



National Audit Office

# Financial management in the European Union

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## EXECUTIVE SUMMARY



**1** In 2004, expenditure by the European Union amounted to €100.1 billion (£67.9 billion<sup>1</sup>). The United Kingdom's net contribution to Community funds was €4.8 billion (£3.3 billion), comprising gross payments to the European Union of €11.7 billion (£7.9 billion), after taking account of the United Kingdom's abatement of €5.3 billion (£3.6 billion) and receipts of €6.9 billion (£4.7 billion).

**2** In recent years, the institutions of the European Union and Member States have focused attention on improving the state of financial management within the European Union. This is partly because the European Court of Auditors (the Court) has not issued a positive Statement of Assurance in each of the last 11 years. To address this issue, the Barosso Commission has made it a strategic objective during its mandate to strive for a positive Statement of Assurance from the Court.

**3** The United Kingdom Parliament has taken a great interest in European Union matters, including seeking better management and oversight of European funds. In April 2005, the Committee of Public Accounts published a report focused on these issues and made a number of recommendations for improvement<sup>2</sup>. The Government responded positively to the Committee's recommendations<sup>3</sup>, and committed itself to taking forward the initiatives to improve the financial management of European funds during its Presidency of the Council of the European Union in the latter half of 2005. Appendix 1 sets out the Committee's conclusions and recommendations and the Government's response to them.

**4** This report continues our practice of recent years of informing Parliament of the results of the examination of the European Union's accounts by the Court and progress on the various initiatives to improve financial management and control. In line with previous years, we summarise:

- the key findings from the Court's report on the 2004 financial year, in particular in relation to the Common Agricultural Policy and Structural Measures;
- the information available on irregularities, including possible fraud; and
- the progress made in improving financial management.

## The key findings

### On the Court's Statement of Assurance for 2004

**5** The Court has not issued a positive Statement of Assurance on European Union expenditure for the eleventh year in succession, although its report noted improvements on the previous year. The Court concluded:

- **the reliability of the accounts:** that, in general, the Community accounts faithfully reflected revenue and expenditure for the year and the financial position at the year end. The Court could not however be certain that all the transactions relating to sundry debtors had been correctly and completely recorded.

<sup>1</sup> This, and all other figures for 2004, has been converted at the 2004 annual exchange rate of £1=€1.4742.

<sup>2</sup> *Financial Management of the European Union*, Committee of Public Accounts, Eighteenth Report, Session 2004-05, HC 498.

<sup>3</sup> Treasury Minutes on the Twelfth, Fourteenth and Sixteenth to Eighteenth Reports from the Committee of Public Accounts 2004-2005.

- **legality and regularity of the transactions underlying the accounts:** that they were, taken as a whole, legal and regular with respect to revenue, commitments, administrative expenditure, expenditure on the pre-accession strategy, and areas of expenditure under the Common Agricultural Policy covered by the Integrated Administration and Control System (IACS)<sup>4</sup>. But it was unable to do so for four (of the six) main areas of expenditure, including expenditure under the Common Agricultural Policy not covered by IACS and Structural Measures.

6 The Court agreed with the Commission's view that while significant progress had been made to improve internal controls more work was required to increase their effectiveness.

## On budget management

7 The Court reported an increase in the percentage of the European Community budget actually spent to 95 per cent from 92 per cent in 2003 and 86 per cent in 2002. The Court concluded that this increase and the reduction in the surplus were due to improved management by the Commission. The Court noted, however, that commitments for future years on the Structural Funds (2000-2006 programme period) had reached €136 billion (£92 billion), equivalent to nearly five years expenditure at the 2004 rate. This reflected delays in earlier years in setting up and starting the operation of these programmes. The Commission responded that the total level of commitments should be seen in the light of the time remaining for the execution of the remaining payments. The Commission considered that existing controls placed limits on the extent to which payments could be pushed back. It did not share the Court's concern that the accumulated commitments would hamper the start of new programmes.

## On the Common Agricultural Policy, Structural Measures, and irregularities (including possible fraud)

8 For expenditure under the Common Agricultural Policy, the Court concluded that, where properly applied, the Integrated Administration and Control System, which covers area aid and animal premium payments, was effective and limited the risk of irregular expenditure. IACS covers 59 per cent of expenditure on the Common Agricultural Policy, or 26 per cent of the European Union's budget. As in previous years, the Court concluded that for expenditure not covered by IACS, for example on export refunds and cotton, olive oil and tobacco production, controls were weaker, resulting in a greater risk to the legality and regularity of the transactions.

