



COMMISSION OF THE EUROPEAN COMMUNITIES

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**REPORT FROM THE COMMISSION TO THE COUNCIL**

**on the follow-up to 2005 Discharge Decisions  
(Summary) - Council Recommendations**

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## PREAMBLE

According to Article 276 of the EC Treaty and Article 180b of the Euratom Treaty, the “Commission shall take all appropriate steps to act on the observations in the decisions giving discharge and on other observations by the European Parliament relating to the execution of expenditure, as well as on comments accompanying the recommendations on discharge adopted by the Council. At the request of the European Parliament or the Council, the Commission shall report on the measures taken in the light of these observations and comments and in particular on the instructions given to the departments which are responsible for the implementation of the budget. These reports shall also be forwarded to the Court of Auditors”<sup>1</sup>.

The Commission has accordingly prepared Follow-up Reports, which relate to the Council recommendation of 27 February 2007 and the Resolutions voted by the European Parliament on 24 April 2007. The present Follow-Up Report deals with the recommendations made by the Council in relation to the 2005 Discharges. A separate Follow-up Report deals with the recommendations made by Parliament in relation to the Discharges given for the 2005 financial year<sup>2</sup>.

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

In the context of the 2005 discharge, the Commission has identified a total of 87 recommendations made by the Council to the Commission. The Commission considers that for 32 recommendations the required action has already been taken. For another 54 recommendations the Commission agrees to take the action recommended by the Council. Finally, the Commission cannot accept one recommendation and will therefore not be taking the requested action<sup>3</sup>.

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<sup>1</sup> See also Article 147 of the Financial Regulation for the general budget.

<sup>2</sup> 2005 General Budget Discharge, 2005 EDF Discharge, 2005 Agencies Discharge.

<sup>3</sup> See recommendation 62.

## **I. COUNCIL RECOMMENDATION ON THE GENERAL BUDGET**

### **A) Introduction (Commission working document, points 1-4)**

The Commission fully agrees with the Council on the importance of continuing to improve financial management and of having controls working correctly and effectively. It provided a mid-term scoreboard on the implementation of the Action Plan towards an Integrated Internal Control Framework in July 2007, and a final report on the implementation of the Action Plan will be provided in early 2008. The final report will take a first look at the impact of the different actions on assurance and will draw conclusions for the future consolidation of the Integrated Internal Control Framework.

In the light of experience, a number of actions under the Action Plan towards an Integrated Internal Control Framework have been refined to give further impetus towards increased assurance, concentrating on direct centralised management and including a detailed examination of the cost-benefit-risk balance for controls. The foundations will be in place by the end of 2007 for the Integrated Internal Control Framework to begin to have the planned impact on assurance

Furthermore, the Commission's annual synthesis on management achievements identifies weaknesses in the design and the operation of control systems and introduces appropriate remedial actions and reports on their implementation. The 2006 Synthesis report gave further impetus to the development of indicators for the legality and regularity of transactions to support the assurance expressed in annual activity reports. Such indicators will become compulsory as from the annual activity reports for 2007.

### **B) The statement of assurance (DAS) and supporting information (Commission working document, points 5-6)**

As regards the accounts, the Commission has corrected, where possible, for the errors that were highlighted by the Court during its 2005 audit. The Commission has also considered these errors and their causes while planning and performing its closure of the 2006 accounts, so as to try to avoid their recurrence.

The Commission will provide the Council with information on recoveries, including amounts recovered by Member States under shared management. This will be based in the first instance on extracts from the financial report of the EAGGF Guarantee Section and the annual report on implementation of the Structural Funds, and the notes to the final accounts 2006.

For information on the measures taken in the various expenditure areas, please refer to the points below.

### **C) Commission Internal Control (Commission working document, points 7-9)**

As recommended by the Council, the Commission continues its efforts to improve financial management. In its Action Plan towards an Integrated Internal Control Framework and in the action plans included in Annual Activity Reports of the Directorates-General for 2006 to address identified weaknesses, the Commission has set out a range of measures which are being taken to improve control and assurance.

