2022

Annual reports

- on the implementation of the EU budget for the 2022 financial year and
- on the activities funded by the 9th, 10th and 11th European Development Funds (EDFs) for the 2022 financial year

EUROPEAN COURT OF AUDITORS

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Pursuant to Article 287(1) and (4) of the TFEU, Article 258 of Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012, and Article 43 of Council Regulation (EU) 2018/1877 of 26 November 2018 on the financial regulation applicable to the 11th European Development Fund, and repealing Regulation (EU) 2015/323

the Court of Auditors of the European Union, at its meetings of 6 and 20 July 2023, adopted its

ANNUAL REPORTS for the 2022 financial year

The reports, together with the institutions' replies to the Court's observations, have been sent to the authorities responsible for giving discharge and to the other institutions.

The Members of the Court of Auditors at the time these reports were adopted were:

Tony Murphy (President), Ladislav Balko, Pietro Russo, Baudilio Tomé Muguruza, Iliana Ivanova, Nikolaos Milionis, Klaus-Heiner Lehne, Bettina Jakobsen, Jan Gregor, Mihails Kozlovs, Ildikó Gáll-Pelcz, Eva Lindström, Hannu Takkula, Annemie Turtelboom, Viorel Ştefan, Ivana Maletić, Francois-Roger Cazala, Joëlle Elvinger, Helga Berger, Marek Opioła, Jorg Kristijan Petrovič, Stef Blok, George Marius Hyzler, Lefteris Christoforou, Laima Liucija Andrikienė, Keit Pentus-Rosimannus

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Annual report on the implementation of the EU budget for the 2022 financial year

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General introduction

0.1. The European Court of Auditors (ECA) is an institution of the European Union (EU) and the external auditor of the EU's finances. In this capacity, we act as the independent guardian of the financial interests of all EU citizens, notably by helping to improve the EU's financial management.

0.2. In line with the Treaty on the Functioning of the European Union (TFEU)[1], our annual report on the implementation of the EU budget covers both revenue and expenditure. It presents our *statement of assurance* as to whether the EU's accounts are reliable and whether the EU budget has been used in accordance with the applicable laws and regulations. This statement is supplemented by specific assessments for major areas of EU budget spending. A separate annual report covers the European Development Funds.

0.3. The EU's general budget is adopted annually by the Council of the European Union and by the European Parliament. In May 2020, the Council of the European Union adopted *NextGenerationEU (NGEU)*, a temporary instrument that was set up in response to the socio-economic impact of the COVID-19 pandemic and is financed through issuing bonds. NGEU provides funding for the *Recovery and Resilience Facility (RRF)*[2], accounting for about 90 % of NGEU funding, as well as for top-ups to existing 2021-2027 MFF programmes, which have to be spent in line with sector-specific rules.

0.4. Both the EU's general budget and NGEU funding are subject to the *discharge procedure*. Through this procedure, the Parliament, acting on a recommendation from the Council, decides whether the European Commission has satisfactorily met its budgetary responsibilities. Our annual report, combined as appropriate with our other products, provides a basis for the discharge procedure. Upon publication, we forward our annual report to member states' national parliaments, the European Parliament and the Council.

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1 Articles 285 to 287 of the TFEU.

2 Regulation (EU) 2021/241 establishing the Recovery and Resilience Facility.

0.5. This annual report is structured as follows:

— ***chapter 1*** contains the statement of assurance, a summary of the results of our audit on the reliability of accounts and the legality and regularity[3] of transactions, including the Commission's regularity information and a summary of our audit approach;

— ***chapter 2*** presents our analysis of budgetary and financial management;

— ***chapter 3*** presents performance aspects (i.e. the *economy*, *efficiency* and *effectiveness*) of the budget's implementation, focusing on our analysis and synthesis of key performance information from special reports adopted in 2022 and our follow-up of recommendations made in our 2019 report on the performance of the EU budget and in our 2019 special reports;

— ***chapter 4*** presents the results of our testing of the regularity of EU revenue transactions and examination of elements of internal control systems for managing revenue, as well as of our review of the Commission's annual activity reports;

— ***chapters 5-10*** show, for the headings of the 2021-2027 *multiannual financial framework (MFF)*, the results of our testing of the regularity of transactions and our review of the Commission's *annual activity reports*, elements of its internal control systems and other governance arrangements.

— ***chapter 11*** presents the results of our testing of the regularity of RRF transactions, as well as our review of the Commission's *annual activity reports*, our assessment of selected supervisory and control systems and our audit approach for the RRF.

0.6. We aim to present our findings in a clear and concise way. We cannot always avoid using terms specific to the EU, its policies and budget, or to accounting and auditing. On our website, we have published a glossary with explanations of most of these specific terms. The terms defined in the glossary appear in *italics* when they first occur in each chapter.

[3] Hereafter in this annual report, we use the term 'regularity' with the same meaning as 'legality and regularity'.

0.7. It is our responsibility, as external auditor, to report our audit findings and draw the necessary conclusions in order to provide an independent and impartial assessment of the reliability of the EU accounts and the legality and regularity of transactions.

0.8. The Commission's replies to our findings (and, where appropriate, the replies of other EU institutions and bodies) are presented together with this report.

0.9. More information on our work can be found in our annual activity reports, our special reports, our review documents and our opinions on new or updated EU laws or other decisions with financial management implications, all of which are available on our website.

Chapter 1

The statement of assurance and supporting information

Contents

The ECA’s Statement of Assurance provided to the European Parliament and the Council – independent auditor’s report

Opinion

I. We have audited:

(a) the consolidated accounts of the European Union, which comprise the consolidated financial statements[1] and the budgetary implementation reports[2] for the financial year ended 31 December 2022, approved by the Commission on 28 June 2023;

(b) the legality and regularity of the underlying *transactions*, as required by Article 287 of the Treaty on the Functioning of the European Union (TFEU).

Reliability of the accounts

Opinion on the reliability of the accounts

II. In our opinion, the consolidated accounts of the European Union (EU) for the year ended 31 December 2022 present fairly, in all material respects, the EU’s financial position as at 31 December 2022, the *results* of its operations, its cash flows and the changes in its net assets for the year then ended, in accordance with the Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

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1 Regulation (EU, Euratom) No 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 966/2012 – OJ L 193/30.07.2018, p. 1, Article 243.

2 *Ibid*., Article 244.

Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue

III. In our opinion, the revenue underlying the accounts for the year ended 31 December 2022 is legal and regular in all material respects.

Expenditure

IV. For 2022, we continue providing two separate opinions on the legality and regularity of expenditure. This reflects the fact that the *Recovery and Resilience Facility (RRF)* is a temporary instrument delivered and financed in a way that is fundamentally different to normal budget spending under the multiannual financial framework (MFF).

Adverse opinion on the legality and regularity of budget expenditure

V. In our opinion, owing to the significance of the matter described under 'Basis for adverse opinion on the legality and regularity of budget expenditure', the budget expenditure accepted in the accounts for the year ended 31 December 2022 is materially affected by error.

Qualified opinion on the legality and regularity of RRF expenditure

VI. In our opinion, except for the effects of the matters described under the 'Basis for qualified opinion on the legality and regularity of RRF expenditure', the RRF expenditure accepted in the accounts for the year ended 31 December 2022 is legal and regular in all material respects.

Basis for opinion

VII. We have conducted our audit in accordance with the International Federation of Accountants (IFAC) International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under these standards and codes are described in more detail in the 'Auditor's responsibilities' section of our report. In that section, we also provide more information on the basis for our opinion on revenue (see paragraph ***XXXV***) and RRF expenditure (see paragraph ***XXXVII***). We have also met independence requirements and fulfilled our ethical obligations under the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions.

Basis for adverse opinion on the legality and regularity of budget expenditure

VIII. Our overall estimated level of error for budget expenditure accepted in the accounts for the year ended 31 December 2022 is 4.2 %. A substantial proportion of this expenditure is materially affected by error. This mainly concerns reimbursement-based expenditure, in which the estimated level of error is 6.0 %. Such expenditure increased to €110.1 billion in 2022, representing 66.0 % of our audit population[3]. The effects of the errors we found are therefore both material and pervasive to the year's accepted expenditure.

Basis for qualified opinion on the legality and regularity of RRF expenditure

IX. Eleven out of the 13 RRF payments (and related clearings of pre-financing) were affected by quantitative findings. Six of these payments were affected by material error. We also identified cases of weak design in the measures and underlying milestones or targets and problems with the reliability of information that member states included in their management declaration. Based on these elements, we consider that the overall effects of our findings are material, but not pervasive to the year’s accepted RRF expenditure.

Key audit matters

We assessed the liability for pension and other employee benefits

X. The EU balance sheet includes a liability for pension and other employee benefits amounting to €80.6 billion at the end of 2022 (2021: €122.5 billion).

XI. Most of the liability for pension and other employee benefits relates to the Pension Scheme of Officials and Other Servants of the European Union (PSEO), amounting to €73.1 billion (2021: €109.7 billion). The liability recorded in the accounts is an estimate of the present value of expected future payments the EU will have to make to settle its pension obligations.

XII. The benefits paid under the pension scheme are charged to the EU budget. While the EU has not created a dedicated pension fund to cover the cost of future pension obligations, member states jointly guarantee the payment of the benefits, and officials contribute one third of the cost of financing the scheme. Eurostat calculates this liability annually on behalf of the Commission’s accounting officer, using parameters such as the age profile and life expectancy of EU officials and assumptions about future economic conditions. These parameters and assumptions are also assessed by the Commission’s actuarial advisors.

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[3] We provide further information in our 2022 annual report, paragraphs ***1.22-1.26***.

XIII. The decrease in the pension liability in 2022 is mainly due to the increase in the nominal discount rate, which is affected by rising global interest rates[4].

XIV. The second largest part of the liability for pension and other employee benefits is the EU's estimated liability towards the Joint Sickness Insurance Scheme (JSIS), which amounted to €5.7 billion at the end of 2022 (2021: €10.3 billion). This liability relates to EU staff members' healthcare costs payable during post-activity periods (net of their contributions).

XV. As part of our audit, we assess the actuarial assumptions made for these schemes and the resulting valuation. We base our evaluation on work carried out by external, independent actuarial experts. We check the basic data underlying the calculations, the actuarial parameters and the calculation of the liability. We also examine the presentation of the liabilities in the consolidated balance sheet and the notes to the consolidated financial statements.

XVI. We conclude that the estimate of the overall liability for pension and other employee benefits is presented fairly in the consolidated annual accounts.

We assessed significant year-end estimates presented in the accounts

XVII. At the end of 2022, the estimated value of incurred eligible expenses due to beneficiaries but not yet claimed was €148.7 billion (2021: €129.9 billion). These amounts were recorded as accrued expenses[5].

XVIII. The increase in that estimate relates mainly to the RRF, which is the centrepiece of *NextGenerationEU* (NGEU), the temporary recovery instrument aimed at helping to repair the immediate economic and social damage brought about by the COVID-19 pandemic. Payments to member states under this facility follow a predefined instalment profile up to 2026. At the end of 2022, accrued RRF expenditure amounted to €22.6 billion (2021: €12.3 billion).

XIX. In order to assess these year-end estimates, we examined the system the Commission had set up for the cut-off calculations to ensure its correctness and completeness in the directorates-general where most expenses were incurred. During our audit work on the sample of invoices and pre-financing payments, we examined the relevant cut-off calculations in order to address the risk of accruals

[4] 2022 EU annual accounts, note 2.9.

[5] These comprise accrued charges of €85.9 billion on the liabilities side of the balance sheet and, on the assets side, €62.8 billion reducing the value of pre-financing.

being misstated. We sought clarification from the Commission's accounting services on the general methodology for establishing these estimates.

XX. We conclude that the estimate of the overall amount of accrued charges and other advances paid to member states is presented fairly in the consolidated annual accounts.

We reviewed the asset generated by the UK's withdrawal process

XXI. On 1 February 2020, the United Kingdom (UK) ceased to be an EU member state. Under the withdrawal agreement, the UK has committed to honouring all financial obligations under previous MFFs arising from its EU membership.

XXII. Following the end of transition period at 31 December 2020, further mutual obligations on the part of the EU and the UK give rise to certain liabilities and receivables for the EU. These obligations must be reflected in the EU's annual accounts. The Commission estimated that, at the balance sheet date, the EU accounts showed a net receivable due from the UK of €23.9 billion (2021: €41.8 billion), of which it is estimated that €9.1 billion will be paid in the 12 months following the reporting date.

XXIII. As part of our normal audit procedures, we discussed with the Commission the timing, accuracy and completeness of the asset recognised and payments made. We recalculated the amounts concerned, reconciled them with the underlying records and checked the appropriateness of any assumptions used.

XXIV. We conclude that the estimate of the total asset recognised in relation to the UK's withdrawal process is presented fairly in the consolidated annual accounts.

We assessed impact on the accounts of Russia's war of aggression against Ukraine

XXV. On 24 February 2022, Russia invaded Ukraine. As the EU provides assistance to Ukraine in the form of loans and grants, we assessed the Commission's calculations concerning the EU's associated financial risk exposure, as well as their underlying basis, to ensure that the actual and potential consequences were reflected appropriately in the EU accounts. We assessed the Commission's calculations against our own and against existing data on the matter.

XXVI. We conclude that the treatment of the impact of Russia's war of aggression against Ukraine on the consolidated accounts is presented fairly in the consolidated annual accounts.

We assessed the impact of NGEU on the accounts

XXVII. With NGEU, the EU mobilised substantial means to reinforce the member states' public health sectors and mitigate the pandemic's socio-economic impact in the EU. To fund NGEU, the European Commission raises debt in the capital markets. These funds are being made available to the member states in the form of non-repayable grants or loans up to a previously agreed allocation. These activities have a significant effect on the financial statements. The most significant part of NGEU is the RRF.

XXVIII. As part of our normal audit procedures, we audited the assets, liabilities, revenue and expenses, including those related to NGEU. We conclude that they are presented fairly in the consolidated annual accounts.

Other matters

XXIX. Management is responsible for providing 'other information'. This term encompasses the 'Financial highlights of the year', but not the consolidated accounts or our report on these. Our opinion on the consolidated accounts does not cover this other information, and we do not express any form of assurance conclusion on it. Our responsibility in connection with the audit of the consolidated accounts is to read the other information and consider whether it is materially inconsistent with the consolidated accounts or the knowledge we have obtained in the audit or otherwise appears to be materially misstated. If we conclude that the other information is materially misstated, we are required to report this accordingly. We have nothing to report in this regard.

Responsibilities of management

XXX. In accordance with Articles 310 to 325 of the TFEU and with the Financial Regulation, management is responsible for preparing and presenting the EU's consolidated accounts on the basis of internationally accepted accounting standards for the public sector, and for the legality and regularity of the underlying transactions. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to *fraud* or error. Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities (laws, regulations, principles, rules and standards) which govern them. The Commission is ultimately responsible for the legality and regularity of the transactions underlying the EU's accounts (Article 317 of the TFEU).

XXXI. When preparing the consolidated accounts, management is responsible for assessing the EU's ability to continue as a going concern, disclosing any relevant matters and using the going concern basis of accounting unless it either intends to liquidate the entity or cease operations, or has no realistic alternative but to do so.

XXXII. The Commission is responsible for overseeing the EU's financial reporting process.

XXXIII. Under the Financial Regulation (Title XIII), the Commission's accounting officer must present for audit the consolidated accounts of the EU first as provisional accounts by 31 March of the following year and as final accounts by 31 July. The provisional accounts should already give a true and fair view of the EU's financial position. It is therefore imperative that all items of the provisional accounts are presented as final calculations, allowing us to perform our task in line with (Title XIII) of the Financial Regulation and by the given deadlines. Any changes between the provisional and final accounts would normally result from our observations only.

Auditor's responsibilities for the audit of the consolidated accounts and underlying transactions

XXXIV. Our objectives are to obtain reasonable assurance as to whether the EU's consolidated accounts are free from material misstatement and the underlying transactions are legal and regular and on the basis of our audit, to provide the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. Reasonable assurance is a high level of assurance, but it is not a guarantee that the audit has necessarily detected all instances of material misstatement or non-compliance that may exist. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence any economic decisions taken on the basis of these consolidated accounts.

XXXV. For revenue, our examination of VAT and GNI-based own resources takes as its starting point the macroeconomic aggregates from which these are calculated, and assesses the Commission's systems for processing these up to the point at which the member states' contributions have been received and recorded in the consolidated accounts. For the own resource based on non-recycled plastic packaging waste, we review the process for compiling forecast data and the Commission's controls on the calculation of member states' contributions based on this data, up to the point the revenue amounts were received and recorded in the accounts. For traditional own resources, we examine the customs authorities' accounts and analyse the flow of duties up until the amounts have been received by the Commission and recorded in the accounts. Customs duties are at risk of either not being declared or being declared incorrectly to the national customs authorities by importers. The actual import duties collected will therefore fall short of the amount that should theoretically be collected. This difference is known as the "customs gap". These evaded amounts are not captured in member states' TOR accounting systems and do not fall within the scope of our audit opinion on revenue.

XXXVI. For expenditure, we examine payment transactions once expenditure has been incurred, recorded and accepted. This examination covers all categories of payments at the point they are made, except advances. We examine advance payments once the recipient of funds has provided evidence of their proper use and the institution or body has accepted that evidence by clearing the advance payment, which might not happen until a subsequent year.

XXXVII. For RRF expenditure, unlike other budget expenditure, the main condition for payment is the satisfactory fulfilment of predefined milestones or targets. Consequently, our audit focuses on whether the payment conditions and horizontal eligibility conditions were met. As compliance of expenditure incurred by final recipients with EU and national rules is not a condition for RRF payments, our audit does not involve a systematic assessment of this aspect. The RRF Regulation does not stipulate further criteria on how to interpret the word 'satisfactory', and, therefore, leaves the Commission with broad discretion when assessing the satisfactory fulfilment of milestones and targets. The assessment of qualitative achievements requires several judgements to be made, leading to different possible interpretations. This risk is particularly present when milestones or targets are vaguely designed.

XXXVIII. We exercise professional judgement and maintain professional scepticism throughout the audit. We also:

(a) Identify and assess the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of EU law, whether due to fraud or error. We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

(b) Obtain an understanding of internal control relevant to the audit in order to design appropriate audit procedures, but not for the purpose of expressing an opinion on the effectiveness of the internal control.

(c) Evaluate the appropriateness of the accounting policies used by management and the reasonableness of management's accounting estimates and related disclosures.

(d) Conclude as to the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, as to whether material uncertainty exists owing to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that such material uncertainty exists, we are required to draw attention in our report to the related disclosures in the consolidated accounts or, if these disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the entity to cease to continue as a going concern.

(e) Evaluate the overall presentation, structure and content of the consolidated accounts, including all disclosures, and assess whether the consolidated accounts fairly represent the underlying transactions and events.

(f) Obtain sufficient appropriate audit evidence regarding the financial information on the entities covered by the EU's scope of consolidation to express an opinion on the consolidated accounts and the underlying transactions. We are responsible for directing, supervising and carrying out the audit, and are solely responsible for our audit opinion.

XXXIX. We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit observations, including any significant deficiencies in internal control.

XL. Of the matters discussed with the Commission and other audited entities, we determine which were of most significance in the audit of the consolidated accounts and are therefore the key audit matters for the current period. We describe these matters in our report unless law or regulation precludes public disclosure or, as happens extremely rarely, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh any public interest benefits.

20 July 2023

Tony MURPHY
President

European Court of Auditors
12, rue Alcide De Gasperi – L-1615 Luxembourg

Introduction

1.1. This chapter of the annual report:

(a) sets out the background to our *statement of assurance* and gives an overview of our findings and conclusions on the reliability of accounts and the regularity of the underlying *transactions*, including the Commission's regularity information;

(b) includes information on our reporting of cases of suspected fraud to the European Public Prosecutor's Office (EPPO) and the EU's anti-fraud office (OLAF) and our audits on EU action to combat fraud;

(c) summarises our audit approach (see ***Annex 1.1***).

1.2. The 2022 financial year was the second in which our work covered payments made from the *Recovery and Resilience Facility* (RRF)[6]. The results of this work form the basis for our 2022 opinion on the regularity of RRF expenditure. As the RRF is a temporary instrument delivered and financed in a way that is fundamentally different to budget spending under the *multiannual financial frameworks* (MFFs), we present our observations on RRF expenditure in a separate chapter (***chapter 11***).

EU spending is a significant tool for achieving policy objectives

1.3. EU spending is an important tool for achieving policy objectives, but not the only one. Other important measures include legislative frameworks, joint policy strategies and the right to free movement of goods, services, capital and people throughout the EU. In 2022, member states' total general government spending (€7 878 billion) represented 50.8 % of their *gross national income* (€15 494 billion). EU budget spending amounted to €196.0 billion, representing 2.5 % of the EU member states' total general government spending and 1.3 % of their gross national income (see ***Figure 1.1***). Taking into account additional payments from *assigned revenue* for RRF grants of €47.3 billion financed by EU debt (see paragraph ***2.7***), payments in 2022 totalled €243.3 billion[7].

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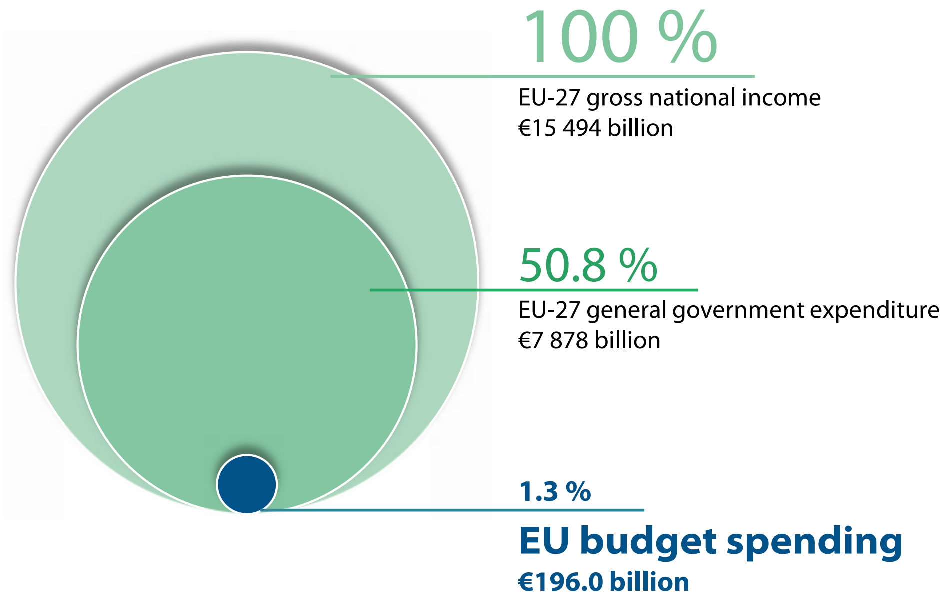
[6] Regulation (EU) 2021/241 establishing the RRF.

[7] 2022 consolidated annual accounts of the EU, budgetary implementation reports and explanatory notes, section 6.3 MFF: Implementation of payment *appropriations*.

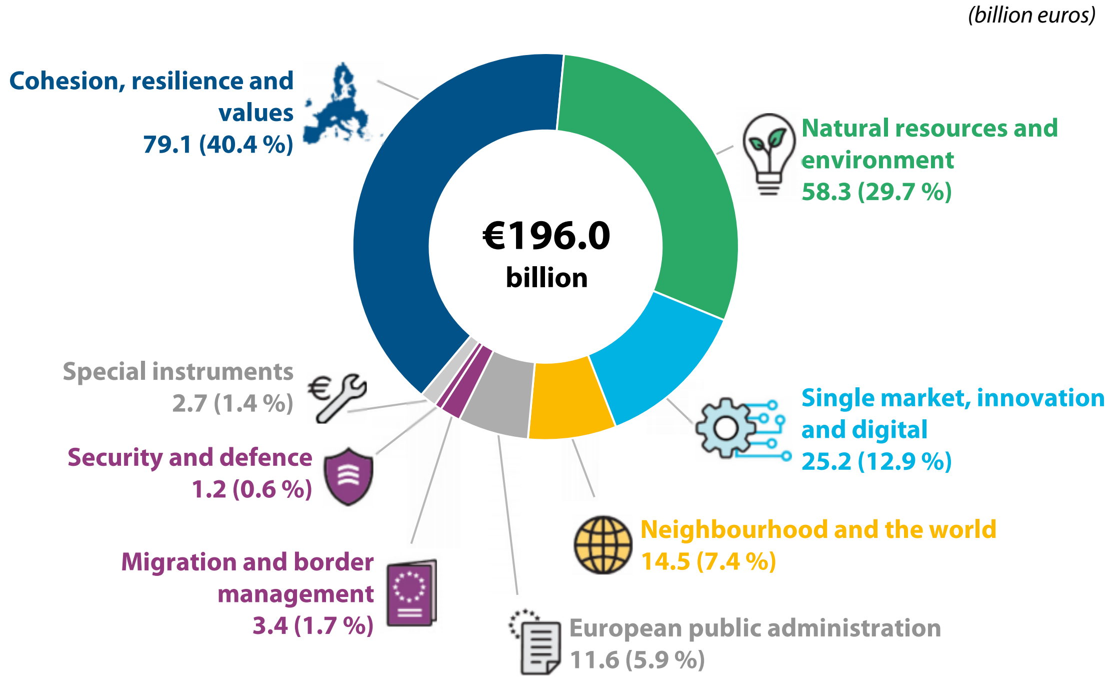
Figure 1.1 – 2022 EU budget spending and general government expenditure as a share of gross national income (GNI)



Source: ECA, based on data on EU-27 GNI from the 2022 consolidated annual accounts of the European Commission – Annex A – Revenue; EU-27 general government expenditure: Eurostat database — Government revenue, expenditure and main aggregates (data extracted on 25.4.2023); EU budget spending: European Commission – 2022 consolidated annual accounts of the European Union.

1.4. EU funds are disbursed to *beneficiaries* either through single payments/annual instalments or through a series of payments within multiannual spending schemes. Payments from the 2022 EU budget comprised €140.8 billion in interim or final payments, plus €55.2 billion in pre-financing. As ***Figure 1.2*** shows, the largest shares of the EU budget went to 'Cohesion, resilience and values' and 'Natural resources and environment', followed by 'Single market, innovation and digital'.

Figure 1.2 – 2022 EU budget spending per MFF heading



MFF 1 (Chapter 5) Single market, innovation and digital
MFF 2 (Chapter 6) Cohesion, resilience and values
MFF 3 (Chapter 7) Natural resources and environment
MFF 4 (Chapter 8) Migration and border management
MFF 5 (Chapter 8) Security and defence
MFF 6 (Chapter 9) Neighbourhood and the world
MFF 7 (Chapter 10) European public administration
Special instruments (outside MFF)

Source: ECA.

Audit findings for the 2022 financial year

Reliability of the accounts

The accounts were not affected by material misstatements

1.5. Our findings concern the EU's *consolidated accounts*[8] (the 'accounts') for the 2022 financial year. We received them, together with the accounting officer's letter of representation, on 30 June 2023, before the final date for presentation allowed under the *Financial Regulation*. The accounts are accompanied by a 'Financial highlights of the year' section[9], which is not covered by our audit opinion. In accordance with auditing standards, however, we have assessed its consistency with the information in the accounts.

1.6. The accounts published by the Commission show that, at 31 December 2022, total liabilities amounted to €577.2 billion, compared with €445.9 billion of total assets. The difference of €131.3 billion represented the (negative) net assets, comprising reserves and the portion of expenses already incurred by the EU up to 31 December that must be funded by future budgets. The (negative) *economic result* for 2022 was €91.9 billion. The amounts expensed for *NextGenerationEU* (NGEU) have contributed significantly to the mentioned negative amounts.

1.7. Our audit found that the accounts were not affected by material misstatements. We present the results of our work on the financial and budgetary management of EU funds in ***chapter 2***.

Key audit matters relating to the 2022 financial statements

1.8. Key audit matters are those matters that, according to our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon, but we do not

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[8] Article 241 of Regulation (EU, Euratom) 2018/1046.

[9] Recommended Practice Guideline 2 (RPG 2) – 'Financial Statement Discussion and Analysis' of the International Public Sector Accounting Standards Board (IPSASB).

provide a separate opinion on these matters. We report on key audit matters in our statement of assurance.

Regularity of transactions

1.9. We examined the EU's revenue and expenditure to assess whether its resources had been collected and spent in compliance with the applicable laws and regulations[10]. We present our audit results for revenue in ***chapter 4*** and for expenditure in ***chapters 5-10***. We report on RRF expenditure in ***chapter 11***.

Our audit covers revenue and expenditure transactions underlying the accounts

1.10. For revenue, we obtained reasonable assurance for our audit opinion by assessing selected key systems, complemented by transaction testing. The sample of 65 transactions examined was designed to be representative of all sources of EU budgetary revenue, which comprises revenue from own resources (customs duties and resources based on value added tax, non-recycled plastic packaging waste and gross national income) and revenue stemming from other sources. Our sample also covered external assigned revenue used to finance the non-repayable (grant) component[11] of the RRF (see paragraphs ***4.2-4.4***).

1.11. For expenditure, we selected a representative sample of 760 transactions, comprising transfers of funds from the EU budget to *final recipients* of EU spending (see paragraphs ***(18)*** and ***(19)*** of ***Annex 1.1***). Our testing of these transactions contributed to our statement of assurance and to our estimation of the proportion of irregular transactions in the overall audit population, in high-risk and low-risk expenditure (see paragraph ***1.18***) and in each MFF heading for which we provide a specific assessment (headings 1, 2, 3 and 7).

1.12. In 2022, our audit population for testing revenue amounted to €245.3 billion (see ***Figure 4.1***). Our population for testing expenditure totalled €166.8 billion, including NGEU top-ups to existing 2021-2027 MFF programmes, which have to be spent in line with sector-specific rules. These amounts include both contributions from

[10] Including transactions from the 2014–2020 MFF and previous MFFs.

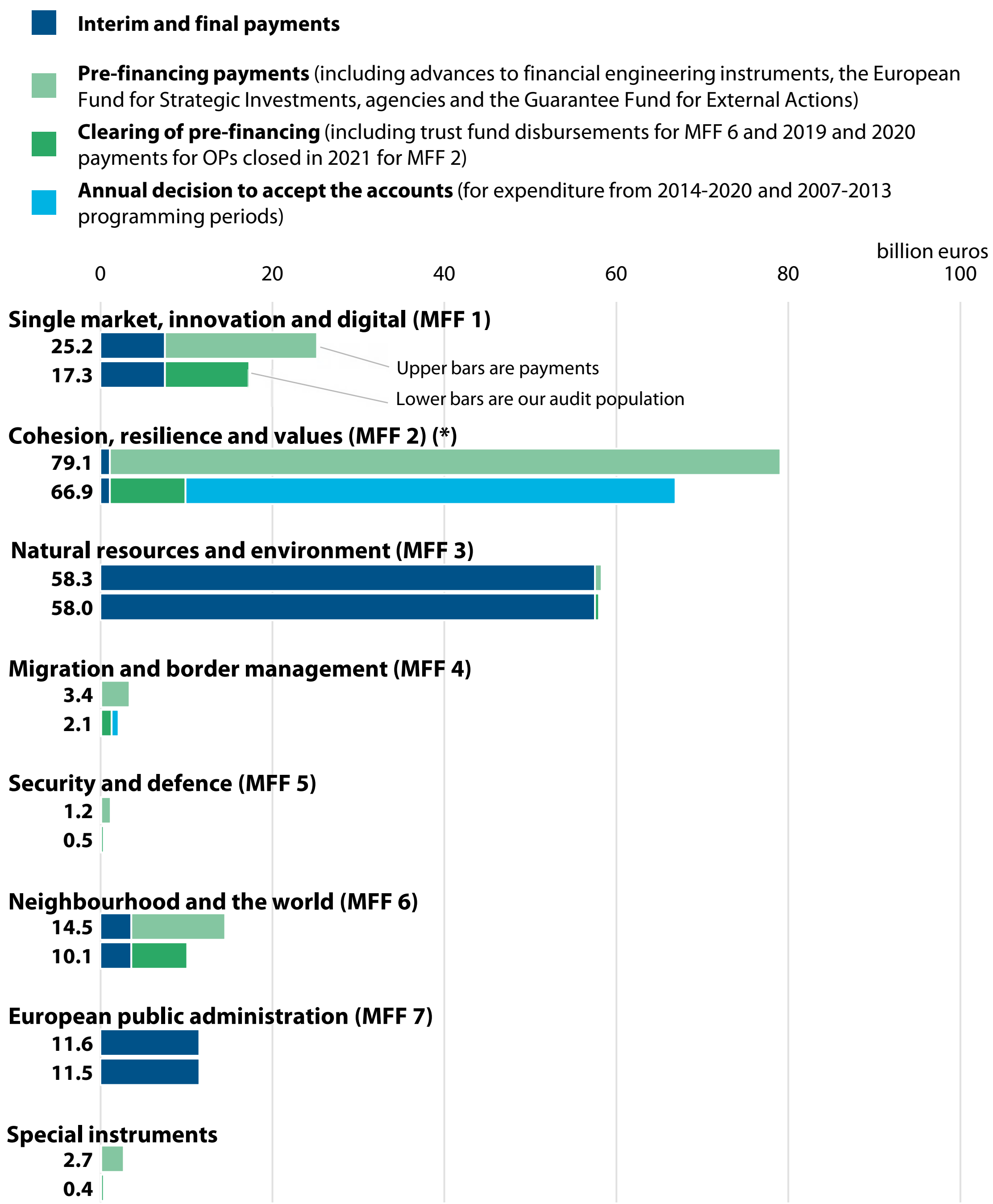
[11] This includes the amounts borrowed by the Commission to provide non-repayable financial support to member states under NGEU. The EU will have to repay these amounts in the future.

and payments to the United Kingdom, in line with the conditions outlined in the Withdrawal Agreement[12].

1.13. ***Figure 1.3*** shows our audit population for testing expenditure – broken down into interim and final payments; *clearing* of pre-financing; and annual decisions to accept the accounts – in comparison with EU spending per MFF heading (see paragraph ***(18)*** of ***Annex 1.1***).

[12] Articles 136 and 138 of the agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community.

Figure 1.3 – Comparison of our audit population (€166.8 billion) and EU budget spending (€196.0 billion) by MFF heading in 2022



(*) See paragraphs ***6.8*** and ***6.9*** regarding our audit population of (€66.9 billion) for 'Cohesion, resilience and values'.

Source: ECA.

Error continues to be present in specific types of spending

1.14. In relation to the regularity of EU revenue and expenditure, our key findings were:

(a) **Revenue:** the overall audit evidence indicates that the level of *error* in revenue transactions was not material. The systems for managing the revenue we examined were generally effective. However, some of the key internal *traditional own resources* (TOR) controls we assessed in certain member states, the management of TOR write-off cases, and the management of VAT reservations and TOR open points at the Commission were partially effective. Moreover, as we stated in our recent special report on GNI[13], risks in data compilation were well covered overall by the Commission's verification but there was scope for increased prioritisation of its actions. We also found that the implementation of selected actions in the Commission's Customs Action Plan that contribute to reducing the customs gap have been further delayed. This weakness does not affect our audit opinion on revenue, as it does not concern the transactions underlying the accounts, but rather the risk that TOR are incomplete (see ***chapter 4***).

(b) **Expenditure:** our audit evidence indicates that the overall level of error[14] was material at 4.2 %[15] (see ***Figure 1.4***). The level of error is mainly driven by 'Cohesion, resilience and values', which was the biggest contributor to this rate (2.5 percentage points), followed by 'Natural resources and environment' (0.8 percentage points), 'Neighbourhood and the world' (0.4 percentage points) and 'Single market, innovation and digital' (0.3 percentage points). Material error continues to be present in high-risk expenditure, which is mainly reimbursement-based (see paragraphs ***1.18***-***1.20***). In 2022, such expenditure represented 66.0 % of our audit population.

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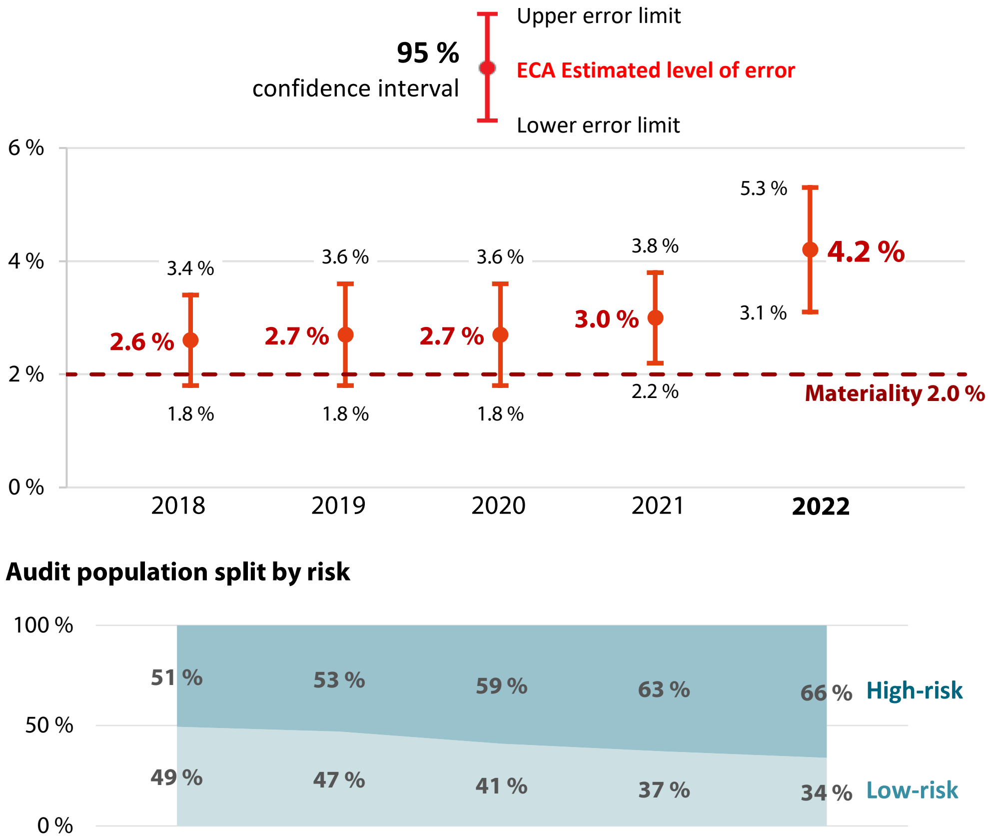
[13] Special report 25/2022: "Verification of Gross National Income for financing the EU budget - Risks in data compilation well covered overall, but scope for increased prioritisation of actions"

[14] Definition of 'error' in ***Annex 1.1*** , paragraph ***(24)***.

[15] We have 95 % confidence that the *estimated level of error* in the population lies between 3.1 % and 5.3 % (the lower and upper error limits respectively).

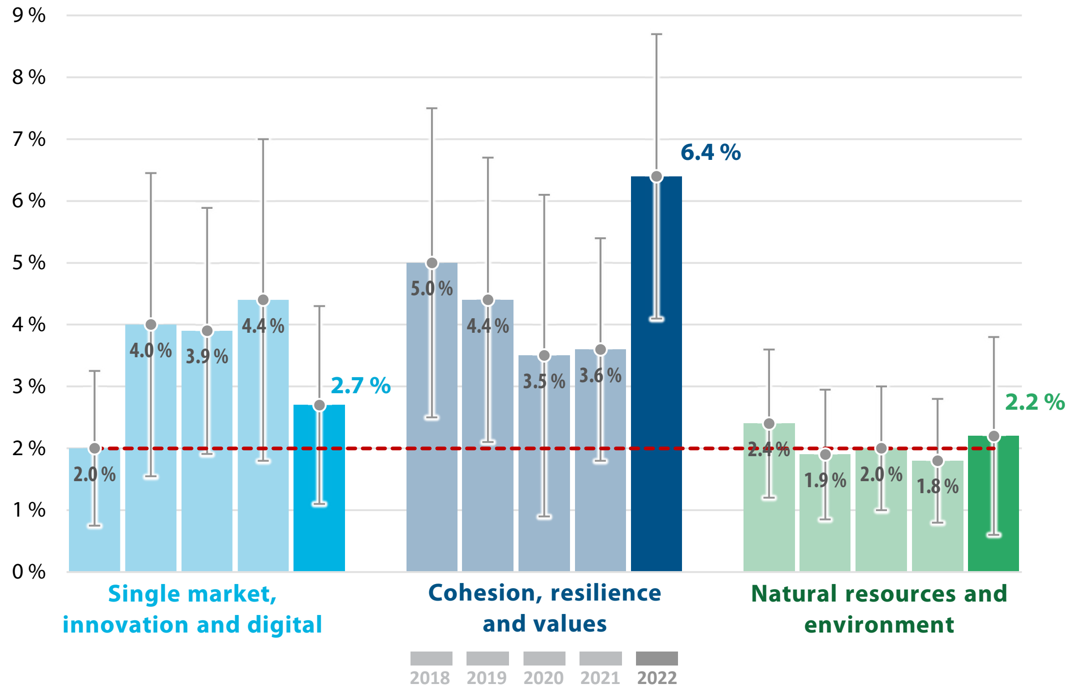
Figure 1.4 – Estimated level of error and audit population (2018-2022)



Source: ECA.

1.15. ***Figure 1.5*** compares our estimated levels of error for 'Single market, innovation and digital', 'Cohesion, resilience and values' and 'Natural resources and environment' between 2018 and 2022. Paragraphs ***1.16*** and ***1.17*** and ***chapters 5-7*** provide further information.

Figure 1.5 – Estimated levels of error for MFF headings 1, 2 and 3 (2018-2022)



Source: ECA.

1.16. This year, both our *estimated level of error* for MFF heading 2 ('Cohesion, resilience and values') and the number of errors we found were higher than in previous years. These increases do not follow a geographical pattern. However, we identified an increase in specific types of error (such as ineligible costs and non-compliance with public procurement rules) (see paragraph *1.22*). We also note that the end of the eligibility period for 2014-2020 programmes (31 December 2023) is approaching, with added absorption pressure. In addition, member states were given considerable flexibility in re-programming funds (including additional funding through *REACT-EU*) and declaring expenditure since 2020. Furthermore, during the COVID-19 period, the effectiveness of the checks and verifications by managing and audit authorities may have been reduced (see paragraph ***6.17***).

1.17. For MFF heading 3 ('Natural resources and environment') we note that the number of small over-declarations of area, for both direct payments and rural development measures, increased from 4 errors in 2021 to 16 errors in 2022, which may indicate specific weaknesses in some member states' management of the *Land Parcel Identification System*.

The complexity of rules and the way EU funds are disbursed have an impact on the risk of error

1.18. Following our risk analysis, which is based on our past audit results and assessment of management and control systems, we divided our audit population of underlying transactions into high-risk and low-risk expenditure in order to select our representative sample. We consider that:

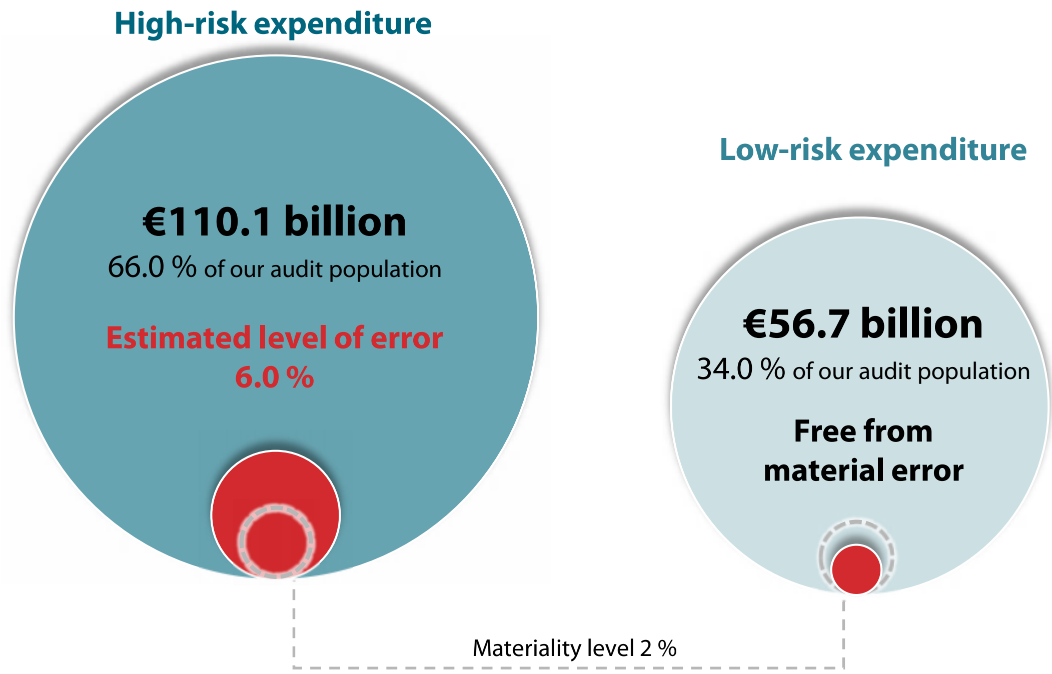
— the risk of error is lower for expenditure subject to simplified rules. This type of expenditure encompasses mainly those **entitlement-based payments** for which beneficiaries must meet certain – often simple – conditions, as well as part of administrative expenditure (salaries and pensions of EU civil servants);

— the risk of error is high for expenditure subject to complex rules. This is mainly the case for **reimbursement-based payments**, where beneficiaries have to submit claims for eligible costs they have incurred. To this end, as well as demonstrating that they are engaged in an activity eligible for support, they must provide evidence of the reimbursable costs they have incurred. In doing so, they must often follow complex rules regarding what can be claimed (eligibility) and how costs can be properly incurred (public procurement or *state aid* rules).

1.19. In 2022, we continued to find that low-risk expenditure was free from material error but that high-risk expenditure remained affected by material error. Our 2022 audit results therefore reaffirm our assessment, as reflected in our risk analysis and classification, that the way funds are disbursed has an impact on the risk of error.

1.20. Taking into account the results of our testing across all MFF headings, we estimate the level of error in high-risk expenditure at 6.0 % (2021: 4.7 %), which exceeds the *materiality threshold* of 2.0 %. ***Figure 1.6*** and paragraphs ***1.21***-***1.29*** provide more information on the high-risk population and the errors we found therein.

Figure 1.6 – Breakdown of the 2022 audit population into high-risk and low-risk expenditure

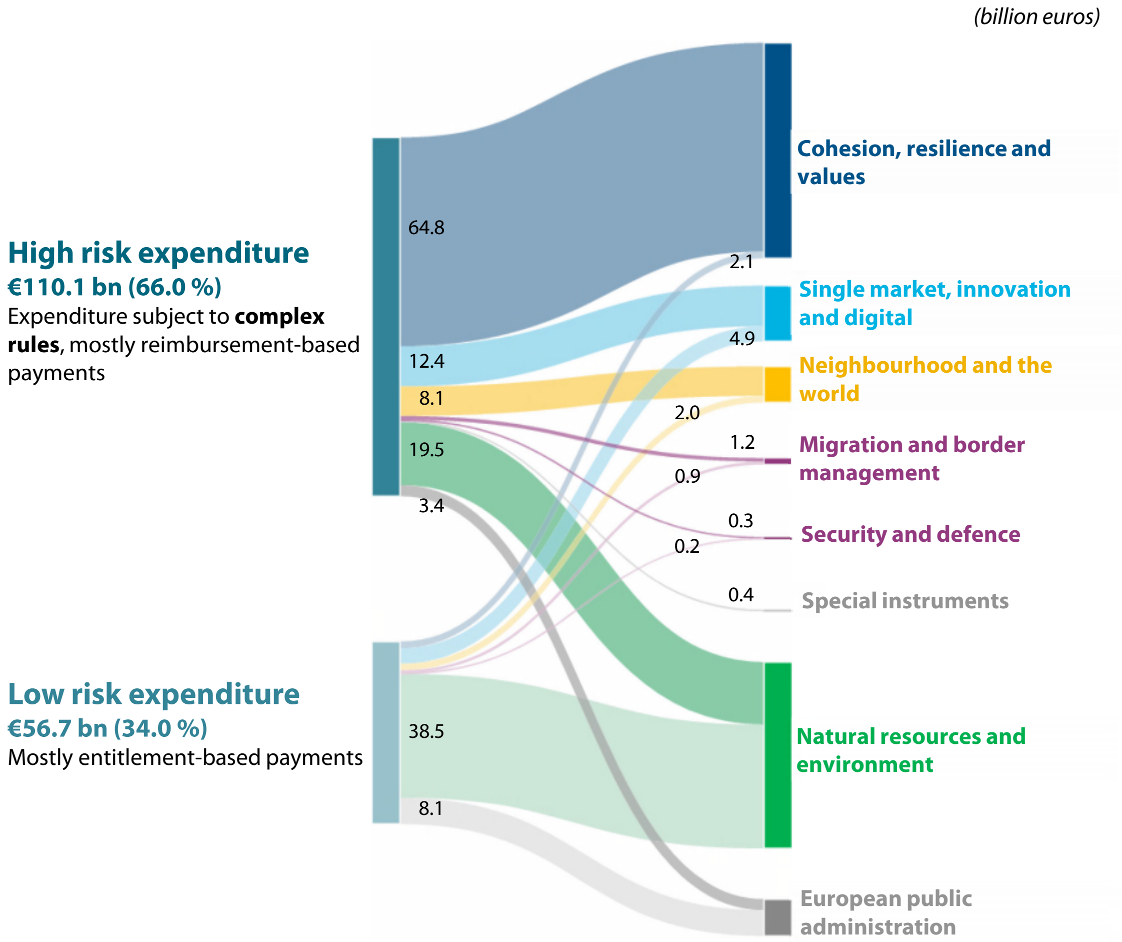


Source: ECA.

High-risk expenditure represents a substantial proportion of our audit population and is affected by material error

1.21. High-risk expenditure represents 66.0 % of our audit population and has increased compared to last year, when it represented around 63.2 %. ***Figure 1.7*** shows that 'Cohesion, resilience and values' makes up the largest share of our high-risk population (€64.8 billion), followed by 'Natural resources and environment' (€19.5 billion), 'Single market, innovation and digital' (€12.4 billion) and 'Neighbourhood and the world' (€8.1) billion. Paragraphs ***1.22***-***1.25*** summarise our findings for each of these headings.

Figure 1.7 – Breakdown of high-risk and low-risk expenditure by MFF heading



Source: ECA.

1.22. ‘Cohesion, resilience and values’ (***chapter 6***): expenditure in this area is mainly implemented through the *European Regional Development Fund* (ERDF), the *Cohesion Fund* (CF) and the *European Social Fund Plus* (ESF+). It is predominated by reimbursement-based payments, which we consider to be high-risk. The main types of error that we found and quantified were ineligible costs and projects and non-compliance with public procurement or internal market rules (particularly state aid rules).

1.23. ’Natural resources and environment’ (***chapter 7***): our results indicate that the level or error was material for spending areas we have identified as high-risk (rural development, market measures and the other MFF heading 3 policy areas outside the *common agricultural policy (CAP)*. These areas represent around 34 % of expenditure under this heading, which mainly takes the form of reimbursement.

Ineligible beneficiaries or expenditure and failure to meet agri-environmental commitments are the most common errors found in these areas.

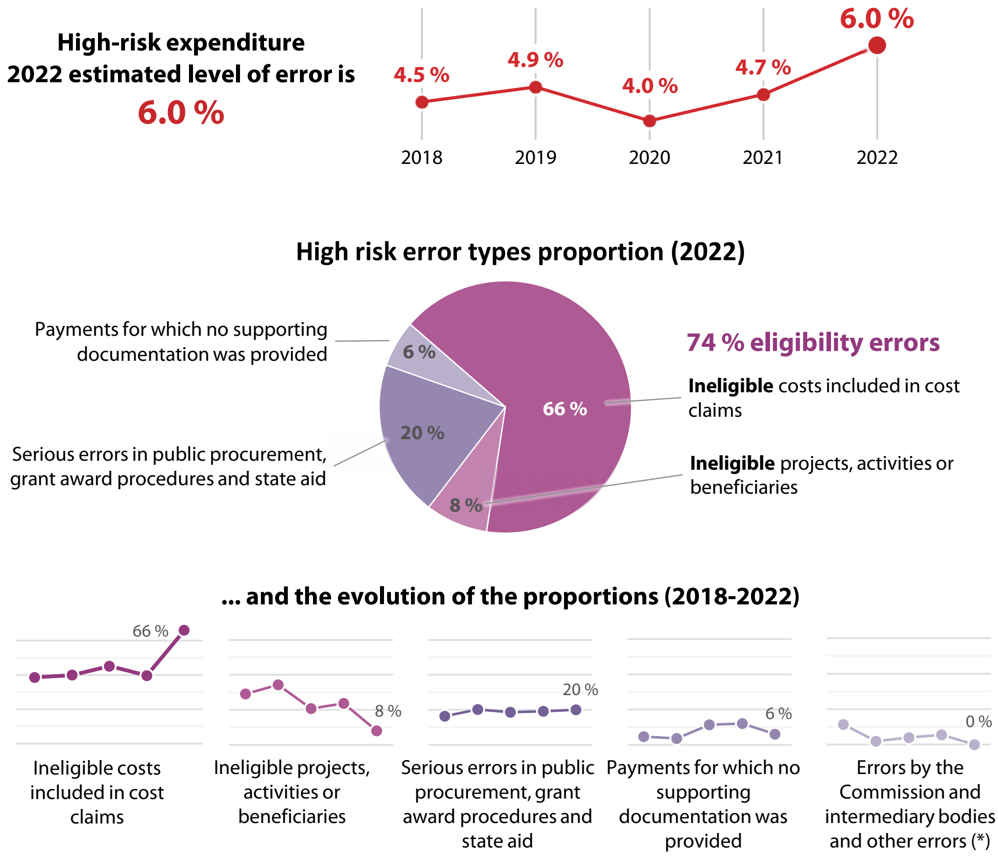
1.24. 'Single market, innovation and digital' (***chapter 5***): as in previous years in this area, research expenditure (mainly Horizon 2020) remains high-risk and the main source of errors. Errors in this area include different categories of ineligible costs (in particular, ineligible amounts related to direct personnel costs, other *direct costs* and subcontracting). In the case of other programmes and activities, we detected *quantifiable error* in one of the 35 transactions in the sample. It concerned an *irregularity* in the procurement procedure of a Connecting Europe Facility project.

1.25. 'Neighbourhood and the world' (***chapter 9***): expenditure in this area is mostly reimbursement-based and covers *external action* funded by the EU budget. We consider all types of expenditure under this heading high-risk, except for *budget support* payments and administrative expenditure, which represent around 20 %. Most errors found in the high-risk expenditure in this area concerned ineligible costs, absence of essential supporting documents, non-compliance with public procurement rules and expenditure not incurred.

Eligibility errors still contribute most to the estimated level of error for high-risk expenditure

1.26. As we have done in recent years, we describe in detail below the error types found in high-risk expenditure, as this is where material error persists. ***Figure 1.8*** shows the contribution of each error type to the estimated level of error for high-risk expenditure in 2022, alongside the estimates from 2018 to 2022.

Figure 1.8 – Contribution to the 2022 estimated level of error for high risk expenditure, by error type



(*) Errors by the Commission and intermediary bodies and other errors were 0.4 % in 2022.

Source: ECA.

1.27. In 2022, we continued to find that eligibility errors, mainly in 'Cohesion, resilience and values', 'Natural resources and environment' and 'Single market, innovation and digital', contributed the most to our estimated level of error for high-risk expenditure, at 74 % (2021: 63.3 %). Of these errors, ineligible costs included in costs claims contributed 66 % and ineligible projects, activities or beneficiaries 8 %.

1.28. In 2022, we found errors relating to infringements of state aid rules in 'Cohesion, resilience and values' and of public procurement rules in 'Cohesion, resilience and values', 'Neighbourhood and the world', 'European public administration', and 'Security and defence'. These errors contributed 20 % to our estimated level of error for high-risk expenditure (2021: 19.1 %).

1.29. In addition, payments for which no essential supporting documentation was provided continued to affect the level of error in high-risk expenditure, mainly in 'Neighbourhood and the world' and 'Cohesion, resilience and values'. These errors contributed 6 % (2021: 12.1 %) to our estimated level of error for high-risk expenditure.

We did not find a material level of error in low-risk expenditure

1.30. For low-risk expenditure, which represented 34.0 % of our audit population, we conclude that the estimated level of error is below our materiality threshold of 2.0 %, as was also the case in 2020 and 2021. Low-risk expenditure mainly comprises entitlement-based payments, part of administrative expenditure ('Salaries and pensions of EU civil servants' – ***chapter 10***) and budget support for non-EU countries ('Neighbourhood and the world' – ***chapter 9***) (see ***Figure 1.7***). Entitlement-based payments include *direct aid* for farmers ('Natural resources and environment' – ***chapter 7***) and student and other mobility actions under *Erasmus+* ('Cohesion, resilience and values' – ***chapter 6***).

The Commission's regularity information

1.31. The Commission is ultimately responsible for implementing the EU budget, regardless of the management mode (i.e. direct, indirect or shared management). The Commission accounts for its actions in five documents, which are included in the 'integrated financial and accountability reporting package':

(a) *Annual Management and Performance Report* (AMPR);

(b) consolidated annual accounts of the European Union;

(c) report on the follow-up to the *discharge* of the previous financial year;

(d) report to the discharge authority on internal audits carried out in the previous financial year;

(e) long-term forecast of future inflows and outflows of the EU budget.

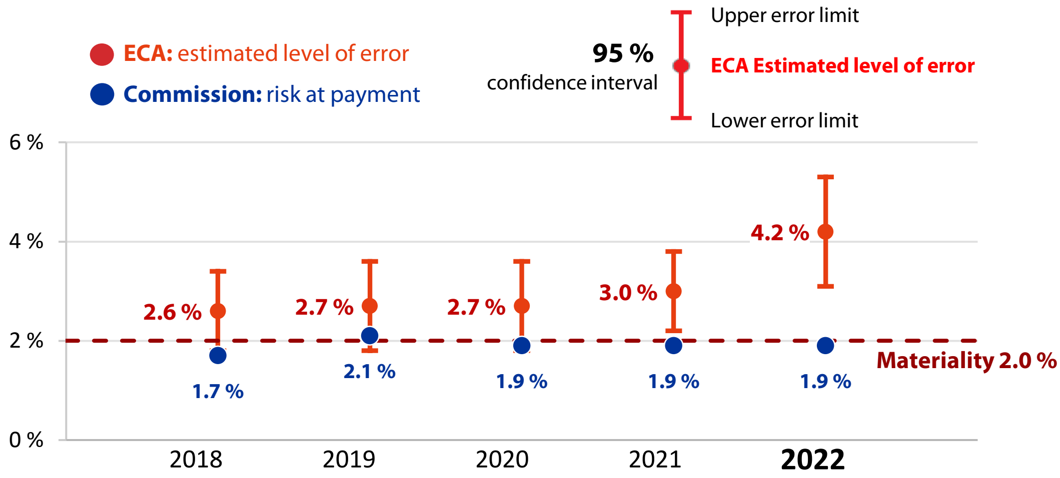
1.32. The AMPR summarises key information on internal control and financial management referred to in the *annual activity reports* (AARs) of the various Commission directorates-general (DGs). Responsibility for these reports follows the division of responsibilities set out in the Commission's governance arrangements. The directors-general are responsible for the reliability of the information provided in their respective AARs, while the college of Commissioners adopts the AMPR and therefore ultimately retains ownership of the report's production and of the information presented therein.

The Commission's estimate of error is significantly below our range

1.33. In the AMPR, the Commission presents its estimation of the risk at payment[16] for the transactions underlying the 2022 accounts. The risk at payment represents the Commission's estimate of the amount, at the moment of payment, that has been paid without the applicable rules having been followed. This concept is closest to our estimate of the level of error.

1.34. ***Figure 1.9*** presents the Commission's figures for the risk at payment alongside the range of our estimated level of error. The Commission's risk at payment for 2022 is 1.9 %, which is significantly below our estimated level of error of 4.2 % (2021: 3.0 %) and below our range, which is between 3.1 % and 5.3 %.

Figure 1.9 – The Commission's estimate of the risk at payment versus our estimated level of error



Source: ECA.

1.35. The risk at payment is disclosed individually for each directorate-general (DG) in its AAR and as aggregate figures for each policy area and for the Commission as a whole in the AMPR. ***Figure 1.10*** compares our estimated level of error with the Commission's estimates for the three biggest MFF headings for which we provide a

[16] Article 247(1)(b)(i) of the Financial Regulation requires that the AMPR include an estimation of the level of error in EU expenditure.

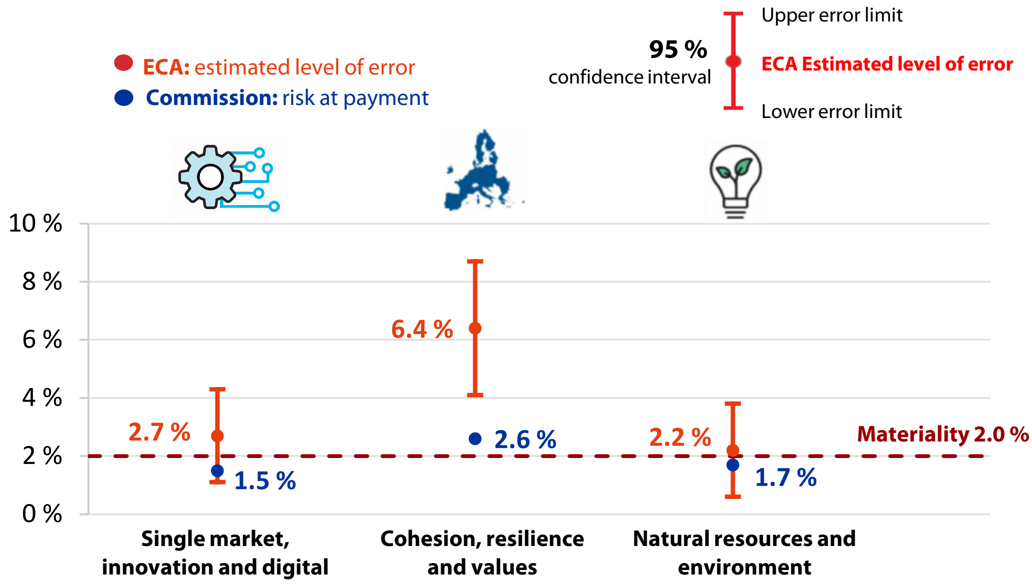
specific assessment. The comparison shows that the Commission's figures are below our estimates for three policy areas. We found that:

— for heading 1 **'Single market, innovation and digital'**, the Commission's estimate of the risk at payment of 1.5 % was in the lower half of our range, below our estimated level of error (see paragraphs ***5.7*** and ***5.40***).