9 In relation to Structural Measures, the Court reported that the Commission had continued its efforts to improve the internal control environment. But the Court found weaknesses in the management and control systems across all the programmes, demonstrating the need for further improvements. It also reported numerous errors of legality and regularity and identified a number of risks inherent to the legality and regularity of transactions. The two programmes examined by the Court in the United Kingdom exhibited some of these weaknesses, such as a failure to carry out day-to-day management checks and to provide a sufficient audit trail.

10 The Court continued to report delays in closing the 1994-1999 Structural Fund programmes. By the end of March 2005, for example, only 661 of the 994 programmes within the European Regional Development Fund had been closed. Delays increase the time required by the Commission to make financial corrections and divert administrative resources in both the Commission and Member States away from managing the current programmes.

4 Integrated Administration and Control System – a computerised database of holdings and aid applications for identifying and registering parcels of agricultural land and animals; plus a set of associated administrative checks and on-farm inspections.

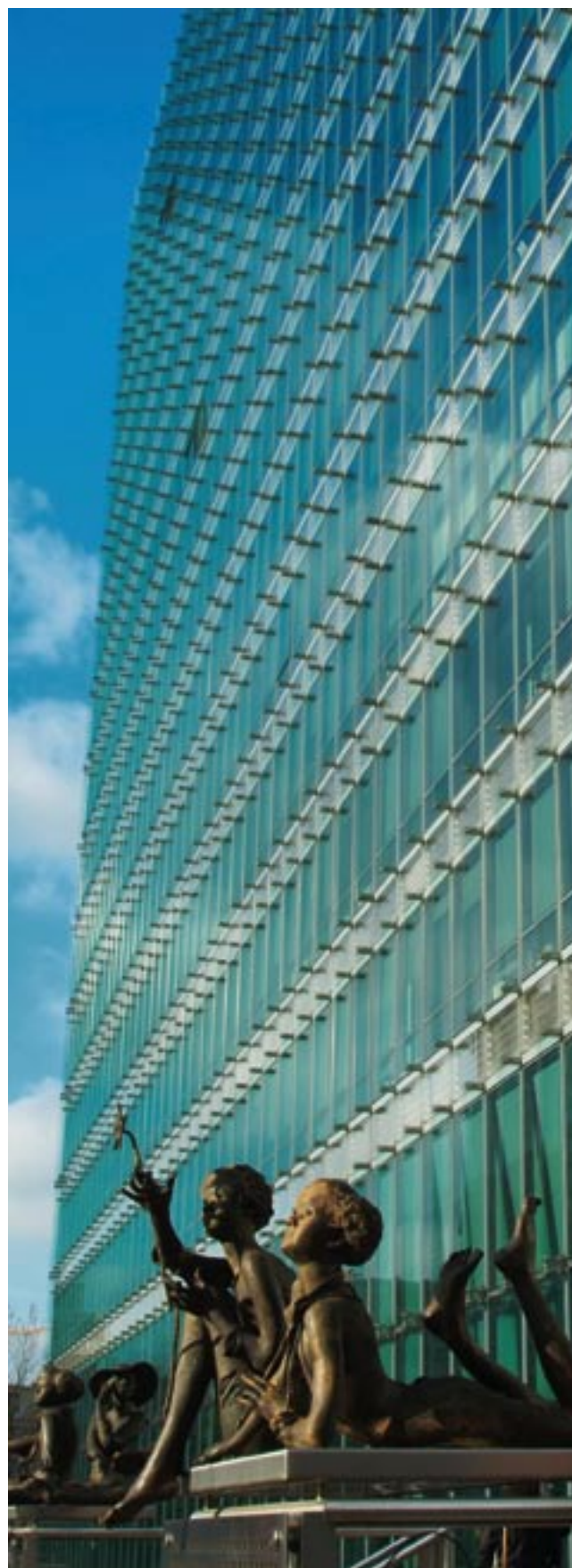
**11** During 2004, the 25 Member States reported to the Commission's anti fraud body (known as OLAF) 9,475 irregularities, including possible fraud, with a value of €983 million (£667 million). Excluding those reported by the ten new Member States (75 cases with a value of €5 million, or £3 million) to enable comparisons with 2003, the number of cases increased by 12 per cent and the value by five per cent.

