



Memorandum to the Public Accounts
Committee on the European Court of
Auditors' Annual Report for 2009

December
2010

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The European Court of Auditors' Annual Report for 2009

7 December 2010

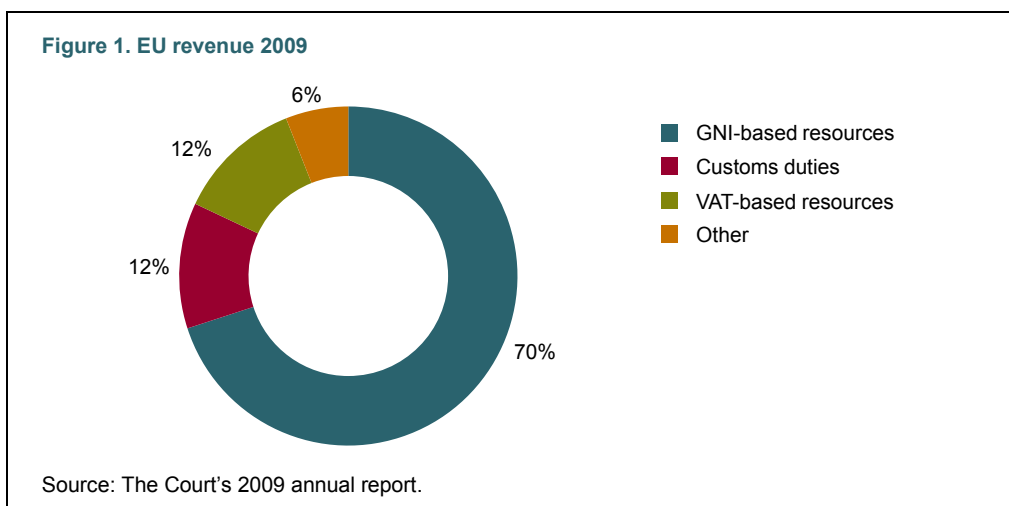
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Translation

I. Introduction and EU revenue and expenditure in 2009

1. On 9 November 2010, the European Court of Auditors (the Court) presented its annual report and statement of assurance for the financial year 2009. I shall in this memorandum inform the Public Accounts Committee of selected parts of the Court's annual report, including the statement of assurance and the most significant conclusions made by the Court. The memorandum will also include information on the most recent development within auditing and management of EU funds. Initially the memorandum presents an overview of EU revenue and expenditure, which will serve as the basis for my subsequent comments on the Court's audit findings.

EU revenue 2009

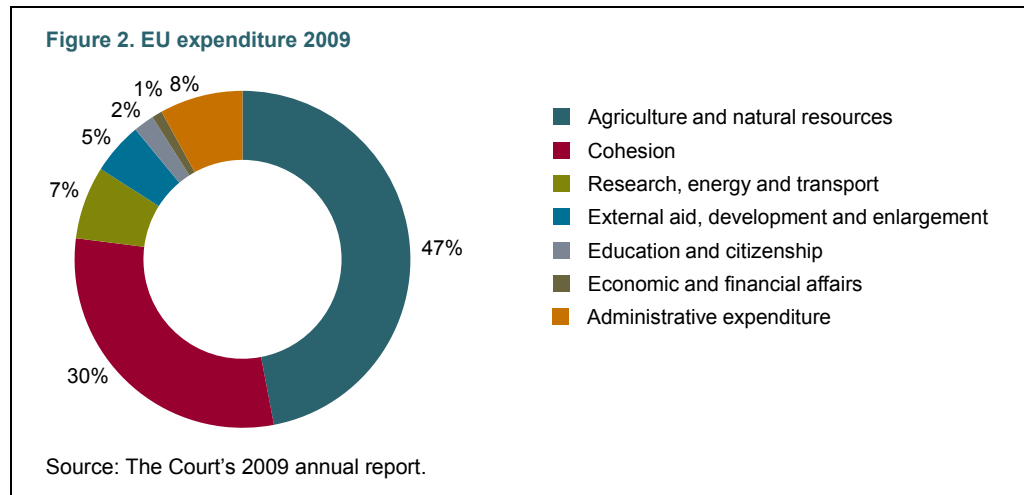
2. In 2009, EU revenue amounted to a total of EUR 117 billion, corresponding to DKK 874 billion. The revenue broken down by source is set out in figure 1.



