Accountability: the aching tooth?

By Gabriele Cipriani [1]

Background

1). The EU and national budgets belong to the same 'category'. They are both financed by the same taxpayers to achieve objectives of public interest.

For Structural Actions, the objective is set by the Treaty. It is to support national actions leading to the strengthening of economic and social cohesion, aiming at *"reducing disparities between the levels of development of the various regions [and the backwardness of the least favoured regions or islands, including rural areas]."* [2]

In short, here the objective is 'Closing the gap' between regions.

2). The EC Treaty has foreseen two main 'eligibility checks' to establish whether a policy that does not fall within its exclusive competence (like Structural Actions) can be financed by the EU budget.

The first is purely financial. Any policy must be capable of being financed within the limit of the Community's own resources. [Article 270 TEC]

The second is more complex. According to the principle of subsidiarity, a policy is financed by the EU budget only if there is an added value as compared with funding from the national budgets. [3] However, even where this condition is fulfilled, Community intervention must be reduced to the "minimum" (principle of proportionality). [Article 5 TEC]

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[1] The author is an official of the European Court of Auditors. These speaking notes, which do not necessarily represent the Institution's position, were the basis of the author's presentation to the European Parliament's Committee on Budgetary Control on 6 May 2008. For a more detailed analysis of the topics discussed, see Cipriani G. (2006) - *The Responsibility for Implementing the Community Budget,* CEPS Working Document No. 247, Centre for European Policy Studies, Brussels and Cipriani G. (2007) - *Rethinking the EU Budget: Three unavoidable reforms,* Centre for European Policy Studies, Brussels.

[2] See Article 158 of the Treaty establishing the European Community (TEC).

[3] According to Article 5 TEC, *"In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community. Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty."*

3). ‘Shared management’ is a direct consequence of the subsidiarity/proportionality principles.

However, ‘Shared management’ is no more than an implementation method.

It is worth recalling here the so-called ‘delegation principle’ as set out by the Financial Regulation [4].

- Implementing tasks delegated must be clearly defined and fully supervised as to the use made of them.
- The delegation implies effective and efficient internal control and an adequate organisational structure.

According to the EC Treaty, the Commission, which *“shall implement the budget”* [5], has final responsibility. *“The implementation methods should guarantee that the procedures for protecting Community funds are complied with, whatever the entity responsible for all or part of this implementation and must confirm that final responsibility for budgetary implementation lies with the Commission in accordance with Article 274 of the Treaty”.* [6]

Article 274 TEC has been modified three times since 1957, by the Treaties of Maastricht (1992), Amsterdam (1997) and Lisbon (2007). However, each time the Commission’s final responsibility has been confirmed.

Under “shared management” arrangements, member states have the obligation to ensure the day-to-day management of the actions funded, including providing for an effective and efficient internal control system. The Commission has to supervise the operation of these systems according to regulatory requirements.

Legislation provides a clear sharing of roles.

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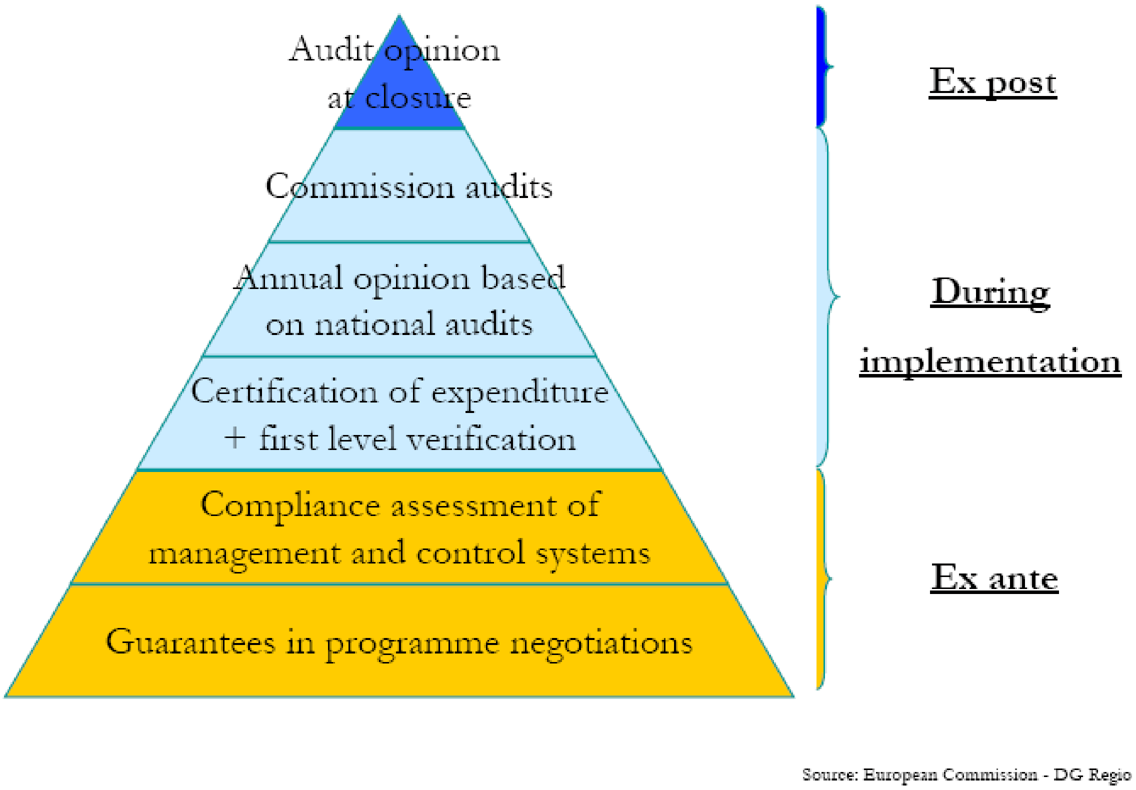
[4] See Articles 54(1), 60(4) and 66(3) of Council Regulation (EC, Euratom) No 1605/2002 as amended by Regulation No 1995/2006 of 13 December 2006.

