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COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION TO THE COUNCIL

on the follow-up to 2006 Discharge Decisions

(Summary) - Council Recommendations submitted pursuant to Article 276 of the EC Treaty, Article 180b of the Euratom Treaty and Article 147 of the Financial Regulation for the general budget, and Article 119(5) of the EDF Financial Regulation and similar provisions in the former ad hoc EDF Financial Regulation

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PREAMBLE

As the Treaties and Financial Regulations require, the Commission has prepared Follow-up Reports to the 2006 discharges, which relate to the Council Recommendation of 12 February 2008 and the Resolutions voted by the European Parliament on 22 April 2008. The present Follow-Up Report deals with the recommendations made by the Council. A separate Follow-up Report deals with the recommendations made by Parliament.

The summary Follow-up Reports, which are published in all EU official languages, are supplemented by Commission working documents giving detailed answers to each specific recommendation of both the Council and Parliament. The replies indicate actions that the Commission intends to take or has already taken and also the recommendations that the Commission will not or is not able to follow up. Due to translation constraints the detailed working documents are published in English, French and German. Each chapter of the summary reports includes cross-references to the relevant recommendation numbers in the working documents.

The Commission has identified a total of 66 recommendations made by the Council to the Commission in the context of the 2006 discharge. The Commission considers that for 42 recommendations the required action has already been taken, though in some cases results of the actions will need to be examined. For another 24 recommendations the Commission agrees to take the action recommended by the Council.

I. COUNCIL RECOMMENDATION ON THE GENERAL BUDGET

A) Introduction (Commission working document, points 1-2)

The Commission shares the Council's view on the need for all actors involved in the implementation of the budget to continue to do their best to improve the functioning of the supervisory and control systems and to continue to make progress towards achieving an unqualified DAS in all areas of the budget.

The Commission presented in February 2008 a progress report on the Commission Action plan towards an integrated internal control framework (COM(2008) 110) and concluded that most of the "gaps" have been filled. Work will be completed in 2008 and the first impact report will be issued in early 2009.

The Commission is completing the assessment of the costs of control in agriculture, the ERDF and direct centralised management. The results will form the basis of a communication by the Commission in autumn 2008 aimed at relaunching the inter-institutional discussion on tolerable risk.

As regards simplification little further change is expected under current legislation. For the 2007-2013 legislative round some elements intended to reduce errors were introduced in specific sectors, including rural development and structural actions. The Commission has clarified rules through guidelines on e.g. FP7, the implementing rules for Structural Funds 2007-2013, the Education Policy 2007. The Commission will continue to provide support and further guidance where necessary. It will also ensure that future legislative proposals include clear and straightforward rules.

B) The statement of assurance (DAS) and supporting information (Commission working document, points 3-5)

As recommended by the Council, the Commission has taken due note of the accounting related remarks of the Court in its 2006 Annual Report whilst preparing the 2007 Community accounts, including as regards cut-off procedures. The split between the Directorate-General for Education and Culture and the Executive Agency has been made and the annual accounts for 2007 have been prepared separately.

C) Commission Internal Control (Commission working document, points 6-10)

Further efforts are needed to resolve weaknesses in the supervisory and control systems, in particular those highlighted in the reservations of the delegated authorising officers, and in relation to budget areas that were not considered satisfactory by the Court of Auditors. The Commission will take vigorous action to address the causes of reservations in the 2007 annual activity reports and will closely monitor progress.

The Commission will make all necessary efforts to demonstrate the effectiveness of its controls. It has included in the notes to the annual accounts of the European Communities for the financial year 2007 a new section about the recovery of undue payments following Commission correction decisions. The objective of this section is to give an overview of the

procedure in place for the recovery of undue payments and to present a best estimate of the total amount.

The Commission's accounting system is being extended to allow, from 2008, full reporting on the correction of errors by the Commission, including those relating to payments of earlier years, and to provide fuller information on the Commission's capacity to recover funds on a multi-annual basis.

The Commission is also stepping up its action to obtain reliable information from Member States on financial corrections and recoveries carried out by them. Information on recoveries was presented in the financial report of the EAGGF Guarantee Section and the 18th annual report on implementation of the Structural Funds and in the notes to the final accounts 2006.

D) Budgetary management (Commission working document, points 11-14)

The Commission fully agrees with the importance of realistic budgeting and has taken the recommended action to ensure effective budgetary management throughout the programming period. The PDB 2009 has been drawn up completely in accordance with these principles.

Commitments are consistently budgeted higher than payments on account of the longer period for payments than commitments. As commitments are also generally increasing year on year, the level of outstanding commitments (RAL) will increase as well. The $n+2/n+3$ rule in Cohesion Policy however ensures that commitments are largely used up within 2-3 years.

E) Revenue (Commission working document, points 15-17)

The Commission is pleased that the Court again in 2006 found that the overall functioning of the supervisory and control systems for revenue was satisfactory and that overall the underlying transactions were legal and regular.

