



**COUNCIL OF  
THE EUROPEAN UNION**

**Brussels, 4 February 2009**

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**ADDENDUM 1 TO NOTE**

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from: Budget Committee

to: Permanent Representatives Committee/Council

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Subject: Discharge to be given to the Commission in respect of the implementation of the budget for the financial year 2007

- Draft Council recommendation

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**Draft**  
**COUNCIL RECOMMENDATION**  
**of**

**on the discharge to be given to the Commission**  
**in respect of the implementation of the general budget**  
**of the European Communities**  
**for the financial year 2007**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 276 thereof,

Having regard to the Treaty establishing the European Atomic Energy Community, and in particular Article 180b thereof,

Having carried out the examination provided for in EC Article 276(1) and EAEC Article 180(1),

Whereas:

(1) According to the revenue and expenditure account for the financial year 2007:

- revenue amounted to	EUR 117 562 980 129.91
- expenditure disbursed from appropriations amounted to	EUR 113 027 971 812.19
- cancelled payment appropriations (including earmarked revenue) carried over from year <i>n-1</i> amounted to	EUR 246 263 210.47
- appropriations for payments carried over to year <i>n+1</i>	EUR 3 114 011 336.73
- EFTA-payment appropriations carried over from year <i>n-1</i>	EUR 2 103 751.46
- the balance of exchange-rate differences amounted to	EUR 123 510 791.35
- the positive budget balance amounts to	EUR 1 541 645 648.65

(2) Cancelled payment appropriations for the financial year amount to EUR 1 464 804 208.59;

(3) EUR 925 290 724.60 (79%) of the EUR 1 174 039 065.74 in appropriations for payments carried over to year *n* have been used;

(4) The observations in the report by the Court of Auditors for the financial year 2007 call for certain comments by the Council, which are ANNEXED hereto;

(5) The Council attaches importance to its comments being followed up and assumes that the Commission will implement all of the recommendations in full, without delay;

(6) The Council has adopted conclusions concerning Special Reports for 2007 and 2008, as set out in the addendum hereto;

(7) Following the examination referred to above, implementation by the Commission of the budget for the financial year 2007 taken as a whole, on the basis of the observations made by the Court of Auditors, is such as to allow a discharge to be given in respect of such implementation;

HEREBY RECOMMENDS the European Parliament, in the light of these considerations, to give a discharge to the Commission in respect of the implementation of the budget of the European Communities for the financial year 2007.

Done at Brussels,

For the Council  
The President

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## INTRODUCTION

1. The Council regrets that the Statement of Assurance (DAS) remains qualified for a significant part of the budget for the financial year 2007 in spite of the initiatives taken by the Commission in the course of the recent years to the improvement of control and management procedures.

The Council welcomes the fact that the annual accounts of the European Communities present, for the first time without a reservation, fairly in all material respects the financial position of the European Communities and the results of their operations and cash flows as of 31 December 2007.

The Council notes with satisfaction the unqualified audit opinion of the Court as regards the transactions for revenue, commitments and payments for "Economic and financial affairs" and "Administrative and other expenditure".

The Council regrets that the Court's opinion for "Cohesion", "Research, energy and transport", "External aid, development and enlargement", "Education and citizenship" and "Agriculture and natural resources" remains qualified, while noting with satisfaction that the Integrated Administration and Control System (IACS) continues to be effective, where properly implemented, and that certain improvements in all policy areas have been identified.

2. The Council stresses the importance of further simplification of legislation without diluting the level of assurance provided by improved controls in order to continue to make progress towards achieving an unqualified DAS in all areas of the budget. In this context, the Council invites the Commission to make proposals aiming at simplification of the procedures including the general rules governing the programmes and specific rules concerning the particular characteristics of the programmes.
3. The Council notes with satisfaction the work done by all actors involved in the various stages of the implementation of the budget and at all levels of control and management of the EU expenditure and awaits the presentation of the "Impact report on the Commission's Action plan towards an Integrated Internal Control Framework" introduced in 2006.

4. The Council recalls that the Commission shall implement the budget, in accordance with the provisions of the regulations made pursuant to Article 279 of the EC Treaty, on its own responsibility and within the limits of the appropriations, having regard to the principle of sound financial management. Member States shall continue to cooperate with the Commission to ensure that the appropriations are used in accordance with the principle of sound financial management.

In this respect, the Council recalls the key role of Member States in improving financial management and accountability of EU funds under shared management, in particular through sufficient and appropriate internal control systems under the relevant legislation.

5. The Council notes that for the financial year 2007 no reimbursements were made as a result of the implementation of the legislation relating to the 2007-2013 programming period and thus the effect of the refined and strengthened control provisions is yet to be seen.
6. The Council welcomes the new presentation of the Court's Annual Report which has been adapted to the 2007-2013 financial framework and the new structure of the DAS specific assessments including transparent indicators in the different sectors and policies.
7. Recalling the great importance it attaches to the protection of the Communities' financial interests, as well as to the fight against fraud and any other illegal activities detrimental to the Communities' financial interests, and to strengthening cooperation between Member States and between them and the Commission in this field, the Council reiterates its satisfaction that the Court identified only a few cases of possible fraud in its audit work.

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## CHAPTER 1

### THE STATEMENT OF ASSURANCE AND SUPPORTING INFORMATION

#### 1. Reliability of the accounts

The Council welcomes the favourable opinion given by the Court on the reliability of the annual accounts<sup>1</sup> drawn up in accordance with the provisions of the Financial Regulation of 25 June 2002<sup>2</sup> and the accounting rules adopted by the Commission's Accounting Officer. It notes with satisfaction the Court's statement that the accounts present fairly, in all material respects, the financial position of the Communities as of 31 December 2007, and the results of their operations and cash flows for the year then ended. The Council encourages the Commission to assure that this high quality of Community accounts is maintained.

