National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 34
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11 JUNE 2010

Financial Management in the European Union

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Financial Management in the European Union

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

8 June 2010

This report outlines the key themes influencing performance in the financial management of European Union funds, including complexity and shortcomings in control systems.

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Summary

1 In 2008, expenditure from the European Union budget totalled €116.5 billion and revenues were €125.7 billion. The United Kingdom made a net contribution of €2.8 billion, the fifth largest, following an abatement of €6.3 billion.

2 This report follows our annual practice of updating the United Kingdom Parliament on the efforts being made by the European Commission (the Commission), working with Member States, to strengthen the financial management of the European Union. It represents a compilation of the audit findings of the European Court of Auditors (the Court); information from the European Anti-Fraud Office (OLAF); the results of our own previously published audit findings on the use of European Union money in the United Kingdom; and a review of the various initiatives under way to strengthen financial management.

3 The report outlines the key themes influencing performance in the financial management of European Union funds, including complexity and shortcomings in control systems, and covers:

- the 2008 budget and the Court's audit opinion on the 2008 financial statements (Part One);
- performance on the main expenditure areas and reported incidences of fraud and irregularity (Part Two); and
- initiatives to improve financial management and accountability (Part Three).

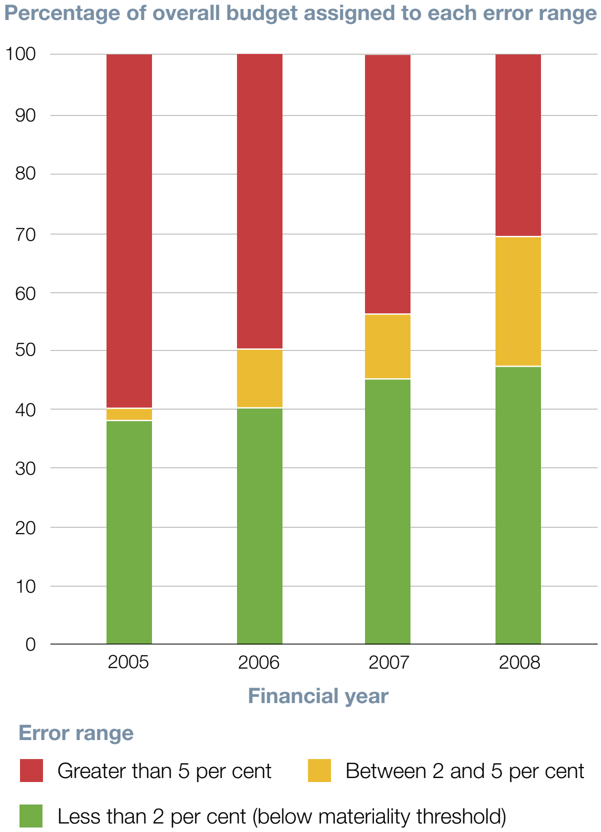
Key findings

4 In November 2009, the Court published its report on the Commission's implementation of the 2008 budget. For the second consecutive year, the Court provided a positive Statement of Assurance, without qualification, on the reliability of the accounts.

5 For the fifteenth successive year, the Court did not provide a positive Statement of Assurance on the legality and regularity of most categories of European Union expenditure. For categories comprising 53 per cent of expenditure, including Cohesion and Rural Development, it reported a material level of error (**Figure 1**). The Court treats as material an error in excess of 2 per cent of total expenditure in that policy area.

Figure 1

The proportion of European Union payments between 2005-2008 affected by the three levels of error assigned by the Court



NOTE

1 The chart represents the percentage of budget according to the relevant error range established by the Court. In the case of the 'Agriculture and Natural Resources' area of the budget, the chart distinguishes between the 'Agriculture' and the 'Natural Resources' components.

Source: The European Court of Auditors' Annual Report for the financial year 2008

Agriculture expenditure – 47 per cent of payments in 2008

6 For the first time, agricultural expenditure achieved a "green" rating with its overall error rate falling just below the 2 per cent materiality threshold. Rural Development, which falls within the overall expenditure on agriculture, continued to contain a higher level of error, above the materiality threshold, but this has fallen since 2007.

7 The Court raised a number of issues specific to the United Kingdom. These arose as a result of the United Kingdom's interpretation of European regulations differing from that of the Court, and from weaknesses with certain elements of the systems holding data used to generate payments. The European Commission did not agree fully with the Court's findings on the United Kingdom's interpretation of regulations and does not necessarily consider the expenditure brought into question by the Court to be irregular.

8 In October 2009, the National Audit Office published a second progress report on the administration of the Single Payment Scheme in England. The report found that while the Department for Environment, Food and Rural Affairs (Defra) and the Rural Payments Agency (RPA) had brought forward the timetable for payments to farmers, progress in recovering overpayments has been slow and the RPA does not have a clear picture of the extent of overpayments, which the National Audit Office estimated to be between £55 million and £90 million.

9 Defra and the RPA included provisions totalling some £247 million in their 2008-09 accounts, a balance brought forward from 2007-08, as an estimate for potential financial corrections arising from disallowed payments under the Single Payment Scheme and other remaining liabilities. During 2008-09, the Commission confirmed disallowance penalties of £92 million, £87 million of which related to Single Payment Scheme predecessors; the National Audit Office qualified the accounts of both Defra and the RPA on the grounds of irregular expenditure.

Cohesion expenditure – 31 per cent of payments in 2008

10 Cohesion projects are designed to reduce disparities in the level of economic, social and infrastructure development between regions. Expenditure on Cohesion continues to be the biggest source of error in the European Union budget. The Court concluded that this area was subject to material error, and reported that at least 11 per cent of the total amount reimbursed by the Commission in 2008 should not have been.

11 The Court tested a sample of supervisory and control systems for recording, reporting and correcting errors found by Member States. It reported ‘unsatisfactory’ elements in five Member States, including the United Kingdom.

12 While expenditure is being incurred on 2007-13 Financial Framework programmes, start-up has been slow. Closure of programmes from previous spending periods is ongoing. There is a risk that Member States will not utilise all European funding available; at the end of 2009, Scotland forfeited £16 million out of £27 million potential European support that it was unable to use within the two-year deadline set by the Council Regulation.

13 In England, the Department of Communities and Local Government, which is responsible for European Regional Development Fund (ERDF) expenditure, included provisions of £75 million in its 2008-09 accounts for potential ineligible grant payments that may be subject to financial corrections. Similarly, in Scotland, there is a provision for £4.3 million. During 2008-09, the Commission confirmed disallowances of £47.3 million in respect of ineligible payments made during the 1994-99 ERDF programmes in the United Kingdom.

14 The Department for Work and Pensions, which is responsible for European Social Fund (ESF) expenditure in England, recognised potential corrections of £38 million for liabilities that could arise as a result of closure procedures for the 2000-06 ESF programme. In Scotland there is a provision for £25.2 million.

Irregularity and fraud

15 Data from the European Anti-Fraud Office (OLAF) showed that the number of expenditure irregularities reported by Member States to the Commission, including possible fraud, increased by 9 per cent to 6,595 in 2008 from 6,047 in 2007, while decreasing in value by 24 per cent to €783 million from €1,024 million in 2007. The increase in number could be the result of: increased audit activity on Cohesion Policy programmes as the 2000-06 Financial Framework closure procedures are due for completion; and a change, in 2008, in the way some data was collected which limits year-on-year comparison, therefore data should be treated with caution. It is not possible to compare how the different Member States are performing due to different practices used at a national level for classifying cases and differences in timeliness of reporting.

16 In 2008, the United Kingdom reported 490 expenditure irregularities (597 in 2007) with a total value of €124 million (€165 million in 2007). For Agriculture the reduction may partly be due to a delay in reporting, reflecting technical difficulties experienced with a new Europe-wide electronic reporting system. For Cohesion, a large amount of additional work was undertaken in 2007 in response to a number of control system weaknesses identified by the Commission which led to an increase in the number of reported cases; it was not necessary to repeat this work in 2008.

Efforts to improve financial management

17 In May 2006, the European Parliament, the Council and the Commission agreed that the Commission should undertake a review of the European Union budget, to report in 2008-09. The fundamental review of the budget is ongoing and offers an opportunity to realign the focus of European support and consider how financial management can be strengthened. The European Council set the Commission a deadline of December 2009 to present the budget review; the review has yet to be published.

