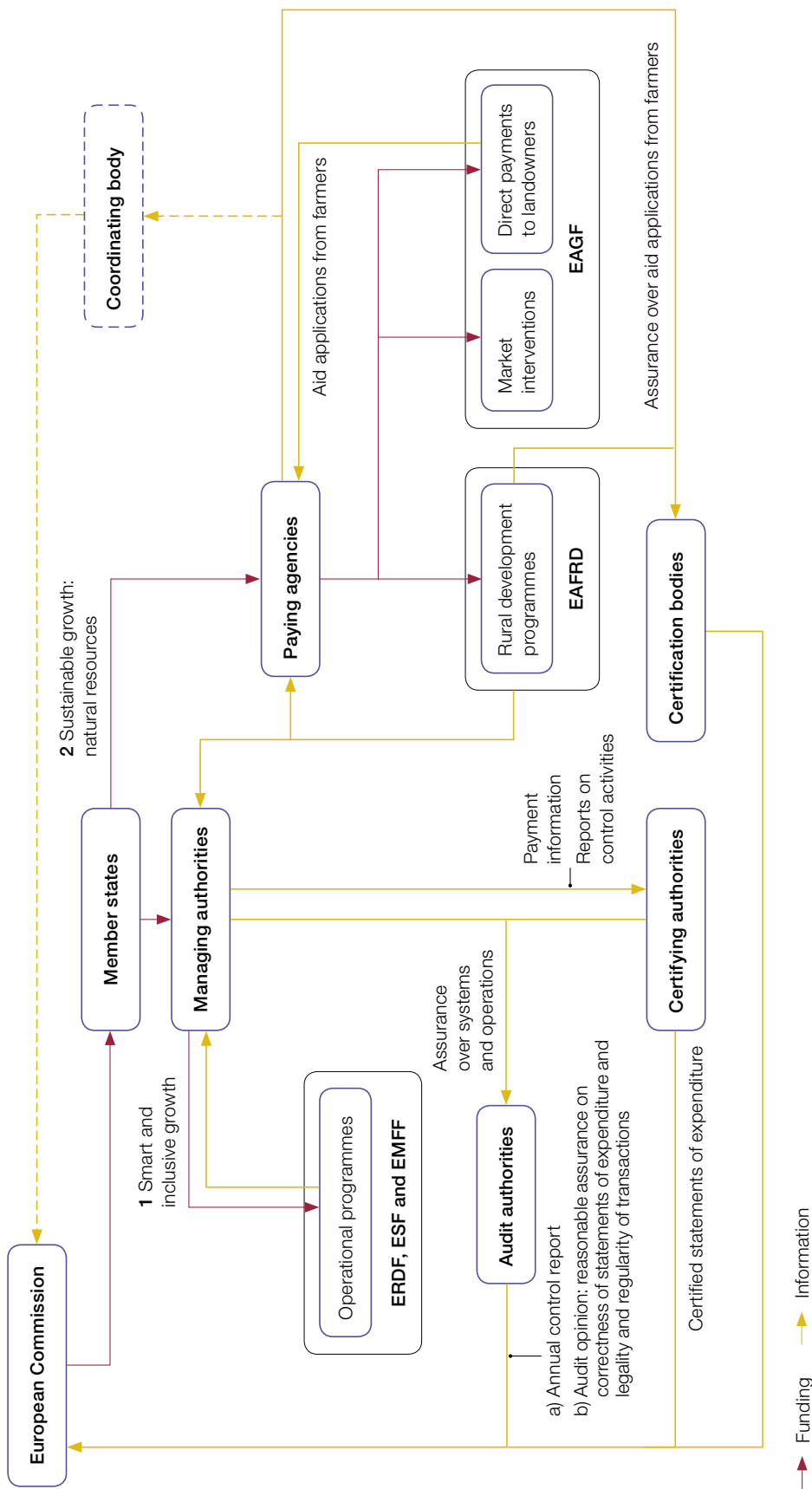
- **managing authorities** to decide which operational programmes to fund, and by how much (in respect of ERDF, ESF, YEI, EAFRD and EMFF);
- **certifying authorities** to seek assurance in respect of the eligibility of payments provided by managing authorities, and to generate and submit certified statements of expenditure to the Commission;
- **audit authorities** to seek assurance over the systems and operations of managing and certifying authorities, and report to the Commission;
- **paying agencies** to distribute EAGF and EAFRD; and
- **certification bodies** to seek assurance over paying agencies' management, monitoring and control systems, and report to the Commission.

Figure 20 identifies the principal roles in relation to the distribution of EU funds. **Figure 21** on pages 38 and 39 seeks to illustrate how these appear when mapped out in the UK.

²⁸ *Europe 2020* is the EU's ten-year jobs and growth strategy, launched in 2010.

²⁹ HM Treasury, *European Union Finances 2012: statement on the 2014 EU Budget and measures to counter fraud and financial mismanagement*, July 2012.

