Memorandum to the Public Accounts Committee on report on the European Court of Auditors' annual report for 2013 and on Rigsrevisionen's cooperation with the Supreme Audit Institutions of the European Union

RIGSREVISIONEN

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SUMMARY

In this memorandum, Rigsrevisionen informs the Danish Public Accounts Committee of the results of the European Court of Auditors' audit and provides an overview of the main conclusions presented in the ECA's annual report for 2013.

In its report, the ECA concludes that the consolidated accounts of the European Union (EU) are correct but affected by too many errors in the underlying payments, like in previous years.

In this memorandum, Rigsrevisionen will also update the Public Accounts Committee on three key issues that preoccupy the Supreme Audit Institutions of the EU Member States:

- achieving results and impact with EU funds;
- the Europe 2020 Strategy and a new landscape review of accountability and public audit issued by the ECA;
- the significance of the EU banking union for independent external public auditing of the financial sector.

I. Introduction and background

1. The European Court of Auditors (ECA) audited the EU's accounts and presented its 2013 annual report to the European Parliament (the Parliament) on 5 November 2014. On the same date, the annual report was submitted to the national parliaments, including the Danish Folketing. The Public Accounts Committee also received a letter from Henrik Otbo, the Danish member of the ECA, with a briefing on the annual report. The annual report is accompanied by a summary report in which the ECA summarises the results of its audit of the EU's 2013 accounts.

2. The Commission and the individual Member States share the management of the bulk of EU expenditure. The Commission has overall responsibility for the correct implementation of the EU budget, whereas the Member States select and check eligible projects and execute payments to the final beneficiaries. This makes the Member States co-responsible for managing EU funds.

The audit conducted by the ECA is part of the chain of accountability (figure 1) that leads to the approval of the EU budget and accounts (discharge).

Figure 1. Chain of accountability for approval of the EU accounts

Source: Rigsrevisionen, based on the ECA's landscape review of accountability and public audit.

The ECA annual report is thus one of the elements in the discharge procedure of the Council for the European Union (the Council) and the Parliament, which is a political assessment and approval of the Commission's and other EU institutions' management of the EU budget.

3. Thus, in its annual report, he ECA does not provide an assessment of EU fund management in the individual Member States, but focuses on the management of the overall EU budget. The Member State SAIs and the ECA cooperate on an ongoing basis, but the ECA oes not apply the work of the individual SAIs directly in its audit, nor do the SAIs use the work of the ECA. The reason is that the focus of the audit work performed is not the same; the ECA's focus is on the Commission and the EU as such, whereas the national SAIs are focused on the management of EU funds in their respective countries.

4. The report on the audit of EU funds in Denmark in 2013 was considered by the members of the Public Accounts Committee at its meeting on 17 September 2014. The report concerns the management of EU funds in Denmark, i.e. revenue received from the EU budget and contributions made by Denmark to the EU budget. In its report, Rigsrevisionen assesses the quality of the overall management of EU funds in Denmark.

The ECA has estimated that the total expenditure of the EU per capita is approx. EUR 290, i.e. approx. 1 per cent of the EU's gross domestic product and approx. 2 per cent of the total public expenditure of all Member States.

II. Main conclusions in the statement of assurance and the Court's annual report

5. The ECA's 2013 annual report presents the results of its financial audit and a summary of its performance audit. The ECA's audit comprises EU revenue and expenditure. In 2013, revenue was EUR 149.5 billion and expenditure totalled EUR 148.5 billion.

6. Based on the audit results, the ECA made the following conclusion.

*An **adverse opinion** is issued when the auditor disagrees with the information provided by the management in the accounts – or if the auditor has been unable to procure sufficient evidence of the correctness of the information included in the accounts.*