— for heading 2 **'Cohesion, resilience and values'**, the Commission's estimate was 2.6 %, significantly below our range for the estimated level of error (see paragraphs ***6.16*** and ***6.77***).

— for heading 3 **'Natural resources and the environment'**, the Commission's estimate of the risk at payment (1.7 %) was in the lower half of our range, below our estimated level of error (see paragraphs ***7.15*** and ***7.34***).

Figure 1.10 – Our estimate of the 2022 level of error versus the Commission's estimate of the risk at payment for MFF headings 1, 2 and 3



Source: ECA.

The Commission's risk assessment is likely to underestimate the level of risk

1.36. In the AMPR, the Commission presents its overall risk assessment of 2022 annual expenditure in order to identify and focus action on high-risk areas. The Commission divides this annual expenditure into areas with a low (less than 2.0 %), medium (between 2.0 % and 2.5 %) and high (above 2.5 %) estimated risk at payment.

It arrives at this split by estimating the risk at payment for each programme and other relevant expenditure segment. For ‘Natural resources and environment’ and ‘Cohesion, resilience and values’, it estimates the overall risk at payment for individual paying agencies and operational programmes in the member states and assigns them to the appropriate risk category (low, medium or high). Based on this approach, the Commission estimates the risk at payment to be low for 63 % (2021: 55 %) of expenditure, medium for 12 % (2021: 23 %) and high for 25 % (2021: 22 %).

1.37. However, our work has revealed the following limitations in the Commission’s *ex post* checks, which, taken together, affect the robustness of the Commission’s risk assessment:

- MFF heading 1 **‘Single market, innovation and digital’** (total relevant expenditure by the Commission: €20 billion) mainly comprises expenditure classified by the Commission as low-risk (65 % of this heading’s total expenditure). However, we have previously reported weaknesses in the Commission’s *ex post* audits in this area[17], which underestimate the Commission’s estimate of risk at payment for the programmes concerned. For 2022, we estimated a level of error of 2.7 % in MFF heading 1 (see paragraph ***5.7***), which indicates that these weaknesses still exist.

- MFF heading 2 **‘Cohesion, resilience and values’** (total relevant expenditure by the Commission: €68 billion) comprises operational programmes classified by the Commission mainly as either low- or medium-risk (64 % of this heading’s total expenditure) depending on their confirmed error rates. For 2022, we estimated a level of error of 6.4 % in MFF heading 2 (see paragraph ***6.77***). As stated in paragraph ***6.68***, the reliability of the regularity information reported by the Commission in its AARs largely depends on the quality of programme authorities’ work. The Commission performs desk reviews and compliance audits to review and assess the work of audit authorities. Through our audit work, we have found that the Commission continues to detect irregularities through its compliance audits, but desk reviews have inherent limitations in confirming the *residual total error rate*[18]. For 2022, our audit findings suggest that the Commission’s risk at payment indicator has been underestimated and that some programmes may therefore have been incorrectly classified as low- or medium-risk.

- MFF heading 6 **‘Neighbourhood and the world’** (total relevant expenditure by the Commission: €14 billion) is classified by the Commission mainly as low-risk (90 %

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[17] 2020 annual report, paragraph 1.37 and 2019 annual report, Box 1.11.

[18] Special report 26/2021: “Regularity of spending in EU Cohesion policy – Commission discloses annually a minimum estimated level of error that is not final”.

of the heading's total expenditure). The error rates reported in the residual error rate (RER) study are an important contributor to the risk at payment for this heading. We have concluded both in the past[19] and in this report (see paragraph ***9.21***) that limitations in the RER study may contribute to the underestimation of the risk at payment in this heading, which in turn would affect its risk classification. In addition, we continue to find a high number of quantifiable errors in 'Neighbourhood and the world' expenditure and our audit results indicate that the risk of error in this heading is high (see paragraphs ***9.8*** and ***9.27***)

The Commission has improved its reporting on financial corrections and recoveries

1.38. The Commission, in line with the Financial Regulation, provides information in the AMPR on preventive and corrective measures to protect the budget from illegal or irregular expenditure. In last year's annual report[20], we found that the Commission's presentation of *financial corrections* and recoveries in the 2021 AMPR was inadequate and prone to misunderstanding, as the Commission had added the amounts resulting from preventive and corrective measures and presented this total as 'corrections for past payments'[21].

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[19] 2021 annual report, paragraph 8.22.

[20] *Ibid*., paragraphs 1.42 - 1.45.

[21] 2021 AMPR, Volume II, Annex 2, section 2.1, p. 49.

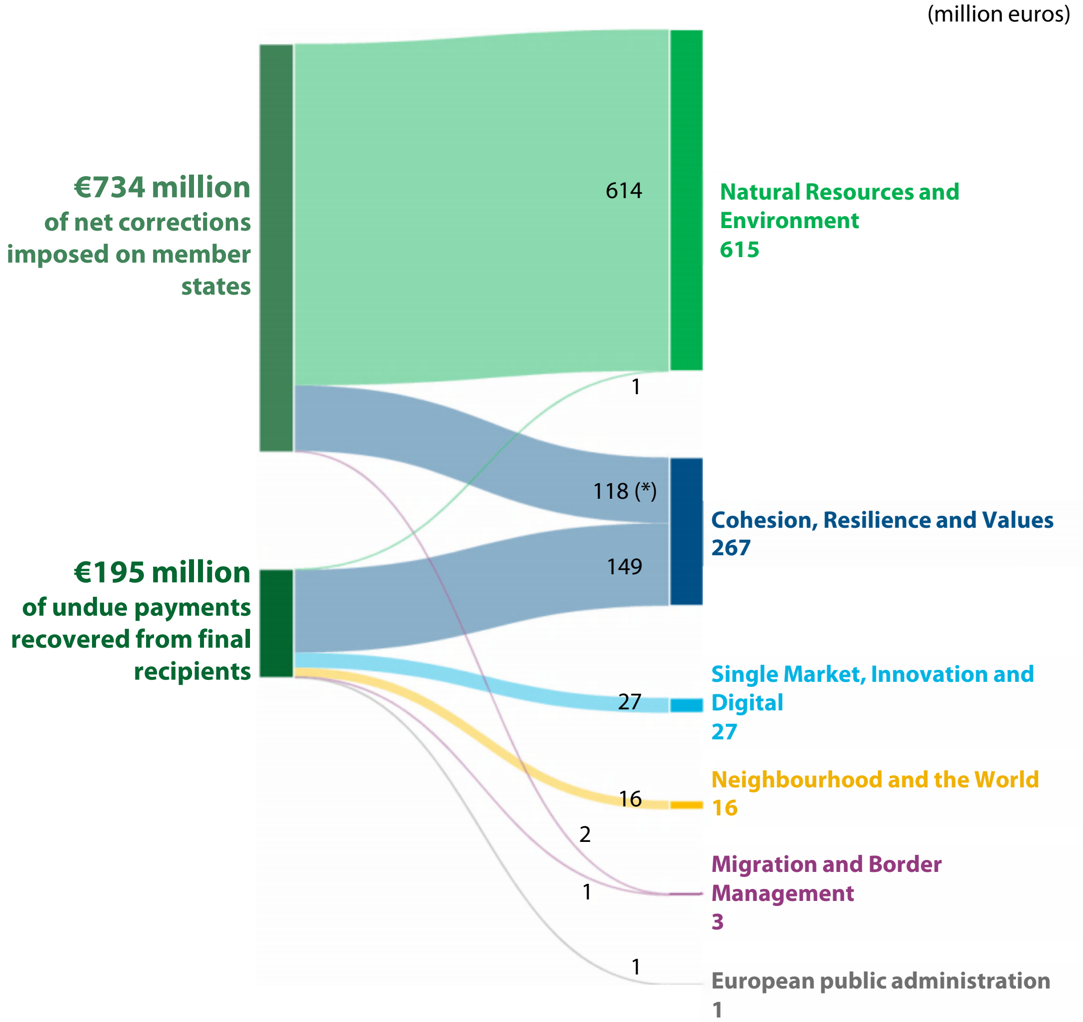
1.39. In the 2022 AMPR, the Commission addressed our observation by clarifying that the total amount reported (€4 950 million) includes preventive and corrective measures taken by both the Commission and the member states[22]. It also provided detailed information on the total of preventive and corrective measures and their origin (member state or EU controls), and presented only the amounts of net financial corrections and recoveries applied in 2022 to past payments or accepted expenditure (corrective measures) as a percentage of relevant expenditure in 2022[23].

1.40. ***Figure 1.11*** shows the composition of actual corrections implemented by the Commission and reported in the 2022 AMPR (€929 million (2021: €765 million)). Net corrections imposed on member states in 2022 totalled €734 million (2021: €523 million), and undue payments recovered from final recipients amounted to €195 million (2021: €242 million).

[22] *Ibid*., p. 59.

[23] 2022 AMPR, Volume III, Annex 5, section 5.4, pp. 30 and 31.

Figure 1.11 – Financial corrections and recoveries (€929 million) implemented by the Commission, as reported in the 2022 AMPR



(*) This amount relates to previous programming periods.

Source: ECA, based on 2022 AMPR.

1.41. The legal provisions introduced for the 2014-2020 period gave the Commission more power to ensure that irregular expenditure is no longer reimbursed from the EU budget. They did this by allowing the Commission to apply net financial corrections in cases where member states fail to identify serious deficiencies, subject to the conditions set out in Article 145(7) of the *Common Provisions Regulation*. In our 2021 annual report[24], we noted that, as at the end of 2021, no net corrections had been imposed on member states for the 2014-2020 period in the area of 'Cohesion'.

[24] 2021 annual report, paragraph 1.44.

As of the end of 2022, the Commission had still not implemented any net financial correction in this area (see paragraph ***6.71***).

1.42. We examined whether, by the end of 2022, the Commission (the main directorates-general managing cohesion spending: Employment, Social Affairs and Inclusion (DG EMPL) and Regional and Urban Policy (DG REGIO)) had disclosed any information about ongoing net financial corrections. DG REGIO reported that it had not yet applied any net financial corrections. According to DG EMPL's AAR, the conditions for applying net financial corrections seemed to have been met in one case and a procedure to this end may be initiated in 2023 (see paragraph ***6.72***).

Reporting on rule-of-law procedures

1.43. Following our recommendation in last year's annual report[25], DG REGIO and DG EMPL included a summary, in their respective 2022 AARs, of the status of the Commission's implementation of the Budgetary Conditionality Regulation (see paragraph ***6.77***).

[25] *Ibid*., recommendation 5.6.

We report suspected fraud to the EPPO and OLAF

1.44. *Fraud* is any intentional act or omission relating to the use or presentation of false, incorrect or incomplete statements or documents, the non-disclosure of required information and the improper use of EU funds[26]. Fraud has the effect of harming or potentially harming the EU's financial interests.

1.45. The primary responsibility for preventing and detecting fraud rests with both the management of an entity and those charged with its governance. Article 325 of the TFEU requires the EU and its member states to counter fraud or other illegal activities affecting the EU's financial interests.

1.46. As the EU's external auditor, we do not have a mandate to investigate cases of suspected fraud against the EU's financial interests. We take account of the risk of fraud before starting audits (see paragraphs ***(31)***-***(33)*** in ***Annex 1.1***) and review our procedures regularly.

1.47. We forward to the European Public Prosecutor's Office (EPPO) any suspicions of criminal offences falling within its competence and involving participating member states, and forward to the European Anti-fraud Office (OLAF) any suspicions of fraud, corruption or other illegal activity affecting the EU's financial interests. Such suspicions may arise either from our audit work (including performance audits) or from information reported to us directly by third parties. The EPPO and OLAF then follow up on these cases, decide whether to launch a criminal (in the case of the EPPO) or an administrative (in the case of OLAF) investigation and cooperate as necessary with member state authorities. Since March 2022, we have forwarded cases of suspected fraud to both the EPPO and OLAF simultaneously where the matter falls within the competence of both bodies.

1.48. In 2022, we reported to OLAF 14 cases (2021: 15 cases) of suspected fraud that we had identified during our audit of 2021 expenditure. Upon this reporting, OLAF has already opened two investigations. In parallel, we reported six of these cases to

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[26] Article 3 of Directive (EU) 2017/1371 on the fight against fraud to the Union's financial interests by means of criminal law (the 'PIF Directive').

the EPPO, from which the EPPO has opened three investigations. During our audit of 2022 expenditure, we already identified 14 cases of suspected fraud.

1.49. The most frequently suspected fraudulent or criminal acts were: artificial creation of conditions necessary for EU financing; use of grants for unauthorised purposes; declaration of costs not meeting eligibility criteria; and procurement irregularities. According to OLAF, it recommended the recovery of a total of €541.8 million from closed investigations based on information arising from our audit work between 2011 and 2022.

1.50. As well as reporting cases to the EPPO and OLAF, we report in this annual report on how the Commission and member states have implemented their fraud risk policies. In ***chapter 5***, we report that the lump sum decision did not contain the justification required under Article 181(4)(a) of the Financial Regulation with regard to the risk of irregularities and fraud (see paragraphs ***5.29*** and ***5.30***). In ***chapter 6***, we report that, despite improvements, audit authorities continue to address the risk of fraud insufficiently (see paragraphs ***6.55*** and ***6.56***), and that member state authorities do not report suspected fraud cases in the Irregularity Management System (IMS) as required (see paragraphs ***6.57*** and ***6.58***).

1.51. In addition, we cover fraud in separate audits. We have completed our audit on conflict of interest in shared management (the CAP and cohesion policy)[27]. We have also followed up the recommendations of our special report on fraud in cohesion spending[28] (see paragraph ***6.62***). This follow-up found that some weaknesses still persisted: in particular, the Commission had not yet published any specific guidance for the 2021-2027 period on anti-fraud measures and had not taken measures to regularly disseminate best practices. In addition, six member states had still not adopted a national anti-fraud strategy. Moreover, we cover specific fraud-related risks in our audits of the Commission's and member states' RRF control systems.

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[27] Special report 06/2023: "Conflict of interest in EU cohesion and agricultural spending – Framework in place but gaps in transparency and detection measures".

[28] Special report 06/2019: "Tackling fraud in EU cohesion spending – managing authorities need to strengthen detection, response and coordination".

Conclusions

1.52. This chapter supports the audit opinion presented in the statement of assurance. We present the related audit results in paragraphs ***1.53*** and ***1.54***.

Audit results

1.53. We conclude that the accounts were not affected by material misstatements.

1.54. As for the regularity of transactions, we conclude that revenue transactions were free from material error. For expenditure, our audit results show that the estimated level of error increased compared to last year, from 3.0 % to 4.2 %. This was due mainly to the increase in MFF heading 2 ('Cohesion, resilience and values'). We conclude that high-risk (mainly reimbursement-based) expenditure was affected by a material level of error. This year, the proportion of high-risk expenditure in our audit population further increased to 66.0 %, and it continues to represent a substantial part of our audit population.

1.55. The Commission's estimate of error (risk at payment), as disclosed in the 2022 AMPR, is 1.9 %, which is significantly below our range.

1.56. Limitations in the Commission's and member states' *ex post* checks in MFF headings 1, 2 and 6 affect the risk at payment disclosed in the AMPR, and hence the Commission's risk assessment. Our review of the Commission's reporting on financial corrections and recoveries shows that the Commission addressed the associated observation from our 2021 annual report by improving the presentation of the relevant data.

Annexes

Annex 1.1 – Audit approach and methodology

(1) This annex outlines our approach and methodology for auditing the reliability of accounts and the regularity of transactions underlying the accounts of revenue and expenditure (budget spending) under the multiannual financial framework (MFF). Our audit approach for expenditure under the Recovery and Resilience Facility (RRF), which is different and temporary, is outlined in ***chapter 11***.

(2) This annex also refers to the main differences between our audit approach and the way the Commission estimates and reports on the level of irregularities, while exercising its duties as manager of the EU budget. To this end, we clarify how we:

— extrapolate the errors found and structure our audit work around MFF headings (paragraph ***(12)***);

— apply EU and national rules (paragraph ***(15)***) and

— quantify procurement errors (paragraph ***(27)***).

(3) Our audit approach and methodology conform to the international standards on auditing and ensure that our audit opinions are supported by sufficient and appropriate audit evidence. Our audit methodology is available on our website. In our planning, we consider the risk of errors occurring (inherent risk) and the risk of errors not being prevented or detected and corrected (control risk).

PART 1 – Audit approach for the reliability of accounts

(4) We examine the EU's consolidated accounts to determine their reliability. These consist of:

(a) the consolidated financial statements; and

(b) the budgetary implementation reports.

(5) The consolidated accounts should properly present, in all material respects:

(a) the financial position of the European Union at year end;

(b) the results of its operations and cash flows; and

(c) the changes in net assets for the year ended.

(6) In our audit, we:

(a) evaluate the accounting control environment

(b) check the functioning of key accounting procedures and the year-end closure process;

(c) analyse the main accounting data for consistency and reasonableness;

(d) analyse and reconcile accounts and/or balances;

(e) perform substantive tests of commitments, payments and specific balance sheet items, based on representative samples;

(f) use the work of other auditors where possible, in accordance with international standards on auditing, particularly when auditing borrowing and lending activities managed by the Commission for which external audit certificates are available.

PART 2 – Audit approach for the regularity of transactions

(7) For our work on the general budget, underlying transactions comprise payments recorded in the EU's budgetary accounts and revenue and expenses included in the EU's statement of financial performance.

(8) Our audit approach for assessing whether the expenditure transactions underlying the accounts comply with EU rules and regulations is to rely mainly on direct testing of compliance for a randomly selected, representative sample of transactions. This may be complemented by an examination of selected management and control systems.

Examination of management and control systems

(9) The Commission, other EU institutions and bodies, member state authorities, beneficiary countries and regions establish control systems for managing the risks to the budget and overseeing and ensuring the regularity of transactions. Every year, we examine selected management and control systems to identify areas for improvement. Furthermore, the results of this work contribute to our risk assessment (see paragraphs ***(11)*** and ***(29)***).

(10) We present the results of our systems work, together with recommendations for improvement, in ***chapters 4-10***.

Selection and testing of transactions

(11) We determine the total sample size for the overall EU expenditure population by categorising EU expenditure into low-risk (mainly entitlement-based expenditure) and high-risk (mainly reimbursement-based expenditure) populations.

(12) We organise our audit work and report its results around the various MFF headings, in line with the budget structure decided by the legislator. We base the sample size for each MFF heading on its accepted expenditure amount, its risk categorisation and whether or not we provide a specific assessment. For this purpose, we use an assurance model which builds on our risk assessment and takes account of the assurance that can be derived from the management and control systems.

(13) Under each MFF heading for which we provide a specific assessment (***chapters 5-7*** and ***10***), we test a representative sample of transactions in order to provide an 'estimated level of error' (ELE) for this heading.

(14) We use *monetary unit sampling* (MUS) to select claims or payments and, at a lower level, individual items within a transaction (e.g. project invoices, parcels in a claim by a farmer).

(15) For each selected transaction, we determine whether the claim or payment was made for the purpose approved in the budget and specified in legislation and in compliance with applicable laws and regulations. Our assessment takes due account of the interpretation of EU and national law provided by national judicial courts or national independent and authoritative bodies and the European Court of Justice.

(16) We examine how the amount of the claim or payment was calculated (for larger claims, we base this on a selection representative of all items in the transaction). This involves tracing the transaction from the budgetary accounts to the final recipient (e.g. a farmer, the organiser of a training course, or a development aid project), testing compliance at each level.

(17) When testing revenue transactions (***chapter 4***), our examination of value added tax and GNI-based own resources takes as a starting point the macroeconomic aggregates based on which these are calculated. For the own resource based on non-recycled plastic packaging waste, we review the process for compiling forecast data, as member states will only provide their first statistical estimates in 2023. We examine the Commission's controls on these member state contributions up to the point they were received and recorded in the consolidated accounts. For traditional own resources, we examine the customs

authorities' accounts and the flow of duties – again up to the point they were received and recorded by the Commission.

(18) We examine expenditure both as at the point it was incurred by final recipients of EU funds in undertaking activities and as at the point it was subsequently accepted by the Commission ('*accepted expenditure*'). This applies to all categories of payments (including those made to purchase assets). In practice, this means that our population of transactions covers interim and final payments. We do not examine pre-financing payments at the point they were made, but rather once:

(a) the final recipient of EU funds (e.g. a farmer, a research institute, a company providing publicly procured works or services) has provided evidence of their use; and

(b) the Commission (or other institution or body managing EU funds) has accepted the final use of the funds by clearing the advance.

(19) Changes to the previous 2014-2020 MFF legislation for 'Cohesion' had an impact on what the Commission considers to be 'accepted expenditure' in this area. Since 2017, our audit population for this MFF heading has consisted of expenditure included in the accounts accepted annually by the Commission. This means we have tested transactions for which member states are supposed to have implemented all relevant actions to correct errors that they themselves identified. The objective of our transaction testing in the area of 'Cohesion', in addition to contributing to the 2022 statement of assurance, is to review the work of audit authorities and conclude on the reliability of the Commission's key regularity indicator for this area – the residual error rate.

(20) Our audit sample is designed to provide an estimate of the level of error for expenditure as a whole rather than for individual transactions (e.g. a particular project). The error rates reported for selected cost items should not be seen as a conclusion on their respective transactions; rather, they contribute directly to the overall level of error for EU expenditure as a whole.

(21) We do not examine transactions in every member state, *beneficiary* state and region in any given year. While we may name certain member states, beneficiary states and/or regions, this does not mean that the examples do not occur elsewhere. The illustrative examples presented in this report do not provide a basis for drawing conclusions on the specific member states, beneficiary states and/or regions concerned.

(22) We consider whether we can make efficient use of the checks on regularity already performed by other auditors. If we want to use the results of these checks in our audit work, in line with international standards on auditing, we assess the independence and competence of those other auditors and the scope and adequacy of their work.

(23) For the part of our audit population concerning EU agencies and joint undertakings, we make use of the results of the audit work carried out for our respective specific annual reports on these agencies[29] and undertakings[30].

Evaluation of the results of transaction testing

(24) We define an 'error' as an amount of money that should not have been paid out from the EU budget. Errors occur when money is not used in compliance with the relevant EU legislation or with specific national rules.

(25) An error may concern all or part of the amount involved in an individual transaction. We consider whether errors are quantifiable or non-quantifiable, i.e. whether or not it is possible to measure how much of the amount examined was affected by the error.

(26) Errors detected and corrected prior to and independently of our checks are excluded from the calculation of error, since their detection and correction demonstrate that the management and control systems have worked effectively.

(27) Our criteria for quantifying public procurement errors may differ from those used by the Commission or member states. We quantify only serious breaches of procurement rules. We quantify as 100 % procurement errors only those infringements that have prevented the best bid from winning the tender, thereby rendering all expenditure under the contract ineligible. We do not use flat rates for the different types of infringement of procurement rules, unlike the Commission[31]. We base our quantification of public procurement errors on the amounts of ineligible expenditure in the transactions examined.

(28) For those MFF headings where we provide a specific assessment, as well as for revenue and for the EU budget as a whole, we present an 'estimated level of

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[29] 2021 annual report on EU agencies.

[30] 2021 annual report on EU joint undertakings.

[31] Commission Decision C(2019)3452 of 14.5.2019, which includes an annex laying down the guidelines for determining financial corrections to be made to expenditure financed by the EU for non-compliance with the applicable rules on public procurement.

error' (ELE), which takes account of quantifiable errors only and is expressed as a percentage. Examples of errors are quantifiable breaches of applicable regulations, rules or contract or grant conditions. We also estimate the lower error limit (LEL) and the upper error limit (UEL).

(29) We no longer base our statement of assurance solely on our overall estimate of error. Since 2016, we have continued to identify low-risk areas of the EU budget, where we expect to find a non-material level of error in accepted expenditure, and high-risk areas, where we assume there will be a material level of error. For this purpose, in addition to inherent and control risks, we consider our assessment of management and control systems, together with past audit results. For example, based on our past audit experience, we treat some entitlement-based rural development expenditure under MFF heading 3 and other administrative expenditure (i.e. non-salary expenditure) under MFF heading 7 as high-risk. This split enables us to determine as efficiently as possible whether material errors found are 'pervasive' (see paragraph ***(37)***).

(30) Our approach is not designed to gather data on the frequency of error in the whole population. Therefore, figures presented on the number of errors detected in an MFF heading, in expenditure managed by a DG or in spending in a particular member state are not an indication of the frequency of error in EU-funded transactions or in individual member states.

PART 3 – Audit procedures in relation to fraud

(31) We identify and assess the risks of material misstatement of the consolidated accounts and of material non-compliance of the underlying transactions with the requirements of EU law, whether due to fraud or error.

(32) We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

(33) If we have reason to suspect that fraudulent activity has taken place, we report this to the EPPO and OLAF, depending on their competence.

PART 4 The statement of assurance – forming our audit opinion

(34) We base our opinion on sufficient, relevant and reliable audit evidence on the regularity of transactions underlying the EU's consolidated accounts. We obtain this evidence through an examination of management and control systems and through transaction testing, and report on the results in ***chapters 4-10***. This work allows us to arrive at an informed opinion as to whether errors in the population exceed or fall within the materiality limits.

(35) We use the level of 2.0 % as materiality threshold for our opinion. We also take account of the nature, amount and context of errors and other information available.

(36) Where we find a material level of error and determine its impact on the audit opinion, we must determine whether the errors, or the absence of audit evidence, are 'pervasive'[32]. Where errors are material and pervasive, we present an adverse opinion.

(37) An error and/or absence of audit evidence are 'pervasive' if, in the auditor's judgment, they are not confined to specific elements, accounts or items in the financial statements (i.e. they occur throughout the accounts or transactions tested). Even if they are thus confined, they are still pervasive if they represent, or could represent, a substantial proportion of the financial statements, or relate to disclosures which are fundamental to users' understanding of the financial statements.

PART 5 — Link between the audit opinions on the reliability of accounts and on the regularity of transactions

(38) International auditing standards[33] specify that where auditors issue audit opinions on both the reliability of accounts and the regularity of transactions underlying those accounts, a modified opinion on the regularity of transactions does not, in itself, lead to a modified opinion on the reliability of accounts.

[32] International Standard on Auditing (ISA) 705 (revised), Modifications to the Opinion in the Independent Auditor's Report.

[33] Paragraph 16 of ISSAI 4000.

Chapter 2

Budgetary and financial management

Contents

Conclusions and recommendations **2.58.-2.66.**

Conclusions **2.58.-2.66.**

Recommendations

Introduction

2.1. This chapter presents the main issues in relation to budgetary and financial management of the 2022 EU budget and the additional financing from the *NextGenerationEU (NGEU)* instrument[1]. We also report on budgetary and financial risks and challenges that the EU may face in future years. The chapter is based on our review of the implementation of the EU budget, and of documents published by the Commission and other stakeholders. It also takes account of the work done for our annual report, special reports, reviews, and opinions.

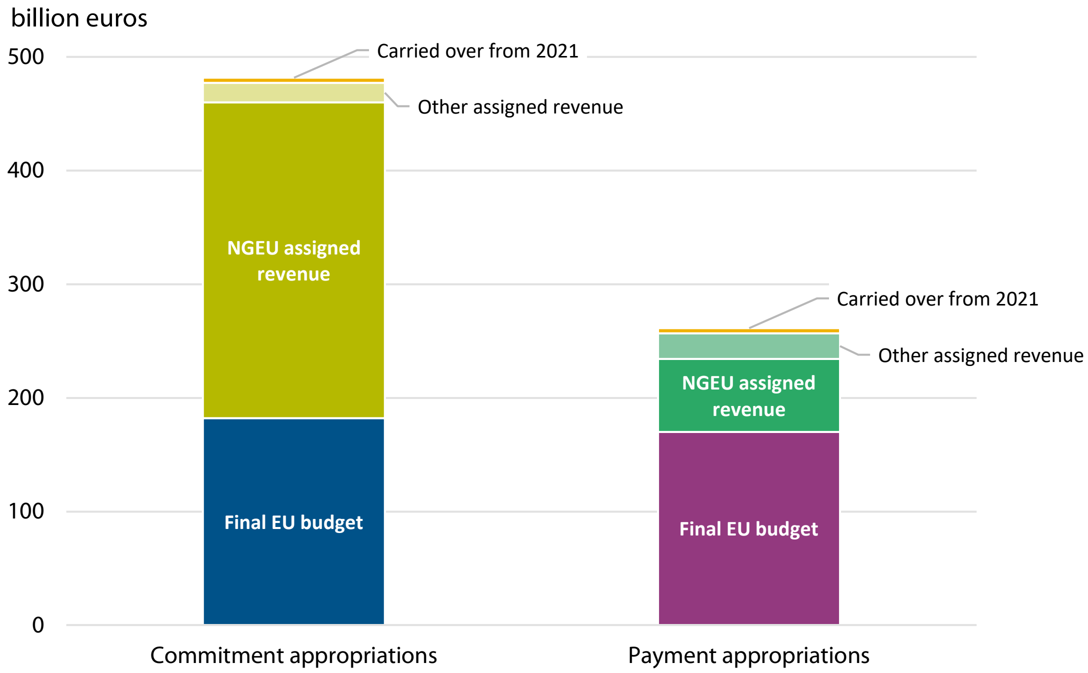
[1] Council Regulation (EU) 2020/2094.

Budgetary and financial management in 2022

EU budget implementation was high for commitments and payments

2.2. In this section, we analyse how the EU budget was implemented in 2022, the second year of the 2021-2027 *multiannual financial framework (MFF)*[2]. ***Figure 2.1*** shows the overall available EU budget expenditure including NGEU grants.

Figure 2.1 – Overall 2022 available EU budget expenditure including NGEU grants



Source: ECA, based on the 2022 consolidated accounts of the EU.

2.3. Expenditure funded by *carry-overs* and *assigned revenue* are excluded from our analysis because they are not part of the adopted budget and subject to different rules. However, as far as assigned revenue is concerned, our analysis also covers the additional amounts stemming from the NGEU instrument (*grant*-based component of

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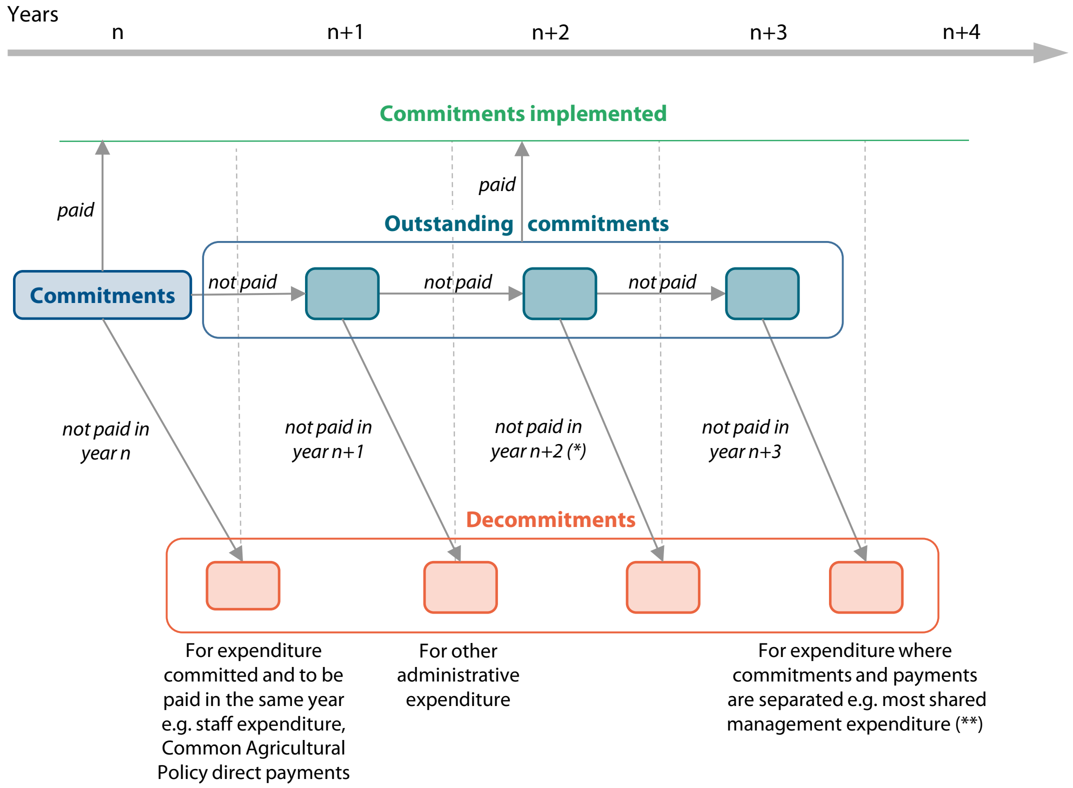
[2] Council Regulation (EU, Euratom) 2020/2093 – 'MFF Regulation'.

the *Recovery and Resilience Facility (RRF)*[3] and top-ups to existing MFF funding programmes), but not the loan-based component of the RRF, which is kept separate from the EU budget. ***Figure 2.2*** shows a simplified timeline of budgetary commitment implementation.

Figure 2.2 – Simplified timeline of budgetary commitment implementation for the overall EU budget



Commitments – legal promises to spend money on specific activities (e.g. projects, contracts).
Outstanding commitments – sum of commitments made but not yet paid.
Decommitments – cancelling of outstanding commitments when legal periods for payment expire.

(*) For the last year of the 2021-2027 MFF. For the 2023-2027 EAFRD, the year n+2 rule applies for the entire period.

(**) Policy areas, such as external actions or 'competitiveness for growth and jobs' under direct and indirect management, follow different patterns in which commitments are cancelled when contractual obligations are not met.

Source: ECA.

[3] Regulation (EU) 2021/241.

In 2022, most of the commitment appropriations were used

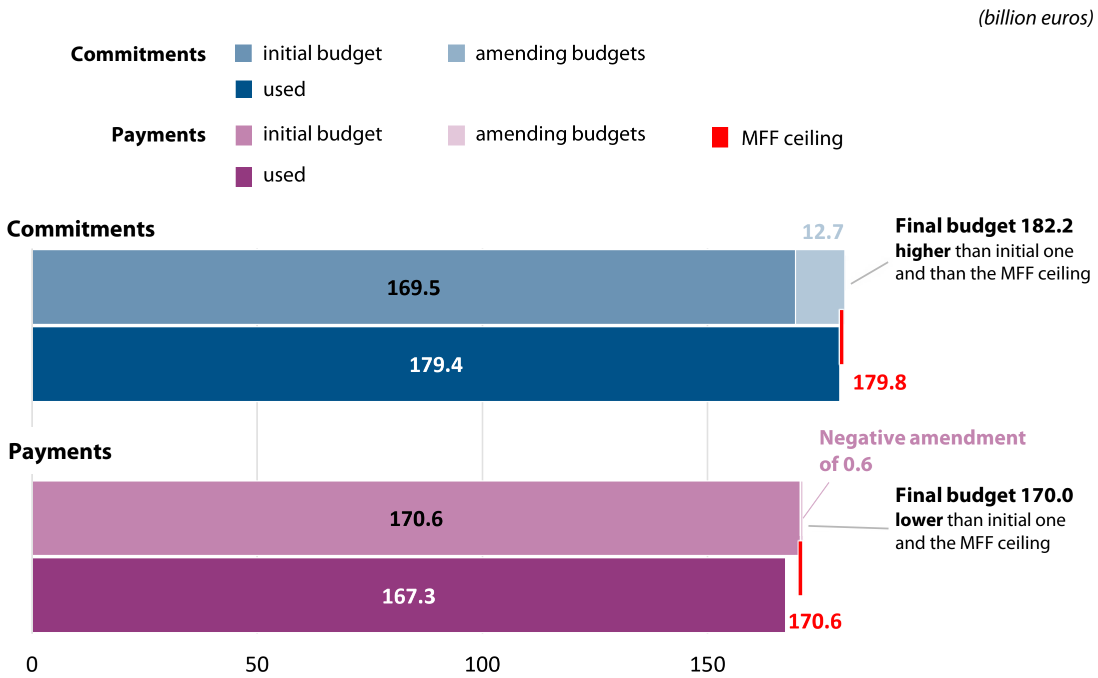
2.4. The *budgetary authority* approved an initial budget of €169.5 billion for *commitment* appropriations. In the course of 2022, there were five amendments (the commitment appropriations changed in three of these), finally increasing the budget to €182.2 billion. Of this €12.7 billion increase, €12.2 billion corresponded to a quarter of the commitment appropriations for the 2021-2027 shared management funds under the Common Provisions Regulation (CPR)[4] which had not been used in 2021[5]. This is in line with the MFF Regulation which, in the event of late adoption of new rules or programmes, allows the transfer of such allocations, in equal proportions, to the annual budgets for the years 2022 to 2025.

2.5. The final budget for commitment appropriations of €182.2 billion was above the MFF ceiling of €179.8 billion (see ***Figure 2.3***). This was made possible by the use of *special instruments*, such as the *Flexibility Instrument, the Brexit Adjustment reserve, the European Globalisation Adjustment fund* and the *Solidarity and Emergency Aid Reserve*, for amounts over and above the ceilings of the 7-year financial framework (maximum €21.1 billion in 2018 prices for the 7-year MFF). These instruments are used when there are new or unforeseen events, such as natural disasters and migration challenges. In the final budget, a total of €179.4 billion was committed during 2022, thus using over 98 % of the available amount. The unused commitments of €0.1 billion related to one programme that was not adopted and had to be cancelled, so the member state "lost" the related commitments.

[4] Regulation (EU) 2021/1060.

[5] 2021 annual report, paragraph 2.8.

Figure 2.3 – Budget implementation in 2022



Source: ECA, based on the 2022 consolidated annual accounts of the EU.

The final payment appropriations were used almost in full

2.6. The initial budget for payment appropriations was set at €170.6 billion. Through various amendments in 2022, the budgetary authority ultimately set it at €170.0 billion. This net reduction resulted from lower payment needs for the European Agricultural Fund for Rural Development (EAFRD) and the programme for the Union's action in the field of health ('EU4Health')[6], of €0.8 billion and €0.1 billion respectively. For the EAFRD, the reduction in payment needs was caused by some beneficiaries postponing or giving up their projects due to high inflation. In addition, in some member states, use of NGEU funding to finance projects accelerated, while implementation of the EAFRD slowed down[7]. Nonetheless, the reduction was partly offset by additional payment needs in other funds resulting from Russia's war of aggression against Ukraine, as well as high inflation and increasing energy prices. Payment appropriations of €0.2 billion reinforced the support for those fleeing Ukraine and for the most affected member states[8], while €0.2 billion were used for

[6] Regulation (EU) 2021/522.

[7] Draft amending budget No 5, COM(2022) 351, paragraph 8.

[8] Draft amending budget No 3, COM(2022) 262, paragraph 3.

administrative expenditure and pensions[9]. Almost all available payment appropriations in the EU budget were used. Payments reached €167.3 billion, 98 % of total available appropriations. See ***Figure 2.3***.

2.7. Taking into account additional payments of €71.8 billion from assigned revenue (mainly NGEU grants, including top-ups to MFF funding programmes), and €4.2 billion of carry-overs from 2021, total payments in 2022 reached €243.3 billion. Utilisation of the budget for payments was thus 93 % of all payment appropriations of €261.3 billion.

The absorption of the 2014-2020 ESIF continued in 2022, albeit more slowly than in 2021 and 2020

2.8. Payments from the European Structural and Investment Funds (ESIF), excluding NGEU resources, amounted to €64.9 billion, which is a lower amount than in 2021 (€75.1 billion) and 2020 (€72.0 billion). At the end of 2022, all payments for the 2014-2020 ESIF operational programmes thus amounted to €396.1 billion, out of the total allocation of €492.6 billion (80.4 %). The Commission expects most of the remaining €96.5 billion to be paid by the end of 2023[10]. The last accounting year for ESIF ends on 30 June 2024[11], and final applications for interim payments must be submitted by 31 July 2024[12]. In ***Figure 2.4***, we present the cumulative absorption rates for each ESI fund, excluding NGEU resources, by the end of 2022.

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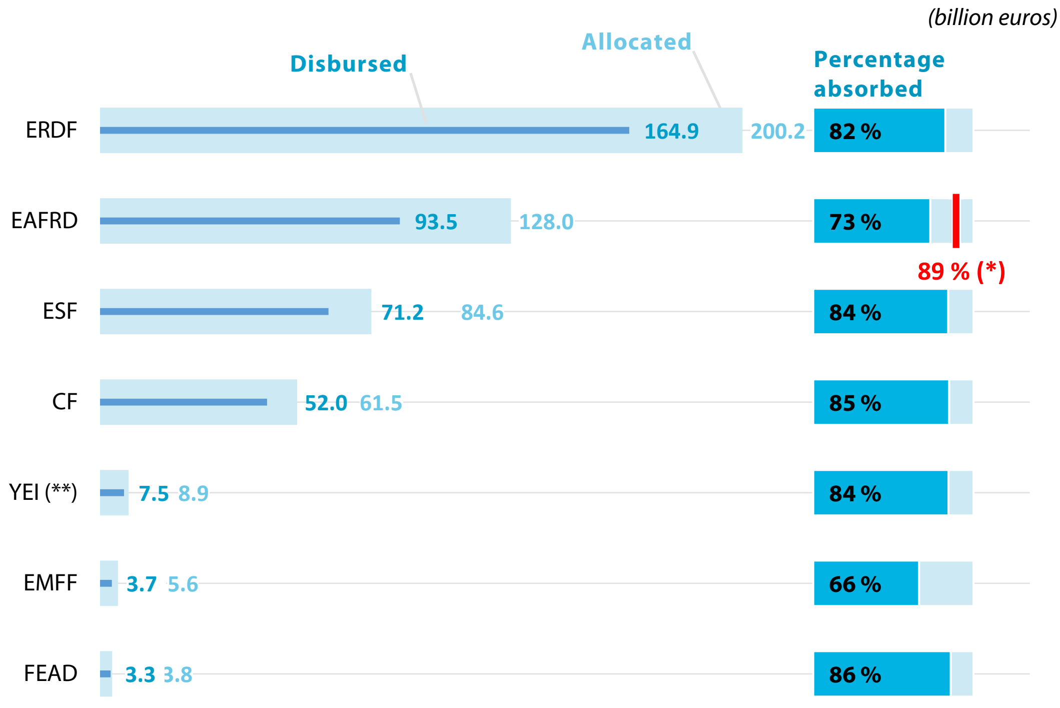
[9] Draft amending budget No 5, COM(2022) 351, paragraph 7.

[10] Long-term forecast report 2023-2027, COM(2022) 315.

[11] Commission guidelines on the ESIF closure, 2021/C 417/01.

[12] Article 135(2) of Regulation 1303/2013.

Figure 2.4 – Absorption of 2014-2020 ESIF (excluding NGEU resources) by the end of 2022



ERDF: European Regional Development Fund
EARFD: European Agricultural Fund for Rural Development
ESF: European Social Fund
CF: Cohesion Fund
YEI: Youth Employment Initiative
EMFF: European Maritime and Fisheries Fund
FEAD: Fund for European Aid to the Most Deprived

(*) The red line shows the absorption rate if the additional 2021 and 2022 allocations for the EAFRD of €28.1 billion from the 2021-2027 MFF had been excluded. The EAFRD received additional allocations due to the introduction of a 2-year transitional period after which it has fallen fully under the framework of the Common Agricultural Policy strategic plans for the period 2023-2027.

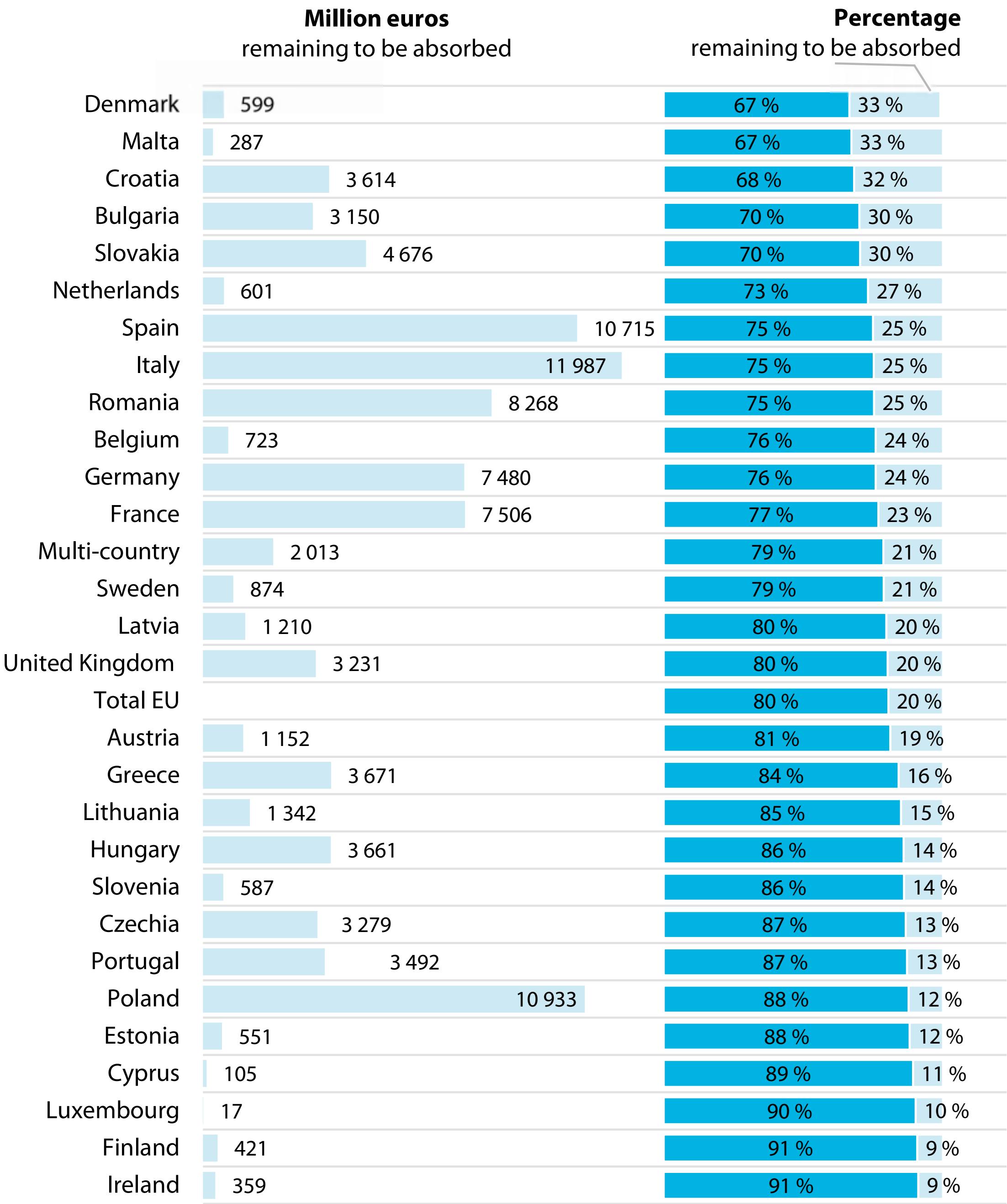
(**) YEI includes specific allocation from the ESF.

Note: differences are due to rounding.

Source: ECA, based on Commission monthly progress report.

2.9. We have noted significant differences in how member states absorb ESIF. On the one hand, 11 member states had received 85 % or more of the allocated amounts by the end of 2022, of which three member states received 90 % or more (Luxembourg, Ireland and Finland). On the other hand, for three member states (Denmark, Malta and Croatia), absorption rates were below 70 %. See *Figure 2.5*.

Figure 2.5 – 2014-2020 ESIF absorption levels (excluding NGEU resources)



Note: Amounts "to be absorbed" are payments that member states may still request from the Commission. They do not necessarily represent the full progress of project implementation in member states. Differences are due to rounding.

Source: ECA, based on Commission information.

The Commission committed more resources from the 2021-2027 shared management funds under the CPR, but late approval of member states' programmes led to low payments

2.10. At the beginning of the new MFF, there was a transition from the 2014-2020 ESIF to the 2021-2027 shared management funds under the CPR. The main changes included: the consolidation of three funds into the European Social Fund Plus (ESF+)[13]; the European Maritime, Fisheries and Aquaculture Fund (EMFAF)[14] succeeding the European Maritime and Fisheries Fund (EMFF); and the establishment of the new Just Transition Fund (JTF)[15] to support economic diversification and reconversion of territories negatively affected by the transition towards climate neutrality. The EAFRD continued to fall under the CPR until 2022[16], and from 2023 onwards, it is covered by the new Common Agricultural Policy (CAP) Regulation[17]. See ***Figure 2.6***.

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[13] Regulation (EU) 2021/1057.

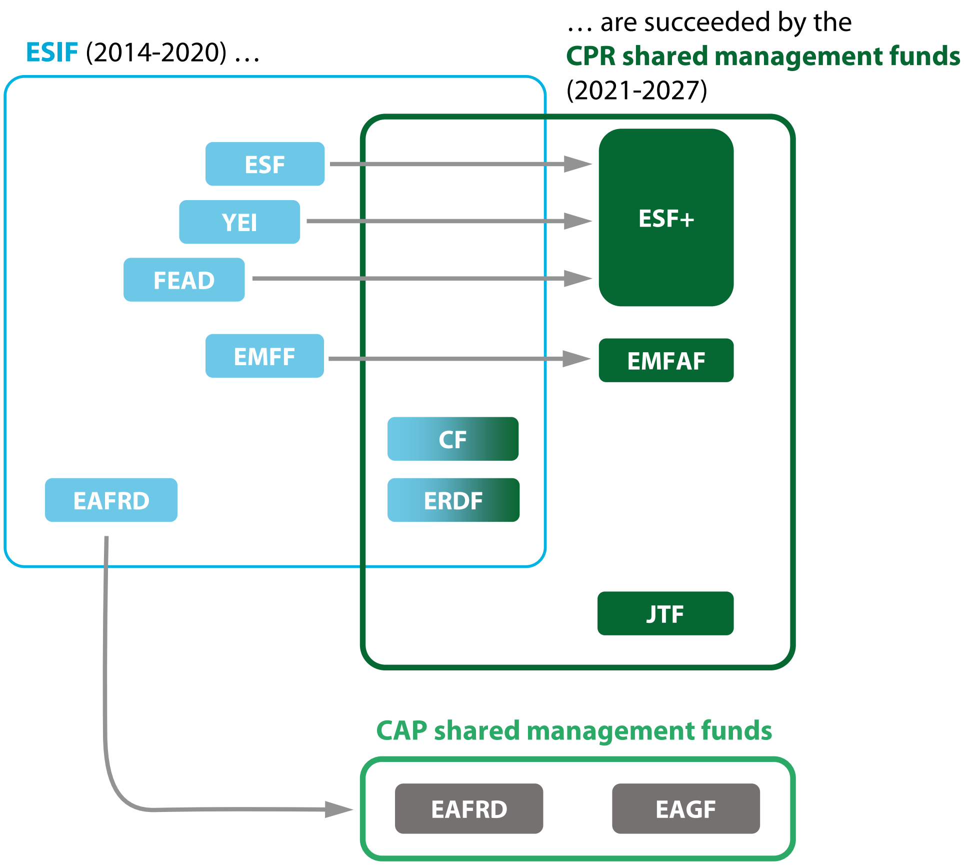
[14] Regulation (EU) 2021/1139.

[15] Regulation (EU) 2021/1056.

[16] Regulation (EU) 2020/2220.

[17] Regulation (EU) 2021/2116.

Figure 2.6 – Transition from ESIF to shared management funds under the CPR



CF: Cohesion Fund
EAFRD: European Agricultural Fund for Rural Development
EAGF: European Agricultural Guarantee Fund
EMFAF: European Maritime, Fisheries and Aquaculture Fund
ESF: European Social Fund

ESF+: European Social Fund Plus
FEAD: Fund for European Aid to the most Deprived
EMFF: European Maritime and Fisheries Fund
ERDF: European Regional Development Fund
JTF: Just Transition Fund
YEI: Youth Employment Initiative

Note: The 2021-2027 CPR funds also include the migration, internal security and border management funds which are partly under direct and indirect management.

Source: ECA, based on the EU legislation.

2.11. For these shared management funds under the CPR, member states committed €65.4 billion in 2022, i.e. 90 % of available commitment appropriations (in 2021, they committed only 2 % of the available €50.1 billion), see *Figure 2.7*. This came about because all the partnership agreements and most of the programmes with member states were approved in 2022 for these funds.

Figure 2.7 – Commitments in 2022 for shared management funds under the CPR

(million euros)

	CF 6 161	ERDF 36 051	JTF 6 388	ESF+ 15 781	EMFAF 1 027	TOTAL 65 407
Poland	1 799	7 565	1 361	2 063	99	**12 887**
Italy		4 402	364	2 522	101	**7 388**
Spain		3 997	307	1 930	217	**6 451**
Romania	550	2 797	757	1 141	32	**5 277**
Portugal	530	1 964	79	1 328	76	**3 978**
Czechia	1 134	1 767	580	415	6	**3 902**
Germany		1 848	876	1 116	41	**3 881**
Greece	494	1 797	385	936	71	**3 682**
France		1 539	364	1 140	110	**3 154**
Hungary	195	1 470	44	808	7	**2 524**
Slovakia	397	1 173	162	378		**2 111**
Croatia	199	908	66	325	47	**1 545**
Multiple countries		1 503				**1 503**
Bulgaria	182	838		429	16	**1 465**
Lithuania	207	603	97	189	12	**1 107**
Latvia	156	417	68	117	26	**784**
Estonia	137	290	125	88	19	**659**
Slovenia	123	294	91	93	5	**606**
Belgium		147	65	229	8	**448**
Finland		134	165	103	14	**416**
Netherlands		86	220	71	19	**396**
Sweden		147	55	121	22	**346**
Ireland		68	30	87	28	**212**
Austria		89	48	70	1	**208**
Cyprus	30	80	36	38	7	**191**
Malta	28	81	8	21	4	**143**
Denmark		42	31	20		**133**
Luxembourg		2	3	3		**8**

CF: Cohesion Fund
ERDF: European Regional Development Fund
JTF: Just Transition Fund
ESF+: European Social Fund Plus
EMFAF: European Maritime, Fisheries and Aquaculture Fund

Note: differences are due to rounding.

Source: ECA, based on Commission information.

2.12. In 2022, the annual payments against these commitments were low (€5.7 billion) and mainly related to pre-financing.

Various EU funding instruments were used as an emergency response

2.13. In 2020 and 2021, the EU legislator made cohesion rules more flexible[18] so that member states could re-allocate funding from the 2014-2020 ESIF to address the COVID-19 pandemic. The amended legislation widened the range of eligible costs to include COVID-19 related expenditure, and allowed 100 % co-financing from EU funding. Member states were thus able to re-allocate €24.0 billion by the first quarter of 2023. ESIF was topped up by additional NGEU resources of €50.6 billion in the Recovery assistance for cohesion and the territories of Europe (REACT-EU) instrument[19] to finance 'crisis repair' and pave the way for a green, digital and resilient economic recovery (with expenditure eligible until the end of 2023 and payments possible until the end of 2026). In 2021, it was possible to use, under certain conditions, the EAFRD to address liquidity problems caused by the COVID-19 pandemic, and since 2022 problems caused by Russia's war of aggression against Ukraine[20].

2.14. In 2022, new flexibility measures were introduced to help member state authorities dealing with inflows of people fleeing Ukraine. The EU introduced Cohesion's Action for Refugees in Europe (CARE)[21] and its successor, Flexible Assistance for Territories – Cohesion's Action for Refugees in Europe (FAST-CARE)[22]. CARE extended the 100 % co-financing rate for the accounting year 2021-2022 for 2014-2020 programmes, and made available emergency funding using ERDF and ESF resources, including REACT-EU, that had not yet been allocated to projects to support refugees under a 'dedicated priority'. For the 2014-2020 period, CARE provided member states with €3.5 billion of additional pre-financing from REACT-EU resources. FAST-CARE makes possible the co-financing rate of up to 100 % for a dedicated priority for both programme periods (until June 2024 for the 2021-2027 period). It also enabled resources to be used from the CF and the EMFF for the 2014-2020 MFF. For

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[18] Regulation (EU) 2020/460 and Regulation (EU) 2020/558.

[19] Regulation (EU) 2020/2221.

[20] Regulation (EU) 2020/872 amending Regulation (EU) No 1305/2013 and Regulation (EU) 2022/1033 amending Regulation (EU) 1305/2013.

[21] Regulation (EU) 2022/562.

[22] Regulation (EU) 2022/2039.

the 2021-2027 MFF, FAST-CARE, among other things, provided €3.5 billion of additional pre-financing for programmes supported by the ERDF, ESF+, and CF, and allowed programming of up to 5 % of the initial allocation from the ERDF and ESF+ for a dedicated priority.

2.15. The 2021-2027 shared management funds under the CPR can also be used in response to unexpected events[23]. Furthermore, there is flexibility to transfer parts of initial national allocations of funds between funding instruments[24]. In addition, the *REPowerEU Plan*[25], which primarily aims to further reduce the EU's dependence on Russian fossil fuels, was approved in February 2023[26]. To mobilise finance for the Plan, member states may use the RRF (remaining loans and new grants), and also other sources, such as national allocations of cohesion policy funds.

2.16. ***Figure 2.8*** presents key EU measures introduced since 2020 in response to the COVID-19 pandemic, Russia's war of aggression against Ukraine and the energy crisis.

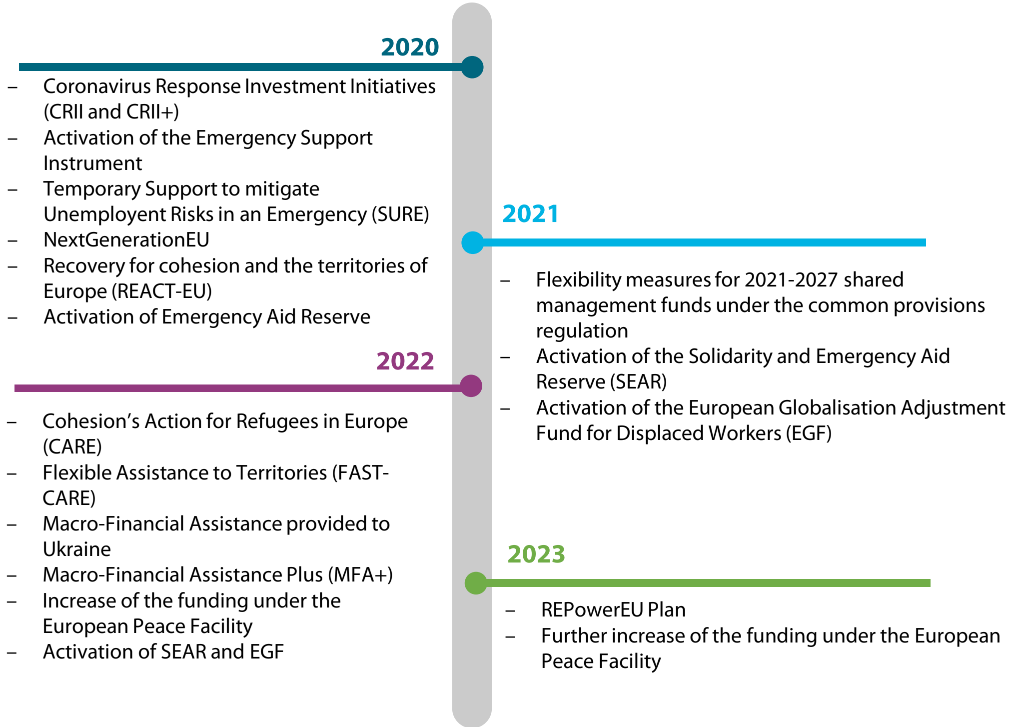
[23] Article 20 of Regulation (EU) 2021/1060.

[24] *Ibid.*, Article 26(1).

[25] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of Regions – REPowerEU Plan, COM(2022) 230.

[26] Regulation (EU) 2023/435.

Figure 2.8 – Key EU crisis response measures in 2020-2023



Source: ECA, based on EU legislation.

2.17. Cohesion funding has also been used as an emergency response to unexpected events, particularly in the past 3 years. From a budgetary perspective, this lowers the risk of decommitments, see paragraphs ***2.48*** to ***2.49***. However, we note that the primary strategic goal of cohesion funding is to strengthen economic, social, and territorial cohesion between European regions[27].

Implementation of NGEU accelerated in 2022, but progress was slower than expected

2.18. For member states to receive RRF grants, first of all, the Commission must give a positive assessment of their national recovery and resilience plans, and the Council must then approve them. The remaining five plans were approved during 2022, so the RRF grant financial envelopes have now been endorsed for all member states. Second, financing agreements must be signed with member states. By the end of 2022, almost 70 % of the grants were covered by these agreements, and the remaining 30 % are available for allocation in 2023[28]. Third, to receive payments, other

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[27] Special report 02/2023: Adapting cohesion policy rules to respond to COVID-19, paragraph 85.

