Financial Management of the European Union

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 402 Session 2000-2001: 27 April 2001

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John Bourn National Audit Office
Comptroller and Auditor General 19 April 2001

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executive summary

1 Each year the Comptroller and Auditor General reports to Parliament on the financial management of the European Union, drawing on the European Court of Auditors' audit of the General Budget of the European Community. In 1999 the Budget totalled 86.9 billion euro (£54.0 billion). The European Commission had overall responsibility for implementing the Budget, although over 80 per cent of expenditure was managed by authorities within the 15 Member States of the European Union.

2 This report summarises the findings in the Court's Annual Report for 1999, which included its Statement of Assurance on the reliability of the accounts of the Community and the legality and regularity of the underlying transactions, and other observations on the financial management of Community activities. It also outlines the progress being made to reform the Commission and the action being taken to tackle fraud and irregularity.

3 Overall the Court's Annual Report and Statement of Assurance for 1999 showed little evidence of improvement in the financial management of the European Union compared with previous years. The Court's work largely concerned revenue and spending that took place before the Commission had embarked on its current programme of reform and, while progress is being made, much of the reform strategy is yet to be implemented. Many of the reforms will require changes in culture, which will be difficult and take time to achieve. Only when the proposals have been implemented in full, will it be possible to judge their success in improving standards of financial management and accounting, and in reducing levels of error and fraud in Community expenditure.

4 The Statement of Assurance provides a valuable assessment of the management of the Community General Budget as a whole. For 1999, the Court drew similar conclusions to previous years and for the sixth year in succession qualified its opinion on the reliability of the Community's accounts. And, also for the sixth year in succession, the Court found an unacceptably high rate of error and therefore declined to provide assurance that the transactions underlying payments (except those relating to staff expenditure) were legal and regular. In relation to the Statement of Assurance for 1999, **we conclude that**:

- in recent years the Court has provided the Commission with useful information about the standards of financial management and rates of error found in different categories of expenditure. The positive assurance given by the Court in respect of staff expenditure for 1999 should provide a stimulus for improvement in other areas. We urge the United Kingdom Government to support further moves in this direction and to encourage the Court to implement the provision in the Treaty of Nice to provide specific assessments for each major area of Community activity. It would also be useful for the Court to explain what the Commission, supported by authorities in Member States, would need to do to secure positive assurance.
- significant problems with the reliability of the Community's accounts persist, which meant that the Court again qualified its opinion. The Commission urgently needs to implement clear accounting policies to enable the production of reliable, accurate and complete financial statements.
- it remains a matter of serious concern that little progress has been made in reducing the high level of error, which meant that for the sixth year in succession the Court was unable to provide positive assurance on the legality and regularity of the transactions underlying payments. The Commission's action plan for improving financial management could be enhanced by the inclusion of more detailed timetables and targets against which performance could be monitored. These would help to stimulate and sustain progress towards reducing the level of error. The Commission could also explain why progress towards reducing rates of error is slow.
- the steps taken by the Commission to simplify some Common Agricultural Policy schemes should help to reduce the extent of error. Further simplification would be desirable to reduce the risk of error, irregularity and fraud, and the Commission, supported by Member States in the Council, should take full account of this in designing schemes.
- the continuing high level of error in Structural Fund payments is particularly concerning and the Commission and Member States need to work together to ensure that the regulation to strengthen financial control is successfully implemented in all Member States and leads to fewer errors.

5 Much of the Court's work involves examining the efficiency and effectiveness of the revenue and expenditure programmes of the Community. As well as the observations in its Annual Report, the Court published 25 Special Reports during 2000 detailing its findings on specific topics. As in previous years, the Court found considerable weaknesses in the management and control of Community funds by the Commission and Member States and **we conclude that**:

- to protect United Kingdom taxpayers, government departments need to take all reasonable steps to ensure that schemes implemented in the United Kingdom comply with European Union regulations, thereby minimising the risk of the Commission subsequently imposing financial penalties.
- in the light of the Court's conclusions that in some areas the rates of aid paid were higher than they needed to be, the Commission and Member States need to ensure that Common Agricultural Policy schemes achieve the intended balance between the interests of European Union producers, consumers and taxpayers.
- it would be beneficial for the Commission and Member States to share information on managing Common Agricultural Policy and Structural Fund schemes and to identify good practice for selecting and designing projects, and for developing performance indicators and targets to evaluate their impact.

- the serious delays in closing Structural Fund programmes continue to be a matter for concern, particularly in respect of the European Regional Development Fund. The Commission and Member States need to make a concerted effort to close quickly programmes still outstanding from periods prior to 1994, so that they can concentrate resources on the more recent programmes.

6 During 2000 the Commission began to implement its strategy for reform, which had been developed by Commission Vice-President Neil Kinnock following the resignation of the previous Commission in March 1999. In a report issued in February 2001, the Commission concluded that progress in implementing the reforms was substantial and generally on schedule. During 2000 the Commission also proceeded with implementing the European Anti-Fraud Office. However, in a report published in August 2000, the Office's Supervisory Committee was critical of delays in the Office becoming fully operational, which it concluded risked compromising the effectiveness of anti-fraud investigations.

7 We welcome the steps being taken to reform the Commission and tackle fraud and irregularity. We recognise that the United Kingdom Government has been supportive of these moves and **we conclude that**:

- some headway has been made in implementing the reform strategy, particularly in terms of strengthening audit, financial management and control. However progress in other areas, including the introduction of new human resources policies, has been patchy. The United Kingdom Government, through the Council of Ministers and its other links with the Community, should continue to support the Commission in its efforts to implement the reforms and ensure that the momentum is maintained.
- key elements of the reform strategy will entail changes to the Financial Regulation and Staff Regulations and will require the support of Member States and the European Parliament. The United Kingdom Government should continue to work to secure the support of other Member States in order to ensure that the necessary modifications to the legal framework are agreed in a timely manner.
- the delay in staffing the European Anti-Fraud Office is a matter for concern. The United Kingdom Government should press the Commission to ensure that the Office becomes fully operational as quickly as possible, so that the intended improvements in the effectiveness of anti-fraud investigations can be secured.
- the convention and protocols on the protection of the European Community's financial interests only enter into force when they have been ratified by all Member States. The United Kingdom Government should continue to press those Member States who have not ratified the convention and protocols to do so as quickly as possible, so that effective action can be taken to deal with fraud against the Community General Budget.

8 As well as his reports based on the findings of the European Court of Auditors, the Comptroller and Auditor General also regularly reports on matters relating to the revenue due to and expenditure funded from the Community General Budget in the United Kingdom. The reports published since May 1997 are listed in Appendix 1. Recent reports have focused in particular on agriculture issues, including the Sheep Annual Premium Scheme, the Arable Area Payments Scheme, and the measures introduced in response to the BSE crisis. We will continue to give a high priority to examining the way that Community funds are managed in the United Kingdom.

Part 1

Introduction

1.1 Each year the Comptroller and Auditor General reports to Parliament on the results of the European Court of Auditors' (the Court) audit of the General Budget of the European Community, which are set out in its Annual Report. This report summarises the findings in the Court's Annual Report for 1999, which was published in the Official Journal of the European Communities in December 2000[1]. It also outlines the progress that has been made in the past year to reform the European Commission (the Commission) and other developments relating to financial management and control.

The European Community General Budget

1.2 The activities and finances of the European Community are governed by European legislation and overseen by the five Community Institutions **(Figure 1)**. The level of revenue and expenditure is set each year in the Community General Budget, which is prepared by the Commission and approved by the Council of Ministers and the European Parliament. The Commission implements the Budget and presents accounts to show how the money has been used. On the basis of the accounts and reports from the Court of Auditors, the Council and the Parliament assess the Commission's stewardship of Community funds and decide whether to 'discharge' the Commission from any further responsibility for the Budget. In April 2001 the Parliament, following a recommendation from the Council, voted to grant discharge to the Commission for the 1999 Budget. Further details of the procedures for setting, controlling and accounting for the Budget are set out in Appendix 2.

1.3 The Commission has overall responsibility for implementing the Budget, although over 80 per cent of Community funds are managed by authorities within the 15 Member States of the European Union. Under the Treaty establishing the European Community, Member States are required to take the same measures to protect the financial interests of the Community as they take to protect their own financial interests.

1.4 The total revenue available to the Community General Budget for 1999 was 86.9 billion euro (£54.0 billion)[2], including a surplus of 3.0 billion euro (£1.9 billion) brought forward from 1998. Total expenditure was 80.3 billion euro (£49.9 billion), leaving funds of 6.6 billion euro (£4.1 billion) to be carried forward to 2000. **Figure 2** analyses the main categories of Community revenue and expenditure in 1999.

1.5 Community revenue and expenditure by Member State in 1999 is shown in Appendix 3. The United Kingdom was the second largest net contributor to the Budget, providing 5.3 billion euro (£3.3 billion).

The European Court of Auditors

1.6 The European Court of Auditors is the external auditor of the European Community. In accordance with the relevant Treaties, the Court examines all Community revenue and expenditure to determine whether revenue has been received and expenditure incurred in a lawful and regular manner, and whether financial management has been sound.

1.7 The Court was established in 1977 and in 1993, under the Treaty of Maastricht, became the fifth Community Institution. The Court consists of 15 Members, one from each Member State, 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 and local administrations in Member States and other recipients in both the public and private sectors. This includes Community funds spent outside the European Union, such as development aid in Eastern Europe. The Court has a right of access to all bodies in receipt of Community funding. These include some recipients of public money in the United Kingdom to which the Comptroller and Auditor General has no statutory right of access, such as farmers and training providers.

1 *Official Journal of the European Communities C 342, 1 December 2000.*

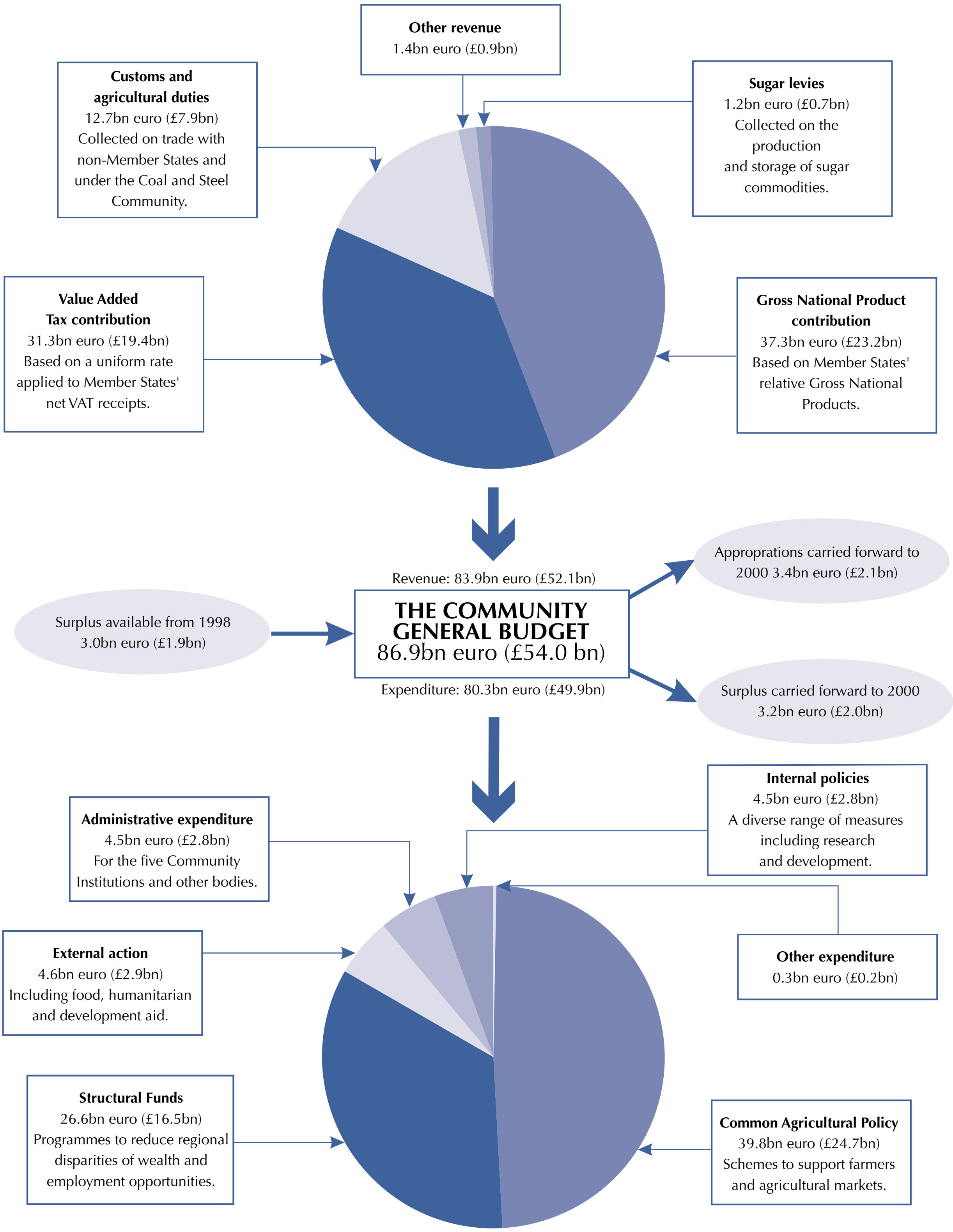
2 *The euro replaced the European Currency Unit from 1 January 1999. A conversion rate of £1 = 0.6213 euro (the exchange rate at 31 December 1999) has been used in this report.*