Figure 20
Funding and information flows involved in the distribution of EU funds

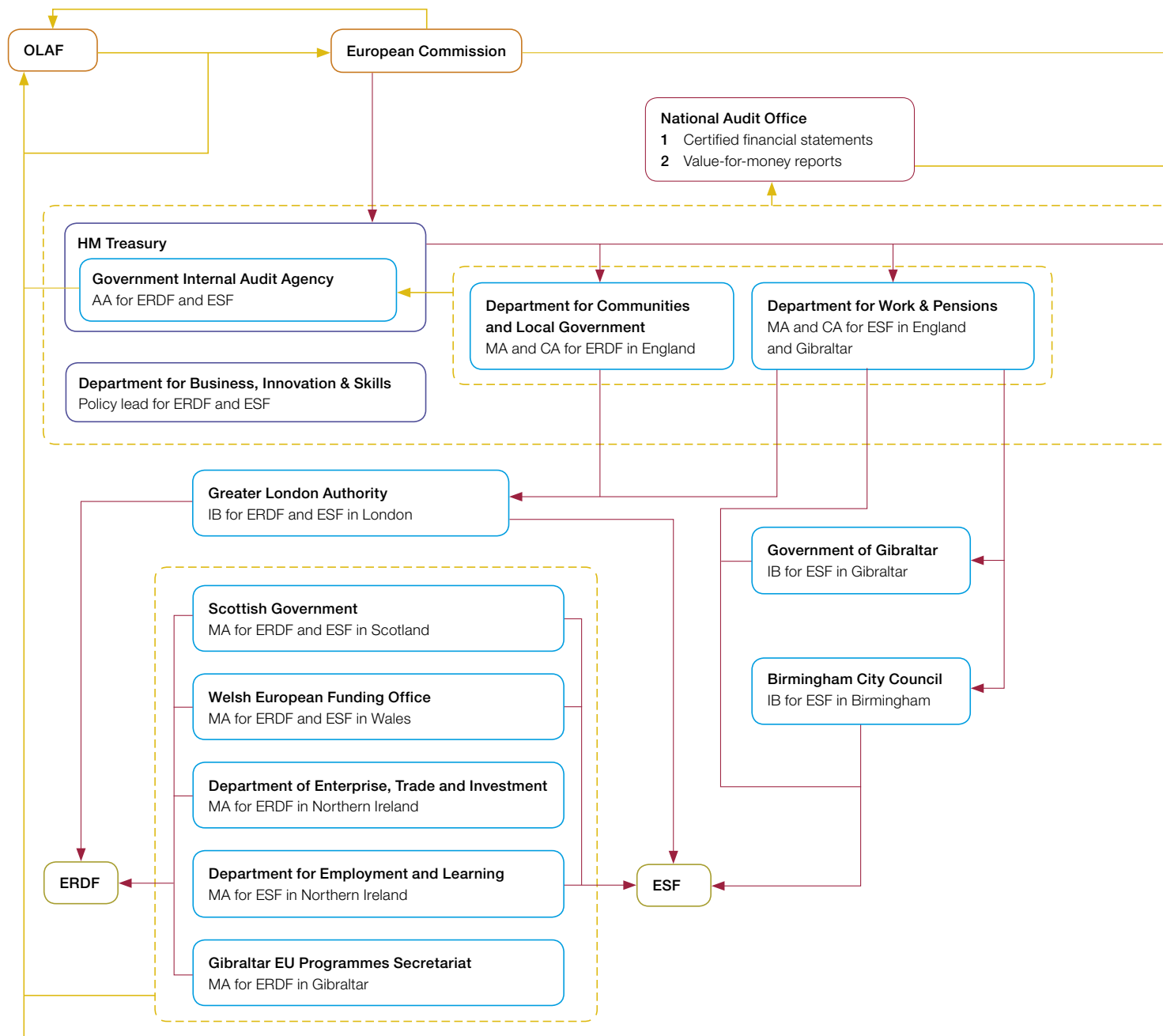


Notes

- 1 ERDF: European Regional Development Fund; ESF: European Social Fund; EMFF: European Maritime and Fisheries Fund; EAGF: European Agricultural Guarantee Fund; EAFRD: European Agricultural Fund for Rural Development.
- 2 1: *Smart and inclusive growth* and 2: *Sustainable growth: natural resources* refer to EU policy areas.
- 3 Commission regulations specify that it is important for member states with more than one paying agency to establish a coordinating body. This organisation is responsible for ensuring consistency in the management of funds within the member state, to provide liaison between the Commission and the paying agencies, and to ensure information flows from paying agencies to the Commission. The dashed lines represent how this would apply in member states with more than one paying agency.

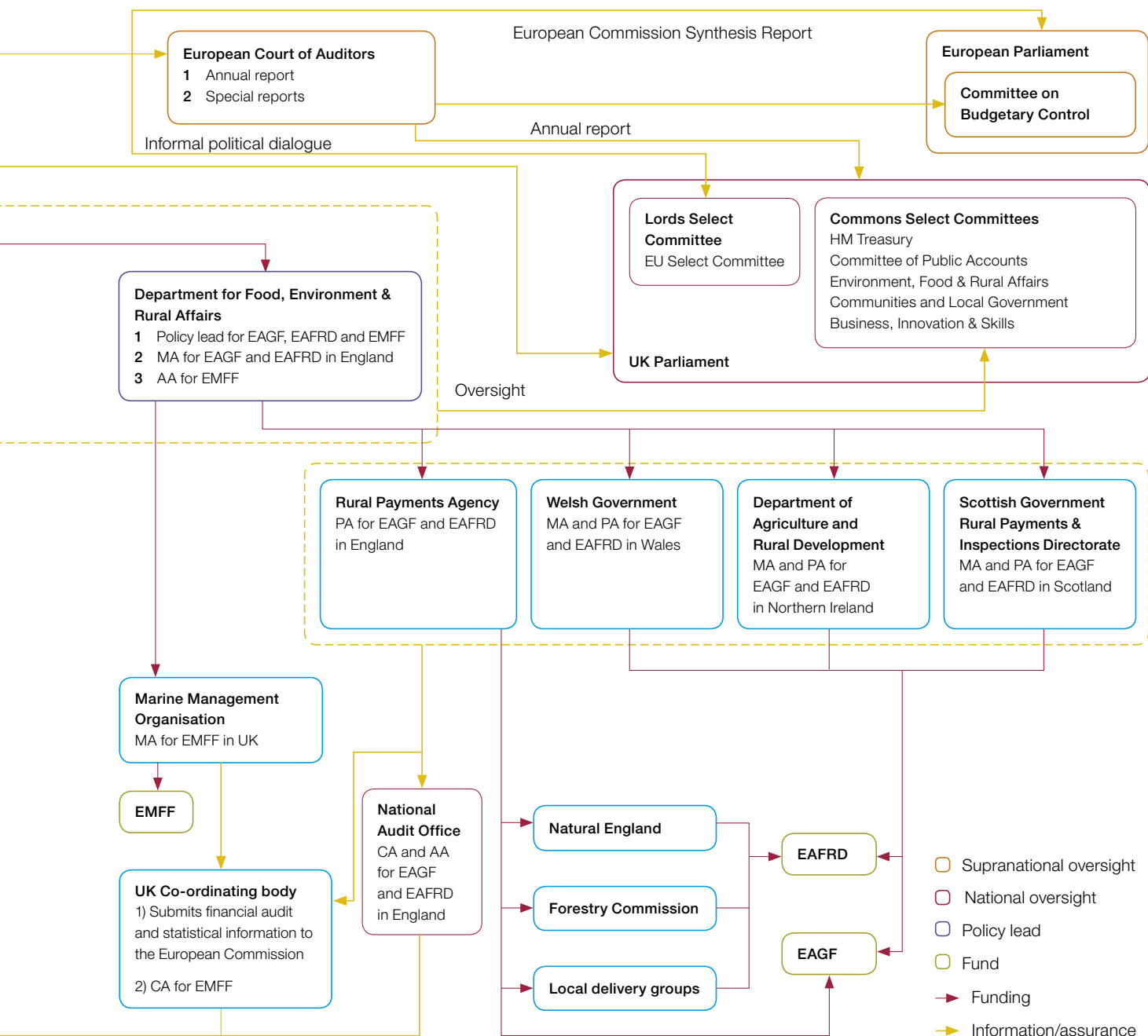
Figure 21

The relationships between the EU institutions and UK public bodies with regard to European monies, 2014



Notes

- 1 MA = Managing authority; PA = Payments agency; CA = Certifying authority; AA = Audit authority; IB = Intermediate body. A managing authority may delegate a number of functions to an intermediate body.
- 2 In 2014, the Greater London Authority and the Government of Gibraltar had a responsibility for ESF expenditure in their respective territories. Birmingham City Council did not have this responsibility, rather it had a national role considering innovations to achieve ESF objectives.
- 3 ERDF: European Regional Development Fund; ESF: European Social fund; EMFF: European Maritime and Fisheries Fund; EAGF: European Agricultural Guarantee Fund; EAFRD: European Agricultural Fund for Rural Development. Youth Employment Initiative does not feature because the UK did not receive monies from the EU in respect of this fund in 2014.



