

The Annual Report of the European Court of Auditors for 1996



This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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Comptroller and Auditor General

National Audit Office
9 April 1998

The Comptroller and Auditor General is the head of the National Audit Office employing some 750 staff. He, and the National Audit Office, are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

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Executive summary

1 The Annual Report contains the main findings of the European Court of Auditors (the Court) from their audit of the accounts relating to the implementation of the European Community Budget, and incorporates the Court's Statement of Assurance. The Budget comprises the revenue collected from the 15 Member States of the European Union, and the Community expenditure in the Member States, the Community Institutions and elsewhere. In 1996 it was some £60 billion (82 billion ECU). The European Commission (the Commission) have overall responsibility for implementing the Budget but over 80 per cent of the expenditure is managed by Member States. The Court's Annual Report contains observations on financial management by the Member States and Community Institutions, and the Statement of Assurance gives an opinion on the accuracy of the accounts, and the legality and regularity of the underlying transactions.

2 In their Annual Report for 1996, published on 18 November 1997, the Court made particular reference to the following administrative and control weaknesses:

- a)** the failure of agricultural compensation scheme regulations to take account of changes in world market prices resulting in unnecessary expenditure, most significantly £2.2 billion (3.0 billion ECU) paid to arable farmers;
- b)** the extensive use by the Community of advances to Member and non-Member States which were accounted for as actual expenditure. The rate of use of the funds at final beneficiary level was unclear. Consequently substantial funds have remained for long periods in the hands of intermediary authorities, for instance 38 per cent of advance payments or £0.4 billion (0.5 billion ECU) made during the period 1990-95 to non-Member States under the "PHARE" programme remained in national administrations' bank accounts at the end of 1995;
- c)** where there was doubt about the proper use of Community funds the Commission could only recover those funds if they could prove that they had been wrongly used. This was a problem, especially in the area of the Structural Funds, because the information and accounting systems had not been developed within all beneficiaries and intermediary organisations to permit the Commission to exercise this supervisory function;

- d) the failure, particularly by authorities in the Member States but also in the Commission, to develop appropriate systems of accounting and financial management which kept pace with expanding and diverse Community activities; and
- e) deficiencies in the efficiency and effectiveness of Community financing had been evaluated particularly for the Structural Funds where the objectives were not clear and performance indicators had not been set.

3 From their work on the Statement of Assurance, the Court concluded that:

- a) the 1996 accounts reliably reflected the European Community's revenue and expenditure for the year and financial situation at the end of the year, with the exception of five significant mis-statements, and the revenue and commitment transactions underlying the accounts were generally legal and regular; but
- b) due to the high rate of error in the payment transactions examined the Court could not give any assurance as to the legality and regularity of the payments underlying the accounts. The Court estimated that the overall most likely rate of error was 5.4 per cent or £3.1 billion (4.2 billion ECU) with a higher rate of error in the Structural Funds and a lower rate in the Common Agricultural Policy.

4 The Court drew attention to the positive way in which the Commission had responded to the Court's reports and noted that they were seeking to resolve many of the problems and weaknesses found. The Court emphasised that the audit of Community finances was more than ever necessary to protect the interests of the European citizen.

National Audit Office conclusions

5 The National Audit Office note that the United Kingdom hold the Presidency of the European Union during the first half of 1998, and that this provides a valuable opportunity for the Government to influence the way Community funds are managed. The following conclusions highlight areas of particular concern which might usefully be addressed.

6 In relation to the Court's Statement of Assurance (Part 2):

- a)** it is a matter of serious concern that for the third year in succession the Court have declined to provide a positive assurance on the Community's payments because of the large number of errors identified;
- b)** the number of exceptions to the Court's assurance on the reliability of the accounts is also a matter of concern, indicating that the Commission have some way to go before they attain the quality of financial reporting expected of public sector financial statements such as government accounts in the United Kingdom; and
- c)** the Commission should produce clear and simplified financial statements of the Community Budget with more accessible financial information, prepared in accordance with generally accepted accounting principles in so far as appropriate. The Statement of Assurance could also be published with the financial statements of the Community Budget. Making these two changes would be in line with the recommendation in February 1996 of the Committee of Public Accounts.

7 In relation to the Common Agricultural Policy, the Community's directly managed expenditure and Community revenue (Part 3):

- a)** the Council did not act on the Commission's proposal to eliminate the over-compensation of farmers arising from unexpected movements in world market prices. The Council and the Commission should ensure that such schemes in future provide only the level of subsidy intended. The Council and Commission need also to address the effectiveness of aid given to tobacco growers;
- b)** the implementation by Member States, including the United Kingdom, of a range of schemes such as those based on eligible farm areas and premiums for the slaughter of cattle has proved problematic, with farmers receiving less or more aid than intended. The Council and Commission need to consider whether there are lessons for the way such schemes are conceived and implemented;
- c)** the various problems experienced by the Commission in administering directly managed expenditure suggest that they must continue to strive for improvement; and

- d)** the systems for ensuring that customs and other duties payable to the Community are actually recovered have not always operated effectively, leading to cases of under-recovery. This suggests that procedures at the Commission and in all Member States need to be improved.

8 In relation to the Structural Funds (Part 4):

- a)** the high level of error found in payments from the Structural Funds was unacceptable. For instance, 31 out of 69 Social Fund payments had errors with a measurable financial impact;
- b)** the Commission's closure of the 1989-93 operational programmes, (that is comparison of expenditure incurred with amounts claimed) and evaluation of outcomes from these programmes had been subject to substantial delays. The management of these schemes needs to be addressed now to prevent this problem recurring when the 1994-98 programmes are completed;
- c)** given the high rate of error, there needs to be a greater emphasis within Member States on vetting applications and checking claims; and
- d)** the work of the Court and the National Audit Office shows that there is no room for complacency in any of the Member States so far as fraud and irregularity against the Structural Funds is concerned.

9 The Comptroller and Auditor General has reported in 1998 on the United Kingdom's management of Community funds in the context of the accounts of the Intervention Board for Agricultural Produce, the Scottish Office and the Department for Education and Employment, and will publish a report on measures taken to eliminate Bovine Spongiform Encephalopathy later in 1998. The National Audit Office will continue to give a high priority to examining the way United Kingdom departments manage Community funds in the future and to co-operating with the Court.

Part 1: Introduction

1.1 The Annual Report of the European Court of Auditors (the Court) contains the main findings from the Court's audit work covering the previous European Community financial year (which runs from January to December). The Annual Report includes the Court's Statement of Assurance on the reliability and legality of the Community's accounts. The Annual Report is published in November as an official European Community document and plays a key part in the process by which the use of the Community's funds is examined.

1.2 This Report by the Comptroller and Auditor General summarises the key points in the Court's Annual Report for the financial year 1996. This is the third time the Comptroller and Auditor General has reported on the Court's Annual Report and Statement of Assurance. This Report is particularly timely given the United Kingdom's Presidency, during the first half of 1998, of the Council of Ministers (the Council). This gives the United Kingdom Government the opportunity to encourage remedial action in response to the Court's findings, particularly the issues raised by the National Audit Office's conclusions in this Report.

The European Community Budget in 1996

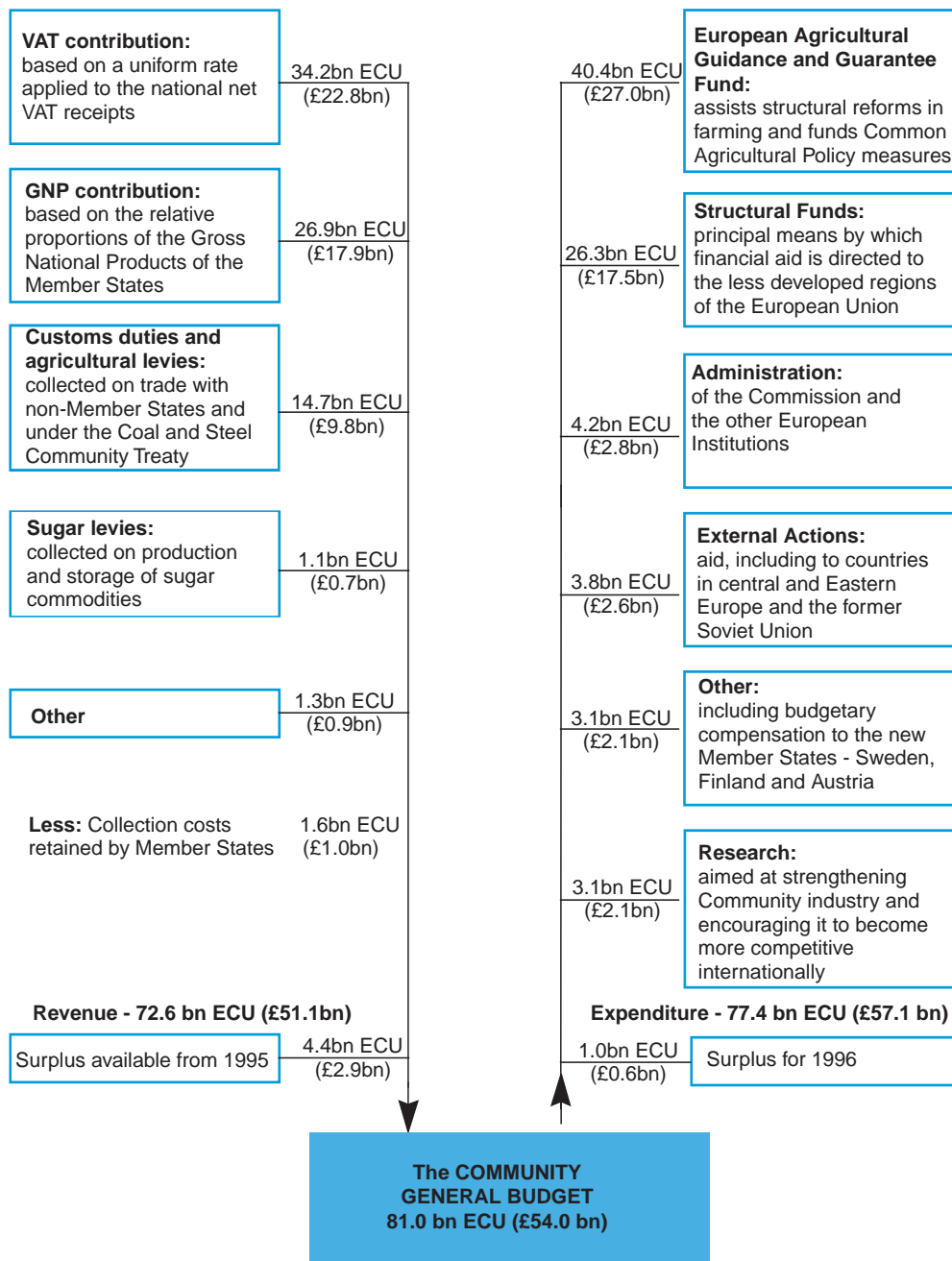
1.3 The revenue available to the European Community Budget for 1996 was some 82 billion ECU (£60 billion), including 9 billion ECU (£6.8 billion) brought forward from 1995. Revenue arose from four main sources (see Figure 1):

- customs duties and agricultural levies;
- sugar levies;
- a Value Added Tax based contribution; and
- a Gross National Product related "fourth resource".

1.4 Total Community spending in 1996 was some 78 billion ECU (£57 billion), 3.6 per cent higher than in 1995 but 4 billion ECU (£3 billion) less than the revenue available to the Community. The difference was carried forward to 1997. Figure 1 breaks down these totals between the main expenditure headings used by the Community. In very broad terms there are three main types of expenditure:

Figure 1

Revenue and expenditure of the European Community in 1996



Note: The General Budget of the European Community is funded by customs duties and agricultural levies, sugar levies, and contributions based on Member States' VAT revenues and Gross National Product. The Budget funds agricultural support, and social and economic development.