1 The European Community Institutions

1.8 For its Annual Report and Statement of Assurance for 1999, the Court carried out around 400 audit visits to Member States and other countries, including 24 to the United Kingdom, to examine selected transactions and systems for the management and control of Community funds. Following each visit, the Court set out its findings in a letter to the relevant authorities in the Member State concerned and took account of the Member State's replies in discussing its findings with the Commission.

1.9 The Court publishes an Annual Report containing a summary of its findings on the management of Community operations, along with a Statement of Assurance on the reliability of the accounts of the Community and the legality and regularity of the underlying transactions. In addition, the Court publishes the results of audits on specific topics in Special Reports. The 25 Special Reports published during 2000 are listed in Appendix 4.

2 Revenue and expenditure of the European Community in 1999



Source: Data from the Anuual Report of the European Court of Auditors 1999

Progress in discharging the 1998 Community General Budget

1.10 In its Annual Report for 1998, as for previous years, the Court had declined to provide assurance as to the legality and regularity of the transactions underlying payments. In response the Commission prepared an action plan for improving financial management and procedures, which was presented to the European Parliament and the Council in February 2000. The plan set out proposals for each of the main areas of the Community General Budget, which the Commission hoped would lead to a substantial reduction in rates of error. The plan was welcomed by the Court and by the United Kingdom Government, which also called for it to include more detailed timetables and targets. The Commission is to update the plan in response to the Court's Annual Report for 1999.

1.11 In April 2000, having considered the Court's Annual and Special Reports, the Council's recommendations and other evidence, the European Parliament voted to postpone granting the Commission discharge for the 1998 Budget. After the Commission had provided further information about the management of Community funds, the Parliament finally granted discharge in July 2000. The Parliament noted that the Commission was planning to take action to cut drastically the levels of error in Community expenditure.

The United Kingdom Parliament's scrutiny of European matters

1.12 The House of Commons Committee of Public Accounts considers the Comptroller and Auditor General's reports on the Court's work. The Committee publishes its own reports on European matters, most recently in August 1999[3] following a fact-finding visit to the European Institutions responsible for the management and oversight of the Community General Budget.

1.13 Two Parliamentary Select Committees are responsible for examining European Community documents and proposals for legislation. The Committees also carry out inquiries into other matters relating to the European Union.

- The House of Commons European Scrutiny Committee considers European documents and, where they are judged to be of particular legal or political importance, may recommend that they are debated on the floor of the House or refer them to one of the European standing committees for questions to Ministers and debate. The Committee usually refers the Court's Annual Report for debate in standing committee. The Annual Report for 1999 was debated in February 2001.
- The House of Lords European Union Committee considers the same documents as the European Scrutiny Committee, referring more important documents to a sub-committee for further scrutiny. The sub-committee may decide to conduct an inquiry, taking evidence and producing a detailed report.

Scope of the National Audit Office examination

1.14 The Comptroller and Auditor General last reported on the management of European funds in April 2000[4]. This report considers the progress made since then and in particular:

- summarises the Court's Statement of Assurance on the accounts of the Community for 1999 (Part 2);
- highlights the Court's other significant findings on the management of the Community General Budget (Part 3);
- outlines the action being taken to reform the Commission, and to tackle fraud and irregularity (Part 4).

1.15 In preparing this report, we:

- reviewed the Court's Annual Report and Statement of Assurance for 1999, which were published in November 2000, and the Special Reports published during 2000;
- reviewed information published by the Commission on financial management, fraud and irregularity, and the reform process;
- visited the Court and the Commission in December 2000 to discuss matters arising from the Court's reports and other issues relating to financial management and the reform process;
- liaised with HM Treasury about the Court's findings and other issues relating to the management of Community funds;
- sought comments from the United Kingdom's Permanent Representative to the European Union, the Foreign and Commonwealth Office, and other relevant government departments.

3 *Financial management and control in the European Union, Committee of Public Accounts Twenty-ninth Report (HC 690, 1998-99).*
4 *Financial management of the European Union (HC 437, 1999-2000).*

Part 2

The Statement of Assurance

2.1 Under the Treaty establishing the European Community, the European Commission is responsible for producing the accounts of the Community, which comprise a single consolidated revenue and expenditure account, a balance sheet and explanatory notes[5]. There is no requirement for separate, more detailed accounts covering different areas of the Budget or individual Community Institutions or Commission departments.

2.2 The European Court of Auditors is required to examine the accounts and provide the European Parliament and the Council with a Statement of Assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. The Court carries out its examination in accordance with its audit policies and standards, which adapt international accounting standards to the Community context. The policies and standards set out the principles that determine how the Court plans, executes and reports its work. The scope of the Court's audit comprises the Commission and other Community Institutions, and extends beyond them to the final recipients of Community funds in the 15 Member States and elsewhere in the world. Many of the funds pass through several levels of administration and numerous different bodies.

2.3 The Court's duty to prepare a Statement of Assurance has similarities with the Comptroller and Auditor General's responsibility to provide an opinion on the accounts of government departments and public bodies in the United Kingdom, although there are also important differences. In particular, while the Comptroller and Auditor General gives a separate opinion on the financial statements of each body that he audits, the Treaty requires the Court to provide a Statement of Assurance on the accounts of the Community as a whole.

2.4 The Statement of Assurance is not therefore intended to provide a quantified conclusion on particular operational or geographical areas, such as individual spending programmes or Member States. However in recent years, the Court has adopted an increasingly sectoral approach, which has enabled it to provide the Commission with useful information on the main categories of expenditure, including details of the rates of error it has found in its sample of payment transactions.

2.5 The Commission told us that it would welcome further moves in this direction. The Court told us that it recognised the value of this work and was seeking to develop its audit approach as far as resources allowed. But the Court considered it would need additional resources if it were required to provide separate opinions on different areas of the Budget. The Treaty of Nice, which was agreed in December 2000 following the Inter-Governmental Conference[6], allows the Court to supplement the Statement of Assurance with specific assessments for each major area of Community activity.

2.6 This part of this report summarises the Court's Statement of Assurance for 1999, which covered:

- the reliability of the accounts of the Community;
- the legality and regularity of the transactions underlying revenue, commitments and payments.

The reliability of the accounts of the Community

2.7 The Court concluded that the accounts for 1999 reliably reflected the revenue and expenditure of the Community for the year and the financial situation at the end of the year, but with a number of significant areas of qualification. Many of the grounds for qualification were identical to those in previous years. They concerned the inaccurate or incomplete disclosure of fixed assets, debtors, commitments and provisional payments.

5 *The Community's accounts for 1999 were published in the Official Journal of the European Communities C 343, 1 December 2000.*

6 *The Treaties on which the European Union is founded can be amended by an Inter-Governmental Conference of representatives of the Governments of the Member States. Changes have to be approved unanimously, before being ratified by national Parliaments.*

2.8 The main problems found by the Court - and their financial impact - are detailed in Appendix 5. Key failings included:

- the five Community Institutions and different parts of the Commission had failed to implement a consistent approach to identifying, valuing and disclosing the Community's assets and liabilities;
- in seeking to reflect the fact that the amounts owed to the Community by Member States in respect of customs and agricultural duties were unlikely to be paid in full, the Commission had assumed that none of the amounts would be recovered. In the Court's view, this meant that the amount recoverable was understated;
- different parts of the Commission had defined commitments differently, such that the figure shown was inaccurate and did not include all legal obligations;
- the value of the financial statements was diminished by the lack of complete and reliable information showing the distinction between advance and final payments, and the extent to which funds had been paid over to final beneficiaries.

2.9 The Court has qualified its assurance on the reliability of the Community's accounts every year since the Statement of Assurance was introduced in 1994. The Court explained the underlying problems as a failure by the Commission to provide an adequate and complete accounting framework and a failure by Community Institutions to implement fully the Commission's instructions. As a result, transactions of the same kind have not always been treated in a consistent and appropriate manner.

2.10 As in previous years, the Court recommended that the Commission should act without delay to rectify inadequate accounting practices and introduce an effective accounting framework, based on the principles of accruals accounting. The ongoing revision of the Financial Regulation[7] provides an opportunity for the Commission to introduce the necessary changes. The accounting framework will need to be supported by sufficient and appropriate human and technical resources. The Court told us that the Commission should focus the expertise of the accountants it employed on improving the quality of its financial statements.

2.11 In its response to the Court's Annual Report, the Commission noted that it was already aware of many of the problems highlighted, which in some instances were caused by the existing accounting rules varying between different areas of the Budget. The Commission acknowledged that it did not have an adequate accounting framework and that improvements were needed to enable it to produce reliable, accurate and complete financial statements. The Commission was therefore reviewing its accounting process and had sought advice from a group of external experts to help ensure that in future its accounts would comply with the standards and principles generally accepted by the public sector. However, the Commission did not expect the more significant changes to be implemented before 2001.

2.12 In a number of specific areas, the Commission noted that it had taken steps to address some of the concerns raised by the Court in previous years. For example:

- in 1999 the Commission for the first time made a significant attempt to record in the balance sheet amounts paid to intermediary bodies but not transferred to final recipients, which the Court recognised went some way towards providing important information about the extent of implementation of Community policies;
- in 2000 the Commission adopted a regulation to improve accounting for the Community's assets, which will be applicable to all the Community Institutions;
- the Commission undertook, in drawing up the financial statements for 2000, to seek to take account of the rate of recovery in previous years in calculating the customs duties owed by Member States to the Community;
- from 2001 Member States will be required to provide the Commission with information on the likelihood of recovering the amounts owed by farmers and other beneficiaries in respect of Common Agricultural Policy payments.

2.13 As in the previous year, the Commission experienced difficulties in providing the Court with a final set of accounts to audit. The first version, produced to meet the deadline, had to be corrected several times and the Statement of Assurance was ultimately based on accounts supplied five months later. The Commission noted that it had taken steps to ensure that the delays did not recur so that the accounts for 2000 should be closed promptly. The difficulties had been caused in part by problems resulting from the introduction of a new accounting system at the start of 1999. The development of the new system had been protracted, having taken five years to complete. The Court was critical of aspects of the Commission's management of the project, which it concluded had added to the delays and reduced the functionality of the system.

7 *The Financial Regulation is the key piece of secondary legislation governing financial management and control in the European Union. The Regulation sets out procedures for agreeing and implementing the Community General Budget, and for presenting and auditing the Community accounts. Changes to the Regulation are proposed by the Commission and require the unanimous approval of the Council, after consultation with the European Parliament.*

The legality and regularity of the underlying transactions

2.14 The second part of the Statement of Assurance covered the legality and regularity[8] of the transactions underlying Community revenue, commitments and payments for 1999.