18 In December 2008, the Commission published a paper examining the concept of a tolerable risk of error in spending European Union funds. This paper argues that some expenditure areas are inherently more complex than others and therefore more prone to error. It advocates that different levels of materiality should be set for each policy area to reflect the cost of the additional controls that would be required to reduce error levels to acceptable levels. In a report published in June 2009, the United Kingdom Committee of Public Accounts noted its concern that such a proposal would remove the incentive to simplify the rules of European expenditure regimes that it considered essential to improve financial management.

19 In October 2009, HM Treasury published the second audited Consolidated Statement on the use of European Union Funds in the United Kingdom covering the 2007-08 financial year. The audit report was qualified due to uncertainty over the completeness and reliability of data concerning transactions and balances and the inconsistent application of accounting policies across the Devolved Administrations of the United Kingdom. Whilst all entities complied, in all material respects, with reporting requirements in producing their own financial statements, transactions and balances have not always been recorded in a consistent manner for the purposes of the Consolidated Statement. The Netherlands, Denmark and Sweden produce their own versions of a national statement of European Union expenditure.

Conclusion on financial management

20 Over recent years there has been a detectable improvement in the financial management of European Funds across the European Union, most notably in agriculture which, with the exception of Rural Development expenditure, for the first time received a clear audit opinion from the European Court of Auditors for 2008. A series of initiatives have been put in train to deliver further improvements.

21 There remain, however, seemingly intractable problems with reducing the high level of error associated with some significant areas of European Union spending, most notably Cohesion Policy. Whilst controls can be tightened and administration improved, many of the problems can be attributed to the sheer complexity of these programmes, implemented by large numbers of bodies, applying detailed and complex rules to multi-annual programmes that can take years to close-off beyond the end of their planned life. Some changes have been introduced for programmes in the 2007-13 Framework period but it is still too early to judge their likely impact.

22 Weaknesses in the administration of European programmes in the United Kingdom over a period of years continue to have an impact on the taxpayer. During 2008-09, the United Kingdom received confirmation from the Commission of disallowances totalling some £140 million; made provision for further potential disallowances totalling £350 million in their 2008-09 accounts; and reported the potential for liabilities beyond that. This reflects a legacy of weaknesses extending back some years in specific areas, including the Single Payment Scheme in England, but it also illustrates a clear need for United Kingdom bodies to have in place controls over current and future expenditure of European monies that are sufficient to prevent the taxpayer suffering further significant disallowances into the future.

23 Over the next year or so, the European Budget Review and work on developing the Financial Framework, commencing in 2014, will provide a key opportunity to press the case for simplification, creating programmes with clear and measurable objectives that add value, that are simple to apply, and capable of being managed efficiently from start to finish. Departments should press vigorously for substantive improvements to the design of the new programmes.

Recommendations

a **The significant ongoing error rates associated with some elements of European Union expenditure, particularly on Cohesion Policy, are in part a reflection of the sheer complexity of administering these programmes.** In the next year or so the European Commission has a unique opportunity to develop programmes for the years ahead that address the weaknesses that have been evident. United Kingdom departments should develop a clear view on how they wish the main programmes to develop, including the need for clear and measurable objectives that identify the added value to be delivered. From the start they should press for programme design that promotes efficient administration consistent with the achievement of the objectives.

b **The number and value of irregularities for each policy area reported to the European Anti-Fraud Office (OLAF) varies significantly for each Member State from year to year.** Differences in recording practices amongst Member States and incomplete data reported to OLAF hinder any attempt to draw comparisons over time and between Member States. These weaknesses have persisted for some years. The United Kingdom Government should encourage OLAF to make known, alongside its published figures, where it has concerns about the quality and timeliness of the information submitted by individual Member States.

c **The United Kingdom was subject to financial corrections of £140 million imposed by the Commission during 2008-09 and has provisions for £350 million more.** It is not acceptable that departmental mismanagement reduces the funding available from the European Union and places an additional burden on Exchequer funds. HM Treasury should take a stronger lead in encouraging the effective financial management of European funds. In doing so it should set departments targets over the coming years to reduce the level of financial corrections with the ultimate target as close to zero as practicable.

Part One

The European Union budget and the opinion of the European Court of Auditors

1.1 This Part summarises the European Court of Auditors' main conclusions on the consolidated financial statements of the European Communities for the year ended 31 December 2008.

The European Union budget

1.2 The 2008 financial year covered by the Court's report is the second year of the 2007-13 Financial Framework (see Appendix Two). Each Framework sets out the budgetary priorities agreed between the European Parliament, the Council of the European Union and the Commission and usually operates for a defined seven-year period. The 2000-06 Framework has ended, but the closure of projects and related expenditure within it will not be completed until 2010.

1.3 In 2008, the final budget for payments was €125.7 billion (£99.9 billion)[1], a 4.7 per cent increase on the final budget in 2007, with actual expenditure of €116.5 billion (£92.6 billion) as shown in Figure 3. Any year end surpluses are returned to Member States. Background to the 2008 budget and more details of the European Union's budgetary process are provided at Appendix Two.

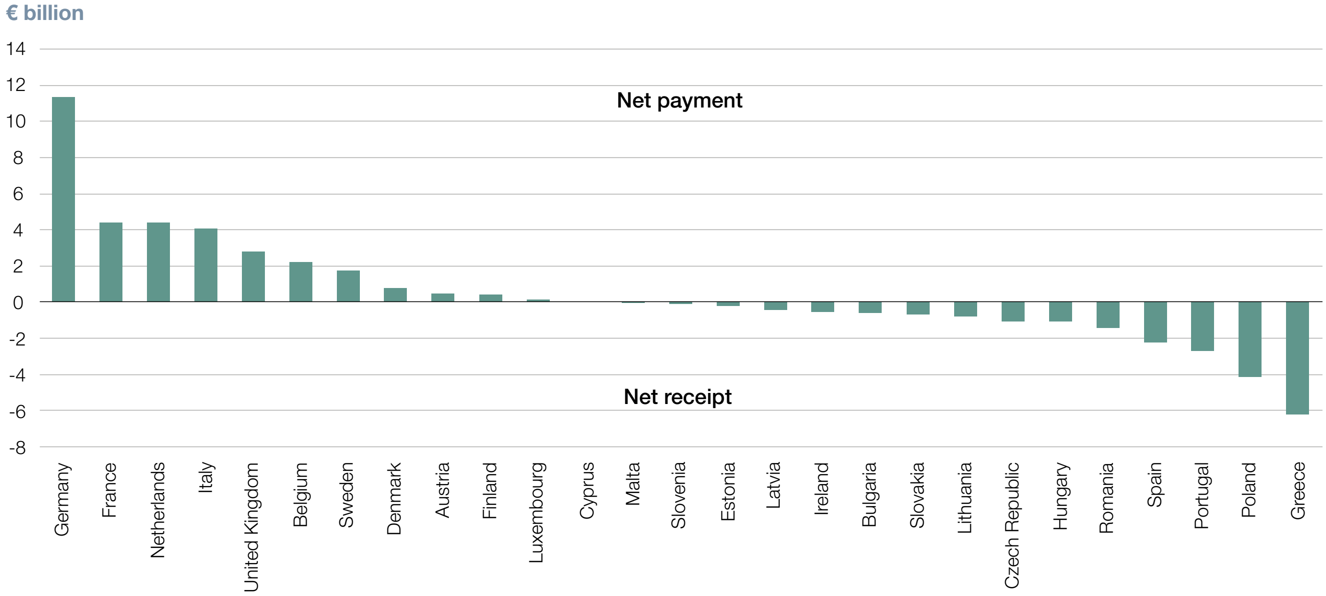
1.4 In 2008, the United Kingdom made a gross contribution of €10.1 billion (£8.0 billion) to the European Union budget. Its net contribution of €2.8 billion[2] (£2.2 billion) was the fifth largest, compared to €6.1 billion (£4.9 billion), the second largest, in 2007 (see **Figure 2**).

1.5 The United Kingdom's net contribution reflected an abatement of €6.3 billion (£5.0 billion), larger than previous years. In 1984, the United Kingdom secured an abatement from the European budget as it received fewer funds than other wealthier nations. In December 2005, the Council of the European Union concluded that the abatement should be adjusted in order for the United Kingdom to contribute fully to the enlargement of the European Union. The total reduction in the abatement arising from this adjustment over the 2007-13 Financial Framework has been capped, in 2004 prices, at €10.5 billion (£8.3 billion).

1 This, and all figures in this report, has been converted at the 2008 average exchange rate of €1 = £0.795223. The use of a constant exchange rate aids comparisons between different periods.

2 This figure comprises a calculated payment to the European budget of €16.4 billion less the abatement of €6.3 billion resulting in an actual contribution to the budget of €10.1 billion. Receipts from the European budget totalled €7.3 billion resulting in a net contribution of €2.8 billion.