[5] See Article 274 TEC and Article 53(1) of Council Regulation (EC, Euratom) No 1605/2002 as amended by Regulation No 1995/2006 of 13 December 2006.

[6] See Financial Regulation No 1605/2002, recital No 16. The Commission's full responsibility is reiterated in recital No 37. Several judgments of the European Court of Justice have confirmed this interpretation (see for example Case-law C-16/88, the Commission/Council, 1989 European Court reports I-3457, point 15; Case-law C-106/96, United Kingdom v. Commission, 1998 European Court reports, I-2729, point 15).

How assurance will be built up

The following Figure presents the 2007-13 assurance system for Structural Actions.



This is the 'latest fashion' in a process started in 1995 (Sound and Efficient Financial Management Programme, SEM 2000) to set down minimum standards of financial control by the member states of operations co-financed by the Structural Actions. One of the main results was the adoption of Commission Regulation (EC) No. 2064/97. Commission Regulation (EC) No. 438/01 confirmed and developed the same basic principles.

The new legislative provisions for 2007-13 [7] are meant to strengthen, once again, the control environment. In particular there is the requirement for the member states:

(a) to provide, <u>and the Commission to assess</u>, the ex ante compliance assessments on systems before a first interim payment to a member state is made;

(b) to designate for each programme an <u>audit authority</u> working under an agreed audit strategy, which

- reports audit results (*including an error rate*), and
- submits an annual audit opinion on the functioning of the systems to the Commission. [8]

The assurance system requires in particular that <u>member states' claims pass through several checks</u> before they can be presented for reimbursement to the Commission [9].

The declaration of expenditure by member states takes the form of <u>accounts certified</u> by a technically competent department or body functionally independent of the spending agency. [10]

This internal control model is based on the idea of a 'single audit', which implies that assurance is built up at each stage, in accordance with a division of tasks. <u>'Reliance' is in this context the 'key' word.</u>

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[7] Council Regulation (EC) No 1083/2006 and Commission Regulation (EC) No 1828/2006.

[8] It should also be mentioned that, as a result of the Interinstitutional agreement on the 2007-13 financial perspective of 17 May 2006 (Article 44), *"As part of their enhanced responsibilities for structural funds and in accordance with national constitutional requirements, the relevant audit authorities in Member States will produce an assessment concerning the compliance of management and control systems with the regulations of the Community"*. This obligation has been introduced in the Financial Regulation, though with a less stringent wording, by stating that member states shall *"produce an annual summary at the appropriate national level of the available audits and declarations"* (see Article 53(b)(3) of Council Regulation (EC, Euratom) No 1605/2002 as amended by Regulation No 1995/2006).

[9] The general principles set out by the Financial Regulation provide that members states shall *"(a) satisfy themselves that actions financed from the budget are actually carried out and to ensure that they are implemented correctly; (b) prevent and deal with irregularities and fraud; (c) recover funds wrongly paid or incorrectly used or funds lost as a result of irregularities or errors; (d) ensure (…) adequate annual ex post publication of beneficiaries of funds deriving from the budget. To that effect, the Member States shall conduct checks and shall put in place an effective and efficient internal control system (…)"* (see Article 53(b)(2) of Council Regulation (EC, Euratom) No 1605/2002 as amended by Regulation No 1995/2006).

[10] See Article 42 of Commission Regulation (EC, Euratom) No 2342/2002 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.