Revenue

2.15 The Court did not find material error in this area. Therefore it concluded that, taken as a whole, the transactions underlying the revenue entered in the Community's accounts for 1999 were legal and regular, subject to restrictions relating to the completeness of the figures for customs and agricultural duties. Also, as in previous years, the Court was unable to audit the macro-economic statistics used to determine Member States' GNP and VAT contributions, which represented some 80 per cent of Community revenue in 1999.

Commitments

2.16 The Court found that during the year the Commission had entered into legal obligations in excess of the amounts provided for in the Community General Budget. The commitments involved totalled 390 million euro (£242 million) and related to international fisheries agreements, the Structural Funds and external action. For other commitments totalling over 93 billion euro (£58 billion), the Court concluded that the underlying transactions were legal and regular.

Payments

2.17 As in previous years, the Court found an unacceptably high incidence of 'substantive' errors, which directly affected the amount or validity of the payments made. As a result, for the sixth year in succession, the Court declined to provide assurance that the transactions underlying payments for the financial year (except those relating to staff expenditure) were legal and regular. The Court also found many 'formal' errors which had no direct effect on the payments made, but where there had been systems weaknesses or failures to comply with the terms of Community regulations.

2.18 The Court supplied the Commission with details of the rates of 'substantive' error it found but, in line with recent years, did not publish this information. The Commission told us that the overall rate of error was more or less the same as in previous years. For 1996 (the last year for which the information was published), the Court found the most probable rate of error affecting payments was 5.4 per cent.

2.19 As in previous years, most of the errors found by the Court concerned the Common Agricultural Policy and Structural Funds, which together represented 80 per cent of the Community General Budget and were managed by authorities in the 15 Member States. But there were also errors in spending managed directly by the Commission, such as programmes for research and development.

Errors in Common Agricultural Policy payments

2.20 In 1999 expenditure on the Common Agricultural Policy represented about half of the Community General Budget (39.8 billion euro (£24.7 billion)). Although the rate of 'substantive' error found in agricultural expenditure was lower than in the Budget as a whole, the Court concluded that the impact of the errors was still considerable and that there was no sign of any significant improvement. On the basis of the Court's results, the Commission estimated that there were probably errors of around one billion euro in this sector.

2.21 More than two-thirds of the errors resulted from inaccuracies in the information provided by farmers or other recipients of Community funds. Most involved often minor over-declarations of field sizes or numbers of animals eligible for subsidy, which had a small impact on the value of the payments made. The Court told us that the bulk of the total error estimated from extrapolating the findings from its examination of a sample of Common Agricultural Policy payments resulted from around 10 significant errors.

2.22 The Court recommended that the Commission should seek to improve the effectiveness of its control systems, in particular by implementing the 'Integrated Administration and Control System' (the System), commonly referred to as IACS. The System was introduced as part of the 1992 agriculture reforms to strengthen controls over schemes involving direct payments to farmers and combat fraud, but it is not yet fully operational in all Member States.

2.23 The System requires the unique identification and registration of agricultural land. Farmers submit an annual application for aid, providing information on the use of their land which is checked against the details held on a computerised database. The System also provides for the application of penalties when the rules of schemes are breached; such penalties currently total some 300 million euro (£186 million) a year.

8 *Legality concerns compliance with European Community legislation; regularity concerns compliance with rules and regulations (including national legislation) put in place as a requirement or consequence of the legislation, which directly govern the activities conducted by the body being audited.*

2.24 The System currently covers around two-thirds of Common Agricultural Policy expenditure, including all arable crop and livestock schemes. The Court regards the System as key to reducing the incidence of error, and the rate of error in payments covered by the System was lower than for the Common Agricultural Policy as a whole. As well as completing implementation of the System, the Court recommended that the Commission should introduce similar measures for those sectors (such as wine) not yet covered by the System.

2.25 More generally, the Commission noted that the quality of controls was improving and reducing the scope for human error (for example, through the use of satellite photography and hi-tech methods such as the electronic tagging of animals). However, the Commission told us that it had doubts about the cost-effectiveness of increasing the level of controls further.

2.26 Both the Court and the Commission acknowledged that the number and complexity of Common Agricultural Policy schemes increased the risk of error and fraud. The Commission noted that it was working to simplify schemes so that they could be more easily and effectively managed. For example in the wine sector, 23 separate regulations had been replaced by one.

2.27 In December 2000 the Commission submitted to the Council a proposal to simplify the aid system for farmers who receive aid of less than 1,000 euro (just over £600) a year. The Commission estimated that 500,000 (20 per cent) of the European Union's farmers could benefit from the scheme, which would involve one global aid application and payment each year. The Commission proposed that the scheme should be introduced for a trial period of three years from 2002. The Commission also highlighted to us the importance of the ongoing consolidation of agricultural legislation (which accounts for half of all Community legislation), which would make it easier for Member States to manage schemes. It expected that this project would take five years to complete.

Errors in Structural Fund payments

2.28 In 1999 expenditure on structural measures (predominantly the four Structural Funds[9], which aim to reduce disparities of wealth and employment opportunities between regions of the Community) represented a third of the Community General Budget (26.6 billion euro (£16.5 billion)). Aid is mainly provided to Member States in the form of funding for programmes, which can last for up to six years and must be co-financed by the Member State concerned. The Commission makes advance payments during the course of a programme, based on expenditure declarations from final beneficiaries in Member States that a given proportion of the funding has been disbursed in line with Community objectives and rules. At the end of each programme, Member States are required to provide the Commission with an implementation report and a complete declaration of expenditure, which is used to arrive at a final settlement and close the programme.

2.29 The Court once again found a high incidence of 'substantive' error due to widespread anomalies in expenditure declarations. The main problems were essentially the same as those found in previous years. They included claims for costs and activities which were not eligible for funding or which failed to comply with the conditions governing the scheme, and claims where the costs declared exceeded those actually incurred.

2.30 The Court recognised that the errors in expenditure declarations submitted by Member States to claim advances of funding did not necessarily mean the payments ultimately made were incorrect. For example, at the end of programmes, the errors might be detected and corrected before any final settlements were calculated and payments made. However, the Court's work in previous years had found the continued existence of a significant number of errors after the closure of programmes and it therefore concluded that many of the errors in advances were unlikely to be corrected at a later stage.

2.31 The high levels of error in the Structural Funds have existed for some years and prompted the Commission to introduce in 1997 a regulation aimed at strengthening Member States' financial control over operations co-financed by the Funds. The regulation sets out minimum control requirements and provides for a greater degree of verification of the costs claimed. Specifically, at least five per cent of expenditure must be checked before programmes are closed and an independent declaration must be provided at the end of each programme certifying the validity of the claim before the final balance is paid.

2.32 In 1999 the Commission reported that considerable progress had been made in implementing the regulation, although the position in some Member States was less advanced than in others. In the United Kingdom, arrangements have been put in place for each of the Structural Funds. For example for the Regional Development Fund, Government Offices for the Regions are to check expenditure in the course of programmes and internal auditors from the Department for the Environment, Transport and the Regions or the Department of Trade and Industry will provide the independent declarations at the end of programmes.

9 *The European Regional Development Fund, the European Social Fund, the 'Guidance' section of the European Agricultural Guidance and Guarantee Fund, and the Financial Instrument for Fisheries Guidance.*

2.33 Most of the payments examined by the Court for the 1999 Statement of Assurance related to programmes that pre-dated the new system. Significant time lags mean that the impact of the new arrangements is not expected to be evident until programmes from the 1994 to 1999 programming period are closed from 2000 onwards. The Court told us that it considered it would be beneficial for the Commission to devote more resources to checking Structural Fund claims.

Errors in payments relating to external action

2.34 In 1999 expenditure on external action (largely humanitarian aid and support for development projects) represented six per cent of the Community General Budget (4.6 billion euro (£2.9 billion)). Most spending on external action is managed directly by the Commission but increasing use is made of intermediaries, including non-governmental organisations, to manage programmes.

2.35 The Court did not find significant errors in this area, but its work highlighted a need for the Commission to enhance its monitoring and control systems to address the risk of ineligible expenditure being funded. In its response, the Commission noted it had improved its arrangements for dealing with external organisations during 2000. In particular it had introduced new procedures for the selection, appraisal and management of projects, including a standard contract with more rigorous reporting and audit requirements.

Errors in payments relating to internal policies

2.36 In 1999 expenditure on internal policies represented six per cent of the Community General Budget (4.5 billion euro (£2.8 billion)), of which over half was funding for research and development projects. Expenditure on internal policies is managed directly by the Commission through contracts with external organisations in the public or private sectors. The Commission supports projects by funding a proportion of the eligible costs incurred by contractors, up to specified limit.

2.37 The Court found a significant incidence of 'substantive' error in this area. The errors mainly concerned contractors overstating costs in their declarations of expenditure, most commonly by including ineligible items. The Court recommended that it would be helpful for the Commission to set out the eligibility of particular costs more clearly and suggested that claims above a certain level should be accompanied by an audit certificate confirming the accuracy and eligibility of the costs claimed. In its response, the Commission noted that in February 2000 a working party had suggested ways of simplifying and improving the management of research programmes, including piloting the use of audit certificates for cost statements. The Commission had begun preparatory work to take these proposals forward.

2.38 The Court concluded that the Commission needed to improve its control of the cost claims submitted by contractors, as it undertook little or no verification beyond a general reasonableness check. However the Court noted that the Commission had fulfilled the commitment it made last year to increase its control work and, in the research sector, had set an objective to audit up to 10 per cent of contractors.

2.39 The Court also concluded that there was little incentive for claimants not to overcharge, as there were no contractual penalties and no risk other than having to repay any amounts found to be overpaid. The Commission stressed that it could terminate contracts in the event of serious financial irregularities but agreed that administrative penalties would be likely to reduce the risk of ineligible expenditure being funded.

Errors in administrative expenditure

2.40 In 1999 administrative expenditure, mainly on the five Community Institutions, represented six per cent of the Community General Budget (4.5 billion euro (£2.8 billion)). The expenditure is managed directly by the Commission and the other Institutions. The Court found a low incidence of error in this area. On the basis of this and other work on the control systems involved, the Court for the first time gave positive assurance in respect of the Institutions' staff expenditure (principally salary and pension costs).

The Court's findings in the United Kingdom

2.41 The Court examined 27 revenue and 21 payment transactions in the United Kingdom for the 1999 Statement of Assurance. On revenue, it found three 'formal' errors which had no direct effect on the transactions but where there had been systems weaknesses. Most of the payments examined related to the Common Agricultural Policy. Around half were affected by small 'substantive' errors, mostly minor over-declarations of arable land eligible for subsidies. The Court also found errors in the small sample of Structural Fund transactions examined, including claims which included estimated rather than actual costs or where expenditure could not be verified due to a lack of supporting documentation.

Conclusions

2.42 The Court's Statement of Assurance provides a valuable assessment of the management of the Community General Budget as a whole. In relation to the Statement of Assurance for 1999, we conclude that:

- in recent years the Court has provided the Commission with useful information about the standards of financial management and rates of error found in different categories of expenditure. The positive assurance given by the Court in respect of staff expenditure for 1999 should provide a stimulus for improvement in other areas. We urge the United Kingdom Government to support further moves in this direction and to encourage the Court to implement the provision in the Treaty of Nice to provide specific assessments for each major area of Community activity. It would also be useful for the Court to explain what the Commission, supported by authorities in Member States, would need to do to secure positive assurance.
- significant problems with the reliability of the Community's accounts persist, which meant that the Court again qualified its opinion. The Commission urgently needs to implement clear accounting policies to enable the production of reliable, accurate and complete financial statements.
- it remains a matter of serious concern that little progress has been made in reducing the high level of error, which meant that for the sixth year in succession the Court was unable to provide positive assurance on the legality and regularity of the transactions underlying payments. The Commission's action plan for improving financial management could be enhanced by the inclusion of more detailed timetables and targets against which performance could be monitored. These would help to stimulate and sustain progress towards reducing the level of error. The Commission could also explain why progress towards reducing rates of error is slow.
- the steps taken by the Commission to simplify some Common Agricultural Policy schemes should help to reduce the extent of error. Further simplification would be desirable to reduce the risk of error, irregularity and fraud, and the Commission, supported by Member States in the Council, should take full account of this in designing schemes.
- the continuing high level of error in Structural Fund payments is particularly concerning and the Commission and Member States need to work together to ensure that the regulation to strengthen financial control is successfully implemented in all Member States and leads to fewer errors.

