RIGSREVISIONEN

Report to the Public Accounts Committee on Denmark's absorption of EU funds

August 2014

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Rigsrevisionen has taken the initiative itself to launch this examination and, accordingly, submits the report to the Public Accounts Committee under section 17(2) of the Auditor General's Act, see Consolidation Act No. 101 of 19 January 2012.

The report relates to the Danish Appropriation Act, section 8. The Ministry of Business and Growth and section 24. The Ministry of Food, Agriculture and Fisheries.

In the period covered by the examination, the ministries were headed by the following ministers:

The Ministry of Business and Growth:
Bendt Bendtsen: November 2001 - September 2008
Lene Espersen: September 2008 - February 2010
Brian Mikkelsen: February 2010 - October 2011
Ole Sohn: October 2011 - October 2012
Annette Vilhelmsen: October 2012 - August 2013
Henrik Sass Larsen: August 2013 -

The Ministry of Food, Agriculture and Fisheries:
Henrik Dam Kristensen: December 1996 - February 2000
Ritt Bjerregaard: February 2000 - November 2001
Mariann Fischer Boel: November 2001 - August 2004
Hans Christian Schmidt: August 2004 - September 2007
Eva Kjer Hansen: September 2007 - February 2010
Henrik Høegh: February 2010 - October 2011
Mette Gjerskov: October 2011 - August 2013
Karen Hækkerup: August 2013 - December 2013
Dan Jørgensen: December 2013 -

The draft report was presented to the Ministry of Finance, the Ministry of Business and Growth and the Ministry of Food, Agriculture and Fisheries, whose comments are reflected in the report.

1. Introduction and conclusion

1.1. Purpose and main conclusion

1. This report concerns Denmark's ability to spend funds allocated from the EU budget. Most of the EU budget is spent on initiatives that support, for instance, growth, employment and environmental improvements in the individual member states. Funding for such initiatives is provided through the national authorities' administration of the EU funds. Projects that are co-financed by the EU require national co-funding.

The maximum funding that may be allocated to the individual member states is agreed among the heads of state and government in the European Council during the political negotiations on the EU's multiannual financial framework. If the Danish authorities fail to use the funds allocated, opportunities to support growth, employment and environmental improvements will be lost for Denmark.

2. Rigsrevisionen therefore decided to work out a cross-cutting report on Denmark's absorption of funds allocated from the EU budget. The examination included the European Regional Development Fund ('the Regional Fund'), the European Social Fund ('the Social Fund'), the European Agricultural Fund for Rural Development ('the Rural Development Fund') and the European Fisheries Fund ('the Fisheries Fund').

The responsibility for the administration of the Regional Fund and the Social Fund in Denmark lies with the Minister for Business and Growth (since May 2003), and the responsibility for the Rural Development Fund and the Fisheries Fund lies with the Minister for Food, Agriculture and Fisheries ('the Minister for Food').

3. The report is a spin-off from the annual audit of EU funds in Denmark and as such a narrow report.

The audit approach and quality requirements to **narrow reports** are identical with those applying to Rigsrevisionen's other reports, but the scope of narrow reports is more limited.

4. The report answers the following question:

- Have the Danish authorities fully used the funding provided through the EU funds?

5. Chapter two describes the extent to which the Danish authorities have managed to use funds allocated in the period 2000-2006, including possible explanations as to why the allocated funds have not been spent. Chapters three and four provide a status on the absorption rates concerning the Multiannual Financial Framework 2007-2013 and describe the specific risks that funds allocated will not be spent. Chapter five presents the basis for Rigsrevisionen's recommendations to reduce the risk that Denmark does not fully use the funding opportunities provided in the financial framework period 2014-2020.

MAIN CONCLUSION

The Danish authorities have not spent all the funds allocated under the EU financial framework.

For the period 2000-2006, approximately EUR 161 million out of approximately EUR 1.2 billion allocated to Denmark from the EU budget to the four funds was not used, i.e. EUR 67 million from the Regional Fund and the Social Fund and EUR 90.3 million from the Rural Development Fund and the Fisheries Fund. This was, among other things, caused by lack of national co-financing and the fact that the Danish authorities – for various reasons – implemented the programmes later than planned.

There are signs of improvement for the period 2007-2013, yet still a risk that Denmark will not be able to use the funds in full. So far, Denmark's absorption rate for funds allocated through two of the funds is below the EU average.

The Danish AgriFish Agency has informed Rigsrevisionen that it expects to fully use the EU funding allocated through the Rural Development Fund. The AgriFish Agency and the Danish Business Authority have stated that they will not be able to use in full the money allocated through the Regional Fund, the Social Fund and the Fisheries Fund. The final absorption rate will be known when the programming period is closed in 2015.

Recommendations

Improved management can reduce the risk that Denmark does not fully use funds allocated in the period 2014-2020. Rigsrevisionen therefore recommends

- that the ministries – when programmes are launched – define clear objectives and milestones for the financial implementation of the programmes in the period 2014-2020, including the extent to which Denmark should use the funding allocated under the EU's multiannual financial framework;
- that the ministries should consider the pros and cons of overbooking, i.e. committing to developing a project pipeline that is bigger in volume than the financial scope of the programme to counter the risk of reductions of the financial framework.

1.2. Background

6. In connection with the adoption of the EU multiannual financial framework, the national frameworks for the Regional Fund, the Social Fund, the Rural Development Fund and the Fisheries Fund, among others, will be calculated. The national frameworks put a limit to the maximum of member state expenses for rural and fisheries development and regional and social development that the EU is prepared to refund. A national framework subject to different bodies of rules exists for each Fund. Member states are then responsible for using the frameworks provided.

Box 1 describes which authorities are responsible for the funds in Denmark.