The Council notes the Commission's success in transferring its accounts to the accruals based system during its third year of operation. It also notes with satisfaction that the Commission has strengthened the transition to accruals based accounts further including numerous agencies in the accounting system, improving the information given on recoveries of undue expenditure and providing a reconciliation of the economic and budgetary outturn. While valuing very much these major steps taken by the Commission, the Council invites it to continue removing the weaknesses in the accounting system that still put at risk the quality of financial information and to continue improving the information in the notes in the accounts on the correction mechanisms concerning undue payments.

As regards the consolidated balance sheet as at 31 December 2007 and the consolidated economic outturn account, the Council calls on the Commission to pay due attention to the remarks presented by the Court in order to improve the completeness and accuracy of the basic accounting data.

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<sup>1</sup> The annual accounts of the European Communities for the financial year 2007, Volume I.  
<sup>2</sup> Council Regulation (EC, Euratom) No. 1605/2002, OJ L 248, 16.9.2002, p. 1.

## 2. **Legality and regularity of the underlying transactions**

The Council notes that, on the basis of its audit of supervisory and control systems and error rates, the Court was able to give an unqualified opinion on certain areas and to state some improvements while the majority of spending continues to be affected by a material level of error.

The Council notes with satisfaction the Court's unqualified opinion for "Revenue", "Economic and Financial Affairs" and "Administrative and other expenditure" including the statement that the supervisory and control systems function effectively and that the error range of this expenditure estimated by the Court lies below the 2% materiality threshold.

The Council regrets again the qualified opinion for the expenditure relating to "Agriculture and natural resources", "Research, energy and transport", "External aid, development and enlargement" and "Education and citizenship", as the Court found that the supervisory and control systems were only partially effective and represent an error range estimated by the Court between 2% and 5%, thus exceeding the materiality threshold. Concerning "Agriculture" the error rate estimated by the Court for European Agricultural Guarantee Fund (EAGF) expenditure, representing almost 85% of spending, was below 2%.

Regarding expenditure in the area of Cohesion, the Council regrets the qualified statement of the Court's audit estimating that the transactions are affected by a material level of error of at least 11% and that the functioning of the supervisory and control systems is only partially effective. Nevertheless, compared to 2006 the Council notes an improvement in this field as regards the functioning of the supervisory and control systems.

### **3. The Court's assessment of progress made towards an effective Community Internal Control Framework**

The Council notes the development by the Court of its DAS methodology and the adjustment to a changing audit environment, taking into account the new accruals based accounting system.

The Council notes that the Court has not included advance payments related to the 2007-2013 period in the areas of Cohesion policies and rural development in the audit samples in 2007 due to an absence of risk of error in these payments.

The Council invites the Court to continue keeping the Council updated on future developments of its working methods and the assurance model, an element of the revised DAS approach.

The Council invites the Court and the Commission to continue to cooperate towards a common understanding on the probability of correction of payments within multiannual programmes during the programme period.

### **4. Other issue**

The Council takes note of the contacts undertaken between the Court and the National Supreme Audit Institutions, and invites them to pursue their collaboration while respecting the independence and competences of each. The Council considers that the work of independent National Supreme Audit Institutions could, where appropriate, continue to be usefully taken into consideration by the Court.

## CHAPTER 2

### COMMISSION INTERNAL CONTROL SYSTEM

The Council welcomes the fact that the Court in its statement concludes that the Commission made further progress in its supervisory and control system, and in particular the improvement of the process of preparation of the annual activity reports and declarations, the impact of the relevant reservations on the assurance given in the Directors-General's declarations and a move towards greater consistency with the conclusions of the DAS specific assessments.

#### 1. Synthesis report of the Commission

The Council notes that the Commission states in its 2007 Synthesis report that the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions for which the Commission takes overall responsibility pursuant to Article 274 of the Treaty. However, the Council notes that the Commission itself acknowledges that further efforts are needed to resolve a number of weaknesses and therefore it encourages the Commission to take all the necessary remedial measures and strongly supports its enhanced efforts to address the remaining deficiencies effectively.

The Council strongly encourages the Commission to continue to improve the annual activity reports, in particular regarding the identification of continuing weaknesses in the assessments provided in the reports of some DGs.

The Council notes that the Court considers that the scope of some reservations should be greater than presented by the Commission's Directors-General, while the Commission considers that the reservations for "Cohesion" and "Agriculture and natural resources" are in line with materiality criteria established and cover all systems where there were material deficiencies. The Council, though aware of the fact that the Court has to work in full compliance with the rules of the Treaty, considers that the effectiveness of controls should also be assessed on a multiannual perspective.

## 2. Annual summaries of available audits and declarations

The Council reiterates its commitment to continue to fulfil the obligation on the transmission by Member States of the annual summaries at the appropriate national level of the available audits and declarations on time and in full compliance with the provisions of Article 53b(3) of the Financial Regulation<sup>1</sup> and Article 42a of its Implementing Rules<sup>2</sup>.

The Council notes the Court's conclusion that the annual summaries do not yet provide a reliable assessment of the functioning and effectiveness of the supervisory and control systems. The Council joins the Court in encouraging the Commission to add value to the process by identifying common problems, possible solutions and best practices and using this information in its supervisory role.

## 3. Supervisory role and control systems

The Council acknowledges that the Commission has been able to demonstrate a consistently high degree of implementation on internal control standards since 2004 and that by the end of 2007, it had implemented more than two thirds of the sub-actions in its "Action plan towards an Integrated Internal Control Framework". The Council welcomes the progress achieved through the action plan and looks forward to the impact report due by the beginning of February 2009.

However, the Council regrets that there is still no evidence that actions undertaken to improve supervisory and control systems have been effective in mitigating the risk of error in policy areas related to "Agriculture and natural resources", "Cohesion", "Research, Energy and Transport", "External aid, development and enlargement" and "Education and citizenship".

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<sup>1</sup> Council Regulation (EC, Euratom) No. 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 248, 16.9.2002, p.1), as amended by Council Regulation (EC, Euratom) No. 1995/2006 of 13 December 2006 (OJ L 390, 30.12.2006, p. 1).