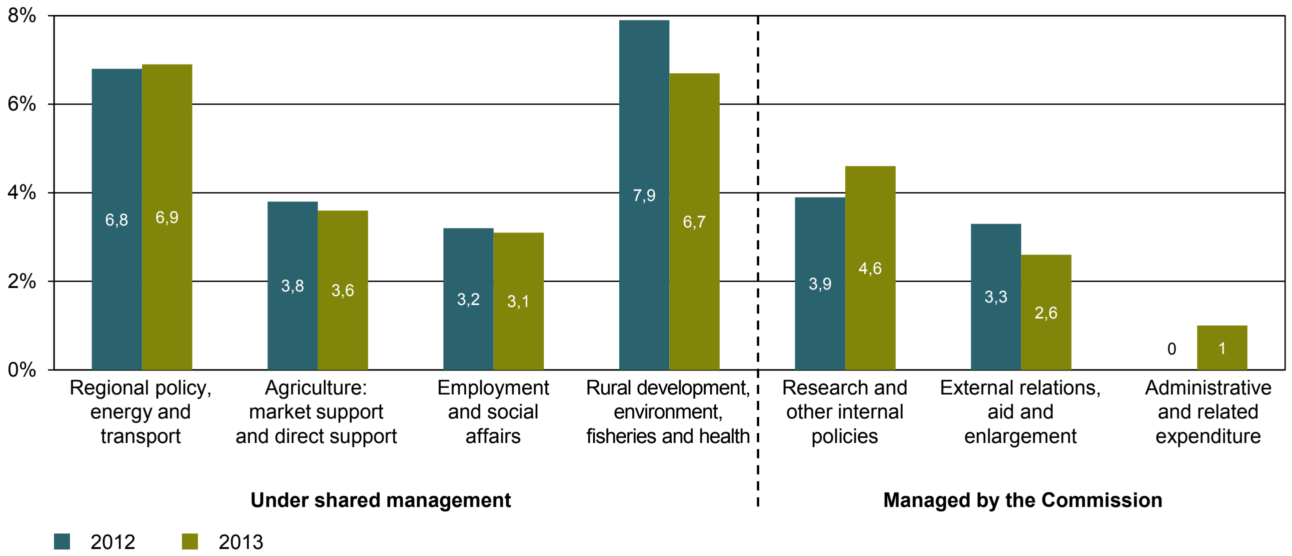
The EU's consolidated accounts are correct, but the ECA issues an adverse opinion on the legality and regularity of the payments underlying the accounts.

The ECA estimates the error rate at 4.7 per cent and therefore concludes that payments are materially affected by error.

The ECA has thus issued a clean opinion on the reliability of the accounts for seven consecutive years, which means that the ECA has confirmed the overall correctness and regularity of revenue and commitments concerning 2013. However, the ECA has also established that supervisory and control systems in the Member States are only partially effective in ensuring the legality and regularity of the payments underlying the accounts. The ECA has estimated the error rate at 4.7 per cent, meaning that 4.7 per cent of all payments executed from the EU budget in 2013 were irregular. For the issue of a clean opinion, the error rate must be under 2 per cent. The error rate has dropped marginally in 2013 compared with the estimated error rate of 4.8 per cent in the 2012 annual report. A detailed overview of the ECA's assessment of the various spending areas is presented in appendix 1.

7. The ECA estimates that six out of seven EU expenditure areas are materially affected by error. The areas most affected are *Regional policy, energy and transport* (6.9 per cent) and *Rural development, environment, fisheries and health* (6.7 per cent). No material errors were detected in *Administrative and other expenditure* (1 per cent) or in *EU revenue* (0 per cent). A comparison of estimated error rates for the various spending areas in 2012 and 2013 is shown in figure 2.

Figure 2. Estimated error rates for EU spending areas 2012 and 2013



Source: *EU audit in brief – Introducing the 2013 annual reports of the European Court of Auditors.*

The ECA highlights that more errors are detected in the areas where management is shared between the Commission and the Member States than in the spending areas that are mainly managed by the Commission. The ECA has estimated the overall rate of error for spending under shared management at 5.2 per cent against an error rate of 3.7 per cent for spending under direct management.

The ECA repeats in its 2013 annual report that the Member State authorities, in many cases, had access to the information necessary to detect and correct the errors.

This year the ECA has estimated also how the error rates would be affected if the Member State authorities had used the information and control systems that are at their disposal to reduce the error rate. Four spending areas under shared management went through this exercise, cf. table 1.

Table 1. Potential error rates if the Member States' had used available information

Spending areas	Error rate 2013	Potential error rate
Regional policy, energy and transport	6.9 %	3.9 %
Agriculture: market support and direct support	3.6 %	2.5 %
Employment and social affairs	3.1 %	1.8 %
Rural development, environment, fisheries and health	6.7 %	2.0 %

Source: Rigsrevisionen based on the *EU audit in brief – Introducing the 2013 annual reports of the European Court of Auditors*

However, it should be noted that the ECA also states that if the Member States had not imposed any corrective measures, the total error rate would have been 6.3 per cent rather than 4.7 percent.