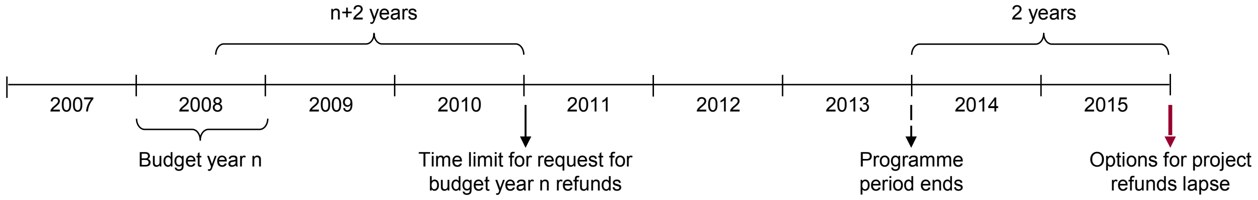
BOX 1. AUTHORITIES RESPONSIBLE FOR THE FUNDS IN DENMARK

The Regional Fund and the Social Fund	The Rural Development Fund and the Fisheries Fund
The Minister for Business and Growth is the authority responsible for administering the programmes funded by the Regional Fund and the Social Fund.	The Minister for Food is responsible for implementing the programmes for the Rural Development Fund and the Fisheries Fund in Denmark.
The Minister for Business and Growth has delegated his or her powers to the Danish Business Authority, which is tasked with the ongoing programme administration and implementation. The regional growth forums recommend to the Danish Business Authority which projects should receive regional and social fund support. The Danish Business Authority then decides whether to grant or refuse the funds and makes the payments.	The Minister for Food has delegated the administrative tasks relating to the two funds to the Danish AgriFish Agency. In connection with the October 2011 change of government, part of the administration was referred to the Ministry of Housing, Urban and Rural Affairs. Certain activities are carried out at local level by a number of special local action groups set up. Yet, the Danish AgriFish Agency continues to grant the funds, carry out the control and make the payments. In addition, the Ministry of the Environment is responsible for administering the grants and the related payments under forestry schemes, among others.
In the period 2007-2013, the maximum EU funding for the Regional Fund amounted to approximately EUR 255 million and for the Social Fund also EUR 255 million.	In the period 2007-2013, the maximum EU funding for the Rural Development Fund amounted to approximately EUR 577 million and for the Fisheries Fund approximately EUR 134 million.
The funds are included under section 08.35.01 of the Danish Appropriation Act. Regional development, etc.	The EU funding for the Rural Development Fund is included under sections 24.23.03. and 24.21.05 of the Danish Appropriation Act. Construction Programme, section 24.21.01. The Danish AgriFish Agency, section 23 regarding forestry. Grants from the Fisheries Fund are included under section 24.26.30 of the Danish Appropriation Act.

The funds operate under a multiannual 'operational programme' ('programme') to be agreed upon between the European Commission ('the Commission') and Denmark. The programme includes an implementation and financing plan specifying how Denmark intends to absorb its national allocation.

7. To ensure continuous absorption, the overall allocation has been distributed to each of the years forming part of the multiannual programme. Member states must regularly document the expenses defrayed and paid that can trigger a refund through the funding provided by the Commission. If this documentation is not presented to the Commission within the time limits set, the national allocation will be reduced. This rule is referred to as the n+2 rule; see figure 1.

Figure 1. Illustration of the n+2 rule



Source: Rigsrevisionen, based on data from the ministries.

Figure 1 shows that the n+2 rule means, for example, that an application for EU funding for expenses relating to the annual framework for 2008 must have been received before the end of 2010.

Decommitment
In accordance with the n+2 rule, programmes risk losing part of their grant if spending targets are not met. Basically this means that if the programme does not spend the money it receives each year within two years, it must pay the unspent money back to the European Commission.

8. The multiannual approach means that it takes time for the final outcome of programme implementation to become known. The financial frameworks cover multiannual periods, for example, 2000-2006, 2007-2013 and 2014-2020. Unexpended funds are typically decommitted two years after the relevant period expires, for example, on 31 December 2015. After this date there is an additional, extended period until final programme closing and presentation of accounts. Accordingly, the absorption rate of each member state will not be determined until long after the programme has been closed. As far as Denmark is concerned, the 2000-2006 period was not fully closed until 2013.

9. Absorbing the funds provided through the financial frameworks is important because the programmes are intended to support and promote growth, employment and environmental improvement initiatives. If the funds are to have the desired effect, they must be applied in the areas of society where the effect is needed. This also means that if Denmark fails to fully absorb the funds allocated, growth opportunities will be lost. Rigsrevisionen points out that use of EU funding requires national co-financing and that national co-financing forms part of the general priorities reflected in the Danish Appropriation Act, among others. Rigsrevisionen has been informed that no decision has been made about whether Denmark wishes to fully use the funds allocated under the EU financial framework.

1.3. Audit criteria, delimitation and method

Audit criteria

10. In accordance with ISSAI 300, the purpose of the examination is to contribute new information, analyses or insight and, where appropriate, to propose improvements.

Through this examination Rigsrevisionen wishes to promote transparency by offering the Public Accounts Committee an insight into whether Denmark takes advantage of the options for obtaining EU funding for certain initiatives aimed at creating growth, employment and environmental improvements. The examination thus contributes to providing useful information and additionally serves as basis for learning and improvements.

11. Rigsrevisionen examined whether the ministries absorbed the funding under the multiannual financial framework for 2000-2006, whether they analysed the risks of failing to absorb the funding pertaining to 2007-2013, whether they set up risk management, and whether the multiannual financial framework for 2007-2013 is likely to be absorbed.

Delimitation

12. The examination is limited to the Regional Fund, the Social Fund, the Rural Development Fund and the Fisheries Fund. Common to these funds is that projects account for a large proportion of their focus and that the projects require national co-financing. The examination does not include other EU funding paid to Denmark, for example, research funding or direct agricultural aid paid through the European Agricultural Guarantee Fund.