<sup>2</sup> Commission Regulation (EC, Euratom) No. 2342/2002 of 23 December 2002 laying down detailed rules for the implementation of Council Regulation (EC, Euratom) No. 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities (OJ L 357, 31.12.2002, p.1), as amended by Commission Regulation No. 478/2007 of 23 April 2007 (OJ L 111, 28.4.2007, p. 13).

The Council acknowledges that, as stated by the Commission, any simplification of the rules, and all improvements to the Commission's controls, will take time to have an effect on the prevention, detection and correction of errors. Nonetheless, it calls on the Commission to take all the necessary measures for a further improvement of control systems including all control levels and to ensure that the measures contained in the "Action plan on the Integrated Internal Control Framework" have a real impact on the supervisory and control systems.

In this context, the Council recalls the utmost importance of training for the staff involved in controls, at all levels, and it invites the Commission to implement all the appropriate measures in order to strengthen their capacities. Furthermore, the Council, urges the Commission, to work closely with the Court of Auditors and the Member States when establishing guidelines and various procedures for the implementation of programmes, in order to achieve a common understanding of rules and procedures and a common approach for their implementation.

The Council invites the Commission to intensify its communication and cooperation with the Court in order to promote common understanding of legal provisions and to avoid differences in interpretation between the two institutions particularly for the compilation of management and control reports. Such a dialogue is particularly important at the beginning of a programming period and could contribute to reducing the level of error. In addition, the Council encourages the Commission to share experience of best practice with regard to the correct implementation of legal provisions with and between Member States in order to prevent any misinterpretation.

The Council considers that rules applying to a given programming period should not be applied retroactively to previous periods and also that the interpretation must be based on the logic and principles applicable to the respective programming period.

The Council invites all actors involved to work towards common audit standards and coordinating audits and reciprocal acceptance of results between Commission and Member States, based on the single audit model and bearing in mind the principles behind the contracts of confidence, within the current legislative framework and with due respect to the differences in the systems of Member States and the independence of their audit institutions, at all levels.

The Council recalls that the controls and the assurance they provide should be improved by building on existing control structures and promoting simplification with a view to improving the cost-benefit ratio and urges the Commission to assess the costs of control by area of expenditure. In addition, the Council reiterates the fact that it is essential that the whole process aimed at reducing the level of error should not necessarily mean that, as a result, there is an increase in administrative and control costs.

To achieve well functioning supervisory and control systems, the Council encourages the Commission to pursue its efforts to ensure that its supervisory and control systems address the risks effectively on all levels of implementation and mitigate the risk that the control systems in the Member States do not collect all unduly paid amounts.

The Council takes note of the communication from the Commission to the European Parliament, the Council and the Court of Auditors "Towards a common understanding of the concept of tolerable risk of error" and considers it an element for a thorough discussion to be held with the European Parliament, the Commission, the Court of Auditors and all relevant actors, once the Council has defined its position.

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## CHAPTER 3

### BUDGETARY MANAGEMENT

The Council notes the consistent level of the implementation of the budget in 2007, where the utilisation rates for both commitments and payments remained at a similar level as in 2006.

As regards the implementation of commitment appropriations in 2007, the Council notes a considerable improvement compared to the first year of the previous programming period, mainly due to the timely adoption of the programmes for the new programming period. Nevertheless, while recalling the joint declaration on Implementation of the Cohesion Policy<sup>1</sup> adopted at the conciliation meeting on 21 November 2008, the Council calls on the Commission to make every effort to avoid delays in the examination of major projects and the management and control systems which could have an adverse impact on the future implementation of the budget.

While noting that the budgetary surplus continues to decrease, the Council reiterates that a realistic and sufficient budgeting from the stage of the preliminary draft budget onwards, which limits to the largest extent possible the need to recourse to amending budgets to reduce appropriations for payments, remains an essential element of good budgetary management.

The Council notes that the accuracy of Member States' expenditure forecasts in the area of "Structural Funds" continues to improve and encourages the Commission and the Member States to cooperate closely in view of improving accuracy even further, thus making these forecasts a useful tool for budgeting purposes.

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<sup>1</sup> Joint declaration of the European parliament, the Council and the Commission on Implementation of the Cohesion Policy (doc. 16229/08 FIN 514 PE-L 114).

Notwithstanding that 2007 is the first year of the new programming period, the Council notes with great concern that the overall level of outstanding budgetary commitments (RAL) continues to increase. The Council, nevertheless, notes with satisfaction a decrease of RAL for Structural Funds for the 2000-2006 programming period and calls on the Commission to continue with its efforts so as to avoid any delays in the closure of these programmes which could have a negative impact on the implementation of the approved programmes for the new programming period. As regards the analysis of the data referring to RAL, the Council shares the Court's view that further improvements are possible and, consequently, calls on the Commission to improve its report on budgetary and financial management.

The Council acknowledges that the " $n+2$ " rule has had the intended effect of encouraging the timely liquidation of commitments. The Council notes the Court's observation on the risk concerning the legality and regularity of underlying transactions if the accelerated payment process to reduce outstanding commitments were to be achieved by applying less strict internal control procedures. Therefore, the Council calls on the Commission and the Member States to take full account of this risk. In this respect, the Council also calls on the Member States to give additional attention to ensuring timely liquidation of commitments in line with the relevant procedures foreseen by the legislation and without compromising the quality of control procedures.

In respect of information on the implementation of the budget, the Council shares the Court's view that the figures mentioned in the different documents are not fully consistent and vary slightly. Consequently, it encourages the Commission to increase transparency, consistency and comparability of the information on implementation and surplus from now on by providing clear definitions and explanations of concepts and calculation methods used. The Council considers it appropriate to present all information needed to calculate different utilisation rates throughout the whole budgetary procedure, from the preliminary draft budget to the total authorised appropriations.