Source: Data from Annual Report of the European Court of Auditors 1996

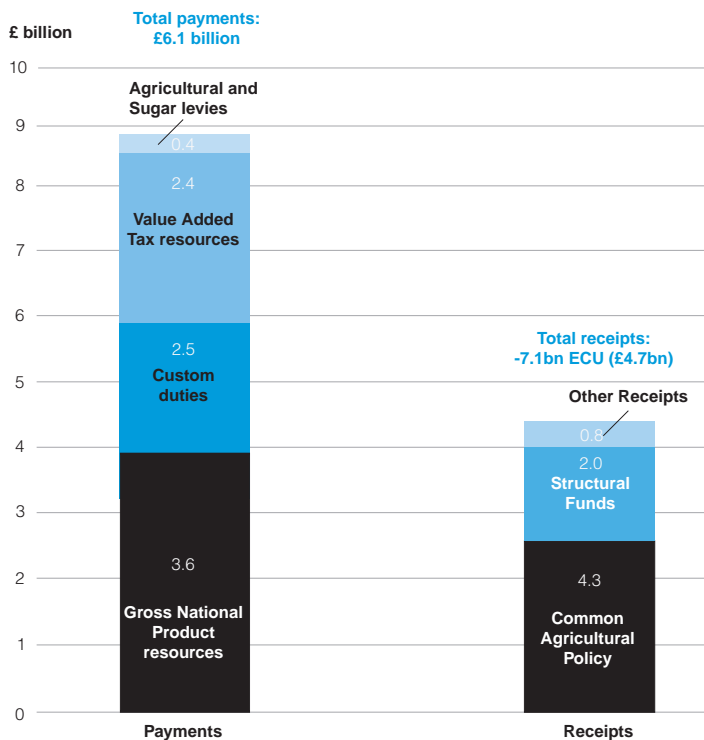
- the **European Agricultural Guidance and Guarantee Fund**, that is agricultural support measures under the Common Agricultural Policy. These include reducing Community intervention prices to bring them closer to world market levels and paying aid to farmers;
- the **Structural Funds** which aim to reduce disparities of wealth and employment opportunities between regions in the Community. Financial assistance is directed at projects including infrastructure development and employment training; and
- **directly managed expenditure** covering administration and schemes which the Commission manage for purposes such as aid to countries in central and Eastern Europe and the former Soviet Union, budgetary compensation to the newest Member States and promoting research.

1.5 Although the Commission are responsible for implementing the Community Budget, some 80 per cent of the funds are spent within the Member States of the European Union by central government, local administrations and other beneficiaries. The Commission are responsible for co-ordinating, stimulating and controlling the effective working of the financial mechanisms of the Community across the Member States. Under Article 209a of the Treaty on European Union, Member States are legally required to take the same measures to counter fraud against the financial interests of the Community as they would their own. Appendix 3 summarises the procedure for setting, controlling and accounting for the Budget.

1.6 The United Kingdom was the third largest net contributor to the Community Budget in 1996, contributing some £1.7 billion (2.3 billion ECU). Figure 2 shows the United Kingdom's payments to (£6.1 billion or 8.2 billion ECU), and receipts from (£4.4 billion or 6.0 billion ECU), the Community Budget in detail. European Community expenditure and revenue by Member State is shown in Appendix 4.

United Kingdom's
contributions to
and receipts from the
1997 Community Budget

Figure 2



- Notes:
1. Ownership of customs duties and agricultural levies ("traditional own resources") rests with the European Communities.
 2. Member States are entitled to retain 10 per cent from levies and duties made available to the Commission to cover their collection costs.
 3. The United Kingdom's Value Added Tax contribution is abated under the 1984 Fontainebleau agreement.
 4. The Value Added Tax and Gross National Product contributions are initially forecast and then adjusted as final figures become available.
 5. A conversion rate of £1 = 1.3563 ECU - the annual average rate for 1996 - has been used.

Source: Expenditure data from the European Commission's SINCOM system, revenue data from the European Union accounts

The European Court of Auditors

1.7 The Court are the external auditors of the European Community. In accordance with the provisions of the European Community Treaty, the Court examine all Community revenue and expenditure and consider whether the revenue has been received and the expenditure incurred in a lawful and regular manner. The Court also assess whether financial management within the Member States and Community Institutions is sound. In addition, since 1994 the Treaty on

European Union has required the Court to provide an annual Statement of Assurance on the reliability of the Community's accounts, and the legality and regularity of the underlying transactions.

1.8 The Court were established in 1977, and in November 1993 became the fifth Institution of the European Community (see Appendix 2). The Court consist of 15 Members, one for each Member State of the European Union, who are supported by some 500 staff. The Court's audit covers the Community Institutions and bodies set up by them, and the use of Community funds by national, regional and local administrations, as well as other recipients of Community aid in both the public and private sectors. The Court also audit Community funds spent outside the European Union, such as development aid in Eastern Europe.

1.9 During 1996 the Court carried out around 300 audit missions, including many to the United Kingdom. During their visits, the Court examine financial control and management systems, and selected transactions. They have statutory access to any document or information relating to the financial management of the departments or bodies subject to their examination, and can question any official responsible for revenue or expenditure. They have a right of access to any body in receipt of Community funding, which includes some bodies in receipt of government funding to which the Comptroller and Auditor General does not have a right of access (such as farmers and training providers). Following each of their audit missions, the Court send their findings to the relevant authorities in Member States in the form of a letter. The Member State authorities have eight weeks in which to respond to the Court who then take account of the replies in discussing their findings with the European Commission. In addition to their Annual Report, the Court publish the results of their work in Special Reports which deal with specific topics such as the management of the European Community cereals trade.

Action taken on the Court's 1995 Annual Report

1.10 The Court's 1995 Annual Report and Statement of Assurance drew attention to:

- insufficient appraisal of the likely effectiveness of Community programmes and evaluation of their success;
- widespread weaknesses in financial management producing irregularities in expenditure, particularly in the Structural Funds; and

- the breadth of Community initiatives tending to exceed the capacity for sound financial management.

1.11 Following their consideration of this Report, the Council criticised the quality of Budget execution and noted that the problem faced by the Community was inefficient management rather than shortage of resources. The European Parliament were, in April 1997, similarly highly critical of Budget execution and asked the Commission to address the various problems identified. The Commission published their response in November 1997, indicating the various actions which were being taken, including actions arising out of the Sound and Efficient Management 2000 Initiative, summarised in Appendix 5.

Content of the Court's 1996 Annual Report

1.12 Given the size and complexity of the Community Budget, the Court are not able to examine all aspects of each sector each year. Instead, they select topics for examination on the basis of the significance of the area, the amount of money involved, the perceived risks, the political interest and the results of previous audit work. The Court also give due consideration to suggestions made by the European Parliament and the Council of Ministers. Figure 3 shows the section headings in the 1996 Annual Report under which the Court grouped their findings. In summary, Volume 1 reflected the structure of the Community Budget and Volume 2 covered the Statement of Assurance. The Court also published an Information Note which summarised the Report's findings.

Parliamentary scrutiny of European matters in the United Kingdom

1.13 Parliamentary scrutiny of the Court's reports takes place primarily in the Committee of Public Accounts and in the Select Committee on European Legislation; in the House of Lords this function is performed by the Select Committee on the European Communities. The Committee of Public Accounts consider the control and management of European Community funds on the basis of reports of the Comptroller and Auditor General. These have included reports on the 1994 and 1995 Annual Reports of the European Court of Auditors¹. When they take evidence on reports by the Comptroller and Auditor General the Committee issue their own report, and have in recent years called, in particular, for:

¹ The Comptroller and Auditor General supplied the Committee with a Note on the 1994 Annual Report in February 1996 and published a report "The Annual Report of the European Court of Auditors and the Statement of Assurance for 1995" (HC 332) in March 1997.

- improvements to the form of accounts prepared by the Commission (10th Report, Session 1995-96); and
- the United Kingdom Government to press for changes to the European Agricultural Guidance and Guarantee Fund, as well as for improvements to the management of Structural Funds (6th Report, Session 1996-97).

Figure 3

Subjects covered in the Court's 1996 Annual Report

Volume and Part *Subjects covered*

Volume 1	Report on activities financed from the general budget and on the activities of the sixth and seventh European Development Funds
1	Own resources - examination of the revenue of the Community including: free zones; aspects of the inward processing regime; establishment and recovery of traditional own resources; and the bases for assessing Gross National Product and VAT contributions.
2	Common Agricultural Policy - examination of: area aid for arable crops; beef and veal premiums; the Integrated Administrative and Control System; follow-up to previous reports on the tobacco and wine markets; and export refunds.
3	Structural Measures - examination of aspects of : the European Regional Development Fund; the European Social Fund; the European Agricultural Guidance and Guarantee Fund, Guidance Section; and the Financial Instrument for fisheries guidance.
4	Internal Policies - examination of direct expenditure by the Commission on research and on industrial policies.
5	External Measures - examination of implementation of the European Development Funds and aspects of external aid programmes to developing and third countries, and countries of central and Eastern Europe.
6	Administrative Expenditure - examination of administrative expenditure of the Commission and the other Community Institutions, and of the Economic and Social Committee and the Committee of the Regions.
7	Financial instruments and banking activities - examination of the European Union's borrowing and lending operations and, in particular, the Guarantee Fund for External Activities and the European Investment Fund.
Volume 2	The Statement of Assurance
1	Statement of Assurance concerning activities financed from the general budget - including chapters analysing European Agricultural Guidance and Guarantee Fund, Guarantee expenditure and fisheries expenditure; and Structural Fund expenditure.
2	Statement of Assurance concerning the activities of the sixth and seventh European Development Funds.

1.14 The House of Commons Select Committee on European Legislation consider a wide range of European documents, including the Court's reports; they have power to refer documents of particular legal or political importance to one of

the two European Standing Committees for questions to Ministers and debate, or to recommend debate on the floor of the House. The Select Committee considered the Court's 1996 Annual Report on 28 January 1998 and referred it to European Standing Committee B for debate. The House of Lords European Communities Committee consider the same range of documents as the Select Committee; some are referred for further scrutiny to a sub-Committee, who may decide to conduct an enquiry, taking evidence and producing a detailed report on the merits of the document before them.

Scope of the National Audit Office examination

1.15 This Report:

- summarises the European Court of Auditors' general findings for 1996 (Part 2);
- highlights the Court's more significant findings on aspects of Community expenditure and revenue (Part 3); and
- highlights the Court's more significant findings on the Structural Funds and outlines some of the remedial measures being taken (Part 4).

1.16 In preparing the Report, the National Audit Office visited the Court to discuss matters arising from their work, and the Commission to obtain their comments on the Court's findings. The National Audit Office also obtained comments from relevant government departments on the references to the United Kingdom.

Part 2: The European Court of Auditors' general findings

2.1 Under Article 188c of the Treaty on European Union, the European Court of Auditors are required to prepare an Annual Report after the close of each financial year. The Annual Report presents the Court's audit findings and observations. The Court's Annual Report for 1996 was published in two volumes. The first volume contained the Court's findings, from their financial audit and value for money work, on the quality and reliability of the systems of management and internal control in place to oversee the use of the Community Budget. The second volume contained the Court's Statement of Assurance on the reliability of the Community's accounts and the legality and regularity of the underlying transactions. This Part of the Comptroller and Auditor General's Report summarises the Court's overall findings on implementation of the Community Budget (in Volume 1 of their Report) and their opinion on the Community's accounts (Volume 2).

Findings on implementation of the Community Budget

2.2 The most significant themes in the Court's 1996 Annual Report are set out in the following paragraphs. The more important findings underpinning these points are examined in greater detail in Parts 3 and 4 of this Report. Because the Court's criticisms of the financial management of the Structural Funds are particularly pronounced, Part 4 concentrates on that expenditure.

2.3 The Court drew attention to:

- the way in which some agricultural regulations failed to take account of world market prices resulting in unnecessary expenditure. In particular, the Court estimated that farmers were overcompensated under the arable aid programme by some £2.2 billion (3.0 billion ECU) in 1995-96, and that producers had been overcompensated by at least £0.6 billion (0.8 billion ECU) under beef and veal premium schemes over a four year period ending in 1996;
- the extensive use by the Community financial system of advances which were accounted for as actual expenditure. The rate of use of funds at final beneficiary level was unclear, particularly in the area of the Structural Funds, and the Court concluded that this impaired sound financial management, because it was difficult to determine whether the levels of

Community resources advanced were appropriate. Consequently substantial funds remained for long periods in the hands of intermediary authorities;

- the Commission's ability to recover those Community funds advanced to Member States only where they could prove that they had been wrongly used. This was a problem because the accounting systems of beneficiaries and intermediary organisations were not robust enough in all cases to justify expenditure and these bodies were not required to provide the Commission with sufficient and relevant proof. The Commission therefore had difficulty in checking the legality, regularity and sound financial management aspects of the European Community's finances;
- observations on administration and control weaknesses in almost all chapters of the Report demonstrated how far the development of appropriate systems of accounting and financial management, in particular in the Member States, had failed to keep pace with the expansion of Community activities and with their diversified nature;
- administration and control often being adversely affected by lack of co-ordination. The Court found examples of this across all areas of the Community Budget, for instance relating to the development of an Integrated Administrative and Control System for agriculture; and
- deficiencies in the Commission's evaluation of the efficiency and effectiveness of programmes arising, for instance from the absence of clear objectives and performance indicators for the Structural Funds. The Court concluded that every legislative proposal or financing decision that involves major expenditure needs to incorporate appropriate arrangements for determining success or failure in terms of precise objectives and in relation to firm baseline performance data.