On the basis of a working document prepared by the Commission, the Advisory Committee on Own Resources (ACOR) discussed the Council's request for a qualitative assessment of the administration, management and control of traditional own resources and VAT own resources. It was concluded that this assessment would be better provided in the wider context of the Budget review.

The B account guidelines have been issued and were discussed in the December 2007 meeting of ACOR.

As regards the lifting of reservation on items in Member States' annual VAT statements placed by the Commission in its control reports, the Commission plans a three-pronged approach. Reservations are to be categorised in a framework which will clearly identify priorities. When necessary, contacts will be made with Member States designed solely to review and devise pathways to resolve outstanding reservations (one such review is already planned for 2008). Where Member States cannot show progress towards the lifting of reservations, the Commission will consider starting infringement procedures.

F) The Common Agricultural Policy (Commission working document, points 18-20)

The Commission and the Member States continue efforts in strengthening the management and control systems notwithstanding the significant improvements already achieved in the management of Common Agricultural Policy (CAP) expenditure. The European Court of Auditors acknowledges that the Integrated Administration and Control System (IACS), where properly applied, is an effective control system to limit the risk of irregular expenditure.

IACS currently covers about 84.5% of the EAGF-expenditure. The effects of the different reforms will extend this coverage to about 89% by 2010 and to about 92% by 2013, which should enhance the positive trend and contribute to reducing the overall risk even further.

As regards eligibility conditions for agri-environmental measures in rural development, the Member States are now under the obligation to ensure that all rural development measures, including agri-environmental measures, are verifiable and controllable and that control arrangements at the level of the Member States provide reasonable assurance that eligibility criteria and other commitments are respected. The issue has been taken up also in the context of the rural development programming for the period 2007-2013.

As regards clearance of accounts, the application of the new "50/50 rule" specified in Article 32(5) of Regulation (EC) No. 1290/2005 is based on figures provided by Member States and certified by the certification bodies. The Commission is following-up the application of this rule by means of on-the-spot checks and desk audits, which may lead to financial corrections in case of non-compliant practices.

G) Structural measures (Commission working document, points 21-25)

The Commission is continuing to work closely with the Member States to improve management and control systems for structural actions expenditure. Recent actions include the issue of guidance on good practices in management verifications (COCOF 08/0020/02) and checks by certifying authorities (COCOF 08/0014/01) and a training seminar for 500 representatives of national managing and certifying authorities in June 2008. Further measures are set out in the Commission's Action Plan of 19 February 2008 to strengthen its supervisory role in this area (COM(2008) 97). The Commission also holds annual coordination meetings with national audit bodies, in addition to regular discussions of management and control issues with Member States in the structural actions management committee (COCOF) and ad hoc technical meetings.

The Commission's guidance, training and coordination activities all aim to simplify the day-to-day use of the funds by clarifying requirements and avoiding duplication of controls. The Commission is taking specific actions to encourage use of the provisions for flat rates and partial closure and to provide guidance on eligibility rules. These are set out in the Action Plan of 19 February 2008, actions 4.3 and 4.4.

The Commission considers that its audit activity is already effective in bringing about improvements in management and control systems, for example through the implementation of remedial action plans, but is seeking to increase its impact by speeding up the adoption of decisions where appropriate to suspend payments or apply financial corrections.

The Commission is now reporting on financial corrections and recoveries resulting from its own or the Court of Auditors' audit work in the structural actions area in its annual accounts

and also on a quarterly basis. Figures on recoveries by Member States are also published in the Annual Report on implementation of the Structural Funds.

H) Internal policies, including research (Commission working document, points 26-32)

The principal risk to the legality and regularity of research expenditure is that beneficiaries overstate costs in their cost statements, and that this is not subsequently detected and corrected by the Commission. Many errors affecting legality and regularity can only be detected (and therefore corrected) by performing on-the-spot checks. To address this problem, the Commission has shifted the focus of its control strategy towards detection and correction of errors ex-post, after the payment has been made. The Research DGs have implemented their FP6 audit strategy consisting of an increase in the number of audits, a new sampling strategy and the correction of systemic errors if they have been repeated by the same beneficiary in other, non-audited contracts. The audit strategy is being implemented over a period of four years. Because of its multi-annual nature, the effectiveness of the Research DG's control strategy can only be fully measured and assessed at the final stages in the life of the framework programme. Efforts have also been made to simplify and clarify the guidelines for calculation and reporting of costs for beneficiaries and certifying auditors.

In the education and culture area, the Commission is implementing a revised supervision strategy based on the "integrated control framework" approach. This includes ex-ante declarations of assurance for the 2007-2013 period issued by National Authorities and annual ex-post declarations of assurance concerning the use of funds during the previous year. Follow-up of systems audit recommendations has been incorporated in the assessment process of the ex-ante declarations of assurance 2007-2013 issued by National Authorities and is constantly monitored. Moreover, the rules for the new programmes 2007-2013 in the area of education and culture have been simplified and lump-sum and flat-rate financing arrangements are largely used.

