

Report by the  
Comptroller and Auditor General

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# Financial Management of the European Union

Ordered by the  
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## Executive summary

**1** The Annual Report of the European Court of Auditors (the Court) brings together the main findings from the Court's audit of the General Budget of the European Union. This Report by the Comptroller and Auditor General covers the findings set out in the Court's Annual Report for 1998 and outlines recent developments relating to reform within the European Commission (the Commission). The Court's Annual Report includes its observations on the financial management of Community activities by Member States, the Commission and other Community Institutions, and its Statement of Assurance on the reliability of the accounts of the Community and the legality and regularity of the underlying transactions. In 1998 Community expenditure totalled some 80.8 billion ECU (£57.0 billion). The Commission has overall responsibility for implementing the Budget but around 85 per cent of the expenditure is managed by authorities within the 15 Member States.

**2** In May 1999 in the light of the findings in the Court's Annual Report for 1997 and other evidence, including the report of a Committee of Independent Experts, the European Parliament decided to postpone granting the Commission discharge for the 1997 Budget. Also during 1999 the Committee of Public Accounts undertook a fact-finding visit to the European Institutions responsible for the management and oversight of the Community Budget. In its report, the Committee concluded that fundamental changes were needed to bring about long overdue improvements in the standards of financial management and accounting and reduce the levels of waste, error and fraud in the Community's expenditure programmes.

**3** The Court's Annual Report for 1998 draws similar conclusions to previous years. For the fifth year in succession the Court found significant weaknesses in the management of the Budget and an unacceptably high rate of error in the transactions underlying payments. However the Court acknowledged that the Commission had taken action in response to earlier criticisms and that in some areas, particularly the Structural Funds, its audit had largely covered transactions and events that occurred before the changes had taken effect.

**4** In summary, the Court concluded in its Statement of Assurance for 1998 that:

- the accounts for 1998 reliably reflected the revenue and expenditure for the Community for the year and the financial situation at the end of the year, with four areas of qualification. These concerned the inaccurate or incomplete disclosure of fixed assets, debtors, commitments and provisional payments;
- taken as a whole the transactions underlying the revenue entered in the Community accounts for 1998 were legal and regular subject to a number of limitations, in particular on the completeness of the figures;
- taken as a whole the commitment transactions for 1998 were legal and regular, with one exception where the Commission entered into binding obligations greater than the amounts provided for in the Budget;
- there was an unacceptably high rate of errors which directly affected the payments made. Therefore for the fifth year in succession the Court declined to provide assurance that the transactions underlying payments were legal and regular.

**5** As well as its work on the Statement of Assurance, the Court's Annual Report for 1998 examined wider issues relating to the efficiency and effectiveness of the revenue and spending programmes of the Community. During 1999 the Court also published four Special Reports detailing its audit results on specific topics. We consider that key conclusions emerging from the Court's work on the management of the Community Budget for 1998 were that:

- on the Common Agricultural Policy, farmers were being overcompensated as a result of the unnecessarily high levels of aid being paid in respect of skimmed milk powder and cereals;
- the Commission had made significant efforts to improve financial management and control of the Structural Funds but weaknesses remained in a number of areas, in particular in the evaluation and closure of programmes.

**6** The Commission also published information on the management of the Community Budget in 1998 in its report on 'Protecting the Communities' Financial Interests and the Fight Against Fraud'. The report included details of cases of fraud

and irregularity investigated by the Commission. In 1998 Member States notified the Commission of just over 5,000 cases of irregularities involving 577 million ECU (£407 million). The Commission estimated that around one in five cases involved suspicion of fraud. As well as these cases, the Commission's anti-fraud unit opened 200 new investigations during 1998. In June 1999 the Commission established a new European Anti-Fraud Office, which is operationally independent and will have more staff than its predecessor.

**7** The Court's Annual Report largely concerned the management of the Community Budget in 1998. However since then there have been major developments in relation to the management of Community funds, including the resignation of the Commission in March 1999. In the new Commission, the Rt Hon Neil Kinnock was appointed as Commission Vice-President with specific responsibility for administrative reform. Vice-President Kinnock set up a Task Force to develop a strategy for reform and modernisation, drawing on proposals from a range of sources including reports from the Committee of Public Accounts and the Committee of Independent Experts set up by the European Parliament. The reform strategy was approved by the Commission in March 2000. The United Kingdom Government has been supportive of the moves to improve financial management and control and reduce levels of fraud and irregularity.

