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**COMMUNICATION FROM THE COMMISSION  
TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE EUROPEAN  
COURT OF AUDITORS**

**Impact Report on the Commission Action Plan towards an Integrated Internal Control  
Framework**

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**1. EXECUTIVE SUMMARY**

In 2005, following successive reports from the European Court of Auditors giving a negative opinion on the underlying transactions in a number of key policy areas, the Commission fixed the ambitious strategic objective of striving for a positive declaration of assurance from the Court. To reach this objective, and inspired by the Court's Opinion 2/2004<sup>1</sup> (the "Single Audit Opinion"), the Commission proposed a "Roadmap to an Integrated Internal Control Framework"<sup>2</sup> in June 2005, and sought to reach "a common understanding" with the Parliament, the Council and the European Court of Auditors on the Roadmap.

Based on the feedback received, as well as the recommendations in the European Parliament's discharge resolution 2003<sup>3</sup>, the ECOFIN conclusions of 8 November 2005 and a detailed assessment made for all major spending areas, the Commission adopted the "Action Plan towards an Integrated Internal Control Framework"<sup>4</sup> in January 2006.

While explicitly acknowledging the Commission's responsibility for the implementation of the budget as set out in Article 274 of the Treaty, the Action Plan set out a framework for Member States to "*cooperate with the Commission to ensure that the appropriations are used in accordance with the principles of sound financial management*"<sup>5</sup>.

In its February 2008 Progress Report<sup>6</sup>, the Commission reported that 7 of the 16 original actions had been completed, 6 were substantially complete and 3 could not be implemented or were being taken forward in other ways. The Court broadly concurred with the Commission's self-assessment of completion rates<sup>7</sup>. A year later, the 6 outstanding actions have been completed.

As well as providing the latest information on Action Plan implementation, the main purpose of this report is to give an updated and objective assessment of its **impact** based on quantitative and qualitative indicators. The overall conclusion is positive, building on the findings in the Court's Annual Report on 2007, which reports significant progress with an unqualified opinion on the accounts for the first time, and the best DAS ever with some 45% of budget expenditure receiving an unqualified opinion on the legality and regularity of underlying transactions. This compares with 6% in the Court's Declaration of Assurance

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<sup>1</sup> Opinion No 2/2004: OJ C107/1 of 30.4.2004 (the 'Single Audit' Opinion).

<sup>2</sup> COM(2005) 252.

<sup>3</sup> OJ L 196, 27.7.2005, p. 4.

<sup>4</sup> COM(2006) 9 and SEC(2006) 49.

<sup>5</sup> TEC 274

<sup>6</sup> COM(2008) 110.

<sup>7</sup> European Court of Auditors, Annual Report for 2007, Table 2.3.

given for 2003. The Court has also identified further progress in the Commission's supervisory and control systems with, for the first time no systems receiving a 'red light' in the 2007 report.

## **2. WHAT IS IMPACT AND HOW CAN IT BE MEASURED?**

The Action Plan proposed a common framework for actions to be taken and the role that the Council, Member States and the European Parliament should play in achieving a reliable and functioning integrated internal control framework, giving assurance to the Commission and, ultimately to the Court of Auditors. Its impact could be assessed according to different criteria:

- whether there is evidence that the common understanding underpinning the Roadmap continues to guide the Institutions involved, and that the necessary cooperation, including from Member States, is materialising and crystallising around "single audit" principles;
- whether the Commission has improved controls where it has full and direct responsibility, through better audit coverage, increased quality of the Annual Activity Reports and effective recovery of undue payments; and
- whether, on actions shared with Member State administrations, there is measurable improvement in Member States' control systems due to their own actions and those of the Commission and by recovery of undue payments.

The different levels of Commission leverage must be kept in mind when assessing the impact of the Action Plan. For these reasons, the present "Impact Report" looks beyond simple quantitative indicators such as error rates or amounts recovered. For example, guidance can help clarify legislative requirements but it does not have a directly demonstrable impact on error rates in the short term. Likewise, the improvement in Commission services' annual activity reports is not measured in such terms but rather through the independent qualitative appreciation of the Court.

To give a complete, realistic and objective overall picture the Commission therefore reports impact in the following section based on an appropriate mix of qualitative and quantitative indicators. Where available, reference is made to independent assessment by the external auditor through observed error rates, DAS traffic lights, system assessments and other observations. This is supplemented with evidence provided from audits opinions delivered by the IAS, or from self-assessments and data collected by Commission services.