2.4 The Court noted that, given the current state of accounting and financial arrangements, the impact of the Court's work is substantial, through identifying expenditure which should not have occurred, amounts which are potentially recoverable and possible future savings. They concluded that "the audit of Community finances, whether by the Commission, Member State auditors or the Court, is more than ever necessary to protect the interests of the European citizen".

The European Commission's response to the Court's findings

2.5 The Court acknowledged that the Commission had reacted positively in their replies to the Court's findings. They have often recognised the need for action and in some cases have indicated quite precisely their intentions to remedy the matters raised. The Court noted that the Commission were seeking to resolve many of the problems and weaknesses through implementing the Sound and Efficient Management 2000 (SEM 2000) financial management improvement initiative (Appendix 5). The Court also highlighted a number of other encouraging developments, many of which related to the Structural Funds (Part 4). The Court, in particular, welcomed recent indications that the Commission intended to propose a general revision of the Financial Regulation², taking account of the Court's formal opinion (earlier in 1997) that it was time it was clarified, and which listed ways in which the Regulation could be improved.

The main findings of the Statement of Assurance

2.6 The Treaty on European Union has since 1994 required the European Court of Auditors to prepare each year a Statement of Assurance on the reliability of the Community's accounts and the legality and regularity of the underlying transactions. This responsibility has similarities with the Comptroller and Auditor General's responsibility to give an opinion on each United Kingdom account which is then published with the account. The Statement of Assurance forms part of a free standing document, covering the accounts of the Community Budget as a whole and is not published with the European Community's accounts. However, the accounts for 1996 were for the first time published in the Official Journal of the European Communities at the same time as the Court's Report.

2.7 The Court are required to give an opinion on (a) the reliability of the Community's accounts and (b) the legality and regularity of the underlying transactions, that is revenue, commitments and payments. The Court's Statement of Assurance is designed to provide an overall opinion covering the Community's revenue (own resources) and expenditure and its balance sheet, and does not form the basis for drawing conclusions on individual Member States. The Court's methodology for the Statement of Assurance was detailed in Annex 2 to the

2 The Financial Regulation specifies the procedure to be adopted for establishing and implementing the Community Budget and for presenting and auditing the Community accounts.

Comptroller and Auditor General's Report on the Annual Report of the European Court of Auditors and the Statement of Assurance for 1995 (HC 332, session 1996-97).

Reliability of the Community's Accounts

2.8 The Court concluded that the 1996 accounts reliably reflected the European Community's revenue and expenditure for the year and financial situation at the end of the year, with the exception of five significant mis-statements:

- a) the amount owed by Member States to the Community Institutions, shown in the accounts as £1.5 billion (2.0 billion ECU), overstated by £190 million (264 million ECU) amounts relating to the clearance of accounts of European Agricultural Guidance and Guarantee Fund Guarantee expenditure and wrongly omitted some entitlements to customs duties and agricultural levies. The omission arose from inadequate procedures for recording customs debts which were unsecured or contested. Whilst the Court could not quantify it, they considered the amount to be material;
- b) cash at bank, recorded in the balance sheet as £8.6 billion (11.7 billion ECU), was not accurately reflected in the accounts. For example, advances to certain third countries were inaccurately recorded as expenditure instead of current assets in the balance sheet. The Court could not quantify the understatement but estimated that several hundred million pounds were involved;
- c) the value of outstanding commitments was understated by a net amount of at least £0.53 billion (0.7 billion ECU), that is about 1.5 per cent of the total of outstanding commitments. This arose from a combination of commitments no longer needed to meet future payments and the Commission's practice of accounting for a lower level of commitments than represent the full amount of sums due in the areas of co-operation and fisheries;
- d) some off-balance sheet commitments were inaccurately stated. For example, advances to non-European Union countries of £3.1 billion (4.2 billion ECU) were omitted; and
- e) the total value of advances and payments on account which were recorded as budgetary payments but which had not yet been definitively accounted for was at least £14 billion (19 billion ECU).

Legality and regularity of underlying transactions

2.9 The Court concluded that transactions underlying the revenue entered in the accounts for 1996 were, taken as whole, legal and regular, subject to standard restrictions on the scope of revenue audit in relation to the completeness of the figures. For instance, they could not pick up certain cases of deliberate irregularity. The Court also found that the commitment transactions for the financial year 1996, taken as a whole, were legal and regular, except for the understatement of commitments referred to in paragraph 2.8(c) above.

2.10 For the third year in succession, the Court declined to provide positive global assurance as to the legality and regularity of the transactions underlying the payments for the financial year 1996, because of the high likely rate of error. On the basis of the findings in their sample, the Court estimated (Figure 4) that the most probable rate of “substantive” error, that is quantifiable error which directly affected the amount of European Community funds spent, was 5.4 per cent (£3.1 billion or 4.2 billion ECU) of the total payment Budget of £57 billion (78 billion ECU). The Court noted that the error rate in the Structural Funds was substantially higher than for the Budget as a whole whilst the rate was lower for the Common Agricultural Policy.

**Error rates in the
European Community
payments Budget**

Figure 4

	Most probable rate of error %	Level of error range %
1996	5.4	3.5 to 8.3
1995	5.9	4.3 to 8.5

Source:

Data from Annual Report of the
European Court of Auditors 1996

Note: Figures are given as proportions of the total European Community payments Budget for the relevant year (£57 billion or 78 billion ECU for 1996 and £55 billion or 67 billion ECU for 1995)

2.11 Most of the errors concerned the eligibility of activities for Community funding. Others concerned the accuracy of expenditure for which financing was claimed, the accuracy of the calculation of the Community contribution, and the quality or existence of supporting documents. Some 90 per cent of “substantive” errors occurred in Member States, two thirds at final beneficiary level.

2.12 The Court also found a high incidence of “formal” errors affecting payments. “Formal” errors have no directly quantifiable effect on the transaction amounts and are not reflected in the analysis above. These errors comprised failures to comply with the relevant regulatory conditions, and failure to apply

management or control procedures stipulated in Community regulations. For example, the majority of the formal errors concerned the failure of recipients or implementing bodies to keep separate accounts for measures financed from the Community Budget, or maintain the quality of supporting documents.

2.13 The Court estimated that for some 4.3 per cent of Community payments it was impossible to obtain sufficient evidence to reach a firm opinion as to the correct use of Community funds. This was due in part to the Court being unable to complete their audit of some transactions and in part by the evidence not being available.

2.14 On the Guarantee Section of the European Agricultural Guidance and Guarantee Fund, that is the Common Agricultural Policy, the Court found that the “substantive” error rate was less than the rate for the Budget as a whole. All the errors found originated in the Member States. About 70 per cent of errors were by the administrative bodies, the rest by the final beneficiaries. The main types of error found were: ineligibility of expenditure; transactions taking place outside the eligibility period; errors in calculating the amount of Community support; and the absence or unreliability of evidence to justify payments.

2.15 The Court also stressed the importance of new procedures introduced to ensure more effective monitoring of European Agricultural Guidance and Guarantee Fund expenditure. The key elements of the new procedures are the formal accreditation of paying agencies by the Member States and the certification of their annual accounts by a certifying body. The Court noted that two Member States - the United Kingdom and Greece - had not delivered their certified accounts for the European Agricultural Guidance and Guarantee Fund by the statutory deadline. In February 1998, the Comptroller and Auditor General described the position in the United Kingdom in his report on the Intervention Board Executive Agency’s accounts covering implementation of the market regulations and agricultural support measures of the Common Agricultural Policy (Appropriation Accounts 1996-97, HC 251-111).

2.16 The Commission were nonetheless able to clear the accounts of all the paying agencies on 31 July 1997, albeit some three months later than intended. The Commission hoped that, with the experience of the first year of the new certification procedure, Member States would in future take effective steps to submit their accounts within the required deadlines.

The Commission's response to the Court's findings

2.17 The Commission noted the overall results of the Court's Statement of Assurance and agreed with the Court that the number of errors was still too high. For the Guarantee Section of the European Agricultural Guidance and Guarantee Fund the Commission noted that it had been able to implement rapidly reforms which were already having a beneficial effect. The Court acknowledged these improvements and that the error rate was below average for Guidance Section expenditure. The Commission also noted that the problems with the Structural Funds were more complex but that the Commission were equipping themselves with the necessary means to improve management. The Commission stressed that the basic responsibility for ensuring proper financial control of the operations co-financed by the Structural Funds lies with the Member States. Part 4 of this Report examines some of the steps which the Commission have taken.

The presentation of the Community's financial statements

2.18 In their 1995 Statement of Assurance, the Court noted that the Community's financial statements were internal documents, had never been published, and were presented to the Council and Parliament only in French. The Court concluded that it would be better if the accounts of the European Community could be published, preferably with the Statement of Assurance, but that the Commission would need to make the decision.

2.19 In February 1996 the Committee of Public Accounts noted³ that the full accounts of the Community Budget were produced as an internal Commission document and were not available in English. The Committee were concerned that improvements should be made to the Community's financial statements, in order to provide more usable information and enhance the accountability of the Commission for the use of the Community Budget. The Committee recommended that the United Kingdom Government press for the publication of audited accounts in a clear format accompanied by the Statement of Assurance. In their response⁴ the Government promised to raise the matter with the Commission.

3 Committee of Public Accounts 10th Report of Session 1995-96: The Annual Report of the European Court of Auditors and the Statement of Assurance.

4 Treasury Minute on 10th Report of the Committee of Public Accounts 1995-96 (Cm 3279).

2.20 The Commission published the accounts for 1996 at the same time as the Court's Annual Report, but separately from the Statement of Assurance. The Commission also published a separate document containing summarised and unaudited financial statements for 1996. These were useful developments. Notwithstanding this progress, the Court noted in their 1996 Statement of Assurance, that there was "a need for a clear statement of the accounting principles and policies applicable to the accounts of the European Community". The Court went on to conclude that this was the basic framework from which to produce a concise, easy to understand and transparent set of financial statements showing the Commission's financial position.

The National Audit Office's conclusions

2.21 The Statement of Assurance provides a valuable assessment of the use of the Community Budget and the National Audit Office fully support its continued use. However:

- it is a matter of serious concern that for the third year in succession the Court have declined to provide a positive assurance on the Community's payments because of the large number of errors identified;
- the number of exceptions to the Court's assurance on the reliability of the accounts is also a matter of concern, indicating that the Commission have some way to go before they attain the quality of financial reporting expected of public sector financial statements such as government accounts in the United Kingdom; and
- the Commission should produce clear and simplified financial statements of the Community Budget with more accessible financial information, prepared in accordance with generally accepted accounting principles in so far as appropriate. The Statement of Assurance could also be published with the financial statements of the Community Budget. Making these two changes would be in line with the recommendation in February 1996 of the Committee of Public Accounts⁵.

5 Committee of Public Accounts 10th Report of Session 1995-96: The Annual Report of the European Court of Auditors and the Statement of Assurance.

Part 3: The Court's findings on Community expenditure and revenue

3.1 This Part of the Report expands on the themes in the Court's 1996 Annual Report summarised in paragraph 2.3, by highlighting the Court's most significant findings on: expenditure under the Common Agricultural Policy; direct expenditure by the Commission; and Community revenue.

The Common Agricultural Policy

3.2 The objectives of the Common Agricultural Policy as set by the Treaty establishing the European Community are: to increase productivity; to ensure a fair standard of living for the agricultural community; to stabilise markets; to guarantee security of supply; and to ensure reasonable consumer prices.