Notes

- The figure does not show funding flows from the UK government to the Scottish Government, Welsh European Funding Office, Department of Enterprise, Trade and Investment (Northern Ireland), Department for Employment and Learning (Northern Ireland) and the Gibraltar EU Programmes Secretariat.
- The European Court of Auditors also communicated its annual report and special reports to the Comptroller and Auditor General.

3.14 EU payments to the UK government are accounted for in the financial statements of the relevant public bodies. Audits undertaken by the relevant UK external auditors will include these monies, although the extent to which EU money is a material element varies significantly. For example, at the Department for Environment, Food & Rural Affairs (Defra), which is the policy lead and managing authority for EAGF and EAFRD, EAGF and EAFRD expenditure accounted for 45.3% of total departmental expenditure in 2014-15. In comparison, at the Department for Communities and Local Government (DCLG), the managing authority for ERDF, ERDF expenditure accounted for 1.8% of total departmental expenditure in 2014-15.

Legality and regularity of EU expenditure in the UK

3.15 In 2014, 80% of UK public-sector receipts from the EU budget related to two funds: EAGF and ERDF. Member states have a responsibility to protect the EU's financial interests, including detecting irregular transactions. This section focuses on error, financial corrections and recoveries in respect of these two funds.

European Agricultural Guarantee Fund

3.16 In 2014, EAGF expenditure in the UK primarily provided payments to farmers (98.0%), based on farm area and application of land management standards. It also funded some coupled (production-related) grants (0.8%), and other market measures (1.2%).

3.17 The NAO leads a consortium that assures the UK annual accounts for the EAGF, in line with Commission guidelines.³⁰ In 2014, the C&AG provided unqualified opinions on the accuracy, validity and completeness of all four regional accounts. The legality and regularity of these accounts was not considered, in line with the EU legislation and guidelines then in effect. From 2015 revised assurance arrangements have been implemented which involve certification authorities (including the NAO) performing specified additional work on the legality and regularity of payments.

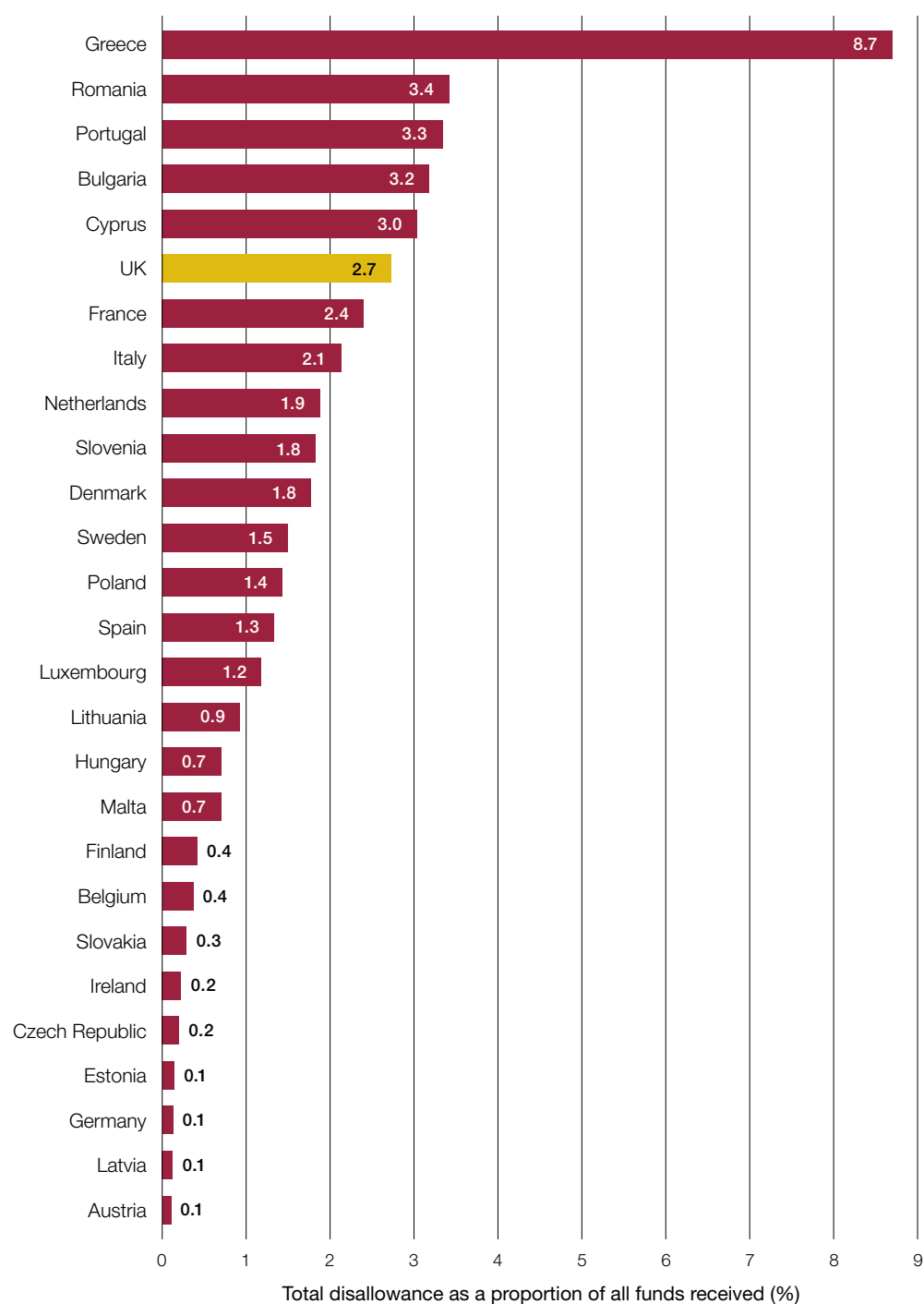
3.18 Since 2005, UK disallowance has amounted to £2.70 for every £100 of EAGF funding it receives from the Commission. This is the sixth-highest figure among the member states. **Figure 22** shows the UK's position in relation to the other member states as at June 2015. This is a snapshot at a particular point in time, so caution is required when interpreting this analysis. Many of the Commission's audits are not yet complete, and member states may be confirming with the Commission disallowances that have yet to be finalised.