Part 3

Other findings on the management of Community revenue and expenditure

3.1 As well as the Statement of Assurance, the Court's Annual Report for 1999 included information on wider issues relating to the management of the Community General Budget. Much of the Court's audit work concerns examining the efficiency and effectiveness of the revenue and expenditure programmes of the Community. During 2000 the Court published 25 Special Reports (Appendix 4), detailing its findings on specific topics.

3.2 This part of this report draws on the Court's Annual and Special Reports to highlight the main findings and issues of relevance to the United Kingdom in the areas of:

- Community revenue;
- the Common Agricultural Policy;
- the Structural Funds.

The Court's examination of Community revenue

Gross National Product contributions

3.3 A growing proportion of Community revenue comes from contributions made by Member States based on their Gross National Products (GNP). In 1999 these amounted to 37.3 billion euro (£23.2 billion), some 45 per cent of total revenue, of which the United Kingdom contributed 6.5 billion euro (£4.0 billion).

3.4 Member States calculate their GNP in different ways on the basis of information from various sources, estimates and economic models. The Commission is responsible for validating the information drawn up at national level to guarantee its reliability and comparability. The Court found[10] that the procedures for checking the data were not sufficiently transparent, and recommended that the Commission should strengthen its controls and document them more thoroughly to provide assurance about the legitimacy of the assessment of Member States' GNP contributions.

3.5 The Commission responded that, during the last 10 years, it had made significant progress in harmonising national statistical systems and efforts were continuing. The Statistical Office of the European Communities was liaising with accountants and statisticians in Member States to improve the quality of GNP data.

Customs duties

3.6 In 1999 customs duties collected by customs authorities in Member States totalled 12.7 billion euro (£7.9 billion), of which 2.2 billion euro (£1.4 billion) was provided by the United Kingdom. In normal circumstances, goods entering the Community are liable for customs duties on import.

3.7 To facilitate trade, Community legislation provides for the collection of these duties to be suspended until the goods either reach their final point of destination in the Community or are exported outside the Community. To safeguard the financial interest of the Community, the suspended duties are protected by securities and guarantees provided by the organisations involved in the movement of the goods. These are intended to ensure that the duties are collected if the goods are ultimately used within the Community.

3.8 The Court found[11] a number of cases where Member States' arrangements for managing the securities and guarantees were ineffective or inconsistent with the requirements of Community legislation. Where amounts due to the Community are not collected, Member States pay additional GNP contributions. Therefore, while total Community revenue remains the same, the amounts paid by individual Member States are different and the burden falls on taxpayers in general rather than on the organisations liable for the duties concerned. The Commission accepted many of the criticisms made by the Court, which confirmed the results of its own inspections, and noted that action to remedy the deficiencies was underway.

10 *Special Report 17/2000 The Commission's control of the reliability and comparability of the Member States' GNP data.*
11 *Special Report 8/1999 Securities and guarantees provided for in the Community customs code to protect the collection of traditional own resources.*

The Court's examination of the Common Agricultural Policy

3.9 The objectives of the Common Agricultural Policy were set by the Treaty establishing the European Community. They 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. Expenditure on the Common Agricultural Policy totalled 39.8 billion euro (£24.7 billion) in 1999.

3.10 Key findings from the Court's examination of the Common Agricultural Policy related to:

- financial penalties imposed in 1999;
- the import of New Zealand butter;
- the sugar market;
- the disposal of butterfat;
- the environmental impact of the Common Agricultural Policy.

Financial penalties imposed in 1999

3.11 Authorities in Member States are responsible for administering Common Agricultural Policy schemes in accordance with European Union regulations. The Commission has the power to disallow expenditure and thereby penalise financially individual Member States where it considers they have not complied with the regulations or exercised adequate financial control. Member States (and their taxpayers) bear the cost of disallowance as it represents failures in their administration of schemes.

3.12 During 1999 the Commission imposed financial penalties totalling 206 million euro (£128 million) on Member States, including just over 47 million euro (nearly £30 million) on the United Kingdom:

- 14.5 million euro (£9.7 million) in connection with weaknesses in administering the Sheep Annual Premium Scheme during 1996;
- 32.7 million euro (£20.3 million) in connection with payments made under the Over Thirty Months Scheme for cattle from 1996 to 1998.

Sheep Annual Premium Scheme

3.13 The Sheep Annual Premium Scheme was introduced in 1990 to guarantee sheep producers a common level of support. The United Kingdom is the largest sheep producer in the European Union, with a flock of 44 million animals, produced principally for their meat. The financial penalties were imposed because the United Kingdom agriculture departments decided to rely on farmers' flock records and conduct a proportion of their on-farm inspections to verify the accuracy of claims outside the 'retention period'[12].

3.14 However the Commission found that farmers' flock records were not of sufficient quality to allow them to be used to confirm that the number of sheep claimed for had been kept throughout the retention period. The departments should not therefore have placed reliance on the records and should have conducted all their inspections during, rather than outside, the retention period. The Commission therefore decided to impose financial penalties on the United Kingdom which totalled 130.5 million euro (£87.3 million) for the four years from 1993 to 1996, more than the total for the 14 other Member States combined.

3.15 The United Kingdom took action to address the Commission's concerns, including conducting all of its inspections during the retention period. New legislation was introduced in 1996 setting out the requirements for keeping flock records. And in 2000 the departments issued a standard record book to livestock farmers to help them keep better records and tighten controls further. The disallowance of 14.5 million euro (£9.7 million) imposed in February 1999 related to 1996 and was significantly lower than the amounts for previous years, reflecting the improvements that had been made. Following an audit in 1998, the Commission indicated that the Scheme complied with European Union regulations and the United Kingdom does not expect to incur disallowance on these grounds in respect of 1997 onwards.

3.16 Following a report by the Comptroller and Auditor General[13], the Committee of Public Accounts reported on the Scheme in November 2000[14]. The Committee concluded that the Ministry of Agriculture, Fisheries and Food had taken a risk that the timing of its on-farm inspections and the quality of farmers' flock records would satisfy the Commission. In the Committee's view, the Ministry should have sought the Commission's opinion on its approach and, once the Commission's concerns were identified, should have acted earlier and not taken unnecessary risks with taxpayers' money.

12 A key requirement of the Scheme is that farmers must keep at least the same number of sheep as claimed for for at least 100 days after the end of the application period - this is known as the retention period.

13 The Sheep Annual Premium Scheme in England (HC 273, 1999-2000).

14 The Sheep Annual Premium Scheme in England, Committee of Public Accounts Thirty-eighth Report (HC 362, 1999-2000).

Over Thirty Months Scheme

3.17 In March 1996 the United Kingdom Government acknowledged a positive link between Bovine Spongiform Encephalopathy (BSE) and Creutzfeldt Jakob Disease in humans, and decided to ban the sale for human consumption of all cattle over thirty months old. In consultation with the European Union, in April 1996 the United Kingdom set up the 'Over Thirty Months Scheme' to protect public health and support the beef industry. The Scheme provided for the Intervention Board to purchase cattle over thirty months old, slaughter them and dispose of the carcasses safely. The European Community co-financed, up to a certain weight level, payments made to farmers for cattle entering the Scheme. Reimbursement by the Community was dependent on the destruction of each animal, which was interpreted as incineration of all animal material after slaughter and rendering.

3.18 Implementation of the Scheme was difficult due to the speed with which it became operational and the volume of animals slaughtered. Considerable problems were caused by there being insufficient rendering and incineration facilities to cope with the demand. This meant that large volumes of carcasses and rendered material had to be stored. In a report published in 1998[15], the Comptroller and Auditor General noted that although the Intervention Board had put in place controls to ensure that all animal material transferred between different stages of the process was accounted for, there remained substantial difficulties in calculating the number of carcasses rendered.

3.19 Audits by the Court and the Commission found that controls had not operated effectively, in particular during the early months of the Scheme. The Court concluded that there was little assurance that all the material from animals slaughtered had been stored or incinerated[16]. The lack of adequate controls over the eligibility of cattle, the movement of carcasses and rendered material, storage and incineration led the Commission to disallow just under seven per cent of the expenditure paid in relation to rendering between April 1996 and August 1997, a total penalty of 32.7 million euro (£20.3 million) imposed in May 1999.

The import of New Zealand butter

3.20 Since the United Kingdom joined the Community in 1973, limited quantities of New Zealand butter have been allowed to be imported at reduced rates of duty, provided the butter meets certain eligibility conditions, notably on its fat content. The Comptroller and Auditor General's report on the Court's Annual Report for 1997[17] noted that the Court had found major weaknesses in the control arrangements intended to ensure compliance with the eligibility criteria[18]. United Kingdom Customs and Excise had relied wholly on import certificates issued by the New Zealand Dairy Board. There was no independent assurance that the eligibility criteria had been met, as Customs and Excise considered that there was no reason to doubt the veracity of the certificates provided.

3.21 When Customs and Excise identified that the failure to observe the criteria had resulted in an underpayment of duty, it issued demands to recover the amount due. The company responsible for importing the butter appealed against the demands and none of the amount has been recovered. The outstanding amount of 326 million euro (£203 million) continues to be under dispute and a number of appeal hearings have been scheduled, with the first in early 2001.

3.22 In its Annual Report for 1999, the Court concluded that the prospects for recovering the amount due had deteriorated as the company involved had sold its assets for 14 million euro (£8.7 million) to a new company, which had not accepted liability for the debts. Security of just under eight million euro (£5 million) had been provided by the company and, should the appeal hearing uphold the demands, the amount recovered was unlikely to exceed this sum.

3.23 Nevertheless, overall the Court concluded that Customs and Excise's action to protect the Community's financial interests had been generally commendable and a strategy to ensure that effective controls were in place had been adopted. However the Court was critical of some aspects of the United Kingdom's response, in particular what it regarded as delays in establishing and recovering the debts.

3.24 In its response, the Commission noted that collection of the debts was proceeding in accordance with Community legislation, which provided for an independent appeals process. The Commission had introduced a new regulation with effect from July 2000, aimed at improving the control arrangements for importing dairy products. But in its Annual Report for 1999, the Court commented that no action had been taken to address the risk of similar problems arising in relation to schemes where other agricultural products were imported at reduced rates of duty.

15 *BSE: the cost of a crisis (HC 853, 1997-98).*
16 *Special Report 19/1998 Community financing of certain measures taken as a result of the BSE crisis.*
17 *Audit of the General Budget of the European Union for 1997 and related developments (HC 279, 1998-99).*
18 *Special Report 4/1998 Importation at reduced rate of levy into the Community and disposal of New Zealand milk products and Swiss cheese.*

The sugar market

3.25 The Community has supported the market for sugar since 1968, largely through production quotas and guaranteed prices. Over half of the cost is recovered from the sugar industry and in 1999 the net cost to the Community was 900 million euro (£559 million). The Court found[19] that many of the objectives of the Common Agricultural Policy were being achieved, in particular sugar supplies were stable and growers had good incomes. But these benefits were achieved at a substantial cost to consumers. Community prices were well above the level on world markets, where prices were kept low by supply considerably exceeding demand. The Court estimated that higher prices cost European Union consumers up to 6.5 billion euro (£4.0 billion) a year.

3.26 The Court also found that sugar production quotas were three million tonnes more than the European Union's internal requirements of around 13 million tonnes a year. The Court estimated that the cost of exporting surplus supplies was up to 1.6 billion euro (£1.0 billion) a year, which was borne by the Community General Budget and European Union consumers. The Court recommended that the Commission should consider alternative support measures in order to reduce levels of production and costs to consumers.