8. Rigsrevisionen is of the opinion that this conclusion should be viewed from two perspectives. Firstly, the error rate is not a reflection of the quality of administration in the individual Member States; the error rate is a reflection of an EU-level assessment and therefore the potential for reducing the error rate in Denmark cannot be directly deduced from the numbers above.

Secondly, Rigsrevisionen is of the opinion that the total estimated error rate of 4.7 per cent should be seen, not as a final indicator of the extent to which the EU budget has financed irregular expenditure. The error rate does not reflect flat-rate corrections, and subsequent corrections may entail that the final annual error rate is reduced to a level below the one reported by the ECA. The audit conducted by the ECA also leads to the detection of errors that may lead to financial corrections later in the programme period,

9. According to the ECA's annual report, some error types appear frequently and the most common errors are:

- applications for payment concerning ineligible expenditure under an eligible project;
- applications for payment concerning ineligible projects, activities or beneficiaries;
- procurement errors like, for instance, failure to comply with the tender requirements;
- incorrect measurement of eligible agricultural land, or applications for payment concerning ineligible land.

10. Last year, the ECA pointed out that the Commission is struggling with a build-up of payment commitments. The gap between commitments and payments is sometimes quite wide due to the nature of the EU's spending programmes, i.e. the long time lag between the appropriation of funds for a project and the execution of payments to the beneficiaries. In its annual report for 2013, the ECA notes that commitments have increased from EUR 313 billion as per 31 December 2012 to EUR 322 billion as per 31 December 2013. This development should be seen in relation with total budget spending in 2013 of EUR 148.5 billion.

The ECA has particular focus on this issue because many payments are released towards the end of a framework period and the ECA wants the Commission to address the risk that it may potentially be unable to fulfil its payment commitments. Since there is growing pressure on future payment obligations, the ECA has encouraged the Commission to publish a long-range cash-flow forecast.

III. Results and impact with EU funds

11. Again this year, the ECA has reserved a chapter in its annual report to address the Commission's ability to achieve results with the EU budget (chapter 10 on performance in the annual report).

Most of the EU budget – in particular funds under shared management – is distributed among the Member States in connection with the adoption of the seven-year framework programmes. The ECA has reviewed the Commission's performance with regard to achieving results and impact in connection with the 6th programming period that covered the years 2007-2013.

In its annual report, the ECA criticises the Commission for focusing too much on spending money rather than on achieving results. In the opinion of the ECA, the root of this problem is the design of the framework programme. Funds are earmarked for the individual Member States, but if a Member State fails to absorb the funds, i.e. spend the money through projects, the money will be transferred back to the EU. According to the ECA, this means that too much focus is on "use it – or loose it" and not enough on achieving results with the money that is spent.

12. Rigsrevisionen agrees with the ECA that keeping focus on achieving results and impact with the EU funds is essential. However, seen from a national perspective, Rigsrevisionen also considers it important that Denmark uses funds allocated from the EU to their full potential, in a responsible manner. Rigsrevisionen has also addressed the issue of absorption of EU funds in report no. 23/2013 on Denmark's ability to absorb funds allocated from the EU budget. This report was submitted to the Public Accounts Committee in August 2014.

In the ***report on Denmark's absorption of EU funds,*** *Rigsrevisionen concluded that Denmark could do more to fully use funds allocated from the EU budget.*

At the same time, Rigsrevisionen emphasized, however, that setting well-defined objectives and milestones for the programmes would help ensure better use of the financial framework.

13. Again, this year, the ECA urges the Commission to ensure that the Member States focus on both compliance with the rules and performance in connection with the 7th programming period (2014-2020). The 7th programming period includes a performance reserve of 6 per cent, which will be released only if the performance of the respective Member State is considered satisfactory. The Commission expects that this measure will increase the Member States' focus on achieving good results. The ECA does emphasize, however, that the effectiveness of this measure will depend on the Commission's ability to negotiate suitable targets and milestones with the Members States and obtain reliable data to determine whether the targets have been met.

14. The ECA has, in its special reports, also focused on performance and the principles of sound financial management and has concluded that not all the projects launched secured added value for the EU. They did not add value that would otherwise not have been achieved through projects and initiatives financed by the Member States. The ECA stresses that creating added value for the EU is what justifies the implementation of projects that are financed through the EU budget. At the same time, the ECA notes in several of its audits that, it can be difficult to determine whether actual added value has been created or the EU financing has served as a substitution for national funds that have subsequently been released for other purposes. The ECA has also detected several incidents of deadweight, meaning that the beneficiaries would have invested in and implemented projects also without funding from the EU. The ECA has recommended that the Commission should continue to develop its performance and reporting system to mitigate the risks referred to in the above.