3.3 Intervention is one of the key features of the Common Agricultural Policy. In the past, the European Community set an intervention price, a guaranteed price for certain types of farmers' produce. If the world market price was below the intervention price, Member States bought produce, funded by the European Community, and stored it for future disposal. Surpluses of production in the 1980s, combined with low market prices, significantly increased the cost of the Common Agricultural Policy to the European Community. As a result, the Common Agricultural Policy was reformed in 1992 to shift Community intervention from a system of price support towards one of income support, enabling intervention prices to be cut.

3.4 The following paragraphs deal with issues identified by the Court in three areas of the Common Agricultural Policy: the arable aid programme; beef and veal premiums; and tobacco subsidies, which between them illustrate many of the systematic problems raised by the Court (paragraph 2.3).

On the arable aid programme

3.5 The reforms of 1992 noted above (paragraph 3.3) led to cuts to the intervention prices and, from 1993-94, a scheme to compensate farmers for income losses due to the abolition or reduction of intervention prices. An

Integrated Administrative and Control System was established to administer and control the compensation schemes. The Court identified three main problems concerning the expenditure on arable crops, following the reforms:

- overcompensation;
- incorrect calculation of base areas; and
- penalised applications.

(a) Overcompensation

3.6 The Court estimated that farmers had been overcompensated by some £2.2 billion (3.0 billion ECU) in 1995-96. As noted above (paragraph 3.5), the Council granted the compensation to make up for the expected income loss because of the cut in intervention prices. Market prices in 1995 and 1996 turned out to be higher than the reduced intervention prices. But, because the basic amount of compensation was fixed under the aid programme, farmers were still compensated despite receiving a market price for their produce above the intervention price. There is no one agreed method for estimating the amount of overcompensation. The Commission's calculation suggested that the amount of overcompensation might have been £2.9 billion (3.9 billion ECU), even greater than the Court's calculation. The Commission proposed to the Council to reduce aid payments to cereal producers in order to finance the special measures relating to Bovine Spongiform Encephalopathy, but the Council decided not to adopt the Commission's proposal.

3.7 The Court were concerned that the compensatory payments should be realistic and appropriate because the area aid system represented more than a third of all European Agricultural Guidance and Guarantee Fund Guarantee expenditure. They also recommended that the Commission should cap payments to individual farmers to avoid very large compensatory amounts being paid. The capped payment system is already the practice in the beef sector.

(b) Incorrect calculation of base areas

3.8 Base areas are used to help regulate spending on arable aid. They are the average areas of land in each Member State which, in the period 1989 to 1991, were cultivated with cereals, oilseeds or protein plants, or were set aside. Member States are responsible for calculating base areas. The Commission pay arable aid provided that the actual area cultivated with these crops is less than the base area.

Overshoots can arise where a Member State underestimated the base area at the outset of the scheme, or more usually, when the aggregate of areas claimed by individual farmers in any one year turns out to be greater than the base area. If an overshoot occurs, area aid scheme payments to each producer in the Member State are reduced proportionally. The Court found a number of problems with overshoots and the calculation of base areas.

3.9 Between 1993-94 and 1995-96, Germany, Spain, France and the United Kingdom notified the Commission of overshoots, which meant that individual farmers received less aid per hectare, in line with the regulations. The reasons for the overshoot in the United Kingdom are summarised below. General problems included:

- underestimation of base areas;
- inaccurate implementation of the regulations;
- inaccuracies in the regulations; and
- incomplete documentation by Member States of their overshoot calculations.

Overshoot of base area in the United Kingdom

There was an overshoot in the United Kingdom in 1994. The Commission advised the United Kingdom in 1996 that incorrect application of the regulations in the United Kingdom in 1994 penalised farmers by some £2.1 million (2.8 million ECU) more than necessary. The Commission informed the United Kingdom of the correct method to use for calculating the base area overshoot and, as a result, the United Kingdom Government made top-up payments to farmers. There was no overshoot in the United Kingdom in 1995 and the correct method was applied from 1996.

3.10 The Court suggested that the area aid system for cereals should be brought into line with that for oilseeds, where there is an initial advance and a final payment. The final payment could take account of overshoots of the base areas. The final payment could also be adjusted accordingly when the market price was higher than the intervention price.

(c) Penalised applications

3.11 Member States are required to carry out on-the-spot inspections each year to check the size of the arable area cultivated and the type of crops grown. The Court reported that the proportion of applications penalised as the result of these inspections had been rising rapidly (Figure 5).

Proportion of arable aid applications penalised

Figure 5

Year	Average proportion penalised in all Member States	Proportion penalised in the United Kingdom
	%	%
1993-94	11	2
1994-95	31	7
1995-96	35	26

Source:
Data from Annual Report of the
European Court of Auditors 1996

3.12 The Court noted that the Commission's statistics did not show the amount by which applications were corrected or sanctioned, and recommended that the Commission should quantify the economic effect of inspections in this way. This is consistent with similar recommendations made in the Comptroller and Auditor General's Report on Common Agricultural Policy irregularities (HC 268, 1996-97). The Court also found that the Ministry of Agriculture, Fisheries and Food (the Department) had recognised the need to improve their data on irregularities and, in 1995, improved the format of the relevant returns. The Department also expanded the instructions to their regional staff to improve the quality and completeness of their information on irregularities. However, irregularities do not necessarily represent fraudulent claims, and may have risen in the United Kingdom because the definition has been more widely recognised by the Department's staff.

On beef and veal premiums

3.13 The European Union set up the Common Market Organisation in beef and veal in 1968. By 1994, the European Union was, after the United States of America, the world's second largest producer, generating 7.5 million tonnes of beef and veal. Since the 1980s, Community production has significantly exceeded internal consumption, especially since the downward trend in consumption caused, among other things, by public concern about the use of hormones, Bovine Spongiform Encephalopathy and animal welfare.

3.14 The Common Agricultural Policy reforms of 1992 (paragraph 3.3 above) shifted Community intervention from a system of price support to one of income support. Total expenditure on the beef and veal premiums increased from £0.7 billion (0.9 billion ECU) in 1992 to £2.5 billion (3.4 billion ECU) in 1996. As a proportion of Community expenditure on beef and veal, spending on premiums rose from around 25 per cent before 1992 to some 60 per cent after 1994.

3.15 The Court identified two areas of concern with the expenditure on beef and veal premiums:

- overcompensation; and
- Bovine Spongiform Encephalopathy measures.

(a) Overcompensation

3.16 The Court concluded that beef and veal producers had been overcompensated by more than £290 million (390 million ECU) in the four years to 1996 under the new scheme, because premium levels had been set too high. The Court found that the Commission had not assessed how much premium levels needed to rise to compensate for the estimated drop in revenue before introducing the scheme. The Court suggested that any future reform of the beef and veal sector should be preceded by a detailed ex ante analysis of its impact on farmers' revenue.

3.17 In their published response, the Commission did not dispute the Court's concerns that there had been no detailed ex ante analysis of the impact of beef and veal sector reforms. However, the Commission concluded that there had been no overcompensation of expected decreases in farm income over the whole beef and veal cycle. The Commission noted that the Court's overcompensation estimate was based on four years and had not taken account of all the ups and downs in farm income over the whole five to six year beef and veal cycle.

(b) Bovine Spongiform Encephalopathy

3.18 In March 1996 the United Kingdom Government admitted the existence of a possible connection between Bovine Spongiform Encephalopathy and Creutzfeldt Jacob's Disease. Demand for beef and veal fell substantially throughout the European Union and prices followed suit. In response, the Commission introduced:

- measures to promote and market quality beef and veal;

- exceptional support measures for the beef market in the United Kingdom (notably the Over 30 Months Scheme); and
- measures in Belgium, France and the Netherlands to support the slaughter of calves imported from the United Kingdom.

3.19 The Over 30 Months Scheme makes a key contribution to the United Kingdom's programme to eradicate Bovine Spongiform Encephalopathy. The Scheme provides compensation for cattle over 30 months old which have been banned from human consumption and hence which are slaughtered, and disposed of appropriately. (Bovine Spongiform Encephalopathy rarely manifests itself in younger animals and the scheme went beyond scientific advice to protect public health with a view to addressing consumer concerns). The Community originally paid the United Kingdom £290 (393 ECU) for each animal incinerated, a figure since reduced, whilst the United Kingdom Government bore the full cost of slaughter and disposal.

3.20 The United Kingdom used £29 million (34 million ECU) to finance the Beef Marketing Payments Scheme which provided aid to producers who sold cattle for slaughter for human consumption between 20 March and 30 June 1996. The scheme instructions initially stated that "any cattle over 30 months of age sold for slaughter after 28 March 1996 are ineligible under the scheme". This wording was subsequently revised. The true eligibility test was based on dentition rather than age. Animals with no more than one pair of permanent incisors could qualify for aid under the scheme. The Court found that 1,695 animals over 30 months of age at the time of slaughter were accepted under the scheme. In the Court's view, therefore, these animals should not have qualified for Community aid.

3.21 In response the Commission noted that the scheme applied only to animals free from clinical signs of Bovine Spongiform Encephalopathy. They considered that an animal's dentition tests provided an acceptable method of determining its age. The United Kingdom extended the scheme to cover cattle sold between 1 July and 9 November 1996, financed by £29 million (34 million ECU) from national funds, and dental tests were also allowable as a test of an animal's age under this extension.

3.22 The Court's examination of the Over 30 Months Scheme, the Beef Marketing Payments Scheme and the Calf Processing Premium highlighted significant system weaknesses in the controls implemented by the Member States concerned. The Court suggested that given the ad hoc and innovatory nature of many of the measures introduced, and the sums involved, there was an urgent need for the

Commission to enhance and broaden their monitoring of the application of such measures. The Comptroller and Auditor General intends to publish a report on Bovine Spongiform Encephalopathy in 1998.

On tobacco subsidies

3.23 The Court found that tobacco grown in the European Union remains a highly subsidised product and that the effectiveness of the subsidy in terms of improving product quality was limited. The total tobacco subsidy for 1996 was some £760 million (1 billion ECU). The aggregate subsidy paid represented more than five times the market value of the product and an aid rate of £5,000 (6,800 ECU) a hectare. Around £4,000 (5,400 ECU) was paid to support each directly dependent job. The Court noted that most Community tobacco remained of low quality, indicating that the aid had had little effect on improving quality. The Court concluded by questioning whether direct subsidies constituted the best form of support for tobacco growers and suggested that some form of direct income aid should be considered as an alternative.

3.24 The Court's 1993 Report criticised controls over refunds for tobacco exports from Greece and Italy to Bulgaria and Albania. A subsequent special investigation by the Commission concluded that the Greek Tobacco Board's controls were non-existent and that the authorities were aware of organised fraud. The Commission therefore made final corrections of expenditure declared of £60 million (82 million ECU) for Greece in clearance procedures 1986-1991. For Italy, corrections of £13 million (18 million ECU) were made in 1990 and 1991.

Expenditure directly managed by the Commission and administrative expenditure

3.25 The Court concluded that the Commission's handling of expenditure which they manage directly was unsatisfactory in many areas. They highlighted instances where the Commission's tendering regulations were weak, contract arrangements were unclear and, audit of compliance by the Commission was inadequate. A noteworthy case was on aid to small and medium-sized enterprises for research, technological development and demonstration programmes. The Court found that weaknesses in enterprises' accounting systems and the complexity of the rules resulted in incorrect claims. The Court concluded that more audits by the Commission were needed to establish the basis for recovery of overpayments and to deter irregular claims for aid.

3.26 The Court also examined the Commission's management of programmes of aid to central and Eastern European countries (the PHARE programme) and the newly independent states of the former Soviet Union and Mongolia (the TACIS programme). The Court found that the Commission had difficulty in implementing and arranging contracts to use up the commitments available for these programmes, and the level of outstanding commitments had continually increased over the period 1990 to 1996. For the PHARE programme, the Court found that 38 per cent of advance payments or £0.4 billion (0.5 billion ECU) made during the period 1990-95 to non-Member States remained in national administrations' bank accounts at the end of 1995. The Court also found that no overall evaluation of assistance to PHARE and TACIS countries had been made, and recommended that such an evaluation was necessary for the Commission to plan future strategies.