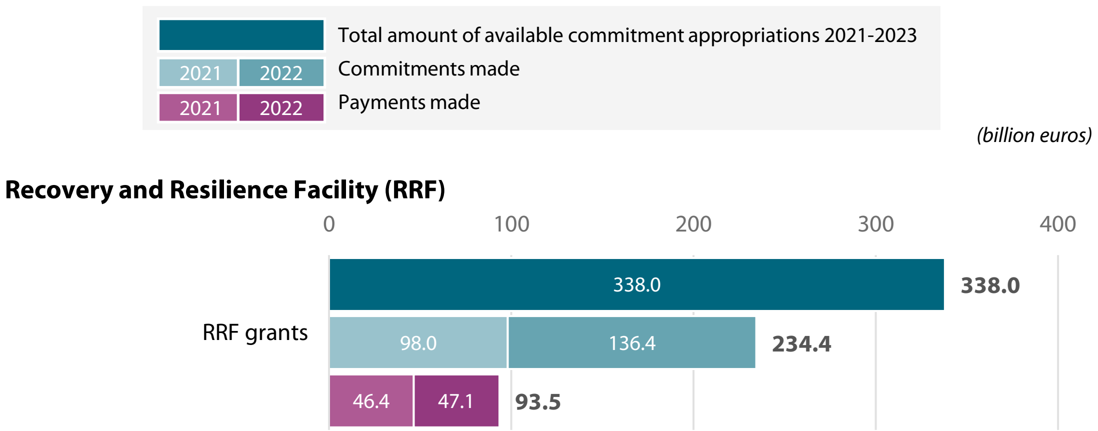
[28] Article 12(3) of Regulation (EU) 2021/241.

than pre-financing, member states must fulfil certain milestones and targets as stipulated in Council implementing decisions.

2.19. 2022 was the second year of implementation of RRF grants and NGEU top-ups to the existing MFF funding programmes. Commitments increased from €143.5 billion (in 2021) to €306.0 billion. Member states will need to commit the rest of NGEU funding (€115.1 billion) in 2023, as it will not be possible for them to do this after the end of the year[29].

2.20. Pre-financing and payments of RRF grants rose only slightly from €46.4 billion in 2021 to €47.1 billion in 2022 (compared to €63.0 billion expected by the Commission[30]). As a result, €244.5 billion of RRF grants need to be paid in 2023-2026, if remaining allocations are committed in 2023[31]. See ***Figure 2.9***.

Figure 2.9 – NGEU implementation related to the RRF



Source: ECA, based on the 2022 consolidated annual accounts of the EU and budgetary implementation reports from the Commission's accounting system.

2.21. In 2022, the Commission made €47.1 billion of RRF grant payments, of which €46.9 billion related to the fulfilment of milestones and targets (2021: €46.4 billion and €10.0 billion respectively). ***Figure 2.10*** shows the amount of RRF grants paid and remaining allocations for payment by the end of 2022.

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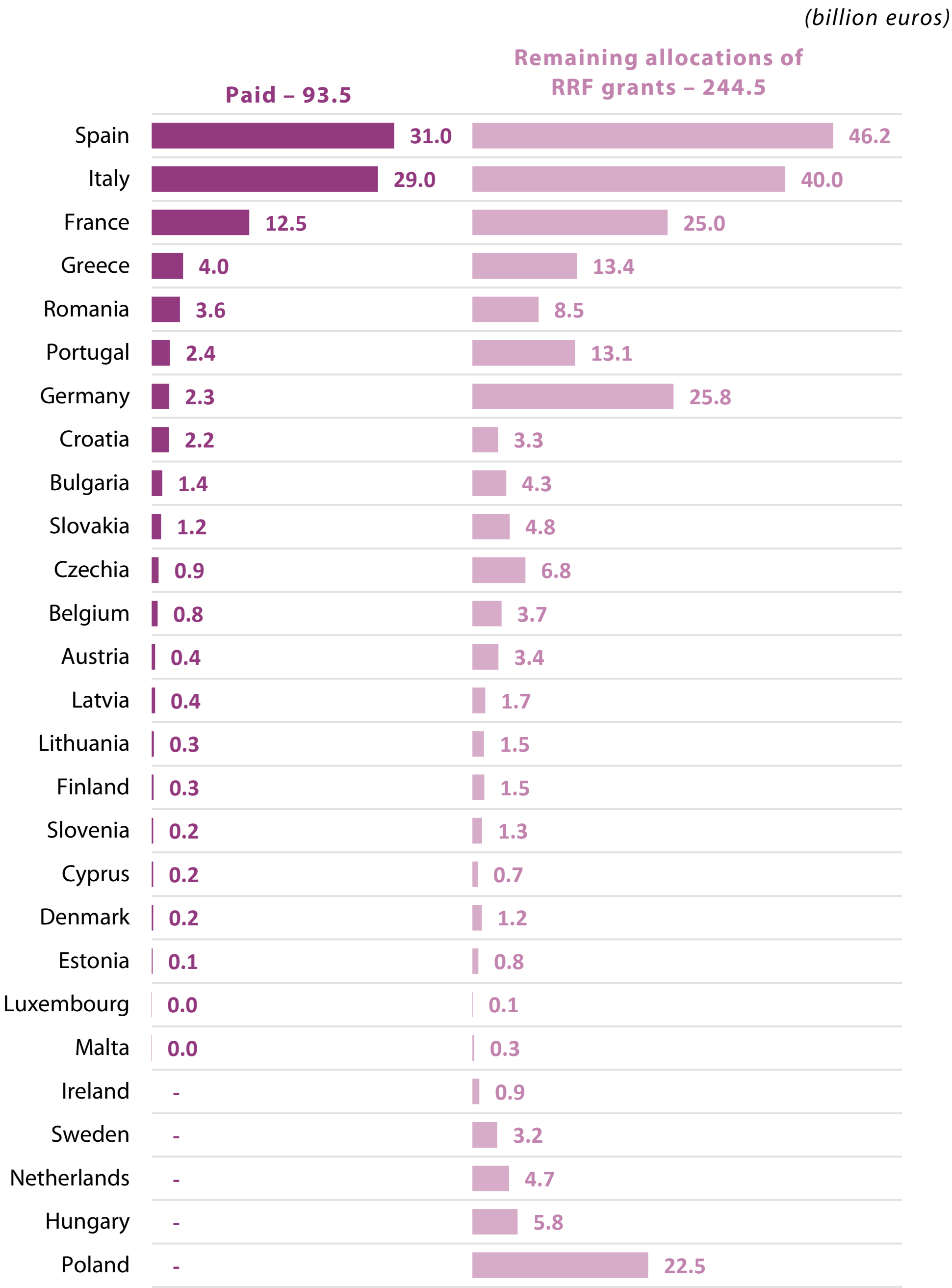
[29] *Ibid.*, Article 12.

[30] Long-term forecast report 2021- 2027, COM(2021) 343.

[31] Article 24 of Regulation (EU) 2021/241.

Figure 2.10 – RRF grant payments and remaining allocations at end 2022

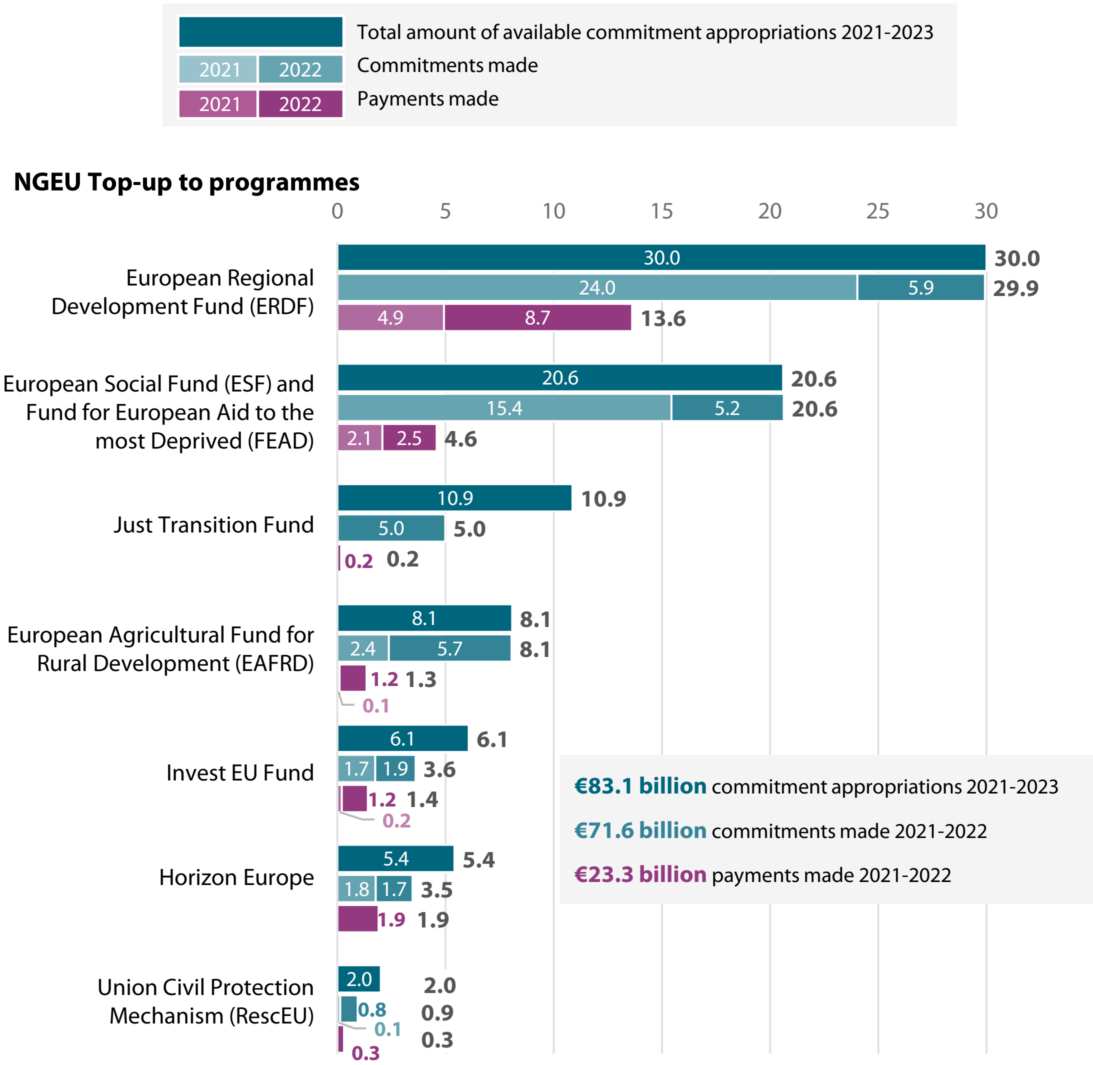


Note: differences are due to rounding.

Source: ECA, based on the 2022 consolidated accounts of the EU.

2.22. Top-ups to existing MFF programmes increased from €7.2 billion in 2021 to €16.1 billion in 2022. Two programmes – the Just Transition Fund (JTF) and the Union Civil Protection Mechanism – started making payments in 2022. As a result, €59.8 billion of top-ups to EU programmes need to be paid in 2023-2026, if remaining allocations are committed in 2023[32]. See *Figure 2.11*.

Figure 2.11 – NGEU implementation related to top-ups to EU programmes



Source: ECA, based on the 2022 consolidated annual accounts of the EU and budgetary implementation reports from the Commission's accounting system.

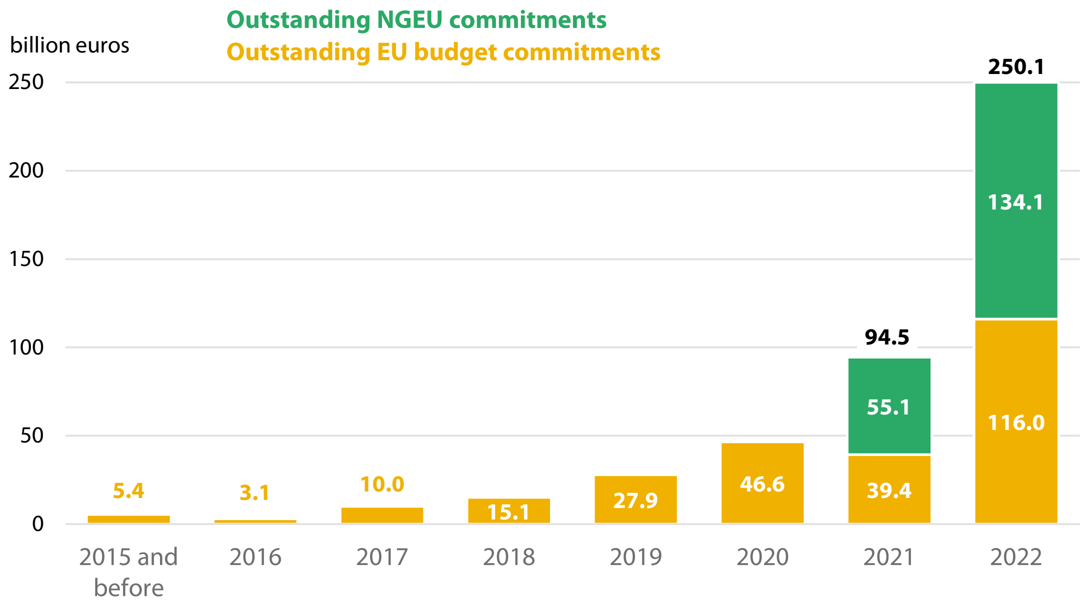
[32] *Ibid.*, Article 24.

Outstanding commitments from the EU budget and NGEU grant funding reached a record €453 billion

2.23. By the end of 2022, *outstanding commitments*, which are accumulated commitments made but not yet paid, reached a new record of €452.8 billion. For 2022, they are composed of those related to the EU budget (€263.7 billion) and those arising from NGEU implementation (€189.1 billion). The 33 % increase from the outstanding commitments of €341.6 billion in 2021 is mainly a result of an increased commitment of funds during the second year of NGEU implementation, as well as the start of 2021-2027 shared management fund implementation.

2.24. The outstanding commitments from 2022 represent 55 % of total outstanding commitments. ***Figure 2.12*** shows the outstanding commitments by year of origin.

Figure 2.12 – Outstanding commitments by year and type of funding (from the EU budget and NGEU)

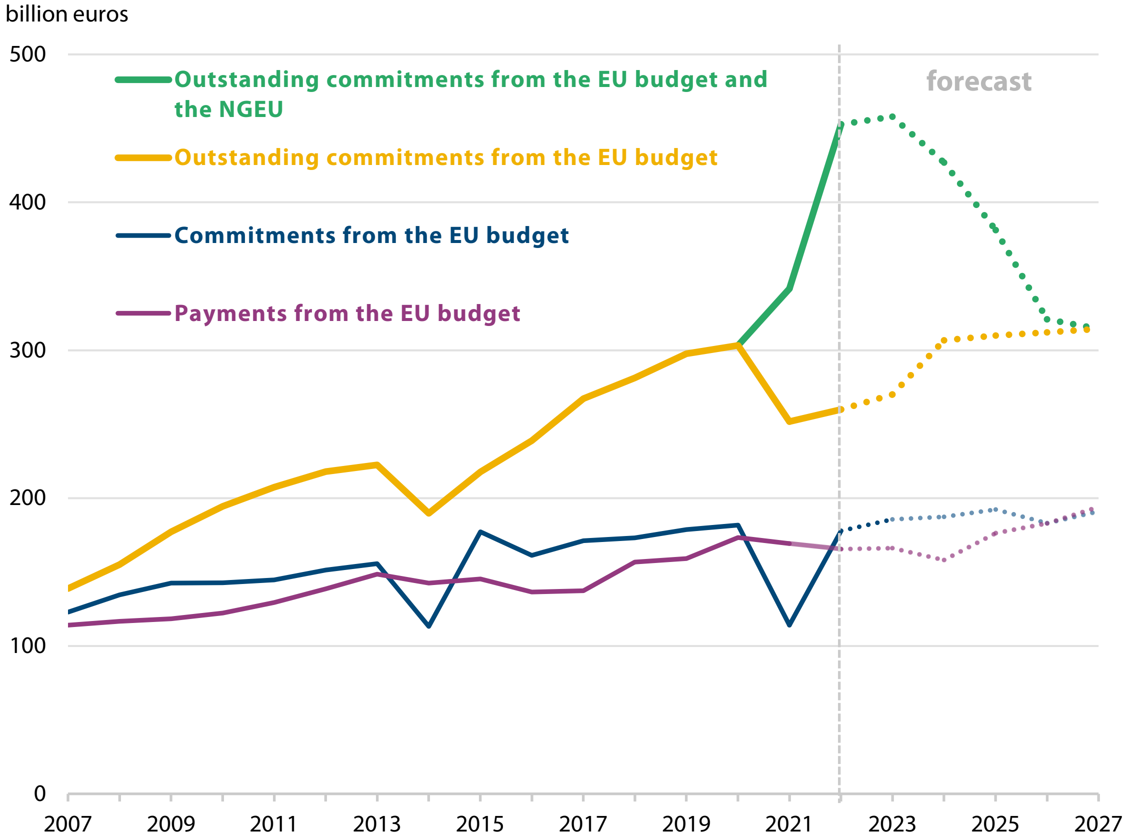


Note: Differences are due to rounding.

Source: ECA, based on the 2022 consolidated annual accounts of the EU and budgetary implementation reports from the Commission's accounting system.

2.25. For 2023, the Commission expects outstanding commitments to reach an historic peak that may exceed €458 billion[33], mainly because of new commitments for NGEU (see paragraph ***2.18***) alongside new commitments for the 2021-2027 shared management funds. As there are no new NGEU commitments post 2023, and payments for NGEU will continue exceeding new commitments from the EU budget until 2026, outstanding commitments are expected to decrease between 2024 and 2026. See ***Figure 2.13***.

Figure 2.13 – Outstanding commitments, commitments and payments 2007 to 2022, and forecast for 2023 to 2027



Source: ECA, based on data from the consolidated annual accounts of the EU for 2006-2022 and, for the projections until 2027, on data from the Long-term forecast report 2023-2027, COM(2022) 315.

[33] Long-term forecast report 2023-2027, COM(2022) 315.

2.26. Based on the Commission's assumptions and projections, outstanding commitments will reduce to €314.4 billion by the end of the last year of the current MFF (2027). Compared with the outstanding commitments in 2020, the last year of the previous MFF, this would still be a small increase. Furthermore, the Commission used two specific assumptions for its projections: first, that member states make more effort to accelerate the use of 2021-2027 shared management funds; and second, that automatic technical adjustments of payment ceilings are sufficient to cover the payment needs. These two assumptions must be fulfilled for outstanding commitments to reduce to the extent shown in ***Figure 2.13***.

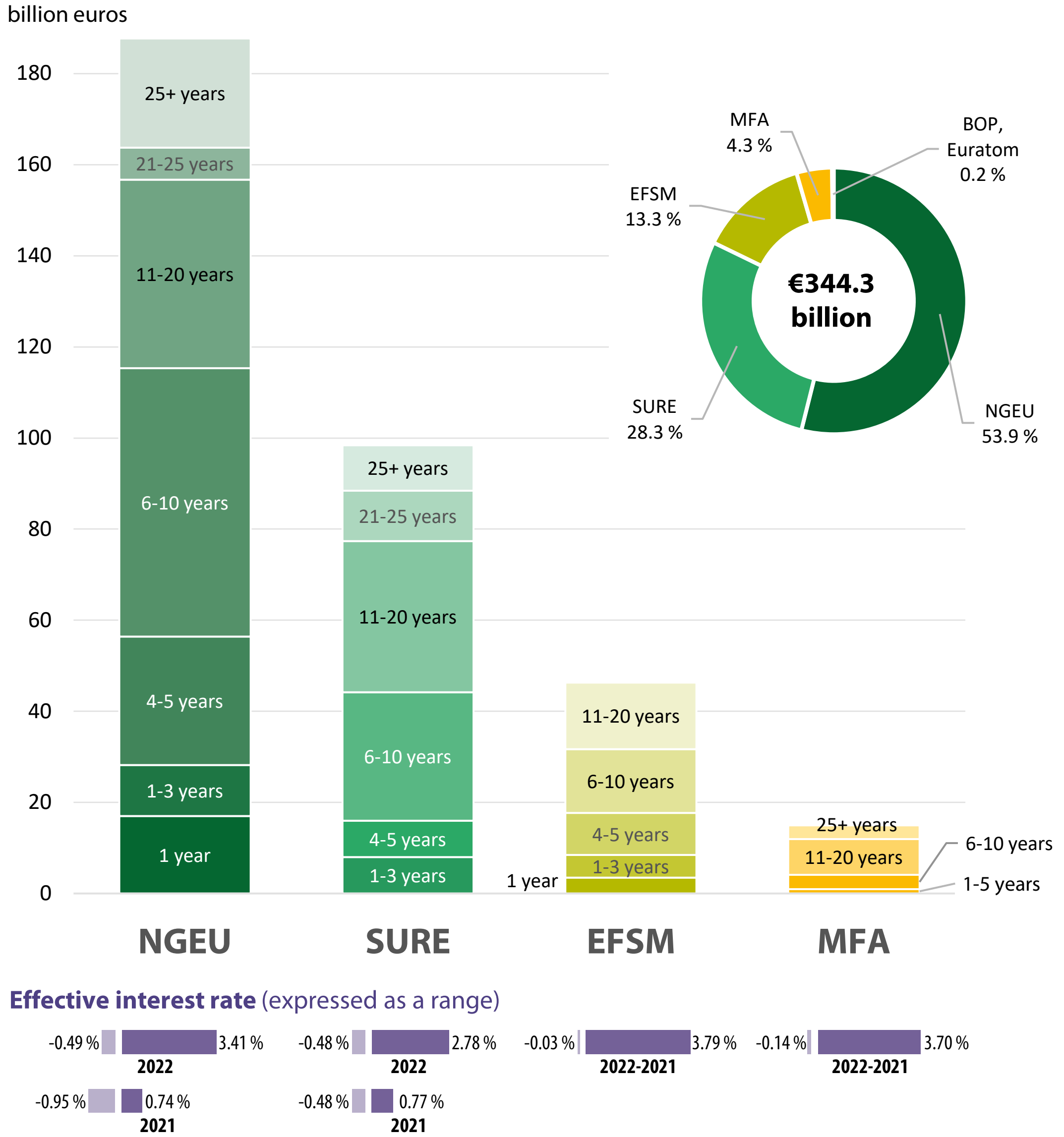
Risks and challenges

EU debt and exposure increased in 2022

Borrowing costs for EU debt have increased significantly

2.27. For our analysis of EU debt, we considered the borrowing from the markets, mainly long-term bonds guaranteed by the EU budget, that was a source of funding for the NGEU and financial assistance to member states and third countries (Temporary Support to mitigate Unemployment Risks in an Emergency (SURE), European Financial Stabilisation Mechanism (EFSM), Macro-Financial Assistance (MFA), Balance of Payments and Euratom). This debt (including accrued interest) increased in 2022 to €344.3 billion by year-end (2021: €236.7 billion), mainly because of new borrowing for NGEU of €96.9 billion, SURE of €8.7 billion and MFA of €7.5 billion. ***Figure 2.14*** shows the maturities and effective interest rates of that borrowing.

Figure 2.14 – Maturities and effective interest rates of EU budget borrowing



NGEU: NextGenerationEU
SURE: European instrument for temporary Support to mitigate Unemployment Risks in an Emergency
EFSM: European Financial Stabilisation Mechanism
MFA: Macro-Financial Assistance
BOP: Balance of Payments assistance facility

Source: ECA, based on the 2022 consolidated accounts of the EU.

2.28. Of this borrowing, only the NGEU instrument entailed interest rate risk for the EU budget. The other financial assistance programmes operate on a "back-to-back" basis. This means that the Commission provides loans to member states or third countries on the same terms and conditions (such as maturity and interest rate) as it borrows money from the markets. Since the loan and borrowing cash flows are offset, the EU budget is set not to face interest rate risk for that borrowing.

2.29. The Commission can borrow up to €806.9 billion for NGEU and average EU financing costs have already risen. The NGEU strategy allocates costs of funding to beneficiaries (for loans) and to the EU budget (for grants). In 2022, due to growing market interest rates, the cost of new NGEU funding increased from 0.14 % in the second half of 2021 to 1.24 % in the first half of 2022, and to 2.60 % in the second half of 2022[34]. Total net borrowing costs amounted to €0.5 billion in 2022. These costs include interest costs on borrowing and interest revenue on borrowing and loans.

2.30. As the ECB is tightening monetary policy to fight inflation, the financing costs for NGEU borrowing are expected to rise. As a result, the Commission had to increase the amount set aside in the 2023 budget by €0.3 billion for interest payments related to NGEU borrowing[35]. It used the *Single Margin Instrument*, i.e. the unused margins of previous years. As interest payments are generally linked to market yields, and these are on a rising trend, financing costs could increase substantially during the coming years.

2.31. The repayment of the NGEU borrowing will have to start by 2028 and has to be completed by 2058[36]. The part of NGEU borrowing that is subsequently provided as loans to individual member states (€385.8 billion) has to be repaid by these member states. However, the share of the NGEU disbursed as grants (€421.1 billion) has to be repaid by the EU budget. In December 2021, the Commission proposed three additional sources of revenue to the EU budget, which may be used for the repayment of the grant component of the NGEU[37]. The Commission is to propose further sources of revenue by the end of 2023.

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[34] Half-yearly reports on the implementation of borrowing, debt management and related lending operations for the period from June 2021 to December 2022, COM(2023) 93, COM(2022) 335 and COM(2022) 43.

[35] Adopted annual budget of the EU for 2023.

[36] Article 5 of Council Decision (EU) 2020/2053 on the system of own resources of the EU.

[37] Commission proposals COM(2021) 569 and COM(2021) 570.

Total exposure is higher mainly due to additional RRF and SURE loans

2.32. To allow for comparison with chapter 2 of our 2021 annual report , this year we continued to analyse the exposure of the EU budget, for which we considered:

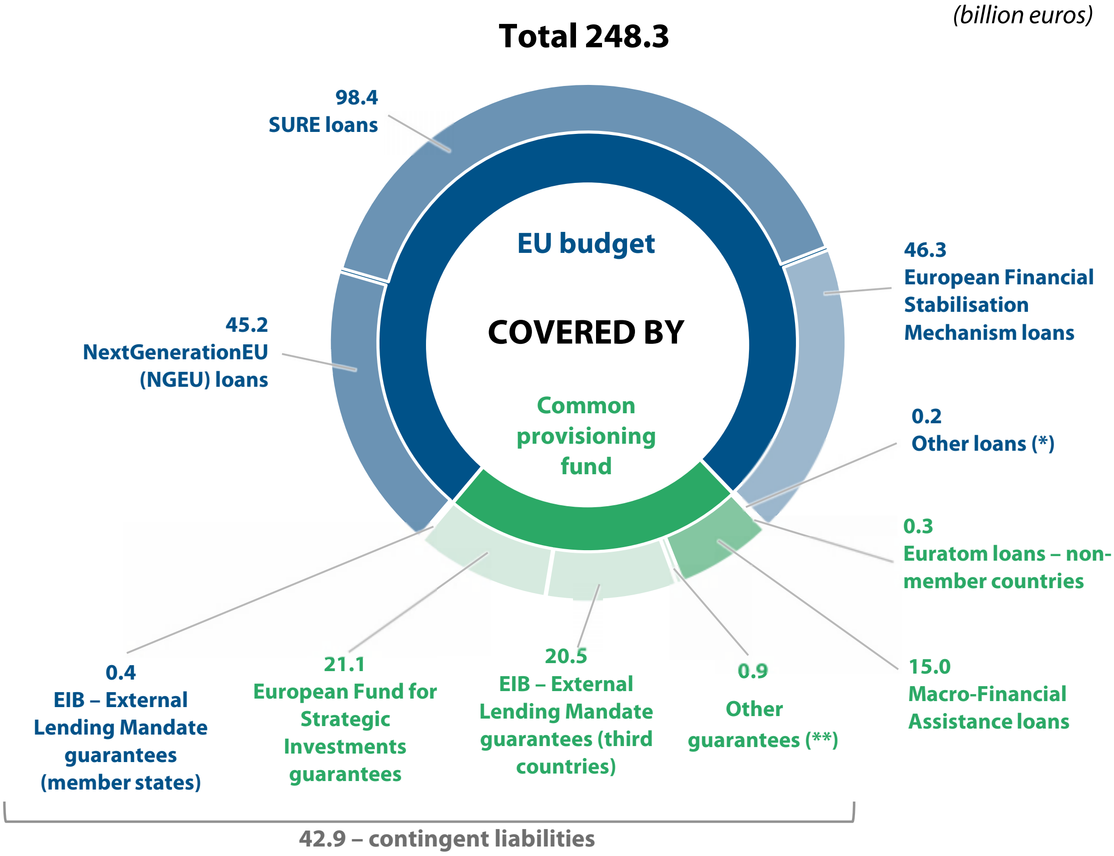
(a) the EU budget guarantees for the borrowing from the markets that was a source of financing for loans disbursed to member states or third countries in the event of defaults on these loans;

(b) liabilities that might arise in future if a specific event occurs, that are disclosed in the annual accounts as *contingent liabilities*, and are composed of budgetary guarantees that have already been extended[38].

2.33. The resulting exposure of the EU budget totalled €248.3 billion by the end of 2022, which was an increase from €204.9 billion in 2021 (which included €0.6 billion of accrued interest). ***Figure 2.15*** provides a breakdown of the exposure by its source types and risk coverage.

[38] Note 4.1.1 of the 2022 consolidated annual accounts of the EU.

Figure 2.15 – Total exposure of the EU budget at end 2022, by source type and risk coverage



(*) Balance of Payments loans – €0.2 billion, Euratom loans – member states €0.03 billion.

(**) European Fund for Sustainable Development (EFSD) guarantee – €0.4 billion, InvestEU guarantee – €0.3 billion and EFSD+ guarantee – €0.2 billion.

Note: differences are due to rounding.

Source: ECA, based on the 2022 consolidated annual accounts of the EU.

2.34. The increase of the EU budget exposure related mainly to the borrowings for the additional RRF and SURE loans of €27.2 billion and €8.7 billion respectively (at the end of 2021: €18.0 billion and €89.7 billion respectively) made to member states, and the MFA loans to Ukraine in 2022 of €7.2 billion, see paragraph *2.43*. The exposure to the contingent liabilities increased from €41.9 billion to €42.9 billion at the end of 2022. This was mainly because of more disbursements for investments that were covered by the European Fund for Strategic Investments guarantee. In the 2022 consolidated accounts, the Commission has changed the disclosure of contingent liabilities. *Box 2.1* provides the explanation of this change.

Box 2.1

Change in the disclosure of contingent liabilities

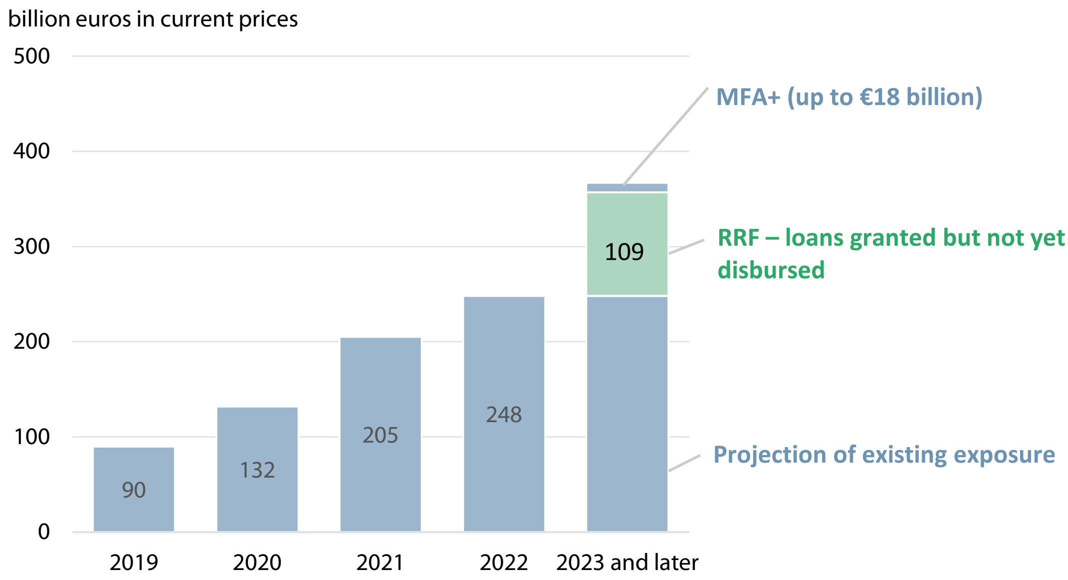
In its 2021 consolidated accounts, the Commission disclosed contingent liabilities (outstanding guarantees on disbursed or borrowed amounts) amounting to €277.9 billion. This included €236.0 billion of EU budget guarantees to cover borrowing related to loans extended mainly to SURE, RRF, MFA and European Financial Stabilisation Mechanism (€163.0 billion) as well as to NGEU borrowing for grants disbursed and for loans not yet disbursed (€73.0 billion). For 2022, these guarantees were no longer disclosed as contingent liabilities. Any call on these guarantees depends on there being a default on the loans made, thus the information on the guarantees is presented in the section of the consolidated accounts on loans.

Source: ECA, based on the 2021 and 2022 consolidated accounts of the EU.

2.35. Furthermore, at the end of 2022, €109.0 billion of RRF loans had already been granted to member states, but not yet disbursed. Additionally, €18.0 billion was granted to Ukraine under the MFA+ instrument to be disbursed during 2023 (see paragraph ***2.44***).

2.36. The overall exposure of €248.3 billion at the end of 2022 will continue to rise, mainly due to RRF loans and the MFA+ in 2023 and 2024, see paragraph ***2.44***. ***Figure 2.16*** compares past and projected exposure of the EU budget from 2019.

Figure 2.16 – Past and projected exposure of the EU budget



Source: ECA, based on the consolidated annual accounts of the EU for 2019-2022 and Commission information.

2.37. Total exposure can be broken down into annual exposure, which is the maximum amount that needs to be covered by the EU budget, or by the 'headroom'[39], if there are payment defaults in any given year. The 'headroom' is the margin between the expenditure limits set in the MFF and the own resources ceiling up to which the Commission, as a last resort, is entitled to call resources from member states to service EU debt. The Commission provided us with the data on the annual exposure stemming from financial assistance to member states and third countries as well as the External Lending Mandate which amounted to €7.7 billion in 2023 (€7.0 billion for 2022 and €4.4 billion for 2021). This figure does not include the annual exposure of the remaining programmes covered by budgetary guarantees (EFSI, InvestEU, EFSD and EFSD+). Furthermore, the Commission publishes the annual exposure of the EU budget that arises from financial assistance to member states, but it does not publish such a figure arising from budgetary guarantees and from financial assistance to third countries.

The common provisioning fund increased its assets in 2022

2.38. The exposure risk of the EU budget can be reduced by appropriately provisioned financial assets or guarantees received from member states. As required by the Financial Regulation[40], the Commission set up a common provisioning fund (CPF) at the beginning of the 2021-2027 MFF. This pools all assets provisioned from the EU budget for the budgetary guarantees as well as loans for financial assistance to third countries, but it has 'compartments' for each one, so that amounts can be linked to the individual programmes. In the event of a default, it will cover guarantee calls arising from budgetary guarantees and financial assistance to non-EU countries before the EU budget is further called upon.

2.39. CPF assets amounted to €12.3 billion at the end of 2021. In 2022, the fund was further reinforced by EU budget contributions of €3.3 billion. The assets are largely invested in debt securities with fixed interest rates and recognized in the financial statements of the fund at their market value. Rising interest rates in 2022 meant that the value of these assets fell by €1.1 billion and stood at €14.4 billion by year end. See ***Figure 2.17***.

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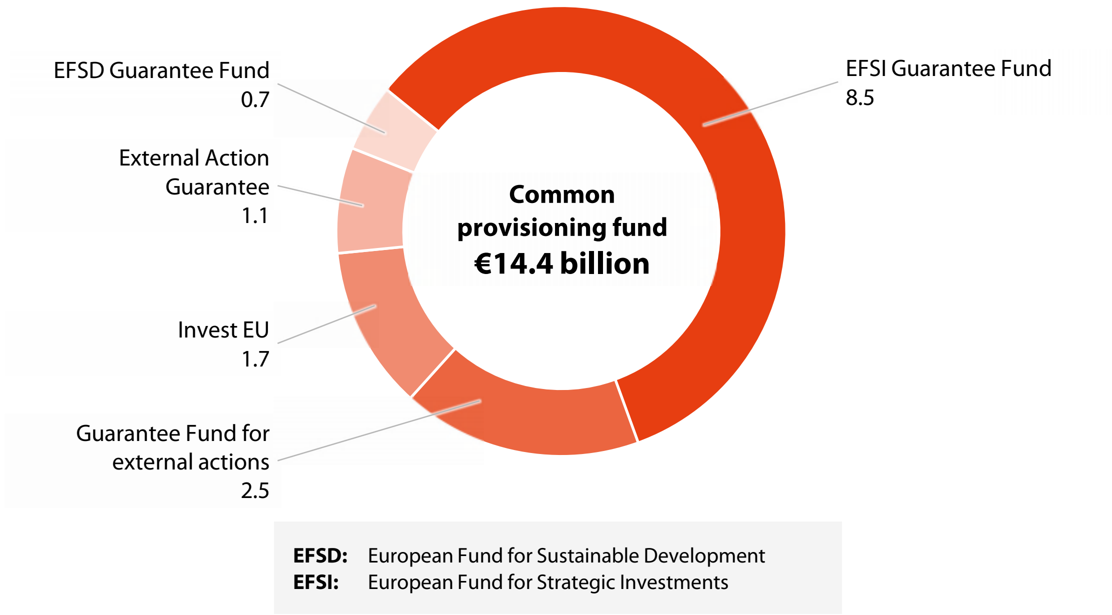
[39] For further information, see special report 05/2023: "The EU's financial landscape", figure 2 and paragraph 16.

[40] Article 212 of Regulation (EU) 2018/1046.

Figure 2.17 – Common provisioning fund and its components at end 2022

(billion euros)



Note: differences are due to rounding.

Source: ECA, based on the CPF financial statements as of 31 December 2022.

Russia's war of aggression against Ukraine increases financial risks to future EU budgets

2.40. At the end of 2021, outstanding loans to Ukraine had a nominal value of €4.7 billion under the MFA and Euratom instruments. In addition, EIB loans to Ukraine, supported by EU guarantees, amounted to €2.1 billion. In our 2021 annual report, we highlighted the risks to the EU budget arising from Russia's war of aggression against Ukraine, and noted that the war might jeopardise repayment of these loans[41].

2.41. Financial assistance to third countries, which includes MFA and Euratom loans, is subject to a provision set aside from the EU budget to the CPF. This is determined by assessing the relevant financial risks and in accordance with the

[41] 2021 annual report, paragraph 2.54.

principle of prudence[42]. The provisioning rate for financial assistance to third countries has been set at 9 %[43].

2.42. In July 2022, the Commission reassessed the risk of default of new MFA loans to Ukraine. As a result, and in order to protect the EU budget, the Commission set the provisioning rate of the €6 billion loans to Ukraine at 70 %. To comply with this requirement, alongside the 9 % first losses covered by the CPF, member states were requested to provide irrevocable guarantees corresponding to 61 % of the MFA amounts disbursed. This decision[44] to apply a 70 % provisioning rate also relates to repurposed ELM loans disbursed by the EIB to Ukraine.

2.43. During 2022, the EU budget's exposure to Ukraine increased by €7.2 billion under the MFA and €1.7 billion of loans disbursed by the EIB and supported by EU guarantees. At the end of 2022, the exposure of the EU budget to Ukraine had risen to €15.6 billion (€11.6 billion of MFA loans, €0.3 billion of Euratom loans, and €3.7 billion of budgetary guarantees for loans provided by the EIB and another institution). At the same time, the Commission recognised an impairment allowance for the MFA loans made to Ukraine of €2.2 billion, which reflected their life-time expected credit losses.

2.44. The MFA+ instrument[45] was approved at the end of 2022. This is for new loans to Ukraine, and authorises an additional €18.0 billion to be disbursed during 2023 if certain conditions are met. However, the MFA+ does not require any provisioning to cover the risk of default, unlike what is laid down for third countries in the Financial Regulation. We have already highlighted that this situation poses a risk to the EU budget in a previous opinion[46]. In the past, it was only financial assistance to member states that did not require provisioning. Any losses relating to the MFA+ will have to be covered by future EU budgets or by the budgetary 'headroom' between the MFF ceiling and the own resources ceiling. See ***Figure 2.18***.

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[42] Article 211(2) of Regulation (EU) 2018/1046.

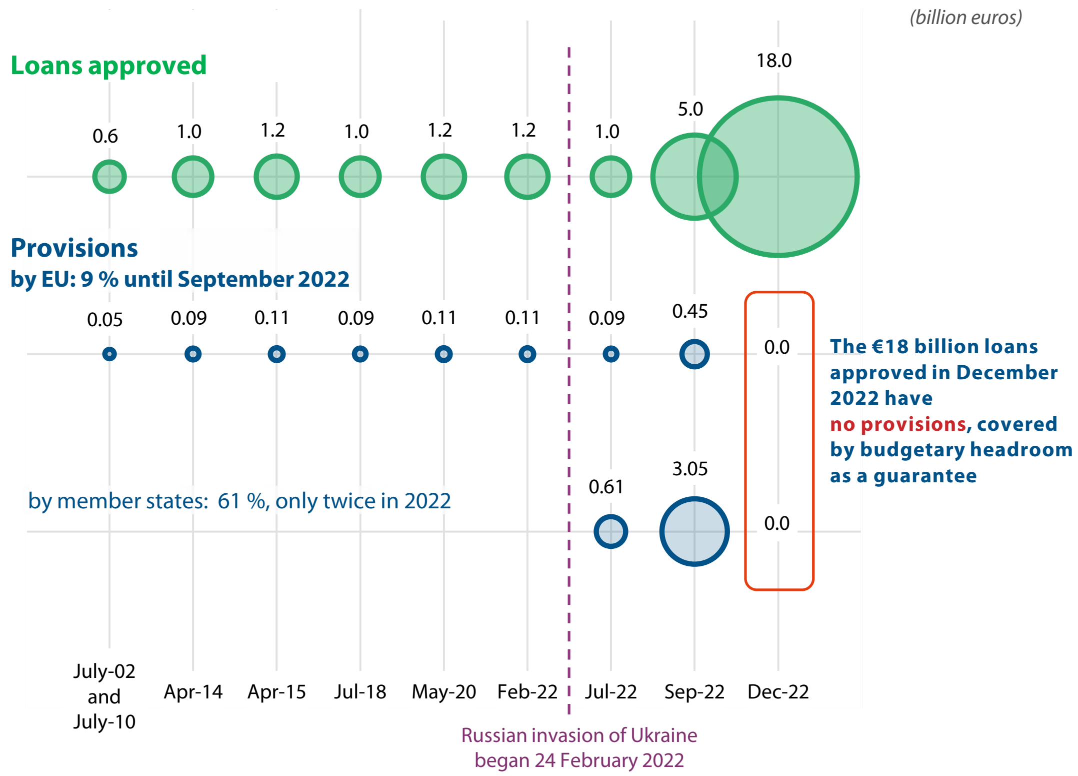
[43] Article 31(5), third paragraph of Regulation (EU) 2021/947 establishing the Neighbourhood, Development and International Cooperation Instrument – Global Europe.

[44] Decision (EU) 2022/1628.

[45] Regulation (EU) 2022/2463.

[46] Opinion 07/2022 regarding the establishment of a diversified funding strategy as a general borrowing method.

Figure 2.18 – Timeline of approved MFA loans to Ukraine, including provisions



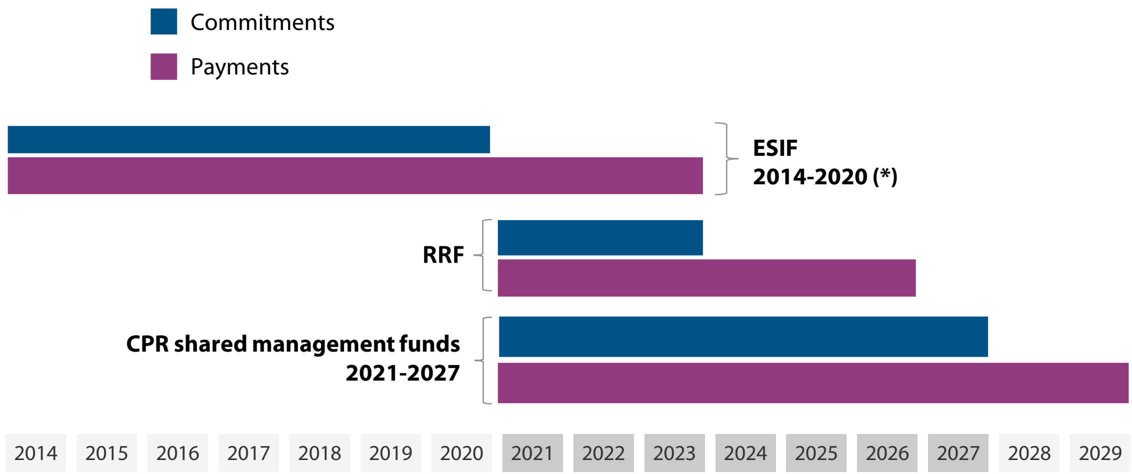
Source: ECA, based on applicable legislation.

Parallel and delayed implementation of several instruments increase the risk of member states losing out on funding

2.45. Member states are currently absorbing funds from several instruments at the same time, see ***Figure 2.19***. They have to close the remaining ESIF programmes from the 2014-2020 MFF, while the implementation of the 2021-2027 shared-management funds under the CPR has also begun, albeit with a delay. At the same time, most member states have reached the implementation phase of NGEU financing. Alongside all this, they need to pursue measures introduced in connection with Russia's war of aggression against Ukraine (such as CARE and FAST-CARE). Last year, we highlighted the risks posed by these simultaneous activities for all bodies responsible for managing and controlling these funds. We still consider that these risks still exist, and that the related recommendation for the Commission to ensure there is additional advisory support to national authorities remains valid[47].

[47] 2021 annual report, paragraph 2.41.

Figure 2.19 – Timeline for committing and paying ESIF, RRF and CPR shared management funds



(*) For the EAFRD, a transitional period was introduced for 2021 and 2022 after which it will fall fully under the framework of the CAP strategic plans. This means that the periods for commitments and payments are effectively extended by 2 years for the EAFRD (2022 and 2025 respectively).

Source: ECA, based on applicable legislation.

2.46. The late adoption of legislation for the shared management funds from the 2021-2027 MFF and the parallel implementation of several instruments resulted in pressure on administrative resources. This in turn led to delays in the approval of all partnership agreements with member states, and of most of the programmes. All of these tasks were not completed until the second half of 2022. In the end, most member states only started allocating financial resources to projects in late 2022 or early 2023, approximately 2 years after the start of the MFF period.

2.47. Generally, the year n+3 rule for decommitments obliges the Commission to decommit amounts in a programme not used by the end of the third financial year following the budget year. However, for the final year of the 2021-2027 MFF, the stricter rule of year n+2 will apply. This differs from the rules for ESIF in the previous MFF period where the year n+3 rule also applied in the final year. The period of implementation for the shared management funds under the CPR is thus shorter than that for the 2014-2020 ESIF.

2.48. The decommitment risk for the 2021-2027 shared management funds under the CPR has risen significantly because several instruments are being implemented at the same time, the remaining ESI and NGEU funding are being prioritised, and there are delays in implementing these funds. There is also a shorter payment timeframe for those funds by 1 year compared to the previous MFF period, and there is an overlap with NGEU payments until 2026.

2.49. Although the measures described in paragraphs ***2.13-2.17*** help absorption of funds, any negative economic developments may make implementation at a sufficient pace impossible in 2023 and 2024, which could increase the risk of decommitments, particularly for the 2021-2027 shared management funds. This is because member states might find it difficult to co-finance projects and choose instead to use other EU funds which offer more flexibility. The Commission produced a slightly lower forecast for decommitments over 2023-2027 of €7.6 billion compared with €8.4 billion in the 2021 forecast. However, if implementation of the shared management funds does not accelerate significantly in 2024 and 2025, the risk of decommitments later in the period will increase exponentially.[48]

High inflation affects the EU budget

2.50. The MFF Regulation sets the maximum expenditure allowed from the EU budget for a period of 7 years. In addition, annual ceilings are defined (commitment and payment appropriations). All these amounts are set at 2018 prices. The adjustment to current prices is done on the basis of a fixed annual increase of 2 %[49]. This fixed deflator is consistent with the European Central Bank (ECB)'s target for price stability and has proved to be sufficient over the last 20 years. Until 2021, EU average inflation has ranged between 0 % and 4 % (for half of the period, it was above 2 %, and for the other half, below that level).

2.51. However, during 2022, consumer price inflation increased significantly, with the EU annual average rate reaching 9.2 %[50]. ECB forecasts suggest that EU inflation will continue at high levels during the next few years. The fixed deflator of 2 % set in the MFF Regulation might therefore prove to be insufficient, if high inflation persists.

[48] Long-term forecast report 2023-2027, COM(2022) 315.

[49] Article 4(2) of the MFF Regulation.

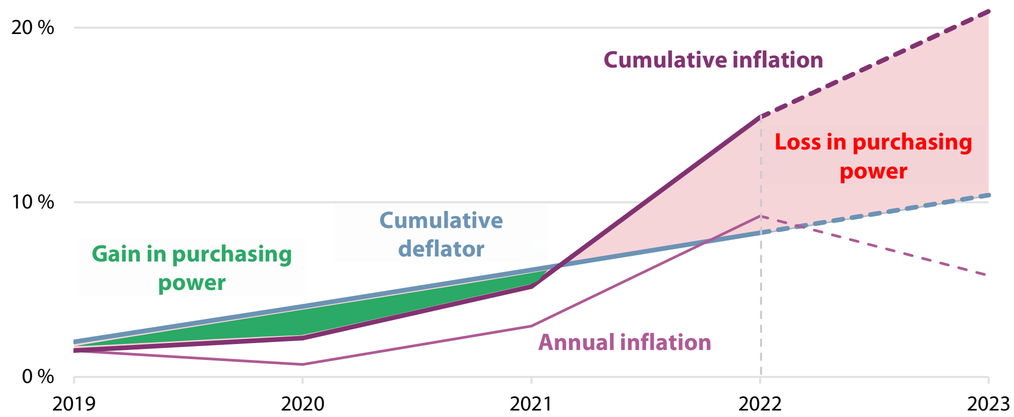
[50] Annual inflation more than tripled in the EU in 2022, Eurostat, 9 March 2023.

High inflation reduces the purchasing power of the EU budget, thereby reducing its real size

2.52. As the increase in the annual EU budget is adjusted with a fixed 2 % deflator, its purchasing power is reduced by the difference between that figure and the average inflation rate, i.e. by approximately 7.2 % in 2022. This basically means that the relative size of the EU budget reduces in proportion to the size of member state economies.

2.53. The EU budget's loss of purchasing power will increase every year that the inflation rate is above 2 %. On the basis of the Commission's inflation forecast[51], we estimate that he EU budget could lose nearly 10 % of its purchasing power by 2023, see ***Figure 2.20***.

Figure 2.20 – Changes in EU budget purchasing power



Source: ECA, based on the Commission's Spring 2023 Economic Forecast.

2.54. The EU budget's loss of purchasing power will affect its expenditure to differing degrees. Parts of the EU budget are fixed costs and they typically correlate with inflation. These budget items will thus increase more than had been expected at the start of the MFF period. This in turn will put further pressure on the EU budget's reduced purchasing power and have a negative impact on the amount of available flexibility for crises and unforeseen events.

[51] Commission's Spring 2023 Economic Forecast.

2.55. A key example is administration costs, which are impacted by inflation. In 2022, the Commission already had to allocate an additional €0.2 billion to heading 7 – European Public Administration – because of rising inflation and energy prices. It used the margin available under the sub-ceiling for the expenditure of the institutions and the overall ceiling for heading 7. Another example is financing costs, see paragraph ***2.30***.

2.56. Inflation and the consequent loss of purchasing power mean that EU funds may not be able to achieve their objectives to the same extent. In 2022, the Commission had already noted a reduction in payment needs from the EAFRD because some beneficiaries of EU funds had postponed or cancelled projects, citing the increase in costs[52] (see paragraph ***2.6***). This situation may continue during 2023 and may negatively affect project timelines.

High inflation changes the proportion of EU revenue from different sources

2.57. In the context of high inflation, other factors being equal, the amounts collected from both the traditional own resources (TOR) and from the own resources based on value added tax (VAT) are likely to increase, as both correlate with the prices of goods sold. This, in combination with the reduction in the relative size of the EU budget (see paragraph ***2.52***), would mean that the share of the gross national income (GNI)-based own resource (the 'balancing own resource') would fall.

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[52] Draft amending budget No 5, COM(2022) 351, paragraph 8.

Conclusions and recommendations

Conclusions

2.58. Most of the available commitment appropriations of the EU budget were used in 2022, particularly because commitment of the 2021-2027 shared management funds under the CPR started in that year. The final payment appropriations were also used almost in full. Absorption of the 2014-2020 ESIF continued in 2022, albeit more slowly than in 2021 and 2020. Absorption of the committed amounts for the 2021-2027 shared management funds remained low and mainly related to pre-financing. See paragraphs ***2.2***-***2.12***.

2.59. Various EU funding instruments were used as an emergency response to unexpected events. New flexibility measures were introduced to help member state authorities dealing with inflows of people fleeing Ukraine. See paragraphs ***2.13***-***2.17***.

2.60. NGEU commitments accelerated in 2022. Member states received €47.2 billion in RRF grant payments that related almost entirely to the fulfilment of milestones and targets. This is more than in 2021, when NGEU payments mostly related to pre-financing, but less than expected. See paragraphs ***2.18***-***2.22***.

2.61. Outstanding commitments from the EU budget and NGEU grant funding, which represent future debts if they are not decommitted, reached a record level of over €450 billion at the end of 2022. This was mainly because there was an increased commitment of NGEU funds, as well as the start of implementation of the 2021-2027 shared management funds in 2022. According to the Commission, after a further increase to some €460 billion in 2023, the outstanding commitments should decrease during 2024 to 2027 to €314 billion, especially as there are no new NGEU commitments post 2023. However, this amount would still be slightly higher when compared to 2020, the last year of the previous MFF. See paragraphs ***2.23***-***2.26***.

2.62. EU debt increased in 2022 to €344.3 billion by year-end (2021: €236.7 billion), mainly because of new borrowing for NGEU, SURE and MFA. Of this borrowing, only the NGEU instrument entailed interest rate risk for the EU budget. In 2022, net interest paid on NGEU borrowing amounted to €0.5 billion. See paragraphs ***2.27***-***2.31***.

2.63. The EU budget's exposure, consisting of its guarantees on borrowing related to loans disbursed through several funding instruments and of contingent liabilities stemming from the EU budgetary guarantees, increased from €205 billion in 2021 to €248 billion in 2022. This was mainly due to the additional RRF and SURE loans provided to member states and the MFA loans provided to Ukraine. In addition, at the end of 2022, there were an additional €109 billion of RRF loans already granted but not yet disbursed, and €18 billion of loans to Ukraine to be granted during 2023 from the recently approved MFA+. The EU budget's exposure will therefore continue to rise. The exposure risk of the EU budget is partially mitigated by guarantees received from member states and by the common provisioning fund. The amounts managed by the CPF increased from €12.3 billion in 2021 to €14.4 billion in 2022 (see paragraphs ***2.32***-***2.39***).

2.64. The EU budget's exposure to Ukraine more than doubled in 2022 compared to 2021 (from €7 billion to €16 billion). The approval of an additional €18 billion for the MFA+ at the end of 2022 will significantly increase this exposure for future budgets. Furthermore, as the additional €18 billion do not require any provisioning, the risk for future EU budgets increases. Any related losses will have to be covered by future EU budgets or by the budgetary 'headroom' between the MFF ceiling and the own resources ceiling. See paragraphs ***2.40***-***2.44***.

2.65. The parallel and delayed implementation of several instruments increases the risk of member states losing out on funding. Most member states only started allocating financial resources to projects from late 2022 due to delays in the approval of the legislation and in turn, of the partnership agreements and programmes. If implementation of the shared management funds is not accelerated significantly in 2024 and 2025, the risk of decommitments later in the period will increase exponentially. See paragraphs ***2.45***-***2.49***.

2.66. High inflation affects the EU budget in several ways. It reduces its purchasing power, increases in particular fixed costs, such as administration costs and the costs of financing, and also affects the proportion of revenue from different sources. See paragraphs ***2.50***-***2.57***.

Recommendations

Recommendation 2.1 – Substantially reduce the level of outstanding commitments

In the light of the high level of outstanding commitments which await payment from future EU budgets, the Commission should identify ways to help member states accelerate the use of EU funds, in particular of shared management funds under the Common Provisions Regulation, while respecting sound financial management.

Target implementation date: By end of 2026

Recommendation 2.2 – Assess the impact on the EU budget of high inflation over several years

The Commission should assess the impact on the EU budget of high inflation continuing over several years and identify tools to mitigate resulting key risks. In this regard, the Commission should protect the EU budget's ability to meet its legal and contractual commitments, such as rising financing costs.

Target implementation date: By end of 2024

Recommendation 2.3 – Sustainability of the EU budget's exposure

In the face of the EU budget's increasing exposure from borrowing for additional payment needs, such as those triggered by the COVID-19 pandemic and Russia's war of aggression against Ukraine, as well as from budgetary guarantees, the Commission should take any appropriate actions needed to ensure that its risk mitigation tools, such as the common provisioning fund, have sufficient capacity, and make public its estimate of total annual exposure.

Target implementation date: By end of 2025

Chapter 3

Getting results from the EU Budget

Contents

Introduction

3.1. Every year, we analyse a number of aspects relating to the *performance* and the *results* achieved by the EU budget, which is implemented by the Commission in cooperation with the member states[1].

3.2. For financial years 2019 to 2021, as a pilot project, we split our annual report into two separate parts. The first part covered the reliability of the EU accounts and the *legality and regularity* of underlying *transactions*, while the second part covered the performance of spending *programmes* under the EU budget. Starting from financial year 2022, we have decided to return to a single annual report that includes a chapter on performance.

3.3. This year, our chapter on performance covers the following topics:

- Part 1 – results and key messages from our 2022 special reports on performance, as well as related information from the Commission and the budgetary and legislative authorities (the European Parliament and the Council);
- Part 2 – implementation of the recommendations made in our 2019 report on the performance of the EU budget;
- Part 3 – implementation of the recommendations we made in the special reports we published in 2019.

[1] Article 317 of the Treaty on the Functioning of the EU.

Part 1 – Results of our performance audits: key messages

Introduction

3.4. Our special reports examine how well the principles of *sound financial management*[2] have been applied in implementing the EU budget. They address key performance and compliance objectives. In 2022, we published 28 special reports addressing many of the challenges the EU is facing across its different spending areas and policies.

3.5. Our audit work targeted the following strategic areas, which we consider to be priorities in line with our 2021-25 strategy:

- the EU's response to the COVID-19 pandemic and post-crisis recovery;
- increasing the EU's economic competitiveness for the benefit of all citizens;
- resilience to threats to the EU's security, and respect for the European values of freedom, democracy and the rule of law;
- climate change, the environment and natural resources; and
- fiscal policies and public finances in the EU.

3.6. ***Figure 3.1*** gives an overview of all the special reports we published in 2022, by strategic area.

[2] Article 33 of the Financial Regulation.

Figure 3.1 – ECA strategic areas covered by special reports in 2022

COVID-19 response	▪ SR 13/2022: Free movement in the EU during the COVID-19 pandemic ▪ SR 18/2022: EU institutions and COVID-19 ▪ SR 19/2022: EU COVID-19 vaccine procurement ▪ SR 21/2022: The Commission's assessment of national recovery and resilience plans ▪ SR 28/2022: Support to mitigate Unemployment Risks in an Emergency (SURE)
Competitiveness	▪ SR 03/2022: 5G roll-out in the EU ▪ SR 06/2022: EU intellectual property rights ▪ SR 07/2022: SME internationalisation instruments ▪ SR 08/2022: ERDF support for SME competitiveness ▪ SR 15/2022: Measures to widen participation in Horizon 2020 ▪ SR 16/2022: Data in the Common Agricultural Policy ▪ SR 23/2022: Synergies between Horizon 2020 and the European Structural and Investment Funds ▪ SR 24/2022: e-Government actions targeting businesses
Resilience and European values	▪ SR 01/2022: EU support for the rule of law in the Western Balkans ▪ SR 05/2022: Cybersecurity of EU institutions, bodies and agencies ▪ SR 14/2022: The Commission's response to fraud in the Common Agricultural Policy ▪ SR 27/2022: EU support to cross-border cooperation in the neighbouring countries
Climate change, environment and natural resources	▪ SR 02/2022: Energy efficiency in enterprises ▪ SR 09/2022: Climate spending in the 2014-2020 EU budget ▪ SR 10/2022: LEADER and community-led local development ▪ SR 12/2022: Durability in rural development ▪ SR 20/2022: EU action to combat illegal fishing ▪ SR 22/2022: EU support to coal regions
Fiscal policies and public finances	▪ SR 04/2022: Investment funds ▪ SR 11/2022: Protecting the EU budget ▪ SR 17/2022: External consultants at the European Commission ▪ SR 25/2022: Verification of Gross National Income for financing the EU budget ▪ SR 26/2022: European statistics

Source: ECA.

3.7. Our auditees have the right to provide replies to our observations[3]. These replies, which also indicate whether they accept or not the recommendations we make, are published together with our special reports. Our 2022 special reports contained 214 recommendations on a wide range of topics, mainly addressed to the Commission. Our auditees fully accepted 91 % of our recommendations.

3.8. The Council and the European Parliament may decide to analyse our special reports. As part of this process, the Council may prepare conclusions. In some cases, the Council refrains from adopting conclusions for special reports, for example when the Commission has already submitted a legislative proposal in the area addressed by our special report.

3.9. At the European Parliament, the Committee on Budgetary Control (CONT) is the principal committee that examines our special reports. The CONT committee may decide to appoint a Member of the Committee for a special report, who may prepare a working document under his or her sole responsibility. If a working document is prepared, it will typically summarise our observations and present the Committee Member's recommendations on the issue, which do not represent the views of the whole CONT committee or those of the Parliament. In some cases, special reports are only presented in the committees specialising in their subject matter. In such cases, working documents are not prepared. Some elements from our special reports may be included in the resolutions relating to the annual *discharge* procedure and in such situations, the observations in these resolutions formally represent the view of the European Parliament. In its discharge resolution for 2021, adopted in May 2023, the European Parliament[4] supported the recommendations of the Court in its annual report as well as in related special reports.