## **3. IMPACT AS AT 31 DECEMBER 2008**

A positive DAS is now a recognised political imperative, focusing attention across the Institutions. This has helped mobilise support in Commission services, motivating them to look critically at their controls and supervision, and creating a consensus on actions to prevent errors. This is a major achievement in the light of competing objectives, such as reconciling the need for extra auditors within tight staff limits, or reconciling rapid disbursement with effective control.

The Commission considers that a common understanding has been reached, and that the conceptual framework of the Action Plan continues to effectively guide further improvements, such as the debate recently launched on the tolerable risk of error. Interest and

support from the European Parliament has remained strong and co-operation with Member States continues to improve. The impact assessment below is based on specific indicators, action by action<sup>8</sup>, at 31 December 2008.

### 3.1. Simplification and common control principles (actions 1-3)<sup>9</sup>

*Action 1: Simplification of proposed 2007–13 legislation*

**Action completed:** Simplification for 2007-2013 was originally not as extensive as hoped. In addition to the actions set out in the Action Plan concerning simplification, the Commission has taken further steps to simplify rules for structural actions through its adoption of proposals to amend the relevant Council regulations, with a view to expand the use of flat rates, lump sums and unit costs to all types of expenditure for both ERDF and ESF. The Commission will consider proposing further measures in 2009 on the basis of recommendations of a joint Commission/Member State working group to be presented in the first half of 2009. Provided support from the European Parliament and the Council on such measures is achieved, the impact of further simplification on the error rate should become apparent from 2010/2011.

#### Impact

*Indicator: Percentage of the budget executed through a simplified approach.* In Agriculture, the introduction of the Single Payment Scheme has decoupled support from production and put an end to complex eligibility requirements. The transitional Single Area Payment Scheme applied in most EU-12 States goes further as it is solely based land areas. The recent Health Check and the single Common Market Organisation have also contributed to simplification. In the Structural Funds, the use of flat rates for overheads reduces the requirement for beneficiaries to analyse and retain cost accounting data and should reduce overpayments due to ineligible costs.

#### **Key supporting information**

*The percentage of funds executed through decoupled direct aids has risen from 47% of total direct payments in the agricultural sector in 2005 to 83% in 2008, with a targeted increase to 93% by 2013 and beyond. Around 25% of the EU budget is thus executed through this simplified approach.*

*Indicator: Reduced ECA error rates due to clearer legislation and extensive guidance.* Considerable simplification has been made in Education and Culture including lump sum grants for the Lifelong Learning Programme. Future clarification on the criteria for use of average personnel costs in the 7<sup>th</sup> Research Framework Programme will make cost claims easier to compile and submit but impact will become evident subsequent to implementation from 2009.

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<sup>8</sup> Actions 2 and 6 are not covered by this report as they were cancelled.

<sup>9</sup> This group of actions included Action 4 on tolerable risk, which is reported in section 3.3 of this Communication along with the related issues of costs and benefits of controls.

**Key supporting information**

*In Education and Culture, the majority of grants (some 80%) awarded through National Agencies are lump sums or flat rates. For example, for Comenius partnerships (€106 million), itemised actual costs no longer have to be presented and grants are determined on the basis of lump sums and flat rates based on a scale of unit costs. However, effects on error rates have yet to be confirmed.*

*Action 3: Control strategies and reasonable assurance*

**Action completed:** Comprehensive Internal Control Templates were used in all 2007 Annual Activity Reports.

**Impact**

*Indicator: Improved evaluation by the ECA of the quality of AARs.* In its 2007 annual report, the ECA noted improvements in the Annual Activity Reports in Agriculture and Cohesion Policy. Improvements, supported by a reinforced peer review process, are continuing.

**Key supporting information**

*All policy areas received a grade 'B' or above (providing at least supporting evidence for the Court's DAS conclusions after corrections).<sup>10</sup>*

**3.2. Management declarations and audit assurance (actions 5-8)**

*Action 5: National management declarations*

**Action completed as revised and agreed<sup>11</sup>:** The first set of **annual summaries** were due from Member States in February 2008.

**Impact**

*Indicator: Quality of summaries received and action taken to improve.* The levels of compliance with minimum requirements varied.

For the **Structural Funds** all Member States but one eventually provided annual summaries which met the minimum requirements. Information recently provided by Germany is being examined by the Commission. The Commission recommended that Member States supplement the summaries with a declaration of assurance, but this is not a legal requirement. The Commission has issued revised guidance to improve the next set of summaries, due 15 February 2009.

In **Agriculture**, Member States complied with legal obligations – both concerning annual summaries and the annual statements of assurance that directors of the paying agencies signed for the first time. Member States followed the guidelines on annual summaries provided by

<sup>10</sup> ECA Annual Report on 2007, Table 2.1.