3.27 In its response, the Commission argued that the Court's estimate of the costs borne by consumers was excessive and inflated by the very low prices on world markets at the time. The Commission noted that sugar prices in the European Union were similar to those in other industrialised countries. Nevertheless the Commission proposed to evaluate the current system during the next two years, with a view to introducing new arrangements from 2003.

Disposal of butterfat

3.28 The Community aims to create demand for butter and limit surpluses of milkfat by providing subsidies for three disposal measures. Aid is given for the use of butter in pastry and cream products, for sale directly to consumers, and for use by not for profit organisations. Around 500,000 tonnes of butter are disposed of in these ways each year, at a cost to the Community of 600 million euro (£373 million) (including spending of 73 million euro (£45 million) in the United Kingdom).

3.29 The Court found[20] that, under the tender system used by the Community to determine rates of aid, almost all aid was paid at the maximum level. Although the Commission had been successful in lowering aid rates on several occasions, the Court considered that levels could be reduced further if market forces were allowed to play a fuller role. The Court also noted that the Commission had not systematically evaluated the impact of the disposal measures, although the data available suggested that the measures had had only limited success in creating additional demand for butter.

3.30 In its response, the Commission concluded that the disposal measures were indispensable, given the surpluses of milkfat and the decreasing consumption of butter in the European Union. It was confident that the levels of aid were appropriate and noted that the reductions in aid rates since 1995 had produced considerable savings. The Commission planned to start a review of the milk sector as a whole in 2001, which would include assessing the efficiency and effectiveness of the butter disposal measures.

The environmental impact of the Common Agricultural Policy

3.31 In recent years agricultural production has become more intensive in some areas of the European Union, while in others farmers have left the industry. These developments have caused a variety of environmental problems, including pollution, soil erosion and damage to wildlife. Under the Treaty on European Union, Community policies are required to take account of environmental concerns. And the 1992 agriculture reforms included measures designed to help the environment, notably changes to aid schemes for arable crops and livestock and the introduction of new 'agri-environment' and 'afforestation' measures[21].

3.32 Overall the Court concluded[22] that the reforms had had only a limited impact and the expected benefits had to a large extent not been realised. For example in the livestock sector, limiting the number of animals which were eligible for aid had not led to less intensive farming, as farmers continued to keep as many animals as they wished and simply limited their claims to the eligible numbers. On the 'agri-environment' and 'afforestation' measures, the Court concluded that the use of Community funds had not been targeted to reflect environmental priorities and the poor design and lack of co-ordination of some programmes had hampered their effectiveness.

19 Special Report 20/2000 The management of the common organisation of the market for sugar.

20 Special Report 8/2000 The Community measures for the disposal of butterfat.

21 The 'agri-environment' measure aims to compensate farmers for using environmentally beneficial but costly farming techniques, and the 'afforestation' measure to compensate farmers for relevant expenses and loss of income resulting from planting trees on their farmland.

22 Special Report 14/2000 Greening the Common Agricultural Policy.

3.33 In its response, the Commission noted that it had also identified many of the shortcomings highlighted by the Court and had taken action to address them. For example, to qualify for aid, beef and veal farmers now had to include in their claims all the animals that were grazing on their farms. The Commission considered that the 'agri-environment' measures had been largely successful, but agreed that it would be important to develop and target them further to ensure that real and quantified environmental benefits were delivered.

3.34 In its report, the Court drew on the Comptroller and Auditor General's report on the Environmentally Sensitive Areas Scheme, which was published in 1997[23]. The Scheme aims to encourage farmers to safeguard areas of the countryside where the landscape, wildlife or historic interest is of national importance. Half the aid paid to farmers under the Scheme is funded by the Community. The Committee of Public Accounts reviewed the progress made in improving the Scheme in a report published in July 2000[24]. Although the level of participation in the Scheme had risen, the Committee noted that over 40 per cent of eligible land was still not covered. The Committee found that there had been progress in developing performance indicators and targets to judge the success of the Scheme. In its response to the Court's findings, the Commission noted that the United Kingdom was at the forefront of developing 'agri-environment' indicators.

The Court's examination of the Structural Funds

3.35 The four Structural Funds aim to promote economic and social cohesion by providing financial assistance to the less developed regions of the European Union. In 1999 expenditure on the Structural Funds (plus other structural measures) totalled 26.6 billion euro (£16.5 billion). The two largest Structural Funds are:

- the European Regional Development Fund (expenditure of 11.1 billion euro (£6.9 billion) in 1999), which aims to address regional imbalances by providing grants for projects to develop declining industrial regions and other undeveloped regions;
- the European Social Fund (expenditure of 7.2 billion euro (£4.5 billion) in 1999), which aims to improve employment opportunities in the Member States by providing financial support for vocational training and job creation measures.

3.36 The Court noted that, although the Commission had taken steps in response to its previous observations, most of the measures were aimed at the 2000 to 2006 programming period and would not have an impact for a number of years. The Court highlighted the need for the Commission and Member States to strengthen management and control of the Structural Funds in the meantime, and its work confirmed the continued existence of shortcomings in a range of areas, in particular the management and closure of programmes.

Management of programmes

3.37 The Court's examination of a Community initiative to provide support to Northern Ireland and the Border Counties of Ireland[25] found that the procedures for appraising projects needed to be more transparent to ensure that applicants were treated equally. As in previous years, the Court emphasised the importance of using clear criteria to appraise and select programmes to be co-financed by the Structural Funds.

3.38 Similarly, the Court recommended[26] that the selection of projects to set up or modernise industrial sites (which are part funded by the European Regional Development Fund) should form part of an overall strategy which set out clear priorities and criteria for regional development. The Court also found that there was a lack of co-ordination between the large number of bodies (such as, in the United Kingdom, local authorities and regional development agencies) responsible for creating industrial sites.

3.39 Structural Fund measures are intended to have a positive effect on employment and economic development, but the Court found that the objectives and indicators used to appraise programmes and evaluate their impact were often inadequate. For example, it was difficult to assess the effect on employment of Community co-financing of industrial sites because little information was available on the jobs created and there was limited consideration of whether the jobs were new or had simply relocated from elsewhere. The Court reported[27] similar shortcomings in the performance indicators used to assess the impact of measures to help young people find employment.

23 *Protecting Environmentally Sensitive Areas (HC 120, 1997-98).*
24 *Ministry of Agriculture, Fisheries and Food: Progress made on the Committee's recommendations, Twenty-fifth Report (HC 257, 1999-2000).*
25 *Special Report 7/2000 The International Fund for Ireland and the Special Support Programme for Peace and Reconciliation in Northern Ireland and the Border Counties of Ireland 1995-99.*
26 *Special Report 7/1999 The development of industrial sites.*
27 *Special Report 3/2000 Measures to assist the employment of young persons.*

3.40 In a number of areas the Court found that a lack of clarity in Community regulations had led to inconsistency and disparity between different programmes and Member States. For example, Structural Fund aid is subject to the principle of additionality, which aims to ensure that European funding is additional to, and not a substitute for, national aid. Although the Commission had sought to make the definition of additionality more precise, the Court found[28] that Member States' interpretations varied significantly. And on youth employment, the Court noted that, although 'young people' were one of the main target groups for European Social Fund aid, the definitions used by the Commission and Member States varied between programmes so that the qualifying age ranged from 14 to 40.

Closure of programmes

3.41 All expenditure declared under Structural Fund programmes should be verified when programmes are closed and the final declaration of expenditure is submitted. As in previous years, the Court found that there were significant delays in the closure process. Except where extensions to the timetable had been granted, claims for the 1994 to 1996 programming period should have been settled by the end of August 1999. By the end of 1999, 56 of the 73 Social Fund programmes, but only two of the 72 Regional Development Fund programmes, had been closed. None of the 13 Regional Development Fund programmes in the United Kingdom had been closed, although the final claim for four programmes had been submitted to the Commission.

3.42 At the end of 1999, a considerable number of programmes from periods prior to 1994 had not been closed, including 272 Regional Development Fund programmes (compared with 337 in 1998), which had received payments of 1.4 billion euro (£0.9 billion). Closure of Social Fund programmes was more advanced, with 39 programmes outstanding (compared with 94 in 1998), with payments of 170 million euro (£106 million). About 20 per cent of the programmes outstanding from the period before 1994 related to measures from 1989 and earlier.

3.43 Delays in closing programmes were caused by a range of factors, including Member States submitting final claims late or with incomplete supporting documentation, and the Commission failing to review claims promptly. In the Court's view, the extent of the delays could not be justified. The Court told us that as time passed it became more difficult to close programmes and claims were more likely to contain errors, for example because supporting documentation could not be found. Closure needed to be systematic and prompt, so that delays were limited to occasions where projects could not be closed because of ongoing legal investigations.

3.44 The Commission noted that it was endeavouring to close all programmes from periods prior to 1994 as quickly as possible and Member States were required to submit final claims by the end of March 2001. The Commission also expected to close a significant number of programmes from the 1994 to 1996 programming period by the end of 2000. It had set clear deadlines for the 1994 to 1999 programming period, with final claims having to be submitted by the end of March 2003.

3.45 In March 2001, the Department of the Environment, Transport and the Regions told us that the position on the closure of Regional Development Fund programmes in the United Kingdom had improved. The Department expected the final claim for all programmes outstanding from periods prior to 1996 to be submitted to the Commission during 2001.

Conclusions

3.46 In relation to the Court's findings set out above on the management of Community revenue and expenditure, we conclude that:

- to protect United Kingdom taxpayers, government departments need to take all reasonable steps to ensure that schemes implemented in the United Kingdom comply with European Union regulations, thereby minimising the risk of the Commission subsequently imposing financial penalties.
- in the light of the Court's conclusions that in some areas the rates of aid paid were higher than they needed to be, the Commission and Member States need to ensure that Common Agricultural Policy schemes achieve the intended balance between the interests of European Union producers, consumers and taxpayers.
- it would be beneficial for the Commission and Member States to share information on managing Common Agricultural Policy and Structural Fund schemes and to identify good practice for selecting and designing projects, and for developing performance indicators and targets to evaluate their impact.
- the serious delays in closing Structural Fund programmes continue to be a matter for concern, particularly in respect of the European Regional Development Fund. The Commission and Member States need to make a concerted effort to close quickly programmes still outstanding from periods prior to 1994, so that they can concentrate resources on the more recent programmes.

28 *Special Report 6/1999 The principle of additionality.*

Part 4

Progress in reforming the European Commission and tackling fraud and irregularity

4.1 The Comptroller and Auditor General's report published in April 2000[29] outlined the action the European Commission proposed to take in the wake of the resignation of the previous Commission in March 1999 and the reports of the Committee of Independent Experts[30]. This part of this report sets out:

- the progress being made to reform the Commission, in particular to strengthen financial management and control;
- the action being taken to tackle fraud and irregularity, including the work of the European Anti-Fraud Office.

4.2 The United Kingdom Government, which seeks to influence the Commission primarily through the Council of Ministers, has been supportive of the moves to reform the Commission, to improve financial management and control, and to reduce levels of fraud and irregularity. The Government is committed to working with the Commission to improve the management of Community funds.

Reform of the European Commission

4.3 In March 2000 the Commission approved the strategy for reform and modernisation[31], which had been developed by Commission Vice-President Neil Kinnock and the Task Force for Administrative Reform. The strategy was supported by an action plan, setting out around 100 specific tasks with implementation deadlines stretching into 2002. In a report published in February 2001, the Commission concluded that there had been substantial progress in implementing the reforms, which were generally on schedule. However, the Commission recognised that much remained to be done before change was fully implemented across the Commission and tangible results were evident.

4.4 In its Annual Report for 1999, the Court welcomed the priority the Commission was attaching to the reform programme, which was intended to address many of the weaknesses which the Court had highlighted in previous years. The Court encouraged the Commission to proceed with the reform process as quickly as was feasible. The Court noted that, although progress was being made, only when the proposals had been implemented in full would it be possible to assess whether the intended improvements in financial management and other areas were being achieved.