One would expect successive reforms to have made national systems correspond to EU requirements and the Commission's supervisory role to have taken due account of the risks associated with the management environment and the nature of the actions financed.

Furthermore, Structural Actions require co-financing by member states, thus reinforcing their interest in applying the rules satisfactorily.

The following table presents the situation for the 2007-13 programming period.

Community Amount

344,4 billion Euro

National Public Amount

143,6 billion Euro

Country	Nbr of OPs	Nbr of decided OPs	Community Amount	National Public Amount	National Private Amount	Total	Cofinancing Rate (%)	EIB Amount	Other Amount
Balgarija	7	7	6,673,628,244	1,345,569,406	0	8,019,197,650	83.22 %	0	0
Belgique-België	10	10	2,063,500,766	2,486,617,235	173,642,921	4,723,760,922	43.68 %	0	0
Ceska Republika	17	16	26,302,604,484	4,636,803,377	0	30,939,407,861	85.01 %	946,236,638	3,817,620,719
Danmark	2	2	509,577,239	326,744,320	182,832,919	1,019,154,478	50.00 %	0	0
Deutschland	36	36	25,488,616,290	12,209,515,362	4,364,335,654	42,062,467,306	60.60 %	0	7,534,633,825
Eesti	3	3	3,403,459,881	442,613,477	227,313,941	4,073,387,299	83.55 %	0	0
Ellada	14	13	20,210,261,445	5,688,375,731		25,898,637,176	78.04 %		13,144,382,549
España	45	45	34,657,733,981	15,644,320,827	125,323,084	50,427,377,892	68.73 %	0	0
EU cross-border cooperation	69	58	7,768,427,675	3,062,720,402	164,577,574	10,995,725,651	70.65 %	0	77,485,365
France	36	35	13,449,221,051	13,937,112,830	5,579,000,114	32,965,333,995	40.80 %	0	0
Ireland	3	3	750,724,742	1,545,292,687	3,000,000	2,299,017,429	32.65 %		314,000,000
Italia	52	51	28,085,670,992	31,647,248,407	0	59,732,919,399	47.02 %	0	154,639,361
Kypros	2	2	612,434,992	116,883,319		729,318,311	83.97 %		
Latvija	3	3	4,530,447,634	774,888,189	448,221,592	5,753,557,415	78.74 %	0	0
Lietuva	4	4	6,775,492,823	950,735,189	552,325,541	8,278,553,553	81.84 %		
Luxembourg (Grand-Duche)	2	2	50,487,332	68,143,473	16,963,743	135,594,548	37.23 %		
Magyarország	15	15	24,921,148,600	4,397,849,766	0	29,318,998,366	85.00 %		
Malta	2	2	840,123,051	148,257,008	0	988,380,059	85.00 %	0	0
Nederland	5	5	1,660,002,737	1,632,017,717	686,570,509	3,978,590,963	41.72 %		
Österreich	11	11	1,204,478,581	1,146,636,272	110,000,000	2,461,114,853	48.94 %		2,554,171,045
Polska	21	21	65,221,852,992	14,108,197,059	2,707,690,412	82,037,740,463	79.50 %	2,005,000,000	5,617,749,990
Portugal	14	14	21,411,560,512	7,668,436,626	3,642,277,158	32,722,274,296	65.43 %	788,900,000	11,328,130,678
România	7	7	19,213,036,712	4,038,360,695		23,251,397,407	82.63 %		1,597,947,099
Slovenija	3	3	4,101,048,636	723,714,483		4,824,763,119	85.00 %		
Slovenska Republica	11	11	11,360,619,950	2,077,706,350	0	13,438,326,300	84.54 %	0	460,666,789
Suomi/Finland	7	7	1,596,966,044	1,927,958,120		3,523,924,164	45.29 %		2,003,132,178
Sverige	9	9	1,626,091,888	1,783,199,986	0	3,409,291,874	47.70 %	0	0
United Kingdom	22	22	9,890,937,463	9,084,952,829	937,531,117	19,913,421,409	49.87 %	0	0
TOTAL	432	417	344,379,156,737	143,620,871,142	19,921,606,279	507,921,634,158	67.80 %	3,740,138,639	48,604,559,598

Source: European Commission - DG Regio – stand 5.2.2008

Hence, the €344,4 billion for Structural Actions are closely linked to the €143,6 billion of national co-financing.

For every €10 of EU expenditure in this area, another €4 are spent (on average) from the national budgets.

However....

1). The European Court of Auditors continues to record a high 'error' rate (at least 12 % in 2006). Although this does not represent an estimate of fraud, it seems actually to be too high to be considered “tolerable”.