<sup>11</sup> Article 44 of the Inter-Institutional Agreement and Article 53 (ter) of the Financial Regulation.

Commission services, giving a factual overview. However the quality of additional analysis in most the summaries could be improved. The Commission has revised its guidelines to improve this analysis in the 2008 summaries.

**Key supporting information**

*"The Court considers that, for this first year of annual summaries, the Commission has adequately supervised the process both by issuing clear guidelines and by pursuing the reasons for non-compliance with deadlines and criteria for scope or quality." It encouraged the Commission to identify the summaries' added value for assurance.<sup>12</sup>*

*Indicator: Receipt of ex ante declarations of assurance in Education and Culture.* Ex ante declarations from National Authorities for the 2007-13 period provided assurance that these are respecting minimum standards on control and that the project cycle complies with procedures.

**Key supporting information**

*All due ex-ante declarations of assurance in Education and Culture were received. 33 of these were followed up via monitoring visits and all were systematically followed-up in the framework of the assessment of the Annual Declaration of Assurance.*

*Indicator: Member State initiatives on declarations.* The Commission supports the voluntary initiatives taken by some Member States. Their coverage and nature vary and the results cannot be compared. They provide some supplementary information on control systems.

**Key supporting information**

*2008 documents from Denmark (audit opinion regarding EU funds, covering the European Social Fund, the European Regional Development Fund, agricultural subsidies, the VAT contribution and the GNI contribution), the Netherlands (national declaration – agriculture only in 2008) and the UK (consolidated statement and audit opinion on the use of EU funds - expenditure on EU supported projects).*

**Key supporting information**

*The Court has stated that "the national declarations can be considered as a new element of internal control, and the Commission and the Court should consider them in this respect".<sup>13</sup>*

*Action 7: Increasing the cost-benefit of audits at project level*

**Action completed:** Agreed upon procedures are used in Research and External Aid to improve assurance from external audits of projects by defining audit procedures to be carried out. Such procedures have not been introduced in Education and Culture as the number of grant agreements over the threshold for providing an audit certificate is very limited. Direct auditing managed by the Commission is considered more cost effective.

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<sup>12</sup> ECA Annual Report on 2007, paragraph 2.20.

<sup>13</sup> ECA Opinion 6/2007.

## Impact

*Indicator: Improved quality of reporting by external auditors.* Agreed-upon-procedures, by more precisely specifying the work to be carried out by the auditor, should increase consistency and reliability of audit conclusions and provide better supporting evidence for management decisions on eligibility of funding.

### **Key supporting information**

*In External Aid a first assessment of a small number of reports indicated that agreed-upon-procedures are having the intended results although the quality and consistency of reports could be enhanced.*

*For Research it is too early to assess the improvement. Impact on errors cannot yet be measured and will need to be corroborated by future audits of projects covered under the new regime.*

*Actions 8 and 8N: Additional assurance from Supreme Audit Institutions*

**Action completed:** The Commission has established relationships with independent SAIs.

## Impact

*Indicator: Number of SAIs in dialogue with the Commission.* Reaction from the SAIs to payment reports from the Commission has been variable but has led to improvements in the reports.

### **Key supporting information**

*Five SAIs have requested detailed additional information and analysis (which the Commission has provided).*

*Ten SAIs have made an overarching report on EU financial management, and two more are considering it.<sup>14</sup>*

### **3.3. Single audit approach: sharing results and prioritising cost-benefit**

*Actions 3N and 11N: Improved assurance via sanctions and recoveries*

**Actions completed:** The scope of sanctions was extended in the 2007-13 sectorial legislation and the Commission is taking a more vigorous approach to recoveries and sanctions. Data quality on recoveries and financial corrections is being improved.

## Impact

*Indicator: Reliability, consistency and completeness of recovery data:* The Court noted improvements in data on 2007 recoveries. Further improvements have been made for the 2008 accounts, yet to be audited by the Court, both on Commission recoveries and on those reported by Member States.

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<sup>14</sup> Dutch EU Trend Report 2008, table 11, p. 52.