30 Other consortium members are Audit Scotland, Northern Ireland Audit Office and Wales Audit Office.

Figure 22

Disallowance as a proportion of EAGF and EAFRD funding received from the European Commission between 2005 and June 2015

The UK has the sixth-highest level of all member states

**Note**

1 As a new member state, Croatia has not yet incurred any disallowance and so has not been included in this figure.

Source: National Audit Office analysis of UK Co-ordinating Body information

European Regional Development Fund

3.19 The Department for Communities and Local Government (DCLG) is currently managing three ERDF programmes, spanning three different MFF periods dating back to 2000-06 (see **Figure 23**). DCLG is still attempting to recover ineligible payments in respect of the 2000–2006 MFF, which in part explains the delay in closing this programme.

3.20 DCLG's 2014-15 annual report notes that in parallel with the closure process, the department undertook a full review of the current state of ERDF-supported projects to identify all potential liabilities. It closed three cases during 2014-15, which resulted in a loss to DCLG of £8.1 million due to ineligible payments. No further provision has been made in respect of the remaining seven cases (2000–2006) as these are not material to the accounts, and existing accruals made in previous years are deemed sufficient.

Errors identified by the ECA in UK EAGF and ERDF transactions

3.21 The European Courts of Auditors' (ECA) annual report does not attempt to draw conclusions in respect of individual member states, but on the EU budget and annual accounts as a whole. Nevertheless, member states are occasionally cited for illustrative purposes. In preparing its 2014 annual report, the ECA tested 40 transactions in the UK, and found 23 to be affected by error. These errors included examples of:

- ineligible and unsubstantiated costs;
- unjustified direct awards;
- serious failures to comply with public procurement rules;
- payments for overstated eligible land; and
- non-compliance with agri-environment commitments.

Figure 23

Status of European Regional Development Fund programmes in England, 2014

Multiannual financial framework	Programme status in UK	Notes
2000 to 2006	Nearly closed	Seven cases to close
2007 to 2013	In closure	Spending deadline December 2015, closure forecast for 2017
2014 to 2020	Live	Operational programme is live

Source: Department for Communities and Local Government

Financial corrections and recoveries in the UK and EU

3.22 The corrections imposed by the Commission on the UK in 2014 were below the EU average when expressed as a proportion of payments received in that year. Since 2012, the Commission has published details of corrections in respect of member states on an annual basis. Published UK correction figures suggest the UK performs equally well, or better, when compared with the EU average. In practice, we might expect annual correction levels to be volatile, reflecting when discussions over amounts are concluded and the factors giving rise to the corrections.

3.23 In 2014 the Commission confirmed €3,890 million of financial corrections relating to 25 countries, and implemented €2,549 million relating to 24 countries. The Commission confirmed €62 million, and implemented €89 million of corrections relating to the UK in 2014 (see **Figure 24**).³¹ Other analysis of financial corrections are presented in **Figure 25** and **Figure 26** overleaf.

Figure 24

UK financial corrections in 2014, compared with the EU-28 average

	UK	EU-28
Payments received (€m)	€5,685 million	€110,537 million
Financial corrections confirmed (€m)	€62 million	€3,890 million
Financial corrections confirmed as a proportion of payments received (%)	1.1%	3.5%
Financial corrections implemented (€m)	€89 million	€2,549 million
Financial corrections implemented as a proportion of payments received (%)	1.6%	2.3%

Notes

- 1 A financial correction is confirmed when it is accepted by a member state, or is subject to a European Commission Decision. A financial correction is implemented when it has been applied, and recorded in the European Commission's accounts.
- 2 EU-28: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, the United Kingdom.

Source: European Commission

³¹ The process of confirming and implementing financial corrections can take a considerable time, and there can be a significant time lag between an error being confirmed and a correction implemented. It is likely that many of the €62 million confirmed corrections, and €89 million implemented corrections relate to previous years.

Figure 25

Number of EU member states with a higher or lower financial correction rate in 2014, compared with the UK

	Financial corrections confirmed	Financial corrections implemented
UK rate of financial corrections as a proportion of payments to the UK	1.1%	1.6%
Number of EU countries with a higher rate than UK	13	9
Number of EU countries with a rate equal to the UK	–	1
Number of EU countries with a lower rate than UK	12	15

Notes

- 1 A financial correction is confirmed when it is accepted by a member state, or subject to a European Commission Decision. A financial correction is implemented when it has been applied, and recorded in the European Commission's accounts.
- 2 Croatia and Cyprus had no financial corrections confirmed or implemented in 2014. Following a Court of Justice of the European Union judgment, the Netherlands had a negative financial correction confirmed in 2014 (that is, the European Commission must reimburse the Netherlands).
- 3 Croatia and Cyprus had no financial corrections implemented in 2014.

Source: European Commission

Figure 26

UK and EU-28 financial corrections confirmed, 2014

Fund	UK (€m)	EU-28 (€m)	UK proportion of all financial corrections (%)
European Agricultural Guarantee Fund	10	1,649	0.6
European Agricultural Fund for Rural Development	2	220	0.9
European Regional Development Fund	47	1,330	3.5
Cohesion Fund ¹	–	292	–
European Social Fund	1	342	0.3
Financial Instrument for Fisheries Guidance/European Fisheries Fund ²	0	39	0
European Agricultural Guidance and Guarantee Fund	3	13	23.1
Other	0	5	0
Total	62	3,890	1.6

Notes

- 1 The UK did not receive Cohesion Fund payments in 2014, because UK GNI per capita was more than 90% of the EU average.
- 2 Financial Instrument for Fisheries Guidance relates to the 2000–2006 MFF; European Fisheries Fund to the 2007–2013 MFF.
- 3 European Agricultural Guidance and Guarantee Fund: provided payments in respect of the Common Agricultural Policy between 1962 and 2006.
- 4 EU-28: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, the United Kingdom.
- 5 Figures may not sum exactly due to rounding.