3.10. In the following paragraphs, we present the key messages of our special reports, by strategic area. We have complemented this with an overview of the references made to our special reports by the Council, and by the European Parliament in its discharge resolution. We have also given examples of early actions taken by the Commission following the recommendations made in our 2022 special reports. This

[3] *Ibid.*, Article 259.

[4] European Parliament resolution of 10 May 2023 with observations forming an integral part of the decision on discharge in respect of the implementation of the general budget of the European Union for the financial year 2021, Section III – Commission and executive agencies.

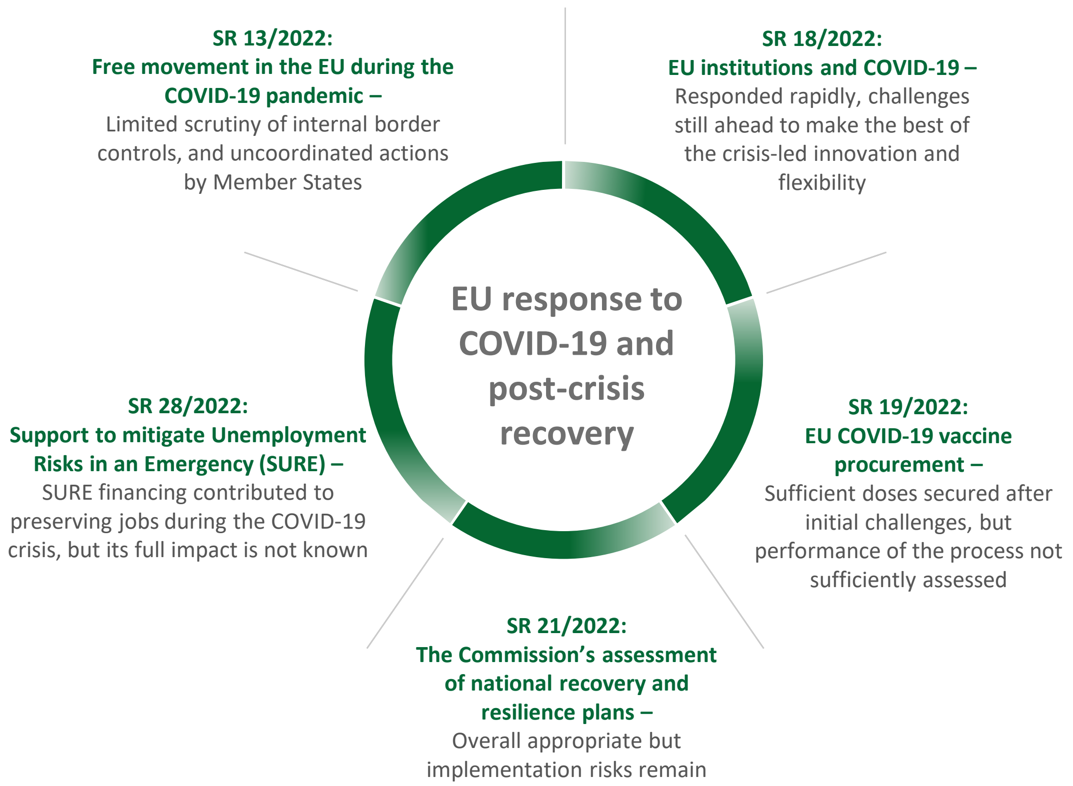
complements the Commission's position as set out in its replies to our special reports, and is without prejudice to the regular follow-up exercise we carry out after 3 years.

EU response to COVID-19 and post-crisis recovery

Introduction

3.11. In 2022, we published five special reports on topics in the strategic area "EU response to COVID-19 and post-crisis recovery" (see ***Figure 3.2***).

Figure 3.2 – Special reports published in 2022 in the strategic area of the EU's COVID-19 response



Source: ECA.

Our key messages

3.12. One effect of the COVID-19 crisis was that member states introduced internal border controls to enforce travel restrictions to limit the spread of the virus. We assessed whether the Commission had taken effective action to protect the right of free movement of persons during the COVID-19 pandemic. We concluded[5] that limitations in the legal framework hindered the Commission's supervision of restrictions imposed by the member states. Furthermore, the Commission did not exercise proper scrutiny to ensure that internal border controls complied with the Schengen legislation. Despite the Commission's initiatives, the member states' travel restrictions were mostly uncoordinated.

3.13. We also looked at how the EU institutions had coped with the COVID-19 pandemic, their level of preparedness and what lessons they had learned. We concluded[6] that EU institutions had been resilient when faced with the COVID-19 crisis, thanks to their rapid and flexible response and their prior investments in digitalisation. However, their business continuity plans were not designed for long-term disruptions and the assessment of the *efficiency* of the new ways of working had been partial.

3.14. Our report on EU action to support the member states in their fight against the COVID-19 concluded[7] that the EU had secured a diversified vaccine portfolio for member states, though it had begun procurement later than the UK and the US. The EU's negotiators were better able to secure the EU's procurement objectives in the later contracts signed with vaccine manufacturers. We also found that the Commission had limited leverage to overcome supply challenges and that the extent of its *impact* on the ramping-up of vaccine production was unclear.

3.15. The *Recovery and Resilience Facility* (RRF) is the centrepiece of the EU's response to the COVID-19 pandemic. We found[8] that the Commission's assessment of member states' recovery and resilience plans (RRPs) was, overall, appropriate given the complexity of the process and the time constraints involved. However, we identified a number of weaknesses in the process and risks for the successful implementation of the RRF. For example:

- disbursement profiles were the result of negotiations rather than a reflection of underlying costs, and the Commission had not yet defined a methodology for calculating the suspension or partial reduction of payments (see paragraph ***3.19***);

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[5] Special report 13/2022.

[6] Special report 18/2022.

[7] Special report 19/2022.

[8] Special report 21/2022.

- some milestones and targets lacked clarity or did not cover all key implementation stages of a measure.

3.16. Our report on *Support to mitigate Unemployment Risks in an Emergency* (SURE) found[9] that while there were indications that funding had reached millions of people, the lack of comprehensive member state data limited the Commission's ability to assess how many jobs had been preserved.

Main institutional stakeholders

Examples of Commission actions

3.17. The Commission published two studies analysing the impact of border-related measures taken by member states in the fight against COVID-19. Similarly to our special report on this topic, a key finding of the first study[10] was that the effect of Commission guidelines on border closures had not been systematic.

3.18. As indicated in the Commission's annual report on internal audits carried out in 2021, the Internal Audit Service of the Commission stressed that the directorates-general and services should continue to:

- duly assess the risks caused by the COVID-19 pandemic in relation to financial management; and
- define and implement adequate mitigating measures, such as adjusting or redefining their control strategies.

3.19. In February 2023, the Commission published a framework to assess the satisfactory fulfilment of milestones and targets, and a methodology to the determine payment suspension under the RRF.

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[9] Special report 28/2022.

[10] European Commission: Analysis of the impact of border-related measures taken by Member States in the fight against COVID-19, 2022.

European Parliament and Council statements

3.20. Members of the European Parliament's Committee on the Budgetary Control prepared working documents for three of the five special reports in this area[11]. One report[12] was referred to other committees, and for another report[13] a background note was prepared, summarising its key messages.

3.21. The European Parliament's 2021 discharge resolution referred to four of the five reports[14].For example, concerning the special report on vaccine procurement, the European Parliament regretted that further information related to the content of these contracts had not been provided by the Commission to the Court. Regarding our report on the assessment of national RRPs, the European Parliament called on the Commission to report to the discharge authority how each payment request related to the number of milestones and targets to be fulfilled for each member state, and to propose measures to guarantee that all milestones and targets be completed by 31 August 2026.

3.22. The Council prepared conclusions for two of the five special reports in this area[15]. Overall, the conclusions supported our recommendations, and they included additional remarks. For example:

- the Council conclusions on our special report on the EU institutions' resilience during the COVID-19 crisis[16] highlighted the need for careful consideration and prioritisation of the environmental impact of the new ways of working in EU institutions as part of their long-term building and *greening* strategies;
- the Council conclusions on our special report on vaccine procurement[17] invited the Commission to carry out an independent evaluation of the adequacy of the procedures to assess *effectiveness* from a public health perspective, of elements of the contract clauses, and of the negotiating team's selection criteria.

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[11] Special reports 18/2022, 19/2022 and 21/2022.

[12] Special report 13/2022.

[13] Special report 28/2022.

[14] Special reports 18/2022, 19/2022, 21/2022 and 28/2022.

[15] Special reports 18/2022 and 19/2022.

[16] Special report 18/2022.

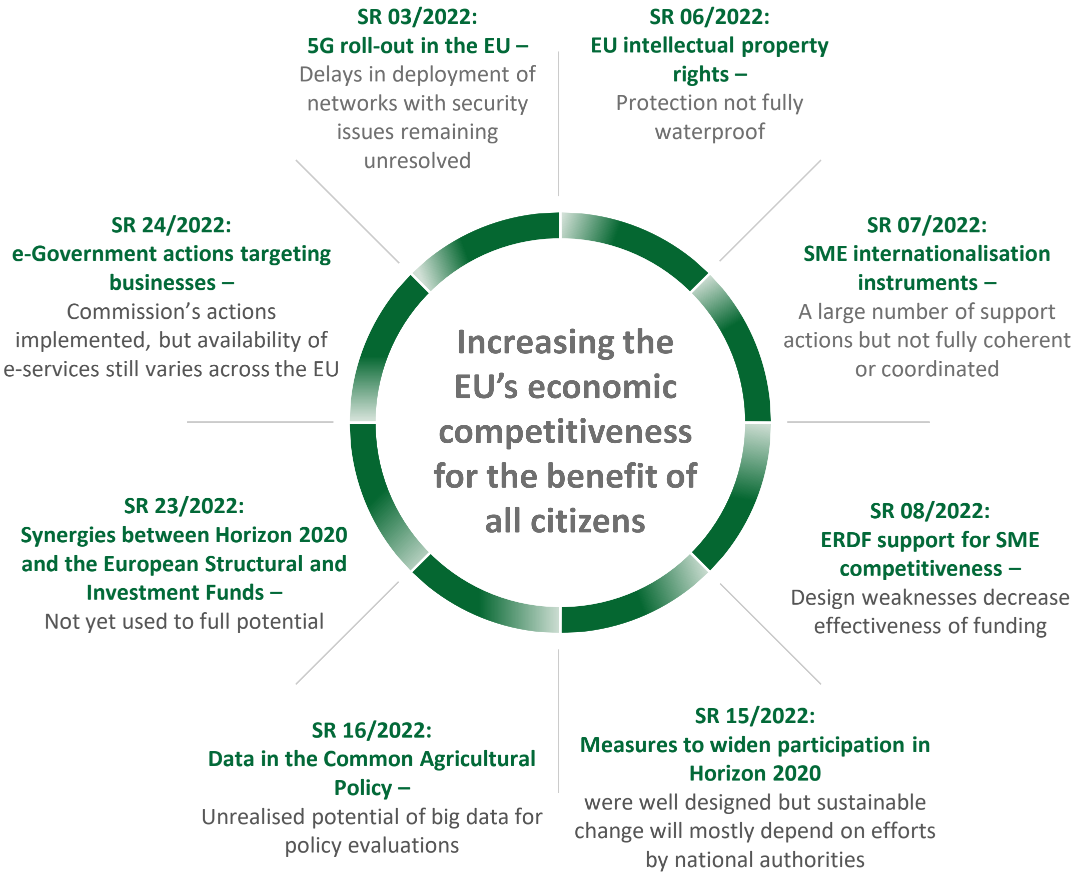
[17] Special report 19/2022.

Increasing the EU's economic competitiveness for the benefit of all citizens

Introduction

3.23. In 2022, we published eight special reports on topics in the strategic area "Increasing the EU's economic competitiveness for the benefit of all citizens" (see ***Figure 3.3***). We focused our audit work on EU support for businesses, for research and innovation (R&I) and for the digital economy and data collection and analysis.

Figure 3.3 – Special reports published in 2022 in the strategic area of EU competitiveness



Source: ECA.

Our key messages

3.24. We examined whether the *European Regional Development Fund* (ERDF) had contributed to improving *small and medium-sized enterprises'* (SMEs') competitiveness. We concluded[18] that although the 2014-2020 ERDF support had stimulated SMEs' willingness to invest, its effectiveness in increasing their competitiveness had been hampered by shortcomings in the funding approach taken by the member states' *managing authorities*. In most ERDF programmes, calls for project submission failed to tackle all relevant obstacles to competitiveness encountered by SMEs. Selection procedures were not designed to award funding to the most competitive project proposals.

3.25. We audited the EU strategy for SME internationalisation and two of the key initiatives in this field: the Enterprise Europe Network and Startup Europe. We found[19] that the strategy correctly identified the main obstacles and that the member states had put in place a large number of actions to support SMEs internationalisation. However, there was no up-to-date inventory of all relevant actions in the field and the financial sustainability of EU actions was not always sufficiently addressed.

3.26. We looked at whether the Commission provided the necessary legislative and support measures to protect EU trademarks, designs and geographical indications. We found[20] that the Commission had established appropriate legislative and support measures to protect EU trademarks. However, legislation on EU designs was incomplete and outdated and there were shortcomings in the legislation on geographical indications. Moreover, we identified weaknesses in the governance and accountability framework of the EU Intellectual Property Office and shortcomings in the EU's intellectual property rights (IPR) enforcement framework.

3.27. In 2022, we completed two audits in the area of support for R&I: one on widening participation in *Horizon 2020* and another on synergies between Horizon 2020 and the *European Structural and Investment Funds* (ESIF).

3.28. We assessed whether the Horizon 2020 widening measures were fit for purpose. We found[21] that while these measures could kick-start progress in R&I in the recipient countries, genuine sustainable change was dependent on national governments fully playing their part in making R&I a priority, in terms of both investments and reforms.

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[18] Special report 08/2022.

[19] Special report 07/2022.

[20] Special report 06/2022.

[21] Special report 15/2022.

3.29. We assessed whether the Commission and the relevant national/regional authorities had taken appropriate measures to establish synergies between Horizon 2020 and the ESIF. We concluded[22] that the implementation of synergies varied. For example, while planned measures to create upstream synergies (ESIF support for capacity-building activities to increase the chances of *beneficiaries* subsequently receiving Horizon 2020 funding) were implemented well, measures to create downstream synergies (ESIF funding for the further development of Horizon 2020 project results) were hardly implemented.

3.30. The 5G network is of strategic importance for the EU's single market, but it also brings security risks. We examined whether the Commission supported member states effectively in achieving EU objectives for the roll-out of their 5G networks and for addressing 5G security concerns in a concerted manner. Our audit showed[23] that there were delays in the member states' roll out of 5G networks. Although the Commission provided member states with support, it did not clearly define the expected quality of 5G services.

3.31. We audited whether the Commission's e-Government actions targeting businesses were effective. We concluded[24] that the Commission had supported the implementation of e-Government solutions by member states through EU-financed projects, by providing technical support and by fostering collaboration between national authorities. However, although the Commission had completed its EU action plan in this area, not all newly developed digital public services were available across the EU.

3.32. One audit concerned data collection and analysis under the *common agricultural policy* (CAP), which accounts for more than a third of the EU budget. We assessed whether the Commission made good use of data and analytics for CAP policy analysis.

3.33. We found[25] that the Commission held large amounts of data for CAP design, monitoring and evaluation and mainly used conventional tools to analyse the data it collected form the member states. However, current CAP data and tools available to

[22] Special report 23/2022.

[23] Special report 03/2022.

[24] Special report 24/2022.

[25] Special report 16/2022.

the Commission did not deliver some significant elements that were needed for well-informed policymaking. The Commission had taken several initiatives to make better use of existing data, but barriers to making the best use of collected data remained.

Main institutional stakeholders

Examples of Commission actions

3.34. The Commission issued several legislative proposals related to intellectual property rights, including a proposal to review the geographical indications system for agricultural products in March 2022 and a proposal for a regulation on geographical indication protection for craft and industrial products, in April 2022. Furthermore, in November 2022, the Commission presented a proposal for a regulation on Community designs and a proposal for a directive on the legal protection of designs.

3.35. In November 2022, a Commission notice entitled "Synergies between Horizon Europe and ERDF" programmes was issued. Its purpose is to outline the new opportunities available to the managing authorities of cohesion policy programmes, national *Horizon Europe* contact points and Horizon Europe project promoters/proposers.

3.36. In September 2022, Commission Implementing Regulation (EU) 2022/1475 was adopted, laying down detailed rules regarding the evaluation of common agricultural policy strategic plans and the provision of information for monitoring and evaluation. It stipulates the scope of the data the member states are required to report to the Commission for the monitoring and evaluation of the CAP.

European Parliament and Council statements

3.37. Members of the European Parliament's Committee on Budgetary Control prepared working documents for four[26] out of eight special reports in this area, while the other four special reports were referred to other committees. The European Parliament's 2021 discharge resolution referred to four of the eight reports[27].

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[26] Special reports 06/2022, 08/2022, 16/2022 and 23/2022.

[27] Special reports 07/2022, 08/2022, 15/2022 and 16/2022.

3.38. The Council issued conclusions for all eight of our special reports in this strategic area. Overall, these conclusions supported our recommendations, and they included additional remarks. For example:

- the Council conclusions on our 5G roll-out report invited the Commission to work together with the member states to recommend policies and measures in order to reach European connectivity targets and 5G coverage of all populated areas in the EU by 2030, while taking into consideration pivotal geopolitical and economic factors.
- the Council conclusions on our report on the protection of IPR also called on the Commission to present the corresponding legislative proposal without further delay, to make design protection more accessible and attractive for creators and businesses.
- the Council conclusions on our Horizon 2020 report also invited the Commission to evaluate the impact of widening measures on participation in the programme, as these were introduced in order to increase the participation of member states with low R&I performance.
- the Council conclusions on our report on synergies between Horizon 2020 and the ESIF considered that the pursuit of synergies between funds should not interfere with the evaluation of proposals under Horizon Europe, and invited the Commission to pay due attention to potential undesired impacts of synergies and take precautionary measures if necessary.
- the Council conclusions on our e-Government report called on the Commission to ensure coherence between the required actions and the relevant *financial instruments* that could assist the member states in achieving the digital transformation of their public services.

3.39. However, in the case of ERDF support for SME competitiveness, the Council did not support our recommendation that selection procedures should be designed to award funding to the most competitive project proposals. Rather, it shared the Commission’s opinion that the managing authority is ultimately responsible for drawing up appropriate ambitious selection procedures and criteria used to select operations. Nevertheless, the Council invited the Commission to consider the advantages and disadvantages of competitive and non-competitive selection procedures on a case-by-case basis.

Resilience to threats to the EU's security and respect for the European values of freedom, democracy and the rule of law

Introduction

3.40. In 2022, we published four special reports on topics in the strategic area "Resilience to threats to the European Union's security and respect for the European values of freedom, democracy and rule of law" (see ***Figure 3.4***). In terms of external threats to the EU, our audit work focused on the rule of law and cross-border cooperation, while in terms of internal threats we focused on cybersecurity and *fraud*.

Figure 3.4 – Special reports published in 2022 in the strategic area of resilience and European values

Source: ECA.

Our key messages

3.41. The rule of law is one of the fundamental values on which the EU is founded and represents an essential condition for *candidate countries* to join the EU. Our audit examined whether EU support for the rule of law in the Western Balkans in 2014-2020 was effective. We found[28] that while EU action had contributed to reforms in technical

[28] Special report 01/2022.

and operational areas, such as improving the efficiency of the judiciary and the development of relevant legislation, it had had little overall impact on fundamental rule-of-law reforms in the region. A key reason for this was insufficient domestic political will to drive the necessary reforms. Moreover, IPA II lacked strict conditionality clauses directly linking stalled rule-of-law reforms to restrictions on funding in other sectors.

3.42. Cross border cooperation is a key element of the EU's neighbourhood policy, which covers 16 countries along its *external borders*. We examined whether cross-border cooperation programmes were effective in enhancing territorial cooperation across the EU's external borders.

3.43. We concluded[29] that the 2014-2020 programmes provided relevant and valuable support to the regions on both sides of the EU external border, but that their implementation started very late. Due to Russia's invasion of Ukraine, the Commission suspended financing agreements for programmes with Russia and Belarus, and the implementation of 9 out of 17 programmes proposed for 2021-2027 involving Russia and Belarus was in severe doubt.

3.44. Due to the sensitive information they process, EU institutions, bodies and agencies are attractive targets for potential hackers. Our audit of cybersecurity of EU institutions concluded[30] that they had not achieved a level of cyber preparedness commensurate with the threats. They did not approach cybersecurity consistently, essential controls and key cybersecurity good practices were not always in place, and cybersecurity training was not provided systematically.

3.45. We examined whether the Commission had taken appropriate action on fraud in CAP spending and whether it had identified and properly responded to the fraud risks affecting CAP spending. We found[31] that the Commission had responded to instances of fraud in CAP spending, but was not sufficiently proactive in addressing the impact of the risk of illegal land grabbing on CAP payments, in monitoring member states' anti-fraud measures, and in exploiting the potential of new technologies.

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[29] Special report 27/2022.

[30] Special report 05/2022.

[31] Special report 14/2022.

Main institutional stakeholders

Examples of Commission actions

3.46. In December 2022, the Commission published a *staff working document*[32] which provides a uniform set of indicators that need to be used in all relevant interventions, to ensure that the results can be aggregated, and the impact and outcomes of IPA III can be more clearly demonstrated for the entire instrument.

3.47. In March 2022, the Commission issued a legislative proposal for a regulation on a common cybersecurity framework.

European Parliament and Council Statements

3.48. Members of the European Parliament's Committee on the Budgetary Control prepared working documents for two[33] of our four special reports in this strategic area, and one special report[34] was referred to another committee.

3.49. The European Parliament's 2021 discharge resolution referred to two of the four reports[35]. For example, regarding our report on fraud in CAP spending, the European Parliament emphasised that weaknesses in member states' checks are prone to being exploited by fraudsters and that the Commission should monitor national anti-fraud measures better, provide more concrete guidance, and promote the use of new technologies for preventing and detecting fraud.

3.50. By the end of March 2023, the Council had drafted conclusions for all four of our special reports in this strategic area. Overall, these conclusions supported our recommendations, and they included additional remarks.

3.51. For example, the Council conclusions on our special report on fraud in CAP also underlined that the financial impact of reported fraudulent *irregularities* was

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[32] Commission Staff Working Document: The Instrument for Pre-Accession assistance (IPA III) Results Framework, 2022.

[33] Special reports 01/2022 and 14/2022.

[34] Special report 05/2022.

[35] Special reports 01/2022 and 14/2022.

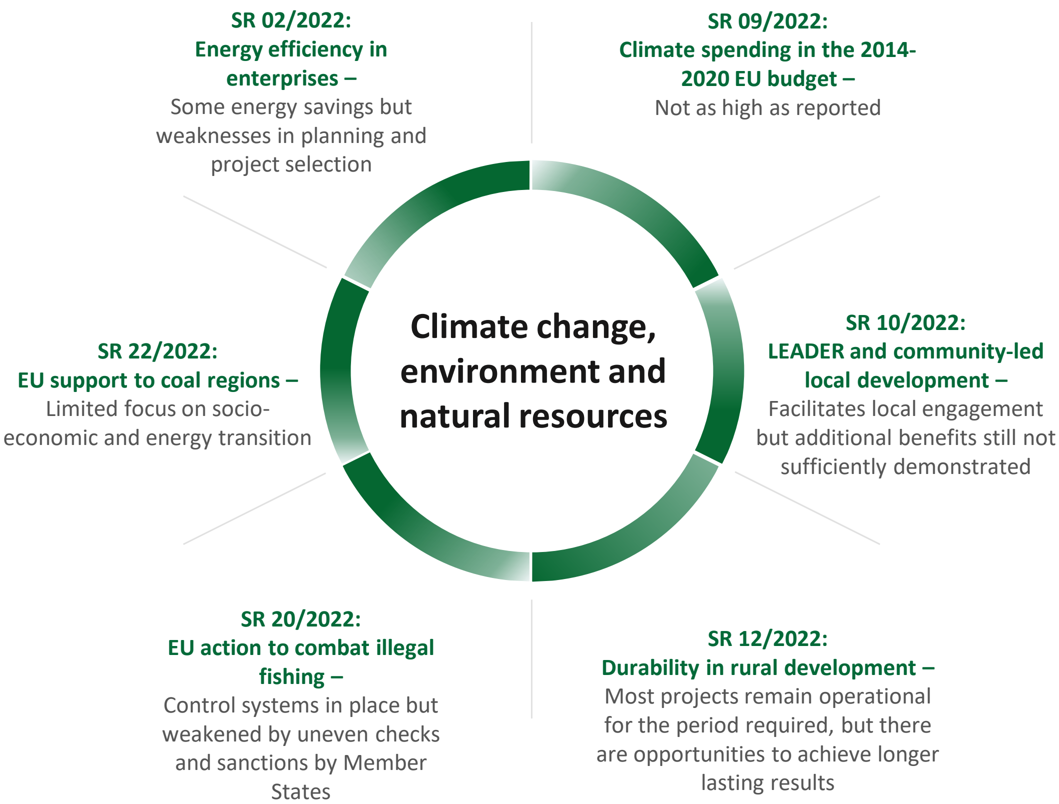
generally low and that the number of irregularities and the associated amounts were not direct indicators of the amount of fraud affecting the EU budget.

Climate change, the environment and natural resources

Introduction

3.52. In 2022, we published six special reports on topics in the strategic area "Climate change, the environment and natural resources". Three of these reports concerned topics relating to the management of natural resources, two concerned topics relating to energy and one concerned the cross-cutting topic of climate spending in the EU budget (see ***Figure 3.5***).

Figure 3.5 – Special reports published in 2022 in the strategic of climate change, the environment and natural resources



Source: ECA.

Our key messages

3.53. The EU introduced the LEADER programme as a bottom-up initiative to support the development of disadvantaged rural regions through projects addressing local needs. We examined whether LEADER delivered benefits that justified its additional costs and risks, in particular compared to mainstream (top-down) EU spending programmes. We concluded[36] that the LEADER approach to rural development facilitated local engagement, but there was little evidence that the benefits of this approach outweighed its costs and risks.

3.54. Since 2007, the EU has spent approximately €10 billion to diversify its rural economy and €15 billion to improve infrastructure in rural areas through *rural development programmes*. Investments supported through those programmes were, in general, required to remain operational for 5 years. We examined whether these investments delivered durable benefits. We found[37] that most rural development projects relating to infrastructure and diversification operated throughout the legal durability period, but that diversification projects ended soon after and that insights on projects' benefits over time were limited.

3.55. Illegal, unreported and unregulated fishing ('illegal fishing') is one of the greatest threats to marine ecosystems, undermining efforts to manage fisheries sustainably. We examined the EU framework, action and spending to prevent products of illegal fishing from ending up on EU citizens' plates. We concluded[38] that the EU control systems mitigated the risk of illegal fishing, but that their effectiveness was reduced by the member states' uneven application of checks and sanctions.

3.56. Improvements in energy efficiency and the phasing-out of coal are essential factors in achieving the EU's ambition to become climate neutral by 2050. We examined whether EU funds for improving energy efficiency in enterprises were spent soundly and whether EU support had contributed effectively to the socio-economic and energy transition in EU regions where the coal industry had been in decline.

3.57. Our report on energy efficiency in enterprises found[39] that the Commission had not assessed the potential for energy savings or financing needs, and that the

[36] Special report 10/2022.

[37] Special report 12/2022.

[38] Special report 20/2022.

[39] Special report 02/2022.

member states’ planning of funds was not aligned with their national energy efficiency priorities. We also concluded[40] that EU support for coal regions had a limited focus and impact on job creation and energy transition. Despite overall progress, coal remained a significant source of greenhouse gas emissions in some member states.

3.58. Our audit on spending on climate action examined whether the Commission had reported relevant and reliable climate-spending information for 2014-2020. We found[41] that the Commission had overestimated such spending by at least €72 billion, mostly due to overestimation of the contribution of agricultural funding, but also of infrastructure and cohesion funding.

Main institutional stakeholders

Examples of Commission actions

3.59. In 2022, the Commission published a staff working document providing a summary of *ex post evaluations* of the 2007-2013 rural development programmes. Overall, the summary report’s conclusions on the topics addressed by three of our special reports in the areas of rural development and climate spending were in line with our findings, albeit that they concerned a different *programming period* in some cases. These conclusions were as follows:

- only 6 % of the member states and regions reported on the positive effects of environmental measures in relation to climate change mitigation. However, these positive effects could be seen as side-effects rather than the result of clear targeting in the rural development programmes;
- interventions encouraging diversification of the rural economy prove to produce less direct and measurable effects in the short term;
- although the LEADER approach received positive recognition from the stakeholders questioned, too few reports provided conclusions on the approach, and quantifiable indicators were not able to capture its specific characteristics and objectives.

3.60. In July 2022, the Commission published a study on the legislative frameworks and enforcement systems of member states in relation to the EU regulation on illegal,

[40] Special report 22/2022.

[41] Special report 09/2022.

unreported and unregulated fishing. The study identified significant weaknesses in many legislative frameworks and a lack of relevant sanctions.

3.61. In December 2022, the Commission published guidance for member states on updating their 2021-2030 national energy and climate plans. The guidance document encouraged member states to increase their level of ambition to speed up the green transition to climate neutrality, including the phasing-out of coal power, while mitigating social and employment impacts.

3.62. In May 2022, the Commission presented *REPowerEU*, a proposal to reduce dependence on fossil fuels and accelerate the green transition.

European Parliament and Council statements

3.63. Members of the European Parliament's Committee on Budgetary Control prepared working documents for five of the six special reports in this area[42], and one was referred to another committee[43].

3.64. The European Parliament's 2021 discharge resolution referred to two of the six reports[44]. For example, regarding our report on climate spending, the European Parliament regretted that the Commission had not yet addressed weaknesses in the reported figures of its new methodology.

3.65. The Council prepared conclusions for five[45] of the six special reports in this area. Overall, the Council conclusions supported our recommendations, and they included additional remarks. For example:

- the Council conclusions on our report on the LEADER approach to rural development noted that it was not always possible to define and achieve the desired targets due to the depopulation of rural areas;

[42] Special reports 02/2022, 09/2022, 10/2022, 12/2022 and 22/2022.

[43] Special report 20/2022.

[44] Special reports 09/2022 and 10/2022.

[45] Special reports 02/2022, 09/2022, 10/2022, 12/2022 and 22/2022.

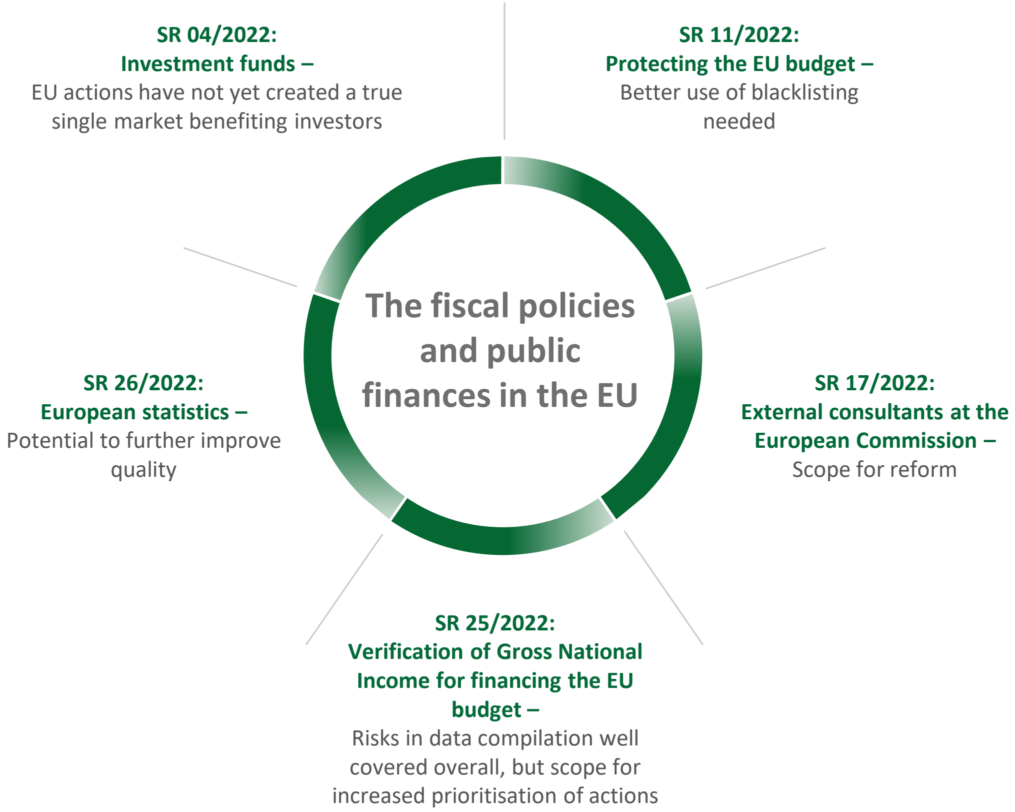
- the Council conclusions on our report on durability in rural development stated that the selection procedure should be further improved and noted that the long-term impact of supported projects is vital for rural development;
- the Council conclusions on our report on energy efficiency in enterprises stressed that energy efficiency projects facing price increases and supply chain disruption issues should be successfully completed;
- the Council conclusions on our report on climate spending highlighted the importance of an EU methodology for climate tracking that is solid, reliable, clearly communicated and based on scientific evidence, to take stock of best practice at national and local level.

Fiscal policies and public finances in the EU

Introduction

3.66. In 2022, we published five special reports on topics in the strategic area "Fiscal policies and public finances in the EU". Three of these reports dealt with EU budgetary issues, one with investment funds and one with statistics (see ***Figure 3.6***).

Figure 3.6 – Special reports published in 2022 in the strategic area of fiscal policies and public finances



Source: ECA.

Our key messages

3.67. When managing payments from the EU budget, the Commission aims to avoid entering into financial agreements with untrustworthy counterparties, such as those involved in fraud. Our audit on blacklisting assessed the effectiveness of the Commission's actions to achieve this objective. As the Commission increasingly uses external consultants to perform a range of advisory and support services, we examined whether the use of external consultants took place in a manner that safeguarded the EU's interests and ensured value for money.

3.68. On the revenue side of the budget, where member states' *gross national income* (GNI) is the main source of financing for the EU budget, we assessed whether the Commission had managed the most recently completed GNI verification cycle (2016-2019) effectively and efficiently.

3.69. The key conclusions of these special reports addressing budgetary issues were:

- the blacklisting of entities applying for EU funds[46] was not used effectively as there was no coherent set of obligations for the different payment modes. For example, the use of exclusion systems was not mandatory for funds managed by member states;
- the Commission's management of the use of external consultants[47] did not fully ensure maximum value for money. It did not manage the risks of overdependence and potential conflicts of interest sufficiently, while its reporting on the use of consultants was weak;
- overall, the Commission was effective in identifying high-risk issues in the verification of GNI-based contributions[48] but did not address all of them in a timely manner.

3.70. In the area of capital markets and investment funds[49], the EU aims to create a single competitive market which provides a wider choice of less costly but reliable investment products and ensures financial stability. We examined the EU's efforts to set up this single market for investment funds. We concluded[50] that EU actions had enabled a single market for investment funds but had not yet achieved the desired outcomes, as true cross-border activities and benefits for investors remained limited. The consistency and effectiveness of fund supervision and investor protection was also insufficient.

3.71. We assessed whether the Commission provided high-quality European statistics. We concluded[51] that the Commission provided European statistics of generally sufficient quality, but identified a number of weaknesses, including data gaps for specific areas (e.g. labour, business and health).

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[46] Special report 11/2022.

[47] Special report 17/2022.

[48] Special report 25/2022.

[49] Special report 04/2022.

[50] *Ibid.*

[51] Special report 26/2022.

Main institutional stakeholders

Examples of Commission actions

3.72. In May 2022 the Commission published a study to contribute to the development of the retail investment strategy that was planned for 2022 under the capital markets union 2020 action plan. The study's conclusions are consistent with those of our report.

3.73. In May 2022, the Commission issued a proposal to recast the financial rules applicable to the EU's general budget. This recast took on board recommendations, from our special report on blacklisting, regarding the exclusion of untrustworthy counterparties from funding and the extension of the early detection and exclusion system to funds under *shared management*.

European Parliament and Council Statements

3.74. Members of the European Parliament's Committee on Budgetary Control prepared working documents for three special reports[52], while the other two special reports[53] were referred to other committees.

3.75. The European Parliament's 2021 discharge resolution referred to two of the five reports[54]. For example, regarding our report on blacklisting, the European Parliament called on the Commission to work hand-in-hand with Parliament on the recast of the *Financial Regulation* to further improve the early detection and exclusion system and make it an efficient and effective tool. Concerning our report on external consultants, the European Parliament demanded the Commission to further develop its framework governing the use of external consultants, and make better use of the results of external consultants' services.

3.76. The Council prepared conclusions for three[55] of our five special reports concerning this ECA strategic area. It did not prepare any conclusions for the report on blacklisting as the timing coincided with the discussions on a legislative proposal, and

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[52] Special reports 11/2022, 17/2022 and 25/2022.

[53] Special reports 04/2022 and 26/2022.

[54] Special reports 11/2022 and 17/2022.

[55] Special reports 04/2022, 17/2022 and 25/2022.

the conclusions on the report on European statistics are still a work in progress. Overall, these conclusions supported our recommendations, and they included additional remarks, for example:

- the Council conclusions on investment funds invited the Commission to continue monitoring market developments in this field and report regularly on possible impediments to the deepening of the single market for investment funds;
- the Council conclusions on external consultants invited the Commission to consider the budgetary implications of outsourcing activities and processes against keeping them as tasks for its own staff, while ensuring the optimisation of staff resources at the current level and seeking efficiency gains.

Part 2 – Follow-up of the recommendations made in our report on the performance of the EU budget – status at the end of 2019

3.77. This part provides information on the follow-up of the recommendations made in our report on the performance of the EU budget covering the financial year 2019. The follow-up exercise is an important part of the audit process and it is explained in more detail in paragraph ***3.81*** of ***Part 3 – Follow-up of recommendations***.

3.78. The report contained five recommendations, with the fifth recommendation divided into four sub-recommendations. All recommendations and sub-recommendations were addressed to and accepted by the Commission.

3.79. We carried out a review to assess the extent to which the weaknesses identified have been addressed. The results of our work reflect the situation at the beginning of April 2023. We classified two recommendations as fully implemented, and two as implemented in some respects. Regarding recommendation 5, we assess two of its four sub-recommendations as fully implemented and the other two as implemented in most respects.

3.80. ***Annex 3.1*** provides an overview of the five recommendations' implementation status.

Part 3 – Follow-up of the recommendations made in our special reports from 2019

Introduction

3.81. Every year, we review the extent to which our auditees have taken action in response to our recommendations 3 years after we made them. This follow-up of our recommendations is an important step in the audit cycle. It provides us with feedback on whether our auditees have implemented the actions we recommended and whether the issues we raised have been addressed, and gives our auditees an incentive to implement our recommendations. It is also important in designing and planning our future audit work and for keeping track of risks.

3.82. This year, we analysed recommendations from 22 of the 25 special reports we published in 2019. The recommendations made in the three remaining special reports[56] are beyond the scope of this exercise as we have followed up on them in separate audits or will do so in the near future.

3.83. In total, we followed up on 213 recommendations. Of these, 179 were addressed to the European Commission. The remaining 34 recommendations were addressed to the European Parliament, the Council of the European Union and the European Council, the *European Union Agency for Asylum*, the European Banking Authority and the European Border and Coast Guard Agency ("*Frontex*").

3.84. We used documentary reviews and interviews with auditees to carry out our follow-up work. To ensure a fair and balanced review, we sent our findings to the auditees and took account of their replies in our final analysis. To avoid double counting, recommendations are listed under the auditee to which they were mainly addressed (with the exception of special report 13/2019, as the recommendations

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[56] Special report 01/2019: "Fighting fraud in EU spending – action needed", special report 03/2019: "European Fund for Strategic Investments – Action needed to make EFSI a full success", and special report 12/2019: "E-commerce – many of the challenges of collecting VAT and customs duties remain to be resolved".

were addressed to all three institutions audited). The results of our work reflect the situation as at the end of April 2023.

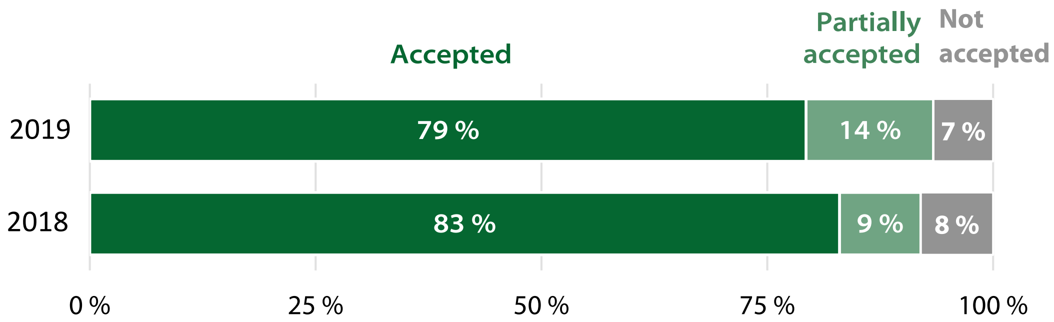
Observations

The proportion of recommendations fully accepted by our auditees has slightly decreased

3.85. Out of the 213 recommendations that we followed up, our auditees fully or partially accepted 199 (93 %) of them and did not accept 14 (7 %) (see ***Figure 3.7***).

3.86. Compared with the previous year, the proportion of our recommendations fully accepted decreased from 83 % to 79 %.

Figure 3.7 – Acceptance of our 2019 and 2018 special report recommendations by our auditees



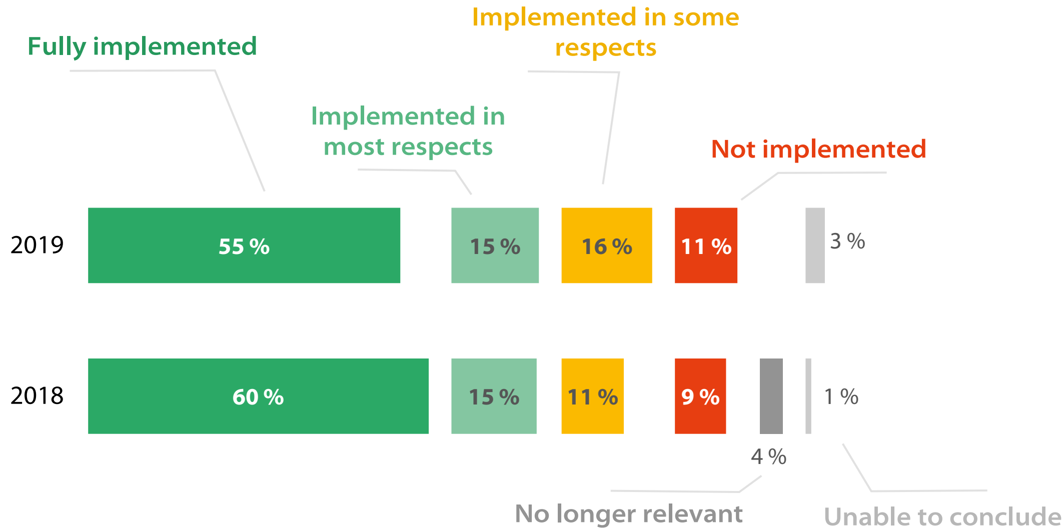
Source: ECA.

The proportion of recommendations implemented in full or in most respects has also slightly decreased

3.87. Four of the 213 recommendations we followed up were not yet due for implementation at the time of our follow-up review. Of the remaining 209 recommendations, our auditees have fully implemented 114 (55 %). They have implemented a further 32 (15 %) in most respects (see ***Figure 3.8***).

3.88. Compared with the previous year, the total proportion of recommendations fully or mostly implemented decreased from 75 % to 70 %. The total proportion of recommendations implemented only in some respects or not at all increased from 20 % to 27 %. ***Annex 3.2*** and ***Annex 3.3*** show the implementation status of the recommendations in more detail.

Figure 3.8 – Implementation of our 2019 and 2018 special report recommendations by our auditees



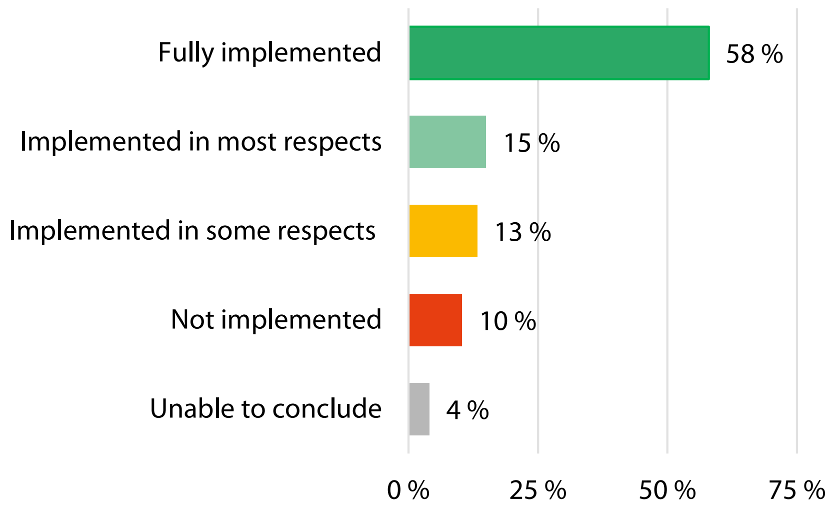
Source: ECA.

73 % of recommendations addressed to the European Commission have been implemented in full or in most aspects

3.89. The total number of recommendations addressed to the Commission was 205. Twenty-six of these came from the three special reports (01/2019, 03/2019 and 12/2019), that are covered by a separate follow-up and therefore not included in this report (see paragraph ***3.82***).

3.90. Four of the 179 recommendations we covered were not yet due for implementation by the time of our follow-up review. Of the remaining 175 recommendations, the Commission has fully implemented 101 (58 %) and implemented a further 26 (15 %) in most respects. In addition, the Commission has implemented 24 (13 %) in some respects, and has not implemented 17 (10 %) of them at all (see ***Figure 3.9***). When our auditees did not implement our recommendations, this was most often because they had not accepted them (see paragraph ***3.101***). In seven cases (4 %), we were unable to conclude (e.g. as it was too early to assess this recommendation's level of implementation).

Figure 3.9 – Implementation of our 2019 special report recommendations addressed to the Commission



Source: ECA.

3.91. ***Annex 3.2*** shows the implementation status of the recommendations in more detail. It also provides brief descriptions of the improvements and of the remaining weaknesses affecting, for example, the recommendations which have been implemented in some respects.

3.92. For nine of the 22 special reports (see ***Annex 3.4***), the Commission implemented all recommendations addressed to it in full or in most respects.

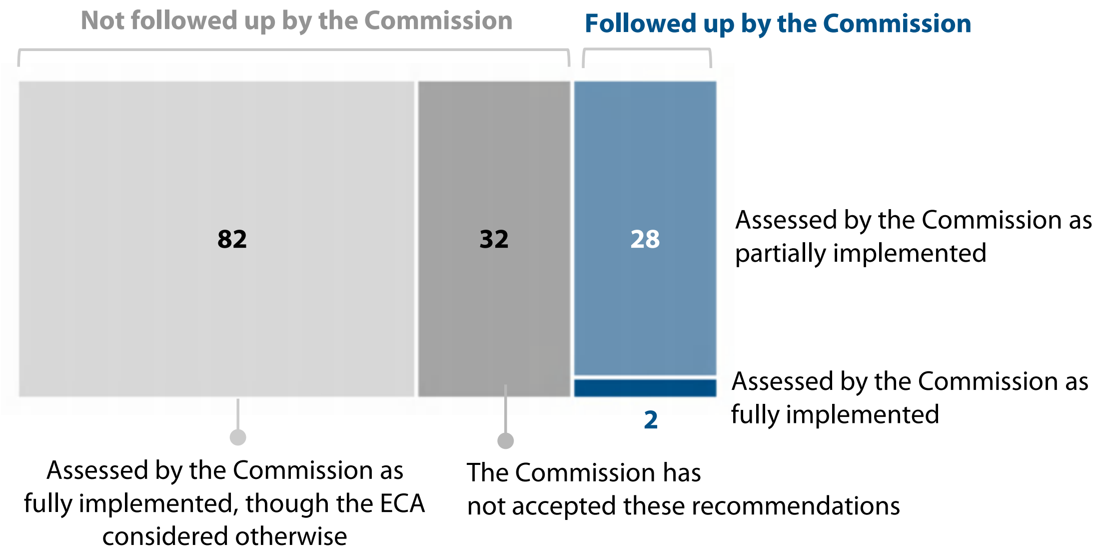
3.93. The Commission sometimes differs from us in its assessment of whether and to what extent recommendations have been implemented. If the Commission considers that a recommendation has been fully implemented, it usually stops following it up, even if our assessment of the level of implementation differs.

3.94. We assessed 47 recommendations from our 2017 special reports and 97 recommendations from our 2018 special reports as outstanding in our follow-up exercises from 2020 and 2021[57]. This year, 114 of those 144 recommendations remained unimplemented and were no longer being followed up by the Commission (see ***Figure 3.10***). The Commission had not accepted 32 of those 114 recommendations in the special reports themselves. It considered that the

[57] See our 2020 report on the performance of the EU budget, paragraphs 7.11-7.13, and our 2021 report on the performance of the EU budget, paragraphs 3.13-3.15.

remaining 82 recommendations had been fully implemented by the time of the last 2 years' follow-up exercises, though our assessment differed.

Figure 3.10 – Follow-up of 2017 and 2018 special report recommendations not fully implemented by the Commission during our two previous years' follow-up exercises



Source: ECA.

3.95. The Commission has continued to follow up the remaining 30 of the 144 recommendations which had not been implemented in full. The Commission considers that it has since finished implementing two of those 30 recommendations. Applying the follow-up approach for outstanding recommendations used for our last two follow-up exercises (from our 2017 and 2018 special reports), we continue to monitor such cases by analysing Commission data, but we have not examined them in detail.

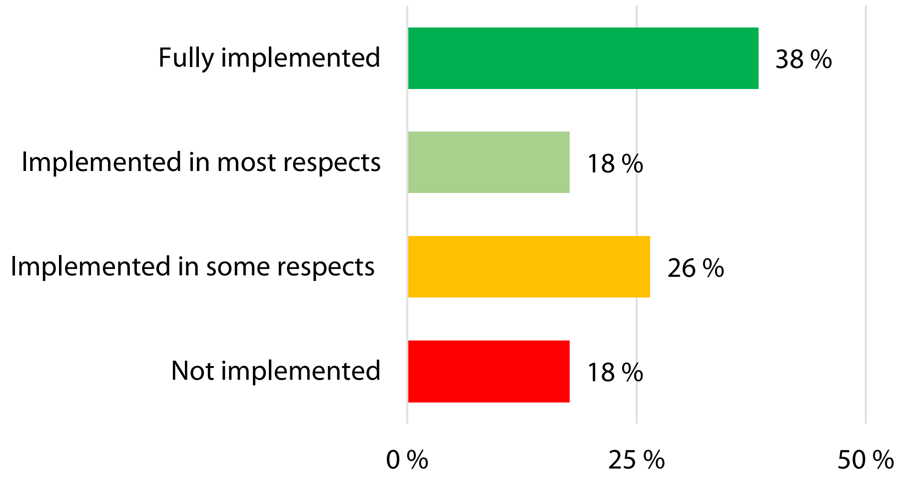
56 % of recommendations addressed to other auditees have been implemented in full or in most respects

3.96. Special reports 10/2019, 13/2019 and 24/2019 contained a total of 34 recommendations addressed to auditees other than the European Commission (the European Parliament, the Council of the European Union and the European Council, the European Union Agency for Asylum, the European Banking Authority and the European Border and Coast Guard Agency ("Frontex")).

3.97. These auditees have fully implemented 13 (38 %) of the recommendations addressed to them. They have implemented a further six (18 %) in most respects (see

Figure 3.11). Of the remaining recommendations, they have implemented nine (26 %) in some respects and have not implemented six (18 %) at all. In all six of those cases, the auditee had either not accepted our recommendation or accepted it only partially.

Figure 3.11 – Implementation of our 2019 special report recommendations addressed to auditees other than the Commission



Source: ECA.

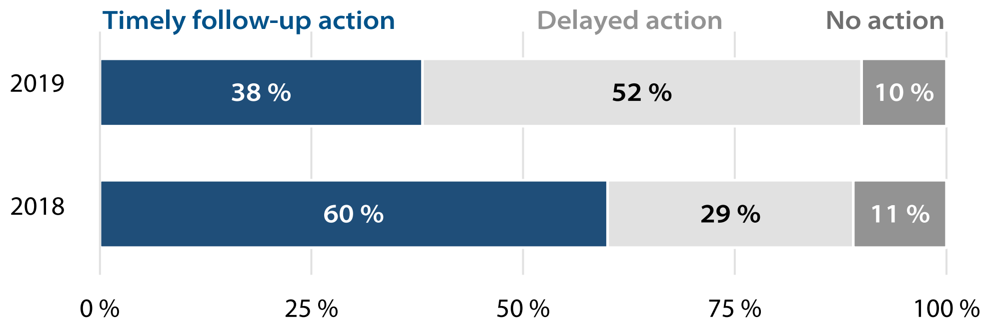
3.98. *Annex 3.3* provides a detailed overview of the implementation status of these recommendations addressed to auditees other than the Commission. It also provides brief descriptions of improvements made and weaknesses remaining in relation to the recommendations which have been implemented in some respects.

The proportion of recommendations implemented on time has decreased

3.99. For the last few years, we have consistently given a timeframe for the implementation of recommendations in our special reports. Timeframes are discussed and agreed with the auditee and specified in our special reports to ensure that they are clear to all parties concerned.

3.100. Compared to the previous year, the proportion of recommendations implemented on time decreased from 60 % to 38 %, while the proportion with no action taken remained relatively stable (see *Figure 3.12*). Our auditees cited the COVID-19 pandemic as a reason for the delays.

Figure 3.12 – Timeliness of actions taken by auditees to address our 2019 and 2018 special report recommendations



Note: Excluded from the calculation are recommendations where the timeline has not yet passed (16 cases in 2018 and four cases in 2019), where we were unable to conclude (three cases in 2018 and seven cases in 2019) and where the recommendations are no longer relevant (13 cases in 2018).

Source: ECA.

Level of implementation correlates with auditees' acceptance of audit recommendations

3.101. Our analysis shows that 105 (66 %) of the 159 special report recommendations fully accepted by the auditees were implemented in full. By contrast, only one (8 %) of the 12 special report recommendations not accepted by our auditees was implemented in full. ***Figure 3.13*** presents the level of implementation broken down by different levels of acceptance and demonstrates the correlation between auditees' acceptance of audit recommendations.

Figure 3.13 – Level of implementation broken down by auditees' acceptance levels

Implementation level	Acceptance level: Accepted	Partially accepted	Not accepted
Fully implemented	66 %	26 %	8 %
Implemented in most respects	18 %	10 %	8 %
Implemented in some respects	13 %	39 %	0 %
Not implemented	3 %	26 %	83 %

Note: The percentage values of the level of implementation relate to the respective level of acceptance. Excluded from the calculation are four cases not yet due for implementation at the time of our follow-up review and seven cases where we were unable to conclude. Figures are presented without fractional digits to improve readability which can lead to rounding differences.

Source: ECA.

Conclusion

3.102. Our analysis shows that the acceptance of our 2019 special report recommendations decreased compared to the previous year, from 83 % to 79 %. The proportion of recommendations implemented in full or in most respects decreased from 75 % to 70 %. Similarly, the proportion of recommendations implemented on time decreased from 60 % last year to 38 % this year. The COVID-19 pandemic was the reason the auditees gave most often for these delays in implementation.

Annexes

Annex 3.1 – Follow-up of previous recommendations for the 'Report of the European Court of Auditors on the performance of the EU budget – status at the end of 2019'

Level of acceptance: accepted; partially accepted; not accepted.

Level of implementation: fully; in most respects; in some respects; not implemented.

Level of timeliness: timely; delayed; deadline still pending; no follow-up action; no assessment of timeliness.

ECA recommendation	Level of acceptance	ECA analysis of progress made in implementing recommendation		
		Level of implementation	Remarks	Level of timeliness
Recommendation 1: The Commission should continue to report on the performance of EU spending programmes for at least as long as substantial amounts of payments related to a given MFF period are being made, i.e. beyond the duration of the MFF period concerned. Consequently, for some time after the launch of next MFF's programmes, the Commission should report on the performance of two sets of programmes in parallel.	accepted	fully		timely

ECA recommendation	Level of acceptance	ECA analysis of progress made in implementing recommendation		
		Level of implementation	Remarks	Level of timeliness
Recommendation 2: The Commission should further improve the reliability of the performance information presented in the programme statements and the AMPR (e.g. through quality checks, sharing of good practices, and through standing instructions for programme statements), and systematically indicate if any issues were identified.			The guidelines issued by the Commission's central services to the directorates-general implementing financial programmes have been updated, stipulating that any issues identified in relation to the reliability of indicator data need to be reported in the *programme statements*. However, these guidelines should additionally include details regarding checks to be performed by the directorates-general on the underlying data, and the results of these checks should be reported in their *annual activity reports*.	
Recommendation 3: The Commission should ensure that lessons learnt from RSB scrutiny are disseminated, so that weaknesses, especially those concerning design and methodology, are avoided in future evaluations.				
Recommendation 4: In order to increase transparency, the Commission should explain in the programme statements how targets for indicators were set and where the underlying data comes from.			The instructions in the budget circular have been updated and require of the directorates-general to publish the method used to set targets for programme indicators. However, a significant number of target-setting methodologies are not yet documented, and around one third of programme indicator targets still need to be defined.	

ECA recommendation	Level of acceptance	ECA analysis of progress made in implementing recommendation		
		Level of implementation	Remarks	Level of timeliness
Recommendation 5a: The Commission should include in its performance reports: (a) more analysis of the efficiency and economy of programmes when information becomes available;				
Recommendation 5b: The Commission should include in its performance reports: (b) more systematic analysis of the significant external factors affecting programme performance;				
Recommendation 5c: The Commission should include in its performance reports: (c) clear assessments, for all the performance indicators reported on, of whether they are on track to meet their targets;				
Recommendation 5d: The Commission should include in its performance reports: (d) clear and balanced assessments of performance, covering all programme objectives in appropriate detail.				

Annex 3.2 – Follow-up of 2019 special report recommendations – European Commission

Level of acceptance: accepted; partially accepted; not accepted.

Level of implementation: fully; in most respects; in some respects; not implemented; unable to conclude.

Level of timeliness: timely; delayed; deadline still pending; no follow-up action; no assessment of timeliness.