13. The examination relates primarily to the programme periods 2000-2006 and 2007-2013. The 2000-2006 period was closed in 2013. The 2007-2013 period has not yet been closed and the absorption rate cannot therefore currently be determined. Expenses relating to the 2007-2013 programme period may be defrayed and paid until the end of 2015.

14. In this examination, Rigsrevisionen did not evaluate whether funds are applied for the intended purpose or whether they are having the desired effect. The examination is limited to addressing whether Denmark exploits the full potential of the EU funding enabled by the funds.

Method

15. The examination is based on interviews with and written material received from the Ministry of Finance, the Ministry of Business and Growth and the Ministry of Food, Agriculture and Fisheries. In addition, Rigsrevisionen examined the legislation and reports of the Commission and the European Court of Auditors ('the Court'). Rigsrevisionen also interviewed the secretariats of the North Jutland and Southern Denmark regional growth forums. These two regional growth forums were chosen because they recorded the highest and the lowest absorption rate, respectively, in terms of regional allocations.

16. The absorption rate for the individual funds was calculated relative to the maximum funding provided on the basis of figures from Commission reports and government agencies.

The audit was carried out in compliance with good public-sector auditing practice, see box 2.

BOX 2. GOOD PUBLIC-SECTOR AUDITING PRACTICE

Good public-sector auditing practice is based on the fundamental public-sector auditing principles (ISSAI 100-999) of the International Standards of Supreme Audit Institutions.

2. For the period 2000-2006, approximately EUR 161 million of the EU funding provided was not absorbed ...

17. The examination showed that for the period 2000-2006, approximately EUR 161 million out of approximately EUR 1.2 billion allocated to Denmark from the EU budget to the four funds was not absorbed. Table 1 shows the Danish authorities' absorption of the funding for the period 2000-2006.

Table 1. Denmark's absorption of the funds provided for the Regional Fund, the Social Fund, the Rural Development Fund and the Fisheries Fund for the period 2000-2006

	Funding (max.)	Non-absorbed	Non-absorbed in %
The Regional Fund and the Social Fund	EUR 628.2 million	EUR 67.0 million	10.7%
The Rural Development Fund and the Fisheries Fund	EUR 596.1 million	EUR 90.3 million	15.2%

Note: The figures in the table have been converted from Danish kroner to euro (exchange rate 7.45).
Source: Rigsrevisionen, based on reports from the Commission (October 2013) and statements by the Danish AgriFish Agency.

Overall, according to table 1, the Danish Business Authority failed to spend 10.7 per cent of the funding provided for the Regional Fund and the Social Fund, equal to non-absorption of EUR 67 million. Rigsrevisionen points out that the Danish Business Authority did not take over the administration of the Social Fund until the halfway into the programme period. The corresponding figure for the Danish AgriFish Agency area was EUR 91 million (15.2 per cent).

18. The Danish Business Authority and the Danish AgriFish Agency provided the following explanations for the failure to fully absorb the multiannual financial framework for 2000-2006:

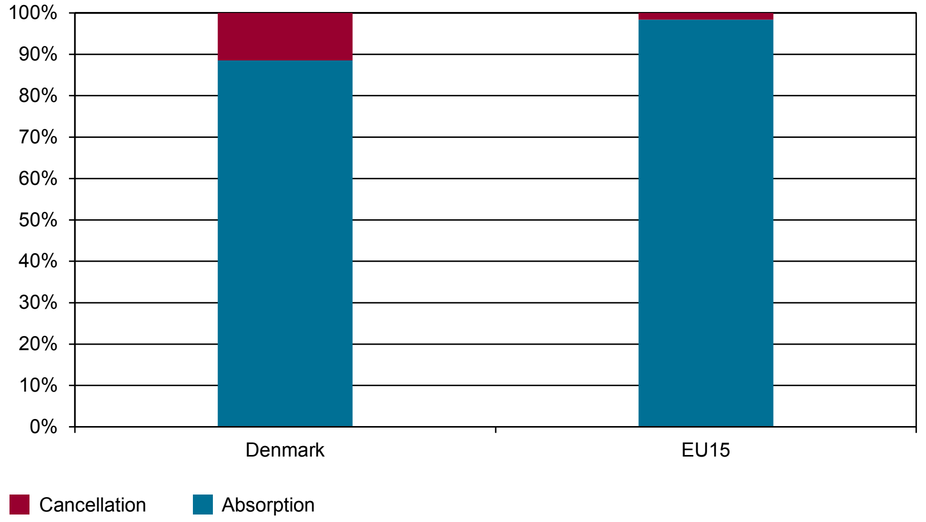
- As regards the Regional Fund and the Social Fund, for various reasons, the authorities had difficulties launching the programmes. Furthermore, the n+2 rules were new, which presented a major administrative challenge. The 2007 local government reform in Denmark meant that the counties, which were responsible for part of the administration, started adapting to the new structure as early as 2005. In addition, the areas eligible for government aid were changed at the end of 2006, which challenged the absorption of the funding provided for the Regional Fund in 2007 and 2008. Furthermore, responsibility for administering the Social Fund shifted from the Danish National Labour Market Authority to the Danish Business Authority halfway into the period.

- As regards the Fisheries Fund, the operational programme was smaller than the maximum funding made available to Denmark. Therefore, national co-financing was not provided through the Danish Appropriation Act, which would have enabled the Danish authorities to fully absorb the funds.

- As regards the Rural Development Fund, according to the final evaluation of the Danish rural development programme, one of the chief explanations was varying political will to give high priority to the rural development programme compared with other political priorities. The general election in November 2001, for example, gave rise to an adjustment of the public funds allocated to the rural development programme in the Danish Appropriation Act for 2002. The most notable adjustment was the zero-setting of an allocation for an investment scheme, which meant that no grants were made under the scheme in 2002 and 2003. Another important factor was that demand for certain schemes was generally lower than expected.

19. For the Regional Fund, the Social Fund and the Fisheries Fund the Commission has reported total withdrawals of funds allocated to Denmark of 11.5 per cent. For the 15 countries, including Denmark, that were members of the EU when the 2000-2006 period started (EU15), funds cancelled averaged 1.6 per cent. Figure 2 illustrates this.

