

Financial management in the European Union
The European Court of Auditors report for the year 2001



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
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executive summary

- 1 This report summarises the findings of the European Court of Auditors (the Court) for the year 2001 and reviews information provided by the European Commission on key developments to strengthen financial management and control of the General Budget of the European Community¹. It also summarises reported rates of fraud and irregularity, compiled by the European Anti-Fraud Office, and considers some aspects of financial control associated with the forthcoming enlargement of the European Union. This report complements a number of earlier National Audit Office reports on specific aspects of the revenue due and expenditure funded from the Community General Budget in the United Kingdom. The reports published since 1998-1999 are listed in Appendix 1. Recent reports covered issues such as agricultural fraud, the Sheep Annual Premium Scheme and the Arable Area Payments Scheme.
- 2 The European Court of Auditors is required to provide the European Parliament and the Council of Ministers with a Statement of Assurance concerning both the reliability of the accounts drawn up by the Commission and the legality and regularity of the underlying transactions. For the year 2001, the Court drew similar conclusions to previous years and for the eighth year in succession qualified its opinion on the reliability of the Community's accounts. The Court's opinion on the financial statements again emphasised the persistent and on-going weaknesses in the Commission's accounting systems, particularly the lack of reliable information on the completeness of assets held, and recommended that urgent action be taken to address these problems.



- 3 The Court was able to provide assurance on the legality and regularity of the transactions underlying revenue and commitments. It was also able to provide the same assurance on administrative expenditure in the accounts, but not to give assurance on the legality and regularity of other types of expenditure, for example, that incurred under the Common Agricultural Policy or structural measures. Such payments accounted for the great majority of budgetary expenditure (some 94 per cent). The problems identified by the Court in regard to the transactions underlying the accounts were similar to those it had

¹ The European Community developed from the European Coal and Steel Community (ECSC) which was established in 1951; the European Economic Community (EEC) established in 1957 and the European Atomic Energy Community (Euratom), also established in 1957. In 1965 the Merger Treaty created a single set of institutions to run the three Communities and in 1992 the Treaty on European Union was signed in Maastricht and created the European Union, a concept comprising the three European Communities in a political Union, and introducing the term European Community to refer to them.

observed in previous years and were most prevalent at the level of final recipients of European funding, for example, individual farmers and businesses or national, regional and local authorities and other public bodies.

- 4 The Court reviewed the Commission's progress in implementing its strategy of financial management reforms, initiated in March 2000 in the wake of the resignation of the previous Commission in March 1999. The Court noted some progress. In particular, it welcomed the introduction of individual declarations by the heads of the main administrative units within the Commission on the reliability of the financial controls in their areas, which the Court considered offered 'an unprecedented degree of openness as regards accountability for management'. The Court also noted that this was the first year that the Commission had used this approach and there were weaknesses which needed to be addressed in order to improve the consistency and reliability of the declarations.
- 5 In June 2002, the Commission secured approval from the Council for a new Financial Regulation², allowing for greater delegation of financial controls to operational units. Most of its provisions came into force on 1 January 2003, although a provision to establish full accruals accounting is not scheduled to be implemented until January 2005. The main outstanding problems relating to the accounting system are:
 - the Commission currently produces financial statements that include some accrual elements: its balance sheet contains fixed assets, creditors and debtors, but it has not yet set out a comprehensive accounting framework; and
 - the Commission does not have a single integrated computerised accounting system which can generate all the figures for the annual financial statements. It has a centralised system dealing with cash transactions - SINCOM 2 - but information on accruals items cannot be automatically derived from this system and must be compiled from a variety of local management records.
- 6 The number and value of cases of suspected fraud or other irregularity detected and reported by Member States to the Commission in 2001³ was substantially lower than in 2000 with the overall reported number of cases falling from 6,634 to 5,455 and the estimated value falling from €1.1 billion (£678 million) to €0.6 billion (£323 million)⁴. No firm conclusions on trends can be drawn from this because cases of fraud and irregularity tend to be identified unevenly within programmes and reported levels can fluctuate considerably from year to year. By their nature, the reported statistics include only identified fraud and irregularity and cannot take account of other frauds which might exist but which have not been identified. The extent to which the figures reported by the Commission equate to actual levels of fraud against the General Budget is therefore unclear.
- 7 Different practices remain between Member States in reporting fraud and irregularity to the Commission. The European Anti-Fraud Office, commonly known by its French acronym OLAF⁵, has been working with Member States to attempt to resolve this situation but progress remains limited.

² Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the General Budget of the European Communities. Official Journal L248, 16 September 2002.

³ Source: Protection of the Financial Interests of the Communities and Fight Against Fraud - Annual Report 2001, 26 June 2002, COM (2002) 348.

⁴ A conversion rate of €1 = £0.6085 (the exchange rate as at 31 December 2001) has been used in this report.

⁵ Office Européen de Lutte Anti-Fraude (OLAF).



- 8 Ten new Member States are expected to accede to the European Union on 1 May 2004, the largest single enlargement in the history of the Union. Each year since 1997, to inform the accession negotiation process, the Commission has produced an assessment of each Candidate Country outlining their progress against agreed political, economic and administrative criteria. This has included an assessment of the financial control arrangements in each Candidate Country and by October 2002, all the Candidate Countries had provisionally concluded this aspect of their accession negotiations with the Commission. However, the Commission noted that most needed to continue strengthening and implementing new financial control structures in the run up to enlargement in order to meet fully the accepted Community standards⁶.

Conclusions

- It remains a matter of concern that for the eighth year in succession, the Court qualified its opinion on the reliability of the accounts and was also unable to provide positive assurance on the legality and regularity of the transactions underlying the great majority of Community expenditure. The Court highlighted persistent weaknesses in the Commission's accounting system which it considered was not adequately designed to provide assurance that all components of the Community assets were recorded. We endorse the Court's view that the Commission needs to take urgent in-depth action to address these problems.
- The declarations made by each Director General in the Annual Activity Reports offer a significant opportunity to improve accountability in the European Union. The Commission has attached great importance to this work and we support the active approach it has taken towards identifying lessons for improving the content and consistency of the Annual Activity Reports in future years. We agree with the Court's view that to maximise their usefulness, Annual Activity Reports should be made available as soon as possible after the end of the year to which they relate, so that the Court can evaluate them as part of its own audit process and the Commission now intends to do this.
- We welcome the new Financial Regulation approved in June 2002. We note the Commission's intention to introduce full accruals accounting by 1 January 2005, supported by a comprehensive, integrated information technology system. While we are supportive of the Commission's intention, we consider this is a very challenging task for the time available. We recommend that United Kingdom departments and other agencies involved in the administration of European funds play an active role in the technical discussions which will be necessary to agree appropriate accruals accounting treatment for Community activities.
- Different practices continue to exist between Member States in reporting fraud and irregularity to the Commission. We urge the United Kingdom Government to continue to play a full role in influencing other Member States to adopt a pragmatic reporting framework.
- The enlargement of the European Union represents a challenge to both the new Member States and the European Institutions. We recommend that the United Kingdom Government use its influence to ensure that financial management issues continue to be given a high priority in Candidate Countries and the remaining improvements planned for key areas are fully implemented.

6 Source: information in the latest Regular Reports on Progress Towards Accession, published individually for each Candidate Country, by the Commission in October 2002.