## **Financial corrections and recoveries**

The Council acknowledges the substantial efforts made and the important improvements achieved by the Member States and the Commission in providing complete, accurate and timely information on financial corrections and recoveries. However, it notes the Court's observations on the remaining deficiencies in the overall information available. The Council shares the Court's opinion that the Commission's initiative to record complete data on recoveries in the central financial and accounting system as from 2008 is a positive development. The Council encourages the Member States and the Commission to further improve, in line with the Court's recommendations, the completeness and accuracy of information with the aim of providing reliable evidence allowing the Court to assess the effectiveness of the multiannual correction mechanisms for EU spending.

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## CHAPTER 4

### REVENUE

The Council welcomes the Court's findings that the overall functioning of the supervisory and control systems was satisfactory and that overall the underlying transactions were legal and regular.

#### 1. Traditional own resources

The Council is concerned that the problems relating to the management of the B-accounts persist. However, the Council notes with satisfaction that the Commission has followed up the Council's recommendation to provide guidance on the current procedures in this area and has issued B-accounts guidelines in December 2007.

Moreover, the Council notes the progress made in overcoming the weaknesses reported in the supervisory and control systems related to the customs warehousing procedure.

#### 2. VAT and GNI own resources

The Council welcomes the fact that the Court found the calculation of the Member States' contributions and their settlement by Member States to be legal and regular. However, the number of long-outstanding reservations in particular regarding the VAT own resources is still high. The Council, while noting that the Commission has adopted an approach that categorises the reservations in a framework which allows priorities to be identified, encourages the Commission to continue its efforts towards an effective implementation, in cooperation with the Member States, in order to speed up its work on lifting VAT reservations.

The Council notes the Court's concerns regarding the correct application of the VAT Directive. However, the Council emphasises the Court's assessment that not every case of incorrect application of the VAT Directive results in a loss of VAT-based own resources.

The Council notes with satisfaction that the Commission started direct verification of the GNI inventories in the Member States in 2007.

### **3. Follow-up to other observations from past Annual Reports**

The Council takes note of the Commission's commitment to provide a *qualitative assessment* of the administration, management and control of the traditional own resources and VAT own resources systems.

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## CHAPTER 5

### AGRICULTURE AND NATURAL RESOURCES

The Council notes with concern that the transactions underlying the expenditure declared for this policy area, taken as a whole, are affected by a material level of error. Therefore, the Commission and the Member States should continue to make efforts in strengthening their supervisory and control systems, which the Court again found only partially effective, thus further reducing the error rates.

The Council notes with satisfaction that the error rate for the European Agricultural Guarantee Fund (EAGF) expenditure remains slightly below 2%.

#### **1. The Integrated Administration and Control System (IACS)**

The Council welcomes the Court's conclusion that the Integrated Administrative Control System (IACS), when accurate and reliable data is introduced and the system is properly implemented, continues to prove effective in limiting the risk of error or irregular expenditure.

The Council regrets the fact that calculation and allocation of Single Payment Scheme (SPS) entitlements by national authorities are still not correct in all Member States and that weaknesses were reported in the management and monitoring of SPS entitlements as well as in the use of the national reserve.

The Council urges the full implementation of controls and checks under IACS in all Member States and calls on the Commission to thoroughly follow-up in the conformity clearance all the errors noted in its audits. Mechanisms ensuring effective and rapid recovery actions against beneficiaries having received irregular payments should also be reinforced.

## 2. Rural development

The Council regrets that rural development is accountable for a disproportionately large part of the overall error rate and notes with concern that the Directorate-General for Agriculture made a reservation in its Annual Activity Report 2007 because of unreliable control statistics.

The Council agrees with the Court's acknowledgement that rural development expenditure is particularly prone to a higher incidence of errors mainly because of the often complex rules.

The Council takes note with interest of the efforts made, in the context of the rural development programming for 2007-2013, towards ensuring that all measures, including agri-environmental ones, 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 Council is aware that the impact of these measures will only become evident to its full extent over a longer time span.

However, the Council strongly calls for a simplification of complex rules and more precise definitions of eligibility criteria, especially for agri-environmental schemes, at Commission level first, but also at national level, in the context of the rural development plans. This effort should lead to the establishment of a set of verifiable indicators, keeping in mind the need to guarantee the substance of existing commitments.

Additionally, the transmission of more comprehensive and clear instructions and guidelines to all stakeholders, as well as the organisation of training actions are crucial in view of streamlining the application and harmonising the interpretation and the scope of the existing rules.

### **3. Commission's clearance of accounts**

The Council encourages the Commission to pursue its efforts in following up the application of the "50/50 rule" (specified in Article 32(5) of Regulation (EC) No. 1290/2005) as regards the clearance of accounts.

In the context of the conformity clearance, the Council emphasises once again the importance of financial corrections which contribute considerably to safeguarding the Community's financial interests, acting also as an important incentive for Member States to improve their management and control systems.

The Council joins the Court in noting the fact that in 2007 the certifying bodies' work was extended and that opinions on the paying agencies' Directors Statements of Assurance and on internal control procedures were required. It encourages the progress in the direction of improving the accountability of paying agencies and increasing the transparency and ownership of the control results.

### **4. Environment, Fisheries, Health and Consumer protection**

The Council expresses its concern about the errors in the payments audited in these areas, which, in the case of "Environment", caused the Directorate-General for Environment to make a reservation in its Annual Activity Report.

Therefore, the Council emphasises the importance of prompt and thorough ex-post audits to detect ineligible expenditure and/or inadequate supporting documentation, in order to allow the necessary corrections. This applies particularly to projects financed through the LIFE instrument, although the situation matured and improved in 2007 with respect to the control systems and the alert mechanisms.

## CHAPTER 6

### COHESION

The Council notes that the Court's findings regarding the Cohesion policies only concern the 2000-2006 period, representing 84% of the expenditure, because for the 2007-2013 period there were only advance payments related to the preparatory phase, thus no expenditure was declared for reimbursement.