This situation is recognised by the Commission, which furthermore considers that for the 2000-2006 programming period, errors already made will continue to affect payments which will be made up to 2010. [11]

2). If the reimbursement of expenditure to Structural Actions projects is subject to material error, this is because :

- *Control systems in member states are not sufficiently effective,*

and

- *this is not compensated by adequate supervision by the Commission*.[12]

3). It should be noted that many ‘errors’ relate to an incorrect application of national rules.

For the ERDF and the Cohesion Fund, over a third of the errors are linked to breaches of rules on public procurement. [13]

This raises concern not just in respect of the national ‘cofinancing’ part, but also in respect of national actions that are not co-financed. For many countries EU expenditure on cohesion represents a rather limited part of their total expenditure in this area.

The problem is therefore not ‘restricted’ to the EU budget. One could then say: EU and national budgets are all in the same boat.

[11] See the Action plan to strengthen the Commission's supervisory role under shared management of structural Actions, COM (2008) 97, point 8.2, page 9.

[12] See ECA Annual Report 2006, paragraphs 6.38-6.39.

[13] See the speech by Mrs. Hübner of 25 February 2008 before the European Parliament’s Committee on Budgetary Control (document SPEECH/08/100).

Where the problem lies

If one looks at the 'map' of the 'errors' (see annex 6.1 of the ECA Annual Report 2006), it will be seen that they are mostly generated at the level of the management and certifying authorities.

Most of the 'red' cells are in this area. And as Mr Barnier observed when he was Commissioner responsible for regional policy, good and bad administration are not a question of geography [14].

In response to the ECA 2006 Annual Report, the Commission indicated that in relation to the volume of funds *"between 20 and 35 %* [of systems are] *satisfactory, around 60 % in need of improvements to correct material deficiencies in key controls, and around 10 % seriously deficient"*[15]**.**

In conclusion, a large number of systems, representing a significant part of the funds, do not yet reach minimum standards for legality of spending.

[14]See Mr Barnier's speech to the conference on sharing responsibility for the decentralised management of the Structural Funds (document SPEECH/00/202).

[15]See ECA 2006 Annual Report, Commission's reply to paragraph 6.35.

The 'Contract of confidence'

The difficulty of putting systems in line with requirements is shown by the development of the 'Contract of Confidence', an initiative launched by the Commission in 2002 as a way of implementing the 'single audit concept'.

For national systems to achieve this *"triple-A rating"* three conditions must be met :

- the Commission has reasonable assurance that the systems comply with the requirements;
- the national authorities have drawn up a satisfactory audit strategy, and
- the member state provides an adequate basis for assessing the effective implementation of the audit strategy and sets out conclusions with regard to the functioning of the systems.

<u>In exchange, the Commission will no longer carry out audits</u> of the functioning of the systems of the managing and paying authorities for the programmes covered, nor of operations in such programmes, <u>unless exceptional circumstances arise</u>.

Undoubtedly such arrangements increase accountability, as the Commission will directly certify the systems charged with implementing the EU budget. As the Commission has stated, this initiative *"has created a bench-marking procedure"*. [16]

One would actually expect all systems to be 'certified' as complying with the requirements of the 'Contract of Confidence'. As such, one could consider that these requirements are in line with the Financial Regulation and the specific 2000-2006 legal basis. It should also be noted that the principle of the 'Contract of Confidence' is recognised in the 2007-13 financial rules (see Article 73(3) of Regulation No 1083/2006).

However, this "quality label" has only recently been obtained <u>for only 10 % of ERDF funds</u> (and for only 6 member states, with no main beneficiaries among them). <u>No ESF programmes</u>, which represent a tenth of the Community budget, are included.

This also means that, contrary to expectations, in general the Commission's level of audit activity cannot be reduced significantly.

[16] See Joint Audit Strategy for Structural Actions (2007-2009), March 2007, page 10.

Threats to full accountability

1). In pure legal terms, the sharing of roles between Commission and member states does not undermine the Commission's final responsibility in implementing the EU Budget. But in practice, it does.

The fact is that, despite a chain of controls and certifications involving the member states and the Commission in a logical sequence, assurance has not been attained yet.

In fact, the assurance model, conceived as an integrated 'single audit' system, has developed into different pieces of internal control which in many cases have proved not to be reliable. Therefore, the last in the chain, the Commission, cannot fully rely on prior control stages. No assurance, no full accountability.

The combination of the absence of genuine controls on the management of the budget, together with the specific responsibilities entrusted to the member states (for example, the Commission has no practical influence on the set-up of national management and control bodies), has led the Commission to interpret the concept of responsibility as basically limited to the implementation of the specific tasks that it considers to be its exclusive responsibility.

Full accountability cannot be reached by decree.