Source: National Audit Office analysis of European Commission data

Appendix One

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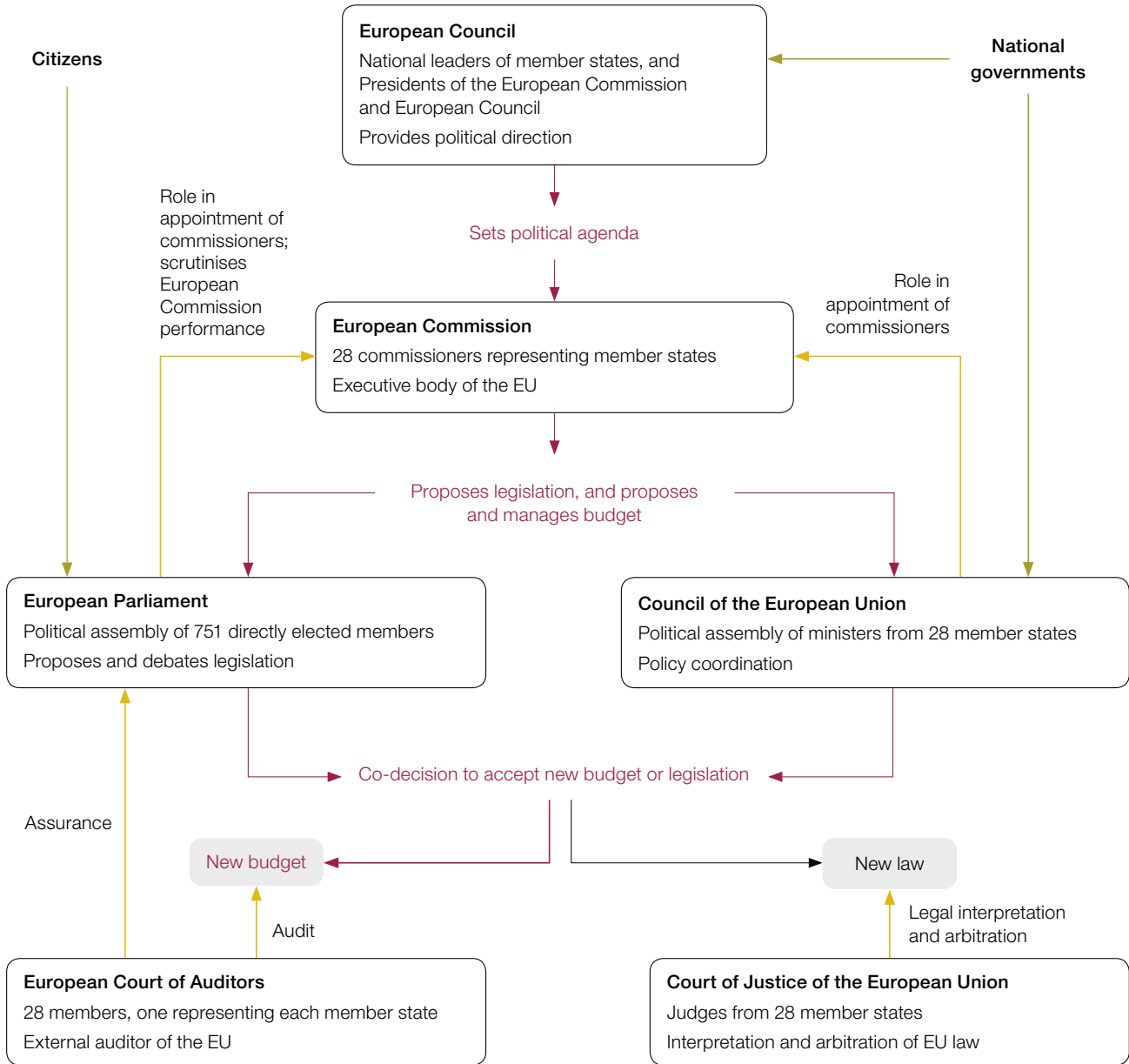
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Appendix Two

EU institutions involved in budget-setting,
budget monitoring, audit and assurance,
or arbitration

See figure overleaf.

EU institutions involved in budget-setting, budget monitoring, audit and assurance, or arbitration



- Function
- Representation
- Red text and arrows indicate process for establishing a new budget
- EU institution
- New budget or law

Note

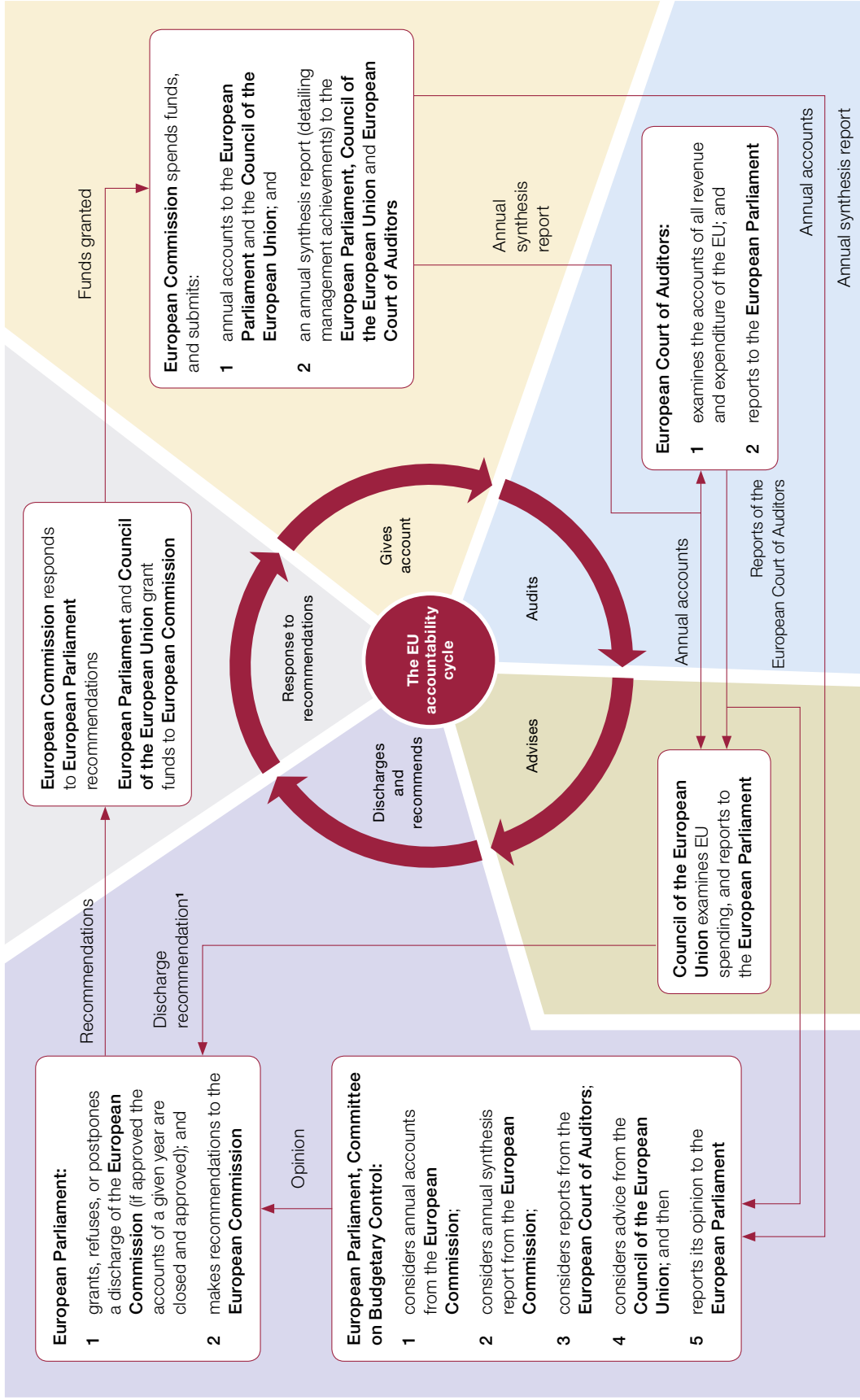
1 The European Central Bank is also an institution of the EU; however, it has no role in budget-setting, budget monitoring, audit and assurance, or arbitration.