It appears from figure 1 that the bulk of the EU revenue is GNI-based resources calculated as a fixed percentage of gross national income (GNI), followed by customs duties and VAT-based resources.

EU expenditure 2009

3. In 2009, EU expenditure amounted to a total of EUR 118 billion corresponding to DKK 882 billion. Expenditure broken down by area of expenditure is set out in figure 2.



It appears from figure 2 that slightly less than half the EU expenditure goes to "Agriculture and natural resources", which consists mainly of the EU common agricultural policy and rural development support. The second largest area of expenditure is "Cohesion", which consists of the EU structural policies (the Regional Fund, the Social Fund, etc.).

"Agriculture and natural resources" and "Cohesion" account for more than two thirds of the EU expenditure. The European Commission (the Commission) and the individual Member States are sharing management of these expenditure areas. The Commission has the overall responsibility for the correct implementation of the budget, but the Member States select and check eligible projects and effect payment of funds to the final beneficiaries.

4. Denmark is mentioned in the Court's annual report for 2009 in a couple of general tables on EU revenue and expenditure and in a table from which it appears that Denmark has five VAT-reservations as per 31 December 2009. It also appears from an appendix to the annual report that the systems established in Denmark to supervise and control the European Social Fund are effective.

The Court is not in its annual report referring to the audit of EU funds that is performed by the Supreme Audit Institutions of certain Member States.

II. The Court's 2009 annual report and statement of assurance

The Court's audit approach

5. On 9 November 2010, the Court presented its annual report and statement of assurance for the financial year 2009 to the European Parliament (the Parliament) and the Council of the European Union (the Council). The Court's annual report for 2009 presents the results of the Court's financial audit, whereas the Court's performance audits are published in special reports issued in the course of the year. The Court has published 13 special reports since the previous annual report.

6. The Court's annual report forms part of the Parliament's and the Council's discharge procedure, which is a political assessment and approval of the management of the EU budget performed by the Commission and other EU institutions. Since 1994, the annual report has included a statement of assurance (Déclaration d'Assurance, DAS for short). The statement of assurance includes the Court's overall assessment of whether the EU revenue and expenditure:

- have been properly recorded in the Commission's accounts (reliability of the accounts)
- have been paid into or out of the Commission's accounts in a lawful and formally correct manner (legality and regularity of the underlying transactions)

7. The Court applies the so-called DAS approach in its audit. The key element of this method is an assurance model which is indicating the level of assurance that can be achieved from the following two principal sources:

- *Systems-based auditing* of the supervisory and control systems applied by the Commission, Member States and Third Countries to examine whether they function as intended and prevent, identify and correct errors in connection with the collection and disbursement of EU funds.
- *Substantive auditing* of payments made to and by the Commission which the Court selects through a random representative sample of transactions. Transactions to be checked are selected by the Court's special sampling method – the so-called monetary unit sampling that identifies and checks individual payments down to the level of the final beneficiary, often through on-the-spot audit visits.

The Court may also decide to supplement these sources with annual activity reports and declarations by the Commission's Directors-General and the work of other auditors.

The Court's 2009 statement of assurance

8. Based on the audit of the 2009 EU annual accounts, the key elements of the Court's statement of assurance are:

Reliability of the accounts:

- The 2009 EU annual accounts are in all material respects presented fairly, and for the third consecutive year, the Court has issued an unqualified statement of assurance on the reliability of the accounts.