The Commission is gradually implementing a better structured and homogeneous presentation of the internal control systems of the Directorates-General. A concise template to ensure a consistent presentation of control structures and sources of assurance was developed for the 2006 Annual Activity Reports. Over time the format is expected to improve awareness of control structures and sources of assurance and will help pinpoint weaknesses and define improvements.

The structures created by the Financial Reform since the year 2000 have for the most part been implemented and the Commission-wide achievement of a very high level of compliance with the baseline requirements of the Internal Control Standards marked the beginning of a new phase which aims to improve the effectiveness of the Commission's internal control systems. Work has started in 2006 to revise the Internal Control Standards to put more emphasis on measuring the effectiveness of internal control.

#### **D) Budgetary management (Commission working document, points 10-12)**

The Commission notes that the Council has welcomed the improvement in the management of the budget in 2005. It considers that the increase in outstanding commitments in 2005, in particular in the Structural Funds, was not unexpected. This was mostly due to the large increase in commitments for the EU-10 countries (in line with the Copenhagen profile), while payments made to these programmes and projects were still relatively slow in their start-up phase. Payments for EU-15 programmes increased again in 2005. The fact that the level of decommitments remains limited also indicates that the n+2 rule provides a powerful incentive for Member States to ensure that implementation proceeds at a sufficiently high rate.

Like the Council, the Commission attaches high importance to the swift adoption of the programmes for the 2007-13 period and reports regularly to the Council on this matter. Forecasting and budgeting are monitored regularly throughout the year. The budget forecast alert tool established in 2006 contributes to the good management of the budget.

#### **E) Revenue (Commission working document, points 13-21)**

Like the Council, the Commission welcomes the fact that the Court again in 2005 considered the overall results satisfactory concerning the reliability of the accounts and the legality and regularity of underlying transactions for revenue.

The Council's request for a general analysis of the overall administration, management and control costs for the Community and Member States of both the traditional and the VAT own resources systems is currently being considered by the Commission, in particular as to which approach will most cost-effectively provide the reliable and comparable data needed to make a meaningful assessment.

As regards traditional own resources, the Commission is considering the feasibility of producing more guidance on the current procedures related to the use of the B-accounts system in Member States and on the underlying conditions to be met by Member States when balancing protection of the Community's financial interests and trade facilitation. The Commission is also taking the necessary steps to improve the systems for handling mutual assistance cases.

The Commission continues discussions on VAT reservations and their impact with Member States in the Advisory Committee on Own Resources. As regards the GNI resource, the Commission will perform more direct verification of selected national aggregates in the sense indicated by the Court during the 2007-2009 round of GNI verification missions, and will continue to encourage best practices in national accounts compilation through the GNI Committee. The Commission will present a proposal for including allocated Financial Intermediation Services Indirectly Measured (FISIM) in GNI for own-resource purposes when it considers that all Member States are able to implement this adjustment in a uniform manner. This is expected to be the case in 2008.

#### **F) The Common Agricultural Policy (Commission working document, points 22-26)**

The Commission is continuing its efforts to monitor the full and correct application of the Integrated Administrative Control System (IACS) in all Member States. In case of deficiencies, the Commission will not hesitate to impose financial corrections.

The Commission has addressed the deficiencies found in the olive oil sector and the clearance of accounts procedures are ongoing. The major part of the olive oil production has been integrated into the single payment scheme. Aid is thereby no longer paid on the basis of the quantity produced but is based on area and controlled within the framework of the IACS. This should significantly reduce any risk of error.

As regards rural development, the Commission has also taken the recommended action to correct the weaknesses identified. Concerning the temporary rural development instrument for some new Member States, the Commission services will present a working document to the Agricultural Funds Committee inviting new Member States to wind up the implementation of these programmes by 16 October 2007 in order to proceed with the final closure of the programme following the 2007 clearance of accounts decision in May 2008.