Figure 2. Denmark's absorption of the funds provided for the Regional Fund, the Social Fund and the Fisheries Fund for the period 2000-2006 compared with EU15



Source: Rigsrevisionen, based on reports from the Commission (October 2013).

The Ministry of Food, Agriculture and Fisheries and the Ministry of Finance have no similar data from the Commission on Denmark's and the other EU member states' absorption of the maximum funding for the Rural Development Fund.

Conclusion

20. Total funding decommitted for the four funds amounted to approximately EUR 161 million for the period 2000-2006. In addition to the decommitment of EU funds for the four funds examined, funding may have been decommitted in other areas also. The Ministry of Finance has been unable to report a total figure.

3. ... there are signs of improvement in the period 2007-2013 ...

21. The period 2007-2013 shows signs of improvement because no funding reductions for the period were made.

3.1. No funding reductions for the period

22. Through interviews with key personnel of the two government agencies Rigsrevisionen has discussed the risk assessment and risk management that the Danish Business Authority and the Danish AgriFish Agency apply in relation to full absorption of EU funds.

23. Delayed projects or projects that are not implemented according to plan entail a significant risk for both the Danish Business Authority and the Danish AgriFish Agency that the funding will be reduced and thus that grants will be cancelled; see box 3. This puts pressure on the government agencies to make new grants and on the projects in terms of defraying and paying eligible expenses recoverable by Denmark within the relevant time limits. According to the Danish AgriFish Agency, this risk increases towards the end of the period, when carrying out new rounds of applications may be difficult.

BOX 3. FUNDING DECOMMITTED

The Danish AgriFish Agency estimates an average decommitment rate of 20 for project grants under the Rural Development Programme.

The Danish Business Authority has withdrawn part of the grant for approximately half of the projects under the Regional Fund and the Social Fund. At 29 April 2014, decommitment of funds allocated for the period 2007-2013 totalled 5 per cent (EUR 12.1 million) for the Regional Fund and 8 per cent (EUR 21.5 million) for the Social Fund.

Conclusion

24. The examination showed that some of the unspent funds for the period 2000-2006 consisted of funds that were decommitted over the period, because Denmark proved unable to regularly absorb the funds within the applicable time limits; see the n+2 rule. The Commission, for example, reduced the Danish allocation under the Fisheries Fund three times by a total of approximately EUR 20.7 million for the period 2000-2006.

Neither the Danish Business Authority nor the Danish AgriFish Agency have decommited unused funds during the period 2007-2013. Rigsrevisionen notes that this represents an improvement compared with the previous period, during which about half of the allocation reductions regarding the Regional Fund, the Social Fund and the Fisheries Fund were caused by regular decommitments over the period.

Both government agencies have stated that absorption of funds in the current period (2007-2013) is improving, because of better fund management and the successful application of the instruments for handling the risk of funding reductions as a result of the n+2 rule.

3.2. Instruments for handling the risk of funding reductions

25. The Danish Business Authority has stated that it is countering the time pressure posed by regular reductions in funding by continuously following up on programme implementation. At the end of the period, the authority identifies the projects that are functioning well and – at the recommendation of the growth forums – then generally adds new activities to these projects rather than initiating new projects. The logic is that starting up new projects is time-consuming, and if the project organisation is already in place, its related expenses can be defrayed and paid faster, thus reducing the risk of failure to fully absorb the funding in time. By expanding already well-functioning projects the logic is further that it is easier to generate an effect through existing projects than through new projects.

26. Unlike the regional and social fund programmes, the rural development and fisheries fund programmes are implemented through a number of grant schemes and related executive orders. The Danish AgriFish Agency has stated that this set-up prevents existing projects from being expanded by new activities because, according to the executive orders on the grant schemes, a round of applications must be run before grants can be made. The agency has stated that it handles the risk of reductions by reprioritising funds from one scheme to another, a method that the agency anticipates will achieve a higher absorption rate. Moreover, the agency expects to take advantage of extraordinary rounds of applications for schemes that allow faster project implementation.

Conclusion

27. Rigsrevisionen's examination showed that both the Danish Business Authority and the Danish AgriFish Agency are actively and continuously following up and reporting on the financial implementation of the programme to avoid funding reductions.

Rigsrevisionen believes the Danish Business Authority and the Danish AgriFish Agency have identified their risk scenarios in terms of absorbing the funds. They actively apply a number of instruments and management tools to counter the risks identified, including continuously following up, expanding existing projects and reprioritising resources among schemes. Rigsrevisionen has no reason to conclude that the risk assessment is inadequate, or that the administration carried out by the two government agencies relative to these risks is inappropriate. Rigsrevisionen finds it positive that the Danish Business Authority and the Danish AgriFish Agency act in accordance with the risks identified. However, the final effect of risk management cannot be evaluated until the programmes have been closed.

4. ... but the risk remains that Denmark may not absorb all funds ...

Rigsrevisionen is of the opinion that the higher the eligible expenses to be defrayed and paid at the end of the programme period, the greater the risk of funding not being absorbed before the programme closes.

4.1. Provisional absorption of funds

28. Rigsrevisionen compared Denmark's provisional absorption of funding under the four funds with that of the other EU member states to see whether Denmark is above or below the EU average.

29. The Commission publishes reports describing the progress of programme fund absorption. Based on these reports, Rigsrevisionen has prepared figure 3, showing each EU member state's provisional absorption rate for each fund.

Figure 3. EU member state absorption rate under the four funds for the period 2007-2013

Note: The data pertaining to the figures have been calculated at different dates and cannot be compared transversely. Figures 3A and 3B were calculated on 15 April 2014, figure 3C on 22 January 2014 and figure 3D on 18 December 2013.

Source: Rigsrevisionen, based on reports from the Commission.