Legality and regularity of the underlying transactions:

- Generally, the level of errors has been reduced again this year and the administration of EU funds continues its positive development. This assessment is, however, based on the fact that the error rate in some areas has gone down, but in others has increased. The Court's overall assessment is that the EU expenditure is materially affected by error (error rates between 2 and 5 per cent).
- The error rates in the policy areas "Revenue", "Economic and financial affairs" and "Administrative expenditure and other expenditure" are not considered material.
- The error rate in the policy area "Cohesion" has been considerably reduced, but is still above 5 per cent.
- The error rates within "Agriculture and natural resources" and "Education and citizenship" on the other hand have increased to a level between 2 and 5 per cent.
- Expenditure relating to "Research, energy and transport", "External aid, development and enlargement" is also affected by an error rate of between 2 and 5 per cent.

Table 1 shows the distribution of the bulk of EU expenditure and revenue for 2009 and the Court's assessment of the legality and regularity of the underlying transactions.

Table 1. The Court's assessment of the legality and regularity of the underlying transactions in 2009

Distribution of EU expenditure and revenue in 2009	EUR billion	Supervisory and control systems	Error rate
Expenditure			
Agriculture and natural resources	55.0	Partially effective	Between 2% and 5%
Cohesion	36.6	Partially effective	Over 5%
Research, energy and transport	7.5	Partially effective	Between 2% and 5%
External aid, development and enlargement	6.2	Partially effective	Between 2% and 5%
Education and citizenship	1.7	Partially effective	Between 2% and 5%
Economic and financial affairs	0.5	Partially effective	Below 2%
Administrative and other expenditure	8.5	Effective	Below 2%
Revenue	121.6	Effective	Below 2%

Source: The Court's 2009 annual report.

9. "Agriculture and natural resources" is the largest policy area in the EU (EUR 56.3 billion in 2009). The Court has established an increase in the error rate and the area is therefore generally characterized as being materially affected by errors. This is a step back compared to last year, where the Court for the first time expressed a positive opinion on the policy area although the opinion was qualified for the sub-area "Rural Development". According to the Court, the principal source of errors is farmers' overstatement of eligible land.

The improvement of error rates recorded in recent years is in particular attributable to the Integrated Administration and Control System (IACS), which all Member States are now applying to ensure correct disbursements of support in the agricultural policy area. However, the Court found that the effectiveness of IACS is adversely affected by inaccurate data in the databases, incomplete cross checks or incorrect or incomplete follow up of anomalies. The Court therefore concluded that the supervisory and control systems in the area are at best partially effective.

The Court also reiterates its recommendation that further efforts are required in the area of "Rural Development" to further simplify the rules and conditions.

10. "Cohesion" is the second largest EU policy area (EUR 35.5 billion) and the Court's audits have over the years documented very high error rates in the area. The Court established that the error rate in 2009 is considerably lower compared to previous years, but remains above 5 per cent. According to the Court, at least 3 per cent of the expenditure certified should not have been reimbursed to the Member States. It is, however, an improvement over last year where 11 per cent of expenditure should not have been reimbursed. The main causes of errors are inclusion of expenditure that is not eligible for reimbursement and failures to respect public procurement rules.

The Court notes that the Member States are bearing the primary responsibility for the management of expenditure for "Cohesion" and states that at least 30 per cent of the errors found should have been corrected by the Member States. The Court therefore recommends that the Commission should supervise that the management and control systems established in the Member States operate as required and call upon the national authorities to be stricter in the application of financial corrections before they certify expenditure to the Commission.

11. I have noted that the Court again this year has issued an unqualified statement of assurance on the reliability of the accounts. The Court concludes that the management of the EU budget has improved in general, but in particular within "Cohesion". However, the error rate in this important policy area is still higher than 5 per cent, and bringing it down to an acceptable level is far in the future. I have also noted that it has not been possible to maintain the progress made in the policy area "Agriculture and natural resources" last year. Thus for the 16th year in a row, the Court has issued adverse opinions on several significant policy areas.