The Council notes with great concern the Court's estimate that at least 11% of the total amount reimbursed to Cohesion policy projects should not have been reimbursed. This estimate should be interpreted with due caution because of the multiannual character of the Cohesion Policy programmes; as noted by the Commission, controls are still ongoing and programmes are not yet closed. Nevertheless, the Council is fully aware that such a rate is a clear indicator of high inherent and control risk, mainly due to the complexity of rules and conditions to comply with.

The Council points out that the mitigation of high inherent risk requires further simplification of rules as well as both effective control systems in the Member States and effective supervision by the Commission. In this respect and taking into account the multiannual nature of the programmes, the Council urges the Commission and the Member States to work closely together at all stages in the control chain to improve the situation.

#### **1. Simplification**

The Council shares the Court's recommendation that the Commission shall, together with improving its supervisory systems and providing guidance to the Member States, actively encourage and facilitate simplification which shall ultimately lead to reducing both the occurrence of errors and the administrative burden at all levels.

The Council notes that further work has been considered regarding issues such as the use of a flat rate, partial closure and eligibility rules fixed at national level and expects to see their beneficial effects for future discharge procedures related to the new programming period.

In this context, the Council welcomes the action taken regarding simplification in the framework of the 2008 recovery plan to reduce regulatory and administrative burdens, such as the clarification of provisions facilitating the launch of financial engineering instruments and the simplification in relation to broadening the use of flat rates and lump-sum costs. The Council encourages the Commission, in close cooperation with Member States, to continue in this way and to explore new possibilities for simplification.

## **2. Supervisory and control systems**

While stressing the fact that Cohesion policies and their regulatory provisions are among the most complex parts of the budget, the Council notes the progress achieved compared to last year, showing that the continuous efforts by the Member States and the Commission to improve the functioning of the management and control systems start having effects. Nevertheless, further efforts are necessary. Therefore the Council urges all actors in the accountability chain to further intensify their efforts so that significant progress can be achieved and made visible in the short term. The Council invites them to make good use of all preventive and corrective measures available, while striking the balance between the need for controls and the administrative costs they entail.

The Council notes with satisfaction that the improved cooperation between the Commission, the Member States and the Court, and the synergy of their joint efforts enhanced the commitment of all actors involved to do their utmost towards a better integrated approach to internal control.

In this context, the Council recalls the joint declaration by the European Parliament, the Council and the Commission regarding the implementation of the Cohesion Policy<sup>1</sup> and invites all the actors involved to do their utmost to fully comply with it.

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<sup>1</sup> Joint declaration of the European parliament, the Council and the Commission on Implementation of the Cohesion Policy (doc. 16229/08 FIN 514 PE-L 114).

The Council notes that, as stated by the Court, the control systems in the Member States are generally only partially effective. Although this shows a progress compared to last year, there is still extensive room for improvement. Bearing in mind the above-mentioned Court's estimate and the Court's recommendation to reinforce the prevention of errors in the early stages of a project, the Council considers that it is essential that the first level controls in the Member States continue to be reinforced and their quality improved.

In this respect, while welcoming the Member States' efforts to strengthen their audit and control systems as well as the remedial measures they have already implemented, the Council urges the Member States to continue taking action.

The Council notes with satisfaction the Commission's action plan adopted on 19 February 2008 to strengthen the Commission's supervisory role and of the interim report presented by the Commission in November 2008. It also takes note that the Commission has issued a guidance document on management verifications stressing the importance of preventive measures by the managing authorities through an effective communication strategy which should contribute to strengthening internal control systems and unifying practices.

The Council regrets the Court's conclusion that the main objective of the Commission's supervision to ensure that Member States establish and operate control systems in compliance with underlying regulations is not yet achieved. Though acknowledging that in the majority of cases the audits have been adequately planned and carried out and the relevant corrections applied, it notes with concern that in a number of cases corrective action has been taken too late, thus reducing the effectiveness of the supervision procedure.

In the Council's view, it is essential that the Commission's audit activity is effective and that the Commission puts in place an effective system to carry out its supervisory role especially since it is the Commission which according to the Treaty is ultimately responsible for the implementation of Cohesion Policy expenditure, notwithstanding the key role of Member States in improving financial management and accountability of EU funds under shared management under the relevant legislation.

### 3. Financial corrections

The Council shares the Court's view that the Commission should make, where appropriate, an effective use of the corrective instruments at its disposal, such as payment suspensions, financial corrections and recoveries. This would act as a deterrent and thus have an important positive impact on the legality and regularity of expenditure. The Council underlines that both reinforced controls at the Member State level and more effective supervision by the Commission should respect the principle of proportionality of controls to the risks and the benefits from control in relation to the costs involved.

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## CHAPTER 7

### RESEARCH, ENERGY AND TRANSPORT

The Council regrets the material level of error in payments as well as the weaknesses in supervisory and control systems identified by the Court's audit of this area of direct centralised management by the Commission. However, the Council expects that the measures taken by the Commission during the reporting period will show visible results in the coming years.

#### 1. Simplification of the legal framework

The Council stresses the importance of a substantial simplification of the legal framework which should be regarded as a general guidance principle for the new programming period. The Council calls on the Commission to use all possible opportunities to further simplify and clarify the rules for the calculation and reporting of costs, which should subsequently reduce the uncertainty about the eligibility of expenditure resulting from possible different interpretation of the often complex legal framework.

Moreover, the Council stresses the need to use more extensively financing methods which are based on lump sums and on the achievement of results, wherever they are suitable.

#### 2. Strengthening of supervision and control

The Council considers that controls need to be reinforced to identify any possible overstatement of eligible costs (with particular attention to personnel and indirect costs) as well as costs declared without justification or without adequate supporting evidence. It asks the Commission to continue its approach of an increased number of on-the-spot audits, targeted according to budgetary impact, aiming at a further reduction of the risk to legality and regularity and at the elimination of systematic errors.

The Council underlines the importance of improving the quality and reliability of external audit certificates. It invites the Commission to provide additional support to beneficiaries and certifying auditors on the audit work to be performed, including the certification of the cost methodology.

