

HOUSE OF LORDS

European Union Committee

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19th Report of Session 2006–07

**Financial Management  
and Fraud in the  
European Union:  
Responses to the  
Report**

Report

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### *The European Union Committee*

The European Union Committee is appointed by the House of Lords “to consider European Union documents and other matters relating to the European Union”. The Committee has seven Sub-Committees which are:

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Internal Market (Sub-Committee B)  
Foreign Affairs, Defence and Development Policy (Sub-Committee C)  
Environment and Agriculture (Sub-Committee D)  
Law and Institutions (Sub-Committee E)  
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Lord Freeman	Lord Sewel
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Lord Grenfell (Chairman)	Baroness Thomas of Walliswood
Lord Harrison	Lord Tomlinson
Lord Kerr of Kinlochard	Lord Wright of Richmond

The Members of the Sub-Committee which carried out this inquiry (Economic and Financial Affairs, and International Trade, Sub-Committee A) are:

Lord Blackwell	Lord Kerr of Kinlochard
Lord Cobbold	Lord MacLennan of Rogart
Baroness Cohen of Pimlico (Chairman)	Lord Steinberg
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# Financial Management and Fraud in the European Union: Responses to the Report

## INTRODUCTION

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1. The European Court of Auditors has now been unable for twelve successive years to give a positive Statement of Assurance to the accounts of the European Communities. In our Report “Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals”<sup>1</sup> we examined the reasons why this is the case. Our report focused on the Statement of Assurance methodology, the Internal Control systems within the Commission, and the management of Community funding by the Member States.
2. On 14 November 2006, one day after its publication, the Report was referred to in a plenary session of the European Parliament, during debates on the Court of Auditor’s Report for 2005 and the 2007 Work Programme. Commissioner Kallas quoted from the Report in his speech to the plenary session and several MEPs also drew attention to the Report’s conclusions.<sup>2</sup> The Report was debated on the floor of the House on 5 March 2007.<sup>3</sup>
3. On 30 November 2006, Ingeborg Gräßle MEP tabled an oral question to the Council, which took up the Committee’s recommendation that the Budget Council should prepare a report on the annual audit and Statement of Assurance from the Court of Auditors (paragraph 172). This was answered on 14 February 2007 by Günter Gloser (German Federal Minister of State for Europe, acting as President-in-Office of the Council), who dismissed the need for an additional reporting while noting there was no majority in the Council to support such a change. Supplementary questions were asked by Ingeborg Gräßle, Richard Corbett MEP and Bart Staes MEP.
4. The Report was referred to in a Written Statement by the Economic Secretary to the Treasury on 20 November 2006. We received the Government’s response on 29 December 2006, a response from the European Court of Auditors on 15 December 2006, and a response from the European Commission on 16 March 2007.<sup>4</sup>
5. The purpose of this Report is to publish, for the information of the House, the three responses we have received and subsequent correspondence, and the Minister’s written statement.

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<sup>1</sup> European Union Committee, 50th Report (2005–06): Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals (HL 270)

<sup>2</sup> The Report was quoted from by Commissioner Kallas, and referred to by Bart Staes MEP, José Javier Pomés Ruiz MEP, Ashley Mote MEP and in the written submission of Richard Corbett MEP.

<sup>3</sup> HL Deb 5 March 2007 cols 71–106

<sup>4</sup> The Commission has undertaken to provide written responses to Reports of Member State Parliaments relating to Commission documents. This was the first Report by the House of Lords to be published since the introduction of this procedure.

## **APPENDIX 1: SUB-COMMITTEE A (ECONOMIC AND FINANCIAL AFFAIRS, AND INTERNATIONAL TRADE)**

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### **Sub-Committee A**

The members of the Sub-Committee which conducted this inquiry were:

Lord Blackwell  
Lord Cobbold  
Baroness Cohen of Pimlico (Chairman) (from 15 November 2006)  
Lord Giddens (from 15 November 2006)  
Lord Inglewood  
Lord Jones (until 8 November 2006)  
Lord Jordan  
Lord Kerr of Kinlochard  
Lord Maclennan of Rogart  
Lord Radice (until 8 November 2006)  
Lord Steinberg  
Lord Trimble (from 27 March 2007)  
Lord Watson of Richmond

### **Declaration of Interests**

A full list of Members' interest can be found in the Register of Lords Interests:

<http://www.publications.parliament.uk/pa/ld/ldreg.htm>

## APPENDIX 2: GLOSSARY

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CAP	Common Agricultural Policy
DAS	Statement of Assurance (Déclaration d'Assurance)
EC	European Communities
ECA	European Court of Auditors
ECOFIN	European Council of Finance Ministers
EP	European Parliament
EU	European Union
GDP	Gross Domestic Product
GNI	Gross National Income
HMT	HM Treasury
IAS	Internal Audit Service
OLAF	European Anti-Fraud Office
SAI	Supreme Audit Institution
UCLAF	Unité de Coordination de La Lutte Anti-Fraude
VAT	Value Added Tax

## **APPENDIX 3: REPORTS**

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### **Recent Reports from the Select Committee**

The Commission's 2007 Legislative and Work Programme (7th Report session 2006–07, HL Paper 42)

Evidence from the Minister for Europe on the Outcome of the December European Council (4th Report session 2006–07, HL Paper 31)

Annual Report 2006 (46th Report session 2005–06, HL Paper 261)

Scrutinising EU Legislation—Public Awareness of the Role of the House of Lords (32nd Report session 2005–06, HL Paper 179)

### **Session 2006–2007 Reports prepared by Sub-Committee A**

Funding the European Union (12th Report, HL Paper 64)

### **Other Relevant Reports prepared by Sub-Committee A**

Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals (50th Report session 2005–06, HL Paper 270)

The 2007 EC Budget (39th Report session 2005–06, HL Paper 218)

A European Strategy for Jobs and Growth (28th Report session 2005–06, HL Paper 137)

The 2006 EC Budget (5th Report session 2005–06, HL Paper 22)

Future Financing of the European Union (6th Report session 2004–05, HL Paper 62)

# Written Evidence

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## HM Government response to the House of Lords European Union Committee report on Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals

### CHAPTER 7: SUMMARY OF CONCLUSIONS (HMG RESPONSE IN ITALICS)

#### BACKGROUND—THE BUDGET OF THE EUROPEAN COMMUNITIES AND ITS AUDIT

144. We concur with the views presented to us that the lack of positive assurance from the European Court of Auditors in their annual Statement of Assurance is a serious problem for the European Union and the governments of its Member States. It was as a result of our concern over this that we decided to launch this inquiry. (paragraph 4)