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
SR 02/2019: "Chemical hazards in our food – EU food safety policy protects us but faces challenges"	1 (a)	73			Since 2019, the Commission has undertaken several evaluations and *impact assessments* of different types of legislation. The Commission identified weaknesses and started taking action to address some of these. The process of assessing potential changes to the legislation on chemical hazards is still ongoing. The Commission plans to complete its assessment by 2025. The Commission has not undertaken any general reflection on how to design legislation in such a way that it can be applied consistently.	
	1 (b)	73				
	2	75				
	3 (a)	76				
	3 (b)	76				
SR 04/2019: "The control system for organic	1 (a)	93				
	1 (b)	93				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
products has improved, but some challenges remain”	1 (c)	93				
	2 (a)	97				
	2 (b)	97				
	2 (c)	97			The Commission has taken specific action to strengthen checks on a range of imported organic products from several non-EU countries. The Commission has not issued general guidance to member states on how to carry out specific checks on the control bodies’ supervision of importers.	
	3 (a)	98			In recent years, the Commission has carried out a limited number of traceability exercises. There is no evidence that their results are used to better target audits or ad hoc checks on control bodies and in non-EU countries.	
	3 (b)	98			In June and July 2020, the Commission presented the results of traceability exercises and acknowledged to the committee on organic production that weaknesses exist. The Commission has not yet identified possible corrective action together with the competent authorities.	
	3 (c)	98			In 2021, the Commission adopted legal provisions to improve the cross-border accessibility of data on organic certificates and, later, to extend the same system to non-EU countries. The operational	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
					developments required in order to improve cross-border accessibility remain a work in progress.	
SR 05/2019: "FEAD-Fund for European Aid to the Most Deprived – Valuable support but its contribution to reducing poverty is not yet established"	1 (a)	61				
	1 (b)	61				
	1 (c)	61			The ESF+ Regulation does not address the particularly important point of the recommendation about requiring member states to set the recommended quantified targets.	
	2 (b)	61				
	3	61			We concluded that it was too early to assess the level of implementation for this recommendation.	
SR 06/2019: "Tackling fraud in EU cohesion spending – Managing authorities need to strengthen detection, response and coordination"	1 (b)	80			Some managing authorities in the ten member states with no national anti-fraud strategies (Bulgaria, Czechia, Greece, France, Croatia, Italy, Latvia, Hungary, Malta and Slovakia) have adopted formal anti-fraud policies, but six member states have not yet taken concrete measures (Ireland, Cyprus, the Netherlands, Poland, Slovenia and Finland).	
	3 (b)	87			The Commission has undertaken some awareness-raising action, but we consider that the EU Funds Anti-Fraud Knowledge and Resource Centre duplicates to some extent the existing dissemination through the electronic data exchange system site. The proposed changes in the recast Financial Regulation, aimed at making data-mining tools compulsory, have the	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
					potential to extend the possibility of using data analytics to all relevant parties, including the European Court of Auditors. No measures have been taken to improve the promotion of fraud detection methods by regularly disseminating specific cases of best practice, and the Commission has not yet published any specific guidance for 2021-2027 on anti-fraud measures to be taken by member state authorities.	
	3 (c)	87			The country profiles assessing member states' detection and reporting capacities, which were already planned at the time of our audit, are still under development and their implementation has been delayed.	
	4 (a)	89			The European Anti-Fraud Office has updated the Irregularity Management System to enable the reporting of irregularities in relation to the 2021-2027 programming period, and three member states have already reported suspected or established fraud cases to date, although not relating to cohesion policy. The system includes a built-in analytical tool that offers a number of tailored analyses. The Irregularity Management System still needs to be further adapted, and member states continue to underreport the number of suspected fraud cases, as evidenced by our *statement of assurance* work. This indicates that additional action is needed.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	4 (b)	89			In 2019 and 2020, the Commission took initial steps to remind *audit authorities*, but not managing authorities, of their obligation to systematically assess the horizontal implications of fraud. In 2022, the Commission requested managing authorities to consider detected fraud cases in their management verification strategy. However, our recommendation was that they should systematically consider the horizontal implications of suspected or established fraud for all other operations potentially affected. Since 2020, and in particular following the adoption of the new *Common Provisions Regulation* for the 2021-2027 programming period, no further steps were taken to require managing authorities to carry out this assessment.	
	4 (c)	89				
	5	91			The Commission encouraged anti-fraud coordination services to expand their role to encompass coordination with all national bodies responsible for the investigation and potential prosecution of suspected fraud, rather than with managing authorities alone. The Commission did not subsequently propose any further clarification about the functions of the anti-fraud coordination services, which remain insufficiently defined. The limitations in the definition of the functions and obligations of the anti-fraud coordination services reduce the effectiveness of this follow-up action. The only way to	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
					remedy these limitations would be for the Commission to propose legislation.	
SR 07/2019: "EU actions for cross-border healthcare – significant ambitions but improved management required"	1 (a)	68				
	1 (b)	68				
	1 (c)	68				
	2 (a)	70				
	2 (b)	70				
	3 (a)	72			The Commission has started evaluating the EU's rare disease strategy. It has not yet decided whether the strategy needs to be modified, but plans to do so by 2023, following consultation and reflection.	
	3 (b)	72				
	3 (c)	72				
SR 08/2019: "Wind and solar power for electricity generation – significant action needed if EU targets to be met"	1	82				
	2	83				
	3 (a)	85				
	3 (b)	85				
	4	86				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	5 (a)	87			Delays in developing the grid infrastructure and interconnectors impact the deployment of renewables. The Commission needs to identify those member states for which the grid is still limiting the further deployment of renewables.	
	5 (b)	87			The Commission needs to advise those member states for which the grid potentially hampers the deployment of renewables to take action to resolve grid insufficiencies.	
	5 (c)	87			In several cases, the Commission has suggested using the cohesion policy funds for the grid and interconnectors. However, all these investment measures were taken after the target implementation date proposed in our recommendation. The completion of the programming exercise for the 2021-2027 European Regional Development Fund and *Cohesion Fund* will provide further evidence of cohesion policy funds having been used for this purpose.	
	6	89				
SR 09/2019: "EU support to Morocco – Limited results so far"	1 (i)	100				
	1 (ii)	100				
	1 (iii)	100				
	2 (i)	101				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	2 (ii)	101				
	2 (iii)	101				
	3 (i)	102				
	3 (ii)	102				
	3 (iii)	102				
	4 (i)	103			The Commission initially rejected our recommendation, maintaining its case-by-case practice. It did not provide us with clear procedures supporting this approach. Therefore, we cannot conclude more generally on the level of implementation beyond the individual case in question.	
	4 (ii)	103			The Commission refused disbursements when conditions were not met, which demonstrates that the payment verification review works as intended. However, the updated guidelines do not provide for systematic verification of the supporting data.	
	4 (iii)	103			The Commission initially rejected our recommendation, maintaining its case-by-case practice. It did not provide us with clear procedures supporting this approach. Therefore, we cannot conclude more generally on the level of implementation beyond the individual case in question.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	5 (i)	104			The number of field visits that took place before 2020 was limited (one field visit in 2019 and one in 2021). The field visits did not allow corrective action to be taken during the implementation period (before deciding on disbursement). The Commission has no methodology for deciding whether field visits are necessary.	
	5 (ii)	104				
	5 (iii)	104				
	6	106			The Commission developed and implemented a thorough action plan on support for the health sector, with three specific campaigns. It also defined goals, specific means of communication and measurable indicators. The Commission and the European *External Action* Service have not introduced any obligation linking disbursements to visibility. The health sector support programme (PASS III) lacked visibility to the general public.	
SR 10/2019: "EU-wide stress tests for banks – unparalleled amount of information on banks provided but greater coordination and	5	113			The Commission highlighted weaknesses in the existing structure of the European Supervisory Authorities in its report (COM(2022) 228) and asked stakeholders for their views. The Commission did not propose any changes to the existing legislation to address the weaknesses identified because it considered that the co-legislators did not support further changes and that the timing was not appropriate.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
focus on risks needed”						
SR 11/2019: “The EU’s regulation for the modernisation of air traffic management has added value – but the funding was largely unnecessary”	1	72				
	2	72				
	3 (a)	73				
	3 (b)	73				
	4 (a)	74				
	4 (b)	74				
	5 (a)	75				
	5 (b)	75			This recommendation was not yet due for implementation by the time of our follow-up review. The new performance plans, including the corresponding performance targets, only need to be submitted by 1 October 2024.	
	1 (2)	88				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
SR 13/2019: "The ethical frameworks of the audited EU institutions – Scope for improvement"	1 (3)	88				
	1 (4)	88				
	2 (1)	89				
	2 (2)	89				
	2 (3)	89			The Commission proposed the creation of an interinstitutional ethics body on 8 June 2023 (COM(2023) 311 final).	
	3	90				
SR 14/2019: "'Have your say!' – Commission's public consultations engage citizens, but fall short of outreach activities"	1 (1st indent)	111				
	1 (2nd indent)	111				
	2 (1st indent)	113				
	2 (2nd indent)	113				
	3 (1st indent)	114				
	3 (2nd indent)	114				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	4 (1st indent)	115				
	4 (2nd indent)	115				
	4 (3rd indent)	115				
	5 (1st indent)	117				
	5 (2nd indent)	117				
	6	118				
SR 15/2019: "Implementation of the 2014 staff reform package at the Commission – Big savings but not without consequences for staff"	1.1	97				
	1.2	97				
	2	97				
	3	97				
SR 16/2019: "European Environmental	1 (a)	58				
	1 (b)	58				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
Economic Accounts – Usefulness for policymakers can be improved”	1 (c)	58				
	2 (a)	60				
	2 (b)	60			Based on discussions with national authorities on costs and benefits, three new modules for the European Environmental Economic Accounts were included in the proposal of July 2022 to revise Regulation (EU) 691/2011 (COM(2022) 329). It is unclear to what extent the Commission assessed the specific policy-making needs of its relevant departments when proposing these new modules.	
	3 (a)	62				
	3 (b)	62				
	3 (c)	62				
SR 17/2019: “Centrally managed EU interventions for venture capital – in need of more direction”	1 (a)	113			The Commission withdrew its original 2018 *InvestEU* proposal and presented a new InvestEU proposal in May 2020 in response to the COVID-19 crisis (COM(2020) 403 final). Due to the urgency of the proposal, the Commission did not conduct any formal impact assessment of those elements that were new compared to its original 2018 proposal. Our recommendation was to be implemented by the time the guarantee agreement between the European Commission, the European Investment Bank (EIB) and the *European Investment Fund* (EIF) was signed, which took place in March 2022. Despite the initial urgency,	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
					the period of almost 2 years between the presentation of the revised legal proposal and the signature of the agreement would have been enough time to subsequently carry out a thorough analysis as recommended.	
	1 (b)	113				
	1 (c)	113			The Commission neither accepted nor implemented the recommendation.	
	2 (a)	116			The investment guidelines now include a new aim relating to moderate and emerging innovator countries (MEICs). The proportion of total InvestEU funding that can be allocated to any three member states combined has also been limited. Although these measures are steps forward, they are modest and unlikely to achieve a major shift towards less developed venture capital markets. In connection with this recommendation, the Commission presented further general actions such as the review of the European Venture Capital Funds Regulation. These actions concern the markets as whole, but not underdeveloped markets specifically.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	2 (b)	116			The Commission improved the definition of minimum thresholds for private investment for each fund by no longer considering promotional banks to be private, but did not set targets. When it comes to the effective *crowding-in* of private investors, minimum thresholds per fund are no substitute for targets, taking into account policy objectives, local venture capital markets or sectors of activity.	
	2 (c)	116			The Commission referred to provisions on the possibility of exiting through *secondary sales*. Secondary sales may be promoted by gradual exit clauses mentioned in the related agreements, but so far guarantee agreements have not included any provisions obliging or encouraging the implementing partners to introduce exit clauses. The agreements only envisage an option of exit clauses, which does not fit the purpose of our recommendation. We therefore assess the recommendation as not implemented.	
	2 (d)	116			The investment guidelines allow deviations from the *pari passu principle* in cases of specific policy relevance, the meaning of which is not further specified. The European Scale-up Action for Risk Capital scheme mentioned in the agreement between the EU and the European Investment Bank and European Investment Fund does not qualify as asymmetric (the relationship between risk and profit is maintained in these schemes) and is not linked to an acute market failure. As it therefore falls beyond	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
					the scope of our recommendation, we assess the recommendation as not implemented.	
	3 (a)	121			The Commission neither accepted nor implemented the recommendation.	
	3 (b)	121			We were unable to assess the level of implementation of this recommendation due to a lack of evidence.	
	3 (c)	121			The Commission accepted this recommendation, but the weaknesses mentioned in our special report still persist. The identification of exit routes played only a marginal role in the Call of Interest published by the EIF.	
	3 (d)	121			The Commission neither accepted nor implemented the recommendation.	
	3 (e)	121				
SR 18/2019: "EU greenhouse gas emissions – Well reported, but better insight needed into future reductions"	1	70				
	2 (a)	75				
	2 (b)	75			In late 2022, we started an audit on the CAP strategic plans, which should allow us to follow up on this recommendation. The audit report is due for publication in the first half of 2024.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	2 (c)	75				
SR 19/2019: "INEA – benefits delivered but CEF shortcomings to be addressed"	1 (a)	83				
	1 (b)	83				
	2 (a)	84				
	2 (b)	84			The Commission and the European Climate, Infrastructure and Environment *Executive Agency* have addressed our recommendation to make use of more result-oriented goals and indicators in some respects. Some performance indicators, such as the ones measuring the quality of services and customer satisfaction, were introduced in the 2021 annual reporting. The indicators do not cover key performance aspects such as the programme implementation rate or the *absorption* of funds.	
	3 (a)	85				
	3 (b)	85				
	3 (c)	85				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	4 (a)	88				
	4 (b)	88				
	4 (c)	88				
	5 (a)	89			A monitoring tool has been implemented to collect information to report on *output* indicators. The indicators introduced for the 2021-2027 *Connecting Europe Facility* do not cover project results.	
	5 (b)	89			Our recommendation to specify *result indicators* in call objectives, monitor them in agreements and report on them has not been addressed. No result-based indicators have been introduced.	
SR 20/2019: "EU information systems supporting border control – A strong tool, but more focus needed on timely and complete data"	1	85				
	2 (a)	88				
	2 (b)	88				
	3	91				
	4 (a)	94				
	4 (b)	94				
	5 (a)	95				
	5 (b)	95				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
SR 21/2019: "Addressing antimicrobial resistance – Progress in the animal sector, but this health threat remains a challenge for the EU"	1 (a)	68				
	1 (b)	68				
	1 (c)	68				
	2	70				
	3 (a)	75			In December 2021, the Commission launched a study for the *ex post* evaluation of Horizon 2020, including the programme's support for research on antimicrobial resistance. The *ex post* evaluation report is expected to be published in 2023. There has been no comprehensive evaluation of the support the Commission has given to antimicrobial resistance research (including but not limited to Horizon 2020 support) to identify weaknesses in the funding/*grants* system and suggest how to address these weaknesses.	
	3 (b)	75				
	3 (c)	75				
SR 22/2019: "EU requirements for national budgetary frameworks – Need to further strengthen them	1	100				
	2	101			The Commission delivered a sound analysis of the main weaknesses in the requirements for medium-term budgetary frameworks and independent fiscal institutions, providing ideas for reforms. Improvements to these requirements are still pending, since they have not been included in the	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
and to better monitor their application”					current legislation. Nor does the communication on the orientations for a reform of the EU economic governance framework, published on 9 November 2022, reflect these improvements. The Commission submitted a legislative proposal on the reform of economic governance in April 2023. This proposal addresses only partially our recommendation mainly with regard to strengthening independent fiscal institutions, but to a much lesser extent with regard to medium-term budgetary frameworks.	
	3 (a)	102			The Commission neither accepted nor implemented the recommendation.	
	3 (b)	102			The Commission neither accepted nor implemented the recommendation.	
	4 (a)	105				
	4 (b)	105				
	4 (c)	105				
	4 (d)	105			The Commission has prepared a strategy for monitoring the functioning of national budgetary frameworks. The strategy does not describe the structured methodology used to assess the application of Directive 2011/85. The Commission did not present sufficient evidence of the first assessment carried out in 2022 (including any follow-up required);	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
					nor did it present sufficient evidence of the strategy being applied on a regular basis.	
SR 23/2019: "Farmers' income stabilisation – Comprehensive set of tools, but low uptake of instruments and overcompensation need to be tackled"	1	86			In late 2022, we started an audit on the CAP strategic plans, which should allow us to follow up on this recommendation. The audit report is due for publication in the first half of 2024.	
	2 (a)	88			The Commission neither accepted nor implemented the recommendation.	
	2 (b)	88			Under the new CAP, the Commission will collect more detailed data on the use of the different risk-management tools than it did under the previous CAP. The Commission will still be unable to monitor area and insured capital covered by the risk-management tools.	
	3 (a)	90			The Commission states the reasons for establishing exceptional measures in the recitals to the corresponding regulations. The Commission has maintained its position that it rejects the part of the recommendation requiring *ex ante* definition of objective market and economic parameters and criteria triggering exceptional measures.	
	3 (b)	90			The Commission neither accepted nor implemented the recommendation.	
	4 (a)	91			The Commission neither accepted nor implemented the recommendation.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	4 (b)	91			The amendment of Commission *Delegated Regulation* 2017/891 is intended to prevent cases of overcompensation in the fruit and vegetables sector. The Commission has not taken action to prevent cases of overcompensation in sectors other than the fruit and vegetables sector; nor to require significant co-financing when member states play a large role in defining key elements of support schemes.	
SR 24/2019: "Asylum, relocation and return of migrants – Time to step up action to address disparities between objectives and results"	1	152				
	2 (a)	157				
	2 (b) (i)	157				
	2 (b) (ii)	157				
	2 (b) (iii)	157				
	2 (c)	157				
	5 (a)	163				
	5 (b)	163				
	5 (c)	163				
	6 (a)	166				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	6 (b)	166				
	6 (c)	166				
	6 (d)	166				
SR 25/2019: "Data quality in budget support – weaknesses in some indicators and in the verification of the payment for variable tranches"	1	55				
	2 (a)	56				
	2 (b)	56				
	3 (a)	57				
	3 (b)	57				
	4	58				
	5	59				
	6 (a)	60				
	6 (b)	60				

Annex 3.3 – Follow-up of 2019 special report recommendations – Other auditees

Level of acceptance: accepted; partially accepted; not accepted.

Level of implementation: fully; in most respects; in some respects; not implemented.

Level of timeliness: timely; delayed; deadline still pending; no follow-up action; no assessment of timeliness.

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
European Banking Authority (EBA)						
SR 10/2019: "EU-wide stress tests for banks – unparalleled amount of information on banks provided but greater coordination and focus on risks needed"	1 (1)	109			The European Banking Authority (EBA) requests more information from competent authorities on their processes than it did previously and summarises them in a report. It has not planned or performed any on-the-spot checks. The checks on competent authorities' work focus on material statistical outliers in high-risk areas and on data *errors*.	
	1 (2)	109				
	1 (3)	109				
	1 (4)	109				
	2	109			The EBA has started working on the development of top-down stress-test capabilities. The EBA's Board of Supervisors decided to introduce centralised elements to the future EU-wide stress-test framework and to build expertise in top-down modelling. The EBA has started	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
					developing internal top-down stress-test capabilities, but tangible results have been limited so far.	
	3	110			The EBA has increased the overall sample size by 20 banks, thereby indirectly enhancing geographical coverage. Its approach to selecting samples for stress tests is still not risk-based or country-specific, as the Board of Supervisors did not support such an approach. Stress tests may not cover banks that are smaller and non-systemic but still high-risk, even though it could be important to cover such banks due to potential spill-over effects.	
	4 (1)	112				
	4 (2)	112			The option of having multiple scenarios was considered but not ultimately implemented. The EBA considers that this option may come into play if a top-down approach is ultimately used. The same applies in the case of country-specific risks and risk analysis.	
	4 (3)	112			The EBA set out the overall severity level, in terms of GDP and its drivers, clearly and early in the adverse scenario for the 2020 stress test. Together with the European Systemic Risk Board, the EBA defined a measure of severity *ex ante* in each country, focusing on GDP as a key driver. The scenarios for the stress tests in 2020 and 2021 were based on a single set of identified risks. The EBA did not carry out any *country-specific shocks* or sensitivity analyses.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	6 (1)	114			The EBA's reports now include bank-specific capital requirements and to some extent present results by group and type of bank. They now compare the results of stress tests with those in previous reports. In the 2023 EU-wide stress test, the EBA plans to further improve the interactive tools by providing tables that include all banks. This will make it possible to compare banks in terms of impacts, capital levels and other important metrics, as well as providing different clustering possibilities for analysis purposes. It is still difficult for users to compare banks on key indicators using interactive dashboards. When explaining the results, the reports do not link them to the stress to which the banks in question are exposed.	
	6 (2)	114			The EBA makes more assertions about which factors are relevant for resilience. Its reports include assertions on the driving factors (such as credit risk or market risk), but these remain rather general. The EBA does not make any assertions about which scenario elements are the key risk drivers. Nor does it make any overall statements on the resilience of the EU's banking system.	
European Parliament						
SR 13/2019: "The ethical frameworks of the audited EU institutions – Scope for improvement"	1 (1)	88			The European Parliament has drafted a single strategy on ethics that also includes future projects in the field of ethics. However, as of December 2022, the draft single strategy on ethics had not yet been adopted, and it does not outline detailed objectives and priorities to be monitored by performance indicators.	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
	1 (2)	88			The European Parliament has incorporated an automated workflow for processing ethics-related requests into its Human Resources Management Portal. It has not yet finalised and approved its procedures for checks on staff declarations.	
	1 (3)	88			The European Parliament neither accepted nor implemented the recommendation.	
	1 (4)	88				
	1 (5)	88			The European Parliament neither accepted nor implemented the recommendation.	
	1 (6)	88			The Parliament has not yet taken sufficient action to strengthen the post-mandate provisions for Members of the European Parliament.	
	2 (1)	89				
	2 (2)	89				
	2 (3)	89				
	3	90				
Council of the European Union and the European Council						
SR 13/2019: "The ethical frameworks of the	1 (1)	88				
	1 (2)	88			The General Secretariat of the Council launched a hub on ethics that provides guidance for staff on matters relating	

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
audited EU institutions – scope for improvement”					to conflict of interest. There are no written internal standard procedures for scrutinising staff declarations of interest.	
	1 (4)	88				
	2 (1)	89				
	2 (2)	89				
	2 (3)	89				
	3	90				
European Union Agency for Asylum						
SR 24/2019: “Asylum, relocation and return of migrants – Time to step up action to address disparities between objectives and results”	3 (a)	159				
	3 (b)	159				
	3 (c)	159				
European Border and Coast Guard Agency (“Frontex”)						
SR 24/2019: “Asylum, relocation and	4 (a)	160				
	4 (b)	160				

Report number and title	No	SR para.	Level of acceptance	ECA analysis of progress made in implementing recommendation		
				Level of implementation	Remarks	Level of timeliness
return of migrants – Time to step up action to address disparities between objectives and results”	4 (c)	160				

Annex 3.4 – Special reports where all recommendations to the Commission have been implemented either fully or in most respects

- Special report 07/2019: “EU actions for cross-border healthcare – Significant ambitions but improved management required”
- Special report 09/2019: “EU support to Morocco – Limited results so far”
- Special report 11/2019: “The EU’s regulation for the modernisation of air traffic management has added value – but the funding was largely unnecessary”
- Special report 14/2019: “‘Have your say!’ – Commission’s public consultations engage citizens, but fall short of outreach activities”
- Special report 15/2019: “Implementation of the 2014 staff reform package at the Commission – Big savings but not without consequences for staff”
- Special report 16/2019: “European Environmental Economic Accounts – Usefulness for policymakers can be improved”
- Special report 18/2019: “EU greenhouse gas emissions – Well reported, but better insight needed into future reductions”
- Special report 24/2019: “Asylum, relocation and return of migrants – Time to step up action to address disparities between objectives and results”
- Special report 25/2019: “Data quality in budget support – Weaknesses in some indicators and in the verification of the payment for variable tranches”

Note: The above list excludes the three recommendations not yet due for implementation by the time of our follow-up review and the two recommendations on which we were unable to conclude.

Chapter 4

Revenue

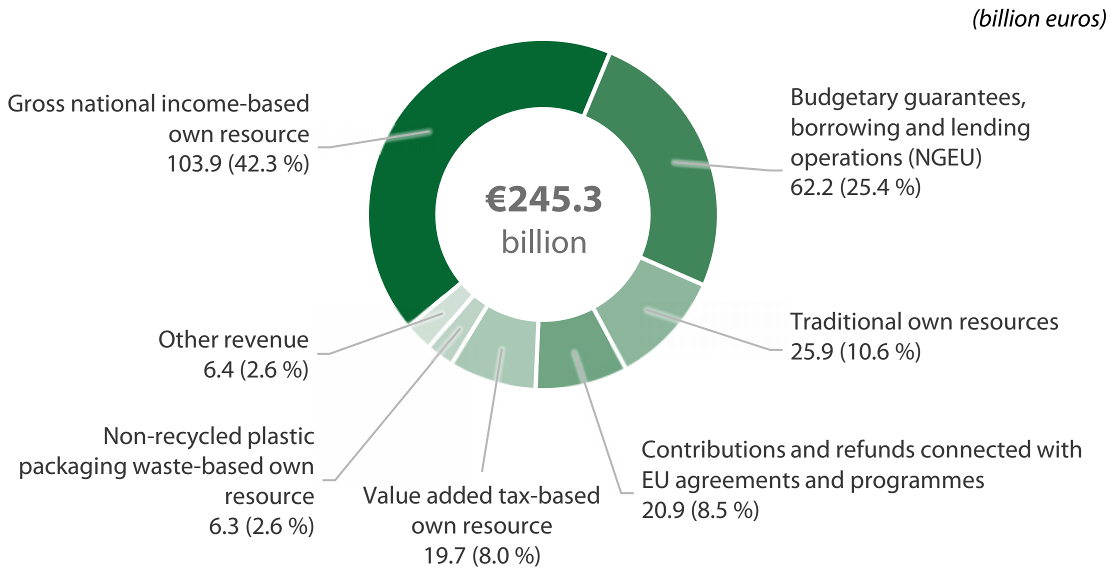
Contents

Annexes

Introduction

4.1. This chapter presents our findings for revenue, which comprises *own resources*, *external assigned revenue* used to finance *Recovery and Resilience Facility (RRF)* expenditure[1], and other revenue. ***Figure 4.1*** gives a breakdown of revenue in 2022.

Figure 4.1 – Revenue – 2022 breakdown(*)



(*) In line with the harmonised definition of underlying *transactions* (for details see ***Annex 1.1***, paragraph ***17***). The total of €245.3 billion represents the EU's actual budget revenue. The amount of €171.2 billion presented in the statement of financial performance is calculated using *accrual-based accounting*.

Source: ECA, based on data from the 2022 *consolidated accounts* of the European Union.

[1] This includes amounts borrowed by the Commission to provide non-refundable financial support to member states under the *NextGenerationEU (NGEU)*, which the Union will have to repay in the future.

Brief description

4.2. Two-thirds (63.5 %) of EU revenue in 2022 comes from the four categories of own resources[2]:

(a) the ***gross national income-based (GNI-based) own resource*** provides 42.3 % of EU revenue, balancing the EU budget after revenue from all other sources has been calculated. Each member state contributes in proportion to its GNI;

(b) ***traditional own resources (TOR)*** provide 10.6 % of EU revenue. They comprise customs duties on imports collected by the member states. The EU budget receives 75 % of the total amount; member states retain the remaining 25 % to cover collection costs;

(c) the ***value added tax-based (VAT-based) own resource*** provides 8.0 % of EU revenue. Contributions under this own resource are calculated using a uniform rate applied to the total amount of member states' VAT receipts collected in respect of all taxable supplies divided by the weighted average VAT rate;

(d) the ***non-recycled plastic packaging waste-based own resource*** provides 2.6 % of EU revenue. It was introduced in 2021 and is calculated by applying a uniform rate to the weight of unrecycled plastic packaging waste generated in each member state.

4.3. External assigned revenue, which mostly relates to amounts borrowed to provide member states with non-repayable financial support in the context of NGEU, provides 25.4 % of EU revenue. There are also other sources of EU revenue. The most significant of these are contributions and refunds connected with EU agreements and programmes (8.5 % of EU revenue), such as revenue relating to the *conformity clearance* of the *European agricultural guarantee fund (EAGF)* and *European agricultural fund for rural development (EAFRD)*, and non-EU countries' contributions to EU programmes and activities.

Audit scope and approach

4.4. Applying the audit approach and methods set out in ***Annex 1.1***, we obtained reasonable assurance for our audit opinion on revenue by assessing key selected systems, supplemented by transaction testing. Our objective was to contribute to the

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[2] Council Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.

statement of assurance as described in ***Annex 1.1***. We examined the following for revenue in 2022:

(a) a sample of 65 Commission *recovery orders*, designed to be representative of all sources of revenue (including 10 transactions relating to external assigned revenue for NGEU grants);

(b) the Commission's systems for:

   (i) ensuring that the member states' GNI, VAT and non-recycled plastic packaging waste data constitute an appropriate basis for the calculation and collection of own-resource contributions. In the first case, we also used the results of our recent special report on GNI[3];

   (ii) managing TOR and ensuring that member states have effective systems for collecting and reporting the correct amounts of TOR and making them available;

   (iii) calculating the amounts resulting from correction mechanisms to own resources;

   (iv) managing fines and penalties;

(c) the systems for TOR accounting and management in three member states (Belgium, Germany and Poland) selected on the basis of both the amount of customs duties they collected and our risk assessment. We also followed up our recommendation in the 2020 annual report regarding the reliability of Dutch TOR statements[4];

(d) the reliability of the information on *regularity* contained in DG BUDG and Eurostat's *annual activity reports*.

4.5. Our assessment of the Commission's systems for calculating GNI- and VAT-based contributions was based on the agreed GNI data and the harmonised *VAT base* provided by member states. We did not directly test the statistics and data produced by the Commission and member states. For the non-recycled plastic packaging waste base, we reviewed the process for compiling forecast data, as member states will

[3] Special report 25/2022: "Verification of Gross National Income for financing the EU budget – Risks in data compilation well covered overall, but scope for increased prioritisation of actions".

[4] 2020 annual report, paragraph 3.14 and recommendation 3.3.

provide their first actual statistical estimates in 2023. In addition, we did not examine the Commission's systems for borrowing and lending operations related to the NGEU. The Commission's debt management systems have been scrutinised in our special report[5].

4.6. Customs duties are at risk of either not being declared or being declared incorrectly to the national customs authorities by importers. The actual import duties collected will therefore fall short of the amount that should theoretically be collected. This difference is known as the "*customs gap*". These evaded amounts are not captured in member states' TOR accounting systems and do not fall within the scope of our audit opinion on revenue. However, since the customs gap may affect the amounts of duties established by member states, we assessed for the fourth year in a row the EU action taken to reduce the gap and mitigate the risk that TOR are not complete. In so doing, we examined the progress achieved by the Commission in implementing selected actions set out in its Customs Action Plan[6] that are intended to address shortcomings highlighted previously in our reports[7] and contribute to reducing the customs gap.

[5] Special report 16/2023: "NGEU debt management at the Commission – An encouraging start, but further alignment with best practice needed".

[6] Communication from the Commission "Taking the Customs Union to the Next Level: a Plan for Action" (COM(2020) 581), 28 September 2020.

[7] See in particular the 2020 annual report, paragraph 3.18, special report 04/2021: "Customs controls – Insufficient harmonisation hampers EU financial interests" and special report 12/2019: "E-commerce – Many of the challenges of collecting VAT and customs duties remain to be resolved".

Regularity of transactions

4.7. This section presents our observations on the regularity of revenue transactions. The conclusion is based on our testing of the regularity of the revenue transactions underlying the EU accounts and our assessment of the Commission's systems for calculating and collecting revenue. Our examination of a sample of 65 recovery orders revealed that none of them was affected by a *quantifiable error*.

Examination of elements of internal control systems

4.8. We examined a number of control systems (see paragraph ***4.4***). The observations on those systems do not affect our overall unmodified opinion on the regularity of EU revenue (see ***chapter 1***). However, they do highlight weaknesses in the collection of individual categories of own resources. In addition, we noted weaknesses in EU action to reduce the customs gap and mitigate the risk that TOR are incomplete.

Weaknesses persist in member states' accounting and management of TOR

4.9. We examined how three member states (Belgium, Germany and Poland) draw up their TOR statements (comprising a statement of duties collected and a statement of duties established but not yet collected)[8], as well as their procedures for managing TOR owed to the EU budget (see ***Annex 4.1***).

4.10. We did not identify any significant problems in the way Germany and Poland managed customs duties collected and drew up the related TOR statements. However, we noted shortcomings in Belgium regarding the TOR accounting and management of these duties (see ***Box 4.1***). As reported last year[9], the Commission assessed the reliability of TOR statements as partially satisfactory in 15 member states, and not satisfactory in one. We found that these member states have not yet addressed all the weaknesses detected.

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8 Commission Implementing Decision (EU, Euratom) 2018/194.

9 2021 annual report, paragraph 3.10.

Box 4.1

Significant amounts omitted from the Belgian TOR statements of duties collected due to an error belatedly detected

The Belgian customs' IT system failed to process financial data on the import declarations covering goods with different statuses for customs duty calculation. Internal controls did not detect this failure for more than 2 years. This led to the omission of €440 million from the TOR monthly statements of customs duties collected (including the collection costs) from mid-2019 to early 2022.

While the Belgian authorities belatedly identified and corrected this error and made the related TOR amounts available to the EU budget, by the time of our audit they had neither performed a wider IT assessment (audit or review) of their accounting system, nor addressed the internal control weaknesses. This may affect the reliability of the statements of duties collected.

Following our audit, the Belgian authorities informed us that some of their internal controls on the compilation of TOR statements had been strengthened and that they plan to centralise the processing of monthly transactions.

4.11. Our audits in the above member states did not give rise to any significant observations on the way in which they draw up their TOR statements of customs duties established but not yet collected. However, as in previous years[10], we found several shortcomings in the way national customs authorities manage these duties. In particular, we noted weaknesses in the management of customs debts in Poland, notably administrative delays following *post-release controls* (see ***Box 4.2***).

[10] See, for example, the 2021 annual report, paragraph 3.12, 2020 annual report, paragraph 3.16, and 2019 annual report, paragraph 3.9.

Box 4.2

Administrative delays in establishing, notifying and recovering customs debts after carrying out post-release controls in Poland

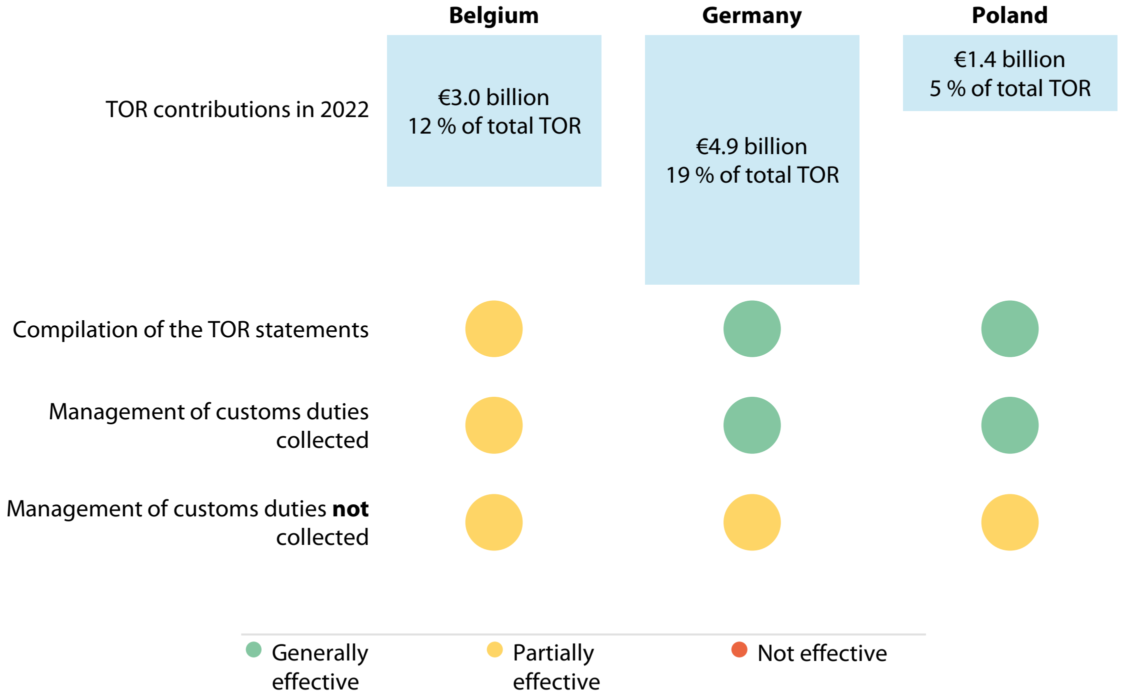
The Polish administrative procedures based on national law unduly delay the establishment, notification, and recovery of customs debts following the post-release controls performed. The procedures are not fully aligned with the requirements of the *Union Customs Code*[11] in that they provide for additional steps on top of the ones in the Union Customs Code with regard to the debtor's right to be heard and calculation of the final debt amounts. The additional time taken to establish customs debts may impede the effective recovery of such amounts.

The Polish authorities informed us that the Ministry of Finance was in the process of discussing the possibility of streamlining administrative procedures.

4.12. We also found cases of incorrect accounting of customs debts in Belgium, and irrecoverable duties not written off in Germany's accounts. The Commission continues to detect and report similar weaknesses in the management of customs duties not yet collected in member states. It also follows up all the observations we report to national customs authorities. Our assessment of member states' key internal TOR control systems is presented in ***Figure 4.2***.

[11] In particular, Article 22(6), 29 and 105(3) of Regulation (EU) No 952/2013 laying down the Union Customs Code.

Figure 4.2 – Assessment of key internal TOR control systems in the member states selected



Source: ECA.

4.13. With regard to the recommendation addressed to the Netherlands in our 2020 annual report, we examined the progress made in resolving weaknesses in the IT systems that affected the reliability of the TOR statements. We welcome the significant efforts made by the Dutch customs authorities to implement a modernised IT system enabling automated compilation of the statements. We note, however, that the new system was deployed in December 2022 and the first quarter of 2023 was viewed as a transitional period, during which the national authorities carried out further work to confirm the reliability of the data compiled. Hence, the recommendation concerning the reliability of Dutch TOR statements had been implemented in only some respects by the end-2022 deadline (see ***Annex 4.3***).

Delays in reassessing customs debt write-off cases

4.14. A customs debt can be written off and removed from member states' TOR accounts when, after a specific period of time, the amounts prove to be irrecoverable for reasons either of force majeure or that cannot be attributed to member states' authorities. Before writing off any such debts that exceed €100 000, the Commission must assess whether to release member states from the obligation to pay the relevant amounts to the EU budget[12].

4.15. We examined the outstanding cases of member states' write-offs amounting to €177.5 million, in which the Commission's assessment had not yet been finalised at the end of 2022. We noted that 58 % of such cases (59 out of 101) were due to reassessment requests from member states that disagreed with the Commission's initial assessment. The Commission's reply to some of these requests had been pending since 2015. A factor contributing to this was that there was no regulatory time limit. This may give rise to long-outstanding cases and uncertainty in terms of the EU budget. We note that, after May 2022[13], a regulatory time limit of three months was introduced for write-off cases whose reassessment was requested by member states within six months of the initial assessment.

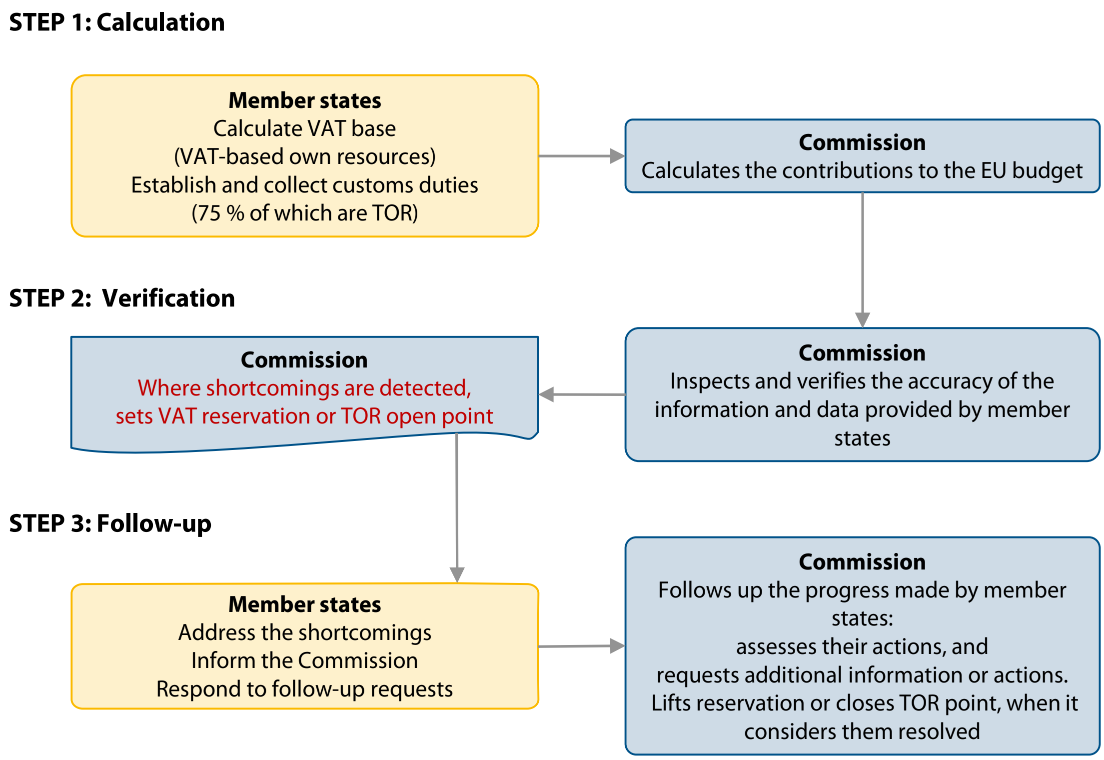
Limited decrease in the number of VAT reservations and TOR open points and continued weaknesses in their management

4.16. ***Figure 4.3*** shows the process the Commission uses to verify member states' calculation of VAT bases and TOR. We examined this process and have provided an overview, as at the end of 2022, of the outstanding reservations and open points set by the Commission for weaknesses detected (see ***Annex 4.2***). Compared to last year, the number of *VAT reservations* decreased slightly from 82 to 81 (1 %) and the number of *TOR open points* decreased from 304 to 283 (7 %). In 2022, the Commission lifted 30 % of VAT reservations (25 out of 82) and 27 % of TOR open points (81 out of 304) out of the number at the start of the year.

[12] Article 13 of Regulation (EU, Euratom) No 609/2014.

[13] Regulation (EU, Euratom) No 609/2014, as amended by Regulation (EU, Euratom) 2022/615 introducing Article 13b.

Figure 4.3 – The process of verifying member states’ VAT bases and TOR



Source: ECA, based on Commission data.

4.17. We observed limited progress in resolving long-outstanding VAT reservations open for more than five years. In 2022, the Commission was able to lift only one long-outstanding reservation, while 14 remained open at the end of the year. Last year[14], we issued the recommendation that the Commission improve the management of VAT reservations.

4.18. In 2022, the Commission introduced internal deadlines for its follow-up work on TOR open points. However, we noted continued delays in communication between member states and the Commission. As the open points are still not prioritised according to significance, we maintain last year’s assessment, which was that the recommendation we made in our 2019 annual report regarding the need to improve the management of TOR points has been implemented in most respects[15].

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[14] 2021 annual report, paragraph 3.16 and recommendation 3.2.

[15] *Ibid.*, paragraph 3.17 and Annex 3.3.

Shortcomings in the management of VAT reservations related to non-application of the VAT Directive

4.19. Four of the long-outstanding VAT reservations relate to shortcomings in the application of EU law. We found that one of them is linked to the Commission's launch of an *infringement procedure* against a member state in 2009 on the grounds of its failure to apply the VAT Directive to the transactions of public and private bodies[16]. The Commission did not pursue all the steps of the infringement procedure, nor did it take any other timely action to resolve the non-compliance without the need for enforcement. The member state did not adopt the legislative amendment required to comply with EU law until December 2021, effective from January 2024. 15 years will have elapsed by the time the member state complies with the EU Directive. In April 2023, following an inspection in this member state, the Commission assessed that the failure to comply with EU law had no financial impact.

4.20. We examined another reservation, which concerned a member state's incorrect application of the VAT Directive with regard to a VAT special scheme for travel agents[17]. We found that there were indications that 13 member states had not implemented the scheme in question in accordance with EU law. However, the Commission did not set reservations for the other member states concerned to assess whether they were in breach of EU law. Delays in setting reservations increase the risk of time-barring and may result in incorrect contributions being paid into the EU budget.

Risks in GNI data compilation well covered overall, but scope for increased prioritisation of actions

4.21. In our 2022 special report[18] on the closed 2016-2019 GNI verification cycle, we concluded that, overall, the Commission was effective in identifying high-risk issues in the compilation of the national accounts in member states but did not address all of them in a timely manner. We found that the Commission checked many issues that proved to have a low impact on GNI, and that there were inefficiencies in relation to the tools it used to document its verifications.

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[16] Articles 2, 9(1), 13 and 132 of the Council Directive 2006/112/EC on the common system of value added tax (VAT Directive).

[17] Articles 306(1) and 308 of the VAT Directive.

[18] Special report 25/2022.

Progress in addressing and lifting the GNI reservations, but some delays observed

4.22. By the end of 2022, the Commission had lifted 60 % of the GNI transaction-specific reservations (96 out of 160) and 47 % of the GNI *transversal reservations* (66 out of 140) set as a result of the 2016-2019 verification cycle (see ***Annex 4.2***). Our analysis of *GNI reservations* outstanding at the end of 2022 showed that member states had presented the relevant information addressing 21 transaction-specific reservations and eight transversal reservations by the deadline of September 2021. However, the Commission did not meet its internal objective of lifting these reservations within one year of receipt of the information it was to assess. In most cases, this was due to the need to obtain further clarifications from the countries concerned and perform additional work. We also noted that, by the end of 2022, seven member states[19] either had not or had only partly addressed the GNI reservations, and that the deadline for doing so had already expired. Delays in addressing and lifting GNI reservations increase budgetary uncertainty in the national and EU budgets as regards the GNI-based contribution.

4.23. The Commission continued its work on the 2020-2024 GNI verification cycle by performing a risk assessment regarding the compilation of national accounts, carrying out desk checks on *GNI inventories*, which describe member states' procedures for compiling statistical data, finalising the first comparison between countries, and making information visits to national statistical institutes. By the end of 2022, the Commission had lifted GNI general reservations[20] for four member states[21], which had delayed in submitting their inventories to the Commission, and kept one open for Malta, which submitted its inventory as late as December 2022.

Further delays in Commission actions to improve TOR risk management and reduce the customs gap

4.24. Last year[22], we reviewed the overall implementation of the Commission's Customs Action Plan and reported that there had been insufficient progress in a number of actions. In 2022, we examined in more detail the implementation of

[19] Bulgaria, Ireland, Greece, Croatia, Luxembourg, Malta and Romania.

[20] 2021 annual report, paragraph 3.18.

[21] Greece, Croatia, Luxembourg and Romania.

[22] 2021 annual report, paragraph 3.13.

selected actions planned to enhance import data analysis capacity at EU level, revise the customs risk management strategy, and make legislative changes to address the customs risk related to e-commerce imports. Our work revealed further delays.

4.25. The Commission made some progress in developing five data analysis projects that would enhance the customs risk assessment capacity at EU level but had finalised just one of them, and shared the related results with the member states, by the end of 2022. In the three member states we audited for TOR (see paragraph ***4.9***), the data analysis tool in question was not used in practice because the customs authorities considered their national systems more suitable for risk management purposes. The Commission has not achieved its internal milestone of implementing all five data analysis projects by end-2022. It now plans to complete four of them by the end of 2023, the deadline by which we previously recommended a fully fledged analysis and coordination capacity be built[23]. ***Box 4.3*** describes examples of challenges in the remaining work on customs data analysis at EU level that we identified.

Box 4.3

Examples of the challenges involved in finalising customs data analysis projects at EU level

- The Commission has no formalised project planning to carry out the four remaining data analysis projects, thereby increasing the risk of not achieving the intended results by the end of 2023.
- The existing confidentiality and data-sharing limitations have not yet been resolved, which may limit the usefulness of the tools and the data analysis results.
- Full data analysis capacity cannot yet be achieved, due to some member states' delay in upgrading their IT systems and reporting the necessary data to the Commission[24].

4.26. The Commission adopted a legislative proposal for significant customs reform[25] in May 2023 with the aim of improving the functioning of the customs union.

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[23] Special report 04/2021, recommendation 2.

[24] The Commission Implementing Decision (EU) 2023/237 granted a derogation from the deadline of the end of 2022 and postponement to the end of 2023 of the full implementation of customs IT systems in 16 member states.

[25] Commission proposal for an EU customs reform, COM(2023) 258.

The setting of the new customs risk management strategy has been deferred from the third quarter of 2022 until the amendment to the Union Customs Code has been adopted. The Commission therefore continued to pursue its 2014 strategy, the final implementation report for which was presented to the key stakeholders in 2021. This means that no further implementation reporting is foreseen from 2022 onwards until such time as the new strategy is approved.

4.27. The current legal framework for e-commerce imports does not allow member states to perform a comprehensive risk analysis, as the information available is insufficient, which impacts the *effectiveness* of customs controls. Even though the new e-commerce declaration introduced as of July 2021 provides additional information, the member states we visited for TOR audits pointed out that its completeness, quality and credibility for risk analysis are limited, and alternative or complementary data on the imported goods would be needed. The Commission's legislative proposal[26] (see paragraph ***4.26***) aims to address these issues. However, at present, the Commission has not yet adopted any guidance for member states on how to tackle the existing financial risks associated with e-commerce imports.

4.28. We also noted that, though scheduled to be completed by the extended deadline of the second quarter of 2022, the Commission has still not assessed the impact of the risks arising from e-commerce on the collection of customs duties. In its 2022 report[27], the Wise Persons Group concluded that the available data on e-commerce imports do not allow estimation of the gap in revenues collected by national customs authorities.

[26] *Ibid*.

[27] The Wise Persons Group report: "Putting more union in the European Customs: Ten proposals to make the EU Customs Union fit for a Geopolitical Europe", Brussels, March 2022.

Annual activity reports

4.29. The information on regularity provided in the 2022 annual activity reports published by DG BUDG and Eurostat generally corroborated our findings and conclusions.

4.30. DG BUDG has lifted the *reservation* that the TOR amounts transferred to the EU budget are inaccurate owing to undervaluation of textiles and shoes imported from China over the period from 2011 to 2017. The reservation was first set in 2016, when TOR losses attributable to the UK were quantified, and then extended to other member states in 2018, without quantification.

4.31. Based on the CJEU's final decision of 8 March 2022[28] on the Commission's infringement case against the UK, the Commission recalculated the TOR losses to the EU budget, amounting to €1.57 billion of principal and a further €1.4 billion in interest. The UK has paid the amounts due[29]. In 2023, DG BUDG intends to recalculate the TOR losses attributable to all member states using the same approach applied to the UK following the above-mentioned CJEU Judgment.

[28] Judgment in case C-213/19 *Commission* v *United Kingdom*.

[29] The UK paid €0.7 billion of principal in 2022, and the remaining amounts in 2023.

Conclusion and recommendations

Conclusion

4.32. The overall audit evidence indicates that the level of error in revenue transactions was not material. The systems for managing the revenue we examined were generally effective. However, some of the key internal TOR controls we assessed in certain member states, the management of TOR write-off cases, and the management of VAT reservations and TOR open points at the Commission were partially effective (see paragraphs ***4.9***-***4.12*** and ***4.16***-***4.20***).

4.33. As we stated in our recent special report on GNI, risks in data compilation were well covered overall by the Commission's verification but there was scope for increased prioritisation of its actions (see paragraph ***4.21***). The special report set out recommendations for improvement in the GNI verification cycle starting in 2025.

4.34. We also found that the implementation of selected actions in the Commission's Customs Action Plan (see paragraphs ***4.24***-***4.28***) that contribute to reducing the customs gap have been further delayed. This weakness does not affect our audit opinion on revenue, as it does not concern the transactions underlying the accounts, but rather the risk that TOR are incomplete.

Recommendations

4.35. ***Annex 4.3*** shows the findings of our follow-up review of the two recommendations we made in our 2019 annual report. The Commission has implemented one recommendation in some respects, while the other has been implemented in most respects.

4.36. We also followed up on one recommendation addressed to the Netherlands in the 2020 annual report that was targeted for implementation by the end of 2022, and one recommendation in the 2021 annual report that was targeted for implementation in line with the deadlines set in the Customs Action Plan. Both recommendations have been implemented in some respects.

4.37. Based on this review and our findings and conclusions for 2022, we recommend that the Commission:

Recommendation 4.1 – Improve the management of cases related to non-application of the VAT Directive

Review its procedures for managing cases of non-application of the VAT Directive that could impact the EU budget by:

(a) systematically monitoring the timelines for the various steps of both the infringement procedure, and other enforcement actions intended to resolve non-compliance, and taking timely action to avoid excessive delays;

(b) assessing whether the non-conformity affecting the VAT-based own resource identified in one member state is cross-cutting in nature and may therefore apply to other member states;

(c) taking timely action, and possibly setting cross-cutting reservations that ensure the correct payment of VAT-based national contributions to the EU budget.

Target implementation date: by mid-2024

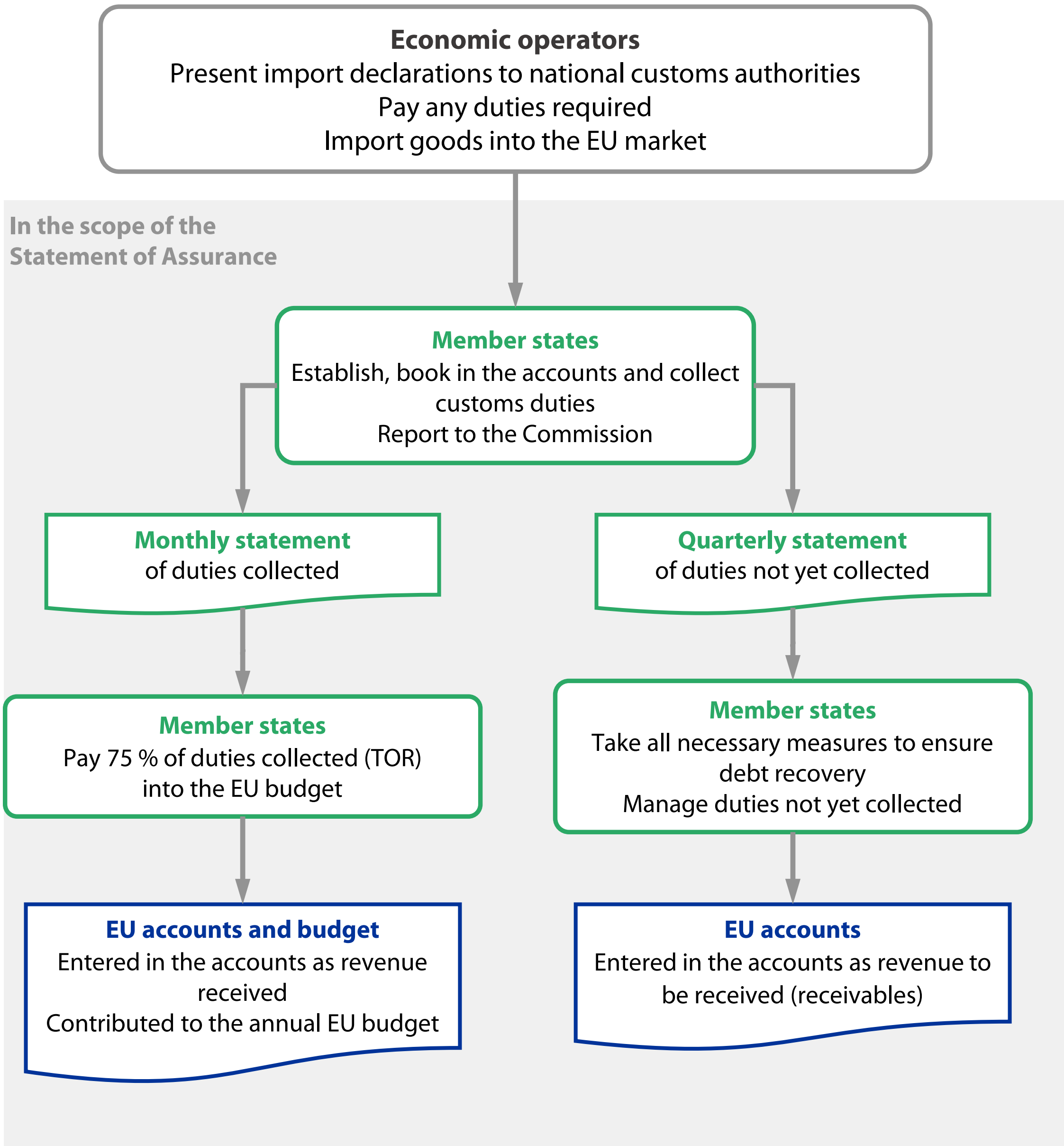
Recommendation 4.2 – Conclude the reassessment of TOR write-off cases not subject to regulatory time limits

Conclude, without delay, the reassessment of requests received from member states (prior to May 2022 that are not subject to regulatory limits) expressing disagreement with the Commission's initial assessment of TOR write-off cases.

Target implementation date: by mid-2024

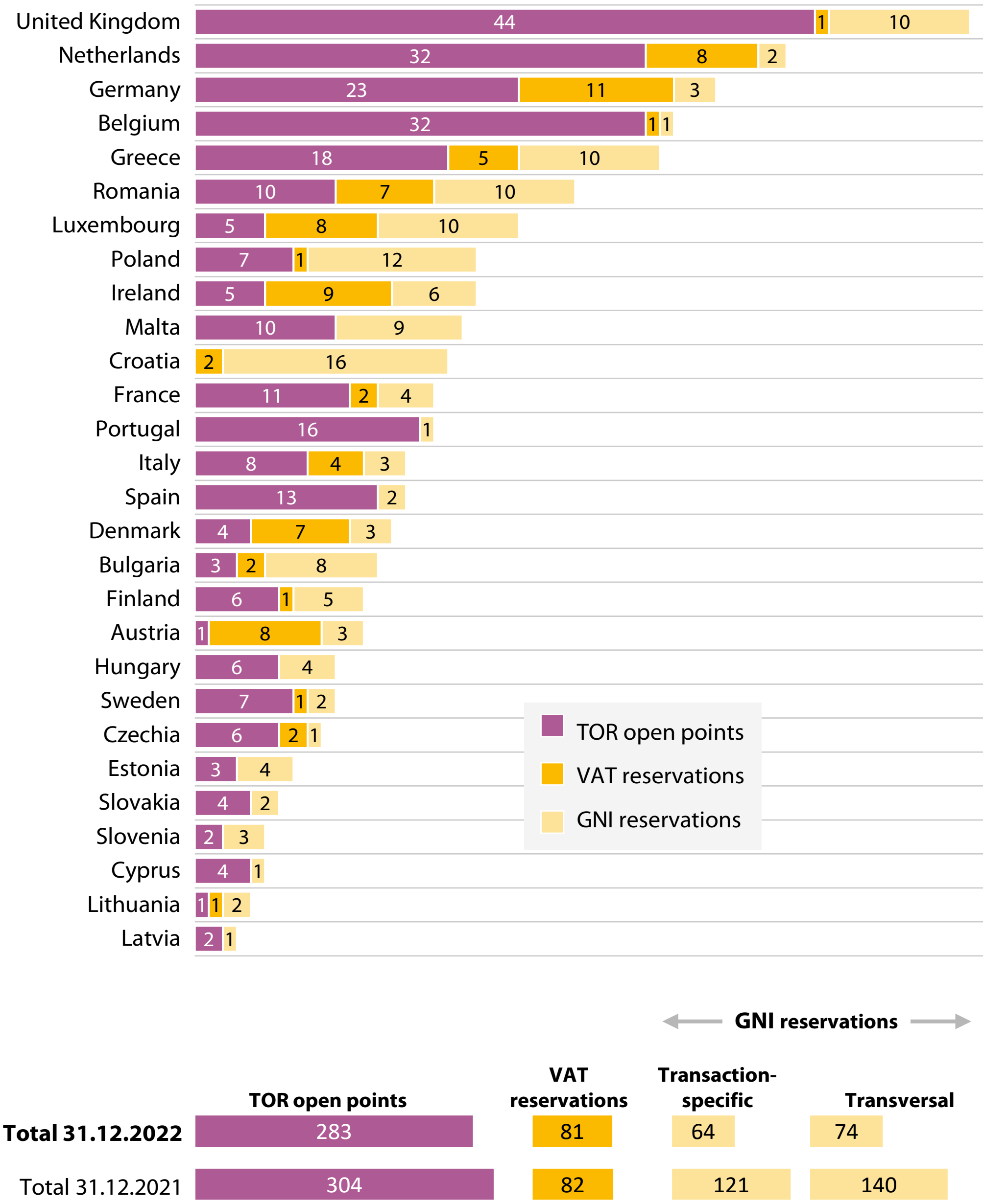
Annexes

Annex 4.1 – The process of drawing up the TOR statements of duties (collected and not yet collected) and their entry in the EU accounts and budget



Source: ECA, based on current EU legislation and rules.

Annex 4.2 – Number of outstanding GNI reservations, VAT reservations and TOR open points by member state as at 31 December 2022



Source: ECA, based on Commission data.

Annex 4.3 – Follow-up of previous recommendations for 'Revenue'

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2019	We recommend that the Commission: **Recommendation 1:** provide member states with regular support in selecting the riskiest importers for post-release audits by: (a) collecting and analysing relevant import data at EU level, and sharing the results of its analysis with member states (by the end of 2021); (b) once Surveillance III becomes operational, providing guidance on how to carry out data analysis within this new system (by June 2023).		In relation to recommendation 1a), the Commission has not yet provided support to member states in selecting the riskiest importers at EU level for post-release audits by collecting and analysing import data, and by sharing the results of its analysis with national customs authorities. As regards recommendation 1b), the Commission has not provided guidance on selecting the riskiest importers for post-release audits, as the full Surveillance III data are not yet available from all member states.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	We recommend that the Commission: **Recommendation 2:** by the end of 2021, revise its procedures by: (a) establishing a system for monitoring TOR open points based on quantitative and qualitative criteria that rank shortcomings detected in member states in order of priority; (b) setting deadlines for member states to address such shortcomings, and for follow-up actions, including the calculation of late-payment interest and the recovery of amounts to be made available to the EU budget.		See paragraph ***4.18***.
2020	We recommend that the Netherlands: **Recommendation 3:** ensure that its monthly and quarterly TOR statements are reliable by solving the current weaknesses in its customs IT system regarding the lack of audit trail, the risk of double entries, and the incorrect allocation of partial payments (by the end of 2022).		As of December 2022, the new automated compilation process was being used for the statements of duties collected and addressed most of the weaknesses we had previously identified. However, the first statement of customs duties established but not yet collected was not compiled using the new system until 2023. See paragraph ***4.13***.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2021	We recommend that the Commission: **Recommendation 3:** Improve the assessment of financial risks for TOR by implementing the relevant measures of its Customs Action Plan in a timely manner (by the deadlines set in the Customs Action Plan).		See paragraph ***4.34***.

Source: ECA.

