

EUROPEAN  
COURT OF AUDITORS

Opinion No 1  
2010

IMPROVING THE FINANCIAL MANAGEMENT  
OF THE EUROPEAN UNION BUDGET:  
**RISKS AND CHALLENGES**



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# INTRODUCTION

1. Since 1999 the Commission has attached considerable importance to improving the financial management of the European Union (EU) budget, amongst other things by implementing a programme of internal administrative reform and setting as a priority the reduction of the level of irregular spending as well as launching initiatives to improve the supervision and control of EU funds and to reform the EU budget<sup>3</sup>. The President of the Commission has indicated that all new Commission initiatives will be inspired by the principle of “smart regulation”<sup>4</sup>.
2. In recent years, the Court has reported improvements in the internal control at the Commission and an overall reduction in the level of irregular payments<sup>5</sup>. However, the Court continues to report a high level of irregular payments in substantial areas of the budget<sup>6</sup> and scope for improving important aspects of diverse EU expenditure programmes and schemes. The planned revision of the financial regulation, the new financial framework, and budgetary reform will provide significant opportunities to address the issues the Court identifies.
3. This document aims to bring together the main messages of recent annual and special reports of the Court in order to identify the main risks and challenges to reducing further the level of irregularity as well as improving the quality of EU spending.

<sup>1</sup>Reforming the Commission, A White Paper (COM(2000) 200/ Final 2).

<sup>2</sup> Action Plan towards an Integrated Internal Control Framework (COM(2006) 9 and SEC(2006) 49).

<sup>3</sup>Reforming the Budget, Changing Europe (SEC(2007) 1188 final).

<sup>4</sup> *Political guidelines for the next Commission*, José Manuel Barroso, Brussels, 3 September 2009.

<sup>5</sup> *Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2008* (AR 2008), Chart 1.1.

<sup>6</sup> AR 2008, Table 1.3.

## REDUCING FURTHER THE LEVEL OF IRREGULARITY

### WHAT ARE THE HIGH RISK AREAS ?

4. Although the overall level of irregularity has fallen, it remains high in significant areas of expenditure. The areas where the Court has found the highest levels of irregularity are in payments for **Cohesion** and **External Aid, development and enlargement**, including pre-accession and neighbourhood programmes. In addition, a high level of irregular payments has been found for the **Framework programme** for Research and technological development and **Rural development** expenditure<sup>7</sup>. <sup>7</sup> AR 2008, Table 1.3.
5. The vast majority of the expenditure in these areas is multi-annual in nature and linked to specific programming periods. Most relates to the reimbursement of costs claimed by final beneficiaries.
6. Cases of irregularity (“errors”) most commonly occur in interim and final payments and are the result of ineligible claims by beneficiaries, over-declaration of eligible costs, and non-compliance with conditions for payment, in particular public procurement rules. The two principal causes the Court has identified for such errors are:
  - (a) deficiencies of systems to control the risks at the final beneficiary level, and
  - (b) the complexity of the eligibility rules and other conditions with which beneficiaries must comply.
7. The Commission has persistently claimed that the “multi-annual nature” of the expenditure concerned means that most errors can be detected and corrected before the closure of the relevant programmes. However, the Court considers that there is, at present, insufficient information available to support this claim.
8. Although changes have been made to financial management systems for the 2007-13 programming period it is too early to say whether they have reduced the level of error since most payments so far are pre-financing or advances, for which there are few conditions. In the case of Cohesion the Court has noted that the late application of the new elements introduced as pre-conditions for first interim payments might slow budgetary implementation and increase the risk that control systems do not prevent or detect errors in the start up phase.

- 9.** The European Economic Recovery Plan (EERP) implies an additional risk as it increases the proportion of expenditure paid in advances in a number of high risk areas where supervisory and control systems are only partially effective, in particular Cohesion and Rural development.

<sup>8</sup> AR 2008, paragraph 2.36.