Appendix Three

EU accountability cycle and EU budget discharge process

See figure overleaf.

EU accountability cycle and EU budget discharge process



Note

1 Since 2010 the Netherlands, Sweden, and the United Kingdom have submitted a counter statement to the Council's discharge recommendation, advising against discharge.

Appendix Four

References to the United Kingdom in the European Court of Auditors' annual report, 2014

1 Chapter 1 of the annual report presents the **statement of assurance and supporting information**. As part of the introduction, Graph 1.1 shows EU spending in each member state as a share of total general public spending of each member state, including the UK, in the calendar year 2014:

- The second table of Annex 1.5 shows the frequency of detected errors in audit sampling for the year 2014 under MFF headings 1b and 2. The table shows that, of the 40 transaction in the UK in the year which the European Court of Auditors (ECA) audited, 23 were affected by error.

2 Chapter 2 of the annual report deals with **budgetary and financial management** in 2014. There are references to the UK in:

- Graph 2.4, which shows the absorption and totals of the European Structural and Investment (ESI) funds for the 2007–2013 MFF period;³² and
- Graph 2.5, showing outstanding commitments of ESI funds as of December 2014 by member state.

³² The European Structural and Investment Funds (ESIF) are the European Regional Development Fund (ERDF), the European Social Fund (ESF), the Cohesion Fund (CF), the European Maritime and Fisheries Fund (EMFF), and the European Agricultural Fund for Rural Development (EAFRD).

3 Chapter 4 covers **revenue**. There are references to the UK in:

- Paragraph 4.4(a)(i), where the audit of revenue is described, specifically identifying the UK as one of the three selected member states whose traditional own resources accounting systems the ECA examined in the year;
- Paragraph 4.8, which discusses member states' addressing of GNI reservations. The UK is mentioned as an example of where the resulting corrections had a 'significant impact on some member states' contributions';
- Paragraph 4.13, footnote 20, which identifies the UK as one of seven member states that requested to postpone their payments, fully or partially, because of 'major revisions to the gross national income (GNI) balances';
- Table 4.1, where the VAT/GNI balances for 2014 for the member states are listed;
- Table 4.2, where the ECA sets out the member states' GNI/gross national product reservations and traditional own resources open points, as of 31 December 2014;
- Paragraph 4.19, footnote 33, which lists the UK as one of three member states which the ECA visited concerning traditional own resources, where the quality, scope and results of the post-clearance was found to vary substantially; and
- Paragraph 4.22, where problems relating to the management of traditional own resources B accounts, which are sent to the Commission quarterly, are described and in which the ECA notes that procedures in the UK are complex and that this has led to mistakes.

4 Chapter 5 deals with **competitiveness for growth and jobs**. There is a reference to the UK in:

- Box 5.3, which provides examples of errors in costs reimbursements. A project in the UK funded by the European Programme for Recovery is mentioned.

5 Chapter 6 deals with **economic, social and territorial cohesion**. There are references to the UK in:

- Paragraph 6.21(a), footnote 20, which identifies the UK as one of the member states sampled in the examination of 161 transactions for regional and urban policy;
- Paragraph 6.21(c)(i), footnote 21, which lists the UK as one of the member states included as part of the ECA's assessment of the Commission's supervisory activities of audit authorities;
- Box 6.1, which provides examples of 'serious failures to comply with public procurement rules'. The UK is mentioned as one of five member states in which errors relating to 'unjustified direct awards' were detected in the ECA's audit of the year; and
- Paragraph 6.39, footnote 37, which shows the ECA identified 14 European Regional Development Fund and Cohesion Fund projects in eight member states that infringed the EU State Aid rules, including the UK.

- 6 Chapter 7 deals with **natural resources**. There are references to the UK in:
- Paragraph 7.14(a), footnote 14, which identifies the UK as one of the member states included in the sample of European Agricultural Guarantee Fund transactions;
 - Paragraph 7.14(a), footnote 15, which identifies the UK as one of the member states included in the sample of transactions for rural development, environment, climate action and fisheries;
 - Box 7.1, where the UK is referred to for errors relating to payments for overstated eligible arable land;
 - Box 7.2, where the UK is referred to in examples of cross-compliance errors; and
 - Box 7.5, where the UK is cited in examples of errors relating to non-compliance with agri-environment commitments.

Appendix Five

Conclusions and recommendations from the 2009 UK Committee of Public Accounts report

1 In 2009, the UK Committee of Public Accounts reported on financial management in the EU.³³ It made ten recommendations to improve the management and accountability of the EU budget. This appendix sets out those recommendations, and provides an update on progress against each.

Committee of Public Accounts conclusion and recommendation

1 The Commission, working with Member States, has made a significant effort over recent years to improve the financial management of the European Union, and this effort is reflected in some progress since our last report. The introduction of accruals accounting helped the Commission, for the first time, to achieve a clear opinion from the Court on the *reliability* of the 2007 accounts. On *legality and regularity*, the Court gave a clear opinion on some 45% of European Union expenditure, compared to an estimated 5% in 2003.

2 There remains an unacceptably high level of error in some key budget areas and consequently, for the fourteenth successive year, the European Court of Auditors has not provided a positive overall Statement of Assurance on the legality and regularity of the underlying transactions. Qualification of the accounts year after year undermines public confidence in the financial management of the European institutions and of Member States and devalues the significance of the qualification. Qualification should be an exceptional procedure not the norm, and yet, although the Court has noted improvements, the same criticisms are repeated year after year. The new Commission, in late 2009, in consultation with the European Parliament and the Council of the European Union, should publish a timetable for obtaining a positive Statement of Assurance. Concerted action is needed by the Commission, the Court of Auditors and Member States on a number of fronts to achieve a positive audit opinion.