Chapter 5

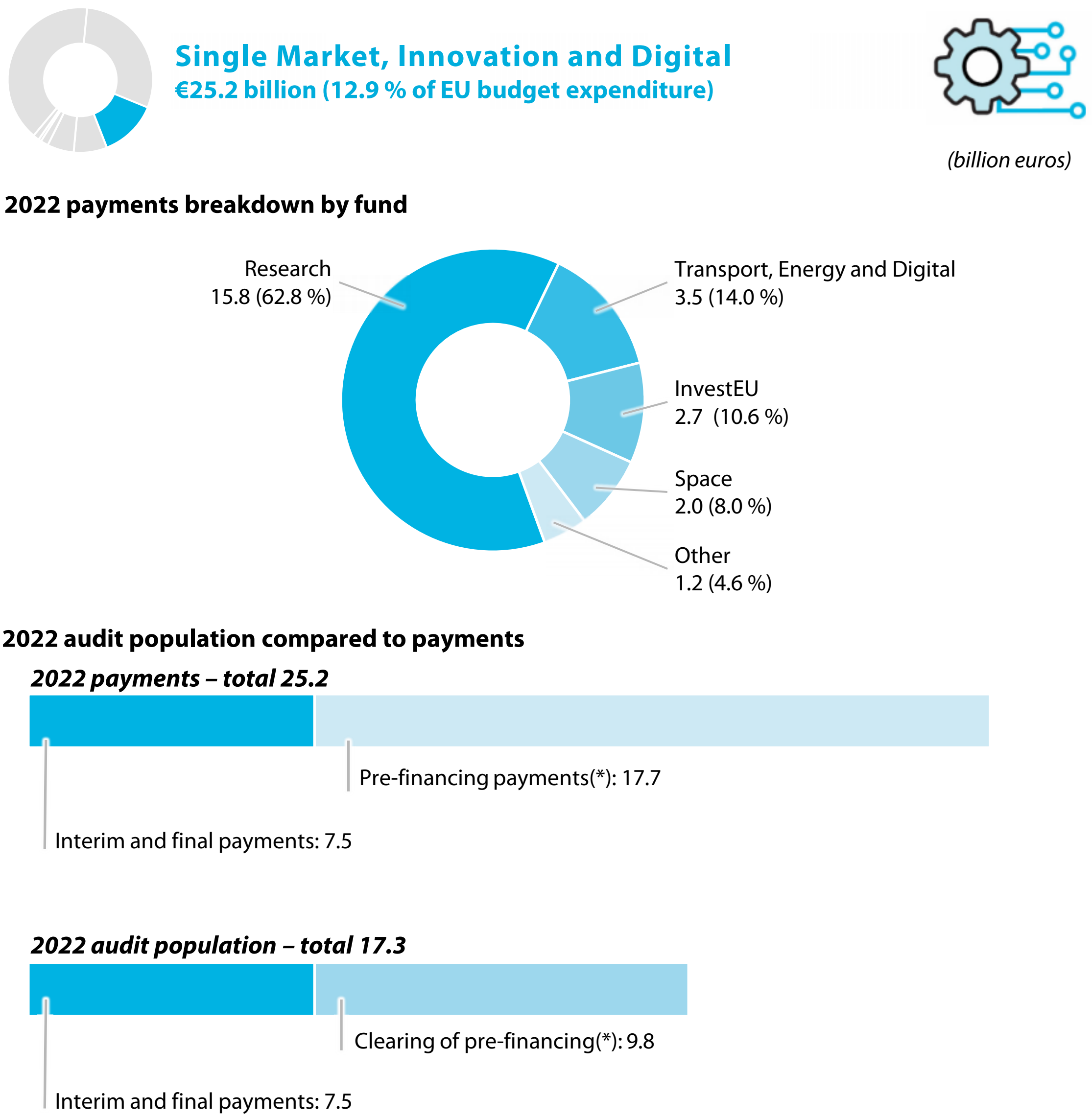
Single Market, Innovation and Digital

Contents

Introduction

5.1. This chapter presents our findings for MFF heading 1 'Single Market, Innovation and Digital' (MFF1). ***Figure 5.1*** gives an overview of the main activities and spending under this heading in 2022.

Figure 5.1 – Payments and audit population



(*) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph ***18***).

Source: ECA, based on data from the 2022 *consolidated accounts* of the European Union.

Brief description

5.2. The *programmes* financed under 'Single Market, Innovation and Digital' are diverse and aim to finance projects that contribute to, among other things, research and innovation, the development of *trans-European transport networks*, communications, energy, digital transformation and the single market, and space policy.

5.3. The principal programme for research and innovation remains *Horizon 2020*[1], as its successor, *Horizon Europe*[2], still only accounts for a small proportion of our 2022 audit population. 2022 was the second year of implementation of the Horizon Europe framework programme, whose start was delayed by the regulation being adopted later than planned. However, there was a significant catch-up, with 5 059 *grant* agreements and two framework agreements having been signed by the end of 2022, though the majority of the payments made constituted pre-financing.

5.4. MFF1 also finances large infrastructure projects such as the *Connecting Europe Facility (CEF)*, the space programmes, such as Galileo (the EU's global satellite navigation system), EGNOS (the European Geostationary Navigation Overlay Service), and Copernicus, the European Earth Observation Programme. It also includes the *InvestEU* fund, which, together with Horizon Europe, benefits from additional funding from the NextGenerationEU (NGEU).

5.5. Most spending on these programmes is managed directly by the Commission, including through *executive agencies*, and takes the form of grants to public or private beneficiaries participating in projects. The Commission provides pre-financing to beneficiaries upon signature of a grant agreement and later reimburses the EU-funded costs, net of the pre-financing. The space programmes are generally managed indirectly on the basis of delegation and contribution agreements signed between the Commission and dedicated implementing bodies (such as the European Space Agency and the EU Agency for the Space Programme). InvestEU financial instruments are implemented mainly by the EIB or EIF, which in turn use financial intermediaries.

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[1] The 2014-2020 Framework Programme for Research and Innovation.

[2] The 2021-2027 Framework Programme for Research and Innovation.

Audit scope and approach

5.6. Applying the audit approach and methods set out in ***Annex 1.1***, we examined the following for this MFF heading in 2022:

(a) *a statistically representative sample* of 127 *transactions* covering the full range of spending under this MFF heading. It consisted of 92 transactions in the area of research and innovation (91 for Horizon 2020 and one for Horizon Europe) and 35 under other programmes and activities, notably the CEF, other financial instruments, and space programmes. The beneficiaries audited were located in 17 member states and six non-EU countries. We also took account of the results of our annual audits of agencies and *joint undertakings*. Our objective was to estimate the level of *error* for this MFF heading and thereby contribute to the *statement of assurance*;

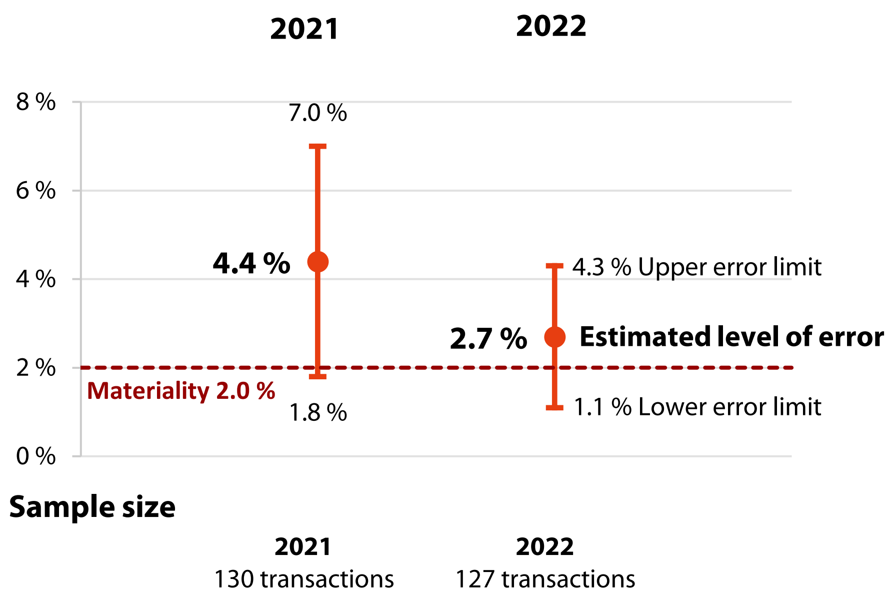
(b) the Commission's procedures and guidance for *lump sum* funded grants in research;

(c) the regularity information given in the *annual activity reports* of the Directorate-General for Research and Innovation (DG RTD) and the Directorate-General for Defence Industry and Space (DG DEFIS), and then included in the Commission's *Annual Management and Performance Report (AMPR)*.

Regularity of transactions

5.7. Of the 127 transactions examined, 43 (34 %) contained errors. Based on the 36 errors we have quantified, we estimate the level of error to be 2.7 %[3] (see ***Figure 5.2***). ***Figure 5.3*** gives a breakdown of our *estimated level of error* by error type for 2022, distinguishing between research and other transactions. ***Figure 5.4*** shows the number of transactions audited and the number of errors found in the last 5 years.

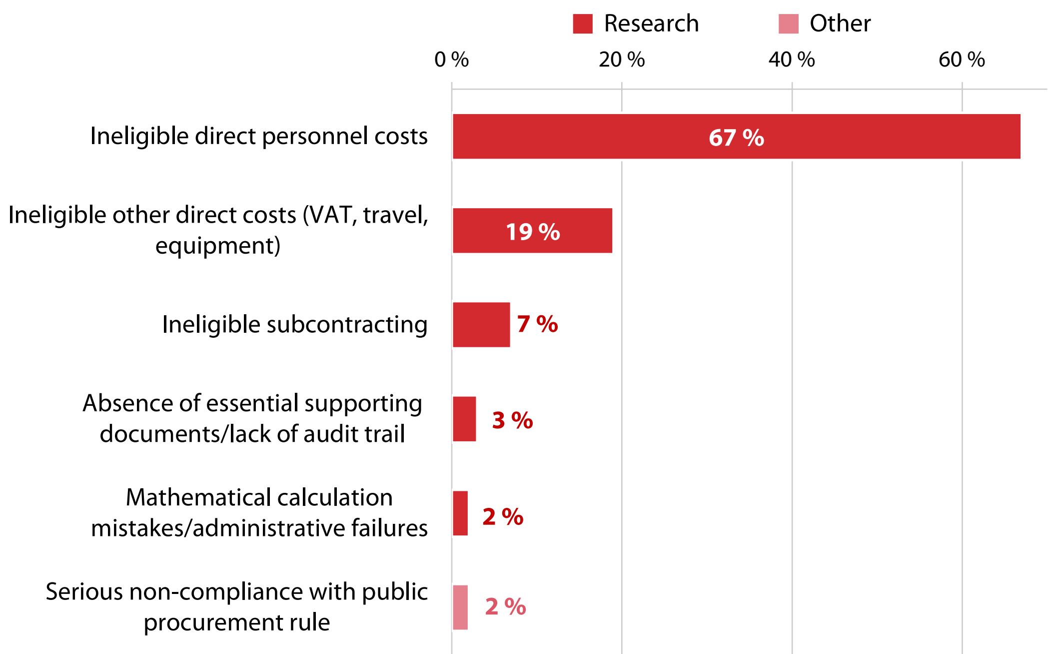
Figure 5.2 – Estimated *impact* of *quantifiable* errors



Source: ECA.

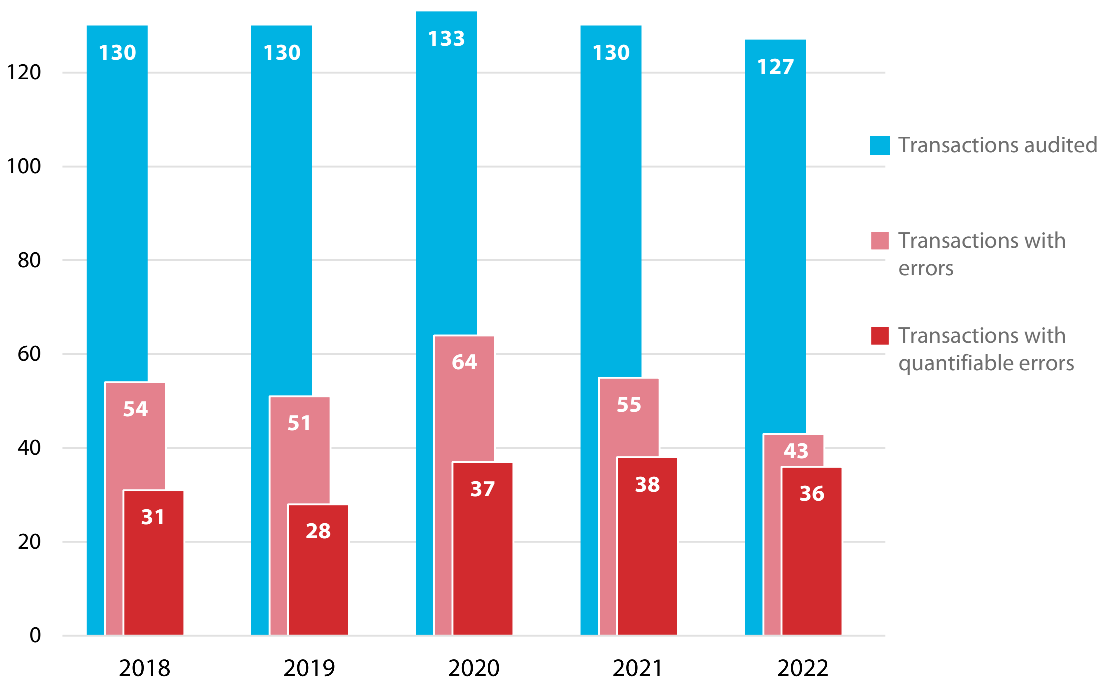
[3] We base our calculation of error on a representative sample. The figure quoted is the best estimate. We have 95 % confidence that the estimated level of error in the population lies between 1.1 % and 4.3 % (the lower and upper error limits respectively).

Figure 5.3 – Breakdown of the estimated level of error by error type



Source: ECA.

Figure 5.4 – Transactions affected by error in 2018-2022



Source: ECA.

5.8. As regards Horizon 2020, we have previously reported on improvements in the programme design and the Commission's control strategy[4]. Certain simplifications, in particular the introduction of a flat rate for *indirect costs*, have reduced the administrative burden on beneficiaries and have the potential to reduce the risk of error. However, our audit shows that the overall error rate has not yet been reduced to below the 2 % materiality threshold.

5.9. Horizon 2020 spending remains high risk and is the main source of the errors we detect. We found *quantifiable errors* relating to ineligible costs in 35 of the 92 research and innovation transactions in the sample. This represents 98 % of our estimated level of error for this heading in 2022.

5.10. In the case of other programmes and activities, we detected a quantifiable error in 1 of the 35 transactions in the sample. It concerned an *irregularity* in the procurement procedure of a CEF project.

5.11. The Commission had applied corrective measures that directly affected eight of the transactions we sampled. These measures were relevant to our calculations, as they reduced our estimated level of error for this chapter by 0.1 percentage points. In five cases of quantifiable errors made by final beneficiaries, the control procedures put in place by the Commission failed to prevent, or to detect and correct, the error before the expenditure was accepted. Had the Commission, or the auditors contracted by beneficiaries (see paragraph ***5.12***), made proper use of all the information at their disposal, the estimated level of error for this chapter would have been 0.2 percentage points lower.

5.12. With regard to research expenditure, one element of the Commission's control system is the certificate on financial statements (CFS) issued by auditors contracted by beneficiaries. These certificates are intended to help the Commission check whether costs declared in the financial statements are eligible. In previous annual reports we have repeatedly reported weaknesses in these certificates[5]. The auditors preparing the CFSs failed to detect the issues we reported in the five above-

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[4] 2018 annual report, paragraph 5.13, special report 28/2018: "The majority of simplification measures brought into Horizon 2020 have made life easier for beneficiaries, but opportunities to improve still exist".

[5] 2018 annual report, paragraph 5.15, 2019 annual report, paragraph 4.10, 2020 annual report, paragraph 4.11 and 2021 annual report, paragraph 4.11.

mentioned cases. Nevertheless, the Commission is ultimately responsible for the operation of such controls.

In research expenditure, personnel costs remain those most affected by error

5.13. The rules for declaring personnel costs under H2020 remain complex, despite simplification efforts, and their calculation remains a major source of error in the cost claims. As we reported in our previous annual reports[6], the methodology for calculating personnel costs has become more complex in some respects under H2020 (see paragraphs ***5.14***, ***5.15***, ***5.16***), and this has increased the risk of error. Of the 35 transactions affected by quantifiable errors in our sample of research transactions, 25, i.e. around 71 %, were affected by incorrect application of the methodology for calculating personnel costs.

Incorrect calculation of the hourly rates

5.14. As we have pointed out in previous annual reports[7], the rule requiring the use of the annual hourly rate calculated for the most recent closed financial year may lead to errors. We found evidence of this again in 2022.

5.15. The incorrect calculation of personnel costs following the reduced work-time patterns brought about by the COVID-19 pandemic resulted in the declaration of ineligible personnel costs. In several member states, short-time work schemes were implemented to protect jobs in companies experiencing economic difficulty. Many businesses made use of such schemes, under which employees worked fewer hours and part of their salary was reimbursed by the state. Beneficiaries did not always properly reflect in their staff cost calculations the reduction in working hours and/or reimbursement received from the state.

5.16. We also found that incorrect hourly rates were used as a result of ineligible bonuses being taken into account.

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[6] 2017 annual report, paragraph 5.34, 2018 annual report, paragraph 5.16, 2019 annual report, paragraph 4.11, 2020 annual report, paragraph 4.13 and 2021 annual report, paragraph 4.12.

[7] 2021 annual report, paragraph 4.15, 2020 annual report, paragraph 4.14, and 2019 annual report, paragraph 4.12.

Weaknesses in time reporting

5.17. In addition to the incorrect application of the methodology for calculating personnel costs, we identified 10 cases where deficient time recording resulted in ineligible personnel costs being declared. These mainly concerned hours claimed during absences, public holidays and weekends, as well as hours recorded incorrectly, or that were not supported by timesheets or other time records.

Breaches of the double ceiling rule

5.18. The double ceiling rule stipulates that the total number of hours declared for a person for a year may not exceed the number of annual productive hours used to calculate the hourly rate. Moreover, the total amount of personnel costs declared (for reimbursement as actual costs) for any person for the given year may not exceed the total personnel costs recorded in the *beneficiary's* accounts for the person concerned for that same year.

5.19. By not respecting this rule, beneficiaries may declare and be reimbursed for personnel costs in excess of those actually incurred in a given year, thereby breaching the no-profit principle laid down in the *Financial Regulation* of the EU. In ***Box 5.1*** we describe one such example.

Box 5.1

Example of a breach of the double ceiling rule

A beneficiary of a Horizon 2020 project in the Netherlands was also the recipient of two ERDF grants whose timescales partly overlapped with that of the Horizon 2020 project audited. Some of the staff involved in the Horizon 2020 project were also involved in implementing one or both of the ERDF projects. When declaring the personnel costs for the Horizon 2020 project audited, the beneficiary did not take account of hours already declared for the ERDF projects and therefore, claimed significantly more hours than the maximum allowed (1 720 hours or corresponding pro-rata for persons not working full time). The surplus hours (i.e. a total of over 1 900 hours for six staff) were ineligible.

Other errors in personnel costs

5.20. Other errors in personnel costs included the declaration of ineligible months in the case of staff working exclusively on the project (e.g. months claimed in full even though the staff had worked for less than half of the working days), claiming personnel costs for persons not employed by the beneficiary, and subcontracting declared as personnel costs. We also found ineligible costs relating to three researchers working on a Marie Skłodowska-Curie Research and Innovation Staff Exchange action (MSCA-RISE), as described in ***Box 5.2***.

Box 5.2

Example of ineligible costs declared for a Marie Skłodowska-Curie Research and Innovation Staff Exchange action

The rules on MSCA-RISE actions stipulate that the eligible cost is a top-up allowance that is to be used exclusively to support a staff member's travel, accommodation and subsistence costs during their secondment. Salaries (or equivalent remuneration) are not eligible costs, and beneficiaries are expected to continue paying their staff during the secondment abroad.

A beneficiary taking part in an MSCA-RISE project in Greece declared secondment costs for three researchers. The costs declared however, related to the remuneration paid for their work (i.e. the equivalent of a salary) and not the top-up allowance. The beneficiary could not provide evidence that it had made additional payments to the researchers (on top of the remuneration paid) to cover their travel, accommodation and/or subsistence costs, hence the costs were considered ineligible.

Ineligible subcontracting and other *direct costs*

5.21. Where necessary to implement an action, beneficiaries may purchase goods, works or services, and award subcontracts. They must ensure best value for money and avoid any conflicts of interest in making such purchases and awards, thereby adhering to the general cost eligibility conditions, i.e. costs must be reasonable and comply with the principle of sound financial management. We found several cases where beneficiaries had failed to demonstrate that they complied with this rule. An example is described in ***Box 5.3***.

Box 5.3

Example of not ensuring best value for money and absence of conflict of interest when awarding a subcontract

The beneficiary, a public entity in Switzerland, had stated explicitly that certain parts of the action would be subcontracted and best value for money would be ensured by requesting and comparing at least three offers. The beneficiary, in the end, awarded the subcontract directly and claimed that only one undertaking held the patent for the specific procedure needed to implement the action. However, the patented procedure had been invented by the two project leaders already employed by the beneficiary. This incorrect procedure resulted in a conflict of interest situation where the beneficiary awarded the contract to a company founded by one of the project leaders, who was also a member of the board of directors. Based on this, we consider the related costs ineligible.

5.22. Another condition governing the eligibility of costs is that they must be incurred in connection with the action and necessary for its implementation. We have found instances of costs declared for consumables purchased but not used for the project, equipment only partially used for the project but claimed for in full, and a prototype developed for a different project, as well as travel costs that did not need to be incurred to implement the project.

5.23. Other *errors* found in other cost categories included ineligible equipment costs due to the incorrect calculation of depreciation, the declaration of deductible VAT, ineligible internally invoiced goods and services, costs not incurred, missing supporting documents and incorrect exchange rates.

Newcomers and *Small Medium Enterprises (SMEs)* are more prone to errors

5.24. One of the strategies for boosting European research is to increase private-sector participation, especially by newcomers and SMEs. SMEs represented 11 % of the sample (14 out of 127 transactions) but accounted for 29 % of the estimated error rate. Moreover, quantifiable errors found in the cost claims of three private newcomers (taking part in just one EU project) accounted for almost half of the estimated error rate. These results indicate that SMEs and newcomers are more prone to errors than other beneficiaries, as has also been confirmed both by the Commission's audits[8] and in our previous annual reports[9].

[8] 2019 annual report, paragraph 4.16.

[9] 2018 annual report, paragraph 5.19, 2019 annual report, paragraph 4.16, and 2021 annual report, paragraph 4.20.

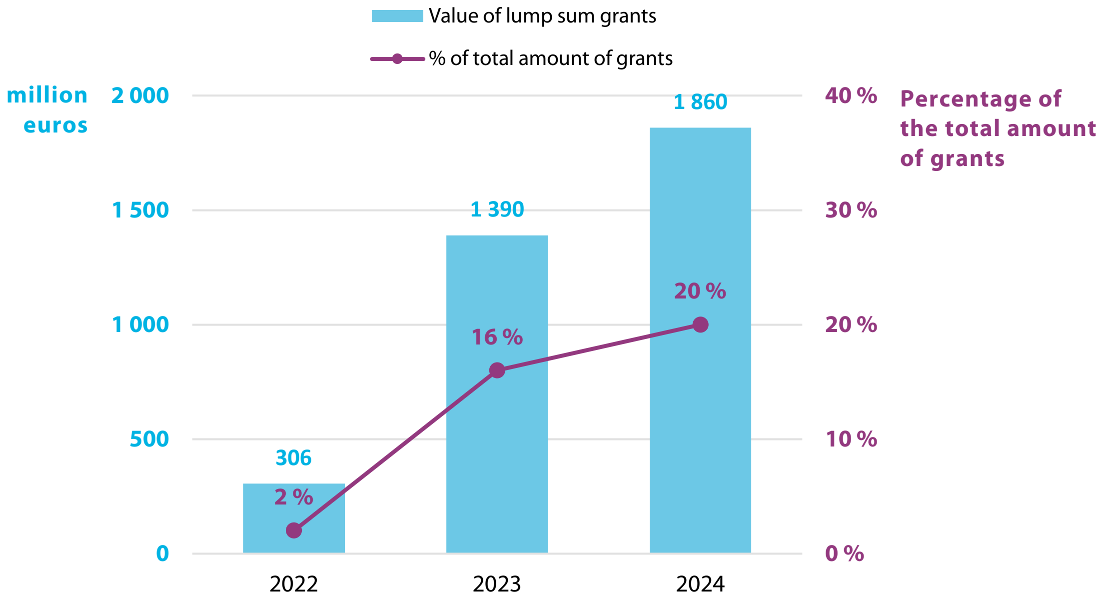
Review of the Commission's procedures for lump sum funding in research

5.25. The concept of a 'single lump sum' (covering all the eligible costs of an action) is defined in the Financial Regulation, which requires that the method used to determine individual lump sum amounts must respect the principle of sound financial management. Lump sum funded grants were piloted from 2018 to 2020 under Horizon 2020. The aim of this type of funding is to reduce the administrative burden on beneficiaries and consequently the error rate. Payments are no longer based on the costs incurred but the activities performed (the completion of work packages), as outlined in the grant agreement.

5.26. Based on the first years of the pilot, the Commission concluded that all types of Horizon Europe actions were in principle suited to this type of funding, regardless of their content or size, and gradually rolled out lump sum funding. This assessment was based mainly on surveys rather than a full evaluation of the pilot covering the appropriateness of such forms of financing in terms of the nature of the different actions or work programmes supported, the risk of irregularities and *fraud*, and the costs of controls.

5.27. At the end of 2022, Horizon Europe lump sum funded grants amounted to €306 million corresponding to 2 % of the total amount of grants with the plan to increase lump sum grants to €1.86 billion in 2024. This will correspond to approximately 20 % of the total value of Horizon Europe grants (see ***Figure 5.5***).

Figure 5.5 – Evolution of Horizon Europe lump sum funded grants in 2022-2024



Source: ECA, based on data provided by the Commission.

5.28. We reviewed the Commission's procedures and guidance on lump sum funded grants in research by examining the relevant Commission documents on lump sum contributions[10], especially the lump sum decision. We also selected 10 lump sum funded grants with budgets ranging from €0.5 million to €11 million and examined the procedure used to determine the final budget, focusing on the external evaluators' assessments. The aim was to confirm whether the budget had been determined in line with both the provisions of the Financial Regulation on the use of simplified cost options[11], and the respective Commission decision, and whether, as a result, the estimated costs were justified.

5.29. We found that the lump sum decision did not contain the justification required under Article 181(4)(a) of the Financial Regulation with regard to the risk of irregularities and fraud.

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[10] Decision authorising the use of lump sum contribution under Horizon Europe (hereafter called 'lump sum decision'), Horizon Europe Work Programme 2023-2024 and the lump sum model grant agreement.

[11] Financial Regulation applicable to the general budget of the Union, Articles 181(4) and 183(4).

5.30. For example, there are no specific rules governing lump sum grants that require, during the implementation phase of the projects, compliance with procurement rules. The lump sum decision contained no information on controls and checks (such as *ex post* controls) on procurement, despite OLAF having stated in its 2021 annual report that it frequently investigated cases of "procurement fraud or corruption in *public procurement* procedures involving EU financing".

5.31. Proper implementation of a project is the sole condition for payment in the case of lump sum projects, and is assessed on the basis of completed work packages. While the grant agreements list objectives, tasks, deliverables and milestones for each work package, they do not define which of these must be achieved as the condition for payment. The Commission did not provide enough guidance on project monitoring and assessment.

5.32. During our review of the 10 lump sum projects selected, we found that the Commission guidance provided to expert evaluators[12] does not oblige them to use 'relevant benchmarks' in their assessments of project budgets, in contrast with what is required under the lump sum decision. There is also limited documentation supporting the experts' assessments of the budgets and how the budget estimates comply with the principles of *economy*, *efficiency* and *effectiveness* as set out in the Financial Regulation.

[12] Experts are contracted by the Commission to carry out the evaluation of grant proposals including the assessment of their budget.

Annual activity reports and other governance arrangements

5.33. The annual activity reports (AARs) we examined[13] reflected the information available in the respective DGs and, based thereon, gave a fair assessment of the financial management in relation to the *regularity* of underlying transactions relating to MFF1 expenditure.

5.34. With regard to Horizon 2020, DG RTD reported an expected representative error rate of 2.71 % for all DGs and other EU bodies managing EU research spending. The *residual error rate*, taking into account corrective actions, is 1.67 % (1.71 % for DG RTD alone). The *ex post* audits underlying these error rates covered payments made over the 2014-2021 period. In order to resolve the methodological issue previously raised by the ECA, which had led to an understatement of the error rate[14], the Common Audit Service calculated a top-up based on 1 937 audits closed in 2020-2022, resulting in an increase in the error rate of 0.38 percentage points, which was disclosed in DG RTD's AAR.

5.35. 2022 was the second year of implementation of Horizon Europe. As the *ex post* audit campaign for this framework programme is due to be launched by the end of 2023, DG RTD did not report a detected error rate for Horizon Europe in 2022. The target the Commission has set for the Horizon Europe residual error rate is no more than 2 % by the end of the framework programme.

5.36. In its 2022 AAR, DG RTD disclosed 17 open Internal Audit Service (IAS) recommendations. Five of the open recommendations were classified as 'very important' and one as 'critical'. The 'critical' recommendation concerned the audit on the design and early implementation of the European Innovation Council (EIC) in DG RTD, the European Innovation Council and SMEs *Executive Agency* (EISMEA) and the Directorate-General for Communications Networks, Content and Technology (DG CNECT). It needs to be noted that we have never audited the EIC in the context of our AAR reviews. The IAS considers that the design of the EIC programme's governance framework has not yet been finalised, hence, key aspects of governance cannot be

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[13] DG RTD and DG DEFIS.

[14] The error rate had been calculated as a share of all the accepted costs, instead of the amount actually audited. This meant that the denominator in the error calculation was higher, so the error rate was understated; 2018 annual report, paragraph 5.34.

implemented or performed adequately. According to the IAS, relations between the EISMEA and its parent DGs have not yet been formalised and no clear rules on the separation of functions have been defined. This has resulted in unclear roles and responsibilities as well as conflicts of interest.

5.37. Due to the 'critical' IAS recommendation, a *reservation* was issued on reputational grounds with respect to the late implementation of and weaknesses in the governance and control systems of the investment component of the EIC Accelerator scheme.

5.38. DG DEFIS' main relevant expenditure under MFF1 in 2022 related to the EU Space Programme, which is mostly managed indirectly via the European Union Agency for the Space Programme (EUSPA), the European Space Agency (ESA) and other entrusted entities. The error rates determined during the *ex post* audits of the different programmes are very low (close to zero). However, as the audited samples of transactions are not statistically representative, DG DEFIS decided to adopt a conservative approach and report an error rate of 0.5 % for all unaudited organisations and those with a zero error rate.

5.39. We reviewed the information in the Commission's 2022 AMPR regarding the estimated risk at payment in the policy areas under MFF1. The Commission calculated an error rate of 1.5 % for MFF1. This percentage is at the lower end of our range of estimated level of error and below materiality.

Conclusion and recommendations

Conclusion

5.40. The overall audit evidence we obtained and have presented in this chapter shows that the level of error in spending on 'Single Market, Innovation and Digital' was material. For this MFF heading, our testing of transactions produced an estimated overall level of error of 2.7 %. The research and innovation expenditure is most affected by error, particularly in the area of personnel costs.

5.41. The introduction of single lump sum funding for research grants was not based on an *ex post evaluation*, but on the results of surveys. As a consequence, important elements are missing, such as the requirement for experts to use relevant benchmarks when assessing budgets, the obligation to comply with procurement rules, clear requirements regarding the completion of each work package, and definition of the scope of *ex post* controls.

5.42. The estimated risk at payment presented in the AMPR is 1.5 %. This percentage is at the lower end of our range of estimated level of error and below materiality. Therefore, in our view, despite the measures already taken by the Commission, this rate remains understated.

Recommendations

5.43. ***Annex 5.1*** shows the findings of our follow-up review of the recommendations we made in our 2020 annual report that were due to be implemented by 2022[15]. The Commission has implemented one recommendation in full and one has not been implemented.

5.44. Based on this review and our findings and conclusions regarding 2022, we recommend that the Commission:

[15] The recommendations we made in our 2019 annual report required action by the end of 2021. We therefore followed them up in the 2021 annual report. The recommendations we made in our 2021 annual report required action by mid-2023 at the earliest, hence they will be followed up in next year's annual report.

Recommendation 5.1 – Evaluate the lump sum funding

(a) In the framework of the mid-term evaluation of Horizon Europe, include an evaluation of lump sum funding in order to assess whether certain types of projects (in terms of content, size, etc.) are not suited to lump sum funding, as well as cover the risk of irregularities and fraud.

Target implementation date: Horizon Europe mid-term evaluation (end 2025)

(b) Prior to the next Horizon Europe calls, assess the appropriateness of using lump sum funded grants for high-budget projects and of fixing a maximum amount for such grants.

Target implementation date: end 2024

Recommendation 5.2 – Improve experts' evaluations of lump sum grants

For lump sum grants, ensure that expert evaluations of grant applications, in particular the budget proposals therein, are carried out with due considerations of relevant benchmarks and are properly documented.

Target implementation date: end 2023

Recommendation 5.3 – Define clearer requirements on implementation of Horizon Europe grants

Further specify for lump sum grants the requirements defining proper implementation, including the elements of each work package that will trigger payment, as well as provide detailed guidance to those involved in assessing the implementation of projects.

Target implementation date: Q1 2024

Recommendation 5.4 – Define the scope of *ex post* controls of lump sum grants

For lump sum grants, define the scope of *ex post* controls, which should include checks on high-risk areas, such as procurement rules, absence of conflict of interest and the use of the resources indicated in the grant agreement.

Target implementation date: mid 2024

Annexes

Annex 5.1 – Follow-up of previous recommendations for ‘Single Market, Innovation and Digital’

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2020	We recommend that by 2022 the Commission should: **Recommendation 1:** Extend the scope of the certificates on financial statements to include unit cost categories for the new Research Framework Programme, Horizon Europe, in order to increase the level of detection and correction of errors in unit costs.		Despite the Commission accepting the recommendation, by the time the 2020 annual report was published the relevant regulation had already been adopted and did not contain any such provision.
	Recommendation 3: Further improve the quality of *ex post* audits by addressing the weaknesses in the sampling procedures at the level of cost statements and apply the corrections to the error calculation method for Horizon Europe.		

Source: ECA.

Chapter 6

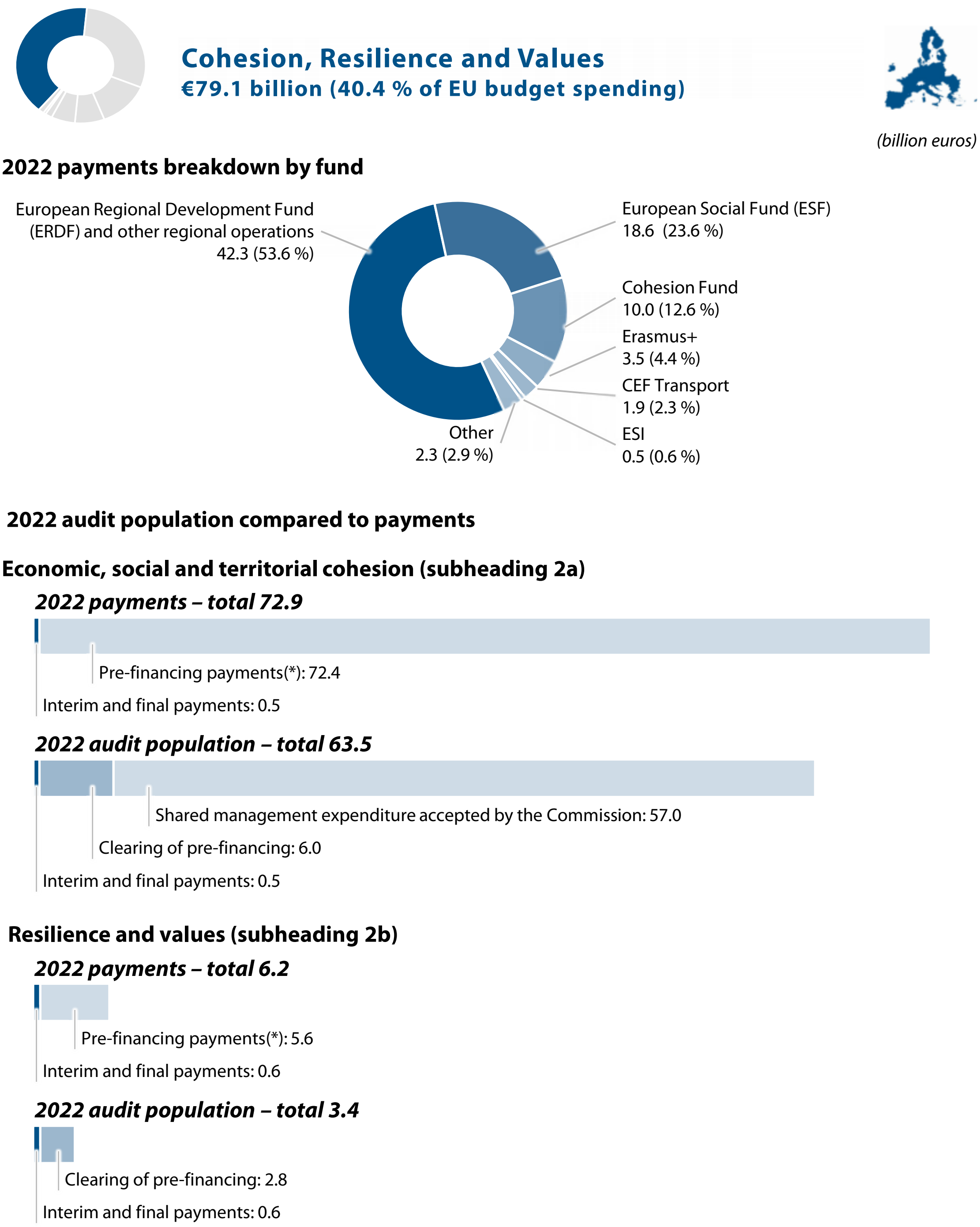
Cohesion, resilience and values

Contents

Introduction

6.1. This chapter presents our findings for *MFF* heading 2 ‘Cohesion, resilience and values’. ***Figure 6.1*** gives an overview of the main activities and spending under this heading in 2022.

Figure 6.1 – Payment and audit population



(*) The payment figure for subheading 2a consists of *shared management* annual advances and *interim payments* for the 2014-2020 *programme period* that were not accepted by the Commission in 2022. In line with the harmonised definition of underlying *transactions* (for details see ***Annex 1.1***, paragraphs ***18*** and ***19***), these payments are considered pre-financing and not part of our audit population for the 2022 annual report.

Source: ECA, based on data from the 2022 *consolidated accounts* of the European Union.

Brief description

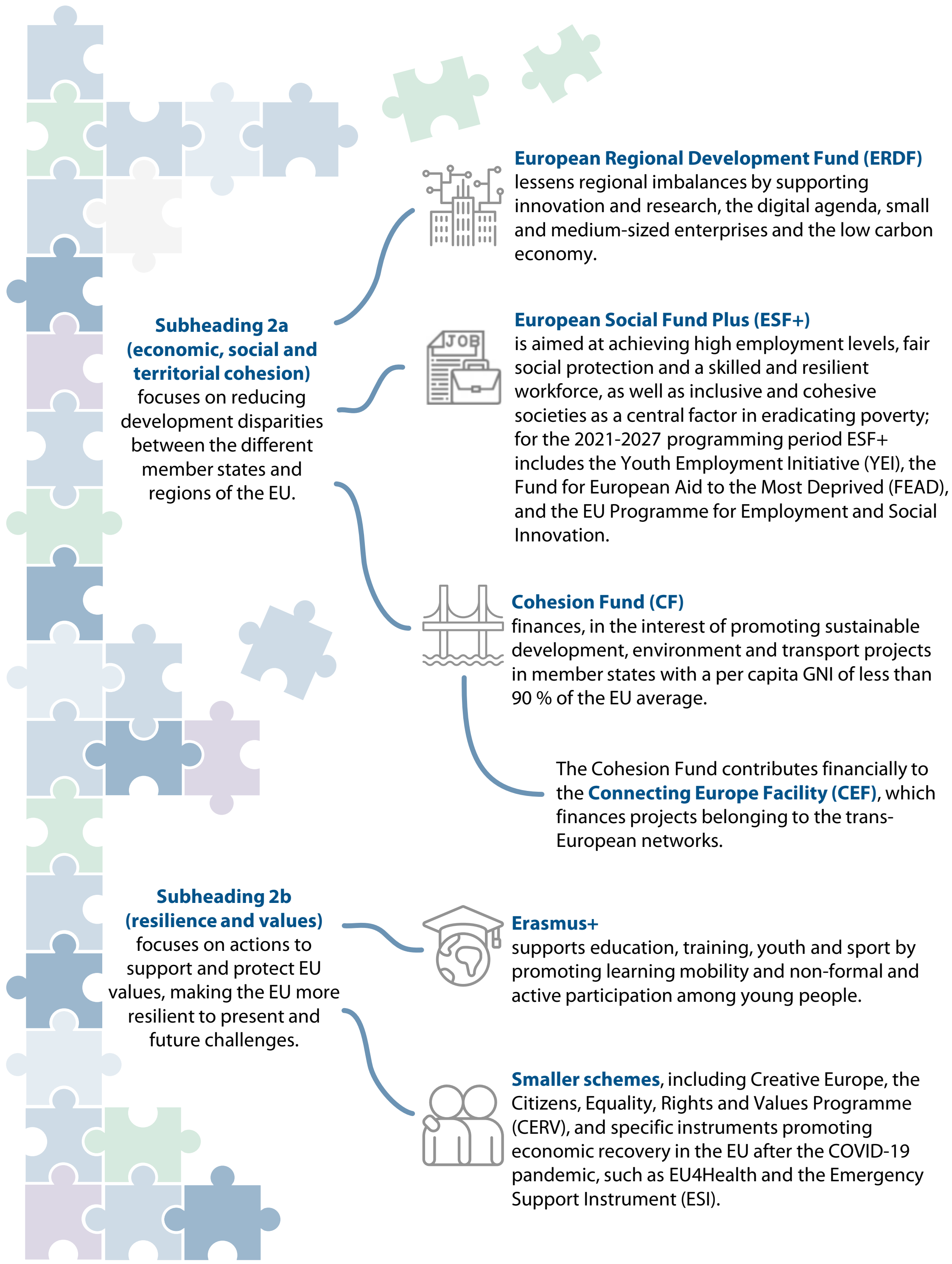
Policy objectives and spending instruments

6.2. Spending under this heading focuses on reducing development disparities between the different member states and regions of the EU (subheading 2a), and actions to support and protect EU values, making the EU more resilient to present and future challenges (subheading 2b). ***Figure 6.2*** shows the objectives of spending under the MFF heading 2 'Cohesion, resilience and values' (subheading 2a[1] and subheading 2b) and the related funds and instruments[2].

[1] See Articles 162 and 174 to 178 of the Treaty on the Functioning of the European Union (p. 73 and pp. 81-82).

[2] We report on 2022 *Recovery and Resilience Facility (RFF)* expenditure in ***chapter 11***.

Figure 6.2 – Policy objectives

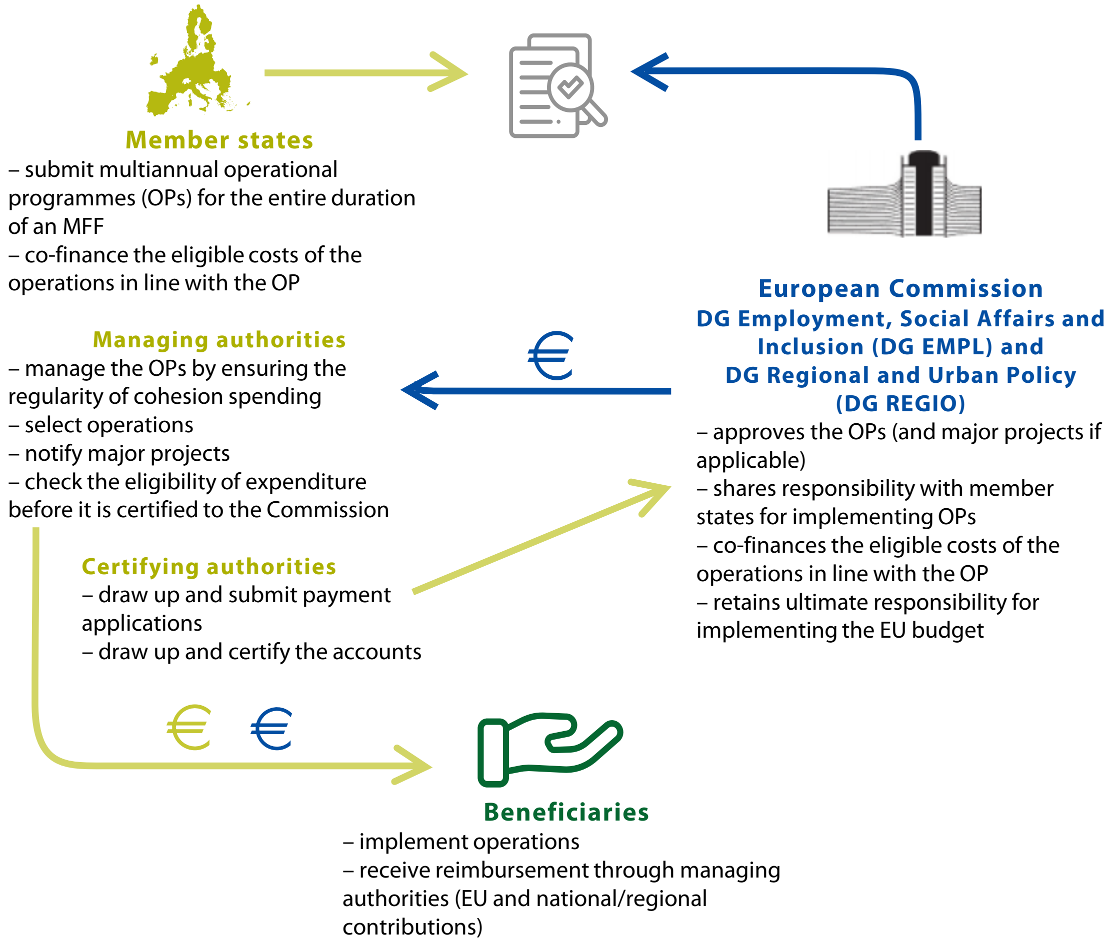


Source: ECA.

Management of funds

6.3. The cohesion policy funds (the *ERDF*, the *ESF* and the *CF*) account for the bulk of expenditure under the MFF heading 2. These funds are implemented under shared management. *Figure 6.3* describes this process and the roles and responsibilities of the different actors.

Figure 6.3 – Roles and responsibilities in shared management



Source: ECA.

6.4. *Audit authorities* play a key role together with the Commission in the control and assurance framework for 2014-2020 spending under shared management[3]. They have to ensure that the *residual error rate*[4] in an *OP's* annual accounts remains below the 2 % *materiality threshold*[5]. After checks by their managing authorities, which are the first line of defence, the member states certify each OP's annual accounts and

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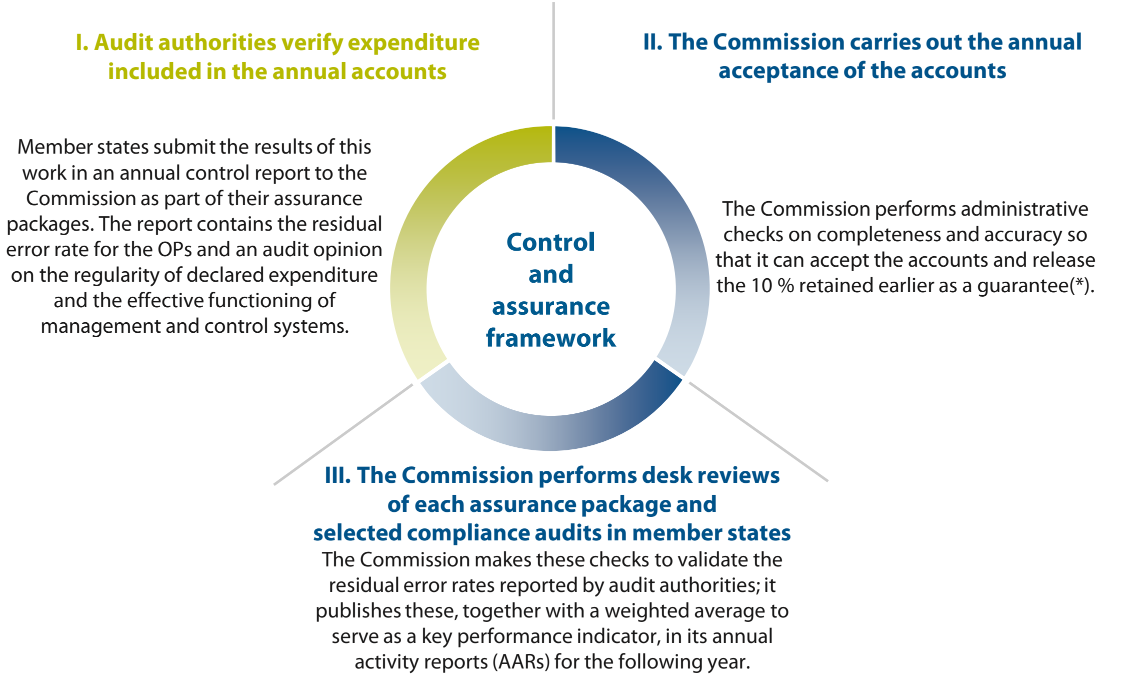
[3] See our 2017 (paragraphs 6.5-6.15) and 2018 annual reports (Figure 6.1).

[4] In its AARs the Commission refers to a 'residual risk rate' (RRR) when dealing with closure for the 2007-2013 *programming period* and to a 'residual total error rate' (*RTER*) when dealing with the 2014-2020 programming period. In this chapter, we refer to both as 'residual error rate(s)'.

[5] Article 28(11) of Regulation (EU) No 480/2014 supplementing Regulation (EU) No 1303/2013.

report to the Commission. To that end, the control and assurance process relies on the three elements shown in ***Figure 6.4***. The process leading up to the *closure* of OPs from the 2007-2013 *programme period* was largely comparable.

Figure 6.4 – Control and assurance framework



(*) Article 130 of the Regulation (EU) No 1303/2013 limits the reimbursement of interim payments to 90 %.

Source: ECA.

6.5. MFF heading 2 'Cohesion, resilience and values' also covers EU funding through *programmes* or actions that are managed either directly by Commission DGs[6], or indirectly with the support of partner organisations or other authorities[7], mostly in the subheading 2b (see ***Figure 6.2***).

Audit scope and approach

6.6. Our objective was to contribute to the overall *statement of assurance* as described in ***Annex 1.1***, and to provide an assessment of the *regularity* of expenditure both under MFF heading 2 as a whole and for the cohesion policy funds

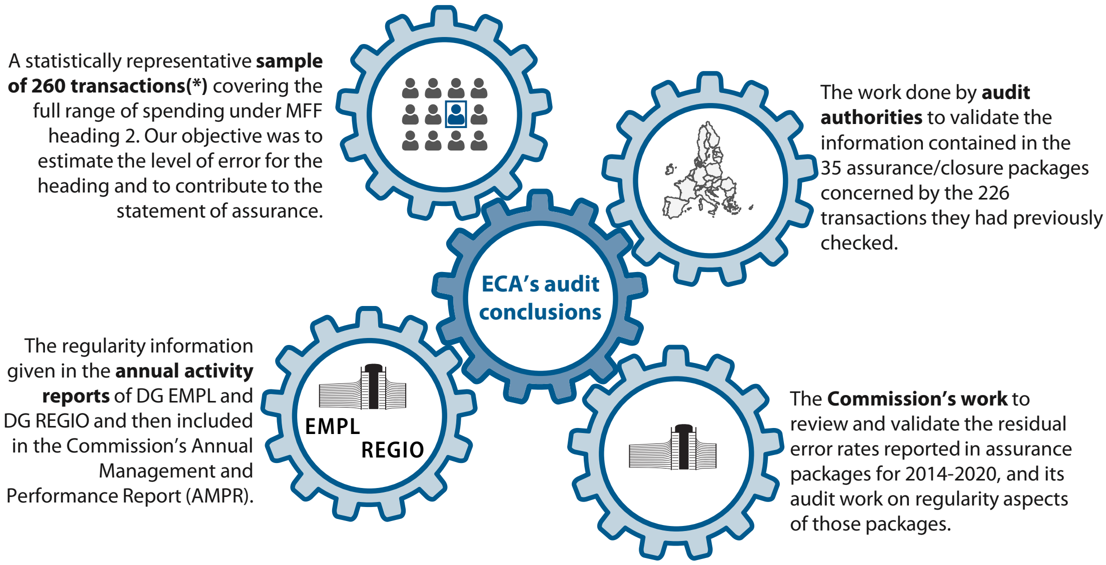
6 DG EAC, DG EMPL, DG HERA, DG REFORM, DG REGIO, DG SANTE and European Climate, Infrastructure and Environment Executive Agency (CINEA) under the supervision of DG MOVE in relation with expenditure in our 2022 population.

7 Such as Erasmus + national agencies.

(subheading 2a). We also assessed the reliability of the audit authorities' and the Commission's audit work.

6.7. To draw these audit conclusions, as in previous years, we applied the same approach and methods to audit cohesion spending as set out in ***Annex 1.1***, examining the elements described in ***Figure 6.5***.

Figure 6.5 – Elements audited under our audit approach



(*) For the cohesion policy funds, the **sample** consisted of 226 transactions for which expenditure had been certified in assurance and closure packages (which had been checked previously by an *audit authority*), as well as 15 *financial instruments* (subheading 2a). The sample also included 19 transactions directly or indirectly managed by the Commission (4 under subheading 2a and 15 under subheading 2b).

Source: ECA.

6.8. Our audit population (€66.9 billion) consisted mainly of expenditure from the 2014-2020 period that had been included in accepted accounts submitted in *assurance packages* for the 2020/2021 accounting year (413 OPs with a total value of €56.1 billion). It also included expenditure from the 2007-2013 period under the three OPs which the Commission had closed or partially closed[8] in 2022 (€840 million), and expenditure from the 2000-2006 period under one OP (€32 million).

6.9. In 2022, the Commission had only made advance payments for the 2021-2027 period. These payments amounted to €6.5 billion. Once expenditure paid by beneficiaries is reimbursed, audited by the *programme authorities* and included in

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[8] The Commission pays only the uncontested amounts, and issues which have a material impact remain open. The final balance is paid and the OP closed once all outstanding issues have been resolved.

payment claims paid by the Commission to the member states, it becomes part of our audit population. Given that this is not applicable for advance payments, also in 2022 no payments for the 2021-2027 period were part of our audit population[9].

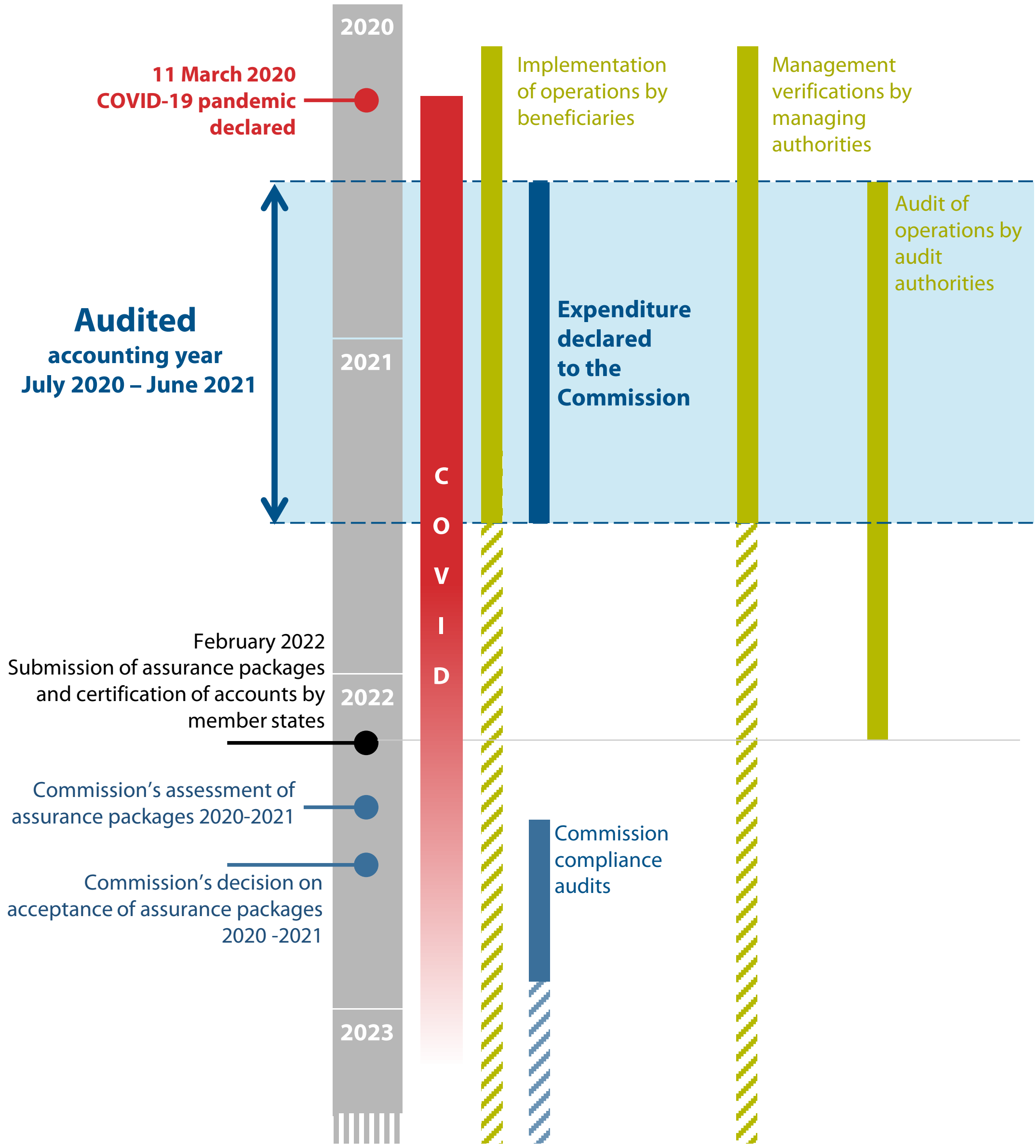
6.10. From early 2020 onwards, the EU took a number of actions to address the challenges of the COVID-19 pandemic (*CRII* and CRII+). These actions comprised procedural simplifications for 2014-2020 cohesion policy funds, including the possibility of a 100 % EU financing. Our sample also included projects benefiting from this possibility. In addition, the *REACT-EU* initiative provided additional funding, equally with a 100 % EU co-financing rate. As the eligibility period for the 2014-2020 expenditure ends on 31 December 2023, the additional funding provided through REACT-EU may have added pressure to spend[10]. At the same time, the 100 % co-financing rate has allowed for a faster *absorption* of the available funding for the 2014-2020 programmes by member states.

6.11. The control and assurance framework remains unchanged by these initiatives and the Commission applied the system in 2022 in the same way as for pre-COVID-19 expenditure. Our audit population covers the expenditure declared by the certifying authorities from 1 July 2020 to 30 June 2021. The audit authorities carried out their checks mainly during the period of the COVID-19 pandemic (see ***Figure 6.6***).

[9] By April 2023, the Commission had adopted 379 programmes for the ERDF, the CF and the ESF+ under the 2021-2027 period.

[10] Special report 02/2023: “Adapting cohesion policy rules to respond to COVID-19”.

Figure 6.6 – Assurance process in 2022 for the 2020-2021 annual accounts (in relation to expenditure declared during COVID-19)



Source: ECA.

6.12. We took our sample of 226 transactions with expenditure certified in assurance and closure packages during 2022 in two stages. We first selected 35 packages (34 from the 2014-2020 period and one from the 2007-2013 period) covering 66 OPs[11]. From these, we sampled transactions which had been previously checked by the audit authorities. For 2022, we carried out on the spot audit visits for 67 transactions, after 2 years of travel restrictions due to the COVID-19 pandemic. This

[11] Through *stratification*, we selected randomly three of the 34 assurance packages from member states we had not audited in previous years in order to cover all member states during our audit of the 2014-2020 period.

allowed us to obtain original documents, interview auditees' staff face to face and verify the physical existence of EU-funded *output*.

6.13. In the 2020/2021 accounting year, the member states reported disbursements through financial instruments under 128 OPs (€5.5 billion). We took an additional sample covering 15 financial instruments from the 2014-2020 period from which payments had been made to *final recipients*. In total we examined 96 loans, 40 guarantees, 8 *equity investments* and 3 management fees.

6.14. ***Annex 6.1*** contains a breakdown of our sample of transactions and transaction-related findings we identified in the 27 member states and the United Kingdom[12] for subheading 2a.

6.15. In 2022, the Commission paid or cleared €4.3 billion for programmes under its direct or *indirect management*, including €3.4 billion in expenditure under subheading 2b. We examined a sample of 19 transactions financed from the CF contribution to the *CEF*, the ERDF contribution to the European Neighbourhood Initiative (ENI), the *ESI*, *Erasmus+*, the Health programme and others.

[12] The programmes of the 2014-2020 period of the United Kingdom are still part of the MFF2 expenditure.

Regularity of transactions, AARs and other governance arrangements

Results of our testing of transactions

6.16. For 2022, we estimate the level of error for MFF heading 2 to be 6.4 %[13] (see ***Figure 6.7***). This is based on our audit of 260 transactions where we identified and quantified 50 errors and the findings of audit authorities which reported 58 such errors. In addition, we took account of the corrections with a total value of €618 million applied by programme authorities. According to Article 287(2) TFEU, '[t]he Court of Auditors shall examine whether all revenue has been received and all expenditure incurred in a lawful and regular manner […]. In doing so, it shall report in particular [but not only] on any cases of *irregularity*'. Our error rate refers to the share of expenditure declared for which we consider that the conditions for payment set out in the *Financial Regulation*, the *CPR* and the Regulation on the protection of the EU's financial interests have not been fully met, leading to a direct and measurable financial *impact* on the payment amount authorised at the time from the EU budget; it should not be interpreted as being equivalent to the potential amount of *financial corrections* the Commission can impose in accordance with the applicable rules.

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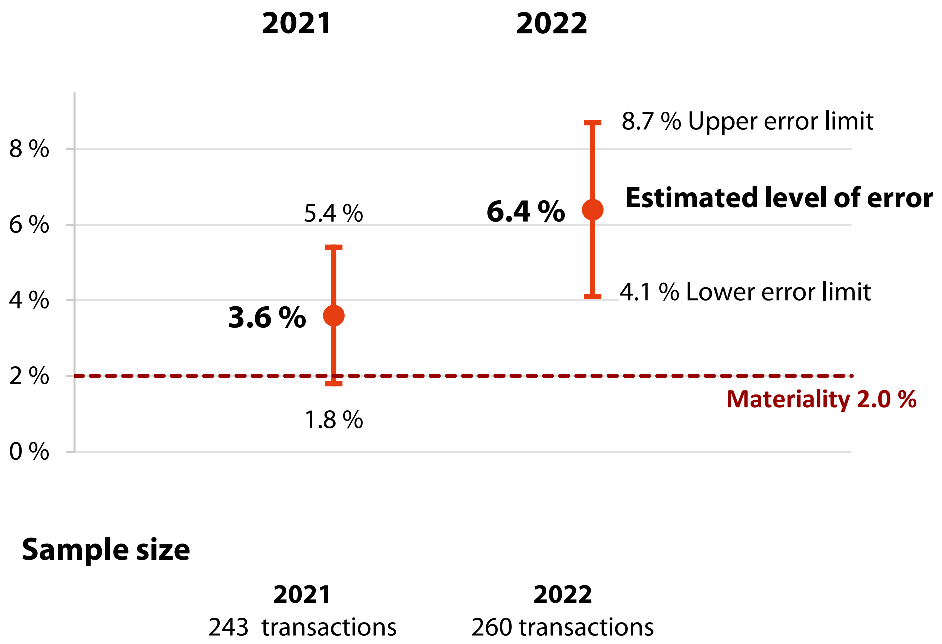
[13] The *estimated level of error* for subheading 2a only is 6.6 % (lower error limit 4.2 %, upper error limit 9.0 %). The estimated level of error for cohesion policy funds only is 6.7 % (lower error limit 4.2 %, upper error limit 9.2 %).