<sup>9</sup> AR 2008, paragraph 7.42.

<sup>10</sup> Commission Communication "Towards a common understanding of the concept of tolerable risk of error" (COM(2008) 866 final).

### **WHAT MORE COULD BE DONE TO REDUCE IRREGULARITY?**

- 10.** The Commission should address the specific systems weaknesses the Court has found in the areas with the highest levels of irregularity. This also implies continuing to monitor the effects of actions already taken as well as improving the reliability of the assessments of the strength of internal controls and of the areas of high risk made in the Annual Activity Reports and declarations of Directors General of the Commission. In this context there is also scope for the Commission to seek to enhance the quality of the Annual Summaries by Member States in order to increase the assurance it can derive from them<sup>8</sup>.
- 11.** The Commission should pay attention to improving the financial correction and recovery mechanisms related to the closure of the 2000-2006 programming period and the Research Framework Programmes<sup>9</sup>. To this end, there is a need for an improvement in the quality of data that Member States are required to supply to the Commission on financial corrections and recoveries in Cohesion and Agriculture and Rural Development.
- 12.** There is, however, a limit to the improvements that can be made to supervision and control without significantly reforming the underlying rules and regulations. As controls increase and error rates fall, the control costs may begin to outweigh the benefits of further reductions in errors. This reality has been recognised by the Commission<sup>10</sup>. There is now a need for good quality information on control costs in the areas of highest risk as a basis for establishing where the appropriate balance may lie. And where no such balance can be found, it is appropriate either to reform or reconsider the programmes and schemes in question.
- 13.** Simplification should remain a priority when reforming the rules and regulations of existing or new expenditure programmes and schemes because rules and regulations that are clear to interpret and simple to apply not only decrease the risk of error but can also reduce the control costs. However, care is needed to ensure that due attention is also paid to the likely effects on the quality of spending of introducing simplification primarily aimed at reducing the level of irregularity.

# IMPROVING THE QUALITY OF SPENDING (ECONOMY, EFFICIENCY AND EFFECTIVENESS)

## WHERE IS THERE SIGNIFICANT SCOPE FOR IMPROVEMENT ?

- 14.** Each year the Court audits a number of specific financial management topics, publishing its findings in special reports. Taken together these reports reveal a number of recurrent themes relevant to improving the **selection, design and operation of expenditure programmes and schemes**, and hence, the quality of spending. In particular, the Court notes in its reports examples of the following eight problems:
- expenditure programmes and schemes not delivering genuine European added value<sup>11</sup>;
  - too wide-ranging, unclear or somewhat conflicting policy objectives<sup>12</sup>;
  - insufficient policy instruments and resources to meet the objectives set<sup>13</sup>;
  - unclear “intervention logic” setting out the causal links between the funded activities and the desired outcomes<sup>14</sup>;
  - overly complex or unverifiable eligibility criteria increasing administrative costs and the risk of non-compliance as well as undermining control and targeting<sup>15</sup>;
  - unclear roles and responsibilities (a particular problem in areas of shared management and development assistance) which undermines ownership and reduces effectiveness and sustainability<sup>16 17 18</sup> ;
  - deficiencies in monitoring and evaluation arrangements<sup>19</sup>;
  - inadequate access to documents and information in some areas of joint management involving international organisations<sup>20</sup> preventing effective monitoring<sup>21</sup>.
- 15.** In many cases, the design of the expenditure programmes and schemes has been developed in a piecemeal way from one programming period to another to address specific issues with insufficient provision for periodic fundamental review and reform to adapt the design of the intervention to changing needs and circumstances.
- <sup>11</sup> Special Report No 2/2009 - The European Union's public health programme 2003-07: an effective way to improve health ?
- <sup>12</sup> Special Report No 14/2009 - Have the management instruments applied to the market in milk and milk products achieved their objectives ?
- <sup>13</sup> Special Report No 10/2008 - EC Development Assistance to Health Services in Sub-Saharan Africa
- <sup>14</sup> Special Report No 8/2009 - 'Networks of excellence' and 'Integrated projects' in Community Research Policy: did they achieve their objectives ?
- <sup>15</sup> Special Report No 8/2008 - Is cross-compliance an effective policy ?
- <sup>16</sup> Special Report No 6/2007 - Effectiveness of technical assistance in the context of capacity development
- <sup>17</sup> Special Report No 1/2009 - Banking measures in the Mediterranean area in the context of the MEDA programme and the previous protocols
- <sup>18</sup> Special Report No 5/2009 - The Commission's Treasury Management