*The Government welcomes the timeliness of this inquiry and shares the Committee's concern.*

#### CRISES AND DEVELOPMENTS IN THE COMMISSION

145. Our investigation was not presented with any evidence of a culture of corruption in the Commission. (paragraph 8)

*Although the Commission must of course always be on its guard against corruption, this finding is welcome.*

#### THE MEANING OF A QUALIFIED AUDIT OPINION

146. We share the concern raised with us by the European Court of Auditors that their decision not to give a positive Statement of Assurance can be misunderstood. We recognise that the lack of a positive Statement of Assurance does not necessarily indicate that high levels of fraudulent or corrupt transactions have taken place. We do not seek to detract from the importance of the issue, nor from the evident underlying problems which have resulted in 12 successive qualified audit opinions. However, we consider that a more accurate reflection of the substance of the Court's annual audit and the Statement of Assurance would be achieved if these two functions were more clearly separated. In addition, the single Statement of Assurance should be split into a series of statements on each of the different spending categories. (paragraph 11)

*The Government welcomes the Committee's conclusion that the lack of a positive Statement of Assurance (DAS) does not necessarily indicate that there are high levels of fraudulent or corrupt transactions. On the subject of the Court's annual audit and the DAS findings, the Government understands that, since 1994, the Court's annual audit has been carried out primarily in support of the DAS. This stems from the requirement in the Treaty (Article 248) for the Court to audit revenue and expenditure and to give a Statement of Assurance. The Court assesses the level of assurance it can give in the Statement from the findings of its annual audit and revenue and expenditure. This is clearly indicated in the text of the annual report, the vast majority of which is concerned with an analysis of the DAS findings by budget sector. The Court supplements this analysis with a review of the follow-up of DAS findings from previous budget years, and a brief description of any relevant special reports.*

*The Government agrees that the DAS should be split into a series of statements on each of the different spending categories. This is already permitted under the Treaty (Article 248(1): "[The DAS] statement may be supplemented by specific assessments for each major area of Community activity"). The Court currently achieves this by including a separate paragraph on each category in the DAS statement itself and with the detailed analysis in each chapter.*

#### THE STATEMENT OF ASSURANCE: ITS DEVELOPMENT AND ITS WEAKNESSES; PROPOSALS FOR REFORM

147. We recommend that in future the annual examination and audit of all revenue and expenditure of the Commission should be separated from the broader objectives of the Statement of Assurance. (paragraph 17)

*As above.*

148. We are pleased to see that the Commission and the European Parliament are actively addressing issues regarding European financial management which are raised by the Court of Auditors in their annual audits. (paragraph 20)

*Agreed. The Government also believes that the Council took an important step forward with the conclusions on the Commission's "roadmap" agreed unanimously at the November 2005 ECOFIN Council, under the UK Presidency.*

#### DAS METHODOLOGY

149. Sir John Bourn, Comptroller and Auditor General at the UK's National Audit Office told us that, were he required to issue a single Statement of Assurance on the UK Government's accounts in the same way as the Court of Auditors does for Europe's accounts, he, like the Court, would be unable to do so (Q 192). This is because last year he issued a qualified opinion on 13 of the 500 accounts of the British Government which he audits (Q 190). (paragraph 22)

*This is an important point. It reflects differences in audit approach and the differing statutory frameworks within which the National Audit Office and the Court of Auditors work.*

150. We consider that the Court's decision to give a single Statement of Assurance on the accounts as a whole means that a positive Statement is difficult to achieve. We consider that it would be preferable for the Court to issue statements on each of the spending areas; in much the same way that the National Audit Office in the UK issues separate audits for each Government department. This would give a more accurate picture of the state of financial management in the Union and would make comparisons with other public bodies easier. (paragraph 23)

*Agreed. Also see the Government's response to paragraph 146, above.*

#### TRANSACTION TESTING AND THE DEVELOPMENT OF THE COURT'S METHODOLOGY

151. We concur with the observation that the methodology employed by the Court still relies heavily on transaction testing. Due to the small number of transactions actually looked at each year, we do not consider that this methodology can lead to an accurate picture of financial management. The Court should aim to improve the methodology behind the Statement's production so as to provide more accurate data. We consider that these weaknesses must be remedied as a matter of priority so an accurate picture of the error rate can be obtained. (paragraph 28)

*It is true that the Court's methodology relies heavily on transaction testing and to a lesser degree on other sources. It would be helpful to have an accurate picture of the soundness of financial management. However, we understand that it is not usual, under international auditing standards, for an auditor to give an opinion on the effectiveness of financial management.*

152. We are pleased to see that the Court has responded to calls from the ECOFIN Council and added additional auditing techniques over the years. In particular we are pleased to see that the Court now conducts an assessment of supervisory systems and controls; reviews the Annual Activity Reports and Declarations from each of the Directors General in the Commission; and evaluates the results of other auditors. We consider that these need to be further developed to give a more rounded picture of performance over the year. In particular, greater use by the Court of the Annual Activity Reports could add positive pressure for their development into proper accounting tools. (paragraph 29)

*Agreed.*

#### THE MEANING OF AN IRREGULARITY

153. We encourage the Court to put in place measures clearly to distinguish between irregularity and fraud and to publish separate figures for the level of fraudulent transactions and administrative mistakes. (paragraph 31)

*It is not the Court's job to publish fraud figures; this is the responsibility of the European Anti-Fraud Office (OLAF). Auditors do not go looking for fraud though, if they happen to discover suspected fraud during an audit, they will pass on the details to the appropriate authority. The Court may report on cases of irregularity detected during an audit.*

154. Whilst the distinction between fraud and other irregularities must be made clear, we consider that administrative mistakes could still indicate deficiencies in the control systems operated by the Member States or the Commission. Attention should therefore be drawn to both administrative mistakes and fraudulent activity. Sources of error, from whatever quarter and for whatever reason under current definitions should be taken into account when calculating material error rates. (paragraph 33)

*The Government believes that the distinction between fraud and irregularity concerning the EU budget is already clear<sup>1</sup>. It is true that the detection of administrative mistakes, depending on their nature and seriousness could indicate deficiencies in control systems, and this is a method normally used by auditors to test their opinion on the effectiveness of control systems.*

#### DIVIDING THE STATEMENT OF ASSURANCE INTO CATEGORIES

155. We support the recent decision of the Court of Auditors to produce a Statement of Assurance giving details of each of the areas analysed. We recommend that this should be developed into a Statement which concentrates on an analysis of the audits conducted each expenditure category and Member State rather than on the single Statement of Assurance on all the accounts. (paragraph 35)