The Commission is taking appropriate measures to comply with Council's recommendation related to delayed payments to beneficiaries and the need to comply with the time limits for expenditure operations set out in the Financial Regulation. The efforts made have increased the percentage of payments made on time. The issue is being monitored closely and is receiving the highest attention to ensure further improvement.

I) External actions (Commission working document, points 33-35)

The Commission has taken a series of actions aimed at improving the systems designed to ensure the legality and regularity of external actions expenditures at the level of project implementing organisations: standard Terms of Reference for expenditure verifications for grants and fee-based service contracts (mandatory since February 2006), new standard Terms of Reference for financial and systems audits (mandatory since October 2007), annual consolidation of external audit results in a synthesis report aimed at identifying a typology of findings and identifying corrective actions, development of CRIS audit which would improve the reporting on audit results.

In the area of humanitarian aid, the balance between headquarter and field audits has been reviewed and should be seen in the context of an overall control strategy. The number of field audits has increased to 37 in 2007 compared to 20 field audits performed in 2006.

J) Pre-accession Strategy (Commission working document, points 36-38)

The Commission continues to monitor closely the national supervisory and control systems for expenditure under the pre-accession programmes, and where necessary, strongly encourages the beneficiary countries to take action to redress unsatisfactory situations. As regards the Sapard programme, the Commission has further intensified its checks and their follow-up as recommended by Council. Closure of Sapard programmes has been made on the basis of the payment application for the final balance, the decision on the clearance of the accounts and the final implementation report.

K) Administrative expenditure (Commission working document, points 39-46)

As regards procurement, OIB and OIL have put in place specific control measures to improve procurement management, as mentioned in the Commission's reply to the Court's 2006 Annual Report. For real estate expenditure, negotiated procedures are allowed under art. 126(1)(h) of the Implementing Provisions.

As regards the Communities' pension liabilities, the Commission gave the figures and estimates as requested at the time of the PDB presentation in the Council's Budget Committee on 10.6.2008 and further documents were transmitted on 13.6.2008. This will henceforth be part of the standard presentation.

As regards agencies, the Commission adopted on 9.7.2008 the revision of the framework Financial Regulation¹, which contains provisions reinforcing the agencies' obligation to submit, in their payment requests, rigorous forecasts on their real cash requirements throughout the year in order to avoid unnecessary cash-flows. This should enable the Commission to follow more closely the cash balances of the agencies and hence should lead to more rigorous planning and increased transparency, in line with the Joint Declaration of 13 July 2008.

The agencies are independent Community bodies which are fully responsible legally and financially for the management of their own resources. Within the limits of the resources available the Commission has supported and will continue to support the agencies to enable them to make use of the knowledge, experience and advice of the Commission in the area of financial management.

Moreover, a horizontal evaluation is to be launched in the context of the Commission's Communication "European Agencies: the way forward" from March 2008. Among other things, the evaluation will also assess the impact of agencies on the Commission's internal organisation and activities. The inter-institutional working group that the Commission proposes to set up with the European Parliament and the Council will contribute inter alia to defining the objectives and the scope of this horizontal evaluation. The Commission intends to report on the results of this evaluation by 2009-2010.

¹ Commission Regulation (EC, Euratom) N° 652/2008 amending Regulation (EC, Euratom) N° 2343/2002 on the framework Financial Regulation for the bodies referred to in Article 185 of Council Regulation (EC, Euratom) N° 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities.

L) Financial instruments and banking activities (Commission working doc., points 47-48)

As regards the management of banking measures in the Mediterranean area under the MEDA Regulation, the weaknesses found by the Court concern the past and have been corrected. The management convention between the Commission and the European Investment Bank (EIB) is in the process of being renegotiated.

II. COURT OF AUDITORS' SPECIAL REPORTS (Commission working document, points 49-63)

The Council has made a number of recommendations to the Commission concerning special reports published by the Court of Auditors in 2006 and 2007. The Commission's replies to these recommendations can be found in the Commission working document (points 49-63).

III. EUROPEAN DEVELOPMENT FUNDS (Commission working document, points 64-66)

The Commission has taken due note of the Council's recommendations concerning the European Development Funds. As regards the accounts, after the migration from OLAS to CRIS, accounting procedures, and specifically closures of accounts, will be automated. However, although closures are performed manually in OLAS, a large number of effective checks are carried out to avoid errors.

As regards budgetary support the Commission confirms that, in the procedures for granting budgetary support and before making transfers of funds, it ensures that the conditions of the Cotonou Agreement and of the financing agreements are met.

Information as regards risk management, analysis of the internal control system and the audit of transactions can be found in the EuropeAid 2007 Annual Activity Report.

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