Figure 6.7 – Estimated impact of quantifiable errors

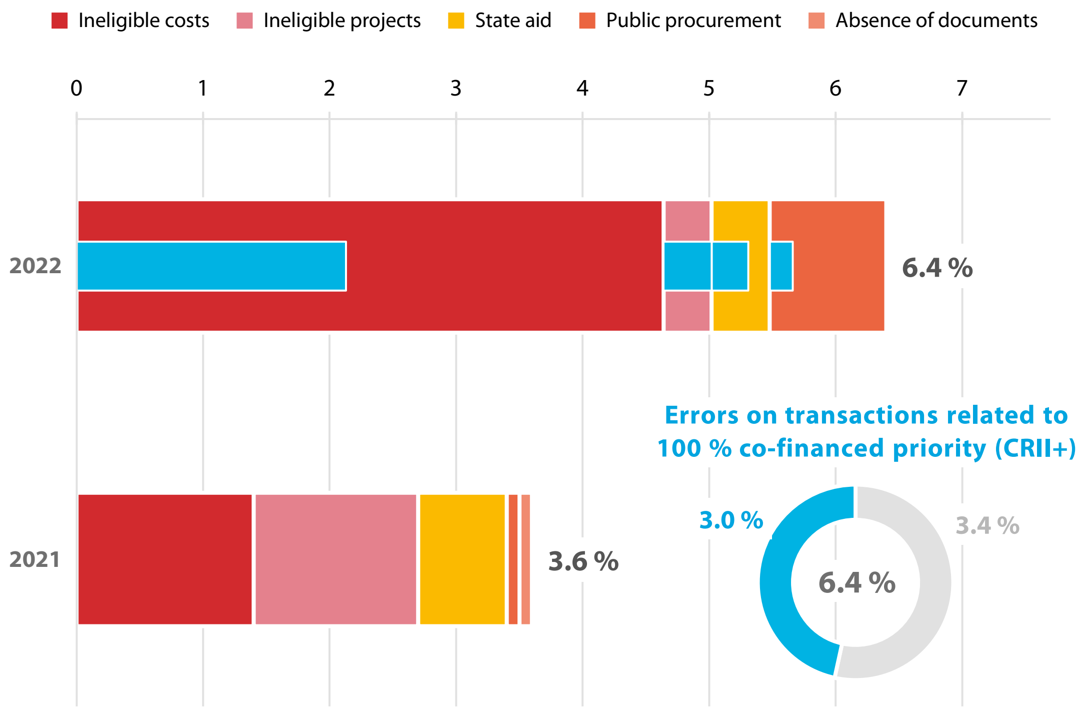


Source: ECA.

6.17. This year, both our error rate estimate and the number of errors we found were higher than in previous years. These increases do not follow a geographical pattern. However, we identified an increase of specific types of errors (such as ineligible costs and non-compliance with public procurement rules). We also note that we are approaching the end of the eligibility period with some absorption pressure (31 December 2023). In addition, member states were given considerable flexibility in re-programming funds (including additional funding through REACT-EU) and declaring expenditure since 2020 (see paragraph ***6.10***). Furthermore, during the COVID-19 period, the effectiveness of the checks and verifications by managing and audit authorities may have been reduced. We provide a comparison with last year in ***Figure 6.8*** for the *estimated level of error* in percentage points, indicating the break down by category. In our 2020 annual report[14] we highlighted the risk that the established control systems could be weakened during the COVID-19 period, potentially increasing the risk of errors and irregularities.

[14] See paragraph 2.32 of the 2020 annual report.

Figure 6.8 – Comparison of the contribution to the Estimated Levels of Error (ELE) per category
(percentage points)



Source: ECA.

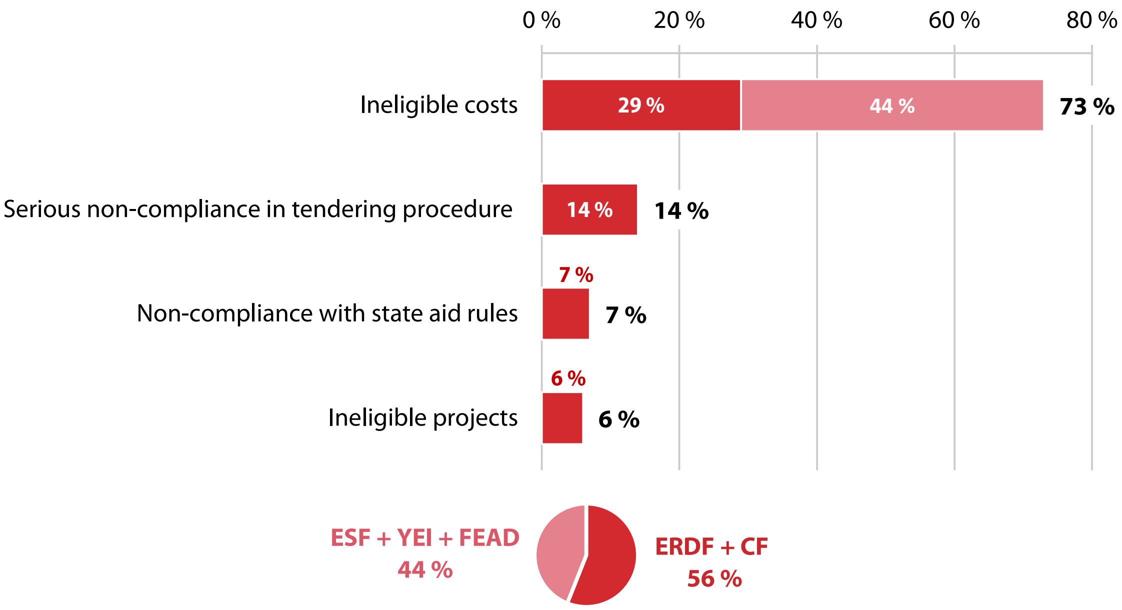
6.18. In the 260 transactions we audited, the audit authorities reported 58 *quantifiable errors*. These concerned ineligible costs (31), irregularities in public *procurement procedures* (21), missing supporting documents (6), accounting and calculation errors (3) and (2) infringements of *state aid* rules[15]. The member states had applied *financial corrections*, extrapolating them as necessary, with a view to bringing the residual error rates to or below the materiality threshold of 2 %.

6.19. *Figure 6.9* shows how the 50 additional errors we found break down by category (before taking account of financial corrections). Ineligible costs and project and infringements of internal market rules contributed most to our estimated level of error.

6.20. Paragraphs *6.22*-*6.40* provide more information on these errors.

[15] A single transaction may be affected by more than one type of error.

Figure 6.9 – Contribution of the errors we found to the overall error rate



Source: ECA.

Ineligible costs

6.21. When member state authorities declare expenditure to the Commission in their accounts, they certify that it was incurred in compliance with the applicable EU and national rules, and that aid was granted to beneficiaries and operations that met the OP eligibility requirements.

6.22. In our sample, we found 37 cases of ineligible costs that had not been detected by the audit authorities and two cases in *direct management*. The main causes of ineligibility were non-compliance with EU or national rules, costs not related to the project, ineligible participants, and expenditure not incurred or paid by the *beneficiary*. These cases accounted for 78 % of the total number of quantifiable errors we found, and approximately 4.6 percentage points of the estimated level of error (a 73 % error contribution).

6.23. *Box 6.1* gives an example of ineligible expenditure.

Box 6.1

Ineligible expenditure for COVID-19 emergency support due to incomplete declaration of sales income

The objective of one ESF measure audited in Slovakia was to mitigate the impact of the COVID-19 pandemic on employment and the labour market by providing financial support to employers or self-employed workers.

To receive support for 13 workers, this final beneficiary reported a decrease in its turnover of 43.5 % at the comparison point of May 2020 versus May 2019.

This 43.5 % decrease, though, was not accurate. It reflected only the decrease in on-site sales. It did not take into account sales the business made through other channels.

Taking into account off-site sales as well, the overall decrease in the company's total sale income was only 9 %. This was below the required 20 % minimum decrease in sales to qualify for the aid. Therefore, we consider the support for the month of May to be ineligible.

For two other final beneficiaries of the same measure, we found that they received more support than was provided for under national rules due to misreporting of income.

We found ineligible costs in relation to COVID-19 measures also in Greece (already partially detected by the Commission), Italy and another case in Slovakia.

6.24. Under the 2014-2020 legal framework, *major projects* financed from the ERDF or the CF are operations carried out in support of an indivisible, defined task, whose value exceeds €50 million (€75 million for transport projects). They are subject to specific approval procedures. During the 2014-2020 period, major projects must be notified to the Commission. This is a compulsory requirement before expenditure associated with a major project can be included in payment requests to the Commission[16]. In the 2021-2027 period, this rule is no longer in force[17]. However, the *provision* continues to apply to operations under the 2014-2020 period.

6.25. We found two cases of expenditure introduced in the accounts for operations exceeding the major project thresholds, but not notified to the Commission

[16] See Article 102(6) of Regulation (EU) No 1303/2013.

[17] See Article 117(1) of Regulation (EU) 2021/1060.

(see ***Box 6.2***). These cases account for 0.8 percentage points of our estimated level of error.

Box 6.2

Expenditure declared without a major project notification being sent to the Commission

Managing authorities need to notify the Commission of the major projects they select for funding. Only after this notification is made can member states include major-project-related expenditure in payment applications to the Commission.

In **Romania**, we audited a project for the creation of a national electronic repository of scientific documents. In accordance with the regulatory definition of total eligible costs, which includes public and private contributions, the costs of this indivisible task exceeded €50 million. Therefore, under the Commission guidelines in force at the time, the *managing authority* should have notified this major project. We already had reported this error in our audit for the 2020 statement of assurance. Despite this, the programme authorities continued to declare expenditure in relation to this project and included it in the accounts in 2022.

In **Hungary**, we found a project, originally part of an overall project, which involved the purchase of 15 trains for use on various rail lines across the country. The project was subsequently split into two parts. This was explained by traffic needs and the track development of specific railway lines. However, we found that the purchased trains were not used on the lines indicated in the separated projects, but interchangeably on various rail lines across the country. Taking into account that, the contracting authority also awarded a single contract under a common public procurement procedure, we considered the project as major project.

6.26. Ineligible cost is also a major source of error outside shared management. We detected ineligible staff costs in a project funded under a health programme under direct management in Spain. In addition, we detected another case of ineligible costs in Poland. The Commission accepted the audit finding and will launch recovery procedures in both cases.

6.27. In cohesion policy, *simplified cost options (SCOs)* are an important simplification measure, but the implementation is not always as it should be. Beneficiaries used SCOs for 77 transactions, or 30 % of our sample, applying either flat rates, standard scales of unit costs or a combination of both. This year, we found errors relating to the use of SCOs in five transactions in three member states – Czechia, Spain and Slovakia. See ***Box 6.3*** for an example.

Box 6.3

Ineligible costs due to inappropriate indirect costs calculation

In Czechia, the managing authority of an ESF/ERDF *operational programme* launched a complementary call for projects approved under the Horizon 2020 programme.

Under the Horizon 2020 rules, depreciation costs can be included in the basis for calculating the 25 % of *indirect costs* which can be submitted for reimbursement.

However, the managing authority incorrectly transposed the Horizon 2020 rules into national legislation. This led to the situation that beneficiaries could declare the investment costs as *direct costs* and a hypothetical depreciation of the same investment in the basis for calculating indirect costs. This led to a systematic over-declaration for all projects under the same national rules.

Ineligible project

6.28. We identified one project in Slovakia that was granted aid even though it did not meet the eligibility conditions listed in the applicable Regulation or national law and the corresponding OP (see ***Box 6.4***). This project accounted for 2 % of all the quantifiable errors we detected, and approximately 0.4 percentage points of the estimated level of error (a 6 % error contribution).

Box 6.4

Project scope did not comply with selection criteria

In Slovakia, for an ERDF programme, a public body beneficiary declared all the costs for the reconstruction and a complete renovation of interior spaces of a public building as eligible expenditure.

However, the call for project applications only mentions energy-efficiency measures as eligible activities for co-financing. In addition, the selection criteria explicitly stated that the project would be not eligible for funding if more than 25 % of the expenditure in the project application were deemed ineligible during the project evaluation.

Since more than 25 % of the project costs were not directly linked to energy-efficiency measures, already the project application did not meet the selection criteria, and therefore the project should have not been selected. In particular, the beneficiary had declared costs for works that, according to the recommendations of the prior energy audit, were not necessary (e.g. a new ventilation system) or that did not relate to increasing energy efficiency at all (e.g. sanitary equipment and internal walls).

In addition, the project did not fulfil other conditions of the call related to the classification of the building, use of the building before and after the project implementation, and having a relevant building permit.

6.29. In two additional cases in Spain, we found significant inconsistencies in the scope of the operation defined in the documents that established the conditions for support.

Infringements of internal market rules: state aid and public procurement

Seven projects infringed state aid rules

6.30. Article 107 of the Treaty on the Functioning of the European Union (TFEU) is intended to ensure that aid granted by a member state or through state resources does not distort competition and trade within the EU. Unless state aid is below a *de minimis* ceiling[18], member states must notify the aid to the Commission. The Commission must then decide whether this aid is compatible with the internal market

[18] Regulation (EU) No 1407/2013 on de minimis aid.

and give its explicit approval. Member states can also grant state aid if the aid falls under the *General Block Exemption Regulation (GBER)* or other exemption schemes.

6.31. This year we identified seven projects that infringed the EU's state aid rules in five member states – Czechia, Hungary, Malta, Poland and Romania. We consider that four of them should have obtained less public funding, or none at all. These projects accounted for 8 % of all quantifiable errors we found, and approximately 0.5 percentage points of the estimated level of error (a 7 % error contribution). We have not quantified the other errors, as they had no impact on the level of public funding. We provide an example of an infringement of state aid rules in ***Box 6.5***.

Box 6.5

Inadequate application of state-aid rules

In an ERDF-funded project in Poland, a private company received a *grant* for R&D activities to install and test a pilot production line that would be used to experiment on and produce a range of innovative chemical substances. After a series of tests, the company confirmed that the production line was suited to producing eco-friendly chemicals. Once the project was completed, the company started using the line for commercial purposes.

During our audit work, we found that the company had declared the whole investment cost of the line for co-financing. This contravened Article 25 of the GBER (aid for research and development projects), according to which only depreciation costs are eligible in cases where an asset is not used only for the project for its full lifespan. As the production line remained in use after the project was completed, we concluded that a significant part of the support granted for this project was non-compliant with state aid rules.

Four cases of non-compliance with EU or national public procurement rules

6.32. Public procurement rules are key to ensure that public money is spent economically and efficiently while respecting the principles of transparency, proportionality, equal treatment and non-discrimination. In our audits, in accordance with the CPR, we examine compliance with EU and national public procurement rules.

6.33. In four procedures, we identified cases of non-compliance with EU or national public procurement rules that had not been detected by the audit authorities in Czechia, Spain and Portugal and we quantified three of these four cases. We also detected three cases where the member state authorities had not correctly applied the Commission decision on quantification of public procurement errors in Czechia, Italy and Slovakia. In these cases, the member states applied lower rates than those, we consider appropriate in accordance with the Commission's guidelines. The six cases we quantified accounted for 12 % of all the quantifiable errors we found, or approximately 0.9 percentage points of the estimated level of error (a 14 % error contribution).

6.34. We found two serious infringements that impacted the public procurement outcome for two ERDF projects in Czechia. One case is presented in ***Box 6.6.***

Box 6.6

Irregular procurement procedure due to undetected conflict of interest at contractor level

In Czechia, the contracting authority of the audited ERDF project was a public company which supplied heat to local residents. One of the purposes of the audited operation was to increase the use of renewable resources by installing a modern boiler for burning biomass. EU and national law stipulate that contracting authorities must avoid conflicts of interest when carrying out procurement procedures.

The audited procedure was below the threshold set out in the EU Public Procurement Directive, therefore national law was applicable (Article 44 of the national public procurement law).

We found that the contracting authority did not identify the conflict of interest and did not apply sufficient mitigating measures when it selected an offer submitted by a company which had participated in the preparation of the project application and in drawing up the tender documentation. The technical tender specification was tailor-made to the company's own product and de facto did not allow for equivalent products to be awarded the tender. Two bids were submitted for the same product included in this tender: one from the company itself and the other from one of its distributors.

Moreover, unlike in a similar case, the Office for the Protection of Competition did not properly address the apparent conflict of interest and did not request any mitigating action such as an independent expert opinion on the contracting authority's procedure for granting the tender. We therefore consider the audited contract and related expenditure to be irregular.

The audit authority detected another irregularity in relation to this contract and the programme authorities applied a 25 % financial correction. However, neither the managing authority nor the audit authority detected the conflict of interest during their verifications for which a 100 % correction would be required[19].

6.35. ***Box 6.7*** gives an example of an infringement of public procurement procedures associated with a rapid award of contracts for a large volume of goods to respond to the COVID-19 pandemic.

Box 6.7

Inconsistent application of emergency exemptions in public procurement procedures for the purchase of face masks

During the early period of the COVID-19 pandemic, medical supplies and related services were in short supply. We audited an ERDF-funded project in Spain concerning the purchase of protective face masks, to be delivered by April 2020.

The contracting authority awarded the contract directly, without prior publication, under an emergency procedure in accordance with Spanish procurement law[20], which allows deviations from the standard procurement procedure in emergency situations. In such situations, the contracting authority must demonstrate that the contractor is the only one able to deliver the required supplies within the technical and time constraints imposed by the extreme urgency[21]. However, contracting authority did not document the selection of the contractor. Furthermore, it should also have performed and documented certain minimum checks to determine whether grounds for exclusion apply to the contractor and to permit a derogation from such exclusion.

To check whether grounds for exclusion applied to the contractor, Spanish procurement law requires at least a self-declaration[22]. However, departing from its own practice for similar contracts, in this case the contracting authority did not

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[19] Categorisation of shortcomings in the awarding of contracts with a determination of the levy amount for breach of budgetary discipline, valid as of 22 November 2017 and Commission Decision of 14.5.2019 laying down the guidelines for determining financial corrections to be made to expenditure financed by the Union for non-compliance with the applicable rules on *public procurement*.

[20] Article 120 of Law 9/2017 (Spanish procurement code).

[21] Communication from the Commission Guidance from the European Commission on using the public procurement framework in the emergency situation related to the COVID-19 crisis (2020/C 108 I/01).

[22] Article 85 of Law 9/2017 (Spanish procurement code).

perform and document any checks. Our audit revealed that one of the contractor's administrators had previously been convicted of a criminal offence.

Finally, the contractor did not deliver the masks by the end of April, a deadline which was the very justification for using a direct award of contract without seeking offers from other suppliers. The bulk of the masks (76.5 %) was only supplied in July 2020.

Absence of essential supporting documents

6.36. Beneficiaries and programme authorities are required to maintain systems and procedures that ensure an adequate *audit trail*. This includes keeping documentary records.

6.37. We found that supporting information or documentation was missing in four of the transactions we examined, but none of which we quantified. In a case in Spain, the monthly timesheets required by the grant agreement were produced by the beneficiary only once the two-year project had been completed and several weeks after the cost claim had been submitted for reimbursement, but before the payment to the beneficiary was made. In another case, in Portugal, the audit authority provided us with a confirmation from participating universities relating to registration and credits obtained, dated after our audit fieldwork. On this basis, we decided not to quantify the error. We note that the Commissions intends to follow-up on this case.

Financial instruments

6.38. Financial instruments, such as loans, guarantees and equity, are a reimbursable form of support. The disbursement through financial instruments increased from €2.1 billion in the 2019/2020 accounting year to €5.5 billion in the audited accounting year.

6.39. We found six quantifiable cases of disbursements where either the final recipients or the supported activities were demonstrably ineligible: one in Italy (for non-compliance with the *NEET* eligibility criteria), one in Czechia (for non-compliance with state aid rules) and four in Spain (for ineligibility of the final recipients and ineligibility of loans). These cases account for approximately 0.3 percentage points of our estimated level of error.

6.40. We also identified 14 system weaknesses in financial instruments. In 4 of these 14 cases, the weaknesses we identified were significant weaknesses at the level of the verifications of the managing authority or intermediate body. These included a lack of checks on whether final recipients were affected by conflicts of interest or had criminal records, and a failure to verify whether the procedure for selection of final recipients complied with the OP's provisions.

Sound financial management

6.41. The EU budget must be implemented in a legal and regular way, in accordance with *sound financial management*, comprising the principles of *economy*, *efficiency* and *effectiveness*. The CPR requires member states to respect these principles when they implement the cohesion policy funds. In our work, we detected 11 cases in Germany, Croatia, Italy, Lithuania and Hungary where these principles had not been respected (see ***Box 6.8***).

Box 6.8

Use of simplified cost options resulting in an excessive financial benefit for a member state

Our sample included four operations from an Italian OP where SCOs had been used. The beneficiaries of these four operations had correctly declared eligible costs based on standard scales of unit costs determined by the managing authority based on Article 67 of the CPR. However, the amount declared by the managing authority to the Commission had been calculated based on another model, using the Commission's standard scales of unit costs (pursuant to Article 14(1) of the ESF Regulation).

As a *result*, the amounts certified to the Commission and paid by the EU budget for each operation were between 16 % and 30 % higher than those agreed and paid to the beneficiaries. The amount of EU funding received by a member state should not be fundamentally different from the amount disbursed to beneficiaries.

We had already reported several such cases in our 2020 annual report[23].

[23] See paragraphs 5.24, 5.25 and 5.26.

Renovated cultural centre not accessible to the public

In Italy, we found that an ERDF-funded cultural centre was still not open to the public 3 years after the completion of renovation works and the delivery of equipment and furniture. At the time of our audit, there was no information available about the existence of a cultural centre other than a poster outside the building still referring to the works in progress. The technological equipment of the media library had been delivered in 2019, but had not yet been unpacked. A fully equipped conference room had never been used.

While the outputs were achieved, the investment did not deliver good *value for money* as the objectives of setting up a community library, fostering community participation and strengthening cultural cohesion had not been achieved.

Only after our audit visit did the beneficiary launch a website dedicated to the project, indicating a calendar of events to be held in 2023

Our assessment of the work of audit authorities

Managing authorities are the 'first line of defence' against irregular spending and audit authorities are the 'second line of defence'

6.42. Managing authorities are the 'first line of defence'. Their effective control is indispensable to ensure both the compliance of the operations with the legal framework and their *performance*. Our audit results over the last 6 years demonstrate that these controls do not yet sufficiently offset the high inherent risk of error in cohesion.

6.43. Audit authorities are the 'second line of defence' in the framework for assurance and control of spending. They verify, on a sample basis, the regularity of expenditure managing authorities declared to the Commission. They must be functionally independent from the management authorities.

Residual error rates above materiality for more than 60 % of the value of assurance packages audited in 2022

6.44. We assessed the work of 24 of 116 audit authorities in 18 member states and the United Kingdom. Our sample comprised 34 assurance packages and one closure package. Except for three cases, the audit authorities had reported to the Commission a residual error rate equal to or below 2 %.

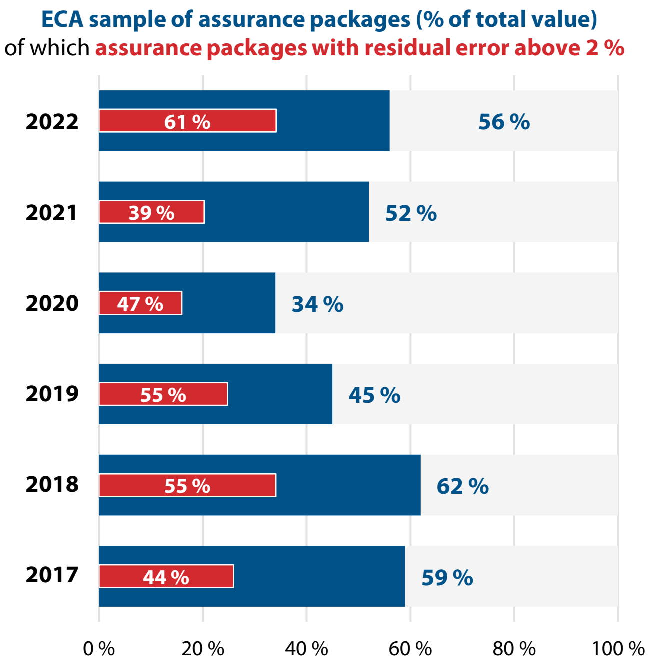
6.45. In its *AARs*, taking account of its own audit work and the preliminary results of our audits, the Commission adjusted the residual error rate for 10 of the 34 assurance packages in our sample to above 2 %. This includes one case where the Commission had excluded advances to financial instruments previously included by the audit authority. We found no additional errors in this case.

6.46. Taking account of the additional errors detected by the Commission and of our own audit findings, our work on this year's sample shows that the residual error rate was above 2 % in 16 of the 34 audited assurance packages.

Share of assurance packages above materiality reaching a peak in 2022

6.47. Since 2017, we have examined 87 assurance packages in 27 member states and the United Kingdom at least once. Our annual sample coverage ranges between 34 % and 62 % of the expenditure certified in the annual accounts (see the blue bars in *Figure 6.10*). We observe that the proportion of assurance packages with residual error rates of above 2 % had not dropped below 39 % of the expenditure in our samples, reaching a peak of 61 % in 2022 (see the red bars in *Figure 6.10*). This reflects the persistent shortcomings in the work of the audit authorities.

Figure 6.10 – Assurance packages with a residual error rate above 2 % (2017 to 2022)



Total number of assurance packages	Number of assurance packages in our sample
354	34
354	31
352	26
308	20
202	15
50	12

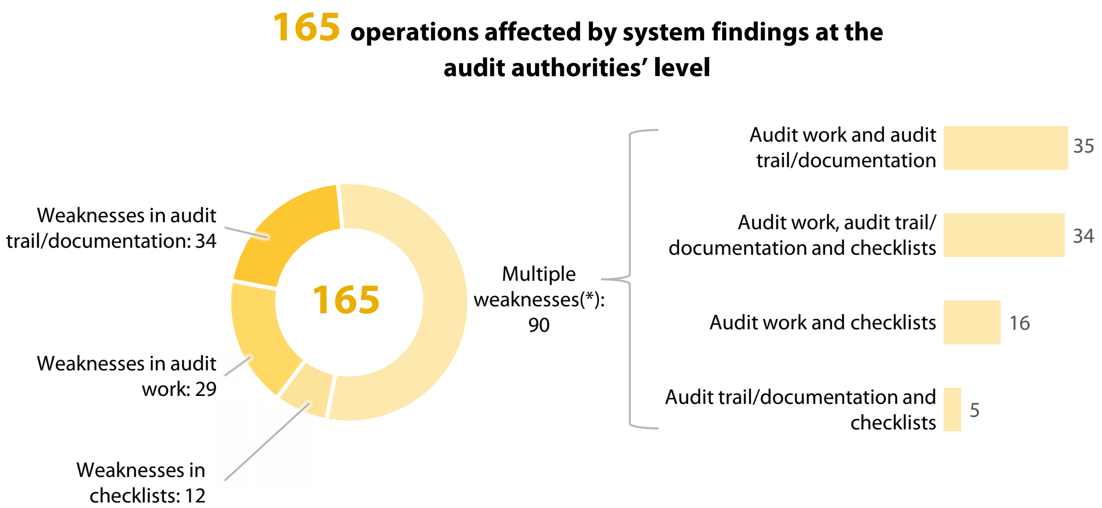
Source: ECA.

Main shortcomings identified in the audit authorities' audits in 2022

6.48. Audit authorities' work has to be in line with the legal provisions[24], and has to take into account the *International Standards on Auditing*.

6.49. Our 2022 audit has also shown a marked increase in shortcomings in the scope, quality and documentation of audit authorities' work. In 165 operations (73 %), we had to re-perform the corresponding audit procedures (see ***Figure 6.11***). For 135 operations (60 % of the total), we were obliged to approach managing authorities, intermediate bodies or beneficiaries for the necessary audit documentation.

Figure 6.11 – Types of shortcomings identified at the level of audit authorities



(*) Number of transactions affected by multiple weaknesses.

Source: ECA.

6.50. Our sample consists mainly of transactions already audited by audit authorities (see paragraph ***6.12***). The errors we found in addition represent weaknesses in the audit authorities' work that the Commission could not always address before accepting the accounts. The weaknesses occur in a wide range, for example concerning the audit authorities' work on verifying:

- the eligibility of expenditure (e.g. personnel costs, SCO and major projects, whether the beneficiary had actually incurred and paid the claimed costs). This includes cases where we found that the audit authority did not carry out sufficient checks on information provided by beneficiaries or where key aspects of

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[24] Commission *Delegated Regulation* (EU) No 480/2014.

well-functioning management and control systems were not in place (see *Box 6.9*);

- the eligibility of projects;
- the compliance with internal market rules (e.g. whether the beneficiary complied with state aid and procurement provisions);
- the risk of fraud and conflict of interest (e.g., in one case in Austria, the tasks of the managing and the *certifying authority* were carried out by the same person. There was no separation of functions.); and
- insufficient quality review on the work of the external auditors to whom they had subcontracted their checks for three OPs.

Box 6.9

Beneficiaries' self-declarations not checked against reliable and verified sources by audit authorities

In several member states (Denmark, Greece, Spain, Croatia, Malta, Portugal and Slovenia), we found that the audit authorities relied exclusively on beneficiaries' self-declarations to verify eligibility criteria and other requirements (such as tenderers' technical capacity, their *SME* status, the conditions for "not in education or training" (NEET) status, household composition, respect of the de minimis ceiling, the absence of double funding and the absence of conflicts of interest).

We found that the audit authorities in question had not requested and verified further supporting evidence to corroborate the reliability of the information declared as part of their audit on a subsample of self-declarations. Such checks would better ensure the protection of financial interests while keeping the audit work in reasonable limits. This would allow the audit authorities to identify incorrect or incomplete self-declarations.

Shortcomings in audit authorities' checks of financial instruments

6.51. We also identified weaknesses in the audit authorities' work in more than half of the financial instruments we audited (7 out of 13). In Czechia, the audit authority had reported in its *annual control report* that it had audited a financial instrument, which in reality it had not audited at all.

Multiannual nature of operations not taken into account when determining financial corrections

6.52. Cohesion policy funds provide support, through multi-annual programmes, to operations whose expenditure can be certified in different years following the progress of implementation. Therefore, an error detected in the expenditure of an operation in 1 year can have an impact on expenditure already declared in previous years.

6.53. Whenever audit authorities detect irregularities also affecting expenditure certified in previous periods, they should ask the managing and certifying authorities to correct all ineligible expenditure in the accounts. In Italy, we found an ERDF operation where the audit authority had detected an irregularity that impacted expenditure certified in previous periods. However, the member state had applied a correction only to the expenditure that the audit authority had sampled and checked.

Measures to fight and report fraud against the EU budget

6.54. Under EU law, the Commission and member states must protect the EU budget from fraud and irregularities[25]. To this end, they are required to put in place effective control systems. See paragraph ***1.48*** for the cases of suspected fraud that we identified in the course of our audit work in 2022 and reported to OLAF and/or EPPO.

Audit authorities insufficiently address the risk of fraud

6.55. During our review of audit authorities' work, we assessed whether they had adequately addressed the risk of fraud, either through specific sections in their checklists for audits of operations, or through other fraud-specific audit procedures such the use of the *Arachne* risk-scoring tool[26].

6.56. We found that the audit authorities explicitly addressed the risk of fraud for 65 % of the audited operations in the 2014-2020 period (145 of 222). This is an improvement on the 38 % we found last year[27], but still insufficient.

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[25] Article 72(h) of Regulation (EU) No 1303/2013.

[26] Arachne is the specific data-mining tool that the Commission offers to programme authorities in the field of Cohesion to help them identify projects that might be subject to risks of fraud.

[27] Paragraph 5.52 of the 2021 annual report.

Member state authorities do not report suspected fraud cases in IMS as required

6.57. According to the CPR, member state authorities must report all cases of suspected or established fraud related to EU-funded projects that they identify. They must report these cases even if they detect them before declaring expenditure to the Commission. This obligation applies to all investigation and prosecution bodies in the member state, not only to programme authorities. This reporting takes place through the Irregularity Management System (IMS) operated by the European Anti-Fraud Office (OLAF).

6.58. In our sample, we found three cases of ongoing fraud investigations that had not been reported in IMS. The programme authorities in the member states were either unaware of the ongoing investigation by the relevant investigation or prosecution body, or they had neglected to fulfil their regulatory obligation to report them. We also refer to recommendation 5.2 in our 2020 annual report, which the Commission so far has implemented in most respects (see ***Annex 6.2***).

New IT tools on data mining and risk-scoring deployed late

6.59. Currently, the charter agreed between the Commission and the programme authorities in the participating member states explicitly prevents OLAF, the European Public Prosecutor's Office (EPPO) and the ECA from accessing the Arachne risk-scoring tool.

6.60. The Commission proposed in 2022 a recast of the Financial Regulation[28] which provided for the development and compulsory use of "a single integrated IT tool for data mining and risk-scoring". This tool would aggregate and exploit data on the ultimate beneficial owners of EU funds provided by the member states. In our opinion 06/2022 we welcomed the proposal to create this IT system and to grant investigative and control bodies access to it, including OLAF, the EPPO and the ECA[29].

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[28] Commission proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (recast), COM (2022) 223.

[29] Opinion 06/2022 (pursuant to Article 322(1), TFEU) concerning the proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (recast).

6.61. The Commission also proposed to make this tool available by 2028. We consider this timing unjustified, as the current legislative framework for cohesion already stipulates that member states are obliged to supply the Commission with such data[30]. Finally, the Commission has not yet taken legislative actions to further clarify the functions and responsibilities of the anti-fraud coordination authorities in the member states as we had recommended in our special report 06/2019[31].

Follow-up to our special report on fraud in cohesion spending

6.62. During our follow-up of the recommendations of our special report 06/2019, we found that some weaknesses identified in our previous audit persisted. In particular, the Commission will not publish any specific guidance for the 2021-2027 period on anti-fraud measures and had not taken measures to regularly disseminate best practices. Finally, five member states have still not adopted a national anti-fraud-strategy. Moreover, not all of the managing authorities in these five member states have adopted anti-fraud policies for their programmes (see ***Annex 3.1***).

The Commission's assurance work and reporting of residual error rate in its annual activity reports

6.63. AARs are the Commission DGs' main tool for reporting whether they have reasonable assurance that control procedures ensure the regularity of expenditure.

The Commission's key performance indicator on regularity in annual activity reports is below materiality, while its estimate of maximum error is above

6.64. In cohesion, the Commission uses individual residual error rates reported by member states, the results of its own regularity work and other available information such as our audits to calculate a weighted average error rate. It reports that rate as a *key performance indicator (KPI)* on *legality and regularity*. As in previous years, for

[30] Opinion 06/2022 (pursuant to Article 322(1), TFEU) concerning the proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union (recast).

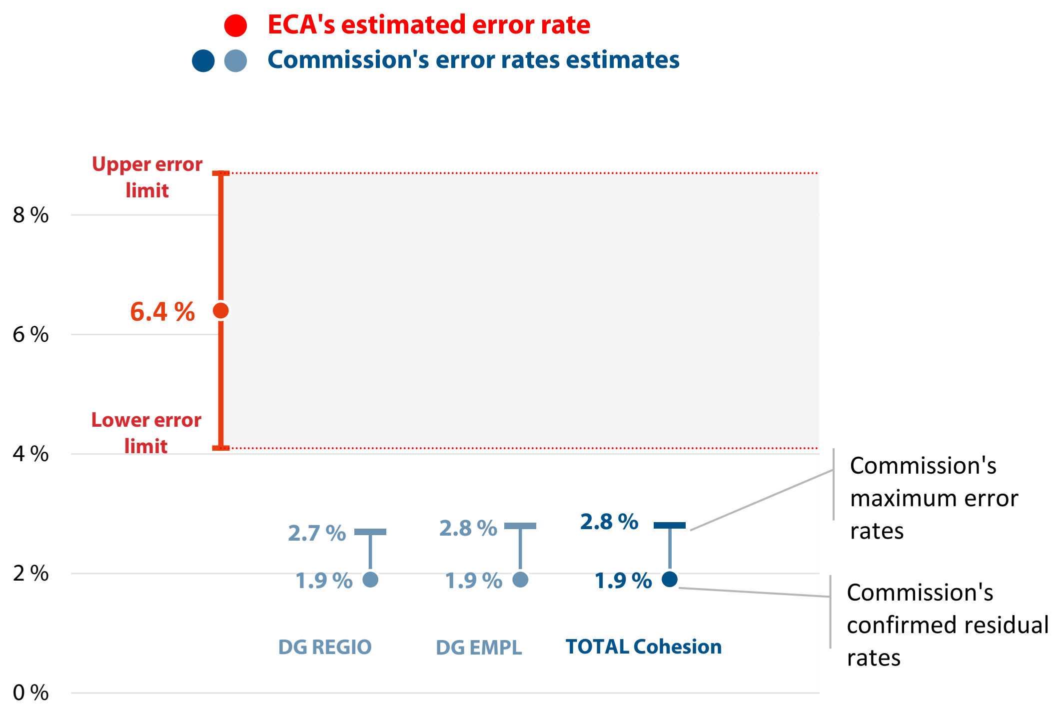
[31] Special report 06/2019: "Tackling fraud in EU cohesion spending: managing authorities need to strengthen detection, response and coordination".

calculating this KPI, the Commission excludes the impact of advances paid to financial instruments.

6.65. For the 2020/2021 accounting year, DG REGIO reported a KPI of 1.9 % and a 'maximum rate' of 2.7 %. The DG EMPL rates were 1.9 % for the KPI and 2.8 % for maximum risk. For both DGs, the maximum rate is intended to address the risk of errors lying outside the sample of transactions in OPs which were audited during the year (either by the Commission or by us). These maximum rates may also include a 'top-up' or flat rate for unaudited OPs[32].

6.66. *Figure 6.12* gives an overview of the KPIs reported by the Commission in its 2022 AARs. For the accounting year 2020/2021, these KPIs lay for the first time outside the error range estimated by us.

Figure 6.12 – Commission's KPIs for cohesion compared to our estimated error rate



Source: ECA.

[32] Footnote 65 of DG REGIO 2022 AAR and footnote 71 of DG EMPL 2022 AAR.

6.67. Similarly, in the 2022 *AMPR*, the indicators reported by the Commission are outside our error range (see also ***Figure 6.12***).

— For MFF heading 2 as a whole, a combined risk at payment of between 1.8 % and 2.6 %[33], basing this on the amounts at risk concluded by the various DGs.

— For MFF subheading 2a on cohesion, a combined risk at payment of between 1.9 % and 2.7 %[34], again based on the DGs' estimates for amounts at risk and their KPIs.

The Commission continues to detect irregularities through its compliance audits, but inherent limitations of desk reviews remain

6.68. The reliability of the regularity information reported in AARs largely depends on the quality of programme authorities' work. The Commission performs desk reviews and *compliance audits* to review and assess the work of audit authorities. In its desk reviews, it checks the consistency of the regularity information included in the assurance packages. The Commission's desk reviews have inherent limitations in confirming the *residual total error rate*[35]. This is demonstrated by the additional errors we detected during our audits.

6.69. The objective of compliance audits is to seek reasonable assurance that no serious weaknesses in management and control systems remain undetected, unreported and therefore uncorrected. In 2022, the Commission carried out 27 compliance audits, often covering ERDF/CF and ESF/*YEI* programmes. In 15 of these audits, the Commission concluded that the residual error rates reported in audit authorities' annual control reports for the 2020/2021 accounting year were underestimated; the Commission therefore increased those rates. In 10 cases, this raised the residual rate above the 2 % materiality threshold.

6.70. In our 2021 annual report[36], we noted that the Commission had improved its methodology for estimating the maximum risk by including a top-up for unaudited OPs. We found that two shortcomings still remain: the Commission does not apply

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33 Volume III of the 2022 AMPR, Annex 5, p. 15.

34 Volume II of the 2022 AMPR, Annex 2, p. 61.

35 Special report 26/2021: "*Regularity* of spending in EU Cohesion policy: Commission discloses annually a minimum estimated level of error that is not final".

36 See paragraphs 5.59-5.62.

these top-ups in the case of OPs audited in earlier accounting years and, in some cases, the level of top-ups may not be sufficient to account for errors that the Commission has not detected through its compliance audits. These weaknesses also affect the Commission’s risk at closure, as the Commission may not in all cases carry out the necessary corrections to bring the residual error rate below materiality.

The Commission has not yet implemented net financial corrections

6.71. The legal provisions introduced for the 2014-2020 period gave the Commission more power to ensure that irregular expenditure is no longer reimbursed from the EU budget, through the possibility of implementing net financial corrections. The Commission should apply these corrections in cases where serious deficiencies are not identified by member states under the conditions set out in Article 145(7) of the CPR. By the end of 2022, the Commission had not yet implemented any net financial correction.

6.72. We examined whether, by the end of 2022, the Commission (DG EMPL and DG REGIO) had disclosed any information about ongoing net financial corrections. DG REGIO reported that it had not yet applied net any financial corrections. According to the AAR of DG EMPL, the conditions for applying net financial corrections seemed to have been met in one case and a procedure may be started in 2023.

Closure of the 2007-2013 programme period still ongoing

6.73. The 31 March 2017 was the deadline for the member state for the submission of the 2007-2013 closure documents. The Commission must then issue its observations within 5 months of the receipt of the closure documents[37]. However, there is no regulatory deadline for the member state to reply to these comments. This is why the Commission in its closure guidelines has set a deadline of 2 months in this respect, extendable on request. In case further audit work is needed, the deadline can be extended to the period considered necessary to conclude this work. These guidelines are however only binding on the Commission, not on member states. In special report 36/2016[38], we highlighted that the absence of regulatory deadlines puts the completion of closure on time at risk.

[37] Article 89 of Council Regulation (EC) No 1083/2006.

[38] Special report 36/2016: “Assessment of the arrangements for closure of the 2007-2013 cohesion and *rural development programmes*”.

6.74. By the end of 2022, DG REGIO has closed 276 out of 322 OPs for the 2007-2013 period. For a further 44 OPs, DG REGIO has made a pre-closure payment covering only the uncontested amounts, while pending issues (such as ongoing investigations, open audit findings, pending recoveries etc.) remain to be solved. DG EMPL has closed 101 out of 117 OPs and pre-closed 13 OPs. Six programmes (DG REGIO: 2, DG EMPL: 4) remain fully open due to pending issues. Since there is no final deadline for the closure in the legal framework, it is not possible to predict how much time will be needed to close all 2007-2013 OPs.

6.75. For the 2014-2020 period, final closure of the programmes will be based only on the documents relating to the final accounting year and the final implementation report. However, programme authorities will still have to address the final assessment of the eligibility of costs declared for some operations, in particular for operations involving investments made by financial instruments, the clearing of state aid advances, the final assessment of revenue-generating operations, and the treatment of non-functioning operations. This may require additional financial corrections, with a risk of further delaying the closure.

Reporting on several rule of law procedures

6.76. Following our recommendation in last year's annual report, the Commission (DG REGIO and DG EMPL) has included a summary of the status of the Commission implementation of the Budgetary Conditionality Regulation 2020/2092 in their AARs. By the end of 2022, all 27 member states have received the pre-financing for their 2021-2027 programmes. In line with Article 15 of Regulation (EU) No 2021/1060, this includes Hungary (€468 million) and Poland (€1.7 billion), even if the reimbursement of payment claims is prevented because neither member state yet fulfils the horizontal enabling condition relating to respect for the Charter of Fundamental Rights of the EU.

Conclusions and recommendations

Conclusion

6.77. The audit evidence we have obtained and presented in this chapter indicates that the level of error in spending on ‘Cohesion, resilience and values’ was material. For MFF heading 2, our testing of transactions produced an estimated overall level of error of 6.4 %.

6.78. Almost all the errors we have quantified in this chapter concern spending under subheading 2a, for which our overall error estimate is 6.6 %.

6.79. The control and assurance framework for cohesion spending in the 2014-2020 period was designed to ensure that annual residual error rates were below the materiality threshold. There is a need for further improvements in the way the framework is applied, both by the member states’ programme authorities and by the Commission.

6.80. Our audit findings suggest that managing authorities’ controls do not always effectively prevent or detect irregularities in expenditure declared by beneficiaries. In addition, we found significant weaknesses in the work of several audit authorities covered by our sample (see paragraphs ***6.44***-***6.58***). This limits the reliance that can be placed on their work. The recalculated error level was above the 2 % materiality threshold in 16 out of 34 assurance packages for the 2014-2020 period. The Commission adjusted the residual error rates for ten of these packages to a figure above 2 %. In doing this, it also took account of our audit work.

6.81. Since 2017, the assurance packages in our annual samples have consistently accounted for over one third of the expenditure accepted by the Commission. The proportion of expenditure covered by assurance packages with residual rates above 2 % has increased from 44 % in 2017 to 61 % in 2022 (see ***Figure 6.10***).

6.82. In the 2022 AMPR and the AARs, the Commission concurs with our overall opinion that there is a material level of error in cohesion spending. At the same time, the Commission’s error estimates are significantly lower than ours (see ***Figure 6.12***).

Recommendations

6.83. *Annex 6.2* shows the findings of our follow-up review of the two recommendations we made in our 2019 annual report. Of these, the Commission had implemented one in most respects and one in some respects.

6.84. We have also reviewed recommendations from the 2020 and 2021 annual reports that required immediate action, or which were targeted for implementation during 2022 or until April 2023. We also reviewed recommendations from the 2017 and 2018 annual reports that had not yet been fully implemented, but which remain relevant.

6.85. Based on this review and our findings and conclusions for 2022, we recommend that the Commission:

Recommendation 6.1 – Mitigation measures for recurring errors

Strengthen the measures designed to address the recurring errors, specifically in relation to ineligible costs and projects, ensure sufficient coverage of its own audit work for all audit authorities and disseminate the results to reduce the occurrence and impact of irregular spending.

Target implementation date: December 2025

Recommendation 6.2 – Major projects notifications

Verify, when closing the 2014-2020 programmes, that only expenditure linked to notified major projects has been accepted, taking particular account of the situation detected this year.

Target implementation date: latest by March 2025

Recommendation 6.3 – Thematic audits on conflicts of interest

Plan and implement focused thematic audits on conflicts of interest for the 2021-2027 programmes, based on its own risk assessment and in view of the shortcomings identified.

Target implementation date: December 2024

Recommendation 6.4 – Targeted checks on financial corrections for multi-annual operations during closure

Carry out specific targeted checks in its 2014-2020 closure audits to ensure that member states have applied the necessary financial correction for errors detected in one accounting year which also affect expenditure in other accounting periods.

Target implementation date: from February 2025 until end of closure of all 2014-2020 OPs

Recommendation 6.5 – Reliability of self-declarations

Ensure that audit authorities have appropriate methods in place to check the validity and reliability of self-declarations and share good practices, taking particular account of the situation detected this year.

Target implementation date: December 2023

Recommendation 6.6 – Enhancing fraud risk awareness to ensure a more effective reporting on suspected fraud

(a) Plan and implement focused thematic audits on risk awareness of the managing authorities and the use of data mining and risk-scoring tools for the 2021-2027 programmes.

(b) Specify minimum requirements for the audit authorities to cover the risk of fraud in their checklists and audit work.

(c) Reiterate to member states their obligations regarding fraud reporting.

Target implementation date: for recommendation 6.6(a) by December 2025, for recommendations 6.6(b) and 6.6(c) by December 2023

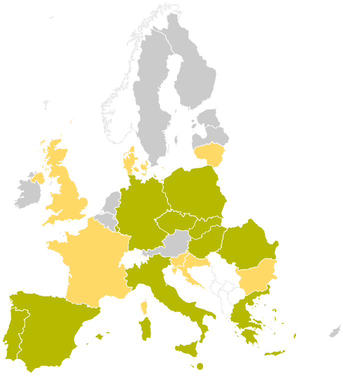
Recommendation 6.7 – Deployment of data mining and risk-scoring tool

Advance the date for deployment of the single integrated IT tool for data mining and risk-scoring from 2028 to 2025, the first year when a significant amount of 2021-2027 expenditure is expected to be declared. In the meantime, ensure that OLAF, the EPPO and the ECA have access to Arachne.

Target implementation date: December 2025

Annexes

Annex 6.1 – Breakdown of our sample of transactions and associated findings for the 2022 statement of assurance



Member state(*)	EU contribution *(million euros)*	Audited transactions	Transaction-related findings	
			Quantifiable errors	Non-quantifiable errors
Poland	12 965	40	2	2
Italy	8 320	27	5	
Spain	7 129	22	7	7
Czechia	3 775	14	6	2
Hungary	3 769	20	7	7
Portugal	3 654	12	5	3
Greece	3 511	12	1	
Romania	3 407	14	3	3
Germany	2 538	13	5	1
France	2 277	6		
Slovakia	1 921	13	4	
Territorial cooperation(**)	1 551	6(***)	2	2
United Kingdom	1 191	7		
Croatia	1 150	8		
Lithuania	955	7		
Bulgaria	934	7		
Latvia	683	--		
Slovenia	628	1		
Ireland	365	--		
Estonia	350	--		
Belgium	276	--		
Cyprus	214	--		
Sweden	205	--		
Finland	186	--		
Austria	168	--		
Netherlands	160	--		
Denmark	72	4		
Malta	72	4		3
Luxembourg	8	4	1	
TOTAL	**62 434**	**241**	**48**	**30**

(*) Our sample is not designed to conclude at member state's level.
(**) Territorial cooperation contributions include Alpine Space (Austria, Germany, France, Italy, Slovenia) and Central Europe (Austria, Croatia, Czechia, Hungary, Poland, Slovakia, Slovenia, eight Länder of Germany and nine regions of Italy). These contributions are transnational and are not included in this illustration.
(***) Audited partners from: Austria, Poland, Germany, Italy (2) and Slovenia.

Source: ECA.

Annex 6.2 – Follow-up of previous recommendations for 'Cohesion, resilience and values'

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2017	We recommend that the Commission: **Recommendation 1:** ensure that the audit arrangements for financial instruments managed by the *EIF* are adequate at the level of financial intermediaries. When the EIB/EIF uses agreed-upon procedures with external auditors, the Commission should define the minimum conditions of such contracts with a view to the need to provide assurance, in particular the obligation for sufficient audit work at the level of the member state. (Implementation date: immediate)	Fully	The *Omnibus Regulation* introduced a requirement for audit authorities to perform system audits and audits of operations on financial instruments at the level of financial intermediaries, including financial instruments managed by the EIB Group but excluding SME Initiative programmes set up before 2 August 2018. The Commission has taken additional measures by including, in the audit methodology for financial instruments, a recommendation that audit authorities audit financial intermediaries for instruments implemented by the EIB Group, regardless of when they were set up. However, the methodology cannot extend the regulatory mandate of audit authorities. The Commission provided proof that in some member states the audit authorities already perform checks at the level of the financial intermediaries. However, our 2020 and 2022 (SMEi Spain) audits revealed that those checks are not yet performed consistently (in the member state we audited, neither the external auditor nor the audit authorities carried out any audit at the level of financial intermediaries). No new elements were provided to show that this was corrected in 2022.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	Recommendation 3: address the weaknesses we have identified in its verification of the audit authorities' work in the context of the Commission's regularity audits. (Implementation date: immediate)		See paragraphs 6.58-6.64 of the 2018 annual report, 5.48-5.62 of the 2019 annual report, paragraphs 5.43-5.44 of the 2020 annual report, paragraphs 5.40-5.43 of the 2021 annual report and paragraph 6.47 of the 2022 annual report. Despite the Commission's increased compliance audit work, we still encounter weaknesses in the audit authorities` work.
	Recommendation 4: address the complexity of the information presented on the 2014-2020 control and assurance framework in the AARs of DGs REGIO and EMPL, by: (…) (iii) disclosing an overall residual error rate for MFF subheading 1b for each accounting year. (Implementation date: June 2019)		Point (iii) is implemented in most respects since the Commission provides an overall estimate for MFF subheading 2a in the AMPR. However, where a DG is responsible for implementing the budget under several MFF headings, expenditure is allocated to a single MFF heading. As a result, this estimate does not fully reflect the underlying expenditure.
	Recommendation 5: ensure that audit arrangements are changed in accordance with the proposal made by the Commission for financial instruments in the post-2020 regulatory framework so that only the actual use of funds at final recipient level is used for the calculation of residual error rates. (Implementation date: before implementation of the post-2020 legislative framework begins)		The new *common provisions regulation* for the 2021-2027 period (Regulation (EU) No 2021/1060) provides for a single advance payment for financial instruments to be included in the first payment application. In its replies to the follow-up for the 2020 annual report, the Commission stated its intention to adopt a delegated act requiring audit authorities to exclude this advance from the audit population. The Commission has now reassessed this position and stated that the initial advance will remain part of the audited population for the accounting year concerned.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	Recommendation 6: carry out sufficient regularity checks to conclude on the effectiveness of audit authorities' work and obtain reasonable assurance on the regularity of expenditure at the latest in the AARs it publishes following the year of accepting the accounts. (Implementation date: immediate)		See paragraph 5.64 of the 2021 annual report.
2018	We recommend that the Commission: **Recommendation 6.1 – Audit arrangements for SME Initiative programmes** Ensure that: (a) regular checks, based on a representative sample of disbursements to final recipients, are carried out at the level of financial intermediaries either by the audit authority or by an auditor selected by the EIB Group; (b) where such checks were insufficient, develop and implement appropriate control measures to prevent the possibility of material irregular expenditure at closure. (Target implementation date: immediate)		Our previous audits confirmed that the EIF has already made or is making improvements to its monitoring and control systems and has voluntarily extended the use of reasonable assurance reports to SMEi programmes. While we acknowledge that some audit authorities have already carried out verifications at the level of financial intermediaries, the full effectiveness of these measures has not yet been proven. We point as an example the results of the audit to SMEi Spain carried out in context of the 2022 *SOA*.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2019	We recommend that the Commission: **Recommendation 5.1 – Project eligibility conditions** Clarify what is meant by 'physically completed' and/or 'fully implemented' operations. This would help member states to verify that operations comply with Article 65(6) of the CPR and avoid the non-detection of ineligible operations. It should be made clear that this condition relates only to works or activities necessary to achieve the operation's output, and not to financial and administrative aspects. (Timeframe: immediate)		We acknowledge the measures which the Commission has already initiated in order to clarify the concepts of 'physically completed'/'fully implemented' operations, including the proposal to modify the 'Typology of errors' for the 2021-2027 programme period to address the separate category of 'retrospective projects'. However, the Commission had not disseminated those clarification or the modified 'Typology of errors' to all member states.
	Recommendation 5.2 – Action to increase the reliability of the residual rates reported by audit authorities Analyse the main sources of undetected errors and develop the necessary measures together with audit authorities to improve the reliability of reported residual rates. (Timeframe: June 2021)		Despite the Commission's efforts, as presented in the AARs of DG REGIO (2019: pp. 25 and 2020: pp. 41-43 and 2021: pp. 32-33) and DG EMPL (2019: pp. 37, 2020: pp. 43-44 and 2021: pp. 49), our audit work for 2020 did not show a significant improvement in this respect (see for example paragraph 5.38 of the 2020 annual report, paragraphs 5.40 and 5.41 of the 2021 annual report and paragraphs 6.48, 6.49 and 6.50 of the 2022 annual report. The Commission had implemented the analysis of main sources of undetected errors.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2020	We recommend that the Commission: **Recommendation 5.2 – Keeping track of the risk of fraud in audit authorities' audits of operations** Encourage audit authorities explicitly to introduce specific questions in their checklists on fraud risks and document the steps taken to address any such risks discovered in the course of an audit. Audit authorities should work in collaboration with national anti-fraud coordination services (AFCOSs) and take account of cases of suspected or established fraud reported to the Commission via the Irregularities Management System (IMS). We also refer to our recommendations in special report 06/2019. (Timeframe: June 2022)		
	Recommendation 5.3 – Follow-up of amounts under an ongoing assessment Ask member states to make available sufficient information available in the annual summary on conclusions and follow-up of operations for which they have withdrawn amounts under an ongoing assessment from the accounts. This would enhance transparency about the way programme authorities monitor these amounts. (Timeframe: 2022)		

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2021	**Recommendation 5.1 – Method used for reimbursing beneficiaries when SCOs are applied to determine the EU contribution to the programme** Reiterate to managing authorities the requirements attached to reimbursing beneficiaries using a methodology that differs from the simplified cost options (SCOs) used for calculating payments to member states from the EU budget, taking particular account of the situation detected this year in Irish ESF operational programme. (Target implementation date: December 2022)		
	Recommendation 5.2 – Contribution of national schemes to ESF objectives Ensure that, when operational programmes are based on existing national schemes, the operation implemented contribute effectively to programme objectives, taking particular account of the situation detected this year in relation to NEET participants in Spanish ESF/YEI operational programmes. (Target implementation date: November 2022)		

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	Recommendation 5.3 – Verification of NEET status by programme authorities Reiterate to programme authorities that they must confirm the NEET status of participants before submitting expenditure declarations for ESF/YEI programmes from the 2014-2020 period. These eligibility checks should be made on the basis of reliable and verified sources, taking particular account of the situation detected this year in French and Irish ESF/YEI OPs. (Target implementation date: December 2022)		
	Recommendation 5.5 – Audit trail for sampling by audit authorities Reiterate to audit authorities that the legal framework requires them to keep an audit trail, with which the Commission can verify that their sampling procedures are independent, objective and without bias. (Target implementation date: December 2022)		
	Recommendation 5.6 – Rule of law Provide information in its *annual activity reports* about ongoing rule of law procedures against member states and how these may affect the assurance that the Commission can obtain about regularity of expenditure from the assurance and control systems of the countries concerned. (Target implementation date: April 2023 (next AARs))		See paragraph ***6.76*** of the 2022 annual report.

Source: ECA.

Chapter 7

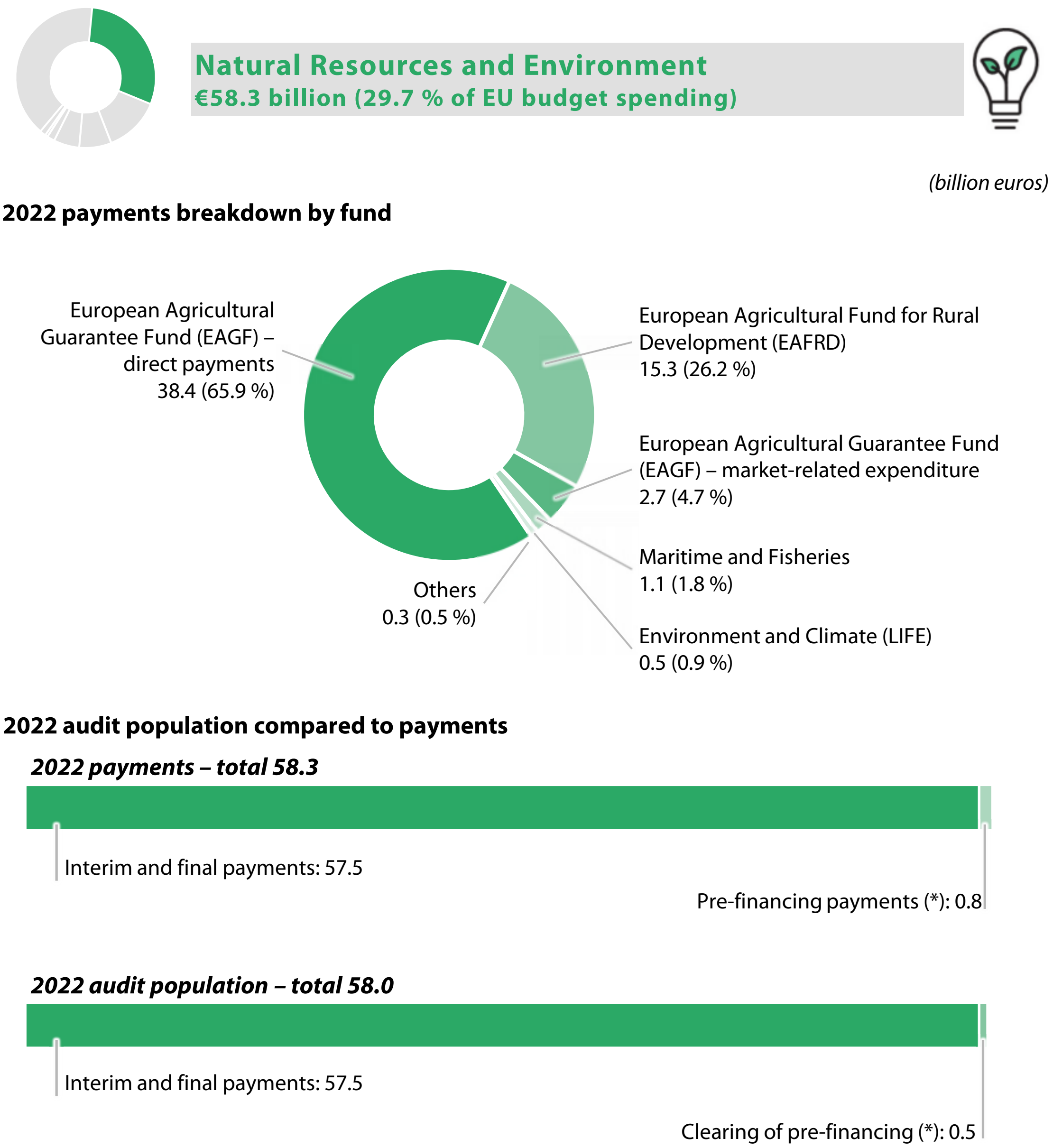
Natural resources and environment

Contents

Introduction

7.1. This chapter presents our findings for MFF heading 3 'Natural resources and environment'. ***Figure 7.1*** gives an overview of the main activities and spending under this heading in 2022.