## **The National Audit Office's conclusions**

- 8** In relation to the Court's Statement of Assurance (Part 2):
- the Statement of Assurance provides a valuable assessment of the management of the Community Budget as a whole, and the increasingly sectoral approach that the Court is adopting is beginning to provide useful additional information about the position on particular categories of expenditure. The Court told us that producing separate opinions on different areas of the Budget would require substantial additional work. However we consider that there would be considerable value in moving in this direction and we urge the United Kingdom Government to support the further extension of this work;
  - as in previous years, the qualifications to the Court's opinion on the reliability of the accounts are a matter for concern. This emphasises the importance of putting in place clear accounting policies, which are then consistently applied, to improve the reliability of the accounts. As changes

to the Financial Regulation are not expected to take effect for at least two years, it is important for the Commission to make what improvements it can in the meantime;

- it is a matter of serious concern that the high level of ‘substantive’ errors found by the Court meant that it was unable to provide positive assurance on the transactions underlying payments for the fifth year in succession. The Commission and Member States need to act urgently to reduce the rate of error, in particular in expenditure on the Structural Funds and internal policies (mostly research and development) where the highest rates of error were found. Providing the Commission and Member States with more detailed information on error rates would help to highlight more clearly the scale of the problems and the progress being made to address them;
  - many of the errors found by the Court relate to errors made in claims by final beneficiaries, which make them particularly difficult to tackle. It is far from clear that the Court will be able to provide assurance until there is substantial simplification of the schemes concerned. The moves already being made to simplify Common Agricultural Policy and Structural Fund schemes should play a key role in reducing the extent of errors, and further simplification in the future would be desirable;
  - the high rate of error found by the Court in European Social Fund payment claims by applicants in the United Kingdom is a cause for concern. We welcome the action that has already been taken by the Department for Education and Employment to address the problems and recommend that it continues its efforts in this area.
- 9** In relation to other findings on the management of the Community Budget (Part 3):
- it is important that the Commission takes full account of the recommendations of the Court relating to fundamental improvements in financial control and accountability, as part of the ongoing reform process;

- in the light of the Court's findings on the failure to adapt the skimmed milk scheme to take account of market changes and on the overcompensation of farmers in the cereals sector, we urge the United Kingdom Government to press the Commission, Council and Parliament to work together to ensure that schemes achieve their objectives efficiently and effectively;
  - on the Structural Funds, the Commission and Member States need to take action to close programmes which are still outstanding from the 1989 to 1993 period and to strengthen procedures to ensure that similar delays do not occur when programmes from the 1994 to 1999 period come to be closed;
  - the Commission and Member States need to work together and share information about Structural Fund programmes, with the aim of identifying good practice in terms of selecting and monitoring projects, and assessing their impact on structural development and employment;
  - the Commission needs to design and simplify schemes to minimise the risk of fraud and irregularity, and we urge the United Kingdom Government to press the Commission to make rapid progress in this regard;
  - where fraud is suspected, the new European Anti-Fraud Office and authorities in Member States need to work constructively together to undertake quick and effective investigations.
- 10** In relation to the moves to reform financial management and control within the European Union (Part 4):
- the United Kingdom Government, through the Council of Ministers and its other links with the Community, should continue to seize all opportunities to facilitate and support the far-reaching programme of reform to ensure that its impetus is maintained and improvements in financial management are secured;
  - although the Commission does not expect the full impact of the reforms to be felt for another two or three years, it is important that some indication of improvements in financial management and control are evident before then;

- implementation of some of the reforms will require changes to the Financial Regulation. We urge the United Kingdom Government to press the Commission and the other Community Institutions to work together to ensure that legislative hurdles to implementing the reforms are overcome in a timely manner.

**11** The Comptroller and Auditor General has reported since May 1997 on a range of matters relating to the revenue due to and expenditure funded from the Community General Budget in the United Kingdom. The reports are summarised in Appendix 1. Recent reports focussed on the handling of the BSE crisis and the management of the Arable Area Payments Scheme. We will continue to give a high priority to examining the way that United Kingdom departments manage Community funds in the future and to co-operating with the Court.