Figure 2
Net Receipts/Payments for 2008 (€ billion)



Source: Data from the European Court of Auditors' Annual Report for the financial year 2008

The Court's Statement of Assurance on 2008 accounts

1.6 The Court published its report on the Commission's implementation of the 2008 budget in November 2009. For the second consecutive year, the Court provided a positive Statement of Assurance, without qualification, on the reliability of the accounts, but for the fifteenth successive year the Court did not provide a positive Statement of Assurance on the legality and regularity of most European Union expenditure. For an overview of the Court's methods and definitions of reliability, legality and regularity, see Appendix Two.

1.7 On the reliability of the accounts, the Court concluded that they give a fair presentation, in all material respects, of the financial position of the European Union and the results of its operations and cash flows.

1.8 The Court's assessment on the legality and regularity of the transactions underlying the accounts was as follows:

a Revenue, commitments and payments for 'Agriculture and Natural Resources' (with the exception of Rural Development), 'Administrative and other expenditure', 'Economic and Financial Affairs' (with the exception of some research expenditure[3]), and 'Education and Citizenship' were free from material error (the Court defines a material error as above 2 per cent of expenditure).

3 Within the 'Economic and Financial Affairs' area, expenditure on the 'Sixth Framework Programme for research and technological development' accounted for a disproportionately large part of the overall error rate.

b The Court identified three areas of expenditure that were materially affected by errors: Cohesion; Research, Energy and Transport; and External Aid, Development and Enlargement.

1.9 The Court's findings on the legality and regularity of underlying transactions in each expenditure area, and the results of control systems testing, are shown in **Figure 3**.

Figure 3

European Union expenditure in 2008 and the Court of Auditors' assessment of error levels and functioning of controls

Policy area	Payments € million	Share of total expenditure (%)	Cumulative total (%)	Errors found through substantive testing	Functioning of supervisory and control systems
Agriculture and Natural Resources	55,115	47.3	47.3	🟢[1]	🟡
Cohesion	36,597	31.4	78.7	🔴	🟡
Administrative and Other expenditure	8,583	7.4	86.1	🟢	🟢
Research, Energy and Transport	7,517	6.4	92.5	🟡	🟡
External Aid, Development and Enlargement	6,323	5.4	97.9	🟡	🟡
Education and Citizenship	1,735	1.5	99.4	🟢	🟡
Economic and Financial Affairs	621	0.5	100.0	🟡	🟡
Operational expenditure on Revenue area	54	0.05	100.0	🟢	🟢
Total	**116,545**	**100.0**	**100.0**		

Key

Error range[2]

🟢 Less than 2 per cent (below materiality threshold) 🟡 Between 2 and 5 per cent 🔴 Greater than 5 per cent

Functioning of supervisory and control systems

🟢 Effective 🟡 Partially effective[3] 🔴 Not effective

NOTES

1 For expenditure on Rural Development the estimated level of error is above 2 per cent.

2 The error range cannot be interpreted as a confidence in a statistical sense. It is the Court's division of the scale of error rates into three intervals.

3 Systems are classified as 'partially effective' where some control arrangements have been judged to work adequately whilst others have not. Consequently, taken as a whole they might not succeed in restricting errors in the underlying transactions to an acceptable level.

Source: The European Court of Auditors' Annual Report for the financial year 2008

Part Two

Performance on the main expenditure areas and combating fraud

2.1 This Part summarises the main activities and results in the areas of:

a Agriculture and Natural Resources;

b Cohesion; and

c Fraud, irregularity and the work of OLAF.

Agriculture and Natural Resources

2.2 Representing 47 per cent of payments made in 2008, Agriculture was the largest component of European Union expenditure. The majority of Agriculture expenditure was made primarily from two funds:

- The European Agricultural Guarantee Fund (EAGF), 78 per cent in 2008 – which provides support for the agricultural sector through direct aid and intervention measures, primarily through the Single Payment Scheme.
- The European Agricultural Fund for Rural Development (EAFRD), 19 per cent in 2008 – which encourages rural development, such as investment in farm holdings and infrastructure in rural areas, as well as schemes to encourage farmers to manage their land in an environmentally-friendly way.

The Court's overall findings on Agriculture

2.3 The Court reported that the estimated level of error on Agriculture expenditure as a whole fell from levels found in previous years. For the first time the error rate fell below the 2 per cent level at which the Court sets materiality. Within this total, the Rural Development component error rate, as in previous years, exceeded 2 per cent.

2.4 Based on its audit work, the Court concluded that most of the supervisory and control systems in this policy area are partially effective in ensuring the regularity of payments. The Court found that while the Integrated Administration and Control System (IACS), which seeks to ensure accurate payments to registered parcels of land, is generally an effective control system for limiting the risk of error or irregular expenditure, significant improvements are necessary in paying agencies examined in Bulgaria, Romania and Scotland.

On the European Agricultural Guarantee Fund

2.5 The Single Payment Scheme is the principal agricultural subsidy scheme with €28 billion of payments in 2008 (€28 billion in 2007), representing 51 per cent of total Agriculture expenditure.

2.6 The Court audited the reliability of the supervisory and control systems applicable to Single Payment Scheme claims in selected paying agencies from four Member States, including Scotland (see **Figure 4**). For Scotland the overall assessment was that controls were not effective, an assessment not fully shared by the Commission. More detail on the limitations that led to the Court's reservations are set out in **Figure 5**.

2.7 The Court also audited a sample of 151 transactions and found 42 were affected by error. The principal weakness detected by the Court related to the over-declaration of area claimed by applicants, leading to overpayment.

Figure 4

Assessment of supervisory and control systems – Integrated Administration and Control System monitoring elements – Single Payment Scheme

Member State	Expenditure € million	Administrative procedures and controls to ensure correct payment including quality of databases	On-the-spot inspection methodology, selection, execution, quality control and reporting of individual results	Implementation and control of GAEC[1]/ Cross-compliance[2]	Overall assessment
United Kingdom – Scotland	579	Not effective	Effective	Not effective	Not effective
Belgium – Wallonia	230	Partially effective	Effective	Effective	Partially effective
Spain – Catalunia	178	Partially effective	Effective	Partially effective	Partially effective
Slovenia	49	Partially effective	Effective	Effective	Partially effective

Key

Functioning of supervisory and control systems

Effective   Partially effective   Not effective

NOTES

1 Good Agricultural and Environmental Condition (GAEC) measures provide a baseline of environmental protection for soils, habitats and landscape features.

2 Cross-compliance requirements, of which GAEC are a part, are a set of conditions which those in receipt of agricultural support must adhere to.

Source: The European Court of Auditors' Annual Report for the financial year 2008

Figure 5
The Court's findings on the Single Payment Scheme in the United Kingdom

The Court examined the reliability of the supervisory and control systems applicable to EAGF in Scotland and found important failures in the application of key elements of the Integrated Administration and Control System (IACS). The Court considers that in Scotland, IACS is not effective in ensuring the regularity of payments. The Commission responded that it does not consider that these deficiencies render IACS ineffective in Scotland.

Quality of information contained within the Land Parcel Identification System (LPIS): the LPIS was found to have more than 12,000 overlapping reference land parcels resulting in double payments for around 15,000 hectares (representing 0.3 per cent of the 4.5 million hectares declared) in claim year 2007. The Commission responded that while the overlap of reference parcels is very limited, an analysis of the potential financial consequences is being carried out.

Potential overshoot of the United Kingdom ceiling for Single Payment Scheme entitlements[1]: Member States must stay within an overall entitlement ceiling determined by the European Commission. The United Kingdom divides its national ceiling[2] for allocation of entitlements into four sub-ceilings, one for each country. While the Scottish sub-ceiling was exceeded by €25.4 million, the Rural Payments Agency (England) reported to have stayed considerably below its sub-ceiling resulting in an overall reported United Kingdom overshoot of only €2.8 million (0.1 per cent of the national ceiling). The Court was unable to verify the total value of entitlements for the Rural Payments Agency because it found the database to be unreliable – incomplete, inaccurate and outdated with more than 1,200 cases of entitlements containing discrepancies awaiting clarification. The Commission reported that the issue is being followed up.

Incorrect aid calculation: The area determined was insufficient for activation of all entitlements claimed or where the farmer did not declare all set-aside[3] entitlements held. The Commission responded that it is aware of the problems related to the calculation of payments and that these are being addressed.