2). 'Shared management' arrangements assume that both the Commission and the member states share the same objectives. They should ideally be partners and not counterparts. But the requirement to put in place adequate systems, operating effectively, may be overridden by other considerations.

For example, absorption is an implicit objective of Structural Actions.[17] The N+2 rule is a "risk" in this respect for the member states, thus creating a tension with regard to the legal spending requirements.

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[17] It is interesting in this respect to recall the conclusion arrived at by the "Committee of Independent Experts" in 1999 with a view to contributing to improving the management by the Commission **17** : *"The ceiling of expenditure in each Member State is also a target (...). There is pressure on the national administrations to find and on the Commission to accept sufficient projects to attain the predetermined levels of expenditure in each Member State (...). The legislative and administrative development of the Structural Funds tends to the conclusion that the balance of decision-making power and effective control of direction and expenditure has passed decisively to the Member States"* Committee of Independent Experts (1999), points 3.15.6 and 3.22.1.

Moreover, this rule, which is intended as a discipline to ensure that spending is well planned, sets up an incentive for the member states and the Commission to favour activities where spending can be undertaken with relative ease.[18]

3). Because of multi-annuality, today's system tends to concentrate activity at the beginning of the financial programming (allocation of funds to programmes) and towards the end (closure process).

But then it may be too late. What's done is done.

As shown earlier, the main problem is that 'preventive' actions are either insufficient or ineffective. And the 'Contract of Confidence' initiative is not yet a 'success story'.

Key points are:

- an early, adequate set-up of systems, and, in particular, carrying out sufficient day-to-day checks on the reality of expenditure;

- awareness by beneficiaries/responsible authorities of the requirements to be met and,

- a prompt 'translation' of audit results into corrective measures going beyond the specific cases of error, and addressing systemic weaknesses. The follow-up of irregularities uncovered by the ECA during the DAS exercise is a minimal requirement. It will have no decisive impact if systemic weaknesses are not addressed.

Once again, in the end the decisive factor will be the capacity of the Commission to ensure a full supervisory role.

It should be noted that for the 2007-13 Structural Actions the Commission should be able to thoroughly assess in a short time (*otherwise the documents are deemed approved*) several hundreds of key documents (audit strategies, systems assessment, annual control reports and annual opinions of the audit authority). It should also take appropriate action on the basis of this significant amount of information. [19]

[18] See in this respect ECA Special Report No 1/2007 concerning the implementation of the mid-term processes on the Structural Funds 2000-2006. The Economic and Social Committee observed that, to avoid cancellations of appropriations, national authorities *"are inclined to make hasty decisions on projects of dubious value, sometimes with the tacit cooperation of the European Commission"* (see Economic and Social Committee, Opinion on the Proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund – 6 April 2005, ECO/150, point 3.5.17). Similar considerations have been expressed in the study "The Structural Funds in Southern Italy", European Parliament, 15 March 2008.

[19] The Commission's services identified assurance on the set-up and the functioning of the management and control systems for the 2007-2013 as one of the priorities for 2007 (see Joint

4). Systems requirements have been intensively regulated for 10 years at least. The main problem does not seem to be the legal framework, but rather its implementation.

Current problems cannot really be attributable to legislative gaps. One should not expect that increasingly tight provisions can make up for insufficient supervision.

There is no doubt that the new legislative framework can contribute to reinforcing the framework for assurance. But the problem will not solve itself, just because there is a new set of legal requirements.

Audit strategy for Structural Actions for 2007-2009, page 8). This same document stresses however that *"The risks are that the new procedures will not be fully understood, that they will not be properly complied with and that the responsible bodies will not have the know-how and/or resources to apply them correctly. For ERDF and Cohesion Fund, there are also specific risks linked to the concentration of Funds in two Member States, Poland and Spain, which together will account for about 30% of these Funds, and to the volume of funds which will be managed by the two new Member States, Bulgaria and Romania."* (see page 18).

Financial corrections, a shortcut for accountability?

There is a tendency in the EU finances system to seek for assurance mainly ex-post. Much focus is put on the "conformity clearance" (Agriculture) or on the "closure" of programmes (Structural Actions). [20]

The Financial Regulation may be interpreted as giving to financial correction mechanisms the function of making good any loss to the Community's budget. Financial corrections would thus represent more than an "*extrema ratio*". Indeed, the Financial Regulation provides that *"In order to ensure that the funds are used in accordance with the applicable rules, the Commission shall apply clearance-of-accounts procedures or financial correction mechanisms which enable it to assume final responsibility for the implementation of the budget."*[21]

The imposition of financial corrections is a key aspect of the Commission's strategy for ensuring the legality of spending [22]. Financial corrections are meant to constitute an essential counterweight to the delegation of responsibility to the member states and would thus provide reasonable assurance regarding the legality, regularity and sound financial management of the measures financed.