EU member states set up a ***monitoring committee*** *for each programme.*

The monitoring committee is tasked with overseeing that programmes are implemented effectively and to high standards.

Denmark has a monitoring committee for the Regional Fund and the Social Fund, a monitoring committee for the Rural Development Fund and one for the Fisheries Fund. The Danish monitoring committees include representatives of trade associations and ministries.

Figure 3A shows that the absorption rate for the Regional Fund in Denmark is above the EU average. The risk of decommitment of funds is thus lower for Denmark than for the member states that have absorbed a smaller share of their allocation. Figure 3B shows, on the other hand, that Denmark's absorption rate for the Social Fund is below the EU average, which increases the risk of reductions because Denmark must use more of its allocation in 2014 and 2015 than most of the other EU member states in order to fully absorb the funding. The Danish Business Authority has stated that the monitoring committee for the period 2007-2013 has taken several initiatives to use as many of the funds prone to cancellation as possible. To this end, the committee closely follows the projects and regularly discusses the proposed use of the resources with the regional growth forums. Moreover, the Danish Business Authority has stated that grants absorbing the entire multiannual financial framework for 2007-2013 have been made, but that overall, it is unrealistic that the EU grants for the two funds will be fully absorbed. The authority has stated that this is because non-absorbed funds in projects ending in mid-2015 are unlikely to be re-used for other projects before the end-2015 time limit.

Figure 3C shows that Danish authorities' absorption of rural development funds is below the average absorption of other EU member states. The Danish AgriFish Agency has stated that it is to pay EUR 121.4 million in 2014 and EUR 108.9 million in 2015 under the Rural Development Fund. The agency has further stated that a politically prescribed objective to fully absorb Rural Development Fund resources never existed, but that the 2009 Green Growth Agreement enabled full absorption. The Danish AgriFish Agency expects to use all EU funds provided. Rigsrevisionen notes that in 2014-2015 the agency needs to repatriate twice as much as the amount (EUR 230.2 million) repatriated during the other years (2007-2013) in order to fully absorb the allocation. According to the agency, one of the reasons for this is the fact that the EU allocation for the rural development programme was increased by just under 30 per cent halfway into the programme period.

Figure 3D shows that as regards the Fisheries Fund, Denmark's absorption rate is higher than that of most other EU member states. However, in order to fully absorb the allocation, the Danish AgriFish Agency still needs to use approximately 40 per cent of the total allocation in 2014 and 2015. The agency is working to absorb the entire allocation, but considers this unrealistic even though supplementary rounds of applications have been initiated in 2014.

Conclusion

30. The examination shows that Denmark's absorption rate for two of the funds is below the EU average. The figures as a whole are snapshots of the amount of funds absorbed by the EU member states. This may give an indication of the risk scenario. The ministries have not determined the ideal speed for absorbing the funds under the multiannual financial framework, but the higher expenses Denmark has to defray and pay towards the end of the programme period, the greater the risk that the funds will not be absorbed before the programme closes.

4.2. Specific areas of risk

31. The 2007-2013 period has not yet been closed. Denmark may defray and pay expenses right up to the end of 2015, after which comes a period during which accounts will be presented and programmes will be closed. The Danish Business Authority and the Danish AgriFish Agency have stated that specific areas of risk for the remainder of the period exist that may affect the final absorption rate. These areas of risk are described below.

Financial instruments may create false sense of security

32. The Danish regional and social fund programmes apply a so-called financial instrument in the form of private equity funds, set up by the regional growth forums. Nine such private equity funds exist in Denmark with a total capital available for lending at the end of Q1 2014 of EUR 62.2 million, of which EUR 29.4 million is EU-funded. The private equity funds provide capital for small and medium-sized enterprises to the extent that they cannot obtain funding in the ordinary capital market. The Danish AgriFish Agency does not apply financial instruments under the rural development and fisheries programmes.

The Danish Business Authority has stated that at the end of Q1 2014, 75 per cent of the EU-funded capital of these equity funds (equal to EUR 22.2 million) had been granted for loans and/or investments in small and medium-sized enterprises. EUR 13 million of these grants have actually been paid to the enterprises to which the funds chose to make capital available. The amounts actually paid to the ultimate lenders came to EUR 22.2 million, of which EUR 0.9 million constituted EU funds, corresponding to a payment rate of 44 out of the total share of capital funded by the EU.

33. Financial instruments offer the advantage of being revolving, ie, resources lent or invested and returned to the private equity fund in the form of return on investments or instalments on loans may be reinvested in growth and employment, for example – also after the programme period has closed.

When the Danish Business Authority grants funding for a financial instrument, it also contributes to fulfilling the n+2 rule once the funds have been paid to the equity fund. Typically, the authority will pay the EU funds to the equity fund on a regular basis, as the fund enters into agreements on loans or investments. However, in some cases the financial instrument may receive a large payment already on project initiation, that is, before the funds are paid to the enterprises obtaining financing from the equity funds. Nevertheless, when the programme period closes, only the resources paid from the equity fund to the enterprises may be taken into account when calculating eligible expenses.

Accordingly, the private equity fund must repay non-circulated resources on project closure. If repayment is made immediately prior to programme closure, the resources cannot be reused in other projects and funding will be reduced. This constitutes a potential risk that allocated funds will not be spent. However, the amount involved in each given case is not entirely clear until the programme closes.

34. The examination identified major differences in the progress made by the individual loan funds in relation to lending the EU funds they have been granted. In an analysis of financial instruments the Danish Business Authority points out that alternative use of the funds of the financial instruments, which may be impossible to pay out in the project period, must be initiated as soon as possible to generate eligible costs before the programme period 2007-2013 closes.

Rigsrevisionen has established that this task is particularly challenging for the Central Denmark Entrepreneurship Fund, the South Denmark Welfare Technology Fund and the South Denmark Loan Fund for Outlying Areas.