IV. Europe 2020 strategy

15. In 201, the Commission presented its proposal to a new EU strategy for sustainable growth – the so-called Europe 2020 strategy. The strategy builds on three overall priorities; intelligent, sustainable and inclusive growth. In order to meet the priorities of the strategy, the Commission has set five objectives that must be achieved by 2020. National targets have been set for the individual Member States in addition to the overall targets set at EU level. Table 2 presents an overview of the five targets set for the EU and Denmark, respectively.

Table 2. 2020 targets set for the EU and Denmark

	EU	Denmark
Share of population between the ages 20 and 64 that is employed	75 %	80 %
Share of GNP to be invested in research and development	3 %	3 %
EU climate goals to be achieved through		
• limiting greenhouse gas emissions	20 %	20 %
• renewable energy	20 %	30 %
Share of young people who		
• drops out of school early	Max. 10 %	Max. 10 %
• completes tertiary education	Min. 40 %	Min. 40 %
Reduce the number of people at risk of poverty to	20 million	22,000

Source: Rigsrevisionen, based on information provided on the Commission's website.

16. In order to support achievement of the 2020 priorities, the Commission has decided that, not only must EU funds and supported activities address national and regional challenges, they should also contribute to implementing the 2020 strategy and achieving the specific targets set for growth, employment, etc. With the framework programme for 2014-2020, the European structural and investment funds will – for the first time – be governed by a common set of rules. The purpose of this innovation is to align and simplify the application of funds to ensure more strategic and complementary use of the different sources of EU funding in order to strengthen growth and employment.

Several SAIs have already analysed national progress on the Europe 2020 targets. The SAIs have different approaches to assessing the effectiveness of the measures implemented nationally to achieve one or several of the 2020 targets. The ECA has invited Rigsrevisionen to participate in an informal collaboration on achievement of the 2020 objectives and Rigsrevisionen is considering how the 2020 objectives can be incorporated in our planning of future audits.

V. Landscape review of accountability and public audit

17. In the autumn 2014, the ECA published its first landscape review of accountability and public audit in the EU. The ECA has not published a report of this type before; it aims to provide a basis for reflection and debate among the European policy makers and legislators. Instead of reporting on actual audit findings, the report gives an analysis of cross-cutting issues on macro-economic level based on experience gained from audits and research conducted.

18. The landscape review addresses the chain of accountability in relation to the EU's management and financial control, and whether the independent external auditor's mandate and right of access to necessary information are appropriate. The ECA's focus on the chain of accountability serves to highlight the democratic (particularly the parliamentary) oversight of EU policy and activities through pointers to issues that the ECA thinks should be discussed by the European policy makers and legislators.

In the report, the ECA points to six areas (figure 3) that are facing accountability and public audit challenges.

Figure 3. Accountability and public audit challenges

EU/Member State coordinated actions	Important to coordinate public audit on EU level in connection with coordinated actions.
Funds managed in partnership with others	Important to meet the transparency and accountability needs of both public and other stakeholders involved in partnerships.
EU multi-speed/variable policy architecture	Important to provide democratic scrutiny and comprehensive public audit for subsets of Member States and third countries participating in different policy areas or instruments.
EU set-up (institutions and bodies)	Important to ensure sufficient oversight and audit of all EU institutions and bodies.
Financial audit and performance management	Important to improve accountability for the overall quality of financial and performance management.
Policy impact and results	Monitoring and evaluating the impact and results of EU policy.

Source: Rigsrevisionen, based on the ECA's landscape review on accountability and public audit.

The complete report can be found on the ECA's website. The ECA has also made a video that presents the main conclusions of its review. This can be viewed on the ECA Official Video Channel – YouTube.

VI. The banking union and audit gap

19. Rigsrevisionen collaborates with the SAIs of the other Member States through the EU Contact Committee. In this forum, the SAIs discuss issues of common interest and exchange knowledge and experience in networks, working groups and through joint audits. In recent years, the focal point of the collaboration has been the financial and economic crisis paired with the financial and economic development in the EU.