Three questions could be raised in this respect.

1. Is this tool sufficiently "dissuasive"?
2. Is it "exhaustive"?
3. Is it a "cure-all"?

1) Dissuasive. Financial corrections are not a sanction system. The highest risk associated with them is that EU money will have to be paid back by member states. In practice, a financial correction may represent either a "net" reduction of a member state's global financial envelope or, more frequently, a simple substitution of new projects for 'incompliant' ones.

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[20] For example, in response to the ECA 2006 Annual Report (paragraph 1.41), the Commission has indicated that *"The findings presented by the Court show the situation at a particular point in the execution of these control processes. A large proportion of the errors are likely to be corrected through the operation of the multi-annual corrective system."*

[21] See Articles 53b(4) (shared management) and 53c(2) (decentralised management) of Council Regulation (EC, Euratom) No 1605/2002 as amended by Regulation No 1995/2006 of 13 December 2006.

[22] For example, in its Communication on a roadmap to an integrated internal control framework the Commission pointed out that *"when a Member State fails to adequately address the risk of error, the Commission will protect the EC budget by rigorously applying the existing provisions for the suspension of payments and financial corrections"* (see European Commission, Communication on a roadmap to an integrated internal control framework, COM (2005) 252 final, page 7).

What happens to the 'incompliant' projects is a different story. Whether, in line with the regulatory requirements[23], final beneficiaries will have to reimburse the funds received is left in practice to member states. [24]

In the end, the final beneficiary may well feel no impact whatsoever. In this case, a financial correction will have the effect of increasing national spending, thus representing further expenditure for the taxpayer. [25]

2). <u>Exhaustive</u>. It is difficult to know whether such corrections *"restore a situation where 100 % of the expenditure declared for cofinancing from Structural Funds is in line with the applicable national and Community rules and regulations".* [26]

Further enquiries are going on at Commission level to produce a global picture of both the Commission's and the member states' actions in this respect.

Only then could one have a better idea as to whether recoveries are in line with ECA findings, and if the systems process fully and properly all irregularities uncovered, or, on the contrary, if there are discrepancies requiring the Commission to take action in the next years through its audits.

3). <u>Cure-all</u>. It should be stressed that financial corrections are in fact an indicator of whether a policy has been successfully implemented. In reality they are proof of missed opportunities. As a matter of principle, one should not welcome a situation where a significant amount of the EU budget has to be reimbursed because of irregularities.

In any event, financial correction mechanisms will only target legality issues. Value for money concerns, in particular impact achievements, are left aside. And this is a significant limitation.

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[23] Regulation No 2988/95 (Article 4(1)) on the protection of the European Communities' financial interests requires the member states to withdraw any advantage wrongly obtained by a beneficiary and to ensure that amounts wrongly received are reimbursed. Similarly, the Financial Regulation (Article 53b(2)(c)) requires member states to *"recover funds wrongly paid or incorrectly used or funds lost as a result of irregularities or errors"*.

[24] For example, in the area of agriculture spending, the Commission has indicated in response to the ECA 2006 Annual Report (paragraph 5.76) that the conformity procedure *"is not a mechanism by which irregular payments to beneficiaries are recovered, which according to the principle of shared management is the sole responsibility of Member States".*

[25] Whereas one of the key assumptions underlying the Commission's proposal concerning the 2007–13 financial framework was precisely that *"pooling national resources at EU level can bring major savings for national budgets"* (See European Commission, Communication on the Financial Perspective 2007–13, COM(2004) 487, page 5).

[26] See Guidelines on the principles, criteria and indicative scales to be applied by Commission departments in determining financial corrections under Article 39(3) of Regulation (EC) No 1260/1999, document C(2001) 476 of 2.3.2001, page 1.

The substitution of “new” projects for “irregular” ones makes the implicit assumption that these new projects are less error prone than the old ones. The question is whether this is confirmed in practice.

Financial corrections tend to correct specific uncovered irregularities. There is a risk of not seeing the wood for the trees. They may limit the damage, but they do not resolve systemic problems, especially if they are applied at the end of the programming period. If systems have not operated in line with the requirements, this cannot be corrected *ex-post*.

Indeed, financial corrections come after the event. As Mr Aigner observed: *“The (…) disadvantage of ex-post control increases with the time lapse between the date on which expenditure is made and that on which it is queried”* [27]. Indeed, the financial correction process is a lengthy one. For example there are still a number of cases relating to the 1994-1999 closure process. [28] And there may be a significant difference between what has been announced and estimated in the first place and what is actually recovered. Also, financial correction procedures incur administrative costs (at the level of both the Commission and the member states).