Disagreement about the definition of what is required to maintain land in good agricultural and environmental condition (GAEC): Scottish authorities allowed Single Payment Scheme claims for rough grazing land that requires no farming activity or any work by the beneficiary to keep it in GAEC. Some claimants rented large tracts of land at very low rates to activate high-value entitlements purchased, without carrying out any agricultural activities on the land. The Court states that these beneficiaries do not meet the definition of 'farmers' and that payments should not be made to beneficiaries for whom it is established that they artificially created the conditions required for obtaining payments. The Commission responded that there is no obligation for Member States to impose grazing or mowing as the Court suggests in the example for Scotland. As regards the GAEC, it is up to the Member State to define the criteria.

NOTES

1 Ownership of entitlements gives farmers the right to claim agricultural aid payments in respect of the land they farm. One entitlement, together with one hectare of land declared by the farmer and kept in good agricultural and environmental condition, gives rise to a payment under the Single Payment Scheme.

2 The national ceiling is the maximum amount a Member State is permitted to pay to farmers in total as set by the Commission.

3 Set-aside is farmland that is removed from agricultural production.

Source: The European Court of Auditors' Annual Report for the financial year 2008

On the European Agricultural Fund for Rural Development

2.8 Expenditure on Rural Development was some €11 billion in 2008 (€12 billion in 2007). The Court tested the supervisory and control systems for this expenditure in seven Member States. The United Kingdom was not one of these. The Court found that the systems are 'partially effective' in ensuring the regularity of payments.[4]

2.9 The Court audited a sample of 42 transactions and found 17 were affected by error. The principal weaknesses detected by the Court relating to the accuracy of payments were: incorrect calculation of eligible costs and of the amount payable; over-declarations of area claimed; and payments at rates other than those set out by Community rules. Concerning eligibility, the Court found breaches of specific conditions attached to the aid for agri-environmental (see paragraph 2.16) and forestry measures; and ineligible areas claimed under agri-environmental measures.

The position in the United Kingdom

2.10 Although the Court's report draws upon findings from audit work in individual Member States, it does not seek to provide an opinion on a country-by-country basis. It is therefore not possible to compare performance across Member States. This section draws on the Court's findings specific to the United Kingdom, the annual reports of the United Kingdom organisations responsible for European expenditure and the work of the National Audit Office.

2.11 The Court's testing in the United Kingdom identified a number of weaknesses (Figure 5) that have the potential to lead to disallowance penalties should the Commission determine that payments did not adhere to scheme regulations.

2.12 The Rural Payments Agency (RPA) has responsibility for administering farming subsidy and support schemes in England. When the Single Payment Scheme was introduced in 2005, the Agency initially experienced considerable difficulties in capturing and processing the data required to make payments under the Scheme. Failure to comply with Commission rules exposes the United Kingdom to the risk of financial penalties. The Commission, in March 2010, proposed a correction totalling some £110.7 million for the United Kingdom's payments under the Single Payment Scheme in 2005 and 2006 in England.

4 The results of this testing can be found in the *European Court of Auditors' Annual Report for the financial year 2008*, Page 116.

2.13 For the financial year 2008-09, the financial statements of both the RPA and Defra were qualified due to matters relating to European Agriculture payments, including:[5]

a irregular expenditure: having to fund European schemes with Exchequer monies due to disallowance penalties totalling £92 million, of which £87 million related to Single Payment Scheme predecessor schemes (see Appendix Three); and

b limitation of scope as there was such a degree of uncertainty on the level of overpayments in respect of the Single Payment Scheme that the Comptroller and Auditor General was not able to obtain assurance over the balance of the overpayments.

2.14 In 2009, in England, the Scheme paid some £1.8 billion to farmers. Defra's 2008-09 accounts contains: a provision of £247 million as a year end balance for potential disallowance across multiple years on the Scheme and other potential remaining liabilities (a reduced balance brought forward from the 2007-08 accounts); and a substantial, but unquantified, contingent liability. These represent monies the European Commission could require the United Kingdom to return as it was not spent in accordance with Commission regulations; any penalties will be met by Exchequer funds. Paragraphs 2.15 and 2.16 outline our value for money findings on Defra's management of two agricultural schemes. Provisions and contingent liabilities of Defra and the Devolved Administrations are set out in full in Appendix Three.

2.15 In October 2009, the National Audit Office published a second progress update on the administration of the Single Payment Scheme.[6] The report found that the speed of making payments to farmers had improved with over 96 per cent of 2008 payments made by mid-May 2009, compared with 80 per cent by the same month for the 2006 scheme. However, the IT system did not meet the scheme's needs, the cost of processing claims, already high, had continued to rise and the administration of the scheme was not value for money. Progress in recovering overpayments had been slow and the RPA did not have a clear picture of the extent of overpayments, which the National Audit Office estimated was likely to be between £55 million and £90 million.

2.16 In March 2010, the National Audit Office published a report on Defra's organic agri-environment scheme[7], where farmers receive annual payments in return for managing their land in ways that will protect or enhance the natural environment or historic landscape. Over its lifetime the scheme will spend some £200 million, funded jointly by Europe and the United Kingdom. The report concluded that the Department had not optimised the value for money achieved from the European funding available for the Scheme.

5 The full qualification can be found in the Report of the Comptroller and Auditor General to the House of Commons in the Defra Resource Accounts 2008-09.

6 HC 880 – *A Second Progress Update on the Administration of the Single Payment Scheme by the Rural Payments Agency* (15 October 2009).

7 HC 513 – *Defra's organic agri-environment scheme* (31 March 2010).

Cohesion Policy

2.17 In 2008, expenditure on the Cohesion Policy area was €36.6 billion (£29.1 billion), making it the second largest component of the European Union's budget. €11.8 billion of payments were to 2007-13 projects while €24.8 billion were to 2000-06 projects.[8]

2.18 Cohesion projects are designed to reduce disparities in the level of development between regions. In 2008, the majority of Cohesion payments were made from three funds:

- The European Regional Development Fund (ERDF) – 59 per cent.
- The European Social Fund (ESF) – 24 per cent.
- The Cohesion Fund – 16 per cent.

2.19 In accordance with European regulations, projects are co-financed by the Commission and the Member States, which often use a combination of public and private funds. The Court noted that at the end of 2008 there were some €103 billion of Commission funds that had been earmarked for Cohesion Policy projects for use by the end of 2008 which had not been requested by Member States; €73.8 billion for 2007-13 projects and €29.3 billion for 2000-06 projects. This represents 2.9 years worth of payments at the 2008 spending rate.

2.20 Within each Member State, each programme is implemented by a Managing Authority, which is responsible for the overall management and monitoring of the programme. A Certifying Authority certifies expenditure and submits applications for reimbursement to the Commission. **Figure 6** shows how the arrangements work in England for the two largest Funds.