20. The establishment of the banking union is currently attracting much attention. One of the elements in the banking union is a common European banking supervision, which will, initially, comprise the euro countries and banks in the Eurozone. It is optional for the Member States outside the Eurozone to participate. The financial crisis and the debt crisis demonstrated that not all national banking supervisory authorities were equally effective, and when the mechanism for resolution of banks in difficulties was created, it was therefore decided to support this with a common banking supervision system.

The heads of the Member State SAIs believe it is important to ensure that the banks in the EU are subject to adequate supervision also after the establishment of the single supervisory mechanism in the EU, and that the supervisory mechanism and related measures are transparent and subject to adequate public auditing.

With the establishment of the banking union, the supervision of a large number of banks will be transferred from the individual Member States to the European Central Bank (ECB). The ECA has not previously audited the ECB's supervision of these banks, whereas some SAIs audit their national banks or financial supervisory authorities routinely.

21. Denmark is not part of the Eurozone and therefore not obliged to join the banking union. At this point, it has not been decided whether Denmark should join or not. Rigsrevisionen's audit of the Danish Financial Supervisory Authority, among others, will thus not currently be affected by developments in this area.

22. However, our colleagues in the Member States that have joined the banking union are very concerned about the development; they are faced with an emerging audit gap caused by less national public audit of the banking sector in a large number of Member States. This concern is reflected in the ECA's landscape review, section V and in the annual EU Trend Report 2014 that is published by the Dutch SAI (Algemene Rekenkamer).

VII. Comments by Rigsrevisionen

23. Rigsrevisionen finds it positive that the ECA for the 7th consecutive year has issued a clean opinion on the annual accounts of the EU. However, at the same time, it is a cause of concern that the ECA has again been forced to issue an adverse opinion, because payments from the EU budget are materially affected by error. The error rate is largely the same as last year, and again this year, the ECA arrives at the conclusion that the system for the administration of EU funds is only partially effective.

It is not possible to draw any conclusions concerning the effectiveness of the individual Member States' administration of EU funds based on the annual report. Still, Rigsrevisionen is encouraged by the limited number of references made to Denmark in the report and the fact that the ECA has not highlighted any negative cases or results related to Denmark in its publication *EU audit in brief – Introducing the 2013 annual reports of the European Court of Auditors*.

24. Rigsrevisionen also finds it positive that the ECA continues to focus on the performance and impact achieved with EU funds. It is essential that the vast amount of EU funds that are managed by the EU institutions and Member States are spent wisely to achieve the intended objectives and impact.

25. Rigsrevisionen has, with great interest, read the ECA's review of the chain of accountability and public audit of EU funds and looks forward to debating the issue in the future. Rigsrevisionen shares the concern of our colleagues in the EU regarding the development towards less independent external audit of the European banks and the banking sector.

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Appendix 1. Results of the ECA's findings

Distribution of the bulk of EU expenditure and revenue in 2013	EUR billion 2013	Error rate 2012	Error rate 2013	Assessment of supervisory and control systems	Conclusion
Regional policy, energy and transport	45.5	6.8 %	6.9 %	**Partially effective**	**Materially affected by error**
Agriculture: market support and direct support	45.0	3.8 %	3.6 %	**Partially effective**	**Materially affected by error**
Employment and social affairs	16.2	3.2 %	3.1 %	**Partially effective**	**Materially affected by error**
Rural development, environment, fisheries and health	15.6	7.9 %	6.7 %	**Partially effective**	**Materially affected by error**
Research and other internal policies	10.4	3.9 %	4.6 %	**Partially effective**	**Materially affected by error**
External relations, aid and enlargement	6.0	3.3 %	2.6 %	**Partially effective**	**Materially affected by error**
Administrative and other expenditure	10.6	0 %	1.0 %	Effective	Free from material error
Total audited expenditure	**149.3**[1)]	**4.8 %**	**4.7 %**	**Partially effective**	**Materially affected by error**
Revenue	149.5	0 %	0 %	Effective	Free from material error

1) The variance between expenditure in 2013 (EUR 148.5 billion) and total audited expenditure (EUR 149.3 billion) is related to the fact that total audited expenditure includes payments executed in 2013 less advances paid in 2013 plus settlement of advances made in 2013 and payments made from financial instruments to final beneficiaries.

Note: The supervisory and control systems are considered effective when the error rate is below 2 per cent.

Source: The ECA's annual report 2013 and the ECA's *EU audit in brief – Introducing the 2013 annual reports of the European Court of Auditors*.