#### **G) Structural measures (Commission working document, points 27-31)**

The Commission is taking the action recommended by the Council. For the 2007-13 Financial Framework period a number of changes should reduce the administrative burden associated with structural expenditure. Member States will mainly determine eligibility conditions, and for smaller programmes with a greater percentage of national funding they will be able to apply national rather than EU requirements and procedures in some instances. At the same time, the control framework and the Commission's ability to supervise its operation will be strengthened by new elements such as an ex ante compliance assessment on national systems to be delivered by the Member State before interim payments start and an annual audit opinion delivered by the audit authority.

The Commission endorses the principle of controls being proportionate to the risks and costs involved. Therefore, as part of the Action Plan towards an Integrated Internal Control Framework (COM(2006)9 and COM (2007)86), it is assessing the cost of controls in Structural Funds through a survey. The Commission is also asking Member States to provide regular information on the error rates they find in their audit work, which are an indicator of the risk. The data obtained will help clarify the relationship between the costs and benefits of controls and achieve a better balance. The cooperation between the Commission and Member States is continuing to be developed in the areas of reporting, sharing of audit results and harmonisation of audit standards. This long-standing development has been given further impetus by the Action Plan and the legislation for the 2007-13 period.

The Commission issued guidance on the closure of 2000-06 Structural Fund programmes in 2006 (C(2006) 3424) and will shortly do so for the closure of Cohesion Fund projects of the same period. It also issued documents in 2006 setting out good practice in management verifications and checks by the paying authority before certifying expenditure.

In 2006 the Commission issued a guidance note on the information on recoveries and financial corrections to be provided by Member States, and in early 2007 it asked all Member States to supply complete information on recoveries, withdrawals and pending recoveries for 2006 and cumulatively for the whole period 2000-06. The Commission is receiving the information and intends to summarise it in a report to be presented in autumn 2007.

#### **H) Internal policies, including research (Commission working document, points 32-38)**

The Commission fully shares the concerns expressed by the Council on the weaknesses detected by the Court of Auditors. It continues to improve its control systems in the context of the Action Plan towards an Integrated Internal Control Framework. A multi-annual approach to mitigating the inherent risk of reimbursement of overstated costs has been introduced in the research area, including a substantial increase in the number of ex-post audits and reinforcement of the audit certificate system. Furthermore, "agreed upon procedures" have been developed to provide a compulsory set of procedures for the certificates on the Financial Statements and the certificates on the methodology described in the model grant agreement for the Seventh Research Framework Programme (FP7). These actions are expected to lead to a reduction in the error rate through improved prevention, detection and correction.

Under FP7 steps have also been taken to simplify the rules for reimbursement of costs, including the use of lump sums for International Cooperation Partner Countries within grant agreements for indirect actions. The requirements for time recording of researchers are clearly specified in the terms of reference for the certificates of financial statements and on methodology annexed to the Grant Agreement and have to be certified by the auditors. The Commission has also in 2007 published guidance for beneficiaries.

In relation to National Agencies the decisions establishing the new generation of programmes in the fields of education, training and youth provide for a comprehensive set of checks and controls regarding respect of procedures and internal control mechanisms in order to ensure and verify the regularity and legality of transactions as well as the reality and eligibility of activities.

#### **I) External actions (Commission working document, points 39-46)**

As recommended by the Council, the Commission continues to improve the functioning of both internal and external audits, management reporting and the supervisory and control systems. The Commission will endeavour to further reinforce the current risk analysis and better communicate the basis for its analysis. It is aware of the risks at project implementing organisation level and has taken a number of measures over the last years to mitigate its potential effects. These include the use and improvement of standard contract provisions. In early 2006, for instance, the standard grant and fee-based service contracts were revised. They now include standard terms of reference for auditors to perform expenditure verifications to be submitted by the beneficiaries of Community funds prior to final payments. These new terms of reference have been revised so as to reinforce the verification of compliance with the contract terms, including those relating to public procurement procedures. EuropeAid's Common Relex Information System (CRIS) allows relevant analyses to be

performed, including by type of implementing organisation or management mode. The system is being constantly improved and refined, in line with evolving management needs.