4.5 The Commission's strategy for reform set out three specific areas for action - audit, financial management and control; priority setting, allocation and efficient use of resources; and human resources development. This section of this report outlines the progress being made by the Commission to implement the proposed reforms in each of these areas.

Audit, financial management and control

4.6 The Commission considered that problems had arisen because financial management and control systems were too centralised for the volume and variety of transactions that they had to handle. The proposals set out in the reform strategy amounted to a radical overhaul of financial systems, with the aim of restoring public confidence and creating a culture where managers took responsibility for the quality, regularity and efficiency of their actions.

4.7 In December 2000 the Commission told us that good progress was being made in implementing the reforms in this area and that changes in culture were being achieved. The Internal Audit Service, Audit Progress Committee and Central Finance Service had all been set up during 2000, and an audit capability had been established within each of the Commission's operational directorates general[32]. Further details of the actions taken are set out in **Figure 3**.

29 *Financial management of the European Union (HC 437, 1999-2000).*

30 *The Committee of Independent Experts was established by the European Parliament and the Commission in January 1999 to examine the ways in which the Commission detected and dealt with fraud, mismanagement and nepotism. The Committee produced two reports, in March and September 1999.*

31 *Reforming the Commission - a White Paper (March 2000).*

32 *Directorates general are the main administrative units within the Commission.*

3 Reforming audit, financial management and control

The Commission's proposals (taken from Figure 10 of Financial Management of the European Union (HC 437, 1999-2000))	*Actions taken by the Commission*
To make operational directorates general responsible for their own expenditure by replacing the present centralised checking of expenditure by the Financial Control Directorate General with systems of internal control integrated within directorates general.	The process of integrating financial control into operational directorates general has begun. After identifying weaknesses in the existing arrangements, managers in each directorate general developed proposals for redesigning their control systems. Their proposals will be reviewed and refined, prior to implementation. An audit capability has been established within each directorate general to provide advice and assurance on internal control systems. The annual activity reports to be produced by each director general will include a statement about departmental control systems. The training of staff responsible for financial management in the operational directorates general is underway. The Commission presented a proposal to amend the Financial Regulation (including abolishing the need for centralised checking of expenditure) to the Council in October 2000. Consideration of the proposal has begun and the Commission expects the reform to be completed during 2002.
To create a new Central Financial Service under the responsibility of the Budget Commissioner, to define and monitor financial rules and procedures, provide advice to operational managers and manage common financial management information.	The Central Financial Service was set up in May 2000 to introduce common standards of financial control across the Commission and to provide advice on sound financial management. The Service will have some 75 staff.
To set up a professional Internal Audit Service under the responsibility of the Commission Vice-President for Administrative Reform, to examine internal control and management systems and to provide advice to management.	The Internal Audit Service has been operational since June 2000. The Head of the Service was appointed in December 2000 and other staff are being recruited. The Service will have some 85 staff. The Service is currently developing its work programme for 2001-02. The Commission presented a 'fast track' proposal to amend the Financial Regulation to allow the separation of internal audit from financial control to the Council in May 2000. The proposal is expected to be adopted in early 2001.
To establish an Audit Progress Committee chaired by the Budget Commissioner, to consider the findings of the Internal Audit Service and European Court of Auditors, and monitor the implementation of audit recommendations.	The first meeting of the Audit Progress Committee was held in December 2000. The Committee is chaired by the Budget Commissioner, and also includes the Commission Vice-President for Administrative Reform, two other Commissioners and an external member. The Committee will review the work programme and reports of the Internal Audit Service, and oversee implementation of the Service's recommendations.

4.8 The Commission told us that it anticipated that, as a result of the reforms, improvements in financial management would start to be evident in 2001, both in terms of fewer errors and better quality of service, for example more payments being made on time. However, while the decentralisation of financial control had begun, abolishing the centralised checking of expenditure by the Financial Control Directorate General would involve modifying the Financial Regulation. This would require the unanimous approval of the Council, after consultation with the European Parliament. It was unlikely that the new Financial Regulation would be in force until 2002 at the earliest.

Priority setting, allocation and efficient use of resources

4.9 An aim of the reform strategy was to implement management systems and procedures to enable strategic priorities and policy objectives to be defined and translated into operational activities, and to integrate decisions on priorities with the allocation of resources. In December 2000 the Commission told us that reasonable progress was being made in implementing the reforms in this area, but changes in culture had not yet been achieved. Further details of the actions taken are set out in **Figure 4**.

Human resources development

4.10 The reform strategy set out plans for a comprehensive overhaul of human resources policies, with the aim of allowing staff to fulfil their potential and managers to manage effectively. In December 2000 the Commission told us that, although a significant amount of preparatory work had been undertaken, progress in this area had been relatively slow and was behind schedule. Many of the proposals (for example, those relating to promotion and pay) were very sensitive and the Commission would be required to consult with staff and their representatives. Some changes would involve amending the Staff Regulations and would require the approval of the Council, after consultation with the other institutions concerned.

4 **Reforming priority setting, allocation and efficient use of resources**

The Commission's proposals (taken from Figure 10 of Financial Management of the European Union (HC 437, 1999-2000))	*Actions taken by the Commission*
To introduce systematic strategic planning, including a system of activity based management to assist in setting priorities and matching resources to them, and in promoting performance management.	A unit with responsibility for strategic planning and programming was set up in July 2000, to design a planning cycle and help the Commission define its priorities and allocate appropriate human and financial resources. The Commission has decided its six main priorities for 2002, which directorates general will translate into programmes and activities. In July 2000 the Commission adopted a two-year strategy to close the gap between its tasks and the resources needed to undertake them. A detailed review carried out by a group of Commissioners, chaired by the Commission President, had concluded that the total resource gap was some 1,250, which the group proposed should be met through just over 700 new posts, efficiency gains and a reduction of activities in some areas. The Commission aims for activity based management to be fully operational during 2002. Information technology systems to support its introduction are currently being piloted. The Commission has also developed proposals to strengthen systems for evaluating its policies and activities.
To appoint a senior official with responsibility for devising more efficient and performance oriented working methods, with simplified administrative procedures, clear job descriptions, better performance information, and specified targets.	In June 2000 the Commission appointed a senior official to draw up and implement an action plan to simplify procedures and promote better working practices. In November 2000 a set of simplifications to working methods was announced. An exercise to draw up job descriptions has been completed.
To achieve a better balance between internal and external management of activities to secure the most efficient and effective way of delivering programmes and to ensure that accountability is maintained where management is devolved.	The Commission has developed a policy to identify when 'externalisation' may be an efficient and effective means of managing activities. The Commission proposes to set up 'executive agencies' to implement Community programmes where appropriate. The agencies would operate under the strict supervision of the Commission to avoid any loss of accountability and control.

4.11 Subsequent to our visit, in February 2001 the Commission announced wide-ranging plans to reform its personnel policies. Key proposals include:

- basing career progression on expertise and achievements, as well as experience, and increasing staff mobility, including setting up a career guidance service;
- the introduction of an annual staff appraisal system to assess performance and potential, and new arrangements for dealing with under-performing staff;
- a significant increase in training provision, including the establishment of a central training office;
- an overhaul of the pay system, including rationalisation of allowances and expenses, and modernisation of pension arrangements.

Further details of the actions taken are set out in **Figure 5** on page 24.

Reform of external aid

4.12 As well as its general programme of administrative and financial reform, the Commission is also making changes aimed at tackling problems in specific sectors, most notably external aid. During the 1990s the Community had become one of the world's largest donors of humanitarian and development aid. But the rapid growth in expenditure had not been matched by increases in staff: whereas Member States and the World Bank had between four and nine officials to manage each 10 million euro (just over £6 million) of aid, the Commission had 2.9. As a result, increasing amounts of money were committed but not spent, and concerns grew about the effectiveness of the Community's aid programmes.

4.13 In May 2000 therefore the Commission announced proposals to overhaul the management of its external assistance programmes, with the aim of improving the timeliness and quality of aid delivery. Key elements of the reforms include:

- in January 2001, creating a single body within the Commission, with more staff, to implement aid projects;
- by autumn 2001, dismantling the technical assistance offices to which the Commission had effectively subcontracted the management of programmes, which had undermined proper financial and political control;
- between 2001 and 2003, devolving responsibility for the management of programmes to local delegations, with more staff and better computer systems.

5 Reforming human resources development

The Commission's proposals (taken from Figure 10 of Financial Management of the European Union (HC 437, 1999-2000))	*Actions taken by the Commission*
To base recruitment, promotion and career development on merit, including the introduction of a staff appraisal system to assess performance and clear procedures for identifying and dealing with under-performing staff.	In February 2001 the Commission announced plans to reform its personnel policies. The proposals include changes designed to improve arrangements for recruitment, career progression, staff appraisal and training, and to modernise pay and pension systems.
To match better staff to jobs through increased mobility and a less rigid career structure, and a greater emphasis on training to ensure that staff have the skills they need.	Consultation with staff representatives about the reforms will continue until July 2001, after which the Commission will finalise the proposals for implementation or presentation to the Council in December 2001. The current system for annual adjustments to pay and pensions has been extended until 2003 to allow all the proposed modifications to the Staff Regulations to be considered together. In December 2000 the Commission decided to introduce new arrangements for the promotion and appraisal of its 250 most senior officials and for compulsory management training. In December 2000 the Commission announced proposals to reform its internal disciplinary system, including the creation of an investigation and discipline office. The changes are designed to make the system fairer and reduce the time taken to resolve cases.
To define explicitly the rights and obligations of staff and establish clear rules for whistleblowers who report alleged wrongdoing.	In November 2000 the Commission announced new procedures for whistleblowing. The proposals are designed to clarify the duty of staff to report responsibly concerns about wrongdoing, to provide channels inside and outside the Commission for this purpose, and to protect whistleblowers who use these channels. The proposals also make clear the responsibility of managers to follow up concerns when they are reported.
To create a European Committee on Standards in Public Life to supervise staff codes of conduct and provide advice on ethical standards in all the Community Institutions.	In November 2000 a code of conduct on good administrative behaviour became operational, aimed at ensuring high standards of integrity and public service among Commission staff. In December 2000 the Commission put forward a proposal to set up an Advisory Group on Standards in Public Life to provide independent guidance on general principles of professional ethics to all the Community Institutions.

Fraud and irregularity

4.14 Irregularity, including fraud, generally results in a loss to the Community General Budget and the European Union taxpayer. Broadly the distinction between fraud and irregularity is that fraud is an intentional act and a criminal offence, whereas irregularity is any infringement of Community law resulting from an act or omission.

4.15 Each year the Commission publishes information about the irregularities it and Member States have detected[33]. For 1999, the Commission classified the cases reported by Member States into fraud and other irregularity, although it stressed that the distinction between fraud and irregularity was not precise and that definitions varied from one Member State to another. Overall the Commission concluded that the level of fraud and irregularity detected or suspected in 1999 was comparable to that in previous years.

4.16 In total in 1999 Member States notified the Commission of 6,147 cases of irregularity, which the Commission classified as 1,235 cases of fraud, involving 190 million euro (£118 million), and a further 4,912 cases of other irregularity, involving 429 million euro (£266 million) **(Figure 6)**. Most of the cases concerned Community revenue or Common Agricultural Policy expenditure.

4.17 In 1999 the United Kingdom notified the Commission of 885 cases of irregularity, which the Commission classified as 28 cases of fraud, involving 8.5 million euro (£5.3 million), and a further 857 cases of other irregularity, involving 136 million euro (£85 million). Twenty-five of the fraud cases related to the Common Agricultural Policy.

4.18 As well as cases reported by Member States, the European Anti-Fraud Office handled 252 new cases, involving 224 million euro (£139 million), most of which it considered involved criminal conduct. Over 100 of these cases concerned expenditure managed directly by the Commission.