**16.** Weaknesses in intervention logic coupled with significant deficiencies in the monitoring and evaluation arrangements of some interventions undermine the assessment of the effectiveness of programmes and the ability to identify appropriate reform. Insufficient information on results and outcomes also undermines accountability and transparency as well as decisions on the allocation of resources<sup>22</sup>.

**17.** The increasing use of agencies, and more recently of joint-undertakings, as vehicles for delivering EU policies involves both opportunities and risks. The Commission should ensure proper supervision so that full advantage can be taken of the opportunities which these management arrangements offer, whilst respecting the principles under the Treaty<sup>23</sup>.

### WHAT MORE COULD BE DONE TO IMPROVE THE QUALITY OF SPENDING?

**18.** The concept of European added value should be articulated in a suitable political declaration or in EU legislation in order to provide guidance to the EU's political authorities to be used when choosing expenditure priorities.

**19.** When revising existing interventions and designing new ones, the Commission should give due consideration to the principles of clarity of objectives, simplification, realism, transparency, and accountability<sup>24</sup>. The Commission's existing processes for developing policies, in particular its practice of ex-ante evaluation and impact assessments could be further strengthened to ensure due consideration is given to these issues and to the question whether and how a programme brings European added value<sup>25</sup>.

**20.** The Commission should complete the Budget Review as soon as possible and take the relevant results into account in preparing the financial framework starting in 2014, setting the improvement of the quality of budgeting and spending as a key objective. In the context of these opportunities for reform, the Commission should consider whether there is scope for focussing more on outputs than inputs, further simplifying cost calculations, reviewing the level at which funds are managed, defining control systems in terms of their outputs and developing further the use of the concept of tolerable risk.

<sup>19</sup> Special Report No 9/2007 - Evaluating the EU Research and Technological Development (RTD) framework programmes - could the Commission's approach be improved?, and Special Report No 7/2008 - Intelligent Energy 2003-2006

<sup>20</sup> E.g. United Nations' bodies and the World Bank.

<sup>21</sup> AR 2008, paragraph 8.13.

<sup>22</sup> Special Report No 10/2006 - Ex post evaluations of Objectives 1 and 3 programmes 1994-1999 (Structural Funds)

<sup>23</sup> Special Report No 13/2009 - Delegating implementing tasks to executive agencies: a successful option? and SR No 5/2008 - The European Union's agencies: Getting results

<sup>24</sup> As described in the Court's response to the Commission Communication "Reforming the Budget, Changing Europe".

<sup>25</sup> Special Report No 10/2006 - Ex post evaluations of Objectives 1 and 3 programmes 1994-1999 (Structural Funds)

## CONCLUSION

- 21.** Building on the progress of the previous Commission in reducing the level of irregular payments from the EU budget will require simplification of the relevant legislative frameworks as well as more cost-effective supervisory and control systems. Such reforms of programmes and schemes need to take place in the context of a broader review of the existing arrangements for EU spending provided by the planned revision of the financial regulation, the new financial framework, and budget reform. Improving the quality of spending should be a high priority for the European Union's institutions. It should, therefore, be a key objective for the new Commission.

This Opinion has been adopted by the Court of Auditors in Luxembourg at its meeting of 14 January 2010.

*For the Court of Auditors*



Vítor Manuel da Silva Caldeira  
*President*



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