It must therefore be concluded that the possibility of imposing financial corrections does not, by itself, ensure the legality of the operations financed by the budget. They are only a limited means for repairing the damage to the Community's budget. [29]

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[27] European Parliament, The case for a European Audit Office, Introduction by Heinrich Aigner, Vice-Chairman of the Committee on Budgets, Luxembourg, 1973, point 12.

[28] Concerning agriculture spending, the ECA indicates in its Annual report 2006 (see paragraph 5.78) that the Commission’s conformity decisions are not complete for any year later than 1998.

[29] The European Parliament wondered for example *“if the current system of financial correction is sufficient to encourage Member States to combat fraud and irregularities”* (see European Parliament, Resolution of 10 April 2002 on the discharge for implementing the general budget of the European Union for the financial year 2000, para. 78).The Court of Auditors observed that the financial corrections could provide no more *“than a limited, auxiliary contribution to the necessary rigour of everyday management. Their effectiveness is essentially dependent on the number of checks performed. Furthermore, since financial corrections would intervene only after the fact, they could not be enough on their own to make good all the consequences of any transactions that might be implemented even though they did not meet the necessary regulatory requirements”* (see European Court of Auditors, Opinion No 2/2005 on the proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund, paragraph 14).

Summing up

The EU budget is based on the principle of added value compared to national budgets.

Full accountability, <u>a principle of public finances</u>, is necessary to ensure the achievement of 'European' objectives.

The lack of full accountability is the result of different factors:

- 'Shared management' has evolved towards 'separated management';
- Lack of assurance on spending, and
- Unclear policy objectives.

Prevention and supervision seem to be the two key areas to improve.

1). <u>Reputation risk</u>.

There are very good reasons to lower drastically the error rate.

The first concern relates to the so-called 'Reputation risk'. Continuous high error rates undermine the credibility of EU spending, and indeed of the EU as such. Instead we should aim at increasing citizens' awareness of both the benefits and the costs of EU actions.

A high 'error rate' is not just a problem for the EU budget. National budgets share a common interest in putting in place adequate management and control structures, the more so for Structural Actions because of national co-financing.

2). <u>Legality of spending: a key condition for effectiveness</u>.

Legality of spending is a key condition for effectiveness. But It cannot be achieved simply by applying financial corrections. It requires effective implementation of systems and, above all, adequate supervision.

3). <u>'Value for money' concerns</u>.

In the last years most of the efforts have been put into trying to achieve 'legality' of spending. This is a necessary, although not sufficient, condition for achieving policy objectives. Indeed, as it has been observed by the Commission's Vice-President

Kallas, *"there can be projects, brilliantly executed in terms of formal rules and formulas, but still failing in achieving any objective, and vice versa"*. [30]

One must recognise that in this respect accountability is even weaker. Value for money has become a kind of 'poor relation'.

As indicated earlier, the *raison d'être* of the EU budget (and of the Commission's management powers in respect of it) is that it can achieve better results than national budgets. The prime overall risk to the European Commission should not be that it will fail to obtain the annual discharge for its management of the Funds [31], but rather that the objectives attached to the EU budget will not be met.

The question of accountability is entirely dependent on the answer we give to the question: what is the EU budget for? Indeed, the point is not just <u>'who'</u> should be accountable towards the budgetary authorities, but also <u>'for what'</u>. Should, for example, questions like <u>'how far have Structural Actions contributed to 'closing the gap'</u> be part of a normal process of rendering the accounts?

The incoming review of the EU Budget represents above all a chance to put in place the conditions for improving effectiveness of EU funded actions. Greater accountability will be the natural outcome of progress towards a better EU budget.

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[30] See Mr Kallas' speech of 23 October 2006 before the European Parliament's Committee on Budgetary Control (document SPEECH/06/625).

[31] See Joint Audit Strategy for Structural Actions (2007-2009), March 2007, page 6.

The EU Budget reform

In this perspective the following should be considered.

1). <u>One EU budget, one final responsibility</u>.

If the EU budget has to achieve specific objectives of public interest for Europe, this presupposes that there should be no exception concerning full accountability, which is a fundamental condition for good management. Therefore, one budget, one final responsibility.

The solution seems to be, not to 'separate' further the responsibilities, but rather to permit appropriate supervision by the Commission. *"In a context where the Member States are both beneficiaries of the Community funds and responsible for the implementation of measures, only the Commission is able to ensure that the Community objectives are applied in a logical and consistent manner."* [32]

We should not look for full accountability just for the satisfaction of blaming someone, but rather to have an 'owner' for the EU budget that can ensure policy objectives are implemented in practice.

But as indicated earlier, full accountability is the natural outcome of a virtuous process where objectives are clear and achievable.