In parallel, the Council emphasises the necessity of a timely explanation of new methods and procedures and asks the Commission to provide regular information by all means to the relevant actors. Existing provisions need to be simplified as well and, together with the guidelines, they have to be properly understood through appropriate training in time.

The Council calls on the Commission to continue the implementation of the measures envisaged in the framework of the common audit strategy, aiming at a refinement of certification and risk evaluation methodologies, the harmonisation of procedures and a more effective cooperation between the different Commission services.

Furthermore, the Council urges the Commission to ensure timely payments to beneficiaries.

### **3. Thorough utilisation of control results**

The Council recalls that the value of the control results could be increased by intensifying their examination and by making more extensive use of the information about types and rates of error obtained from this analysis. This goes in line with the need to step up the sharing of findings between the different research Directorates-General and to set up tools transferring them automatically into the Commission's central audit tracking facility.

The Council invites the Commission to remedy the persisting shortcomings in the management information on audit results and their timely and effective implementation. It asks the Commission to improve the monitoring tools and the follow-up of detected errors, the supervision of corrective action and the recovery of amounts unduly paid to beneficiaries.

In this context, the Council is also of the opinion that more effective use should be made of the available sanction mechanisms and that they should be used as an incentive for beneficiaries to improve the quality of their cost statements.

## CHAPTER 8

### EXTERNAL AID, DEVELOPMENT AND ENLARGEMENT

The Council takes note of the new presentation of this chapter, which also includes the Enlargement policies, previously dealt with separately, in order to align the structure of the report with the headings of the financial framework 2007-2013.

The Council regrets that a material level of error was once again detected, mostly at the level of project implementing organisations. However, the Council notes with satisfaction that the Court's findings show a slight decrease in the rate of error compared to the previous year and that the Commission's own system on payments was generally effective.

Therefore, the Council, while acknowledging the Commission's continuous efforts to mitigate the problems identified in this area, calls on it to continue the work done, to enhance its efforts as well as to take all the necessary measures to decrease the material level of error significantly. In this context, the Council is aware that, due to the multiannual nature of the programmes, the errors detected during the course of a project can be remedied in a year later than the one under examination. The Council considers that the Commission should enhance its audit strategy by ensuring a better coverage of operations at implementing organisations' level.

#### **1. Ex-ante checks**

The Council welcomes the fact that the Commission's system of ex-ante checks on its own payments and contracts was generally effective, although noting that significant weaknesses persist in a specific case. The Council takes note that the Commission has taken the necessary measures to face those weaknesses and it is ready to go further, if needed.

The Council encourages the Commission to continue to closely monitor the beneficiary countries' systems and welcomes the action plan set up by the Commission to ensure that improvements take place.

Regarding budget support, the Council expresses its concerns about the fact that the performance indicators used to provide assessments and to measure progress achieved were not in all the cases examined time-bound, sufficiently clear and unambiguous and achievable. In addition, the Council notes with some concern that the Commission's budget support guidelines leave room for interpretation, thus limiting their effectiveness as far as an adequate management of the risk is concerned.

The Council is fully aware of the necessity to strike a balance between the achievement of objectives and the need for most precise conditions for payments; however, the Council encourages the Commission to pursue its work to strengthen the indicators in order to carry out a more rigorous assessment and to provide a clear link between funding and performance, to achieve a more result oriented approach.

In this context, the Council stresses the need for additional training and urges the Commission to do its utmost to provide adequate support and expertise, in particular to all staff on the field in order to improve their performance and their capabilities. The Council notes with satisfaction the Court's intention to present a Special Report on budget support in 2009.

## **2. Monitoring of implementing organisations**

The Council notes with deep concern the recurrent weaknesses in the systems designed to ensure the legality and regularity of External actions expenditure at the level of project implementing organisations and asks the Commission to take the necessary steps to remedy this situation.

Although noting the efforts made by the Commission regarding the clarification of the terms of reference for audits, and in particular the tendering and public procurements, as well as the monitoring of the compliance with them, the eligibility of costs and the required documentation for the allocation of expenditure, the Council encourages the Commission to further enhance its action and urges it to provide for more training and support to project finance staff and to increase the active monitoring of their work by Commission's delegations.

Furthermore, the Council invites the Commission to pursue and deepen its action to simplify and standardise partnership agreements and the related documentation; the Council expects to see the positive effects of these measures in the coming years.

As regards the funds channelled through United Nations organisations, the Council insists on the need for a closer control by the Commission, to make sure that the implementation of EU funds is dealt with adequately and that there is a clear understanding by all actors of the rules and procedures of control to be carried out and of the standards to be met, in order to fully achieve the objectives of the EU policies and action.

In this context, the Council regrets the impossibility for the Court to assess the full value of the verification missions carried out by the Commission in 2007 because of insufficient or untimely reporting. Nonetheless, the Council takes note of the positive evolution of the relationship between the Commission, the Court and the United Nations and welcomes the strengthened cooperation developed in 2008 between the three organisations and expects to see its beneficial effects reflected on the ground and in the future reports.

As far as the Enlargement policies are concerned, the Council regrets weaknesses detected in some implementing organisations, while taking note of the improvements made in the course of 2008 to redress the situation under the impulse of the Commission. The Council encourages the Commission to continue its monitoring and to closely follow up the evolution of this case.

Regarding ex-post controls in the field of Enlargement policies, the Council shares the Court's view that the procedures should be speeded up and the delays in obtaining final replies on closure audits should be reduced. Therefore, the Council calls on the Commission to take all the appropriate measures and to provide all the necessary supports to partners in order to shorten the delays.

### **3. External audits of project claims**

The Council notes the improvements achieved in 2007 concerning the external audits at project level, although their quality is still not always sufficient, and encourages the Commission to pursue its efforts, to prevent the occurrence of such weaknesses, in particular for new contracts.

As for additional risk-based projects audits, the Council calls on the Commission to further develop procedures to derive full benefit from it. The Council invites the Commission to collect and analyse the results of the whole programme of audits to control quality and to make best use of lessons learned.