The Central Denmark Entrepreneurship Fund, for example, has a total budget of EUR 13.4 million, of which EUR 6.7 million originates from the Social Fund. At 31 March 2014 this Fund had paid out a total of EUR 1.5 million, of which EUR 0.7 million originates from the Social Fund. The Danish Business Authority estimates that it seems as if it will be difficult for the entrepreneurship fund to achieve the assumed consumption. In this connection, the Central Denmark Growth Forum has requested that the Danish Business Authority postpone the project closing date to 1 July 2015.

Weaknesses in grant administration may reduce absorption rate
35. Protection of the financial interests of the EU is a Commission objective. Recovering unduly paid funds from the member states is one of the methods used to do this.

The Commission's Director-General of Agriculture issued a qualified declaration of assurance on the annual activity report 2013 due to, among other things, reservations concerning payments under the Rural Development Fund in 17 member states, including Denmark.

36. In its Special Report No. 18/2013 the Court concluded that the administrative and control procedures in Denmark to ensure correct payment under the rural development programme were *not effective.* Some of the reasons for the Court conclusion were:

- ineffective checks on eligibility conditions and commitments
- shortcomings in the administrative organisation and internal control of the checks
- incorrect calculations and payments
- systematic weaknesses in measures resulting in approval of ineligible expenditure.

In its reply to the Court's report, the Commission stated that it would follow up on the Court's findings with the national authorities. Rigsrevisionen notes that this follow-up entails a risk that reductions will be made when, prior to programme closing, the Commission will try to 'sort out' the member states facing the problems identified by the Court.

37. In its annual activity report the Directorate-General for Agriculture estimates the level of error for payments under the Danish rural development programme at 6.6 per cent in 2013. According to the report, the Danish AgriFish Agency reported an error level of 3.28 per cent. The Directorate-General for Agriculture has since adjusted the level upwards to 6.6 per cent as a result of the Court's findings and because the action plan drawn up in 2011 failed to cover all the shortcomings identified and ought to be strengthened. Only five member states (Bulgaria, Greece, Rumania, Portugal and France) were estimated to have a higher level of error than Denmark.

38. Rigsrevisionen is of the opinion that the Director-General's qualification and the Court's report indicate a risk of financial corrections being imposed on Denmark that may cause a reduction in the funding allocated to Denmark.

Rigsrevisionen notes that the related risk is not equal to the rate of 6.6 per cent mentioned above, because the actual risk of financial corrections can only be determined if the Commission follows up through audit missions and finds that Denmark's control system has weaknesses or shortcomings.

In February 2014 the Danish AgriFish Agency drew up a list of six current and potential cases of financial corrections by the Commission regarding project support under the Rural Development Fund. The agency has provisionally estimated the potential financial consequences of these cases to range from EUR 6 million to EUR 18.4 million.

39. The Danish AgriFish Agency is responsible for administering the rural development programme in Denmark. The agency has stated that the Court's visit took place in 2011 and that the agency subsequently took several initiatives to improve administrative control, for example, by introducing full vouching procedures for projects.

40. No cases of potential financial corrections regarding the Fisheries Fund exist; similarly, the Danish Business Authority has stated that it has no knowledge of potential financial corrections for the Regional Fund and the Social Fund.

Interruptions and reallocations in the period cause delays

41. Since the start of the 2007-2013 programme period, the Danish AgriFish Agency has implemented the rural development programme through a large number of grant schemes, approximately 34 by mid-2013. During a service check of the Rural Development Programme, the agency found some of these schemes to be ineffective. This service check was one of the factors that motivated a decision to close down well over 40 per cent of the schemes (15 schemes) in connection with the new rural development programme 2014-2020. A service check of the Fisheries Fund Programme was also performed, but the upcoming programme has not yet been decided.

42. Rigsrevisionen considers it positive that the Ministry of Food, Agriculture and Fisheries has made a service check and that ineffective schemes under the Rural Development Programme were closed down. In this connection Rigsrevisionen emphasises the importance of ex ante needs analyses for the grant schemes introduced.

43. Politicians' options for reprioritising and changing policies in the direction they desire are part of the political reality. However, the examination showed that in some cases closing schemes and reprioritising the implementation of the multiannual programmes may cause delay. Such delay increases the risk of funding reductions because no activities are carried out and thus no recoverable expenses are created during this period.

Example 1 describes two situations in which interruptions caused delays in programme implementation.

EXAMPLE 1. INTERRUPTIONS CREATE DELAYS IN PROGRAMME IMPLEMENTATION AND INCREASE THE RISK OF FUNDING REDUCTIONS

Following the Danish general election in 2011, political negotiations were conducted in early 2012 between the Minister for Food and the party spokesmen about the distribution of resources under the Fisheries Fund. In this connection they discussed the underspending in 2011, partly because of the delay in schemes due to the general election and budget negotiations.

The monitoring committee of the Fisheries Fund also discussed the delay and inquired about the lengthy case processing time from application to grant. The agency explained that the reason for the lengthy case processing time was that the grant schemes were temporarily closed down during the election period and not re-opened until the new government had been formed. Once the schemes reopened they all received the same closing date for applications.

The Danish AgriFish Agency has stated that the Rural Development Programme was also discontinued and re-prioritised for political reasons. The general election in 2001, for example, led to zero-setting of the national appropriation for the investment scheme for manufacture and sale of products of the soil, meaning that the agency made no grants under this scheme during 2002 and 2003.

44. The Commission highlighted the risk of a reduction in the funds allocated in a letter to the Danish AgriFish Agency in October 2013. In the letter the Commission warned the agency of the risk that the funds allocated to the Fisheries Fund might be reduced.

Conclusion

45. The various challenges described above all indicate that improved management will reduce the risk of reductions in the allocation under the financial framework period 2014-2020.

One way of reducing the risks deriving from the specific risk areas is improved management, for example, by ensuring that decision-makers are aware that interruptions in programme implementation may have implications for Denmark's ability to fully absorb the funding provided by the EU funds.