**Key supporting information**

*The Court stated "more information concerning the recovery of undue payments has been presented ... However, the notes to the financial statements do not yet contain complete and reliable information on the financial correction activities made by the Member States"<sup>15</sup>.*

*Extension of recording in ABAC of recoveries by Commission services due to control or audit: over €500 million worth of such recoveries was recorded in 2008.*

*Indicator: More systematic follow-up of DAS errors: Commission services set out in their Annual Activity Reports the follow-up to main findings of the Court and explain differences of opinion. The Commission sends Member States each year<sup>16</sup> a list of observations made and errors found by the Court in their country, seeking information on follow-up and the reasons for the most common errors in structural actions. The follow-up of DAS 2006 errors is included in the Structural Funds Action Plan<sup>17</sup>.*

**Key supporting information**

*The latest report, on 2006 DAS errors<sup>18</sup>, noted that when Member States accept errors identified by the ECA, they report for the most part on recovery of funds or withdrawal of ineligible expenditure.*

*Indicator: Effectiveness of the recovery process:*

**Key supporting information**

*For structural funds, an IAS review evidenced the significant progress made by the Commission report effective recovery of undue payments. The Commission is now able to present an overall table on financial corrections made or in the pipeline, with the number of procedures and amounts broken down by programmes and on the sources of correction. The overview shows that Commission controls are at the starting point of 80% of corrections currently underway. The Commission also carried out verifications<sup>19</sup> of the data for structural actions in 10 Member States in 2008.*

*A second internal audit provides reasonable assurance on the recovery process in centralised management, with some qualifications relating to the duration of certain procedures.<sup>20</sup>*

*For the research area, the audit coverage has increased significantly under the multi-annual audit strategy (over 900 audits in total closed for FP6, including 378 in 2007 compared to the Action Plan target of 300), giving the research DGs a much wider appreciation of the nature and extent of errors.*

<sup>15</sup> ECA Annual Report 2007, paragraph 1.29.

<sup>16</sup> Under Council Regulation (EC, Euratom) No 1605/2002 of 25.6.2002 amended by Council Regulation (EC, Euratom) No 1995/2006 of 13.12.2006.

<sup>17</sup> Action 1.4 of SFs Action Plan - COM(2008) 97.

<sup>18</sup> COM(2008) 112.

<sup>19</sup> Actions 2.3, 6.1 and 6.2 of SFs Action Plan.

<sup>20</sup> Internal Audit Service audit of the recovery process in AIDCO, EAC, INFSO, BUDG, Legal Service and the Education, Audiovisual and Culture Executive Agency.

*Indicator: Volume of financial corrections:* Recoveries are made when justified, and increasing their value is not a target in itself.

**Key supporting information**

*The volume of financial corrections applied by the Commission in the Structural Funds has increased substantially according to provisional figures: in 2008 the total was €1.5 billion, compared with €288 million in 2007. Further evidence of impact is reported in the Structural Funds Action Plan progress report, adopted February 2009<sup>21</sup>.*

*Action 9: Sharing audit results*

**Action completed:** An audit recording and monitoring tool is fully operational and effective within ABAC for audits principally in centralised direct management.

**Impact**

*Indicator: Use of the audit tool and improved coordination of audits.* Improved coordination increases efficiency of audits through making better use of available resources rather than reducing error rates.

**Key supporting information**

*Some 5,000 audits are recorded providing key information on audits of individual beneficiaries and allowing better targeting and coordination. Procedures are in place to ensure systematic exchange of results on common bodies between the Structural Funds DGs.<sup>22</sup>*

*Actions 4, 10 and 11: Tolerable risk and cost-benefit analysis of controls*

**Action completed:** The Commission provided in its December 2008 Communication on Tolerable Risk<sup>23</sup> the results of Actions 10 and 11 to form a basis for moving forward discussions on tolerable risk.

**Impact**

*Indicator: Progress towards a common understanding of Tolerable Risk.* Discussions with the Budgetary Authority are underway. The Commission is fully committed to these.

**3.4. Sector-specific gaps**

*Actions 12 and 12N: Address gaps identified by participating services*

**Action completed:** For Action 12, DGs and services are implementing the core elements of the Action Plan in line with the Gap Assessment – clear descriptions of the control approach, coordinated audit and control according to agreed standards.

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<sup>21</sup> COM(2009) xxx  
<sup>22</sup> Action 2.1 of SFs Action Plan.  
<sup>23</sup> COM(2008) 866.

## Impact

*Indicator: Quality of control systems.*

### **Key supporting information**

*The Court concludes in its 2007 DAS that none of the supervisory and control systems for EU funds is ineffective but in some spending areas these may not succeed in reducing errors to an acceptable level.*

*Indicator: Error rates in FP6.* The Court of Auditors stated that although the new strategy for FP6 represents a sound basis for addressing the problems identified by the Court, potential benefits depend on its full and effective implementation from 2008 onwards. It further noted that the strategy includes several initiatives likely to contribute to more effective operation of this control including the use of common risk criteria and sample selection methods focusing on large beneficiaries.**Key supporting information**

*The cumulative error rate detected by the Commission for FP6 at the end of 2008 was 2.47%. Taking account of the resulting recoveries this is on course for achieving an error rate of less than 2% over the lifetime of FP6.*

*Action 13: Analyse controls under Shared Management at regional level and the value of existing statements*

**Action completed:** The Commission has improved reporting in the relevant AARs. Better control arrangements are included in 2007-13 legislation.