Finally, the Council underlines the importance of field audits for all types of partners and notes that the Commission has increased them in 2007. The Council underlines the need to achieve a better balance between headquarter and on-the-spot audits of the implementing partners, for a better view of the reality of project expenditure. The Council encourages the Commission to pursue its efforts in this field, though keeping in mind the principle of proportionality.

### **4. Follow-up observation from past annual reports**

The Council welcomes the follow-up given by the Commission to the Court's recommendations and acknowledges the positive effects of the new Terms of Reference, some of them already visible in 2007, which concur to facilitate the assessment of the situation and expects to see more tangible benefits in the future.

In addition, the Council notes the improvements achieved in the information on audits and their results; however, the Council notes that the CRIS-Audit was not in full use in 2007, and expects to see more concrete benefits in the near future.

Furthermore, the Council notes the improvement achieved in the enlargement field regarding Extended Decentralise Implementation System (EDIS), thanks to the implementation by the Commission of a close monitoring, however, the Council shares the Court's view that the efforts at the level of national supervisory and control systems should continue under the close monitoring of the Commission.

In this field, the Council notes with satisfaction the beneficial effects of a close cooperation between the Court and the Commission, which allowed a faster closure of the audits.

Finally, concerning the external audits in the field of Humanitarian aid, the Council notes that, in spite of the entry into force of a New Framework contract, the majority of audits are undertaken at partners' headquarters, however, it acknowledges the steady increase in the number of field audits undertaken by the Commission and encourages it to make the best possible use of their results, and to pursue its efforts, in full respect of the principle of proportionality.

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## CHAPTER 9

### EDUCATION AND CITIZENSHIP

The Council appreciates the harmonisation of programmes realised in 2007 by grouping them according to the rules under which they are managed.

However, the Council regrets that this policy area - as shown by the Court's audit - was affected by a material level of error in payments resulting from a limited effectiveness of the supervisory and control systems. It calls on the Commission to enhance the simplification of the often complicated legal framework by establishing clearer eligibility criteria and easier rules for the calculation of eligible expenditure, in particular personnel costs, in order to reduce the error rate and to improve the correctness of the declared cost.

The Council is aware of the fact that many programmes are multiannual and that their execution has just started. The management of these programmes - mostly delegated to national agencies - will therefore need to be evaluated in further detail in the coming years during the period of their validity.

#### **1. Indirect or shared management of multiannual programmes and Funds**

The Council welcomes the Commission's efforts in establishing an integrated audit system in the areas of education and culture as well as justice, freedom and security, with a strong link between national agencies and the Commission and an increased liability on the Member States' side. It invites the Commission to verify in further detail the certification of management structures carried out by national entities, with the intention of obtaining more reliability from the supervision by the Member States. Furthermore, it urges the Commission to make sure that the ex-ante and ex-post declarations of assurance by Member State entities in respect of their own financial management of Community expenditure constitute a real added value.

The Council notes with satisfaction that progress has been achieved by an increased number of monitoring visits in Member States. This has enabled the Commission to check in a timely manner the description and effective operation of management and control procedures on the spot and to ensure the application of key internal control features.

The Council encourages the Commission to move forward in this direction and to refine the control objectives. It stresses the importance of establishing exact criteria for the assessment procedure, to foresee precautionary measures, including financial corrections, in the contractual relationship with national agencies, to monitor systematically the progress made by the Member States and to follow up scrupulously the implementation of the necessary remedial actions.

## **2. Direct management of communication expenditure**

The Council asks the Commission to reinforce the ex-ante control system, by improving the rules and by increasing the general level of supervision, in order to achieve a higher effectiveness of the controls. In this context it notes with satisfaction the Commission's commitment to provide adequate check lists to be used consistently.

## **3. Follow-up to previous observations**

The Council recalls its recommendations for the Commission to ensure an efficient monitoring of payment times with the aim of reducing the delays in payments.

Moreover, it urges the Commission to complete as soon as possible the sharing of ex-post audit results with the aim of increasing the efficiency and effectiveness of audits.

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## CHAPTER 10

### ECONOMIC AND FINANCIAL AFFAIRS

The Council welcomes the Court's overall assessment that the transactions in this policy area were free from material error and that the supervisory and control systems as a whole were functioning effectively.

It recalls, nevertheless, the errors and weaknesses set out in the Annual Report. It underlines the importance of further simplifying and harmonising the cost calculation methodology and the rules for cost eligibility, particularly with regard to the eligibility period. In addition, the requirement to use actual cost figures and the need to provide supporting evidence to justify the claimed cost should be pointed out more clearly.

These proposed measures are aimed at a further reduction of the error rate, but should not result in a reduced level of control if this cannot be clearly justified.

#### **1. Ex-ante checks to prevent irregular payments**

The Council invites the Commission to further strengthen the ex-ante checks of the cost statements submitted by beneficiaries for interim and final payments of grants, taking into account cost-benefit considerations, in order to support the identification of errors as regards not only accuracy but also eligibility and occurrence of the declared cost.

Moreover, the Council considers that it is essential to increase the number of on-the-spot audits and desk controls, with particular attention to areas of high risk or major budgetary impact, to improve the correctness of cost statements and to reduce the risk to legality and regularity of grants to beneficiaries.

## **2. Reduction of the risk of a cost being financed twice**

The Council suggests the Commission to look into possibilities of reducing the risk of double-financing of the same cost by the general budget, as stipulated by the Financial Regulation.

## **3. Audit certification as a reliable control**

The Council stresses the importance of increasing the quality and reliability of the audit certificates provided by the final beneficiaries, through detailed explanation of the cost methodology and support of the audit certification process to be performed.

Furthermore, it recalls the importance of the independence of the certifying auditors.

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## CHAPTER 11

### ADMINISTRATIVE AND OTHER EXPENDITURE

#### 1. Specific assessment in the context of the Statement of Assurance

The Council notes with satisfaction that overall in 2007 all the institutions continued to operate satisfactorily the supervisory and control systems required by the Financial Regulation and that the sample of transactions underlying the accounts continued to be free from material error.