*Agreed. The Government understands that Treaty Article 248(1) would permit a Statement of Assurance by expenditure category, but it is unlikely that this could also permit a Statement of Assurance by Member State.*

156. We note with approval the achievements made by the Commission in developing a system for agricultural payments which led the Court to give a positive Statement of Assurance to this area for the first time in 2004. (paragraph 36)

*The Government also welcomes the Court's endorsement of the Integrated Administration and Control System.*

#### NATIONAL MANAGEMENT OF EUROPEAN FUNDS

157. We support calls for the European Court of Auditors to produce a list of those Member States demonstrating poor management of European funds. We consider that such a list would encourage all the governments of the Member States to take this issue seriously. Such a list should only be produced on the basis of accurate data and so will require the development of a sound basis for payment transaction sampling. (paragraph 38)

*The Government would welcome this recommendation. But the response to paragraph 167 is also relevant.*

#### A COMMITMENT TO IMPROVEMENT

158. We recognise the commitment which the Commission has shown to improving its accounting system, particularly with regard to the introduction of accruals based accounting. We were pleased to hear from the Accounting Officer that the Commission now respects internationally recognised rules; and from the UK Minister that the EU is now one of the leaders in public accounting terms. (paragraph 42)

*Agreed.*

#### SEGREGATION OF DUTIES

159. We therefore support the Commission's system of payment authorisation and execution as introduced by the Prodi-Kinnock reforms. We consider that segregating the authorisation and execution of payments is appropriate. (paragraph 46)

*Agreed.*

#### CONTINUING CRITICISM

160. During our inquiry we heard considerable evidence on the Commission's financial management. None of that evidence supports the allegation that there is a significant element of corruption within the Commission. (paragraph 49)

*The Government welcomes this finding.*

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<sup>1</sup> "Irregularity" is defined in Article 1(2) of Regulation 2988/95. "Fraud" is defined in Article 1(1) of the Convention on the Protection of the Financial Interests of the European Community.

#### DOUBLE ENTRY BOOKKEEPING AND THE COMMISSION'S ACCOUNTING SOFTWARE

161. In spite of the improvements which have been made to the accounting system there are areas which remain in need of attention. We are concerned that there remains a question over whether local accounting systems in the Directorates General are indeed compliant with the standards needed for double entry book keeping. All accounting systems operated in the Commission should fully support double entry accounting. We expect the Commission to investigate these allegations and to publish a full account of its findings. (paragraph 53)

*This is a helpful recommendation which the Government supports.*

#### INTERNAL AUDIT AND CONTROL

162. In contrast to the progress reported to us in relation to the Commission's internal accounting system we are concerned that the Commission's system of internal audit is inadequate. We urge the Commission to review fully the procedures in place and bring forward proposals to make the system more robust. These proposals should not seek to create new audit bodies. Rather they should focus on requiring Commission officials and existing audit bodies to take responsibility for the systems and the accounts. (paragraph 61)

*The Government has no evidence to believe that the Commission's Internal Audit Service (IAS) is not doing a good job, and notes that the Committee did not take evidence from the current head of the IAS.*

#### DEVOLVED MANAGEMENT IN THE COMMISSION

163. We are not convinced by the arguments for recentralising responsibility for financial transactions. Rather, we consider that the decentralised system introduced by the Prodi-Kinnock reform has allocated financial management responsibility to the appropriate level, so long as effective control systems are in place. (paragraph 63)

*Agreed.*

#### A SYSTEM REQUIRING COMMISSION OFFICIALS TO TAKE RESPONSIBILITY

164. We are strongly in favour of a system of signing off whereby responsibility for accounts is shouldered first by the accountants and auditors in each Directorate General and then at more and more senior levels. This system should culminate in the requirement for the Secretary General of the Commission to sign an assurance that the Commission's annual accounts are true and fair. (paragraph 67)

*The Government agrees that the Community accounts should be signed off at the appropriate level, but considers that this should be done by the Commission's Chief Accountant, as the revision to the general Financial Regulation proposes.*

#### RISK ASSESSMENT

165. We fully support the proposal in the Roadmap to introduce a common methodology for risk assessment. However we recognise that that the accounting system is not tailored to provide the data to which such a common methodology could be applied. We consider that efforts should be made to develop the accounting system to produce the necessary data. We endorse the use of qualitative methods to assess the risk in the meantime. (paragraph 70)

*This was one of the actions the Commission proposed for itself in the "Roadmap". The Commission believes that a common methodology for risk assessment would help to give an assurance on the management of the risk of error in the underlying transactions. However, the Commission should consider how the methodology should be developed and how data can be used to facilitate better risk assessment. The Commission had proposed that the qualitative assessment of tolerable risk should be carried out on an annual basis by the budgetary authority via an assessment of the activity statements, but the Council was unable to agree to this. The Court of Auditors had originally proposed<sup>2</sup> that the budgetary authority should be responsible for approving the cost/benefit balance for the different policy areas, and it is right that this should be subject to political agreement. The Government will press to put this back on the agenda.*

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<sup>2</sup> Paragraph 55 of Opinion 2/2004 of the Court of Auditors of the European Communities on the "single audit" model (and a proposal for a Community internal control framework). OJ C 107, 30 April 2004.

**DEBT RECOVERY**

166. We are generally satisfied with the Commission's procedures and reporting requirements on debt waivers. We see no evidence of the "ruthless exploitation" of these procedures that some have suggested. (paragraph 73)

*Agreed.*

**WHO IS RESPONSIBLE FOR FINANCIAL MANAGEMENT?**

167. While the Commission should do its best to monitor the disbursement of funds we do not consider that the Commission can be held responsible for the regularity of the large majority of European transactions (over 80 per cent) which take place within Member States. We are pleased to see that both the Maastricht Treaty and the recent Financial Perspective agreement recognised the role of the Member States in ensuring proper financial management. (paragraph 79)

*Under the Treaty (Article 274), the Commission is responsible for the implementation of the budget "on its own responsibility". The Government encourages Member States to fulfil their duties under the Treaty to co-operate with the Commission in ensuring that funds are spent in accordance with the principles of sound financial management, but recognises that some Member States would remind the Council of the Commission's ultimate responsibility.*

**IS THE LEGISLATION TOO COMPLEX?**

168. It is of great concern to us that the regulations underpinning the spending programmes continue to be very complex and that this complexity can lead to errors. We are pleased to see that the Commission and the Council have committed to simplifying the rules. (paragraph 86)