### On the introduction of a new accruals accounting system

**12** In January 2005, the Commission introduced a new accounting system designed to produce accounts on an accruals, rather than a cash, basis. The first set of accounts produced on the new basis will therefore be for the 2005 financial year. During 2004, the Court carried out an audit of the different phases of the project's implementation. The Court reported that the Commission had made considerable progress towards introducing the system, but was concerned over whether the opening balances for 2005 would be established in time to produce a draft account. The Commission considered that the project had largely met the objectives set for the first eight months of 2005, and expected to have established the opening balances by the end of March 2006 in line with the project's timetable.

### On the development of an action plan to improve financial management

**13** In June 2005, the Commission published its 'roadmap', intended to move the European Union towards a positive Statement of Assurance. In November 2005, the Council of Ministers (Economic and Financial Affairs), known as ECOFIN, published its conclusions on the 'roadmap'. Taking into account the Council's comments, the Commission published its Action Plan in January 2006, designed to address important gaps between the current system of controls and those proposed as part of an integrated internal control framework. The Action Plan proposes to address four key themes: simplification of the management of European Community funds; strengthening management declarations and audit assurance; developing the approach to audit and determining the costs and benefits of controls; and addressing known weaknesses in specific programmes. The Plan sets a timetable for delivering the different action points.





## CONCLUSION AND RECOMMENDATIONS

**14** As mentioned in the Comptroller and Auditor General's last report, there is a need for further improvements in the management and control systems used in the Commission and Member States, particularly with regard to the closure of old programmes under Structural Measures. The delays in closing the 1994-1999 Structural Measures programmes continue to divert resources that could otherwise help with managing current programmes. The United Kingdom Government, working with other Member States, should share lessons learnt from the closure of the 1994-1999 programmes and ensure that there are robust plans to apply these lessons to the closure of the 2000-2006 programme. The United Kingdom authorities should use their influence to encourage the Commission and Member States to establish efficient and effective procedures for the 2007-2013 period.

**15** The United Kingdom authorities have acknowledged some weaknesses in their management and control systems for Structural Measures and, despite making some progress, have accepted that further improvements are needed. The Office of the Deputy Prime Minister and the Department for Work and Pensions should ensure that the guidance they issue to the nine regional Government Offices and other organisations administering projects makes schemes' requirements clear and that day-to-day management checks are given sufficient priority.

**16** The report of the Committee of Public Accounts and the Commission's Action Plan highlight 'contracts of confidence', relevant to Structural Measures, as a way of improving accountability. And the Government said that it was hopeful that the relevant authorities in the United Kingdom would be able to sign up to this initiative. To date, no 'contracts of confidence' have been signed. The Government should therefore renew its efforts to implement this initiative by continuing to encourage the development of the 'contracts of confidence' in the European Union and by identifying opportunities for the United Kingdom to enter into them.

**17** OLAF (the Commission's anti-fraud body) has taken welcome steps to estimate the level of fraud in individual sectors of the budget, drawing on information provided by Member States. The United Kingdom authorities should support OLAF's work and continue their efforts to encourage Member States to agree on ways of measuring irregularity and fraud that can provide a complete and reliable picture of the stewardship of European funds.

**18** We welcome the continuing improvements to the Court's Statement of Assurance and Annual Report, which contains more information on the Commission's progress in improving financial management, for example its assessment of expenditure on the Common Agricultural Policy. The Committee of Public Accounts was keen to see the Court develop its report in this way, and thereby assist the Commission and Member States in making the progress needed to achieve a positive Statement of Assurance.



**19** The Court is currently completing a self assessment exercise to identify its strengths and weaknesses and is arranging a peer review of its approach and work. This is an important step towards addressing a recommendation made by the Committee of Public Accounts in its 2005 report. However, the Court has no plans at present to develop its value for money work as suggested by the Committee.

**20** The Committee of Public Accounts considered that the size of the European Union's budget and the United Kingdom's contribution to it emphasised the need for strong financial management and frameworks of accountability and that the European Union's audit and accountability arrangements had been characterised by inertia. There have been valuable developments during the United Kingdom's Presidency including work on the Commission's roadmap which are intended to move the European Union towards a positive Statement of Assurance. There is still a long way to go. The successful implementation of the Commission's proposals will need the co-operation and support of other European Institutions and the State Audit Institutions and control agencies of Member States to obtain clear agreement on the approach to be taken. The United Kingdom authorities, working with their Austrian and Finnish counterparts, should give a high priority to helping to bring the current initiatives to a successful conclusion during the Barroso Commission's mandate.