3.27 In their response, the Commission noted that both the PHARE and TACIS programmes had been the subject of regular monitoring and interim evaluations. A monitoring and assessment programme began in 1996, and before this, there were 19 evaluation reports on individual PHARE agricultural assistance programmes. The Commission also noted that reports on both PHARE and TACIS had been transmitted to the European Parliament.

3.28 The Court found inadequacies in the system for reimbursing travel expenses and allowances to members of the Economic and Social Committee, and to a lesser extent, the Committee of the Regions. The Court estimated that unwarranted reimbursements had been made for 52 per cent by value of reimbursements of air travel by Economic and Social Committee members paid during two months in 1995. The Court found for three months in 1996 that 69 per cent of tickets examined resulted in unwarranted reimbursement. The Court also found that the evidence used to verify claims was sometimes unreliable.

Community revenue

3.29 The Community's revenue (see paragraph 1.3) referred to as "own resources" comprises customs duties and agricultural levies, sugar levies, a proportion of Value Added Tax revenues and a contribution from Member States based on their Gross National Product. Customs duties and agricultural levies are Community based and are collected from traders by national customs authorities on behalf of the Community. The Gross National Product contribution acts as a "balancing figure" ("fourth resource") to fill the gap between the other sources of revenue and the Community Budget. This means that it is in the interests of Member States to help maximise the proper collection of duties and levies so as to minimise the call for direct contributions from their government budgets.

Nonetheless, the Court found that the Commission and Member States did not always have adequate financial procedures to ensure that all Community revenue due was collected, most notably in the areas set out below.

General findings relating to financial procedures

3.30 The Court examined in all Member States the establishment of Community entitlements, the accounting procedures and specific aspects of collection procedures. They found delays in establishing and recording customs dues and in making them available to the Community. From their examination of a sample of approximately 3,000 declarations, the Court concluded that at least £2.2 million (3.0 million ECU) still needed to be paid over to the Commission and, furthermore, that interest needed to be paid on the arrears.

3.31 The Court noted that, where their audits or the Commission's investigations had identified that customs duties were owed to the Community, the Commission had encountered difficulties in timely recovery of the amounts. Furthermore, the Commission had not always charged interest on arrears as soon as payment dates were passed.

On establishment and recovery of money in cases of fraud and irregularity

3.32 In 1996, the Court examined procedures for establishment and recovery of customs duties and levies on imported goods in eight Member States, including the United Kingdom. The Court's examination concentrated on cases of fraud and irregularity dealt with by the Member States, in co-operation with the Commission, concerning imports benefiting from preferential arrangements.

3.33 Goods originating from certain non-Member State countries benefit from preferential tariff arrangements when imported into the Community where they are supported by a valid certificate of origin. The Court noted that more than half of all Community imports benefited from preferential arrangements and significantly more than half of all cases of identified fraud and irregularity were committed against the preferential arrangements scheme. The Court recommended that if a non-Member State enjoyed the benefits of the preferential arrangements, but did not fulfil its obligations so that the Community Budget suffers, steps should be taken to suspend the benefits.

3.34 European legislation imposes a three year time limit on the establishment and recovery of customs duties and agricultural levies due. From a sample of 23 cases, the Court estimated that £59 million (80 million ECU) of own resources had been lost as a result of the time-bar when Member States had not respected relevant regulations or had not uniformly applied them.

3.35 The Court therefore recommended that a suitable regulatory framework be implemented to ensure that Member States adopt identical practices for seeking preventative guarantees against loss of own resources and the implementation of measures for establishing and recovering amounts due. The Court also recommended that the Commission improve their monitoring of cases of fraud and irregularity and take action where Member States are responsible for losses through non-establishment and non-recovery.

3.36 The Court cited seven examples found in Member States to illustrate the problems with procedures for establishing customs debts. European legislation requires that where customs authorities consider that the amount of duty payable on goods could be greater than that declared, they should seek a sufficient guarantee to ensure that the higher duty can be recovered if this ultimately proves to be payable.

3.37 In particular, the Commission had observed as long ago as 1993 that the quantities of Israeli certified orange juice imported into the European Union were equal to approximately three times Israel's orange production capacity. In August 1995, the Commission therefore asked Member States to require guarantees in respect of the duties and levies payable on such imports, pending confirmation of the validity of certificates from the Israeli authorities. The Court found that three Member States, including the United Kingdom, had no plans to institute such guarantee arrangements. HM Customs and Excise told the National Audit Office that in 1995 and 1996 the United Kingdom had decided not to institute guarantee arrangements because, following careful examination, the evidence available was considered to be insufficient to justify such a step, when balanced against the significant repercussions for United Kingdom importers. Nevertheless, the United Kingdom endorses the Commission's call for uniform and rapid action on matters such as guarantees, where sufficient evidence exists.

3.38 The Court also cited cases relating to "anti-dumping duties". The Commission are responsible for investigating allegations of the "dumping" of goods on export markets which could damage the domestic industry in the country of importation and, where appropriate, can impose anti-dumping duties on them. The Court reported on an investigation into car radios from Indonesia where the

certificates of origin issued by the Indonesian authorities were found to be invalid for preferential purposes and radios from certain manufacturers were considered by the investigators to have originated in South Korea. The radios were therefore subject to both customs duties and anti-dumping duties. The Court reported that most of the Member States visited had decided to establish the customs debt and to notify importers of customs duties and anti-dumping duties. Some Member States, including the United Kingdom, although seeking recovery of customs duty arrears, considered that the evidence collected by the Commission was insufficient from a legal point of view to allow recovery of the anti-dumping duties.

On Value Added Tax and Gross National Product contributions

3.39 The Value Added Tax and Gross National Product based contributions of Member States represent some 80 per cent of Community revenue. The Court reported that in order to ensure that these contributions were correctly and uniformly charged, the Commission should ensure that the bases are calculated by Member States in accordance with the current rules. The Court also noted that the Commission could enter a reservation whenever they believed that one of the factors used to calculate the assessment base was incorrect. Member States were also entitled to enter reservations. The Court concluded that the procedures for clearing cases where there were reservations were protracted and that the revenue concerned, sometimes substantial, was only made available to the European Union several years after a reservation had been notified, usually without any interest being charged on the arrears. The Court found 115 cases pending relating to Value Added Tax based contributions and 115 cases relating to Gross National Product contributions. The Court could not estimate the sums at stake because the financial implications could only be known when the case was cleared.

3.40 The Court recommended that the Commission should use their powers, if necessary by proposing amendments to the relevant legislation, to obtain a precise framework for examining reservations. The Court also proposed that there should be a deadline for the payment of the own resources in question and interest should be paid on arrears once that deadline had expired.

The National Audit Office's conclusions

3.41 In relation to the Common Agricultural Policy, the Commission's directly managed expenditure and Community revenue:

- the Council did not act on the Commission's proposal to eliminate the over-compensation of farmers arising from unexpected movements in world market prices. The Council and the Commission should ensure that such schemes in future provide only the level of subsidy intended. The Council and Commission need also to address the effectiveness of aid given to tobacco growers;
- the implementation by Member States, including the United Kingdom, of a range of schemes such as those based on eligible farm areas and premiums for the slaughter of cattle has proved problematic, with farmers receiving less or more aid than intended. The Council and Commission need to consider whether there are lessons for the way such schemes are conceived and implemented;
- the various problems experienced by the Commission in administering directly managed expenditure suggest that they must continue to strive for improvement;
- the systems for ensuring that customs and other duties payable to the Community are actually recovered have not always operated effectively, leading to cases of under-recovery. This suggests that procedures at the Commission and in all Member States need to be improved.

Part 4: Financial Management of the Structural Funds

4.1 Expenditure on the Structural Funds has grown rapidly over recent years and now accounts for around one third of Community spending (some £18.2 billion or 24.6 billion ECU in 1996). The Court's 1996 Annual Report concluded that there was a high incidence of error in the Structural Funds compared with other Community expenditure, and that there were significant weaknesses in the administration of the funds by the Commission and Member States. In addition, the value of irregularities detected in structural operations and reported to the Commission's anti-fraud unit more than doubled in 1996. This Part therefore:

- summarises the Court's 1996 findings on the Structural Funds including those relating to the United Kingdom; and
- highlights some of the action being taken by the Commission and the United Kingdom to improve financial management.

Background

4.2 The two largest European Structural Funds are the Regional Development Fund and the Social Fund. The Regional Development Fund provides grants for projects to develop declining industrial regions and other underdeveloped regions. The Social Fund is designed to improve employment opportunities in Member States by providing financial support for vocational training and job creation measures. The other Structural Funds are the "guidance" section of the European Agricultural Guidance and Guarantee Fund which is designed to provide financial assistance for measures to reform farm structures and develop rural areas, and the Fisheries Guidance Instrument which is designed to control fishing and provide investment aid for the processing and marketing of fisheries and aquaculture products.

4.3 Aid is mainly provided to Member States in the form of funding for operational programmes, which can last up to six years, and which must be co-financed by Member States. At the beginning of an operational programme, the Commission generally make an initial advance payment of 50 per cent of the first year's instalment of European Community funding. Subsequent payments are then made when the Member State declares to the Commission that a given proportion of the previous funding has been disbursed in line with Community objectives and

rules. At the end of each programme, the Member State is required to provide the Commission with an implementation report and a final declaration of expenditure, which is used to arrive at a final settlement.

The Court's findings

4.4 In their 1996 Statement of Assurance the Court devoted a separate chapter to their findings on the Structural Funds. The Court found that, as in 1995, the error rate in the Structural Funds was higher than the average for the Budget as a whole (paragraph 2.10 above). Most errors occurred in Member States, mainly at final beneficiary level but also at the level of local and central authorities responsible for managing the operations. The Court reported that the majority of the “substantive” errors concerned:

- expenditure not meeting the required eligibility criteria relating to the nature of the operation financed, the type of costs claimed or the eligible period; and
- expenditure claimed which had not been disbursed at the time of the declaration.

4.5 As in previous reports the Court drew attention to deficiencies in the way in which Structural Fund operations were planned, managed and accounted for. In particular, the Court noted that:

- objectives had not been set in a way which enabled progress to be measured;
- there had been insufficient clarity in prescribing which expenditures could be eligible for Community assistance;
- reliable accounting systems had not been put in place; and
- there had not been sufficient controls to ensure that expenditure declarations reflected only eligible expenditure.

4.6 The Court also found a high incidence of “formal” errors in the Structural Funds which, whilst they had no quantifiable financial impact on the Community Budget, represented breaches of Community regulations and weaknesses in the controls over expenditure. Over 80 per cent of these “formal” errors originated in Member States. Around 70 per cent concerned either national and final

beneficiary accounting systems which did not provide for separate identification of expenditure of Community funds or a lack of complete or adequate data on underlying transactions.

4.7 The Court emphasised that the main responsibility for proper financial management and control rests with Member States, although the Commission should ensure that adequate systems and controls were established and consistently applied. They recognised that the Commission had taken action under their Sound and Efficient Management 2000 programme (Appendix 5) which should result in some improvements in the management and control of Structural Fund programmes for future years. However, the Court concluded that the regulations themselves needed to be reconsidered. In particular they needed to provide for:

- unambiguous definitions of eligible expenditure;
- clear and comprehensive reporting and accounting arrangements;
- the proper discharge by the authorities in the Member States of their responsibilities for the control and certification of expenditure; and
- the imposition of net financial corrections where authorities use Structural Funds financing other than in accordance with the regulations.

4.8 In their replies to the Court, the Commission outlined some of the actions they were taking to improve financial management of the Structural Funds, including new eligibility rules and a new Regulation on arrangements for the financial control by Member States of operations co-financed by the Structural Funds. The Commission also stated their intention to fundamentally review existing Council regulations for the next programming period starting in 2000 and to take the Court's suggestions into account.

On the European Regional Development Fund

4.9 The Court examined the closure of 1989-93 programmes, including the quality of final claims and the reliability of final payments. The Court carried out audits in five Member States, including the United Kingdom. The Court found that there were substantial delays in the closure of co-financed measures because of the numerous extensions of deadlines granted by the Commission to allow

beneficiaries to complete measures and because some Member States submitted essential documents late. At the end of 1996, 75 per cent of the measures for the 1989-93 programme period had still to be closed.

4.10 The Court also found that final reports submitted by Member States were of poor quality and usually contained only a description of the financed measures, with no analysis of results. The Commission had not established systematic procedures for verifying the documents used as the basis for closure and, like Member States, rarely performed on-the-spot checks. The Court's audit of programme closures showed that Member State's final declarations contained ineligible expenditure and expenditure which was not adequately substantiated. Four of the 10 examples which the Court cited occurred in the United Kingdom, three in the East Midlands (one is described below) and the other in Northern Ireland.