*Agreed.*

**DELEGATION RISK**

169. We share some of the concerns raised with us in respect of Member State management of EU funds. We consider it particularly unacceptable for the government of a Member State to treat European money with less care than national funds and urge the Council to make this clear. We are also concerned about the variability of control standards between Member States. We consider that all European expenditure should be subject to equivalent standard of control to ensure that the risk of fraud and error is minimised. (paragraph 90)

*Agreed. This is covered by Article 280(2) of the Treaty ("Member States shall take the same measures to counter fraud affecting the financial interests of the Community as they take to counter fraud affecting their own financial interests.") The Government agrees that equivalent standards of internal control should be complied with, but with due respect for cultural and organisational differences.*

**SUFFICIENT INTEREST IN THE COUNCIL?**

170. We are strongly in favour of a national Statement of Assurance on the monies disbursed in each Member State. As in the Dutch pilot project, such a Statement should be sent to national parliaments as well as to the Commission as we consider that this will encourage the Member States to take responsibility for the systems and controls they operate. Consideration should be given to ensuring the length of time the discharge procedure takes is not extended. (paragraph 105)

*The Government agrees, and announced on 20 November its intention to provide an annual consolidated statement of the UK's use of EU funds, which would then be audited to international standards by the National Audit Office. Both the consolidated statement and audit opinion would be presented to Parliament and made available to the European Court of Auditors and European Commission. The Government also agrees that it is important not to lengthen the already long discharge procedure.*

171. In line with the system operating in UK Government departments, we do not consider that a national Statement of Assurance requires a political signature. (paragraph 106)

*Agreed.*

#### RESPONSIBILITY IN THE COUNCIL

172. We consider this lack of Council level consideration to be a serious weakness. We consider that the Budget Council should be at least as concerned with the Union's accounts as it is with drawing up the Budget. We therefore consider that the Budget Council should to prepare a report on the annual audit and Statement of Assurance from the Court of Auditors. This would be debated by the European Parliament at the same time as the Court of Auditors' report. In this way the Council of Ministers would be drawn much more closely into consideration of the accounts and into the process of ensuring that the financial systems of the Union meet appropriate international standards. (paragraph 108)

*The Government believes that the Council should maintain its interest in improving financial management and control, following the agreement reached at the November 2005 ECOFIN Council, and calls on the current and future Presidencies to ensure that progress is maintained. However, the Government does not believe it would be possible for the November Budget Council to discuss the Court of Auditor's report. The Council's Budget Committee, which prepares the recommendation on discharge for ECOFIN, is not able to begin discussing the report until January, as during the autumn its work is entirely taken up with negotiating the budget. If a separate Council Working Group were set up, to consider exclusively financial management issues, then it might be possible for discussions to proceed in parallel. Even so, it is unlikely that the discharge process could be shortened, and the recommendation discussed in advance of the ECOFIN Council in February or March, as at present.*

#### RESPONSIBILITY IN NATIONAL PARLIAMENTS

173. None the less we consider that there is a clear role for national parliaments: not least because in the UK, for example, there is considerable misunderstanding of the real position. We consider that this stems, at least in part, from the sporadic and sometimes capricious way in which this issue is debated in the two Houses and discussed in the press. (paragraph 109)

*Agreed.*

174. There is a strong argument for a more consistent and regular approach to the audit and management of the European Union's accounts than may perhaps have been the case in the past in the European Committees of both Houses. This in turn might lead to a regular annual debate on the topic on the floor of each House as part of the annual political cycle. Similar debates could be held in the Welsh Assembly and the Scottish Parliament. (paragraph 110)

*The Government welcomes this recommendation. It is important to discuss these issues in Parliament.*

#### A SINGLE NATIONAL ACCOUNT AND AUDITING PROBLEMS IN DEVOLVED OR FEDERAL STATES

175. We are concerned that a single national European account would impose an additional layer of bureaucracy and would pose a number of difficulties in relation to devolved and federal states. (paragraph 112)

*The Government recognises the Committee's sensitivity to the problems of devolved and federal states, which of course includes the United Kingdom. These problems can be overcome, given an appropriate degree of willingness to seek improvements in the provision of assurance.*

#### SANCTIONS FOR NON-COMPLIANCE

176. We note that the Commission has existing powers of disallowance of expenditure and recovery of funds, and the power to certify paying agencies in the agricultural sector. In the context of the reforms outlined above we consider that the existing Commission powers are sufficient. (paragraph 115)

*Agreed.*

#### THE ROLE OF THE COURT AND ITS WORKINGS WITH NATIONAL SUPREME AUDIT INSTITUTIONS

177. We note the desire expressed to us by Members of the Court not to become "part of the political game". We consider that it would be highly inappropriate for the Court to promote a political agenda. (paragraph 118)

*Agreed.*

178. We are pleased to see the work the Court has done to develop its relationships with the Supreme Audit Institutions in the Member States. We hope that these will be further developed in the future with a view to giving the Court a supervisory role over the audits of European expenditure conducted by the Supreme Audit Institutions in the Member States. (paragraph 123)

*The Government agrees that the Court should continue to develop its relationship with Member States' Supreme Audit Institutions (SAIs). However, it would not be appropriate for the Court to exercise any supervisory responsibility over SAIs, as these are accountable to national Parliaments.*

#### VALUE FOR MONEY AUDIT

179. We call upon the Court to bring forward concrete proposals to extend the aspects of its work which are not directly concerned with the annual Statement of Assurance. We consider that developments in the value for money and performance auditing side of the Court's work would be particularly valuable. (paragraph 125)

*Agreed.*

#### THE RATE OF FRAUD

180. Any fraud committed against the European Budget is a problem which should be addressed seriously by the Commission and the Member States. We conclude that while the level of fraud is no higher than in comparable public expenditure programmes, including in the UK the fight must go on. We consider that efforts should be made to convey these messages to Europe's citizens more effectively. (paragraph 131)

*Agreed.*

#### PROBLEMS ESTIMATING THE RATE OF FRAUD

181. We are concerned that estimates of the level of fraud rely on self-reporting by the Member States. We consider that the Commission should bring forward proposals for a new, more objective, method of determining the rate of fraud. (paragraph 133)

*The Government takes the responsibility of reporting suspected fraud seriously. However, we recognise that in some Member States there are legal problems with making a report of suspected fraud before a conviction is obtained in the Courts. The Government agrees that the Commission should work with these countries to reach an acceptable solution. However, detecting and reporting fraud should remain primarily the responsibility of Member States. The Government welcomes the work of OLAF in analysing and publishing the details of fraud reported by Member States, and calls on OLAF to extend this work to cover the expenditure sectors managed by the Commission. Action to prevent fraud cannot be effectively targeted by Member States, or the Commission, until they are aware of the amounts of fraud occurring, where they are occurring, and why.*