2). <u>Objectives in line with the resources.</u>

The financial perspective is traditionally very much focused on '<u>how much</u>' should be made available, much less on '<u>what</u>' in terms of clear objectives and, particularly, on '<u>how</u>' all this is expected to be achieved.

What we should certainly avoid is setting ambitious "all-embracing" objectives, knowing already that they cannot be achieved because we lack funding or an adequate administrative framework. Or both.

This would imply setting clear, selective, measurable objectives. And we should also make sure that these objectives are achievable in practice. We should not set the Commission an impossible task.

In this respect, the adequacy of administrative structures, at all levels (EU, national), are a decisive factor for achieving objectives. For example, to what extent

[32] See European Court of Auditors, Opinion No 2/2005 on the proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund, paragraph 5.

can the delegated administrations put forward, manage and maintain projects? How much money can they 'effectively' absorb? How far can the Commission ensure an effective supervisory role for today's approximately 60 spending programmes? Is there 'European added value' everywhere?

3). Prevention is better than cure.

Looking at the audit strategy for Structural Actions 2007-2009 one could read: *"The risks are that the new procedures will not be fully understood, that they will not be properly complied with and that the responsible bodies will not have the know-how and/or resources to apply them correctly.*[33]

One question could be raised in this respect. Should, as the 'principle of delegation' would recommend, assurance on systems charged with implementing the EU budget (whichever, at EU or national level) be a pre-condition for managing EU funds? In other words, a 'rating' of systems prior to the bidding for EU money. Take as an example the 'Contract of Confidence' model.

In particular, the question is whether *"it would be desirable to make arrangements, if not for an approval procedure, then at least for the Commission to oversee the procedures by which management and control bodies are appointed at national level."*[34]

4). A dynamic of rewards.

Today we tend to apply a 'defensive' policy. In case of problems, we see 'financial corrections' as a kind of 'full-damage insurance'. But this expectation is not confirmed by the reality.

A strategy based on 'financial corrections' may at the very best achieve what one could call 'buying' with EU funds a 'proper' (formally legal) share of national spending. It will not enforce the achievement of the objectives underlying the policy.

We should therefore find ways to rebalance the system towards a more 'positive' approach, to reward systems that can effectively implement projects and achieve objectives, to inspire trust and encourage best practices.

Such a concern might find satisfaction in the provision added to Article 275 TEC by the Treaty of Lisbon, stating that in the framework of the discharge procedure *"The*

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[33]See Joint Audit Strategy for Structural Actions (2007-2009), March 2007, page 18.

[34] See European Court of Auditors, Opinion No 2/2005 on the proposal for a Council Regulation laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund, paragraph 10.

Commission shall also submit to the European Parliament and to the Council an evaluation report on the Union's finances based on the results achieved (…)".

5). 'Who fails pays' principle.

One could consider whether the nature of the financial correction system should be changed, from an instrument of pure recovery to a sanction system. Actually, we would not start from zero. The regulation on the protection of financial interests and the Financial Regulation already constitute a proper basis. Indeed, in order to have a dissuasive effect, financial corrections should lead to recovery of funds from beneficiaries.

The reference to Article 280 TEC inserted by the Treaty of Lisbon in the financial provisions, according to which the Union and the member states shall counter fraud and any other illegal activities affecting the financial interests of the Union, reinforces the principle of equivalence between EU and national funds.

6). Policy 'eligibility' checks.

It is a matter of fact that the EU budget can pursue only a limited number of objectives. The expected added value should play a fundamental role in the choice. Policies should be assessed against their costs (all kinds of) compared to the objectives. One could refer, in this connection, to the Protocol on the application of the principles of subsidiarity and proportionality annexed to the Lisbon Treaty which provides that *"the reasons for concluding that a Union objective can be better achieved at Union level shall be substantiated by qualitative and, wherever possible, quantitative indicators"*.

On top of the two 'checks' foreseen today (being in line with the own resources ceiling and in conformity with the principles of subsidiarity/proportionality), there is perhaps room for further checks to ensure a policy is 'eligible' under the EU budget. For example, the European Parliament has stressed *"that an initiative that is insufficiently verifiable should not be financed by public money"*.[35]

The conditions for full accountability could well constitute another of these checks. To show if, up to what point and how, the management and control of different policies can be subject to complete acceptance of responsibility. This assurance should be, in the full sense, one of the criteria for deciding that the objectives of the action can *"by reason of the scale or effects (…) be better achieved by the Community".* [Article 5 TEC]

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[35] In this respect, the European Parliament referred to the Court of Auditors' special reports on the European Social Fund combating early school leaving and on rural development (see European Parliament, Resolution of 24 April 2007 on the discharge for implementing the general budget of the European Union for the financial year 2005, paragraphs 205 and 238).