East Midlands - Unreliable final payment claims

For some projects under a 1990-91 operational programme for East Midlands the Court noted that the final claims were inaccurate because they were not based on audited expenditure. The Court's sample of projects under the programme, identified that the eligible cost certified to the Commission should be reduced by some £1 million (1.4 million ECU). There is a six month limit for declaration of final expenditure after the end of a programme period, and the Department for Environment Transport and the Regions told the National Audit Office that late receipt of audited final claims after this limit had expired meant that expenditure was declared without the Department being certain that it was "true and correct" for payment.

On the European Social Fund

4.11 The Court's 1996 work on the European Social Fund examined implementation of the changes in the relevant regulations for the 1994-99 Community Support Framework. These changes sought to reinforce partnership (between the Commission, national authorities and "economic and social partners"), and to ensure additionality and improve the monitoring and evaluation of European Social Fund projects at each level of management. The Court carried out audits in the Commission and in 10 Member States, including the United Kingdom.

4.12 The changes to the regulations provided that monitoring committees in each Member State should plan, appraise, monitor and evaluate measures to ensure maximum effectiveness is achieved. The Court identified several areas where the working practices and procedures of these committees needed to be improved. For example:

- non-governmental members of the committees could be more fully involved in planning measures by identifying needs and solutions;
- the committees could promote sound financial management by being consulted on the findings of audit reports and by helping to develop solutions to the problems identified; and
- the committees needed to review and develop performance indicators to measure the effectiveness of European Social Fund effort.

4.13 The Court reported that, whilst in the United Kingdom monitoring committees included members from local government, training and enterprise councils, the voluntary sector and, in some cases, the industrial and service sectors, they did not include representatives from employers or employees as was the case in other Member States. The United Kingdom Government announced that it was for individual monitoring committees to encourage, in whatever manner seemed most valuable, the involvement of employers and employees representatives. The Department for Education and Employment were discussing with the Confederation of British Industry and the Trade Unions Congress how best to manage this for the European Social Fund.

4.14 The principle of additionality in the Structural Funds aims to ensure that European funding is additional to, and not a substitute for, national aid. Member States are required to demonstrate additionality to the Commission. The Court noted the Commission's examination of some Structural Fund measures under the 1990-93 Community Support Framework had shown that in five Member States, including the United Kingdom, additionality had not been demonstrated. The Department of Trade and Industry have subsequently improved the system for reporting on additionality.

4.15 The Court highlighted weaknesses in the systems for administration, monitoring and evaluation of European Social Fund measures. In particular, the Court found a serious problem caused by Member States not systematically applying the criteria for replacement of expenditure, found to be ineligible following audits or other checks, with other expenditure deemed eligible.

4.16 The Court also reported a steady increase in the financial value of irregularities detected in projects and reported to the Commission and highlighted weaknesses and errors in European Social Fund payments. The Court examined 69 European Social Fund projects and found errors having a potential financial impact in 31 of them. Errors included some final claims not supported by any

evidence and based on amounts provided to rather than actually incurred by training providers, and frequent over-declaration by final beneficiaries, through the inclusion of ineligible items, of European Social Fund eligible payments. For a further 19 projects the Court found “formal” errors where, for example, publicity to beneficiaries, the trade and the general public of European Social Fund participation was missing or separate accounts of European Social Fund funding were not kept. Therefore errors of some kind were found in 50 of the 69 projects.

4.17 The Court concluded that the Commission’s controls should be supplemented by an audit and verification programme of beneficiaries by the responsible authorities in the Member States, to provide assurance when declarations are made. The Court noted that more than half of the Member States did not have a separate verification and audit team within the responsible national authority. In the United Kingdom, the Department for Education and Employment set up a special Verification and Audit Section some years ago.

On the European Agricultural Guidance and Guarantee Fund: Guidance Section

4.18 The Court examined the reliability of the administrative and control systems over Guidance Section funds in six Member States including the United Kingdom. The Court found weaknesses in the appraisal, monitoring and control of various funded measures. In particular:

- there was no systematic evaluation of projects submitted for funding;
- applications frequently contained unrealistic or unsupported assumptions, or failed to take account of all relevant factors;
- for compensatory allowances, there were weaknesses in the conduct of physical inspections by national authorities (see United Kingdom example below);
- on a number of occasions grant claims included ineligible expenditure (see United Kingdom example below);
- in relation to systems for paying aid to farmers for improvements to their agricultural holdings; Member States, including the United Kingdom, did not follow up investment plans to verify that they were fully implemented and they did not check that eligibility criteria were satisfied; and

- in the Member States visited, the regulatory deadlines for payments to final beneficiaries were often breached by national authorities.

Grants and subsidies to industrial concerns in the United Kingdom

The Court noted that the United Kingdom was one of only two of the Member States adequately to document inspection visits, but that normally only one physical inspection was undertaken per project in the United Kingdom. The Court considered that this was inadequate to detect some items of ineligible expenditure, particularly in view of the time allocated to inspections. The Court also highlighted two United Kingdom cases where ineligible expenditure had been accepted, including £59,000 (80,000 ECU) for machine spare parts. The Ministry of Agriculture, Fisheries and Food informed the Court that procedures to exclude ineligible expenditure have now been improved.

4.19

The Court also found notable weaknesses in systems for administering compensatory allowances to hill-farmers and farmers in less-favoured areas. The Court noted that the level of physical inspections was not adequate in most Member States, that it was often not possible to verify whether eligibility conditions had been satisfied and that cash payments lacked transparency in some Member States.

4.20

The Court concluded that the scale and diversity of Guidance Fund schemes did not facilitate control. The Court's audit had shown that the summary declarations of Guidance expenditure submitted by Member States to the Commission were often incorrect and frequently based on forecasts rather than real expenditure, whilst Member States' accounting records lacked transparency. The Court therefore recommended that the Commission should monitor more effectively Member States' management and control procedures.

The National Audit Office's findings on the Structural Funds

4.21

The National Audit Office have identified the Structural Funds as a particular risk area warranting attention. Their audits have uncovered similar problems to those identified by the Court in the area of the European Social Fund. In January 1998, the Comptroller and Auditor General reported on overpayments and monitoring and verification audit arrangements for the European Social Fund in Scotland (HC251-XIII). In February 1998, the Comptroller and Auditor General reported on the Department for Education and Employment's Programmes and Central Services Vote (HC 251-IX). This referred to problems with schemes administered by Training and Enterprise Councils which are in part funded by the European Social Fund.

Actions to improve financial management

By the Commission

4.22 Under Sound and Efficient Management 2000, the Commission have sought to improve procedures for the adoption and implementation of the European Union's Structural Fund programmes by seeking to:

- clarify and consolidate the eligibility criteria for the Structural Funds;
- restate the obligations for the European Union's Member States on financial control of the Structural Funds; and
- redefine the rules on re-allocating funds misused in programmes.

4.23 In their discharge of the 1994 Budget, published in March 1996, the Council called for all sources of uncertainty regarding the eligibility of Community expenditure, particularly the Structural Funds, to be eliminated to help ensure that the best possible use was made of Community funds. Accordingly, on 23 April 1997, the Commission issued a decision promulgating 22 "Datasheets" for Member States to use in evaluating the eligibility of projects for Community funding. The "Datasheets" seek to set out clearly the eligibility criteria for expenditure under the different Structural Funds. The clarification of eligibility was suggested by the Council of Finance Ministers, and this work has been taken forward by a Personal Representatives Group of Finance Ministers, which was established under the Sound and Efficient Management 2000 programme in March 1995 to consider how to improve the management of Community funds.

4.24 On 15 October 1997, the Commission issued a new Regulation detailing arrangements for the financial control by Member States of operations co-financed by the Structural Funds. The Regulation requires Member States to establish a sufficient audit trail to permit verification of expenditure and reconciliation of expenditure records at all levels of administration from final beneficiary to the Commission. The Regulation also requires Member States to provide an independent Control Statement certifying the validity of the claim before the final payment is made in respect of each form of assistance. At the same time, the Commission adopted a set of internal guidelines on making "net financial corrections" and recovering funds shown to have been misused. Relevant authorities in Member States including United Kingdom departments have also concluded bilateral agreements on co-operation between the internal auditors of national bodies administering Community funds, and the Commission services.

In the United Kingdom

4.25 During 1997, two seminars on fraud and irregularity in the Structural Funds were held in the United Kingdom with the support of the Commission's anti-fraud unit. Representatives from the European Court of Auditors gave presentations at both seminars. In February, the Scottish Office held a seminar in Edinburgh. The National Audit Office hosted a seminar in November on "Working Together to Combat Fraud and Irregularity in the Structural Funds". The latter seminar was attended by some 80 officials with direct involvement in management and financial control of the Structural Funds in the United Kingdom, and representatives from the police and prosecution services.

4.26 Both seminars provided a valuable opportunity for the exchange of information and views on how management and control of the Structural Funds in the United Kingdom could be improved to help prevent and detect fraud and irregularity. At the November seminar, the Department of Trade and Industry and the Department for Education and Employment highlighted some of the measures being taken in the United Kingdom to tighten management and control. These include:

- simplified guidance to departments on what constitutes an irregularity and how to report irregularities to the Commission;
- closer monitoring of action in response to irregularities;
- reviews of the financial systems for administering the Structural Funds; and
- the development of a control framework for European Social Fund projects to support regionalisation of the oversight of these projects, based on establishing clear accountability and a system of independent risk-based monitoring and review of projects.

The National Audit Office's conclusions

4.27 In relation to the Structural Funds:

- the high level of error found in payments from the Structural Funds was unacceptable. For instance, 31 out of 69 Social Fund payments had errors with a measurable financial impact;

- the Commission's closure of the 1989-93 operational programmes (that is comparison of expenditure incurred with amounts claimed) and evaluation of outcomes of these programmes had been subject to substantial delays. The management of these schemes needs to be addressed now to prevent this recurring when the 1994-98 programmes are completed;
- given the high rate of error, there needs to be a greater emphasis within Member States on vetting applications and checking claims; and
- the work of the Court and the National Audit Office shows that there is no room for complacency in any of the Member States so far as fraud and irregularity against the Structural Funds is concerned.

Appendix 1

Other findings of the Court in the United Kingdom

1 The Court's 1996 Report contained more references to the United Kingdom than in 1995. The number of references to a Member State in the Court's Annual Report depends on which countries the Court chooses to visit each year and the topics it examines in those countries. The Court told the National Audit Office that the number of references to a Member State was not meant to be an assessment of that country's management of Community funds. Nor does inclusion in the Annual Report indicate that the case was necessarily more significant than other cases found. The National Audit Office have highlighted elsewhere in this Report the Court's more significant findings relating to the United Kingdom. This Appendix summarises some other noteworthy references to the United Kingdom in the Court's 1996 Annual Report.

2 This year, for the second year running, Member States are replying in writing to the Court's criticisms of their financial management of Community funds. During its Presidency of the European Union the United Kingdom intends to hold a Ministerial discussion of these responses in the Council of Finance Ministers.

Common Agricultural Policy expenditure

a) Regionalisation plans for agricultural aid

3 Area aid for arable crops is differentiated by region according to past production. Differentiation is based on regionalisation plans established by Member States which assess regional yields on criteria such as fertility of the soil and irrigation. The Court checked the regional yields used in five Member States' regional plans, including the United Kingdom plan which it praised as the only one for which the regional yields conformed with independent data from the Statistical Office of the European Union.

4 Member States were required by a Council Regulation to provide statistics by 1994 to show that the calculations in their regionalisation plans were of a specified accuracy. The Court noted that a report by the Statistical Office of the

European Union to the European Parliament in November 1994 found that of the 12 Member States, only four, including the United Kingdom, had been able to provide statistics of the required accuracy.

b) The Integrated Administrative and Control System

5 The system of area aid for arable crops relies on applications whereby farmers declare parcels of land for which they wish to claim aid. Member States were required by a Council Regulation in November 1992 to implement an Integrated Administrative and Control System, based around a computerised database, to process and cross-check applications. The Court noted that the United Kingdom had created four regional databases which were developed without observing the compatibility and data access requirements of the Regulation. The Court found that manual procedures had been developed to make inter-database checks, which worked satisfactorily. In their reply to the Court's findings, the Commission noted that they had held meetings in the United Kingdom and two other Member States and national documents had been drafted in an attempt to achieve compatible databases.