*The Government would also like to take the opportunity to respond to the comment in paragraph 128 of the report, on the amounts of fraud reported. The difference in the figures quoted by the Economic Secretary and those quoted by OLAF is explained by the fact that, at the time of the Economic Secretary's evidence, figures covering 2004 were the latest available. By the time the Committee took evidence from OLAF, the 2005 figures quoted by OLAF were available.*

#### OLAF'S POWERS AND ACTIVITIES

182. We are content with the extent of the investigations which OLAF has undertaken. We consider that OLAF should conduct a survey of the uses to which Member States put its reports. On the basis of the results of this survey OLAF will be able to improve the relevance of the information it passes relevant authorities in the Member States. (paragraph 138)

*Agreed.*

#### OLAF'S INDEPENDENCE

183. We are convinced by the arguments presented in favour of keeping OLAF administratively within the Commission. On the basis of the evidence we have received we emphatically refute claims that OLAF is too

close to the Commission or that the Commission seeks to divert and influence OLAF's investigative activities. (paragraph 143)

*Agreed.*

*29 December 2006*

### **Statement by Ed Balls MP, Economic Secretary to the Treasury, to the House of Commons**

A year ago, under the UK's presidency of the EU, finance Ministers agreed important conclusions on strengthening the EU's internal financial control framework. Progress has since been made in this area, and agreement is close on a revised EU financial regulation.

So it is highly regrettable that, once again, the European Court of Auditors, in its annual report published on 24 October, was unable to give a positive "statement of assurance" on the EU's accounts. The Court once again qualified the reliability of the EU's accounts—for the 12th year in succession—and found that not all EU money had been spent strictly in line with the regulations.

This comes as a considerable disappointment after the work that the EU has done to improve financial management in recent years. The Court's standards are high, and rightly so. So it should be of real concern to all member states that the proportion of spending on which the Court had doubts is the same as in the previous year.

Improving EU financial management and achieving a positive statement of assurance on EU spending will require further action across a broad front by all the parties involved: the Commission, the Council, each member state working with its national audit institution, and the European Court of Auditors itself. Unless we all accept our responsibilities, we will not achieve the positive statement of assurance that EU taxpayers are entitled to expect.

It is particularly important that member states take action at national level to improve their management of agriculture and structural funds spending, for which they share responsibility with the Commission.

In this context, the Government warmly welcome the recent report on "Financial Management and Fraud in the European Union" by the House of Lords EU Committee (HL paper 270). The report offers a timely and balanced analysis of the problems and makes some interesting and far-reaching recommendations. It also serves to dispel some popular myths about fraud and corruption in the EU. The Government will respond to all the detailed recommendations in the report in due course and in the normal way.

However, the Government are determined that the UK should take a lead in promoting the sound management of EU funds. I have therefore written today to the Chairmen of the Public Accounts Committee, the House of Lords EU Committee and the Treasury Select Committee to inform them that the UK will now undertake further reforms to demonstrate how EU funds can be better managed at the national level, and how national parliaments can be more closely involved in scrutinising EU spending.

In particular, we now intend to pursue, in close consultation with Parliament and the National Audit Office, the proposal for a statement of assurance on the national use of EU funds. The Government intend, subject to these detailed discussions, to prepare and lay before Parliament an annual consolidated statement on the UK's use of EU funds, prepared to international accounting standards, which would be audited by the National Audit Office. The statement and audit opinion would also be made available to the European Court of Auditors and European Commission.

These arrangements would enhance audit and parliamentary scrutiny of our own use of EU funds, help detect any irregularities and thus improve financial management. The Court of Auditors and the Commission could take into account the NAO's audit opinion when performing their own audit and controls.

In time, the UK hopes to be able to welcome similar reports about the national use of EU funds in other member states. I know that the Dutch Finance Ministry and Danish national audit office are already developing similar initiatives.

I will therefore be sending copies of this statement and the House of Lords report to my counterparts in other EU countries, encouraging them to reflect fully on all its recommendations, and urging them to take similar initiatives to our own to improve national accountability for the sound management of EU funds.

It is of fundamental importance to EU taxpayers that EU money is spent correctly. That is the focus of the House of Lords report. But it is also of equal importance that EU money is spent effectively. In the view of the UK, we need to go further in equipping the EU with a performance-driven and results-oriented system of

financial management and administration, which ensures EU money is spent both efficiently and effectively. That will be a focus of the review of the EU budget that will be conducted in 2008–09 and on which I will make further reports to the House in the coming months.

20 November 2006

**European Commission replies to recommendations of the House of Lords European Union Committee  
Report on “Financial Management and Fraud in the European Union: Perceptions, Facts and  
Proposals” (HL Paper 270 published on 13.11.2006)**

**RECOMMENDATION 161: DOUBLE ENTRY BOOKKEEPING AND THE COMMISSION’S ACCOUNTING SOFTWARE**

In the Commission’s view, there are no local accounting systems for budgetary transactions in the Directorates General but there are local management systems. There is only one, central accounting system, based on SAP software, which is owned and managed by the Directorate General of the Budget. There is no local accounting system which has to support double entry accounting because there is no booking made at the level of the Directorates General. They register invoices in their management information systems and send the accounting data to the central “ABAC” accounting system which creates automatically a double entry bookkeeping in SAP.

Local systems for recording extra-budgetary operations, for example the commercial operations of the Publications Office, and the European Development Funds, comply with the standards required of double-entry bookkeeping.

The remaining local IT systems are designed to provide the management of the services concerned with data additional to that held by the central accounting system. They draw on the central system’s accounting records to provide reports and information to the managers of programmes and projects. Information relevant to the accounts is sent to the central system as soon as it is encoded, and the central system is used as a source for the reports produced by the local systems. Local IT systems are therefore not accounting systems in their own right, and double-entry is not relevant to them, though their ability to register all economic events which have to trigger accounting bookings is relevant.

Local systems were scrutinised by the central services in 2005 in order to assess their compliance with validation criteria, in particular their ability to register all economic events which have to trigger accounting bookings. Having chosen the services where risk was adjudged to be highest, 13 services were reviewed in 2005 and a further nine services in 2006, a total of 22 services, that is more than half of the total of 40 services in the Commission. In financial terms, the Directorates General covered represent more than 80 per cent of the total EU budget. In 2007, the validation team is continuing this work in order to cover progressively all of the 40 Services. For each investigation, a full report is prepared.