5. ... and even better management may reduce this risk during the financial framework period 2014-2020

5.1. Objectives and milestones

46. The examination showed that ministries fail to set objectives and milestones to ensure ongoing absorption of the funding from the start of a programme.

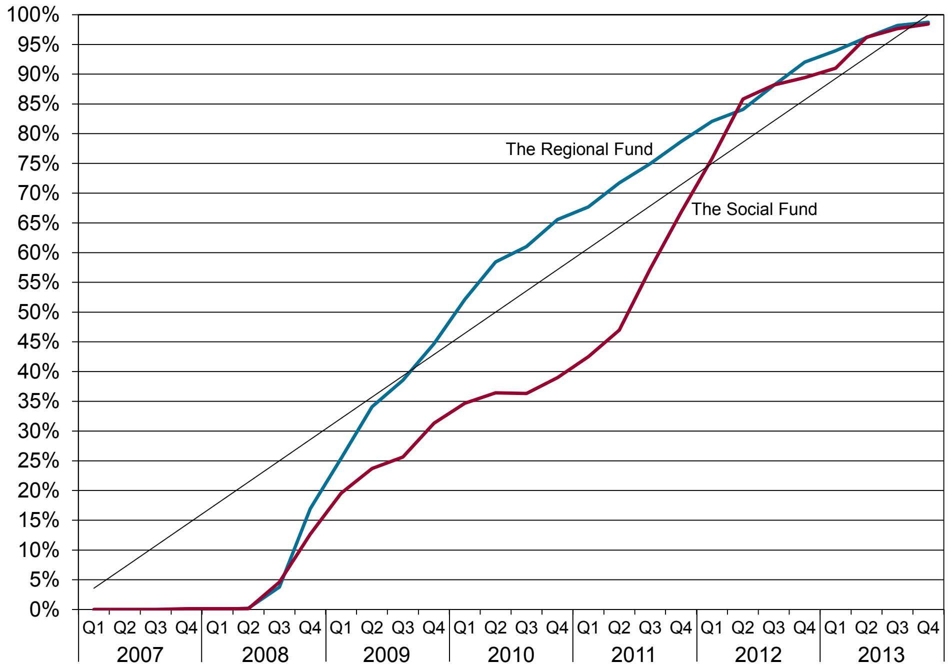
47. Rigsrevisionen believes that the financial implementation of multiannual programmes can be better managed if the ministries set objectives and milestones for grants and payments. Objectives and milestones will enhance management during the period concerned, because they highlight whether programmes are proceeding according to plan.

Rigsrevisionen is of the opinion that the authorities' objectives and milestones should take into account the risks of a funding reduction as a result of the n+2 rule. In this connection Rigsrevisionen notes that large-scale granting and payment of resources early in the programme period will enhance absorption of the national financial frameworks in relation to the n+2 rule. Objectives and milestones should not detract focus from compliance and impact.

Both the Ministry of Business and Growth and the Ministry of Food, Agriculture and Fisheries have stated they agree with the above observation.

48. The need for objectives and milestones is illustrated below. Figures 4 and 5 show the financial implementation of regional and social fund programmes. Rigsrevisionen would like to inform the Public Accounts Committee that the trends in the rural development and fisheries fund programmes also show higher absorption for the final part of the programme period.

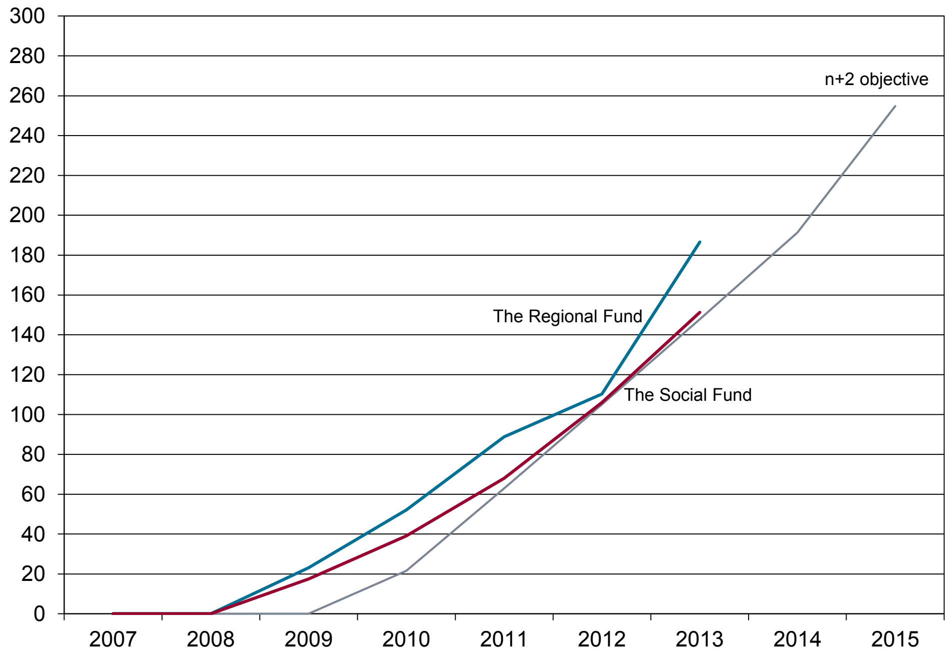
Figure 4. Grants for the period 2007-2013



Source: The Danish Business Authority.

Figure 4 shows that early in the period the volume of grants for the Regional Development Programme exceeds that for the Social Fund Programme early in the programme period. This is of particular benefit in relation to full absorption of Denmark's financial framework: the higher the volume of grants early in the programme period, the better the opportunity for generating expenses in the course of the programme period, which the agencies may recover from the EU, thus increasing the potential for full absorption of the funding options.

Figure 5. Payments from the EU for the period 2007-2013 (EUR million)



Note: The grey line shows the financial implementation that the funds are required to accomplish to avoid a funding reduction during the period (n+2).

Source: The Danish Business Authority.