6 A further Council Regulation in 1992 required Member States to check five per cent of applications through site visits or remote sensing, and that the farms to be checked should be based on risk analysis. The Court found that the risk assessment used for selecting applications for site visit checks in the United Kingdom was not sophisticated enough to ensure that very large holdings were checked according to their weighting in the area aid system. The Ministry of Agriculture Fisheries and Food noted that methods of risk assessment were being developed and introduced, in discussion with the Commission, which would give additional weighting to larger claims for aid.

c) The calf processing premium

7 The calf processing premium is paid to producers in respect of young male calves of dairy breeds which are slaughtered before exceeding the age of 10 days. The aim of the premium is to restrict market supply of veal by reducing the number of young calves for fattening. In the United Kingdom, the Court found that since 1 July 1996, all new born cattle had been required to have passports which include the animal's date of birth. However, before the introduction of passports, 46,000 calves had been processed when it was not possible to confirm their age and eligibility for the premium by this method.

8 The Court also found that in United Kingdom abattoirs there was no control to ensure that what left the abattoir arrived at the rendering plant, and there was therefore no assurance that the calves slaughtered were properly disposed of. The Ministry of Agriculture Fisheries and Food (the Department) told the National Audit Office that the United Kingdom practice of slashing and dyeing carcasses effectively denatured the calves processed under the calf processing premium scheme, and that there was no evidence of such meat being processed for human consumption. The Department noted that, in response to the continuing concern expressed by the Court and the Commission, United Kingdom authorities had started to require calf carcasses to be left intact to prevent offal being diverted for human consumption. The Department also reported that trials were taking place with a chemical which would make calf meat unpalatable to humans and leave stains which permeated the flesh. The Commission have indicated that this matter is under examination.

Community revenue (“own resources”)

a) Establishment of Community revenue

9 European legislation requires that customs debts are entered into the Department’s accounts in accordance with specific regulations. The Court reported that in the United Kingdom in cases where customs duties were notified with respect to traders subject to criminal investigation the Community’s entitlement was not promptly recorded in accordance with those regulations. And though in many cases such debts were established before criminal proceedings were started, prosecution took precedence over debt collection. HM Customs and Excise (the Department) told the National Audit Office that, in criminal cases, calculation of debts may be difficult particularly as they are not normally verifiable with the debtor. They also noted that until the debts were eventually recovered, if at all, no monies were payable to the Community. Nonetheless, they are reviewing their procedures to identify improvements that may be made to improve their accounting methods in criminal cases.

b) Accounting for community revenue

10 HM Customs and Excise take cash deposits to secure potential tax debts, for example, United Kingdom and Community duties on temporarily imported goods which are refundable upon subsequent export of the goods. The Court reported that HM Customs and Excise accounting systems were not able to identify deposits by revenue type and therefore did not show the value of deposits relating to potential Community revenue. The Department told the National Audit Office that

Community elements of these deposits are returnable to the trader once goods are re-exported, and any amounts that are crystallised due to non-export are brought to account and made available to the Community. They said that separately accounting for deposits would require changes to the systems controlling a number of tax regimes and having reviewed their systems they believed that the information and any benefits that might flow therefrom could only be obtained at disproportionate cost.

c) The customs tariff

11 Import duties are imposed on goods entering the European Union according to an integrated Community tariff. The Court reported an error in HM Customs and Excise's own version of this tariff which had resulted in an underpayment of duties on imported pilchards. Under the integrated Community tariff, pilchards are generally classified as sardines and attract a duty of 25 per cent. HM Customs and Excise told the National Audit Office that a change in the United Kingdom's own version of the tariff in 1976 had failed to remove a subdivision for pilchards which meant that in some cases pilchards were incorrectly classified and attracted a customs duty of only nine per cent. The Department indicated that the Commission's anti-fraud unit had brought the error to their attention in December 1991 and they had made appropriate amendments to the tariff systems in April 1992. The Department had established that there was an underpayment of some £2.6 million (3.5 million ECU) relating to duties for a period of up to three years prior to correction of the error in the United Kingdom version of the tariff, which they paid to the Commission in February 1995.

d) Duties payable on passengers' baggage

12 In the United Kingdom, as in some other Member States, customs duties, excise and Value Added Tax are assessed on imports in passengers' baggage at a flat rate. The receipts from passengers are subsequently apportioned between customs duties payable to the Community, excise duties and Value Added Tax. The Court noted that the United Kingdom used an incorrect percentage in this apportionment for three years which led to underpayments to the Community of customs duties and overpayments of the Community's proportion of Value Added Tax. HM Customs and Excise, having identified the error, disclosed the information to the Commission and made available an underpayment of £2.3 million (3.1 million ECU) of customs duties in March 1996. The overpayment of Value Added Tax, which was a smaller sum, was adjusted in December 1996. As

requested by the Commission, the Department are preparing a schedule of monthly underpayments of duty so that interest may be calculated. The Department's estimate of the interest is approximately £600,000 (810,000 ECU).

e) Free zone control

13 Free zones are specified separate areas within the European Community where goods meeting certain provisions under Community legislation can qualify for beneficial treatment, for example exemption from import duties. The Court examined control arrangements over 16 free zones in six Member States for compliance with Community regulations, including the Port of Tilbury in the United Kingdom.

14 The Court found that the Tilbury Freeport free zone occupies the whole of the Port of Tilbury and was simultaneously operated as a free zone and as a normal port, that is goods were considered to be in the free zone as if it were a separate area for customs purposes without being physically segregated from other goods in the port. The Court concluded that this approach meant that free zone goods had been removed without the appropriate payment of customs duties, and had been replaced by similar goods from outside the free zone system. Customs duties should have been collected on the goods removed for free circulation as the regulations do not provide for such replacement.

15 HM Customs and Excise (the Department) told the National Audit Office that, as a result of studies of practices in free zone control among Member States including Tilbury, the Commission had proposed changes to the Community Customs Code. The Department are hopeful that new Community legislation by the end of 1998 will allow Member States the opportunity to control free zones using audit style controls and risk analysis and that free zones would not then need to be physically separated from the rest of the port. The United Kingdom did not intend therefore to bring the operating procedures for free zones into line with the existing requirements of the Community Customs Code.

f) Video cassettes from Macao

16 European legislation imposes a three year time limit on recovery of customs dues. The Court reported on video cassettes from Macao where they had found in three Member States, including the United Kingdom, that recovery measures had not been taken, or had been subject to delays, so that recovery action became time-barred. The Court estimated that £516,000 (710,000 ECU) of anti-dumping duties were irrecoverable due to time-barring, but the Department

told the National Audit Office that they were not collected because the United Kingdom considered that the evidence to support collection was insufficient. The Court also estimated that £79,000 (107,000 ECU) of customs duties were time-barred for recovery but the Department's records did not show that any customs duties had been time-barred in the period examined by the Court. The Court reported a similar case involving the import of car radios from Indonesia where the United Kingdom decided not to recover anti-dumping duties because they considered that the evidence was insufficient to support recovery (paragraph 3.38).

g) Suspension of payment

17 The Community Customs Code requires that where an appeal is made against a customs debt, payment of the debt should usually only be suspended if security is lodged. The Court reported that in the United Kingdom enforcement measures were usually suspended without requiring the lodging of security. The Department told the National Audit Office that in 1996 this was the case at the initial review stage of an appeal, because the original decision can still be overturned at this stage. They did, however, require payment of a security, where appropriate, before cases could proceed to tribunal. HM Customs and Excise have now changed this policy and appeals, at whatever stage, are subject to the lodging of security except where a formal hardship application has been approved.

Structural Fund expenditure

a) Closing European Regional Development Fund projects

18 The Court reported the case of a European Regional Development Fund assisted project in the East Midlands which had been sold but where the final declaration of expenditure and corresponding claim to the Commission had not taken account of the proceeds of the sale. The declared expenditure therefore exceeded the eligible expenditure by £147,000 (200,000 ECU). The Department of the Environment, Transport and the Regions told the National Audit Office that they had not been told of the sale until after the final claim had been submitted. The Court found that the Commission failed to recover the ineligible amount from the final programme payment. The Commission's response to the Court's findings stated that the problem was caused by a misunderstanding between the United Kingdom authorities and the Commission, and that they were in touch with the authorities to decide how best to correct the situation.

19 The Court also reported discrepancies and delays between the Commission and the United Kingdom in clearing final claims relating to projects in the East Midlands from 1990-91, some of which had not been approved until one year after submission of the final declaration of expenditure. The Commission's reply stated that many of the final reports presented by the United Kingdom had not been of the required quality and that examination by the Commission and consequent modifications by the authorities often took a considerable time. The Commission added the situation had since improved substantially.

b) Common policy on fisheries and the sea

20 In their 1993 Report on the restructuring, modernisation and adaptation of the capacities of the fishing fleets in the Community, the Court noted that the Community's fishing vessel register was unreliable. During 1996, the Court examined measures taken by the Commission in response to this Special Report and found that the fleet register was still incomplete in many respects, including the omission of 404 boats in the United Kingdom (five per cent of the United Kingdom fleet). The Ministry of Agriculture Fisheries and Food told the National Audit Office that the national fleet register was complete and that the base data supplied by the United Kingdom to the Commission did classify all vessels. They believed that problems may have occurred with the Commission's downloading of the data or that the Commission's register might contain some de-commissioned vessels from earlier periods which would not appear in the United Kingdom data.

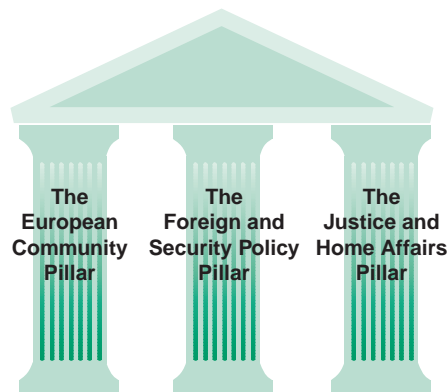
21 European legislation required that the gross tonnage for all ships of 24 metres or more in length should be communicated to the Commission by Member States before 15 March 1995. The Court found that in September 1996 this information was only available for 70 per cent of the United Kingdom fleet. The Ministry of Agriculture Fisheries and Food told the National Audit Office that in order to establish the gross tonnage figures it had been necessary for the Marine Safety Agency to re-register all vessels over 24 metres. This work was still in hand.

Appendix 2

Structure of the European Union and the European Community Institutions

The European Union is often described in terms of three 'pillars'

The European Community 'pillar' relates to matters arising from the Treaty of Rome, such as the Community Budget.



The two 'inter-governmental' pillars relate to collaboration by the Member State governments in the areas of Foreign and Security Policy, and in Justice and Home Affairs.

The European Union and the European Community are managed by the five Community Institutions



The Court of Justice: Comprising 15 Judges, the Court of Justice rules on questions of Community law and whether actions by the Commission, the Council of Ministers, Member Governments and other bodies are compatible with the Treaties.

The Council of Ministers: Comprising 15 Ministers, one from each Member Government, the Council of Ministers is the principal decision-making body of the Community.

The European Parliament: Comprising 626 elected members, the European Parliament exercises democratic scrutiny and control over the European Union's decision-making process. The Parliament has the right to make alterations to certain aspects of the Community Budget and gives discharge to the Commission for its implementation.

The European Commission: Comprising 20 Commissioners and some 19,000 staff. The Commission proposes and executes Community policies and ensures that Member States meet their Treaty obligations. The Commission participates in decision-making along with the Parliament and the Council of Ministers, and is answerable to the Parliament for use of the Community Budget.

The European Court of Auditors: Comprising 15 members and some 500 staff, the European Court of Auditors are the external auditors of all revenue and expenditure of the Community.

Appendix 3

The procedure for setting, controlling and accounting for the Community Budget

1 The Comptroller and Auditor General's Report on the Annual Report of the European Court of Auditors and the Statement of Assurance for 1995, published in March 1997 (HC 332) described in detail the respective roles of the different Community Institutions in setting and controlling the European Community Budget. This year's Report gives a summary of the procedure which is shown in Figure 6.

