



National Audit Office

Financial Management in the European Union

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 480 Session 2007-2008 | 25 April 2008



SUMMARY

1 In 2006, expenditure by the European Union totalled €106.6 billion (£72.7 billion) and its revenue was €108.4 billion (£73.9 billion). The United Kingdom made a net contribution to the European Union of €4.3 billion (£2.9 billion), the highest after Germany.

2 The European Court of Auditors (the Court) published its report on the implementation by the European Commission (the Commission) of the 2006 budget in November 2007. For the thirteenth successive year the Court did not provide a positive Statement of Assurance on the legality and regularity of most European Community expenditure.

3 In January 2005, the Commission made it a strategic objective to strive for a positive Statement of Assurance from the Court. In January 2006 the Commission published an Action Plan setting out a series of measures designed to achieve this objective. In February 2008 the Commission published its final report on the Action Plan, highlighting that most actions are complete but it will take time before they feed through into a measurable impact on error rates.

4 This report continues our practice of recent years of informing the United Kingdom Parliament of the results of the examination of the European Union accounts by the Court and progress on the range of initiatives by the Commission, in cooperation with Member States, to improve financial management and control. The report follows up themes identified by the Committee of Public Accounts in its 2005 report on Financial Management in the European Union, notably the need to simplify European Union programmes and reduce the risk of error. The findings of the report, including progress made by the Commission, are outlined in Appendix 5. This report covers:

- The European Union's budget and the opinion of the European Court of Auditors on the 2006 financial year;
- The performance on the main expenditure areas; and
- Developments in financial management and accountability.

Our methodology is summarised at Appendix 1.

Findings and recommendations

5 The Court's latest report identified some improvements in the financial management of European Union funds in 2006, specifically in the legality and regularity of expenditure. The Court concluded that the accounts were *reliable*, faithfully reflecting revenue and expenditure for the year, but it noted some errors in balance sheet items. It also found that, with respect to some areas^a the underlying transactions taken as a whole were *legal* and *regular*. However, on the main areas of expenditure, the Common Agricultural Policy and Structural Funds, it reported material errors which mean that the underlying expenditure transactions, in some cases, are not *legal* or *regular*.

6 In the Common Agricultural Policy, the Court noted a marked reduction in the overall estimated level of error to a point where it was just above the level at which a positive opinion could be given. The introduction of the Single Payment Scheme and the increasing application of the Integrated Administration and Control System were important factors in the reduction in the rate of error. The Court again found a material level of error in Common Agricultural Policy programmes not covered by the Integrated Administration and Control System or where it was not properly applied.

7 The new Single Payment Scheme replaced eleven previous schemes based on subsidies for production with one single subsidy based on land farmed. Its implementation simplified Common Agricultural Policy expenditure in the ten Member States where it was applied in 2005. A further five Member States implemented this system in 2006. In these early stages, however, the Court's findings included some problems with the United Kingdom's implementation of the Scheme. Some of these issues arose because the United Kingdom's interpretation of the European Regulations differed from that of the Court.

8 We have reported separately on the delays and errors in payment that affected farmers in the United Kingdom during the introduction of the Single Payment Scheme, and the action being taken to address these delays. The Department for Environment, Food and Rural Affairs included provisions totalling some £348 million in its accounts for 2006-07 as an estimate for potential financial corrections arising from: disallowed payments under the Single Payment Scheme for 2005 and 2006 (£221.7 million); and for other schemes administered by the Rural Payments Agency and Devolved Administrations (£126.3 million).

9 The Court concluded that expenditure on Structural Measures projects was subject to material error and reported that at least 12 per cent should not have been reimbursed in 2006 because control systems in the Member States were generally ineffective, or moderately effective and their supervision by the Commission was only moderately effective. The Member States and the Commission are working to improve transparency through the use of annual summaries but, due to the relative complexity of the Structural Measures budget area, achieving a positive Statement of Assurance for this expenditure remains the most challenging component of the budget.

10 The Court highlighted a number of problems with the United Kingdom's management of Structural Measures. The Commission formally suspended payments to six English Regions from April 2007 until it could confirm that control systems were working effectively. Following improvements by the Department for Communities and Local Government, the Commission has since lifted the suspensions on all except the North West Objective 2 and URBAN programmes. The Commission has confirmed a decision to impose a financial correction of some €25 million (£17 million) on the United Kingdom.

^a Revenue; commitments; administrative expenditure; external action payments managed directly by the Commission; and expenditure on pre-accession (with the exception of the Special Accession Programme for Agriculture and Rural Development).

11 The relevant United Kingdom authorities (administering Structural Measures and the Common Agricultural Policy) should ensure that they design and maintain controls that are sufficient and proportionate to meet Commission requirements and minimise the risk to Exchequer funds. They should redouble their efforts to make sure that guidance issued to the relevant public bodies and funding recipients clarifies the scheme requirements and reinforces the importance of carrying out management checks, as appropriate to the individual schemes.

12 The Commission's ability to reduce the level of error on Structural Measures will depend, in part, on how efficiently and quickly it can close older programmes. In the past, the closure of previous period programmes working to one set of rules created additional complexity for Member States and the Commission as they start up programmes working to a new set of rules. The Court noted that at the end of 2006 some €131.6 billion (£89.8 billion) of commitments relating to the 2000-2006 Financial Framework were yet to be paid. The majority of these related to Structural Measures, equivalent to 2.5 years' expenditure at the 2006 spending rate. **United Kingdom departments responsible for distributing monies should work to close the 2000-2006 programmes as quickly as possible to ensure that resources can be focused on bringing programmes in the new Framework into operation.**

13 A number of Member States have indicated their intention to explore some form of enhanced reporting to improve the transparency of the expenditure of European Union Funds to their national parliaments. In November 2006 HM Treasury announced that it would produce an annual consolidated statement on the United Kingdom's use of European Union funds (sometimes referred to as a National Declaration). It expects to publish the first such statement for the period 1 April 2006 to 31 March 2007 in May 2008. The statement will be prepared to international accounting standards and will be audited by the National Audit Office. **HM Treasury, working with officials at United Kingdom Permanent Representation to the European Union, should play a proactive part in exploring options for increasing transparency, in relation to European Union funds, with other Member States.**

14 In May 2006, the European Parliament, the Council and the Commission agreed that the Commission should undertake a fundamental review of the European Union budget, both of expenditure (including the Common Agricultural Policy) and of resources (including the United Kingdom abatement), to report in 2008-2009. **The United Kingdom departments should engage fully with this process with the aim of encouraging further simplification and improving transparency.**

15 Data from the European Anti-Fraud Office (OLAF) showed that the number of irregularities reported to the Commission, including possible fraud, decreased by 7.3 per cent in 2006, but the total value of reported irregularities increased by some 10 per cent to €1,155 million (£788 million). OLAF noted that its estimates depended on the quality of information reported by Member States and should be treated with caution (particularly comparisons across Member States). **HM Treasury should press OLAF and other Member States to develop a consistent arrangement for reporting and recording fraud across the European Community.**

Overall conclusion

16 The Commission, through its Action Plan, and Member States have made progress in strengthening the financial management of European Union funds, most notably for the Common Agricultural Policy. The achievement of a positive Statement of Assurance remains a significant challenge for the future. It is essential to maintain the momentum begun by the Action Plan; this will involve support and cooperation by all the authorities – the European Parliament, the Council of the European Union, the Commission, the European Court of Auditors and the Member States.