33 *Protecting the Communities' Financial Interests - The Fight Against Fraud, Annual Report.*

6 **Cases of fraud and irregularity in 1999**

	Fraud		Irregularity	
Area of the Budget	**Number of cases**	**Amounts involved (million euro)**	**Number of cases**	**Amounts involved (million euro)**
Revenue from customs and agricultural duties, and sugar levies	522	51	2,230	215
Common Agricultural Policy expenditure	633	116	2,064	117
Expenditure on structural measures	80	23	618	97

Source: Data from Protecting the Communities' Financial Interests - The Fight Against Fraud, Annual Report 1999.

4.19 The Commission's figures for fraud and irregularity did not include cases involving excise duties, because their impact is initially on the budgets of Member States. The Commission noted that alcohol trafficking and cigarette smuggling were currently the most serious forms of fraud within the Community. On the basis of cases investigated by the European Anti-Fraud Office since 1999, the Commission estimated that the impact of alcohol trafficking on the budgets of Member States was over 500 million euro (£311 million).

Tackling fraud and irregularity

4.20 In 1999 the Commission reorganised its anti-fraud systems, with the creation of a new European Anti-Fraud Office (known by its French acronym, OLAF[34]). The new Office was intended to strengthen anti-fraud operations, the effectiveness of which had been questioned by the Committee of Independent Experts and the Council.

4.21 The Office is responsible for conducting administrative anti-fraud investigations in Member States, the Commission, and other Community Institutions and bodies. It does not have the power to conduct criminal investigations and prosecutions, which are the responsibility of Member States. The Office is operationally independent in terms of opening and conducting investigations but remains part of the Commission in other respects, for example in contributing to the development of anti-fraud legislation.

4.22 The first Director General of the Office was appointed by the Commission following consultation with the European Parliament and the Council, and took up post in March 2000. The Office is recruiting staff and expects to have 300 by the end of 2001, around 170 more than its predecessor.

4.23 To reinforce its independence, the Office is overseen by a Supervisory Committee, comprising five members who are independent of the Community Institutions and who have particular expertise in the area. In its first report, published in August 2000, the Committee was critical of delays in the Office becoming fully operational. In the Committee's view, the slow progress risked compromising the effectiveness of anti-fraud investigations. Overall the Committee concluded that the protection of the European Union's financial interests had not yet improved appreciably.

4.24 A large proportion of the frauds detected in recent years have resulted from large-scale organised crime across national borders. Many of the European Union's initiatives to tackle fraud have therefore been directed at harmonising national criminal laws and penalties, and strengthening co-operation between Member States. Work is underway to create 'Eurojust', a judicial co-operation unit involving magistrates, prosecutors and police officers across the European Community. 'Eurojust' is intended to facilitate the proper co-ordination of national prosecuting authorities and support criminal investigations in cases of serious organised crime across national borders.

4.25 The Council adopted a convention on the protection of the European Community's financial interests in July 1995, and two protocols to the convention in September 1996 and June 1997. The convention specifies minimum rules that Member States should incorporate into their criminal law to deal with fraud against the Community General Budget. It also requires Member States to ensure that such frauds are punishable with imprisonment and that offenders are extraditable. The convention and protocols only enter into force when they have been ratified by all Member States. The United Kingdom ratified the convention and protocols in September 1999, and by January 2001 ratification was fully or partially complete in ten Member States[35].

34 Office européen de lutte antifraude.

35 In January 2001, ratification was fully complete in Denmark, France, Greece, Portugal, Spain and the United Kingdom, and was partially complete in Austria, Finland, Germany and Sweden.

Conclusions

4.26 We welcome the steps being taken to reform the Commission and tackle fraud and irregularity. We recognise that the United Kingdom Government has been supportive of these moves and we conclude that:

- some headway has been made in implementing the reform strategy, particularly in terms of strengthening audit, financial management and control. However progress in other areas, including the introduction of new human resources policies, has been patchy. The United Kingdom Government, through the Council of Ministers and its other links with the Community, should continue to support the Commission in its efforts to implement the reforms and ensure that the momentum is maintained.
- key elements of the reform strategy will entail changes to the Financial Regulation and Staff Regulations and will require the support of Member States and the European Parliament. The United Kingdom Government should continue to work to secure the support of other Member States in order to ensure that the necessary modifications to the legal framework are agreed in a timely manner.
- the delay in staffing the European Anti-Fraud Office is a matter for concern. The United Kingdom Government should press the Commission to ensure that the Office becomes fully operational as quickly as possible, so that the intended improvements in the effectiveness of anti-fraud investigations can be secured.
- the convention and protocols on the protection of the European Community's financial interests only enter into force when they have been ratified by all Member States. The United Kingdom Government should continue to press those Member States who have not ratified the convention and protocols to do so as quickly as possible, so that effective action can be taken to deal with fraud against the Community General Budget.

Appendix 1

Reports by the Comptroller and Auditor General on European matters since 1 May 1997

House of Commons number	Title
HC 437, 1999-2000	Financial management of the European Union
HC 273, 1999-2000	The Sheep Annual Premium Scheme in England
HC 279, 1998-99	Audit of the General Budget of the European Union for 1997 and related developments
HC 223, 1998-99	Arable Area Payments Scheme
HC 853, 1997-98	BSE: the cost of a crisis
HC 697, 1997-98	The Annual Report of the European Court of Auditors for 1996
HC 566, 1997-98	Reform of customs transit in the European Community
HC 276, 1997-98	Exchange of information on direct taxation within the European Union
HC 251-XIII, 1997-98	Appropriation Accounts 1996-97 (Class XIII, Vote 2): European Social Fund (Scotland)
HC 251-III, 1997-98	Appropriation Accounts 1996-97 (Class III, Vote 1): Intervention Board Executive Agency
HC 120, 1997-98	Protecting environmentally sensitive areas

Appendix 2

The procedure for setting, controlling and accounting for the Community General 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 (HC 332, 1996-97) described in detail the roles of the different Community Institutions in setting, controlling and accounting for the Community General Budget. This appendix provides a summary of that procedure, which is shown in **Figure 7**.

2 The Budget is set by a procedure involving the European Commission, the Council of Ministers and the European Parliament. The preliminary draft Budget is prepared by the Commission and presented to the Council, which may make amendments before establishing the draft Budget. The draft Budget is forwarded to the Parliament, which has powers of amendment, although these are limited in respect of 'compulsory' expenditure (including expenditure on the Common Agricultural Policy), which is necessary to fulfil the Treaty obligations of the European Union. Individual Member States influence the level of the Budget and their resulting contributions through their representatives on the Council.

3 Once adopted, the Budget has the force of law. The Commission implements the expenditure set out in the Budget under its own authority and in accordance with financial regulations approved by the Council. These regulations are intended to secure sound financial management and control of expenditure both within the Commission and in Member States, which administer around 80 per cent of the expenditure.

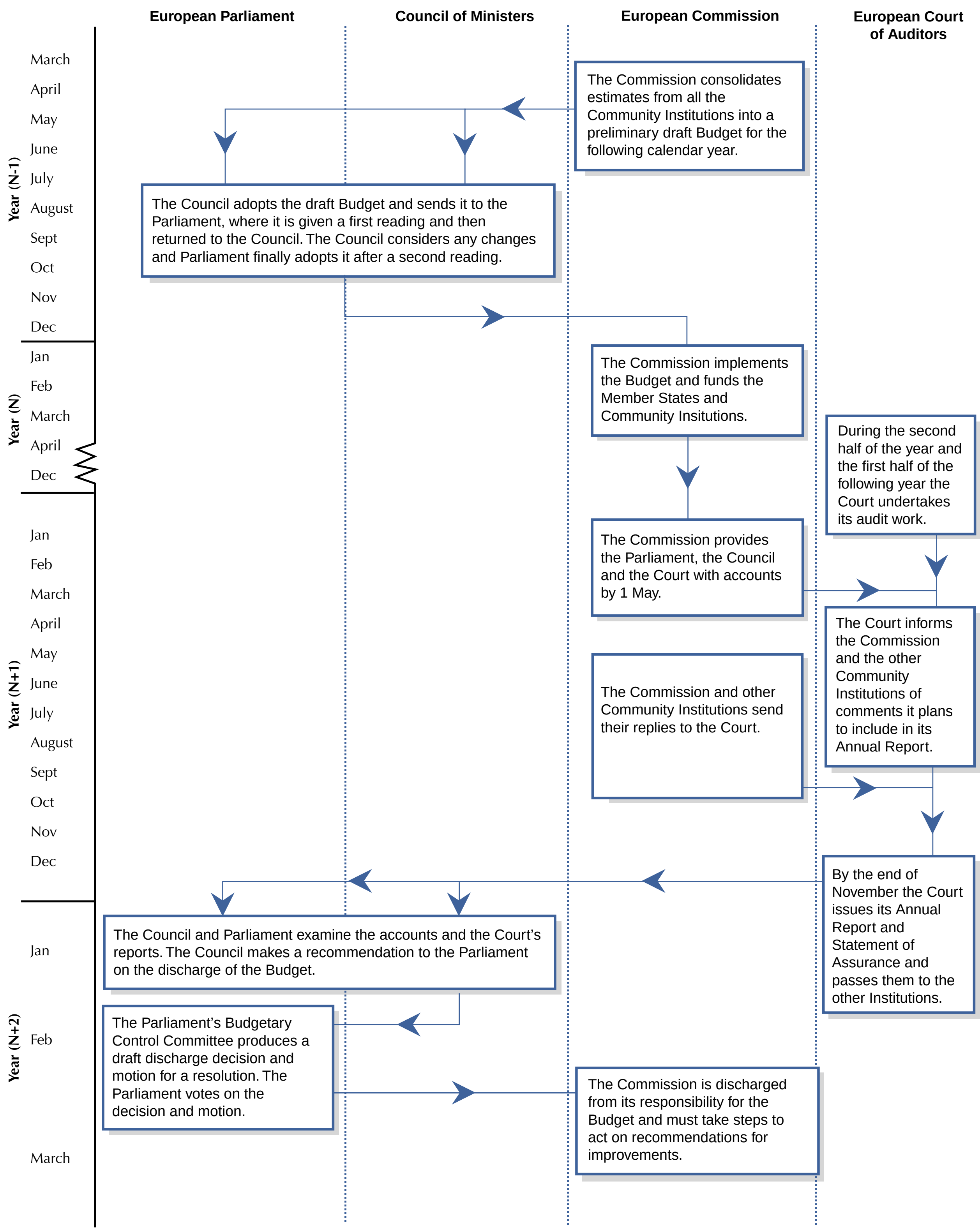
4 The Council and the Parliament monitor the implementation of the Budget during the year. This is done through the 'Notenboom procedure' whereby the Commission is invited to comment on the level of implementation of individual appropriations in the autumn of each year. Following a resolution by the Parliament, the 'Notenboom transfer' may be made, through which the Commission adjusts the Budget with a view to maximising the effectiveness of appropriations. This procedure is also designed to inform the Parliament's discussions on the appropriations to be voted for the following year. The Commission also provides monthly data on the use of appropriations, as well as reports on agricultural spending. These are known as early warning reports and are designed to indicate whether spending is likely to exceed the appropriations provided. These mechanisms provide an opportunity for the Commission to provide assurance to the Council and the Parliament that their wishes are being adhered to, or to explain why variances have occurred.

5 By the beginning of May each year, the Commission is required to present to the Council, the Parliament and the Court of Auditors accounts of Community revenue and expenditure, and assets and liabilities, to show how the Budget for the previous year was implemented. The accounts form the basis for the Court's audit work for the Statement of Assurance. This, together with other work by the Court on the revenue and expenditure programmes of the Community, is brought together when the Court publishes its Annual Report in November.

6 The Court's Annual Report and Statement of Assurance are the starting point for the discharge procedure that completes the cycle of accountability for Community funds. In essence this requires the Council and the Parliament to give their opinion on the Commission's stewardship of Community funds, and then for the Parliament to decide by the end of the following April, on a recommendation by the Council, whether formally to discharge the Commission from any further responsibility for the Budget. Discharge indicates acceptance that the Commission's stewardship of monies has been sound, expenditure lawful and regular, financial management effective, and appropriations utilised to further the objectives set when the Budget was adopted. The granting of discharge formally ends the budgetary process for a given year.