3 In 2005, we highlighted the inherent complexity of some European programmes as a major factor leading to error, but this complexity persists, as do the resultant errors. Some of the most complex programme expenditure in the budget continues to be in the Cohesion policy area, which is responsible for some €42 billion of expenditure in 2007. It is usual for auditors to set a threshold before the audit opinion must be qualified. The Court set the threshold for the value of error which can be tolerated at 2% of the expenditure. In Cohesion policy the Court estimated that at least 11% of spending is subject to error. This level of error is unacceptable. Challenging targets should be set for the Commission to simplify regulations as much as possible and the relevant national delivery bodies should prioritise simplicity when interpreting Commission requirements.

Developments since Committee report

Clear audit opinion on reliability of accounts since 2007.

Adverse audit opinion on legality and regularity of payments since 1994.

Estimated level of error of 4.4% in 2014 was above the materiality threshold of 2%.

No timetable has been published.

The Commission has attempted to simplify the complexity through the financial regulation governing the 2014–2020 MFF: simplification, increased accountability, and increased flexibility.

33 HC Committee of Public Accounts, *Financial Management in the European Union*, Thirty-second Report of Session 2008–09, HC 698, June 2009.

Committee of Public Accounts conclusion and recommendation

4 The Commission has proposed introducing higher levels of ‘tolerable error’ in areas of expenditure where the implementation of programmes is riskier and more prone to error, for example, in Cohesion policy. The solution to such complexity does not lie in adjusting the level of tolerable error. This would undermine the accountability of European Union funds rather than enhance it, and European citizens would see this as lowering the bar; whether a €1 million error occurs within a complex or a simple area of expenditure should not make a difference to its acceptability. The European institutions concerned should consider the repercussions of such a change, including the risk of removing the incentive to simplify rules governing European funding at a time when simplification is needed.

5 Ongoing problems with controls over Cohesion policy expenditure are, in effect, condemning the European Union accounts to qualification for many years to come. The Court’s ‘traffic light’ assessment of performance across expenditure areas, produced since 2007, has brought much needed clarity to where the challenges in financial management lie. This clarity should help in targeting activity to overcome those challenges. The Court could bring further clarity by providing a Statement of Assurance on each individual expenditure area in addition to that for the whole budget. If necessary, the Court should seek changes to its treaty obligations to effect this.

6 The Commission has increased its focus on recovering ineligible expenditure through financial corrections. Where the Commission identifies ineligible expenditure it seeks to recover the funds from the Member State. The Commission’s activities in this area are to be commended and it should seek to recover all irregular expenditure. We hope that the threat of correction will lead to improved administration by Member States to ensure that corrections are, ultimately, unnecessary.

7 The United Kingdom authorities made provisions for possible future financial corrections of over £400 million in 2007-08, and some £100 million of corrections have since been imposed. Financial corrections made by the Commission often result in a loss to exchequer funds and it is unacceptable that the United Kingdom authorities, through mismanagement, have exposed the taxpayer to this level of recovery. The United Kingdom authorities must ensure they manage European funds more effectively in the future to minimise the likelihood of financial corrections.

8 The number of Special Reports on value for money produced by the European Court of Auditors has increased but it could do more to assess whether European Union programmes are achieving their objectives in an efficient and effective manner. The Court has increased the number of Special Reports it produces from five in 2005 to 12 in 2008. This is an improvement but still short of the level required to provide the necessary assurance that European Union funds are well used. We would like to see the growth in reports continue and encourage the Court to focus on the efficiency and effectiveness of programmes.

Developments since Committee report

In 2014 estimated level of error varied from 0.5% (heading 5: *Administration*) to 5.7% (heading 1b: *Economic, social and territorial cohesion*).

In 2010 the Commission proposed introducing a level of tolerable error above 2%.¹ The European Court of Auditors noted that the question of what should be considered tolerable is a political decision. The decision to determine a level of materiality is for the external auditor, and must be set in accordance with international standards.² Materiality has remained at 2%.

Whilst the traffic light presentation no longer features in the ECA’s annual report, the analysis in the report has been expanded to provide extensive analysis of the main risks, sources and patterns of error across the EU budget as a whole and in the specific spending areas. For example, in its annual report 2014, see paragraphs 1.17 to 1.29.

During the period 2009 to 2014 financial corrections and recoveries showed an increasing trend (see Figure 27 on page 57).

See Part Three of this briefing.

Year	Number of special reports published
2010	14
2011	16
2012	25
2013	19
2014	24
2015	22
2016	4 to date

Source: European Court of Auditors

Committee of Public Accounts conclusion and recommendation

9 The level of fraud and irregularity within the European budget is unclear. OLAF continues to report that the reliability of published information on fraud and irregularity depends on the quality and timeliness of information submitted by Member States and should be treated with caution. To resolve this longstanding issue, on which we reported in 2005, OLAF and the Commission should press Member States to work with them to develop a consistent arrangement for recording and reporting irregularity and fraud across the European Union. OLAF should state alongside its published figures where it has concerns about the quality and timeliness of the information submitted.

Developments since Committee report

OLAF would like to point out that improvements are constantly being achieved in this area and specific initiatives are ongoing in this respect. After the publication on 10 November 2015 of the harmonised reporting of irregularity provisions package for the MFF 2014–2020 concerning all shared management funds, OLAF and experts from the Member States work, under a collaborative approach, to develop consistent guidelines for irregularity and suspected fraud reporting across the European Union.

The annual report on the protection of the EU's financial interests – Fight against fraud, in its analytical part always includes information about the quality and timeliness of the information reported by the Member States.

10 The Fundamental Review of the European Union budget presents the Commission with a rare opportunity to make long term changes to improve financial management. The Commission, the Court and Member States should work together to ensure that suitable, practical changes are implemented, using this review as a springboard for large scale constructive action to resolve the issues which have blighted European Union financial management for years.