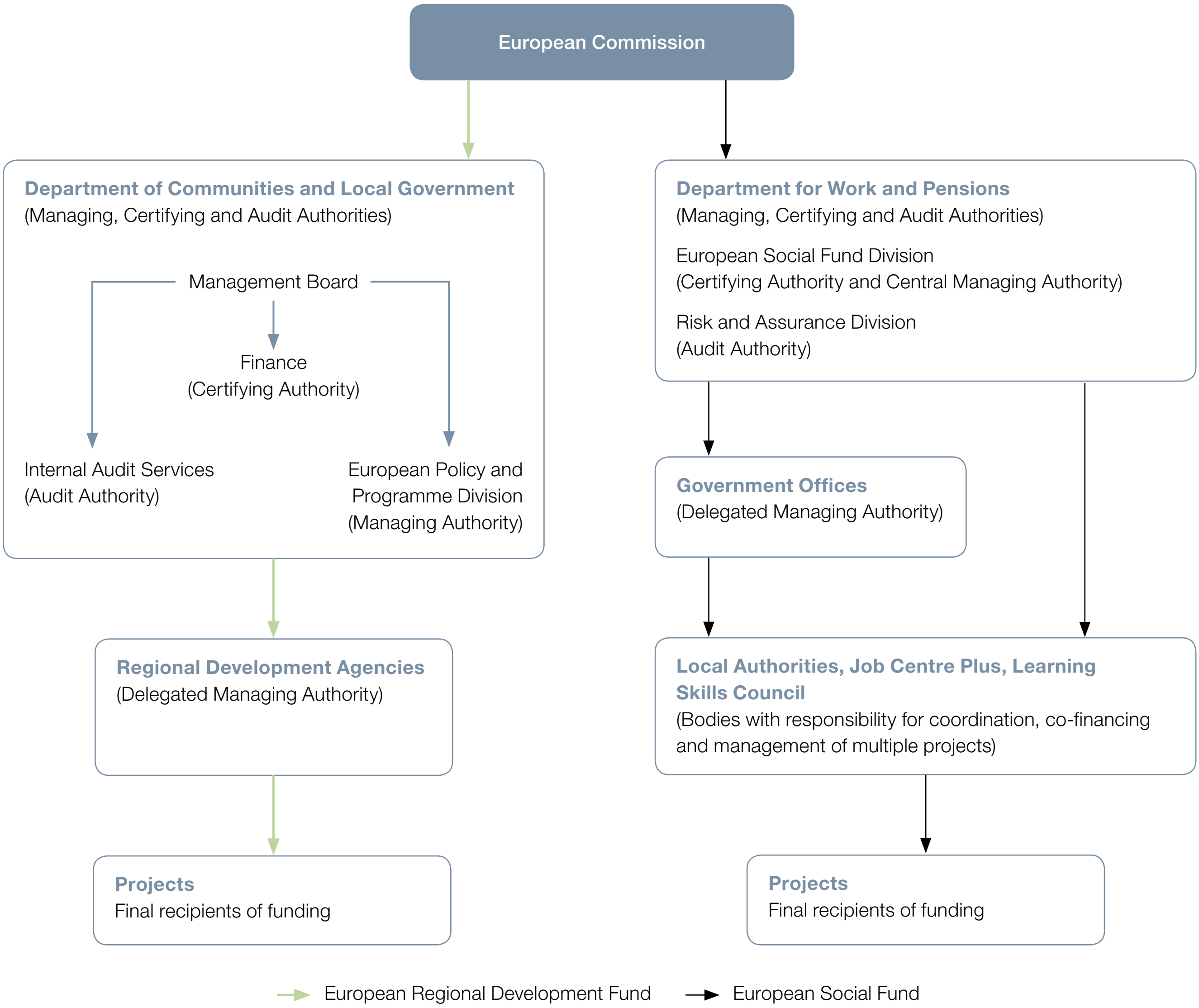
2.21 For the 2007-13 Financial Framework, Member States must submit a description and independent compliance assessment of the management and control systems in place, within 12 months of programme approval. This must be approved by the Commission before reimbursements for actual expenditure are made. The Court found that the Commission had carried out its approval procedures within the deadlines set but Member States had submitted their systems description and compliance assessment late in 38 per cent of cases. Late submissions, leading to delayed approvals, could increase the probability that the control systems do not prevent and detect errors at the start-up phase.

2.22 The Audit Authority for the programme in the Member State must present an audit strategy within nine months of programme approval. By the end of 2009, the Commission had received strategies for 98.6 per cent of approved programmes.

2.23 In the interim, pre-financing payments, which require no claim for actual expenditure, are made by the Commission to enable the start-up of projects. In 2008, €11.7 billion of the €11.8 billion Cohesion payments to 2007-13 projects were pre-financing.

8 The balance of Cohesion expenditure is made up of amounts that do not constitute project funding, for example administrative costs.

Figure 6
Responsibilities for managing 2007-13 Cohesion Policy programmes in England



Source: Department of Communities and Local Government and Department for Work and Pensions

The Court's overall findings on Cohesion Policy

2.24 Funding for individual Cohesion projects can be spread over several years and scheme regulations allow projects to continue receiving funding after the end of the Financial Framework in which they started. Payments in 2008 for 2000-06 projects totalled €24.8 billion, compared to an estimate of €16.3 billion. For the purposes of legality and regularity testing, the Court only selected payments relating to the 2000-06 Financial Framework since little 2007-13 programme expenditure had been declared for reimbursement (paragraph 2.23).

2.25 The Court found that the reimbursement of Cohesion Policy expenditure in 2008 was subject to material error. Consistent with 2007, it reported that at least 11 per cent of the total amount reimbursed to Cohesion projects should not have been. It found 43 per cent of the 170 reimbursements tested were affected by legality and regularity errors, down from 54 per cent in 2007.[9]

2.26 The most frequent causes of incorrect reimbursements were eligibility errors, arising from payments or beneficiaries not meeting specific funding conditions, serious failures to respect procurement rules, and inclusion of costs that are not reimbursable.

2.27 The Court tested a sample of 16 supervisory and control systems for processing detected errors and reporting corrections to the Commission (see **Figure 7**); it reported 'unsatisfactory' elements in the audited systems of five Member States, including the United Kingdom. The least satisfactory aspect of the systems across all Member States tested was the reporting of corrections to the Commission. Deficiencies in reporting data on irregularities to the European Anti-Fraud Office (OLAF) are discussed in paragraph 2.46.

2.28 In 2008, the value of proposed financial corrections, due to ineligible expenditure, relating to 2000-06 Cohesion Policy programmes increased to €1,169 million from €220 million in 2007.[10] Member States which identify ineligible expenditure themselves may remove it from claims to the Commission without penalty and replace it with eligible expenditure which has not previously been declared. Member States removed and replaced around 56 per cent of the €1,169 million proposed financial corrections.

2.29 In 2008, the Commission adopted 'An action plan to strengthen the Commission's supervisory role under shared management of structural actions'. The Commission reported progress in February 2010[11] and concluded that it had strengthened its capacity to supervise 'structural actions under shared management' and had taken vigorous measures to address outstanding recommendations made by the Court. In its report, the Commission outlines a sampling exercise it conducted to assess error rates in the reimbursement of 2007-13 Cohesion programmes up to May 2009 in 15 Member States; it suggests a prudent interpretation of the findings but observes that they indicate its actions are moving error rates in the right direction.

9 The Court picked a representative sample of payments for testing from the 2000-06 period. The value of the payments tested was €24.8 billion of which 11 per cent was found to be in error.

10 The cumulative amount of financial corrections relating to the 2000-06 period as a result of the Commission's supervisory actions is €3.3 billion.

11 European Commission – Impact of the action plan to strengthen the Commission's supervisory role under shared management of structural actions (18 February 2010).

Figure 7

Assessment of selected supervisory and control systems – Systems related to recoveries and corrections at the Member State level

	Recording of errors	Correction of errors	Recording of corrections	Correction reporting to the Commission	Irregularity reporting to OLAF
The European Regional Development Fund					
Greece – Epirus	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
INTERREG – Germany/Poland – System Germany	Partially satisfactory	Satisfactory	Partially satisfactory	Unsatisfactory	Satisfactory
INTERREG – Germany/Poland – System Poland	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
INTERREG Spain/Portugal	Partially satisfactory	Partially satisfactory	Satisfactory	Satisfactory	Partially satisfactory
Italy – Calabria	Partially satisfactory	Partially satisfactory	Partially satisfactory	Partially satisfactory	Partially satisfactory
Italy – Puglia	Unsatisfactory	Unsatisfactory	Unsatisfactory	Unsatisfactory	Unsatisfactory
Spain – Andalusia	Partially satisfactory	Partially satisfactory	Satisfactory	Partially satisfactory	Satisfactory
Poland – Competitiveness	Partially satisfactory	Satisfactory	Partially satisfactory	Partially satisfactory	Satisfactory
Portugal – Accessibility and transport	Satisfactory	Satisfactory	Partially satisfactory	Partially satisfactory	Satisfactory
Spain – objective 1	Unsatisfactory	Unsatisfactory	Unsatisfactory	Unsatisfactory	Unsatisfactory
United Kingdom – Cornwall objective 1	Satisfactory	Unsatisfactory	Unsatisfactory	Partially satisfactory	Unsatisfactory
The European Social Fund					
Belgium – Hainaut	Satisfactory	Satisfactory	Partially satisfactory	Unsatisfactory	Satisfactory
France – objective 3	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Greece – Competitiveness	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Netherlands – objective 3	Satisfactory	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Sweden – objective 3	Satisfactory	Satisfactory	Satisfactory	Partially satisfactory	Satisfactory

Key

Functioning of supervisory and control systems

Satisfactory Partially satisfactory Unsatisfactory

Source: The European Court of Auditors' Annual Report for the financial year 2008

The position in the United Kingdom

2.30 The Court carried out testing in England on the 2000-06 Cornwall objective one programme.[12] It found that while the systems for recording errors were satisfactory, reporting corrections to the Commission was only partially satisfactory and correction of errors, correction recording, and reporting, of irregularities to OLAF were unsatisfactory. In September 2009, the Commission concluded that, following changes implemented by the Department of Communities and Local Government (DCLG), the situation for correcting errors and reporting corrections to the Commission had improved considerably and is now acceptable.