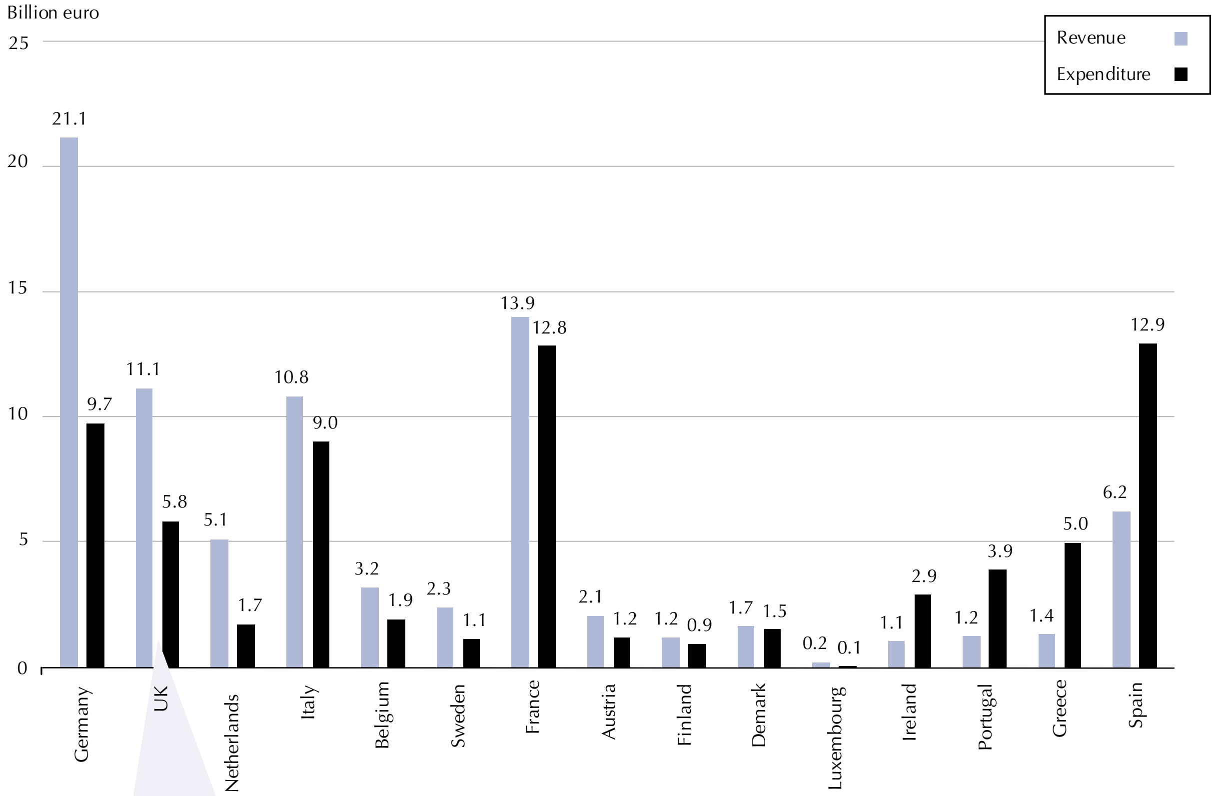
7 The Parliament may refuse to grant discharge if it is dissatisfied with the Commission's management of Community funds. Failure to give discharge is one of the strongest rebukes which the Parliament can give to the Commission and may precipitate a motion of censure. The Parliament may also postpone discharge until the Commission has taken action on key weaknesses identified by the Court of Auditors.

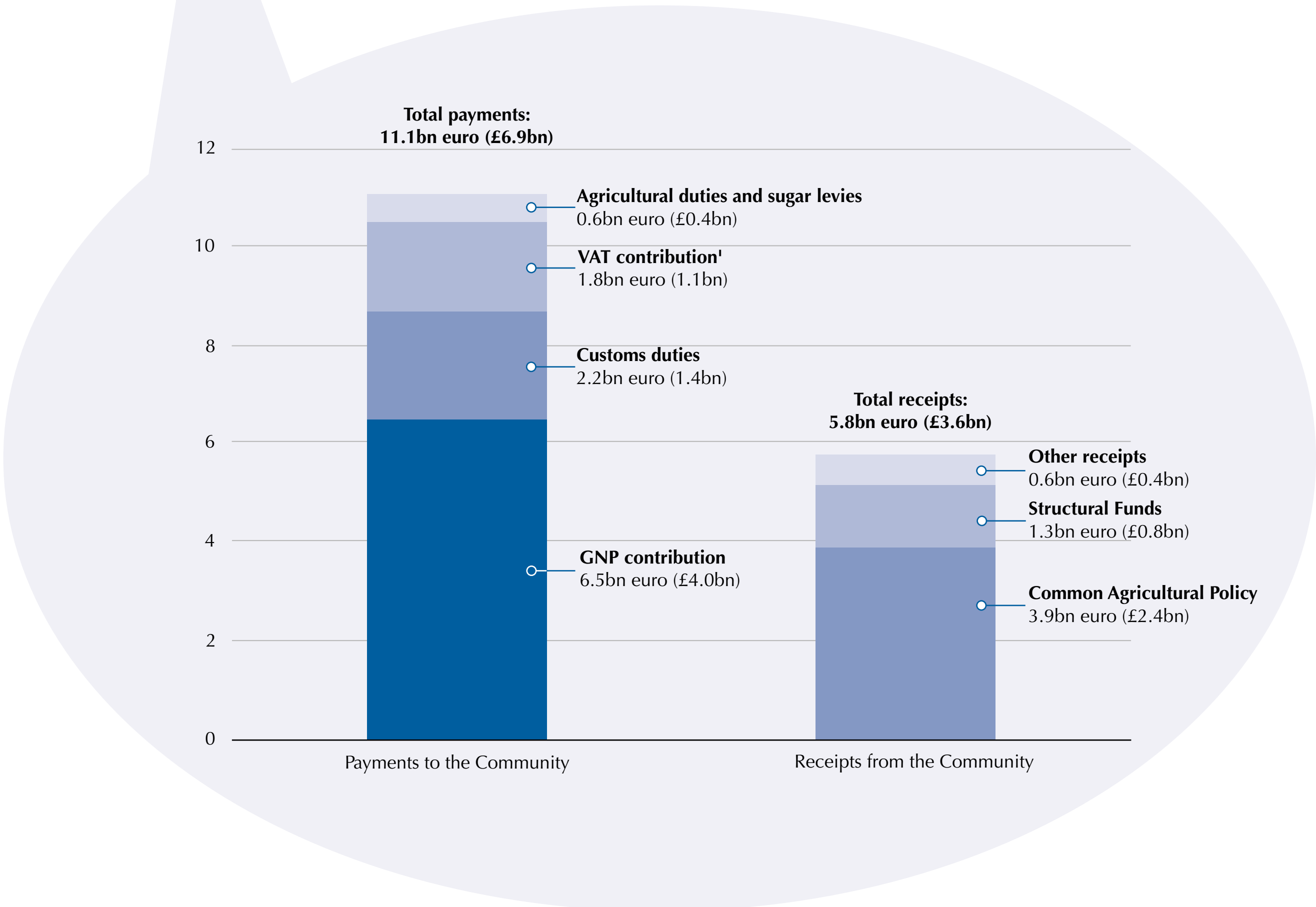
7 Control of the Community General Budget



Appendix 3

Community revenue and expenditure in 1999 by Member State





Note[1]: The United Kingdom's VAT contribution is abated under the 1984 Fontainebleau agreement.

Appendix 4 Special Reports published by the European Court of Auditors during 2000

Special Report number	Title
5/1999	PHARE cross border co-operation (1994 to 1998)
6/1999	The principle of additionality
7/1999	The development of industrial sites
8/1999	Securities and guarantees provided for in the Community customs code to protect the collection of traditional own resources
9/1999	Research activities in the field of agriculture and fisheries (FAIR programme - Fisheries, Agriculture and Agro-Industrial Research)
1/2000	Classical swine fever
2/2000	Aid given by the European Union to Bosnia-Herzegovina with a view to restoring peace and the rule of law
3/2000	The European Social Fund and the European Agricultural Guidance and Guarantee Fund (Guidance section) - measures to assist the employment of young persons
4/2000	Rehabilitation actions for African, Caribbean and Pacific countries as an instrument to prepare for normal development aid
5/2000	The Court of Justice's expenditure on buildings (annexe buildings Erasmus, Thomas More and Annexe C)
6/2000	The granting by the Community of interest subsidies on loans by the European Investment Bank to small and medium-sized enterprises, through its temporary lending facility
7/2000	The International Fund for Ireland and the Special Support Programme for Peace and Reconciliation in Northern Ireland and the Border Counties of Ireland
8/2000	Measures for the disposal of butterfat
9/2000	Trans-European networks - telecommunications
10/2000	The public contracts awarded by the Joint Research Centre
11/2000	The support scheme for olive oil
12/2000	The management by the Commission of European Union support for the development of human rights and democracy in third countries
13/2000	The expenditure of the European Parliament's political groups
14/2000	Greening the Common Agricultural Policy
15/2000	The Cohesion Fund
16/2000	Tendering procedures for service contracts under the PHARE and TACIS programmes
17/2000	The Commission's control of the reliability and comparability of the Member States' Gross National Product data
18/2000	The programme to supply agricultural products to the Russian Federation
19/2000	The management by the Commission of the programme of assistance to Palestinian society
20/2000	The management of the common organisation of the market for sugar

Appendix 5 The European Court of Auditors' main findings on the reliability of the accounts of the Community for 1999

Problem	Effect
Disclosure of fixed assets	
The figure for fixed assets was understated because it did not include buildings purchased through leases or similar arrangements by the European Parliament and the European Court of Justice.	Understatement of approximately 668 million euro (£415 million).
The amount shown for fixed assets was uncertain because not all Community bodies followed the Commission's instructions on the presentation of the balance sheet with the result that assets were inconsistently identified, valued and classified. Only the European Commission, the European Court of Auditors and the European Ombudsman calculated depreciation and showed the net value of their assets in the balance sheet.	The Court estimated that depreciation of some 430 million euro (£267 million) was not disclosed, leading to a corresponding overstatement in the value of fixed assets.
Disclosure of debtors	
Unlike previous years, the Commission sought to take account of the extent to which amounts owed by Member States in respect of customs duties and agricultural levies were likely to be recovered. For 1999 the Commission assumed that none of the amounts owed would be recovered. In the Court's view this was not realistic and the amount shown for debtors was understated.	Understatement of up to 3 billion euro (£1.9 billion).
In contrast, the Commission took no account of the extent to which amounts owed by sundry debtors were recoverable and made no provision against the risk of these amounts not being recovered in full.	Overstatement of up to 2.4 billion euro (£1.5 billion).
The amount shown in the balance sheet for amounts due to be recovered from farmers and other beneficiaries who had received Common Agricultural Policy payments to which they were not entitled was incomplete because of the omission of data.	Possibly several hundred million euro not disclosed.
In 1999, for the first time, the Commission made a significant attempt to record in the balance sheet amounts transferred to intermediate bodies but not paid over to final recipients. However the amount shown was incomplete and unreliable.	Estimated understatement of several hundred million euro.
Disclosure of commitments	
The figure for commitments included amounts outstanding from before 1998, which had not been subject to any payment during 1998 or 1999. In some cases, the Court considered there was no longer an obligation to make payments.	Estimated overstatement of approximately 940 million euro (£584 million).
The amount shown for commitments was incomplete and did not include all obligations entered into by the Commission.	Understatement of some 2.6 billion euro (£1.6 billion).
Disclosure of provisional payments	
The financial statements did not distinguish between advances and payments on account, and final payments due to a lack of accurate information. The statements also gave no indication of the extent to which most advances had been utilised and paid over to final recipients. These were mostly Structural Fund advances where the extent to which Community funds had been absorbed by expenditure reported in certified declarations was not shown.	Unknown.