## Impact

*Indicator: Quality of Member States' systems.* The Structural Funds DGs carry out an annual assessment of each Member State system.

### **Key supporting information**

*DGs REGIO and EMPL presented a detailed assessment of Member States' systems in their 2007 AARs<sup>24</sup>. Systems presenting no material deficiencies in ERDF covered 28% of expenditure plus 11% with "qualified assurance" with moderate impact; for the Cohesion Fund and the ESF the figures were 24%/44% and 10%/38% respectively.*

*Action 14: Greater guidance for structural funds on managing the risk of error<sup>25</sup>*

**Action completed:** In 2008 the Commission published new guidance documents for managing and certifying authorities.

## Impact

*Indicator: Member States' assessment against regulatory benchmarks.* The Commission has developed a self-assessment tool to facilitate managing authorities' self-assessments against

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<sup>24</sup> Action 9 of SFs Action Plan.

<sup>25</sup> Actions 2.4 and 5 of SFs Action Plan.

regulatory benchmarks on key elements of internal control. Following 2 pilot studies the tool was modified and will be finalised in January 2009 so impact is not yet visible.

*Action 15: Promote 'Contracts of Confidence' for Structural Funds<sup>26</sup>*

**Action completed:** 7 Contracts have been signed. Two more contracts should be signed by February 2009. The concept of reliance on work of national audit bodies is now included in 2007-2013 legislation.**Impact**

*Indicator: Single audit approach extended under Contracts of Confidence.* Member State systems covered by Contracts of Confidence are considered by the Commission to provide reasonable assurance on the regularity of expenditure, so that the Commission may reduce its own audit work. By creating a benchmark procedure and engaging constructively with the Member States, this initiative has resulted in improvements in national systems.

**Key supporting information**

*DG REGIO has a positive assessment of the systems covered by contracts of confidence which is in line with the ECA's general evaluation in its 2007 report.*

*Action 16: Establish common guidelines per policy family*

**Action completed:** The Commission has stepped up guidance and internal coordination in all policy areas.

**Impact**

*Indicator: DGs with clear strategies based on generally accepted auditing and control standards.* Commission services, intermediaries and beneficiaries have access to guidance and training on key control aspects such as managing external auditors, sampling and compliance with legislation. In Research, control and audit strategies are underpinned by inter-service groups which ensure a consistent approach on all framework programmes.

*Indicator: Level of control awareness and consistency of approach in the Structural Funds.* The structural actions DGs have developed closure guidelines for 2000-06 programmes. Extensive training and seminars have been provided to Member States.<sup>27</sup>

**Key supporting information**

*Training seminars for almost all Member State audit authorities on the new regulations in 2007, two seminars in Brussels in 2008 on management verifications and certification function, and closure of programmes.*

*The structural actions DGs have finalised all relevant guidance for Member States for 2007-13 which will be compiled in the Structural Actions Audit Reference Manual to be issued in 2009.*

<sup>26</sup> Action 2.5 of SFs Action Plan.

<sup>27</sup> Actions 2.6 and 5 of SFs Action Plan.

#### 4. CONCLUSIONS

Significant progress has been made in strengthening internal control systems during the mandate period of the current Commission. A part of this positive impact is due to actions launched before 2005, but there is certainly evidence that progress was significantly accelerated with the launch of the Action Plan in early 2006. Likewise, the positive impact of the Action Plan will extend well beyond the current mandate period.

To keep the momentum, further efforts are necessary. The Commission will pursue its efforts, and in line with the original concept of the Action Plan, the Commission will continue to need and call for the help and support of the other Institutions.

In the Commission's view, progress in the following areas is vital to underpin further improvements:

- as set out in the Communication on tolerable risk (COM(2008)866), appropriate targets need to be set in some policy areas to form a basis for a clear judgement on how the Commission is managing risk across its different activities. This will ensure the relevant balance between control costs and error rates;
- simplification of legislation (while providing for cost-effective control) is necessary as complex rules cause errors and increase control costs. The Commission has already proposed some simplifications in structural actions and will consider the scope for possible further proposals; and
- as part of this initiative, the Commission will attach to all relevant future legislative proposals a description of the associated control arrangements.