Figure 5 shows that a higher volume of grants for the Regional Fund Programme – compared with the Social Fund Programme – leads to a higher absorption rate earlier in the programme period and thus less risk of financial framework reductions.

49. The Minister for Business and Growth divides the allocations for the two programmes into regional sub-allocations that are made available to each growth forum in the programme period. When allocations are made, no objectives and milestones are set for regional growth forum grants.

EXAMPLE 2. EVEN DISTRIBUTION OF THE MULTIANNUAL FINANCIAL FRAMEWORK FOR 2007-2013

In an effort ensure that resources were also available for the growth forum to be established after the regional election in 2010, Growth Forum Southern Denmark distributed the funds allocated under the framework evenly to all seven years. Growth Forum Southern Denmark and the Danish Business Authority agree that equal distribution of the funds allocated leads to n+2 problems, because many projects are delayed or not implemented as planned, thus increasing the need for eligible expenses later on in the period. The consequent rise in expenses towards the end of the programme increases the risk of funding reductions. Growth Forum Southern Denmark has therefore taken steps to ensure that as many grants as possible are made early in the programme period in the future.

The Danish Business Authority has stated that in the forthcoming programme period, growth forums must prepare action plans that include allocation and payment profiles for the funds allocated.

50. In addition to general management enhancement, Rigsrevisionen is of the opinion that clear objectives and milestones can also reduce the risk of cancellations due to interruptions in programme implementation or missing payments from the financial instruments.

5.2. Overbooking?

51. One reason that it may be difficult for EU member states to absorb the financial frameworks for co-financing from the EU is that it is difficult forecast expenses accurately. Consequently, the member states do not always have an adequate amount of defrayed and paid expenses that can be recovered from the EU. Overbooking is one way of increasing the absorption rate.

52. In this context, overbooking means that the responsible national authority grants more EU funds than appropriated by the Commission's decision to allocate resources to the national programme.

53. The reason for overbooking is that a certain amount of the assumed expenses and grants made will be decommitted. In the case of overbooking, the additional grants will compensate for decommitments of funds late in the programme period at a time when it may be difficult to re-use the EU funds for other new projects.

The advantages of overbooking may be higher (or full) absorption of the EU funding and that numerous new projects or activities in existing projects need not be initiated over a short period of time to replace funds cancelled. Furthermore, this makes for smoother administration, because administrative resources need not be devoted at the end of the period in an attempt to re-use resources in time.

One disadvantage of overbooking may be the risk that a small portion of the expenses has to be fully financed through national funds without EU funding. The member state must itself finance the portion of the EU grant that exceeds the maximum funding allocated by the EU to the member state.

54. In Special Report No. 3/2012, the Court reports that several member state authorities have a buffer ranging from 1 per cent to 28 per cent of additional eligible expenses that can be applied to counter framework reductions in connection with programme period closure.

Furthermore, the Danish Business Authority has stated that during a presentation of the programme period closure, Commission officials recommended that member states consider overbooking to maximise their absorption of the funding available in the field of the structural funds.

55. Example 3 provides a theoretical example of overbooking.

EXAMPLE 3. OVERBOOKING

Illustrative fictitious example:

Fund X
Total EU financial framework: EUR 500
EU funding: 50 per cent

Without overbooking
100 projects with budgeted expenses of EUR 10 per project = total budgeted expenses of EUR 1,000.

Funding: EUR 500 EU resources and EUR 500 national resources.

In connection with programme closure the actual accounts show that EUR 50 of the budgeted expenses were not defrayed and paid, that is, total expenses amount to EUR 950. Under the programme the EU grant rate of 50 thus equals EUR 475. The repatriation rate can then be calculated at EUR 475/ EUR 500 = 95 per cent.

EUR 25 of the allocation remains unspent.

With overbooking
105 projects with budgeted expenses of EUR 10 per project = total budgeted expenses of EUR 1,050.

Based on 50 per cent EU funding, the EU resources amount to EUR 525 (additionally EUR 25 is allocated compared with the programme allocation according to the Commission's decision) and the national resources amount to EUR 525. Grants at 105 per cent of the EU funds allocated are thus made.

In connection with programme closure the actual accounts show that EUR 50 of budgeted expenses were not defrayed and paid, thus bringing total expenses to EUR 1,000. The funding provided by the EU will amount to EUR 500 and 50 per cent of total expenses.

The repatriation rate will thus amount to EUR 500/EUR 500 = 100 per cent.

The allocation is fully absorbed.

However, if it is established in connection with programme closure that budgeted expenses of EUR 1,030 have been defrayed, paid and are eligible according to the grants made, then the grantor (eg, the Danish Business Authority) is obliged to provide co-funding of EUR 515, or an extra EUR 15 over and above the amount recovered from the EU, because grants are for 50 per cent of the total expenses. The sum of EUR 15 is thus payable from the grantor's (the Danish Business Authority's) own resources, and the grant rate is EUR 515/EUR 500 = 103 per cent.

56. The Danish Business Authority has stated that it does not use overbooking for the Regional Fund and the Social Fund in Denmark, but that several other member states like Sweden and Austria do.

The Danish Business Authority has added that overbooking may also be used to improve absorption rates but that this decision must be made within the auspices of the Danish Appropriation Act.

57. The Danish AgriFish Agency has stated that it does not use overbooking for the Fisheries Fund. The Rural Development Fund has budgeted for overbooking regarding the multiannual financial framework 2007-2013, that is, more commitments are made than assumed in the financing plan. The agency expects funds to be decommitted during the period and considers overbooking feasible because some commitments are multiannual and may be paid out of the EU resources provided for the old (2007-2013) as well as for the upcoming (2014-2020) programme period.

58. Rigsrevisionen finds that the relevant ministries and the Ministry of Finance should consider the pros and cons of a certain amount of overbooking, that is, committing to developing a project pipeline that is larger in volume than the financial scope of the programme to counter the risk of reductions of the financial framework.

Rigsrevisionen, 14 August 2014

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