In addition, a new procedure for the validation of changes to the local systems has been introduced in June 2006, to cover developments of an IT or an administrative nature in local systems. This procedure is now fully operational. All material changes are notified by the Services to the Accounting Officer and the validation team assesses these changes and must give its prior agreement to a change before it is introduced.

All weaknesses identified in the in-depth investigations are followed up and reported on six-monthly in order to assess the Directorates General’s progress. Global and interim reports are also prepared on a regular basis—at least once a year—and cover the situation of all the services, and the progress achieved to date.

**RECOMMENDATION IN §162: INTERNAL AUDIT AND CONTROL**

The Commission understood the concern expressed under §53 and §162 (as well as under §60 and §61) of the report as being mainly about the role of the internal auditor in the accounts’ certification. Under its current charter, the Internal Audit Service (IAS) is not called to play any part in that annual process. It is up to the external auditor (the European Court of Auditors) to certify the annual accounts. The IAS has audited and will continue to audit from time to time the accounting system, the treasury management, the security of the IT accounting systems and related matters.

Pursuant to an IAS recommendation and to the provisions of the Financial Regulation, as recently modified<sup>3</sup>, the Commission’s accounts will henceforth be signed-off by the Accounting Officer.

<sup>3</sup> Council Regulation (EC, EURATOM) No 1995/2006 of 13 December 2006 amending Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities—OJ L 390, 30.12.2006, p 1.

At the level of Directorates General, the Commission has systems in place to require that Commission officials take responsibility for the systems and the accounts in their departments. The Authorising Officer Delegate, with the Resource Director, provides a management assurance on the annual activity report and on the Directorate General's accounts.

#### RECOMMENDATION IN §163: DEVOLVED MANAGEMENT IN THE COMMISSION

It is not the intention of the Commission to re-centralise ex-ante controls since the current model has greatly clarified the responsibility of the authorising officer.

#### RECOMMENDATION IN §164: A SYSTEM REQUIRING COMMISSION OFFICIALS TO TAKE RESPONSIBILITY: SIGNING OFF BY THE COMMISSION'S SECRETARY GENERAL

The role of the Secretary General is not conceived as one which allows her to provide a formal declaration of assurance concerning all the annual activity reports (AAR) of the Directors General (DG). She makes an assurance for her own department, the Secretariat General. A declaration by her on all the annual activity reports would make the lines of responsibility much less clear. It would lead both to a potential interference between Commissioners and their Directors General and to an important increase in administrative processes.

Such a declaration of assurance on all the AARs and DGs' declarations would entail:

- A fundamental change in the current organisation of the Commission and a call for the strengthening of central control tools, a move which would run against the decentralisation implemented for several years.
- A serious risk of duplication and interference by the Secretary General in the vertical political responsibility between the individual Commissioner and his or her Director General, as a declaration of assurance from the Secretary General would have to cover financial and administrative management as well as policy aspects.
- Such a declaration from the Secretary General would also add little to the signature of the Directors General who are best equipped to certify the management of funds and actions coming under their direct area of competence and responsibility.

The need of a formal signature of the accounts has already been settled by the Commission, which proposed that the current financial rules be amended to provide that the Accounting Officer sign off the final accounts, declaring that they were prepared in accordance with both the provisions on the presentation of the accounts and accounting principles, rules and methods. The legislative authority has accepted this proposal in the revised Financial Regulation<sup>4</sup>. To be able to exercise this responsibility, the Accounting Officer will be empowered to make the necessary checks on the information received from Directorates General.

In line with the decentralisation of management responsibilities the Directors General are responsible for the underlying transactions and the reliability of the information made available to the Accountant. The Directors General will therefore have to inform adequately and to provide assurance to the Accounting Officer. This will be done through the declaration of assurance made in the Annual Activity Reports, certifying that the accounts for which they are responsible are accurate and exhaustive.

This provides a further clarification of responsibility and will give the necessary level of accountability, to which the extra signature of the Secretary General would add no value but rather, by blurring the responsibilities and inducing unnecessary duplications, would engender serious confusion and hinder the common aim of enhanced accountability and clear lines of responsibility.

#### RECOMMENDATION IN §165: RISK ASSESSMENT

The Commission welcomes the support for the risk management methodology which it has developed and will continue to apply<sup>5</sup>. It will adapt it in line with experience gained. As regards the accounting system, this can be exploited to provide input to risk management. This capacity will be increased during 2007 by the development of a single Data Warehouse which will include accounting data as well as financial management

<sup>4</sup> Council Regulation (EC, EURATOM) No 1995/2006 of 13 December 2006 amending Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities—OJ L 390, 30.12.2006, p 1.

<sup>5</sup> Communication to the Commission from Ms Grybauskaitė in agreement with the President and Vice-President Kallas "Towards an effective and coherent risk management in the Commission services" SEC(2005)1327, Communication from the Commission to the Council, the European Parliament and the European Court of Auditors "On A Roadmap To An Integrated Internal Control Framework" COM(2005) 252 final, and Communication from the Commission to the Council, the European Parliament and the European Court of Auditors "Commission Action Plan Towards An Integrated Internal Control Framework" COM(2006) 9 final, and Communication to the Commission from Vice-President Kallas in agreement with the President and Ms Grybauskaitė "Commission Action Plan towards an Integrated Internal Control Framework: Gap analysis and action plan for Commission services" SEC(2006) 49 [final].

data from the central systems. A second phase of the implementation of this Data Warehouse (planned to be completed in 2009) involves the incorporation of data from the DGs' own management systems which will further extend the support given to risk management.

#### RECOMMENDATION IN §181: PROBLEMS ESTIMATING THE RATE OF FRAUD

With an "architecture" such as the one that is established by the European Community Treaty it is difficult to imagine anything which does not rely on the information provided by the Member States which administer programmes and whose authorities investigate and prosecute fraud.

#### RECOMMENDATION IN §182: OLAF'S POWERS AND ACTIVITIES

In order to facilitate increased cooperation with its partners, OLAF will assess the added value of the information it provides to them. To this end OLAF will carry out a customer survey in order to obtain an idea of the level of customer satisfaction. This survey will respond to your request.

As part of the reform of OLAF's legal basis, the Commission has proposed that Member States should systematically inform OLAF of the follow-up they give to information transmitted to them by the Office. This will also ensure feedback on the use made and allow adjusting the content of the transmission. This proposal is currently under discussion.