12 Objective one programmes target the structural adjustment of regions whose development is lagging behind.

2.31 There are 10 European Regional Development Fund programmes under way in the United Kingdom for the 2007-13 period, worth €3.2 billion. Although the Euro value of the programmes remains the same, as projects are paid in Sterling, changes in the exchange rate mean that an additional £144 million was available over 2009-10.

2.32 European regulations require that expenditure under the European Regional Development Fund is declared to the Commission by 31 December of the second year following the year of budget commitment otherwise the potential funding is withdrawn.

2.33 Member States across Europe have struggled to identify sufficient partner organisations willing to provide co-financing for projects (see paragraph 2.19). As a result of this problem, at the start of 2010, against a maximum £27 million Cohesion Policy funding available to one Scottish programme, some £16 million was withdrawn by the Commission. In 2008-09, DCLG reported an underspend against its Departmental budget estimate relating to 2007-13 European support schemes of £62.2 million due to delays in programme start-ups. As this is the Department's own estimate, the funding does not yet stand to be lost under the two-year rule as there is still opportunity for the Department to spend these funds.

2.34 In March 2009, the Commission confirmed financial corrections of £24.6 million would be imposed on DCLG, as Managing Authority for ERDF funds in England, for irregularities relating to 1994-99 ERDF programmes. A further £22.7 million of financial corrections for 1994-99 ERDF programmes were confirmed for the Devolved Administrations. DCLG has included provisions totalling £74.5 million in its 2008-09 Resource Accounts for potential irregularities relating to 2000-06 ERDF payments as well as contingent liabilities of £215.1 million. Financial corrections confirmed by the Commission will be met by the Exchequer. The provisions and contingent liabilities are covered in Appendix Three.

2.35 The Department for Work and Pensions included a contingent liability of £38 million in its 2008-09 Resource Accounts to cover potential financial corrections that result from the closure of 2000-06 European Social Fund programmes in England. An unquantified contingent liability was also disclosed.

European Economic Recovery Plan

2.36 In December 2008, the European Council agreed on a European Economic Recovery Plan to provide a coordinated fiscal stimulus package of around €200 billion in response to the global economic crisis, consisting of €170 billion worth of stimulus measures from Member States, and European Union funding of €30 billion. The European Union's financial contribution is based mainly on bringing forward and re-prioritising existing spending commitments, while also increasing the volume of loans available from the European Investment Bank.

2.37 The strategic aims of the Recovery Plan are to:

- swiftly stimulate demand and boost consumer confidence;
- lessen the human cost of the economic downturn and its impact on the most vulnerable;
- prepare Europe to take advantage when growth returns so that the European economy is in tune with the demands of competitiveness and the needs of the future; and
- speed-up the shift towards a low-carbon economy.

2.38 As part of the Recovery Plan, €4 billion has been made available for investment in energy infrastructure projects. By December 2009, the Commission had approved some €300 million investment in energy infrastructure projects in the United Kingdom. An additional €200 million will be shared by the United Kingdom and other Member States for regional energy projects. The House of Commons European Scrutiny Committee raised concerns over the lack of an Impact Assessment, but recognised that there were political pressures and that the projects appeared to be worthwhile. The Government gave assurances that it would press for a thorough assessment of individual projects before they were selected.

Fraud and irregularity, and the work of OLAF

2.39 The role of the European Anti-Fraud Office (OLAF) is to fight fraud, corruption, and other illegal activity that has financial consequences for the European Union. It is part of the Commission, but is autonomous in its investigative role. OLAF reports annually on the number and value of irregularities and suspected frauds notified by Member States and on the results of its internal and external investigations. The budget for OLAF activities in 2008 was just over €74 million.

2.40 It is important to distinguish between fraud and irregularity. Irregularities are transactions that have not complied with all of the regulations that govern European Union income and expenditure, and may be intentional or unintentional. Fraud is an irregularity that is committed intentionally and constitutes a criminal act.

Irregularities and suspected fraud reported in 2008

2.41 Member States are required to notify the Commission of irregularities, including possible frauds, that are detrimental to the European Union's financial interests. In 2008, Member States notified the Commission of 11,939 irregularities (2007: 12,144) with a total value of €1,134 million (2007: €1,425 million) of which some €152 million (2007: €340 million) was estimated as suspected fraud (Appendix Four).

2.42 While the total number of irregularities reported to the Commission remained relatively stable compared with 2007, the total value of reported irregularities decreased by some 20 per cent. The biggest decrease came in the Structural Funds sector where the value of reported irregularities fell to €585 million in 2008 from €804 million in 2007. OLAF has noted that it is difficult to explain this decrease, particularly given the increase in the number of cases. Often, a few high value cases can impact on the overall value of irregularities.

2.43 For the 2008 financial year, Member States recovered: €125 million for reported Agriculture sector irregularities leaving €1,254 million yet to be recovered (€31 million relating to the United Kingdom); €110 million for reported Structural Fund irregularities leaving €1,743 million to be recovered (€257 million relating to the United Kingdom); and €132 million of the €351 million Own Resources irregularities detected in 2008 (€69 million of the remaining €219 million relating to the United Kingdom).

2.44 In 2008, the United Kingdom reported 1,513 irregularities (including possible fraud) totalling €222 million, a decrease from 2007 of 9 per cent by number and 21 per cent by value (see Appendix Four). The decrease for the United Kingdom is partly due to technical difficulties with reporting Agriculture irregularities (paragraph 2.47). A complete analysis of the value of suspected fraud reported by each Member State is not published.

2.45 While the United Kingdom reports a relatively high number and value of transactions affected by irregularity (see Appendix Four), OLAF is unable to report whether this is due to a higher volume of irregularities in the United Kingdom, or more comprehensive irregularity reporting compared to other Member States.

2.46 OLAF's statistical assessment of irregularities is influenced by the timeliness and accuracy of the Member States' reporting. OLAF has noted, for some years, that the recording practices of the national administrations vary, and that data communicated by Member States is sometimes incomplete. OLAF continues to warn that its figures should therefore be interpreted with caution, and that no simple conclusion can be drawn about the geographical distribution of fraud. More meaningful comparisons can be made year-on-year for individual Member States.

2.47 In 2008, a new online reporting system, the Irregularity Management System (IMS), was introduced. IMS became fully operational for agriculture from the summer of 2009 (after a successful pilot in Germany) and is due to go live for the Cohesion Policy area in mid 2010. This should reduce the period between irregularities being detected by Member States and reported to OLAF which in 2007 averaged 1.2 years. The United Kingdom has not been able to report agricultural irregularities using IMS due to computer software compatibility issues. This does not appear to be affecting any other Member State.

Part Three

Developments in financial management and accountability

3.1 The Commission and Member States have taken a range of actions to address the ongoing weaknesses in financial management. This Part examines progress on some of the key initiatives, in particular it looks at:

a the fundamental review of the European budget;

b the Lisbon Treaty;

c tolerable risk of error;

d simplification of regulations; and

e the preparation of the Consolidated Statement on the use of European Union funds in the United Kingdom.

a The fundamental review of the European budget

3.2 In May 2006, the European Parliament, the Council and the Commission agreed that the Commission should undertake a 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 2008-09.

3.3 This fundamental review provides the Commission with an opportunity to align the budget with the aims set out in the Lisbon Treaty as well as building on the strategic aims contained within the European Economic Recovery Plan. In November 2008, the Commission publicised the themes emerging from its initial stakeholder consultation:

- Agriculture spending requires reform;
- Cohesion Policy expenditure should concentrate on the less developed Member States and regions, focusing on economic convergence whilst responding to global challenges; and
- the budget requires increased transparency, a simplified structure and greater flexibility.

3.4 The Commission was expected to produce a paper in late 2009, to present to the European Parliament and Council that brought together the main themes identified during the consultation process. The paper was not published. A new Commission took office on 9 February 2010 and will serve for five years, and a budget review paper is expected in the third quarter of 2010.

b The Lisbon Treaty

3.5 The Lisbon Treaty amends the two main Treaties which govern the European Union. It was ratified by the United Kingdom in July 2008 and entered into force on 1 December 2009. The European Commission has three key aims for the Lisbon Treaty: more efficiency in the decision-making process; more democracy through a greater role for the European Parliament and national parliaments; and increased coherence externally. The impact of the Treaty on the working of the European institutions will take time to become clear.

c Tolerable risk of error

3.6 In December 2008, the Commission published a paper on the tolerable risk of error[13] and sought to encourage debate on the subject. The paper outlined that the risk of error differs across expenditure areas and reducing this error rate carries an associated cost. The Commission therefore considered where the appropriate balance might lie between the risk of not detecting errors and the costs of ensuring the control systems are effective. The Commission called the point where the controls are the most cost effective the 'tolerable risk of error'.