#### **J) Pre-accession Strategy (Commission working document, points 47-52)**

As recommended by the Council, the Commission will continue to monitor closely the effective functioning of the national supervisory and control systems for programme expenditure under the pre-accession strategy, in particular within the SAPARD/IPARD paying agencies. Under the Phare programme the Commission has taken action to clarify the eligibility of VAT expenditure and has received and dealt with most of the final declarations from the national authorities. The Commission shares the Council's regret at the delays in the Extended Decentralised Information System (EDIS) accreditation process for Phare and ISPA. However, the Commission had to insist on further improvements of the national administrative structures before granting EDIS in order to ensure the sound financial management of the funds.

#### **K) Administrative expenditure (Commission working document, points 53-62)**

The Commission has taken due note of the Council's recommendations concerning administrative expenditure. As regards the NAP (New Payroll System), all reports are available, upon request, to every authorising officer, but it is up to the authorising officers in each institution to define their own set of controls. The PMO runs its own controls, including some ex-post controls, and in the light of the experience of the past years it considers its current controls sufficient and does not envisage, at this stage, further strengthening its ex-post controls. As regards the reimbursement of mission costs, the Guide to missions – the internal rules adopted by the Commission governing missions of its staff – is currently under review to take due account of the remarks of the Court. Adoption of the new rules is scheduled for the beginning of 2008.

Under this heading the Council has also included recommendations concerning the regulatory agencies. The Commission shares the concerns about good governance and better regulation of the agencies expressed by both the Council and the European Parliament. It considers that the adoption of the draft interinstitutional agreement on the operating framework for the European Regulatory Agencies (COM(2005)59) would go a long way towards addressing the issues raised such as impact assessment, cost-benefit considerations, evaluation and annual reporting. The Commission therefore hopes that Council can make further progress on this important issue in the near future. Whilst fully respecting the autonomy of the regulatory agencies, the Commission in the meantime continues to provide extensive guidance and support to these agencies. The Service Level Agreements drawn up with many regulatory agencies in 2006 in different areas of administration and training<sup>4</sup> are an important example of this. As recommended by the Council, the Commission has for the first time with its Preliminary Draft Budget for the financial year 2008 presented an overview document of the agencies. The Commission has also committed itself to providing a meta-evaluation of the existing decentralised agencies.

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<sup>4</sup> See also the other examples mentioned in point 56 of the working document.

**L) Financial instruments and banking activities (Commission working document, points 63-65)**

The Commission is taking the necessary action to implement the Council's recommendations on the management, follow-up and closure of programmes relating to financial operations, such as MEDIA II and ECIP, and to tackle the backlog relating to coal research programmes. Moreover, a revised Tripartite Agreement between the Court of Auditors, the European Investment Fund and the Commission was signed on 16 January 2007.

**II. COURT OF AUDITORS' SPECIAL REPORTS (Commission working document, points 66-84)**

The Council has made a number of recommendations to the Commission concerning special reports published by the Court of Auditors in 2005 and 2006. The Commission's replies to these recommendations can be found in the Commission working document (points 66-84).

**III. EUROPEAN DEVELOPMENT FUNDS (Commission working document, points 85-87)**

The Commission has taken due note of the Council's recommendations concerning the European Development Funds. The Commission's main supervisory and control systems have been continuously improved in recent years, inter alia on the basis of the recommendations made by the Court. Further improvements will be made in line with the Commission's Action Plan "Towards an Integrated Internal Control Framework", which addresses the main gaps identified in the control framework. This includes formalisation and harmonisation of the presentation of the internal control strategies, the aim of which is to provide an overall view of the internal control flow and related accountability chain and to document how associated risks are addressed. As regards the EDF Financial Management Report, the Commission has, in the 2006 report, addressed the issues raised by the Council.

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