*March 2007*

#### **European Court of Auditors response to the House of Lords European Union Committee report on Financial Management and Fraud in the European Union: Perceptions, Facts and Proposals**

Your Committee's recent report on the EU budget has been read with considerable interest here in the Court of Auditors. My colleagues and I thought that it might be of interest to set out the Court's reactions to a number of its observations and recommendations, which in some cases go beyond the subject matter discussed when three of my colleagues and I met the Sub-Committee in Luxembourg on 16 May. Specifically, we should like to comment on:

- the scope and nature of the "DAS" audit;
- audit methods; and
- "national declarations" and the role of national audit institutions in the audit of EU expenditure.

#### THE DAS AUDIT

The Committee's report raises a number of issues about the interpretation and practical implementation of the "DAS" provisions in Article 248 of the Treaty establishing the European Communities.

First, the Committee recommends that "the annual examination and audit of all revenue and expenditure of the Commission should be separated from the broader objectives of the Statement of Assurance" (paragraph 17).

This recommendation appears to flow from the analysis of Article 248 in paragraph 17 of the Committee's report. Paragraph 17 describes the requirement to provide a statement of assurance, set out in the second paragraph of Article 248, as additional to (and by implication separate from) the requirement in the first paragraph of Article 248 to examine the accounts of all revenue and expenditure.

The Court was not the author of the "DAS" paragraph inserted into the Treaty at Maastricht: but it has assumed that the two paragraphs are to be read together and interpreted, as it were, in apposition. The Court is to audit revenue and expenditure and, on the basis of that audit, provide a statement of assurance. It is difficult to see how else, in practice, the two paragraphs concerned could be interpreted.

Second, there is the question whether there should be one or many statements of assurance. The Committee concludes that "the Court's decision to give a single Statement of Assurance on the accounts as a whole means that a positive Statement is difficult to achieve" and recommends instead "statements on each of the spending areas; in much the same way that the National Audit Office in the UK issues separate audits for each Government department" (paragraph 23). In paragraph 35 of its report, on the other hand, the Committee supports "the recent decision of the Court of Auditors to produce a Statement of Assurance giving details of each of the areas analysed" and recommends "that this should be developed into a Statement which concentrates on an analysis of the audits conducted in each expenditure category and Member State rather than on the single Statement of Assurance on all the accounts."

The Court would wish to make four points in reply.

- The form of the statement of assurance cannot be settled independently of the structure of the Commission's accounts. The Court is enjoined by the Treaty to make a statement of assurance on the reliability of the accounts (and on the legality and regularity of the underlying transactions). There is a single set of accounts for the Community Budget: logically there can only be a single statement of assurance for the Community Budget. (There is of course a separate statement of assurance for the European Development Fund, which has separate accounts).
- The Court has, for every year since 1998, provided "specific assessments" giving more detailed information about the main areas of the budget and, in the Committee's words, "concentrating on an analysis of the audits conducted in each expenditure category" (and revenue)—though the Court has not, *pace* the Committee's report, produced separate statements of assurance for each category.
- Within this framework the Court has commented on the legality and regularity of different categories of transaction, giving a positive assessment on commitments, receipts, administrative expenditure and pre-accession aid, but not on payments for internal policies, the structural funds etc; and, in the 2004 and 2005 annual reports, commending the Integrated Administration and Control System (IACS) for agricultural spending where it is properly applied. It is not the form in which the Court publishes its findings that leads to the absence of a "positive DAS": it is the facts as we find them.
- Where appropriate, the annual report contains references to findings in specific Member States, either to illustrate the Court's findings or if the Court's audit has identified a particular national problem. In addition the chapter on agriculture contains detailed information at Member State level provided to and by the Commission. But the Treaty does not ask the Court to provide separate assessments for all programmes in all Member States; and doing so would be impractical without a massive expansion of the scale of the Court's activities and resources.

Third, the Committee's report encourages the Court "to put in place measures clearly to distinguish between irregularity and fraud and to publish separate figures for the level of fraudulent transactions and administrative mistakes." (paragraph 31).

The Court of course shares the Committee's view that it is wrong to regard all errors in payment as a reflection of fraud, ie as a result of deliberate and criminal attempts to misapply EU funds. At the same time "administrative mistakes" perhaps gives the impression that clerical failures by those administering EU funds are the principal problem uncovered by the Court's audit. In fact, as the Court's annual reports have repeatedly made clear, most errors identified by the Court appear at final beneficiary level, in the amounts claimed from the Community budget. Such errors may be caused by the very complex nature of the relevant EU legislation.

Whether in any particular case an error occurs as a result of fraud or from mere confusion or carelessness is a question which it is rarely possible to answer from an audit alone. I am afraid that our existing practice of sending to OLAF details of suspected frauds uncovered by the Court's audits is far more practical than attempting ourselves to estimate fraud and irregularity separately. OLAF are best placed to estimate the impact of fraud.

#### AUDIT METHODS

The Committee's report appears to contain two strains of criticism of the Court's audit methodology, both relating to the Court's use of sampling, and both concentrating on the second aspect of the DAS—the legality and regularity of transactions.

On the one hand the Committee appears to ask for more and better sampling of transactions. Paragraph 28 of the report says "Due to the small number of transactions actually looked at each year we do not consider that this methodology can lead to an accurate picture of financial management. The Court should aim to improve the methodology behind the Statement's production so as to provide more accurate data. We consider that these weaknesses must be remedied as a matter of priority so an accurate picture of the error rate can be obtained." Paragraph 38 also calls for "the development of a sound basis for payment transaction sampling" in the context of "naming and shaming" of individual Member States (see above).

Paragraph 29 however puts the emphasis on other sources of evidence. "We are pleased to see that the Court now conducts an assessment of supervisory systems and controls; reviews the Annual Activity Reports and Declarations from each of the Directors General in the Commission; and evaluates the results of other auditors. We consider that these need to be further developed to give a more rounded picture of performance over the year. In particular, greater use by the Court of the Annual Activity Reports could add positive pressure for their development into proper accounting tools."

It is perhaps useful to go back to first principles.