3.7 At the time the paper was produced, the Commission estimated that the tolerable error rate for European Regional Development Fund expenditure was some 4 per cent, by which it meant the cost of additional controls would be more expensive than the amount of errors detected at anything above a 4 per cent error rate. The Commission plans to provide a refined analysis on the tolerable risk of error for each policy area in stages, starting in May 2010 and continuing to the end of 2011.

3.8 In 2009, the United Kingdom Committee of Public Accounts stated that the proposal for different levels of acceptable error on each policy area "would undermine the accountability of the European Union funds rather than enhance it and European citizens would see this as lowering the bar; whether a €1 million error occurs within a complex or a simple area of expenditure should not make a difference to its acceptability." It urged the European institutions to consider the repercussions of such a change, including the risk of removing the incentive to simplify rules governing European funding at a time when simplification is needed.[14]

3.9 The Commission has stated that a tolerable risk of error approach does not mean that individual errors will be tolerated; it will still recover ineligible expenditure, and it will not accept inadequate management and control systems at Commission or Member State level.

13 European Commission – Towards a common understanding of the concept of tolerable risk of error (2008).
14 HC 698 – House of Commons Public Accounts Committee – *Financial Management in the European Union* (30 June 2009).

d Simplification of regulations

3.10 A recurring theme proposed in the quest to reduce the level of irregular expenditure is simplification of the regulatory framework under which payments are made. In March 2009, the Commission outlined activities carried out since 2005 to reduce the administrative burden on farmers, for example the Common Agricultural Policy Simplification Action Plan. In April 2009, the Council of the European Union's Agriculture and Fisheries group proposed 39 steps to help achieve, in its view, the level of simplification required to deliver tangible results in agricultural policy. Some measures focused on reducing the burdens placed on beneficiaries from administrative and compliance tasks, whereas others focused on attaining simplifications for national authorities. The Commission has reported that it is taking forward the majority of the steps and that some have already been implemented.

3.11 In the area of Cohesion Policy, the regulations for the 2007-13 period have been amended to simplify the programme rules. These provisions are intended to reduce the administrative burden on Member States and contribute to a more efficient use of the funds through, for example, applying a standardised reimbursement rate for certain unit costs, although the changes to the legislation may take time to filter through to an impact on the error rate.

e The preparation of the Consolidated Statement on the use of European Union funds in the United Kingdom

3.12 In November 2006, HM Treasury announced that the Government intended to prepare and lay before Parliament an annual consolidated statement on the United Kingdom's use of European Union funds (sometimes referred to as a National Declaration). The objective is to increase the transparency and accountability of the United Kingdom's management of European Union funds. The Statement is prepared for the United Kingdom Parliament but it may also provide an additional source of assurance for European institutions in the future. The Netherlands, Denmark and Sweden produce similar statements.

3.13 In October 2009, for the second year in succession, HM Treasury laid before Parliament a Consolidated Statement for 2007-08. The Comptroller and Auditor General qualified his opinion on the truth and fairness of the account due to uncertainty over the completeness and reliability of data concerning transactions and balances, and the inconsistent application of accounting policies across the Devolved Administrations of the United Kingdom. Whilst all entities complied, in all material respects, with reporting requirements in producing their own financial statements and their interpretation of the guidance was within an acceptable range of professional judgements, transactions and balances have not always been recorded in a consistent manner for the purposes of the Consolidated Statement.

Appendix One

Methodology

Selected Method	Purpose
1 Literature Review	
We reviewed documents published by the European Commission, the European Court of Auditors, the European Anti-Fraud Office and other key stakeholders regarding financial management in the European Union, the main policy areas and wider developments.	To inform the content of the study and identify key individuals and organisations to contact.
2 Interviews	
We held interviews with policy and delivery staff at the European institutions listed above and staff from United Kingdom Government Departments with European responsibilities.	To understand the key current and future issues for the management of European funds.
3 Data analysis	
We analysed data available to European Institutions on the Community as a whole, and data provided by United Kingdom Government Departments on topics such as irregularities reported and progress in delivering 2007-13 projects.	To assess significant variances on previous years and analyse progress against measurable targets.

Appendix Two

The European Union's budgetary process, and the European Court of Auditors' methodology

The European Union's budgetary process

1 The Council and Parliament act jointly as the budgetary authority to approve the budget proposed by the Commission. The current annual budgets are set within a seven-year expenditure framework known as the Financial Framework (**Figure 8**). The European Union budget is not allowed to be in deficit.

2 The annual budgetary procedure determines the level of expenditure for a specific year, by activity within each heading and for allocating appropriations between the various budget headings.[15]

3 The main sources of funding for the budget are a contribution based on Member States' Gross National Income, a contribution based on Value Added Tax and customs duties on a range of commodities imported from non-Member States. The main sources of expenditure are shown at **Figure 9**.

Figure 8
What is a Financial Framework?

The Parliament, the Council and the Commission agree in advance on the main budgetary priorities for a seven-year period and establish a framework for Community expenditure, known as the Financial Framework.

The Financial Framework imposes a financial ceiling (maximum) on individual expenditure headings (such as the Common Agricultural Policy and Structural Measures) for the period. It can be revised to take account of events not foreseen when it was agreed.

The current Framework was established in 2006 and covers the period 2007-13.

15 Further details of the annual budgetary procedure can be found in Appendix Three of National Audit Office report HC 349 – *Financial Management in the European Union* (27 March 2009).

Figure 9
The main sources of expenditure for the European Union

Expenditure policy areas[1]

- **Agriculture and Natural Resources** – schemes to support farmers, agricultural markets and rural development.
- **Cohesion** – programmes to promote structural adjustment in under-developed regions, supporting economic and social conversion in areas facing structural difficulties, and to support the adaptation and modernisation of policies and systems of education, training and development.
- **Research, Energy and Transport** – research policy promotes the European Union as an area of education, training, research and innovation. Energy and transport policies aim to support economic growth, safety and security of supply.
- **External Aid, Development and Enlargement** – including food aid, humanitarian and development aid. Payments offering assistance to pre-accession countries.
- **Education and Citizenship** – funding schemes to various thematic areas and types of projects such as grants to actions in favour of Citizenship or for mobility in the education and training sectors.
- **Economic and Financial Affairs** – programmes to promote research and development, increase competitiveness and provide macro-economic assistance.
- **Administrative and other expenditure** – this covers the expenditure of the European Union institutions other than the Commission, pensions and European Schools.

NOTE

1 The term "Expenditure policy areas" is a term used by the European Court of Auditors – these are not the same as the financial framework headings.

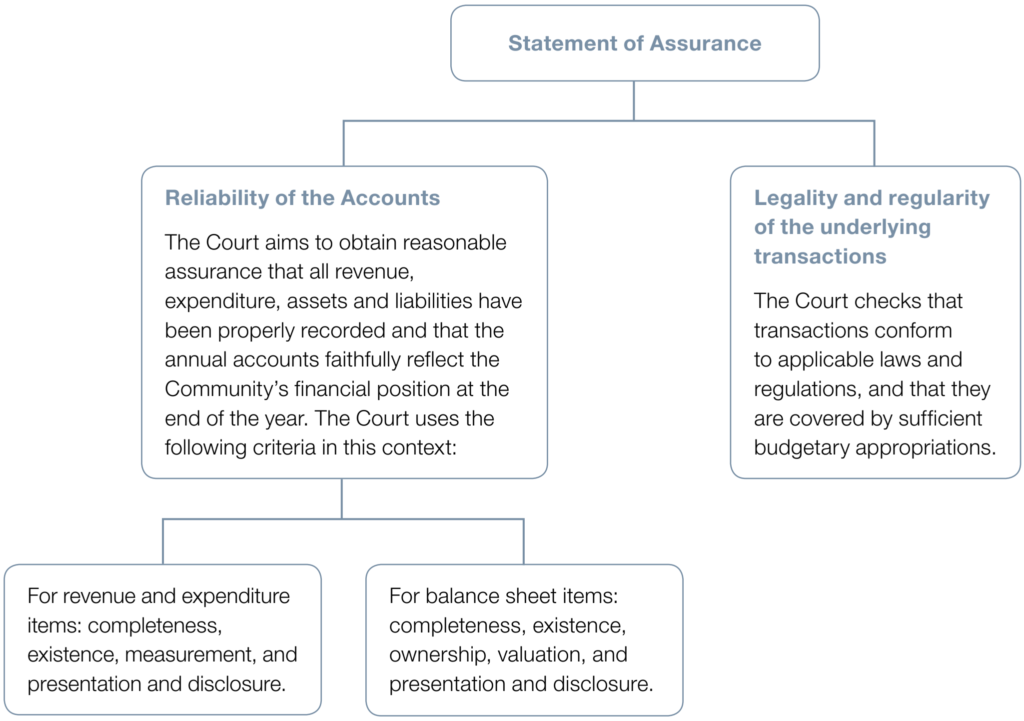
Source: European Union and the European Court of Auditors' Annual Report for the financial year 2008

The Court's Statement of Assurance

4 **Figure 10** outlines what is meant by reliability, and legality and regularity.[16]

5 The Court's Annual Report is complemented by a number of 'Special Reports' on selected budget sectors or issues. These reports examine the impact and effectiveness of policies and whether they give value for money.[17]

Figure 10
The key elements of the Statement of Assurance



Source: The European Court of Auditors

16 Further details of the Court's audit methodology can be found in Appendix Three of National Audit Office report HC 349 – *Financial Management in the European Union* (27 March 2009).
17 The Court's Special Reports can be found at http://eca.europa.eu/portal/page/portal/publications/auditreportsandopinions/specialreports.