III. Development within auditing and management of EU funds

12. For the first time, the Court's annual report was this year forwarded to the Danish parliament, and the other national parliaments in the EU in accordance with protocol no. 1 to the Lisbon Treaty on the role of national parliaments in the EU. The protocol is encouraging the Member States to greater involvement in the activities of the EU, and lists a number of documents that should be forwarded directly to the parliaments, including the Court's annual report, the Commission's annual legislative programme, consultation documents, etc.

As usual I shall keep the Public Accounts Committee and the Danish parliament informed of the Court's annual report, and report on the discharge decision of the Parliament in a forthcoming memorandum.

13. On 28 May 2010, the Commission presented its proposal to reform the EU's Financial Regulation governing the implementation of the Union's general budget. The Financial Regulation contains all the principles and rules, which govern the financial management, control and audit of the implementation of the Union's budget. The objective of the Commission's proposal is to improve and simplify the management and control of EU funds. The Commission wants to adopt the proposal before the end of 2011, so that the new rules can become effective on 1 January 2012.

Of particular interest is the Commission's proposal to let the Parliament and Council determine the level of tolerable risk of error per policy area, taking into account the cost of controls, risk of error and benefits of the policy. This means that the tolerable risk of errors levels in some areas will be fixed above the general level of 2 per cent which is currently applied by the Court.

The Commission is also proposing to harmonise the administrative structure concerning shared management in the Member States and introduce an obligation of the Member States to issue an annual management declaration of assurance including independent audit opinions on all areas under shared management.

I shall follow the discussions of the proposal in the Council and Parliament and update the Public Accounts Committee on the proposal in more detail when I have a clearer picture of the outcome of the negotiations.

14. The impact of the Lisbon Treaty on the national parliaments and supreme audit institutions in the Member States as well as the proposal to change the Financial Regulation were discussed by the Auditor Generals of the EU at the annual EU Contact Committee meeting in Luxembourg in October 2010.

15. The Ministry of Finance has, as appears from Report no. 17/2009 on the audit of EU funds in Denmark in 2009, for the state accounts in 2008 and 2009 prepared statements of the contributions that Denmark has made to the EU and the revenue that Denmark has received from the EU. Being able to present an actual EU consolidated financial statement for Denmark is considered important by Rigsrevisionen and the Ministry of Finance has committed to working out a consolidated EU financial statement within the next few years.

IV. Conclusion

16. According to the Court's annual report 2009, the positive trend in EU-fund management is continuing. For three consecutive years now, the Court has issued an unqualified statement of assurance on the reliability of the EU accounts, and the overall error rate in underlying transactions has been reduced also this year. However, the number of errors detected within "Cohesion" remains high and recent years' positive development in the error rates within "Agriculture and natural resources" has turned, which means that the Court again this year has given the area an adverse opinion.

17. The Court has not in its annual report referred to the audits of EU funds that have been performed by the supreme audit institutions in the respective Member States. In my opinion, the Court's audit would be strengthened, if the audit work performed by the supreme audit institutions was taken into consideration. Cooperation between the Court and the national audit institutions would underpin the Court's assessment of management of EU funds in the Member States. A cooperation of this nature would strengthen the Court as well as the national audit institutions.

18. For the first time this year, the Court forwarded its annual report to the Danish parliament in accordance with the provisions of the Lisbon Treaty to further the involvement of the national parliaments in the EU activities. I shall, however, as usual keep the Public Accounts Committee informed of the annual report of the Court and the Parliament's discharge procedure.

19. The Commission has proposed a number of changes to the EU's Financial Regulation, including several essential new elements concerning the management of EU funds. I shall follow the negotiations to change the Financial Regulation and keep the Public Accounts Committee updated on relevant new developments.

20. I shall also brief the Public Accounts Committee on the progress made by the Ministry of Finance with respect to the elaboration of a consolidated EU financial statement.

I shall also keep the Public Accounts Committee informed of the general development within auditing and management of EU funds, and report on the Parliament's discharge procedure in a memorandum, which I expect to issue in spring 2011.

Henrik Otbo