- The Court uses a number of sources of evidence in arriving at its audit judgment.
- The extent to which the Court can place reliance on (“take assurance from”) analysis of systems, the reports of Directors General etc depends on the quality of the systems concerned and the extent to which they assist in answering the Treaty DAS questions. In a good many areas of the EU budget the Court has found that financial control systems are weak; it follows that the Court can place little reliance on them as a source of assurance for the DAS. In some areas of the budget there are financial reporting arrangements which work reasonably well (for example the annual “financial clearance” of CAP paying agencies’ accounts); but they do not necessarily provide a satisfactory answer to the DAS questions (for example the “certifying bodies” which audit the accounts of CAP paying agencies do not necessarily investigate transactions all the way to the final beneficiary).
- However good the management systems in place, there must be some direct testing of transactions. For the reasons set out above the Court has to rely on transactions testing to a greater extent than might be ideal.
- Two arguments might be advanced for increasing the sample size. The first is that a larger sample size might lead the Court to change its view as to the level of irregularities present within the payments for a particular year (ie lead us to conclude that a level of error that appeared at first material would appear immaterial if a further three or five hundred transactions were tested). In practice both the nature of the results the Court finds and the corroboration available from sources such as the IACS inspections suggest that our results can be considered as robust.
- The second argument is that a larger sample would assist Member States, Parliament, and the Commission in identifying where things go wrong (by type of transaction, or by Member State). There is some force to this, but it is necessary to consider several factors here: the sample is not the only source of information; for most transaction streams risks change little from year to year; the Commission has access to our cumulative results; and the Commission itself is responsible for monitoring the implementation of control systems, and for proposing penalties when Member States fail to implement systems.
- Mr Gray pointed out in his evidence to the Committee that the Commission has more than 100 auditors to examine Structural Funds expenditure and more than 100 to examine agricultural expenditure. My understanding of the situation is that the Commission has the information it needs, but that there could be an increase in accountability if the Commission found some way of summarising the results of its examinations and proposed corrections, and of publishing this in the Annual Accounts. This would be in line with the Single Audit principles, and would enable the Court to comment when it had reason to believe that the information was out of line with its own findings.

It is perhaps worth underlining the point that audit methodology is not something that the auditor can freely choose, and that the best way to more economical audit by the Court is through improved management by the Commission. Ms Andreassen (page 111 of the Committee’s minutes of evidence) makes the point very well:

“The question here is do we ask the European Court of Auditors to hire 10,000 people to do the audit or do we ask the European Commission to strengthen the controls. My response is you should ask the European Commission to strengthen the controls.”

#### NATIONAL DECLARATIONS AND NATIONAL AUDIT INSTITUTIONS

The Committee is “strongly in favour of a national Statement of Assurance on the monies disbursed in each Member State. As in the Dutch pilot project, such a Statement should be sent to national parliaments as well as to the Commission as we consider that this will encourage the Member States to take responsibility for the systems and controls they operate” (paragraph 105); though it does not consider that a political signature is necessary (paragraph 106) or that a single national account is desirable (paragraphs 111 to 112).

The Committee also expresses the hope that joint or single audit work including Supreme Audit Institutions (SAIs) and the Court can be developed (paragraph 121) and envisages arrangements in which the Court would have a supervisory role over the audits of European expenditure conducted by the Supreme Audit Institutions in the Member States” (paragraph 123).

How Member State governments and SAIs can best contribute to improving the management and audit of EU funds is a large question. Articles 274 and 280 of the Treaty place clear responsibilities on Member States for the management of the budget and the combat of fraud. Individual SAIs already produce reports of considerable interest and value on EU spending (for example the UK NAO’s recent report on the Rural Payments Agency, and its report of a few years ago on the case of an individual farmer whose claimed holding

included part of the North Sea). And there have been valuable joint audits involving the Court and SAIs, for example a parallel audit on the structural funds carried out in 2005–06 (whose findings were in line with the Court’s previous observations on the funds).

As for the potential contribution which “national declarations”, perhaps audited by SAIs, can make to the management of EU expenditure and to the DAS, the Court would wish to underline the following points.

- Declarations that expenditure has been properly and legally undertaken are a normal feature of systems of financial management. Such arrangements already exist in a number of contexts within the EU budget; the Court has commented from time to time on their appropriate form and substance.
- It is not clear at the moment how some of the ideas for global national declarations would fit together with and add to the effectiveness of these sector-specific declarations. For example there is current discussion of amending the Financial Regulation in order to require Member States to produce a national summary of sector-specific declarations relevant to EU expenditure within their territory. It is not clear how in itself this change would directly improve financial control.
- The Court has to carry out the DAS on an annual timetable (specified in Community law) and in order to answer the DAS questions in the Treaty. The Court can, does and will take account of professionally conducted audits of EU spending carried out on the appropriate timetable and which address those questions—but the qualifications are important.

## CONCLUSION

The Committee’s report at a number of points compares and contrasts EU and UK public spending and the Court and the UK National Audit Office (NAO). I understand that the NAO has repeatedly qualified the accounts of the Department of Works and Pensions (and its predecessor bodies) which has a budget of £124 billion, and where most of the expenditure concerns transfer payments to benefit claimants. The NAO quotes an error rate of 2.2 per cent, which it judges to be substantial and of serious concern. In the case of agriculture expenditure (outside IACS), structural measures, internal policy and external aid the audits of the Court have identified levels of irregular or illegal expenditure which are significantly higher than that. These results are derived on the basis of similar statistical techniques to those applied by the NAO and other European SAIs. They are not one off results but, rather, have been consistent over a number of years. There is sufficient and compelling evidence that public funds are not being spent according to the regulations and the intentions expressed by the legislator.

My colleagues and I trust that these comments will be of assistance to the Committee in any further discussion of the subject matter of its report.

*15 December 2006*

### **Letter from Lord Grenfell to Hubert Weber, President, European Court of Auditors**

Thank you for your letter of 15 December 2006 regarding our report on Financial Management and Fraud in the EU. We are grateful to you for setting out the Court’s views on the three issues you discuss and they are indeed of use to the Committee ahead of the debate on the Report, currently scheduled for early March.

I suspect that the Committee and the Court largely agree on most points, but wish to clarify our thinking on four issues:

- (a) In paragraph 17 we wished to emphasise the difference in philosophical approach between the statement of assurance, which will make a judgement on the soundness of the accounts as a whole, and the detailed annual report which provides the detail of the financial management of the spending programmes. The Committee accepts that proving separate statements of assurance for all programmes in all Member States would be onerous but we had in mind only sector DASs which as your letter notes are allowed for by Article 248 of the Treaty;
- (b) The Committee accepts your argument that the Court would have difficulty distinguishing between fraud and irregularity;
- (c) We support your multi-source methodology, although we still argue for an increased sample size. We agree with your suggestion that there should be some way of summarising the Commission’s examinations and proposed corrections, and publishing these in the Annual Accounts;

- (d) Regarding national declarations and their role, the Committee still believe that there is benefit to be gained from these and we are pleased to hear that the Court takes note of existing SAI findings. We do not believe we have yet reached a point where the cost of additional audit work outweighs the potential benefits, although we note your point that these costs and benefits have not yet been quantified.

*21 February 2007*