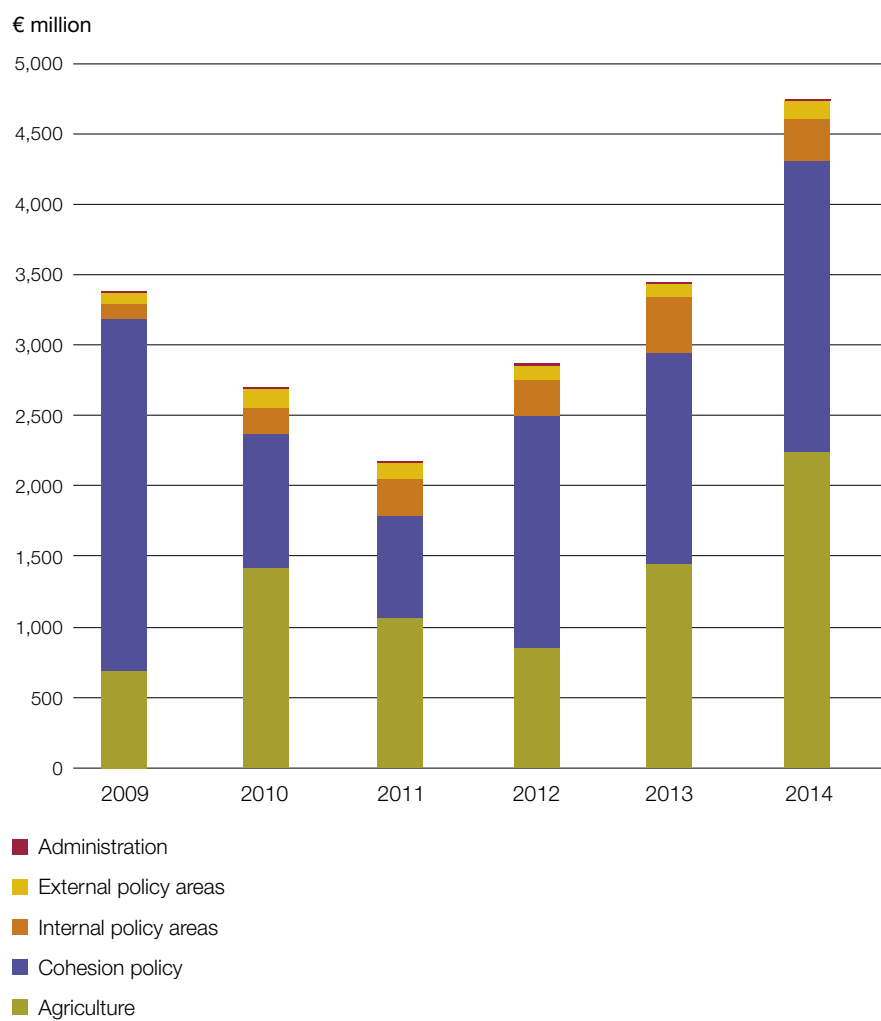
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-

Figure 27

European Commission combined financial corrections and recoveries, 2009 to 2014

Financial corrections and recoveries confirmed 2009–2014



Source: European Commission

Appendix Six

Special reports and landscape reviews adopted by the European Court of Auditors, 2014 to 2016

Special reports and landscape reviews adopted by the European Court of Auditors in 2014

Special reports

Effectiveness of EU-supported public urban transport projects

Are preferential trade arrangements appropriately managed?

Lessons from the European Commission's development of the second generation Schengen Information System (SIS II)

Integration of EU water policy objectives with the CAP: a partial success

European banking supervision taking shape – EBA and its changing context

Cohesion policy funds support to renewable energy generation – has it achieved good results?

Has the ERDF successfully supported the development of business incubators?

Has the Commission effectively managed the integration of coupled support into the single payment scheme?

Is the EU investment and promotion support to the wine sector well managed and are its results on the competitiveness of EU wines demonstrated?

The effectiveness of European Fisheries Fund support for aquaculture

The establishment of the European External Action Service

Is the ERDF effective in funding projects that directly promote biodiversity under the EU biodiversity strategy to 2020?

EU support for rehabilitation following the earthquake in Haiti

How do the EU institutions and bodies calculate, reduce and offset their greenhouse gas emissions?

The External Borders Fund has fostered financial solidarity but requires better measurement of results and needs to provide further EU added value

The effectiveness of blending regional investment facility grants with financial institution loans to support EU external policies

Can the EU's Centres of Excellence initiative contribute effectively to mitigating chemical, biological, radiological and nuclear risks from outside the EU?

EuropeAid's evaluation and results-oriented monitoring systems

EU Pre-accession Assistance to Serbia

Has ERDF support to SMEs in the area of e-commerce been effective?

EU-funded airport infrastructures: poor value for money

Achieving economy: keeping the costs of EU-financed rural development project grants under control

Errors in rural development spending: what are the causes, and how are they being addressed?

Is EU support for preventing and restoring damage to forests caused by fire and natural disasters well managed?

Landscape reviews

Gaps, overlaps and challenges: a landscape review of EU accountability and public audit arrangements

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

Special reports adopted by the European Court of Auditors in 2015

EU Pre-accession Assistance to Serbia

Has ERDF support to SMEs in the area of e-commerce been effective?

Errors in rural development spending: what are the causes, and how are they being addressed?

Is EU support for preventing and restoring damage to forests caused by fire and natural disasters well managed?

Inland Waterway Transport in Europe: No significant improvements in modal share and navigability conditions since 2001

EU-funding of Urban Waste Water Treatment plants in Danube river basin: further efforts needed in helping Member States to achieve EU waste water policy objectives

EU Youth Guarantee: first steps taken but implementation risks ahead

Technical assistance: what contribution has it made to agriculture and rural developments?

Are financial instruments a successful and promising tool in the rural development area?

The integrity and implementation of EU Emissions Trading Scheme (ETS)

The EU policy in Afghanistan: mixed results

Is EU financial support adequately addressing the needs of micro-entrepreneurs?

EU support for the fight against torture and the abolition of the death penalty

Efforts to address problems with public procurement in EU Cohesion expenditure should be intensified

Are the Fisheries Partnership Agreements well managed by the Commission?

The EU priority of promoting a knowledge-based rural economy has been affected by poor management of knowledge-transfer and advisory measures

EU support to Timber-Producing Countries under the FLEGT Action Plan

The ACP Investment Facility: does it provide added value?

ACP–EU Energy Facility support for renewable energy in East Africa

Commission's support of youth action team: redirection of ESF funding achieved, but insufficient focus on results

Improving the security of energy supply by developing the internal energy market: more efforts needed

Review of the risks related to a results-oriented approach for EU development and cooperation

Special reports adopted in 2016 to date

The cost-effectiveness of EU Rural Development support for non-productive investments in agriculture

Water quality in the Danube river basin: progress in implementing the water framework directive but still some way to go

Financial assistance provided to countries in difficulties

EU supervision of credit rating agencies – well established but not yet fully effective

Source: European Court of Auditors

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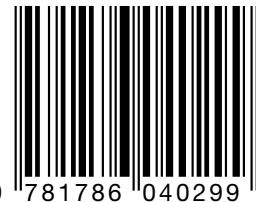


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