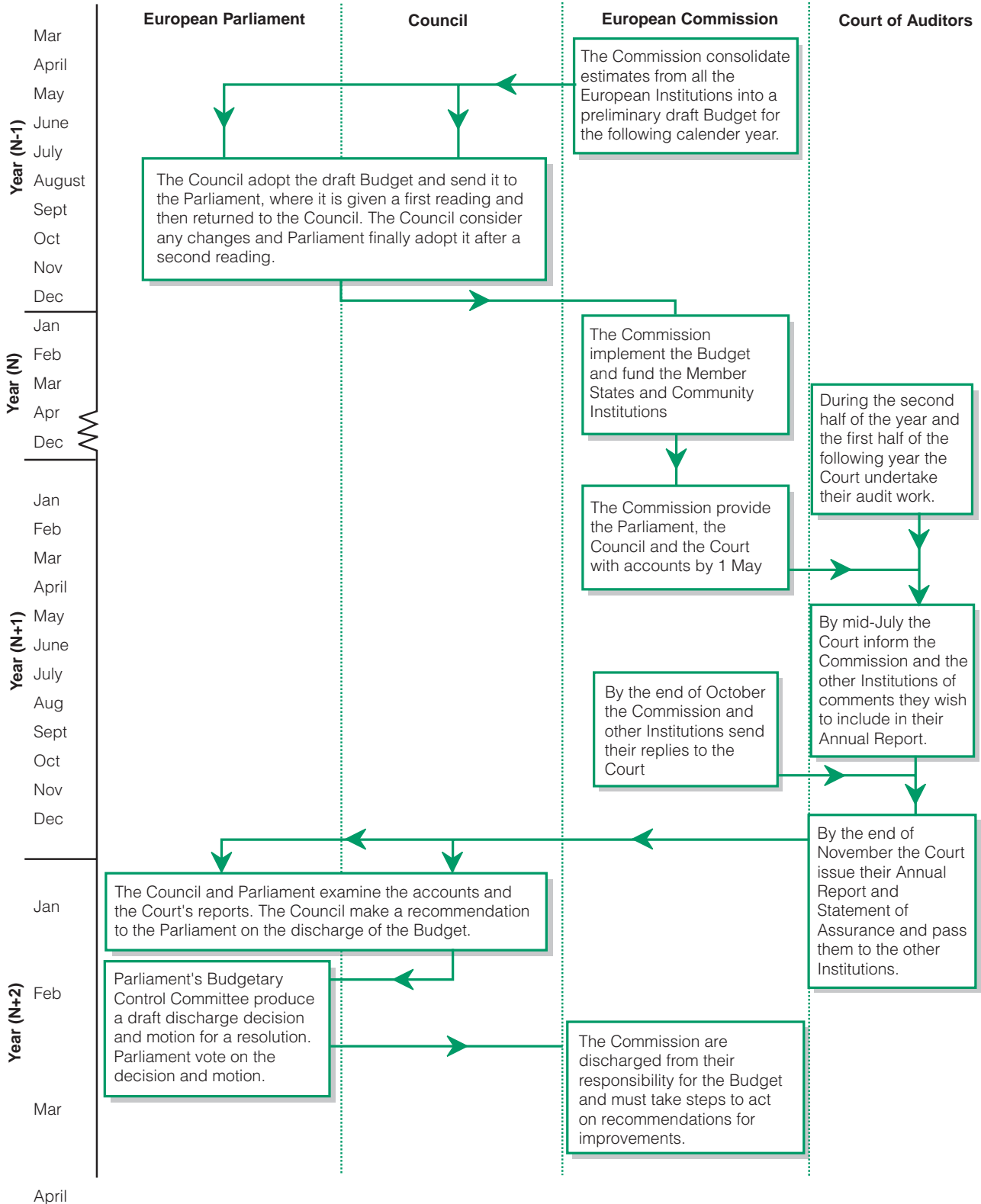
2 The preliminary draft Budget is prepared by the Commission and presented to the Council which makes amendments and establishes a draft Budget. The draft Budget is forwarded to the European Parliament which has the power to amend the Budget, in respect of expenditure other than that defined as "obligatory". The Common Agricultural Policy is by far the largest element of obligatory expenditure. Individual Member States influence the level of the European Community Budget and their resulting contributions through their representatives on the Council. The budgetary framework is set by the "financial perspective" laid down by the European Council and by an inter-Institutional agreement (between the Commission, Parliament and Council) on its implementation year by year.

3 Once adopted the Budget has the force of law and the Commission implement expenditure set out in the Budget under their own authority and in accordance with Financial Regulations approved by the Council. These regulations are intended to secure sound financial management and control of the expenditure both in the Commission and in Member States, who administer more than 80 per cent of the expenditure.

4 The Parliament follows the implementation of the Budget during the year through the "Notenboom procedure" whereby the Commission are invited to comment on the level of implementation of individual appropriations around September of the financial year. Following a resolution by the Parliament, the "Notenboom transfer" is made, through which the Commission adjust the Budget with a view to maximising the effectiveness of appropriations. This procedure is also designed to help the Parliament in its discussions on the appropriations to be voted for the following year. Since 1987 the Commission have provided monthly data on the use of appropriations as well as reports on agricultural spending.

Figure 6

The control of the European Community Budget



These are known as early warning reports and are designed to indicate whether agricultural spending is likely to exceed the appropriations provided for it. These mechanisms are an opportunity to provide assurance to the Parliament that its wishes are being adhered to, or explain why variances have occurred.

5 The Commission are required, by 1 May each year, to present to the Council, the European Parliament and the European Court of Auditors accounts of Community revenue and expenditure and assets and liabilities to show how the Budget has been implemented. These form the basis for the Court's audit work in support of the Statement of Assurance. This, and other work by the Court on the Community's receipts and expenditure during the previous year, is brought together when the Court report in November.

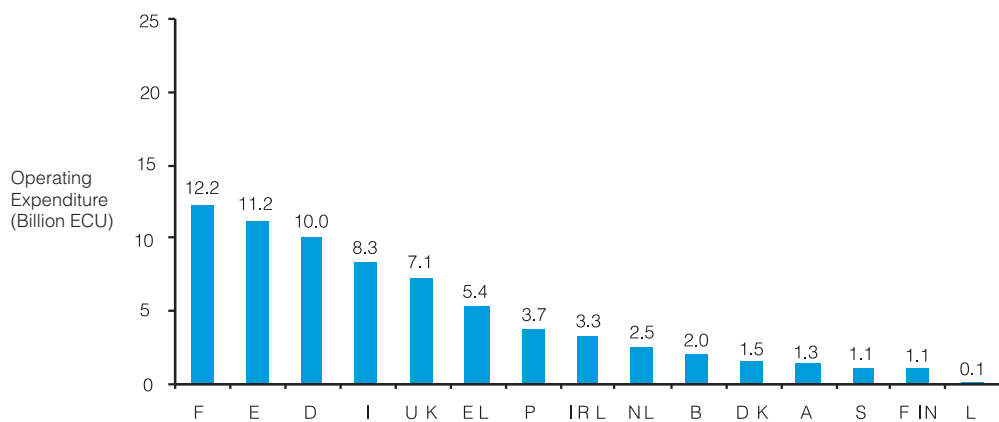
6 The Court's Annual Report and Statement of Assurance are the starting point for the Community's discharge procedure which completes the cycle of accountability for Community funds. In essence this requires the European Parliament to give its opinion on the Commission's stewardship of the Community's funds, and to decide whether to formally discharge the Commission from any further responsibility for the Budget.

Appendix 4 European Community expenditure and revenue by Member State

Figure 7

European Community expenditure and revenue by Member State

a) Community expenditure^{1,2} by Member State in 1996



b) Community revenue by Member State in 1996



Key:

B - Belgium	DK - Denmark	F - France
D - Germany	EL - Greece	I - Italy
L - Luxembourg	NL - Netherlands	P - Portugal
S - Sweden	UK - United Kingdom	E - Spain
A - Austria	FIN - Finland	IRL - Ireland

Notes: 1. Figures exclude expenditure on administration in the Member States

2. The European Commission's SINCOM system shows only the first destination of Community payments. Payments made to one Member State in the first instance may subsequently be used by that Member State on transactions in another Member State.

Source: Expenditure data from European Commission's SINCOM system, revenue data from European Union accounts

Appendix 5

The European Commission's Sound and Efficient Management 2000 initiative

1 In 1995 the Commission adopted a programme to improve the financial management of the Community Budget. The initiative, Sound and Efficient Management 2000 (SEM 2000), encompasses three stages, of which the first two involved the Commission improving the standard of their own financial management. The last stage aims to bring about improvements in the management of Community resources by Member States and it is hoped that it will lead to greater transparency and security for the benefit of taxpayers. The initiative is lead by Commissioners Erkki Liikanen (Budget) and Anita Gradin (Financial Control).

2 As part of the first two phases, practical measures were announced at the end of 1995 to improve the Commission's financial management. In particular, these were aimed at: improving Budget monitoring; audits; control; assessment; and the policing of fraud against the European Union Budget. An annual assessment programme was introduced whereby each Directorate General assesses the implementation of programmes and Community actions for the coming year. The first results of the programme were presented to Commissioners in January 1997 and showed a high level of assessment activity but a need for more consistency in the quality of assessments and to improve the link between assessments and decision-making.

3 Within the framework of Sound and Efficient Management 2000, the Commission have decided to introduce procedures aimed at "fraud proofing" European Union legislation. These will focus on six themes: detection of irregularities; recovery of the amounts concerned; fraud prevention; administrative sanctions; judicial protection of the European Union's financial interests; and preparation for enlargement.

4 Sound and Efficient Management 2000 is already of considerable importance to attempts to improve financial management at all levels within the Community. Themes from Sound and Efficient Management 2000 are frequently referred to by the Commission in their responses to the European Court of Auditors' Annual Report.

5 Sound and Efficient Management 2000 is now in its final phase. As part of the third stage a Working Group of Personal Representatives of Finance Ministers was established in March 1995 to consider how to improve the management of Community funds. The group met for the first time in March 1996 under the Chairmanship of Commissioners Liikanen and Gradin.

6 The Personal Representatives Group reported in December 1996, and their conclusions were endorsed by the Council of Ministers at a meeting in Dublin later that month. Among the most important conclusions were:

- while improved co-operation between Member States was essential for improvements in financial management, the emphasis should be on working within existing national systems rather than on harmonisation;
- Member States should report in the budget discharge procedure on measures they have taken in response to ECA observations about them in their Annual Report;
- more effective measures were needed to combat fraud in the transit system;
- better forecasting of expenditure was necessary in order to ensure effective implementation of budget appropriations;
- there should be stronger systems for the evaluation of Community programmes;
- there was a need for clearer guidelines on eligibility for Structural Funds' finance; and
- bilateral protocols between the Commission and national bodies on co-operation in financial control of Community moneys should be concluded swiftly.

7 In 1997, the Personal Representatives Group submitted two progress reports to the European Council of Finance Ministers (ECOFIN), the first in May, and the second in October. In reviewing the progress made towards achieving the objectives of Sound and Efficient Management 2000, the Personal Representatives Group noted:

- discussions on eligibility for the Structural Funds have been successfully concluded;
- the Commission have adopted a new Regulation establishing detailed arrangements for the financial control by Member States of operations co-financed by the Structural Funds;
- co-operation between Member States and the Commission in responding to criticism by the Court of Auditors has improved, but there is still room for improvement;
- further bilateral protocols on financial control have been negotiated by the Commission and Member States;
- the Commission have begun a review of the adequacy of the data systems and audit trail arrangements in the Member States;
- some improvements have been made in budget forecasting; and
- the Commission have made presentations to the Group on their action plan on fraud in transit and on the annual report on fraud against the Community budget.

8 In its latest report of October 1997, The Personal Representatives Group noted that progress was still needed on a number of the key principles set out in their report of December 1996. In particular, the Group took note of some of the key weaknesses identified by the Court of Auditors. The Group made a number of further recommendations in the progress reports, including the need to review specific regulations.

9 The Personal Representatives Group will continue to meet in 1998. As well as continuing to assess general progress towards achieving Sound and Efficient Management 2000 objectives within the Commission, they will also present their ideas on the financial aspects of forthcoming legislation for the new programming period of the Structural Funds and will look at proposals for revision of the Financial Regulation (paragraph 2.5).