Appendix Three

Financial Corrections and Provisions – The United Kingdom position

1 Legislation outlines how European funds should be spent. If this legislation is not adhered to, the European Commission can refuse to reimburse payments made by Member States to beneficiaries and reclaim, through financial corrections, any monies previously paid out.

2 The Commission has the power to apply extrapolated or flat-rate corrections in certain cases where it is not possible or practicable to quantify the amount of irregular expenditure precisely, or when it would be disproportionate to cancel the expenditure in question entirely. Extrapolation may be used when there are results of a representative sample of files available in relation to a systemic irregularity. Flat-rate corrections, among others, are applied in the case of individual breaches or systemic irregularities where the financial impact is not precisely quantifiable because it is subject to too many variables or diffuse in its effects.

3 **Figure 11** provides a summary of the confirmed financial corrections and the provisions and contingent liabilities disclosed in the 2008-09 accounts of the three United Kingdom Government Departments responsible for the majority of European Union related expenditure.

Figure 11

Disallowances and financial corrections imposed, provisions raised and contingent liabilities disclosed relating to Agricultural Funds, the European Regional Development Fund (ERDF) and the European Social Fund (ESF) in the United Kingdom

Department	Confirmed disallowance or financial corrections	Provisions included in 2008-09 accounts	Proposed corrections since 2008-09 accounts	Contingent Liabilities
Department for Environment, Food and Rural Affairs (including Rural Payments Agency)	£87.3 million on Single Payment Scheme predecessor schemes – the Arable Area Payments Scheme; Fruit and Vegetable grant schemes relating to 2003 to 2006; Export Funds; Exceptional Measures; and Livestock Premiums, Bovines and Ovines 2003 and 2004. £4.9 million for Single Payment Scheme 2006 cross-compliance issues.	£246.6 million for Single Payment Scheme to cover Scheme years 2005 to 2008. (In March 2009, the Commission proposed a correction that is covered by this provision. In March 2010, the Commission revised its proposal to some £110.7 million for Scheme years 2005 and 2006.)	In September 2009, the Commission proposed a correction of some £3.3 million for the England Rural Development Programme 2005 to 2007. In January 2010, the Commission proposed a correction of some £28 million related to the Fruit and Vegetable grant schemes 2005 to 2008.	Disclosed but cannot quantify a "potential substantial liability".
Department of Communities and Local Government	£24.6 million in respect of 1994-99 ERDF Programmes.	• £44.9 million for 2000-06 ERDF where ECA/DG Regio audits are outstanding. • £27.2 million for 2000-06 ERDF Business Link projects. • £2.4 million for 2000-06 ERDF grants that will not be recovered due to inability to claw back the funds.		• £24.2 million for 2000-06 ERDF where ECA/DG Regio audits are outstanding. • £63.9 million for 2000-06 ERDF Business Links projects. • £2.2 million for 2000-06 ERDF grants that will not be recovered due to inability to claw back the funds. • £124.8 million in anticipation of 2000-06 ERDF closure audits.
Department for Work and Pensions	None reported.	None reported.		£38 million against additional liabilities that could arise as a direct result of closing the 2000-06 ESF programme. Further disclosure made but cannot quantify as the "risk and likely amount cannot be assessed with any degree of certainty".

Figure 11

Disallowances and financial corrections imposed, provisions raised and contingent liabilities disclosed relating to Agricultural Funds, the European Regional Development Fund (ERDF) and the European Social Fund (ESF) in the United Kingdom continued

Department	Confirmed disallowance or financial corrections	Provisions included in 2008-09 accounts	Proposed corrections since 2008-09 accounts	Contingent Liabilities
Scotland	£9.3 million in respect of 1994-99 ERDF – Highlands and Islands.	£29.5 million (£25.2 million ESF, and £4.3 million ERDF).		Unquantifiable potential disallowance arising from Commission audits of agriculture funding for 2005-07 and the closure of Structural Fund programmes.
Wales	£13.4 million in respect of 1994-99 ERDF – Industrial South Wales.	None reported.		None reported.
Northern Ireland	None reported.	None reported – see proposed corrections.	In January 2010, the Commission proposed a correction of some £62 million relating to agriculture funding between 2004 and 2008 (of which Defra has already provided for £11 million leaving a balance of £51 million).[1] In December 2009, the Commission proposed a correction of some £10 million for ERDF.	None reported.
Total	£139.5 million	£350.6 million	£92.3 million	£253.1 million plus unquantified but potentially substantial amounts relating to Defra and DWP.

NOTE

1 From 2007-08 onwards Defra no longer creates provisions for potential corrections due to new errors which occur in the Devolved Administrations. Devolved Administrations should create provisions for these in their own accounts. Provisions relating to Devolved Administrations existing at the start of 2007-08 remain in the Defra Resource Account.

Source: National Audit Office analysis of departmental Resource Accounts

Appendix Four

Cases of irregularity, including possible fraud, reported to the Commission in 2008

Figure 12

Cases of irregularity, including possible fraud, reported to the Commission in 2008

Area	Number of irregularities reported		Total estimated financial impact of irregularities, including suspected fraud € million		Estimated financial impact of suspected fraud only € million	
	2007[1]	2008	2007	2008	2007	2008
Agriculture (European Agricultural Guarantee Fund and European Agricultural Fund for Rural Development)	1,548	1,133	155	102	45 (~0.1% of allocations)	4 (0.01% of allocations)
Structural Funds and Cohesion Fund	3,756	4,007	804	585	141 (~0.31% of allocations)	57 (~0.11% of allocations)
Pre-accession Funds	332	523	32	61	5 (~0.38% of allocations)	13 (~0.9% of allocations)
Direct Expenditure[2]	411	932	33	35	18 (~0.17% of allocations)	3 (~0.03% of allocations)
Total expenditure	**6,047**	**6,595**	**1,024**	**783**	**209 (~0.22% of the expenditure in the four areas)**	**77 (~0.07% of the expenditure in the four areas)**
Own resources	6,097	5,344	401	351	131 (~0.81% of the total amount of own resources)[3]	75 (~0.46% of the total amount of own resources)

NOTES

1 Figures for 2007 are restated as Member States often notify the European Anti-Fraud Office (OLAF) of irregularities some time after the irregularity has occurred.

2 In 2007, as a first step towards integrating the areas of the budget directly managed by the Commission into the Fight Against Fraud report, statistics on fraud and irregularities detected by the Commission were included. Changes were made to the data collection method in 2008. The data should therefore be treated with caution.

3 This percentage is based on an estimate of traditional own resources in the 2008 general budget, and not on accounts.

Source: European Anti-Fraud Office Fight Against Fraud 2008

Figure 13
Irregularities reported by the United Kingdom

	2008	2007
Agriculture[1]		
Cases	7	95
Total Amounts (€)	225,775	4,167,640
Structural Funds		
Cases	483	502
Total Amounts (€)	123,321,443	161,179,907
Own Resources		
Cases	1,023	1,069
Total Amounts (€)	98,362,245	115,284,887
Total		
Cases	1,513	1,666
Total Amounts (€)	221,909,463	280,632,434

NOTE

1 In 2008, the United Kingdom was unable to report agricultural irregularities using the new Europe-wide Irregularity Management System due to technical difficulties.

Source: OLAF Fight Against Fraud 2008 Annex 2-22 and OLAF Fight Against Fraud 2007 – Annex 2-22

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