However, the Council is seriously concerned about the lack of uniform application of rules affecting the staff across the institutions. Most notably, the Court's audit revealed significant differences in the application of the multiplication factor applicable to salaries as defined in the Staff Regulations. Such differences are not in line with the principle of equality of treatment for all staff since staff of some institutions may benefit from an advantage the others do not. This can also have a potentially non-negligible impact on the EU budget. Therefore, the Council encourages all the institutions to agree on a uniform approach to the application of the Staff Regulations, for example by means of common interinstitutional guidelines. Furthermore, the Council expects all the institutions to respect the rulings of the Court of Justice in this respect.

The Council is equally concerned by the Court's observation on the absence of any formal selection procedures for contract staff for auxiliary tasks in some institutions and urges all the institutions to comply fully with the provisions of the Conditions of employment of other servants of the European Communities, thus avoiding any risk of non-objective elements influencing the recruitment decisions.

The Council notes the Court's findings on the payments on carried over appropriations and urges all the institutions to comply strictly with the provisions on the principle of annuality as stipulated by the Financial Regulation.

## 2. Specific issues regarding administrative expenditure

In respect of the Communities' pension liabilities, the Council recalls its conclusions on the discharge for the financial year 2006<sup>1</sup> and insists that the Commission provides an updated estimate of annual Communities' pension expenditure at least up to 2013 well before the preliminary draft budget for the financial year 2010.

The Council also recalls its request for regular annual information on building needs as specified in the Council's conclusions on the Court's Special Report No. 2/2007 concerning the institutions' expenditure on buildings<sup>2</sup>. This annual information should be made available by all the institutions each year before the presentation of the preliminary draft budget.

## 3. European Union agencies<sup>3</sup>

The Council notes with satisfaction that the Court has issued unqualified opinions on the reliability of the accounts and on the legality and regularity of the underlying transactions for nearly all the agencies audited. It welcomes the visible improvements observed by the Court, compared to the previous year.

The Council deeply regrets however the serious problems identified by the Court in respect of the European Police College, as set out in its specific recommendation for discharge of this agency<sup>3</sup>, and insists that the College resolve these as a matter of utmost urgency.

The Council also draws attention to its observations on the European GNSS Supervisory Authority accounts in its specific recommendation for discharge of this agency<sup>3</sup>.

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<sup>1</sup> Doc. 5842/08 ADD 1 FIN 30 PE-L 7.

<sup>2</sup> Doc. 13525/07 FIN 453 INST 104 SGC 5 and 5842/08 ADD 2 FIN 30 PE-L 7.

<sup>3</sup> Decentralised agencies are subject of specific recommendations recorded in separate documents (Doc. 5588/09 ADD 1 FIN 4 PE-L 21).

The Council also recalls the weaknesses again identified by the Court in respect of a large number of agencies, relating mainly to their operational and budgetary programming, to their budgetary implementation which in some cases falls short of full compliance with the Financial Regulation, to deficiencies in the process of recruitment of staff and to difficulties in applying procurement procedures.

The Council appreciates the increasing role played by the Commission in assisting and supervising the financial management of the agencies and encourages Commission and agencies to continue working together in this direction. It invites the Commission to further intensify its assistance to the agencies, in particular by sharing expertise and by providing access to existing accounting systems and framework contracts, with the aim of remedying the reported weaknesses. It stresses the importance of coordination and supervision by the Commission, in particular of the day-to-day management of funds attributed to the agencies.

The Council regrets the persistently unrealistic requirements for funds which translate into high carry-over and cancellation rates. Therefore it urges the agencies to further improve the planning and follow-up of their budgetary requirements and to bring them in line with their detailed operational planning, in order to fully respect the principle of sound financial management.

The Council welcomes in this context the Commission's new approach to taking the agencies' unused appropriations into account when establishing the preliminary draft budget 2009, and considers it as a huge improvement. It urges the Commission to continue with this principle also in the coming budgetary procedures, with the aim of bringing down the agencies' annual surpluses. It urges the Commission as well to carefully check, and if necessary revise, the requirements of funds and posts as proposed by the agencies taking into account proven problems with implementation and recruitment with the aim of presenting a realistic budget proposal. It recalls the key role of the Member States' representatives in the agencies' Management Boards as regards supervision.

The Council calls on the agencies concerned to speed up their recruitment procedures and to bring down their persistently high vacancy rates, in order to be entirely operational without delay and to fully complete the attributed tasks.

Moreover, the Council is concerned about the problems relating to procurement procedures reported by the Court for a number of agencies. It asks the agencies concerned to take remedial action as soon as possible and to establish the appropriate internal procedures to ensure a transparent use of public funds in full conformity with the Financial Regulation.

The Council has noted with interest the Commission's Communication on European agencies<sup>1</sup> published in March 2008. The Council recalls its declaration of 17 July 2008 laying down the elements on which the evaluation of the agencies should be based. Moreover, the Council has committed itself to actively participate in the evaluation process initiated by the Commission and recalls in this respect the joint declaration regarding the creation of an Interinstitutional working group on agencies<sup>2</sup> adopted on 21 November 2008 which constitutes a good basis for the work to be carried out. The Council welcomes the decision that it will be attributed to independent external experts. It looks forward to the outcome of the evaluation and expects concrete proposals for improving the functioning and the transparency of the agencies.

The Council also recalls its conclusions<sup>3</sup> on the Court of Auditors' Special Report on the European Union's agencies<sup>4</sup>.

#### **4. Follow-up to observations from past Annual Reports**

The Council takes note of some outstanding recommendations from the past Annual Reports and invites all the institutions concerned to act on the Court's recommendations as soon as possible.

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<sup>1</sup> Doc. 7972/08 INST 26 JUR 145.

<sup>2</sup> By the European Parliament, the Council and the Commission.

<sup>3</sup> Doc. 13538/08 FIN 344.

<sup>4</sup> Doc. 11888/08 FIN 284.