Figure 7.1 – Payments and audit population



(*) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph ***18***).

Source: ECA, based on data 2022 from the *consolidated accounts* of the European Union.

Brief description

Policy objectives and areas

7.2. Agriculture and rural development account for 97 % of EU spending on 'Natural resources and environment' and are implemented through the *common agricultural policy* (CAP). The CAP has three general objectives[1]:

- viable food production, with a focus on agricultural income, agricultural productivity and price stability;
- the sustainable management of natural resources and climate action, with a focus on greenhouse gas emissions, biodiversity, soil and water;
- balanced territorial development.

7.3. While the European Commission, in particular the Directorate-General for Agriculture and Rural Development (DG AGRI), is ultimately responsible for the CAP, it shares its management with *paying agencies* in the member states. Since 2015, independent *certification bodies* in the member states have been providing annual opinions on the *legality and regularity* of the expenditure.

7.4. This MFF heading also covers EU spending on the maritime and fisheries policy financed by the *European Maritime and Fisheries Fund (EMFF)*, under the responsibility of the Directorate-General for Maritime Affairs and Fisheries (DG MARE), and the *LIFE programme* for environment and climate action under the responsibility of the Directorates-General for the Environment (DG ENV) and Climate Action (DG CLIMA). For the first time, under the 2021-2027 MFF, the Directorate-General for Energy (DG ENER) is also implementing part of the LIFE programme.

Spending instruments

7.5. The main spending instruments for the CAP are:

- *direct payments* to farmers, fully funded by the EU budget;

[1] Article 110(2) of Regulation (EU) No 1306/2013 on the financing, management and monitoring of the common agricultural policy.

- member states' national and regional *rural development programmes*, co-financed by the EU budget and the member states;
- agricultural *market measures*, fully funded by the EU budget except for certain measures, such as agri-food promotion measures, which are co-financed by the member states.

7.6. Direct payments account for 66 % of spending under MFF heading 3 (€38.4 billion in 2022). The main schemes are:

- the '*basic payment scheme*' (€14.9 billion) and the '*single area payment scheme*' (€4.1 billion), which provide income support based on the area of agricultural land declared by farmers;
- the '*greening* payment' (€11.0 billion) to support agricultural practices beneficial for the climate and the environment;
- 'voluntary *coupled support*' (€4.1 billion) for specific types of agricultural produce (e.g. beef and veal, milk, or protein crops).

7.7. Direct payments to farmers are entitlement-based, as receiving them depends on meeting certain conditions. Such payments carry a lower risk of *error* than reimbursement-based payments, provided the attached conditions are not complex (see paragraph ***1.18***). Direct payments are managed through the *Integrated Administration and Control System (IACS)*, which interlinks databases of holdings, aid applications, animal registries and agricultural areas. The paying agencies use the IACS, which incorporates the *Land Parcel Identification System (LPIS)*, a geographical information system based on multiple sources. The LPIS helps farmers to fill in their area-related aid applications and paying agencies to check them afterwards. This gives them the possibility to correct certain errors in aid applications and reduce the risk of error.

7.8. Rural development accounts for 26 % of spending under this MFF heading and falls into two broad categories:

- payments to farmers based on environmental and climate-related criteria applied to the agricultural area or on the number of animals on the holding ('area/animal-related');
- aid to investment projects intended to support social and economic development in rural areas ('non-area-based'). ***Box 7.1*** provides an example of a rural investment project.

Box 7.1

An investment project in a rural area

A private *beneficiary* in Spain received support under Measure 19 (Leader) to increase economic activity in less favoured rural areas while also maintaining and creating employment following a call for proposals for developing businesses in the area. The objective of this project was to refurbish a disused warehouse and preserve jobs of a distribution company as part of the Local Action Group's strategy to revive a former industrial zone. Our audit confirmed the completion of works and the respect of eligibility conditions. The photos below show the storage premises before and after the project.

7.9. Member states implement EU spending under national and regional rural development programmes. The Commission approved 118 rural development programmes in the member states for 2014-2020, consisting of 20 measures. Following delays in adopting the legislation for the post-2020 CAP, all programmes were extended until the end of 2022[2]. Additional measures were introduced to

[2] Under the United Kingdom Withdrawal Agreement, the former member state's rural development programmes will continue to run until the end of 2023 and will be closed in 2024.

provide exceptional temporary support in response to the COVID-19 outbreak in 2021[3] and the impact of Russia's invasion of Ukraine in 2022[4].

7.10. Agricultural market measures, which account for 4.7 % of MFF heading 3 spending, include a number of diverse schemes (e.g. producer organisations in fruit and vegetables and restructuring of vineyards) each with their own eligibility conditions. ***Box 7.2*** provides an example of a market measure.

[3] Regulation (EU) 2020/872 amending Regulation (EU) No 1305/2013 as regards a specific measure to provide exceptional temporary support under the *European Agricultural Fund for Rural Development (EAFRD)* in response to the COVID-19 outbreak.

[4] Regulation (EU) 2022/1033 amending Regulation (EU) No 1305/2013 as regards a specific measure to provide exceptional temporary support under the European Agricultural Fund for Rural Development (EAFRD) in response to the impact of Russia's invasion of Ukraine.

Box 7.2

Example of a market measure

A producer organisation in Italy received EU support to modernise its fruit handling facilities with the aim of increasing productivity. During our on-the-spot visit we confirmed that the investment had been made in line with their approved operational programme and that the equipment was in place and operational. The photos below show an advanced forklift truck and high-precision machinery for sorting, weighing, and packaging fruit.

7.11. The remaining 3 % of MFF heading 3 spending, mainly under the *EMFF* and LIFE programmes, also involves a variety of selection criteria, eligibility requirements and disbursement methods.

7.12. The eligibility conditions for most spending on rural development, market measures and the other MFF heading 3 policy areas outside the CAP are more complex than for direct payments, and the risk of error is higher (see paragraph ***1.18***).

Audit scope and approach

7.13. Our objective was to estimate the level of error for this MFF heading and to contribute to the *statement of assurance*. Applying the audit approach and methods set out in ***Annex 1.1***, we examined the following for MFF heading 3 in 2022:

(a) a statistically representative sample of 218 *transactions*, designed to estimate the level of error for this MFF heading and comprising:

   (i) 88 direct payments covering the main schemes,

   (ii) 56 area/animal-related transactions under rural development programmes,

   (iii) 52 non-area-based rural development transactions,

   (iv) 14 transactions related to market measures, and

   (v) 8 transactions under spending areas outside the CAP, four under the EMFF, three under the LIFE programme, and one under a Sustainable Fisheries *Partnership Agreement*;

(b) the coherence of CAP 'control statistics' and payments data submitted to the Commission by selected paying agencies;

(c) the regularity information given in the *annual activity reports* of DG AGRI and DG MARE and then included in the Commission's *Annual Management and Performance Report* (AMPR).

7.14. The 218 transactions we audited covered 17 member states[5] and the United Kingdom. We audited direct payments in 13 member states, and our testing of rural development transactions covered 20 national and regional programmes in 16 member states and the United Kingdom.

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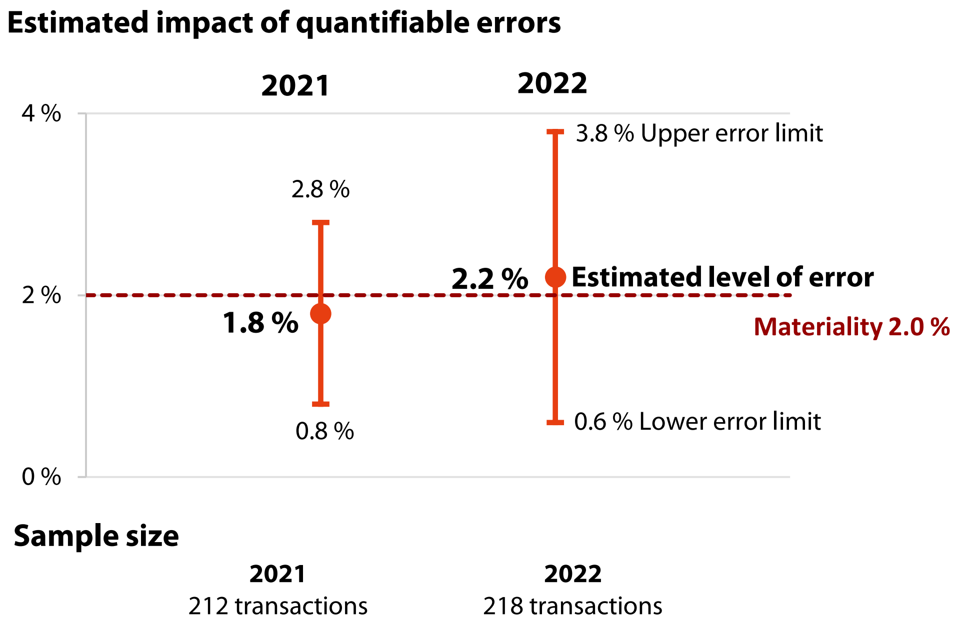
[5] Bulgaria, Germany, Ireland, Greece, Spain, France, Croatia, Italy, Latvia, Hungary, Netherlands, Austria, Poland, Portugal, Romania, Finland, Sweden.

Regularity of transactions

Results of transaction testing

7.15. Of the 218 transactions we examined, 46 (21 %) contained errors. Based on the 32 errors we have quantified, we estimate the level of error for MFF heading 3 to be 2.2% (see ***Figure 7.2***).

Figure 7.2 – Results of transaction testing

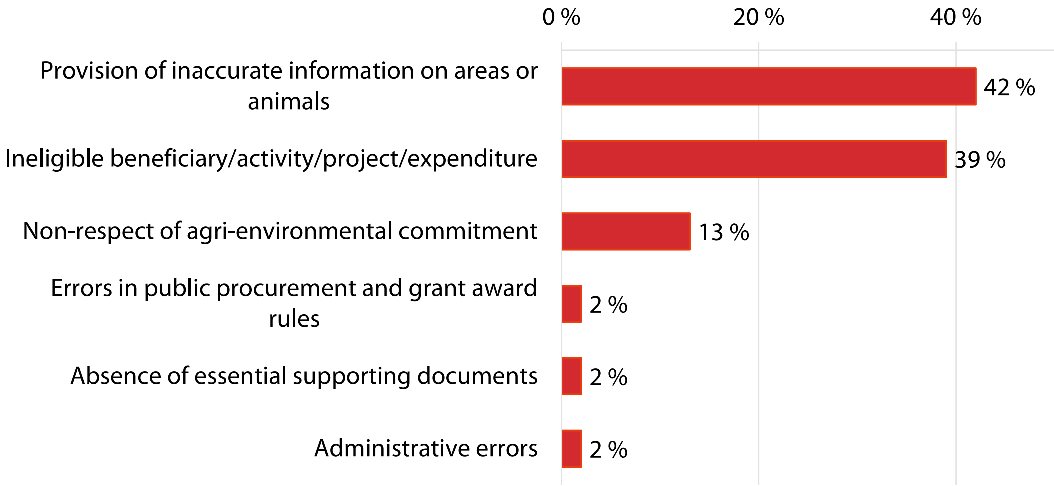


Source: ECA.

7.16. The majority of the quantified errors we found affected rural development transactions (21). We found seven *quantifiable errors* in direct payments, two in market measures, and two in non-CAP expenditure. We also found 15 compliance issues without impact on the error rate. For example, we found a case where a *managing authority* did not sufficiently check the reasonableness of the costs of the services provided to a beneficiary by related parties. ***Annex 7.1*** presents an overview of MFF heading 3 payments and the results of our transaction testing by member state.

7.17. ***Figure 7.3*** gives a breakdown of our estimated *level of error* for 2022, by category of error.

Figure 7.3 – Much of the *estimated level of error* is related to the provision of inaccurate information on areas or animals



Source: ECA.

7.18. The member state authorities and the Commission had applied corrective measures that directly affected 49 of the transactions we sampled. These measures were relevant to our calculations, as they reduced our estimated level of error for this chapter by 0.9 percentage points. In 19 cases of *quantifiable errors*, the member state authorities and the Commission had sufficient information to prevent, or to detect and correct, the error before accepting the expenditure. Had the member state authorities and the Commission made proper use of all the information at their disposal, the estimated level of error for this chapter would have been 1.3 percentage points lower.

Direct payments

7.19. In the 88 direct payment transactions tested, we found six minor quantifiable errors, which resulted from farmers overstating the eligible area of agricultural land. We also found one major quantifiable error, where the declared agricultural activity had not taken place (see ***Box 7.3***).

Box 7.3

Example of an incorrect declaration of an agricultural activity

A farmer in Italy received *direct aid* for maintaining a permanent crop (lemon trees) on a large proportion of his holding (highlighted in blue). Overhead photos did not show lines of trees like those on adjacent agricultural parcels. Our on-the-spot visit confirmed that the declared area did not have any lemon trees on it and had not been maintained in an agricultural state for several years. The national authorities did not identify this error.

Source: Provided by the Italian paying agency AGEA.

Rural development, market measures and other payments

Area/animal-related rural development spending

7.20. We examined 56 rural development payments based on the area or animal numbers declared by farmers. These included payments for meeting specific *agri-environment-climate commitments*, compensation payments for organic farming, and payments to farmers in areas with natural constraints.

7.21. Of the 56 area- or animal-related rural development transactions we tested, 15 contained errors. We found 13 quantifiable errors, nine relating to the over-declaration of the eligible area. For the remaining four findings, the sources of error included an ineligible beneficiary, breaches of agri-environment-climate commitments, non-respect of animal welfare commitments and the declaration of a vineyard for which the beneficiary did not have planting rights.

Investment projects

7.22. We examined 52 rural development payments to investment projects, such as investments in physical assets, farm and business development (including business start-up aid for young farmers), and risk management (insurance).

7.23. We quantified errors in eight payments, resulting from beneficiaries having declared expenditure or activities that did not meet the eligibility conditions (two errors over 20 %). For example, in one case, a beneficiary in France had received start-up aid for young farmers, despite having been the head of an agricultural holding for more than 10 years.

Market measures

7.24. In the 14 *market measure* transactions tested, we found two cases in which paying agencies had reimbursed ineligible costs (one over 20 %).

Maritime, fisheries, the environment and climate action

7.25. For the maritime, fisheries, the environment and climate action areas, we audited eight transactions and we found two quantifiable errors in the *direct management* transactions.

Coherence checks of member states' control statistics and payments data

7.26. Each year, member states submit data on their checks of aid payments (control statistics) to the Commission, as well as data on the payments made to beneficiaries. These data are the basis on which the Commission reimburses EU funds to the member states. For the financial year 2022, we examined the quality and coherence of the control statistics and payments data reported by six paying agencies selected in our direct payments sample. Since we first carried out this exercise for the financial year 2020, we have examined the control statistics and payments data of 23 paying agencies.

7.27. We found some inconsistencies between the control and payments data, which were largely due to the different update schedules of the two datasets. While the control data are static, prepared as of 15 July each year, the paying agencies continuously update their payments data during the financial year. The updates are based on changes on the beneficiary's side (for example, transfers of holdings) or on the agency's side (as a result of its checks). Despite these inconsistencies, we found that the selected paying agencies' systems reliably calculated the aid payments, correctly taking into account adjustments resulting from the control data.

Annual activity reports and other governance arrangements

DG AGRI and DG MARE reporting on the regularity of spending

7.28. Each *paying agency* director provides DG AGRI with an annual management declaration on the *effectiveness* of their agency's management and control systems, and the legality and regularity of their expenditure. In addition, the member states report annually on their administrative and on-the-spot checks (control statistics).

7.29. Since 2015, in order to provide additional assurance, certification bodies have been required to give an annual opinion for each paying agency on the legality and regularity of the expenditure for which member states have requested reimbursement.

7.30. DG AGRI uses the error rates reported in the control statistics, making adjustments based on the results of the certification bodies' audits, and its own audits of paying agencies' systems and spending, to calculate a figure for 'risk at payment' for direct payments, rural development and market measures. The adjustments stemming from DG AGRI's own analysis result in corrections. DG AGRI deducts its estimate of future *financial corrections* and recoveries from the 'risk at payment' to estimate a 'final amount at risk'.

7.31. The control statistics reported by the paying agencies indicated a level of error equivalent to 1.1 % of CAP spending as a whole. DG AGRI, taking into account the work of the certification bodies and its own audits, calculated the 'estimated amount at risk at payment' to be €996 million, i.e. around 1.8 % of total CAP expenditure in 2022. DG AGRI estimated a risk at payment (adjusted error rate) of around 1.3 % for direct payments, 2.7 % for rural development and 2.9 % for market measures.

7.32. We also performed a limited review of the regularity information in DG MARE's annual activity report. We noted that the methodology for the calculation of the final risk at payment (or *closure*) for DG AGRI and DG MARE was in line with the Commission guidelines.

The Commission's Annual Management and Performance Report (AMPR)

7.33. The Commission's estimate of risk at payment for 'Natural resources' presented in its AMPR is 1.8 %.

Conclusion and recommendations

Conclusion

7.34. The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on 'Natural resources and environment' as a whole was material (see paragraph ***7.15***). For this MFF heading, our testing of transactions produced an estimated overall level of error of 2.2 %.

7.35. Our results indicate that the level of error was not material for direct payments, representing 66 % of spending under this MFF heading, while it was still material for the other spending areas (rural development, market measures, maritime, fisheries, the environment and climate action), representing 34 % of spending. In addition, we note that the number of small over-declarations of area, for both direct payments and rural development measures, increased from four errors in 2021 to 16 errors in 2022, which may indicate specific weaknesses in some member states' management of the Land Parcel Identification System.

Recommendations

7.36. We reviewed the recommendations we made in our last three annual reports. There are no recommendations from those annual reports targeted for implementation in 2022. All recommendations in the 2019-2021 annual reports have either been implemented and reported in a previous annual report[6] or have a target implementation date later than 2022[7].

7.37. Based on this review and our findings and conclusions for 2022, we recommend that the Commission:

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[6] 2019 annual report, recommendation 6.1 which we reported as implemented in some respects in AR 2021.

[7] 2021 annual report, recommendation 6.1 and 6.2 with target implementation date 2023 and 2025.

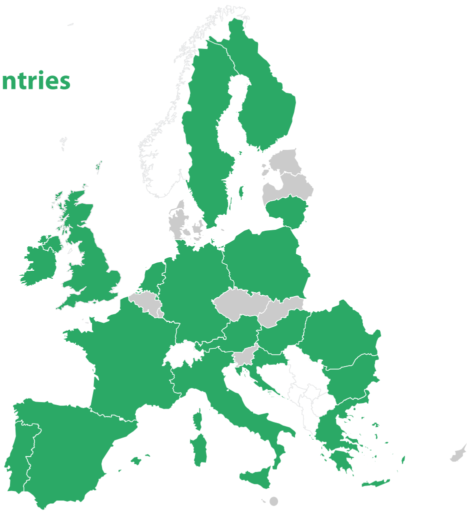
Recommendation 7.1 – Monitoring the quality of agricultural area data

Given that agricultural area will be the basis for performance indicators under the new CAP 2023-2027, continue monitoring how accurately members states assess the eligible area in the Land Parcel Identification System.

Target implementation date: 2024

Annexes

Annex 7.1 – Information on EU action in member states and the UK



Member state / country	EU contribution (*million euros*)	Audited transactions	Quantifiable errors	Non-quantifiable errors
CAP spending	**56 079**	**210**	**30**	**10**
France	9 450	32	8	4
Spain	6 992	24	1	0
Germany	6 371	22	1	2
Italy	5 914	22	4	1
Poland	4 787	20	3	1
Romania	2 992	12	0	0
Greece	2 880	12	1	0
Hungary	1 983	8	1	0
Ireland	1 579	4	2	1
Portugal	1 458	10	1	0
Austria	1 339	4	2	1
Bulgaria	1 055	8	1	0
Sweden	1 008	10	1	0
Finland	997	4	1	0
Netherlands	835	9	1	0
Lithuania	823	4	0	0
Croatia	759	8	1	0
United Kingdom	291	4	1	0
MS not audited	4 567	N/A	N/A	N/A
Other spending	**2 197**	**8**	**2**	**5**
TOTAL	**58 276**	**218**	**32**	**15**

Source: ECA, based on Commission data.

Chapter 8

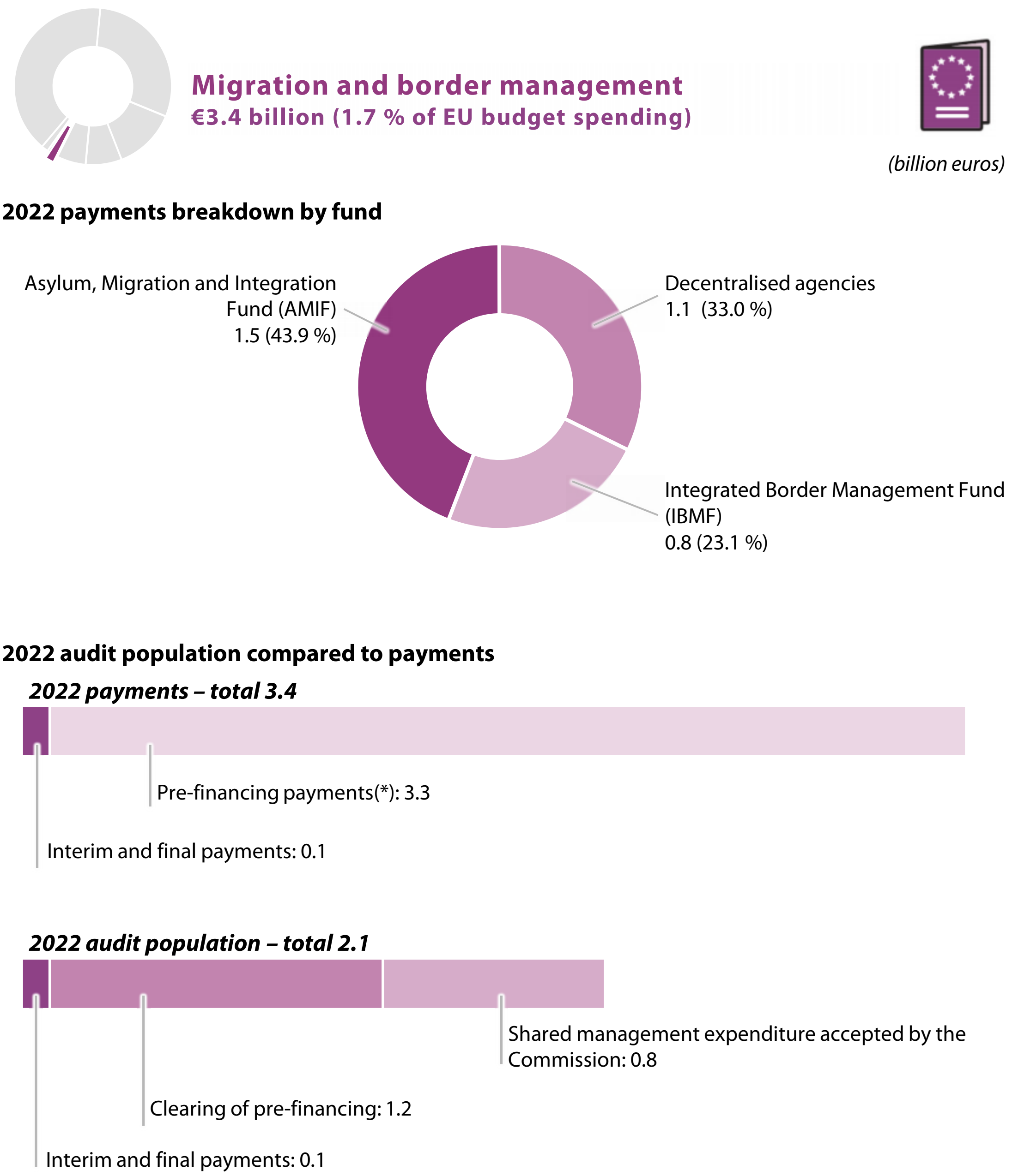
Migration and border management
Security and defence

Contents

Introduction

8.1. This chapter presents our findings for the *multiannual financial framework (MFF)* headings 4 'Migration and border management' and 5 'Security and defence'. In the previous MFF period, these headings were mainly budgeted for and recorded under a single heading, MFF3 'Security and citizenship'. ***Figure 8.1*** and ***Figure 8.2*** give an overview of the main activities and spending under these headings in 2022.

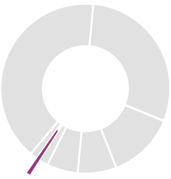
Figure 8.1 – Payments and audit population – Migration and border management



(*) Pre-financing also includes *shared management* annual advances. In line with the harmonised definition of underlying *transactions*, *pre-financing payments* made in 2022, but not *cleared* in that year, are not part of our audit population (for details see ***Annex 1.1***, paragraph ***18***).

Source: ECA, based on data from the 2022 *consolidated accounts* of the European Union.

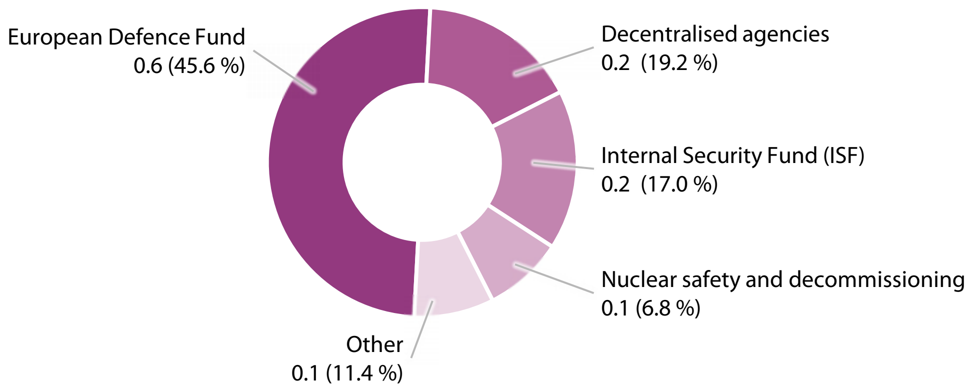
Figure 8.2 – Payments and audit population – Security and defence



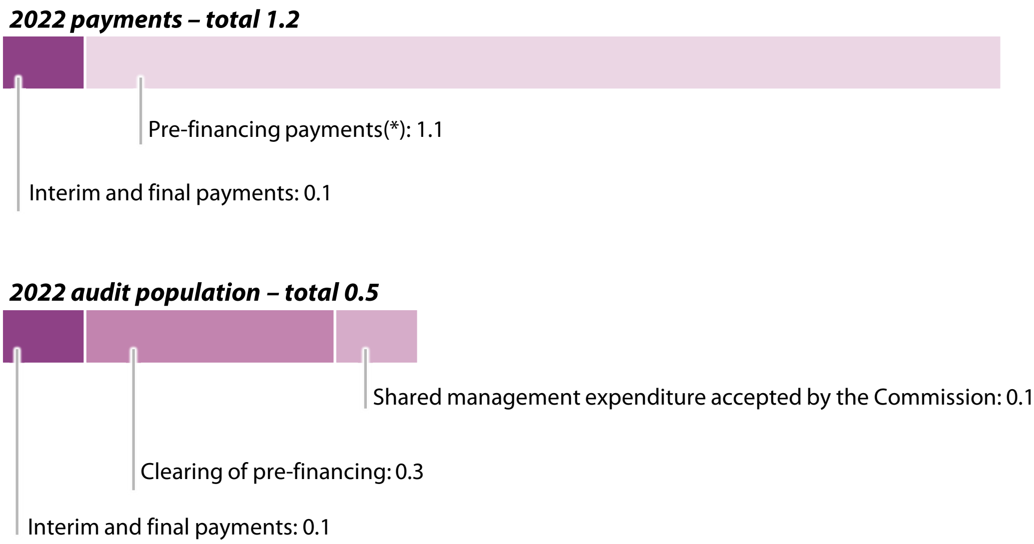
Security and defence
€1.2 billion (0.6 % of EU budget spending)

(billion euros)

2022 payments breakdown by fund



2022 audit population compared to payments



(*) Pre-financing also includes shared management annual advances. In line with the harmonised definition of underlying transactions, pre-financing payments made in 2022, but not cleared in that year, are not part of our audit population (for details see ***Annex 1.1***, paragraph ***18***).

Source: ECA, based on data from the 2022 consolidated accounts of the European Union.

Brief description

8.2. Given the increasing importance of migration and border management in recent years, the European Union has established heading 4 of the 2021-2027 MFF specifically for these policy areas, as shown in ***Figure 8.1***. A significant portion of the spending in this area in 2022 still concerned the completion of projects and schemes outstanding from the 2014-2020 MFF. Thus, most of our audit population comes from the winding-up of the *Asylum, Migration and Integration Fund*[1] *(AMIF)* for 2014-2020 and the completion of funding from the *Internal Security Fund* – Borders and Visa instrument[2] (ISF-BV). The objective of the 2014-2020 AMIF was to contribute to the effective management of migration flows and bring about a common EU approach to *asylum* and immigration. The aim of the ISF-BV was to contribute to ensuring a high level of security in the EU while facilitating legitimate travel, through a uniform and high level of control of the *external borders* and the effective processing of Schengen visas.

8.3. These 2014-2020 funds have been replaced in the 2021-2027 MFF by, respectively, a new AMIF[3], and the *Instrument for Financial Support for Border Management and Visa Policy*[4] *(BMVI)* of the *Integrated Border Management Fund (IBMF)*. AMIF's objective for 2021-2027 is to contribute to the efficient management of migration flows and to implementing, strengthening and developing the common policy on asylum and immigration. The BMVI's objective is to support strong and effective integrated border management at the Union's external borders, ensuring a high level of security and safeguarding the free movement of persons on EU territory.

8.4. Another significant spending area for MFF heading 4 is the funding for three *decentralised agencies* (European Border and Coast Guard Agency (*Frontex*), *European Union Agency for Asylum (EUAA)*, and European Union Agency for the Operational Management of Large-Scale IT Systems in the Area of Freedom, Security and Justice (*eu-LISA*)) that are active in the implementation of key EU priorities in the areas of migration and border management. We report separately on agencies in our specific annual reports.

8.5. In the 2021-2027 MFF, heading 5 is devoted to security and defence, as shown in ***Figure 8.2***. The 'security' component includes funding from the Internal Security Fund (ISF) for 2021-2027[5], completion of funding from the Internal Security Fund –

1 Regulation (EU) No 516/2014 establishing the Asylum, Migration and Integration Fund.

2 Regulation (EU) No 515/2014 establishing, as part of the Internal Security Fund, the instrument for financial support for external borders and visa.

3 Regulation (EU) 2021/1147 establishing the Asylum, Migration and Integration Fund.

4 Regulation (EU) 2021/1148 establishing, as part of the Integrated Border Management Fund, the Instrument for Financial Support for Border Management and Visa Policy.

5 Regulation (EU) 2021/1149 establishing the Internal Security Fund.

Police instrument (ISF-P) for 2014-2020[6], funding for nuclear decommissioning (EU financial support for the decommissioning of nuclear installations in Bulgaria, Lithuania and Slovakia), and funding for three EU decentralised agencies in the area of security (European Monitoring Centre for Drugs and Drug Addiction (EMCDDA), European Union Agency for Law Enforcement Cooperation (Europol), and European Union Agency for Law Enforcement Training (CEPOL)). The 'defence' component includes the European Defence Fund[7], which supports collaborative defence projects at all stages of research and development.

8.6. The ISF is narrower in scope for 2021-2027 than it was previously (since the objectives of the 2014-2020 ISF-BV have been moved to a different instrument), and it is now dedicated to the objectives of the 2014-2020 ISF-P. Its purpose is to contribute to ensuring a high level of security in the EU, particularly by preventing and combating terrorism, radicalisation, serious and organised crime, and cybercrime, by assisting and protecting victims of crime, and by preparing for, protecting against, and effectively managing security-related incidents, risks and crises. A significant portion of the spending in this area in 2022 concerned the completion of projects remaining from the 2014-2020 MFF.

8.7. The management of most AMIF and ISF funding for 2014-2020, and most AMIF, BMVI and ISF funding for 2021-2027 is shared between the member states (or Schengen associated countries) and the Commission's DG for Migration and Home Affairs (DG HOME). Under this arrangement, member states implement multiannual national programmes that have been approved by the Commission.

8.8. Since 2019, member states have stepped up implementation of their AMIF and ISF national programmes for 2014-2020. Nevertheless, significant amounts remain undisbursed (26 % for AMIF and 33 % for the ISF at the end of 2022), although funding for 2014-2020 has to be spent by June 2024[8]. ***Figure 8.3*** sets out the expenditure that member states have reported to the Commission for reimbursement since the beginning of the 2014-2020 *programming period*.

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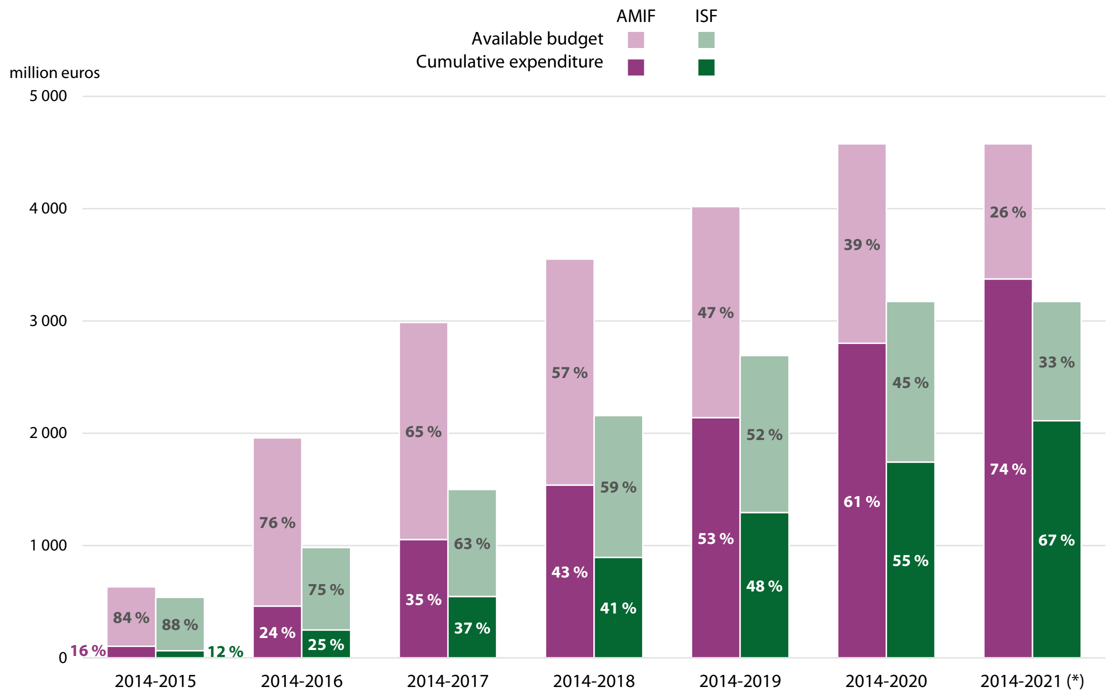
6 Regulation (EU) No 513/2014 establishing, as part of the Internal Security Fund, the instrument for financial support for police cooperation, preventing and combating crime, and crisis management.

7 Regulation (EU) 2021/697 establishing the European Defence Fund.

8 Regulation (EU) 2022/585 amending Regulations (EU) No 514/2014, 516/2014 and 2021/1147.

Figure 8.3 – Progress of the 2014-2020 AMIF and ISF national programmes



(*) AMIF/ISF expenditure at member state level is declared to and approved by the Commission the year after it is incurred. Thus, the Commission's accounts for 2022 show this expenditure for 2021.

Source: ECA, based on Commission data (national programmes and *clearance* decisions until the end of 2022).

Audit scope and approach

8.9. Applying the audit approach and methods set out in ***Annex 1.1***, we examined the following for the MFF headings of this chapter in 2022.

(a) A sample of 23 transactions which, while contributing to the overall *statement of assurance*, is not representative of the spending under these MFF headings. We therefore cannot provide an *estimate of the error rate* for these headings. The sample consisted of:

— 14 transactions under shared management with member states (two transactions per member state: Germany, Latvia, Romania, Spain and United Kingdom for MFF heading 4; Croatia and Czechia for MFF heading 5);

— seven under the Commission’s *direct management* (five for MFF heading 4, two for MFF heading 5) and two under its *indirect management* (one for MFF heading 4, one for MFF heading 5).

We also took account of the results of our *compliance audits* of agencies.

(b) The *regularity* information given in the *annual activity report (AAR)* of DG HOME and then included in the Commission's *Annual Management and Performance Report (AMPR)*.

(c) Selected systems, which concerned how *audit authorities* in six member states (Germany, Spain, and Romania for AMIF; Latvia for BMVI; Czechia and Croatia for the ISF) are preparing for the 2021-2027 AMIF, BMVI and ISF.

Regularity of transactions

8.10. Of the 23 transactions we examined, 11 (48 %) were affected by *errors*. We have quantified nine errors which had an *impact* on the amounts charged to the EU budget. These errors related to ineligible expenditure (for example, some personnel or equipment costs, *value added tax*) and *public procurement* issues. ***Box 8.1*** shows examples of errors that we have quantified.

Box 8.1

Ineligible personnel and equipment costs

We audited an AMIF project directly managed by DG HOME that came under the umbrella of *Union actions*. It consisted of providing IT skills training to refugees to facilitate their integration in the labour market. Five co-beneficiaries implemented the project. We checked a sample of ten items included in the cost claim.

For three items, we found ineligible personnel costs. In one instance, the employment contract for the project manager was replaced during the project by a service contract. This led to a significant increase in the personnel costs for that person. We did not consider the increased cost eligible, as there was no corresponding change in the tasks assigned. In another case, the declared personnel costs for one person under a service contract were significantly higher than those for two other staff with employment contracts doing similar tasks (by 42 % and 34 % respectively). In a third case, the daily rate charged to the project for a consultant was more than double the daily rate agreed in the consultancy contract.

For two other items, we found ineligible equipment costs related to the acquisition of computers. According to the grant agreement, the eligible costs for equipment were limited to depreciation incurred during the project implementation period, but DG HOME had effectively accepted the entire acquisition cost as eligible.

Overall, we considered 19.4 % of the accepted expenditure (totalling €706 592.15) ineligible for EU funding. Some co-beneficiaries submitted audit certificates to support their cost claims, but none of the errors described above had been reported by the external auditors. Nor did DG HOME find these errors through its *ex ante* checks prior to payment.

Ineligibility of declared accommodation costs due to irregularities in public procurement procedures

We audited an AMIF project under shared management with Spain. The project was implemented by a non-profit organisation (‘the *beneficiary*’) and mainly consisted of the provision of accommodation (including meals) to applicants for international protection. Using the final project implementation report submitted by the beneficiary to the Spanish responsible authority in November 2021, we checked a sample of ten items included in the cost claim, eight of them being invoices for rented rooms and meals.

We audited a procurement procedure that had led to the signature of a contract with a travel agency for accommodation and meals. The value of services provided under this contract during the implementation of the project totalled €2 400 492.85. We found that the beneficiary had failed to comply with applicable requirements for publication of the tender notice. Furthermore, in line with the tender specifications, the successful bidder was to provide a guarantee after being awarded the contract. The basis for calculating the guarantee had been changed just before the deadline for offers. This change had reduced the amount of the guarantee significantly, but it had not been properly communicated to potential bidders. The guarantee therefore acted as a barrier to competition, as its initial higher amount might have discouraged some potential bidders from applying. In addition, the beneficiary did not establish any methodology for objectively assessing offers against the award criteria. We considered that, taken together, these *irregularities* meant there was a lack of transparency in the procedure and insufficient reasoning behind the award of the contract to the travel agency.

We also audited a procurement procedure that had led to the signature of a contract with a hotel for a maximum value of €417 240. As the beneficiary conducted the procurement procedure using oral communication and could not provide any documentary evidence produced at the time, we were unable to verify whether a procurement procedure had actually been carried out. This absence of evidence led us to conclude that the contract had been awarded directly to the hotel. We thus considered that 100 % of the declared costs for this particular procurement procedure were ineligible.

Overall, we considered 40.7 % of the audited expenditure for this AMIF project to be ineligible for EU funding.

8.11. We also found four cases of non-compliance with legal and financial provisions (but with no impact on the EU budget). These related to, for example, an insufficient *audit trail* for verifying invoiced amounts.

Examination of elements of internal control systems

8.12. For the 2021-2027 AMIF, BMVI and ISF, we assessed the work of six member state audit authorities (Germany, Spain, and Romania for AMIF; Latvia for BMVI; Czechia and Croatia for the ISF) as follows:

(a) how the implementation of the new *Common Provisions Regulation (CPR)*[9] was affecting these audit authorities;

(b) how they were taking account of the specific requirements of the CPR in relation to AMIF, BMVI and the ISF; and

(c) whether the transfer of competences between audit authorities was properly organised (for the member states where the audit authorities for the 2014-2020 AMIF and ISF were not the same as for 2021-2027).

8.13. Each member state is required to have in place, at the latest by 30 June 2023, a description of their management and control system, which is a prerequisite for defining their audit strategy for system audits and audits of operations. Overall, the six audit authorities already had a clear picture of the main changes required in the audit strategy, system audits and audits of operations compared with the 2014-2020 programming period. However, as none of the six member states had finalised the description of their management and control system at the time of our visits (which took place between September 2022 and February 2023), they were not yet able to approve their audit strategy, which is a prerequisite for submitting an '*assurance package*' to the Commission. Article 98 of the CPR states that, each year, member states are to submit to the Commission by 15 February, an 'assurance package' which includes the annual accounts of the preceding accounting year audited by the designated audit authorities. The six member states we visited will submit their first annual accounts for AMIF, BMVI and the ISF to the Commission at the earliest in 2024.

[9] Regulation (EU) 2021/1060 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy.

8.14. We also examined the resources that the audit authorities had at their disposal, particularly staff and IT systems. Where necessary, member states have started recruiting additional resources for their audit authorities. Each audit authority of the six member states is also due to have read-only access to the *managing authority*'s IT system where the information and documentation they need for their audits is stored by project beneficiaries and managing authorities. These systems were either under development or yet to be developed when we visited the member states in question.

8.15. Overall, we noted that the six audit authorities were making progress in their preparations for the 2021-2027 AMIF, BMVI and ISF, even though their audit strategies had not yet been adopted.

Annual activity reports and other governance arrangements

8.16. For the 2022 financial year, we reviewed the AAR of DG HOME. Our analysis focused on whether DG HOME had presented the regularity information in its AAR in accordance with the Commission's instructions, and whether this information was consistent with the knowledge we had obtained during our audits. We found no information that might contradict our findings.

8.17. We reviewed DG HOME's estimates for risks at payment and at closure. We found that they were calculated in accordance with internal methodology and correctly reported in the AMPR. Of the total expenditure in 2022 (€2 479 million), DG HOME estimated the total amount at risk at the time of payment to be €34 million (1.4 %), and it estimated a figure of €3 million for corrections resulting from its checks in future years.

8.18. The Director-General of DG HOME declared that she had reasonable assurance that the resources assigned to the activities described in the AAR had been used for their intended purpose and in accordance with the principles of sound management, but with some *reservations*. As our checks on 22 transactions concern only a small proportion of the transactions under DG HOME's responsibility, we are unable to verify this statement against the results of our audit work.

Conclusion and recommendations

Conclusion

8.19. Our examination of transactions shows that the expenditure is affected by eligibility and procurement issues. While we did not audit sufficient transactions to estimate the level of error for these MFF headings (see paragraph ***8.9***), our audit results indicate that it is a high-risk area. The results of transaction testing contribute to our statement of assurance.

Recommendations

8.20. ***Annex 8.1*** shows the finding of our follow-up review of the recommendation from our 2020 annual report that was targeted for implementation by the end of 2022. This recommendation concerned guidance to the member state authorities responsible for implementing DG HOME funds in both the 2014-2020 and 2021-2027 MFFs. It referred to documenting the completeness and quality of services when funding is based on *standard unit costs*. We consider this recommendation to have been implemented in full because DG HOME has issued guidelines and a practitioner's manual on the use of *simplified cost options*.

8.21. Based on our findings and conclusions for 2022, we recommend that the Commission:

Recommendation 8.1 – Better target checks on project cost eligibility for Union actions directly managed by DG HOME

Carry out better targeted *ex ante* checks on the eligibility of expenditure for Union actions, with a specific focus on the potential risks related to, for example, the type of expenditure (e.g. personnel costs, equipment, procurement), or the type of beneficiary.

When preparing its risk assessment, the Commission should take into consideration that audit certificates supporting beneficiaries' payment claims have limitations.

Target implementation date: End of 2024

Annexes

Annex 8.1 – Follow-up of previous recommendations for ‘Migration and border management’ and ‘Security and defence’

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2020	We recommend that the Commission: **Recommendation 2:** Provide guidance to the member state authorities responsible for implementing DG HOME funds, in both the 2014-2020 and 2021-2027 MFFs, on documenting the completeness and quality of services when funding is based on standard unit costs.	Fully	

Source: ECA.

Chapter 9

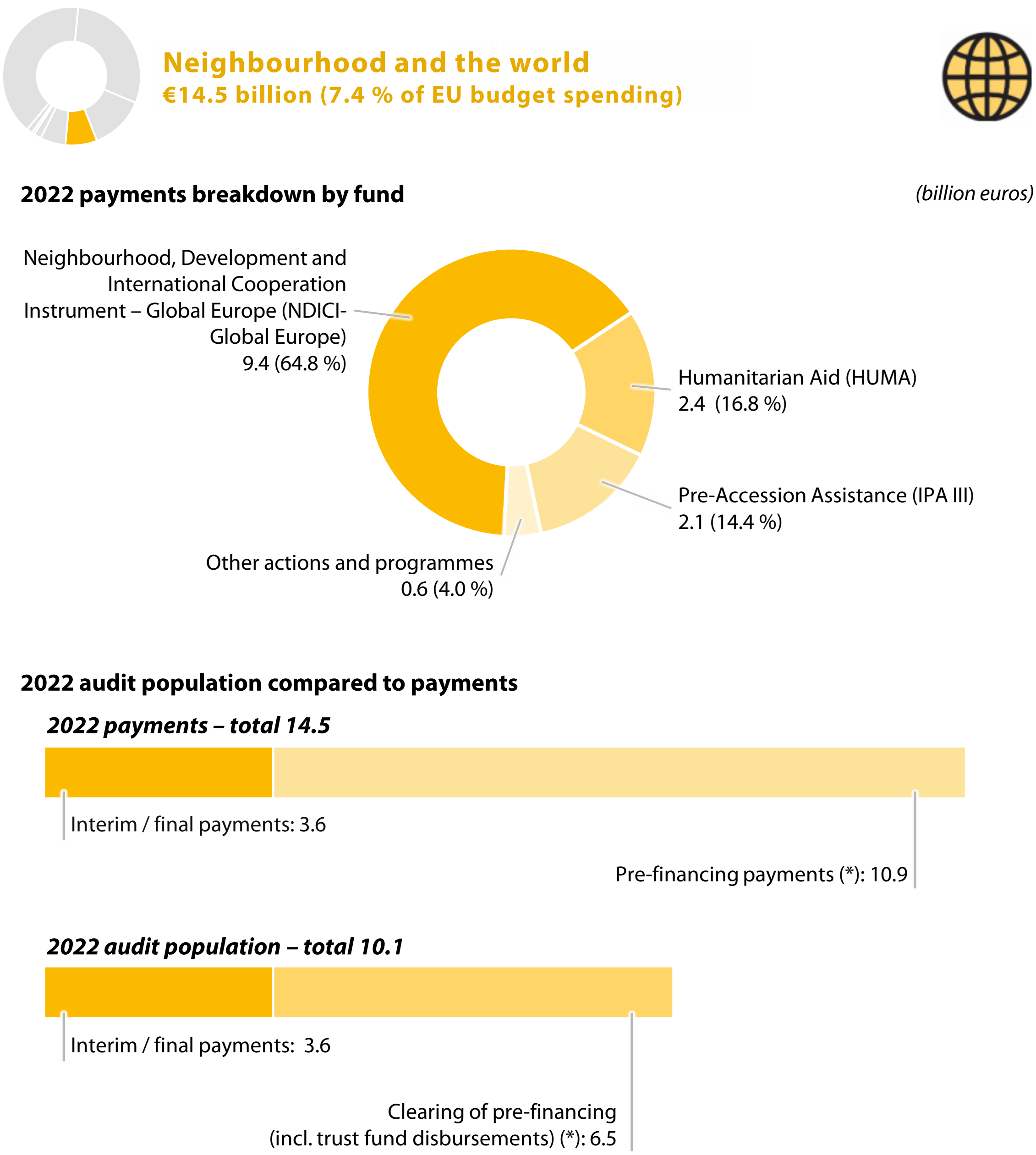
Neighbourhood and the world

Contents

Introduction

9.1. This chapter presents our findings for *MFF* heading 6 ‘Neighbourhood and the world’. ***Figure 9.1*** gives an overview of the main activities and spending under this heading in 2022.

Figure 9.1 – Payments and audit population



(*) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph ***18***).

Source: ECA, based on data from the 2022 *consolidated accounts* of the European Union.

Brief description

9.2. The spending area comprises several funding instruments, most notably the *Neighbourhood, Development and International Cooperation Instrument - Global Europe ('NDICI - Global Europe')*[1] and the Instrument for Pre-accession Assistance[2]. It also covers the humanitarian aid budget.

9.3. The general objective of NDICI - Global Europe is to uphold and promote EU values, principles and fundamental interests worldwide, and help promote multilateralism and stronger partnerships with non-EU countries. It reflects two major changes, compared to the 2014-2020 MFF, in the way the EU finances *external action* (foreign policy):

(a) cooperation with African, Caribbean and Pacific partner countries, previously financed by the European Development Funds, has now been brought under the EU's general budget;

(b) such cooperation is now funded under the same instrument as the EU's neighbourhood policy, while preserving the specific features of both types of support.

9.4. The general objective of the Instrument for Pre-accession Assistance is to support *beneficiary* countries in adopting and implementing the reforms required to align with EU values with a view to membership, thereby contributing to their stability, security and prosperity.

9.5. The main directorates-general and services involved in implementing EU external action are the Directorate-General for Neighbourhood Policy and Enlargement Negotiations (DG NEAR), the Directorate-General for International Partnerships (DG INTPA), the Directorate-General for European Civil Protection and Humanitarian Aid Operations (DG ECHO) and the Service for Foreign Policy Instruments (FPI).

9.6. In 2022, payments for 'Neighbourhood and the world' amounted to €14.5 billion (*pre-financing*, *interim* and final *payments*) and were disbursed using

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[1] Regulation (EU) 2021/947 on the Neighbourhood, Development and International Cooperation Instrument - Global Europe.

[2] Regulation (EU) 2021/1529 establishing the Instrument for Pre-Accession assistance (IPA III).

several instruments (see ***Figure 9.1***) and delivery methods. These include works/supply/service contracts, *grants*, special loans, loan guarantees and financial assistance, *budget support* and other targeted forms of budgetary aid in non-EU countries (see ***Annex 9.1***). The total payments under this heading increased from €10.9 billion in 2021 to €14.5 billion in 2022. The increase in payments is mainly under NDICI - from €5.8 billion in 2021 to €9.4 billion and is due to pre-financing payments.

Audit scope and approach

9.7. Applying the audit approach and methods set out in ***Annex 1.1***, we examined the following for this MFF heading in 2022:

(a) a sample of 72 transactions which, while contributing to our overall statement of assurance, is not representative of the spending under this MFF heading. We therefore cannot provide an estimate of the *error* rate for this heading. We sampled 35 DG NEAR, 17 DG INTPA, 14 DG ECHO and six FPI transactions;

(b) the regularity information given in the *annual activity report (AAR)* of DG NEAR and then included in the European Commission's *Annual Management and Performance Report (AMPR)*;

(c) selected systems in four EU delegations including their systems for:

   (i) audit, verification and follow-up – we assessed whether the implementation of the annual audit and verification plans was appropriate and compliant with the applicable rules and guidelines;

   (ii) *fraud* prevention and ethics – we assessed whether staff received proper training in fraud prevention and ethics and were aware of the procedures and obligations in cases of suspected fraud.

Regularity of transactions

9.8. Of the 72 transactions we examined, 34 (47 %) were affected by errors. Despite the limited sample size, our audit *results* indicate that the risk of error in this MFF heading is high. We have quantified 25 errors which had a financial *impact* on the amounts charged to the EU budget. These errors related to ineligible costs, absence of supporting documents, public procurement and expenditure not incurred. ***Box 9.1*** shows examples of the errors we have quantified.

Box 9.1

Serious failure in applying grant award rules

DG INTPA

We audited an invoice for €728 221 under a grant contract signed with non-governmental organisations (NGOs). The project was aimed at strengthening public participation in local government consultations in an African country. The action's estimated costs amounted to €993 304, with 75 % financed by the EU. One of the eligibility requirements in the award procedure was that the lead applicant should be directly responsible for managing the action and not merely act as an intermediary.

The application was submitted by an international NGO registered in an EU member state, as lead applicant. While preparing the contract, the Commission discovered that the action would not be implemented by the lead applicant but rather by a related African entity, which was not originally named as an applying entity.

However, the evaluation committee accepted the proposal despite the lead applicant's failure to meet the eligibility criterion of being directly responsible for managing the action. Moreover, the Commission added the African entity to the contract, thereby allowing an alteration from the original application, for which the rules make no provision. We therefore considered the outcome of the award procedure to be incorrect and the declared expenditure to be ineligible for EU funding.

Ineligible expenditure included in the cost claim

DG NEAR

We audited the clearing of a transaction worth €3.79 million under an *indirect management delegation agreement* financed by a neighbourhood investment facility. The transaction related to a project, implemented by a development agency, to promote the sustainable use of natural resources in order to support Palestine's* transition to a 'green' economy.

The project was financed under a measure which consisted of a loan facility, with a total budget of €35.7 million (including an EU contribution of €10.7 million), and an incentive component of €5 million fully financed by the EU. The incentive component was intended for small and medium-sized enterprises (SMEs) in the form of grants for 'green' projects in the areas of energy *efficiency*, renewable energy and pollution abatement. This was payable to final beneficiaries through a partner bank.

In the second half of 2020, the development agency reported to the Commission that it had approved a grant of €190 500 for a final beneficiary. The approval was based on information provided by the partner bank, which offered the final beneficiary the loan facility at the same time. However, the beneficiary never accepted the financing and did not implement the project.

As of the end of 2021, the development agency was still reporting to the Commission in its progress reports that the project was being financed, even though it had never been implemented. The Commission regarded the project as incurred expenditure, based on the financial information received from the development agency. Neither the development agency nor the Commission had carried out checks on this financial information. Such checks could have detected the incorrect reporting by the bank.

*This designation shall not be construed as recognition of a State of Palestine and is without prejudice to the individuals positions of the member states on this issue.

9.9. We also found 17 cases of non-compliance with legal and financial provisions (but with no financial impact on the EU budget). These related to, for example, mandatory procedures not followed, insufficient evidence, unclear allocation of costs and lack of audit trail. ***Box 9.2*** shows one example of errors we have not quantified.

Box 9.2

Mandatory risk assessment not conducted

DG NEAR

We audited the final payment for a project to deliver and install communication equipment for a government authority in the beneficiary country. The supply contract was signed with a local supplier for a total of €255 492. Upon signing the contract, the Commission made a pre-financing payment of €102 197, representing 40 % of the agreed contract price.

The manual of procedures requires the Commission to carry out risk assessments to ensure that pre-financing payments between of €60 000 and €300 000 are only made without a bank guarantee if the risk is assessed as low. In this case, a risk assessment was required as the pre-financing amount was €102 197. However, the Commission made the payment without conducting any such risk assessment and without obtaining a bank guarantee.

9.10. We identified two spending areas in which transactions are generally less prone to errors due to specific payment conditions. These areas are (i) budget support and (ii) projects subject to the '*notional approach*', which are implemented by international organisations. In 2022, we audited three budget support transactions and five 'notional approach' transactions.

9.11. Budget support is a contribution to a state's general budget or its budget for a specific policy or objective. Budget support payments financed by the EU general budget amounted to €1.7 billion in 2022. We examined whether the Commission had complied with the conditions governing budget support payments to partner countries and had verified that these countries met the eligibility conditions (such as satisfactory improvement in public-sector financial management). Our regularity audit cannot cover what happens after the Commission pays aid to the recipient country, since these funds then merge with that country's own budget resources.

9.12. Under the 'notional approach', when contributions from the Commission to multi-donor projects are pooled with those from other donors and not earmarked for specific, identifiable items of expenditure, the Commission assumes that expenditure is compliant with EU eligibility rules provided that the total pooled amount includes sufficient eligible expenditure to cover the EU's contribution. We took this approach into account in our substantive testing. In 2022, payments to international organisations from the EU general budget amounted to €4.7 billion. We cannot state the proportion of this amount to which the notional approach applies, since the Commission does not monitor it separately. We detected five *non-quantifiable errors* in 'notional approach' transactions.

9.13. When examining the regularity of transactions, we also noted examples of effective controls by the Commission. We present one such example in ***Box 9.3***.

Box 9.3

Ineligible expenditure identified in verification report

DG NEAR

Through a grant contract, the Commission financed an action with a budget of €210 million to improve the health status of refugees in their host country.

When auditing expenditure claimed under this grant contract, we found that the Commission had correctly rejected an amount of €2.27 million (6.67 %) of a €34 million invoice following its expenditure verification. The ineligible expenditure concerned, in particular, the use of incorrect procurement procedures to purchase services and the inclusion of ineligible *VAT* in the costs claimed.

9.14. As in previous years, we faced delays in receiving requested documentation from some international organisations and, consequently, in carrying out our work. These organisations provided only limited access to documents (e.g. in read-only format), which hindered the planning, execution and quality control of our audit. These difficulties persisted despite the Commission's attempts to resolve them through ongoing communication with the international organisations concerned.

Examination of elements of internal control systems

9.15. We visited four EU delegations in non-EU countries (Bosnia and Herzegovina, North Macedonia, Rwanda and Serbia) and examined the following elements of their internal control systems:

(a) whether the delegations prepared their annual audit and verification plans in accordance with the relevant methodology;

(b) whether they carried out project risk assessments in accordance with the applicable guidelines;

(c) whether they contracted out audits and expenditure verifications on time and how they managed these;

(d) whether they followed up on the results of these audits and expenditure verifications; and

(e) how they addressed any critical findings.

9.16. We also assessed awareness raising among delegation staff in the areas of fraud prevention, ethics and integrity. In particular, we examined:

(a) whether delegation staff were aware of their obligations in cases of suspected fraud;

(b) whether staff regularly attended appropriate training in these areas;

(c) how often such training took place and who was required to attend.

9.17. We identified some shortcomings in the functioning of the internal control system elements we examined. These shortcomings related to expenditure verifications, fraud prevention training and the Commission's OPSYS IT system. ***Box 9.4*** shows examples of such shortcomings.

Box 9.4

Expenditure verification report received after final payment already made

DG NEAR

The Commission usually requires grant beneficiaries to engage a contractor to verify their expenditure to date and produce expenditure verification reports, which they submit to the EU delegation before they can receive further pre-financing or final payments. One EU delegation we audited engaged contractors directly to verify beneficiaries' expenditure.

We reviewed three expenditure verification reports received by that EU delegation. In one case, in order to meet the deadline set in the grant contract, the EU delegation had already made the final payment to the beneficiary before receiving the expenditure verification report.

Some delegation staff not trained in fraud prevention in past 5 years

DG NEAR and DG INTPA

During our visits to four EU delegations, we conducted interviews with four staff members selected by each of those delegations. We noted that one staff member in one delegation and two staff members in another had not attended fraud prevention training in the past 5 years.

OPSYS information system not fully operational

Several years ago, DG INTPA, DG NEAR and FPI launched a large-scale business and IT transformation programme called OPSYS to manage the EU's entire external action portfolio.

During our visits to EU delegations, staff reported problems with OPSYS that had led to delays, disruptions to the smooth functioning of the delegation and increased resource consumption.

In its annual activity report (AAR), DG NEAR reported difficulties with the implementation of OPSYS, highlighting that the new IT tool was at times unstable, did not meet user expectations and required frequent intervention by the support teams of DG INTPA and the Directorate-General for Informatics (DIGIT). This could lead to unreliable data and incomplete management information.

Annual activity reports and other governance arrangements

DG NEAR's AAR

9.18. We reviewed DG NEAR's AAR for the 2022 financial year. We focused on whether DG NEAR had presented the regularity information in its AAR in accordance with the Commission's instructions and had been consistent in its application of the methodology for estimating future corrections and recoveries.

9.19. Based on instructions issued by the Commission's Directorate-General for Budget (DG BUDG) on the preparation of their AARs, the directorates-general estimate their risk at payment using the data in their possession. To the risk at payment they apply a *corrective capacity* rate, corresponding to the historical average of recoveries and corrections provided by DG BUDG and adjusted by the directorates-general as needed, to calculate their risk at closure. The risk at closure is an important indicator of the *effectiveness* of a directorate-general's internal control.

9.20. However, the risk at closure that DG NEAR reports in its AAR is derived from a study carried out by an external contractor on DG NEAR's behalf, known as the *residual error rate (RER)* study. The purpose of the study is to estimate the rate of those errors not detected by all DG NEAR management checks to prevent, detect and correct such errors across its entire area of responsibility, in order to conclude on the effectiveness of those checks. It is an important element underlying the Director-General's *declaration of assurance*, and feeds into the regularity information on external action disclosed in the AMPR.

9.21. The RER study does not constitute an *assurance engagement* or an audit. Our previous annual reports[3] have already described limitations in the study that may contribute to the RER's underestimation. More specifically, in previous years we have observed, among other things, that the contractor can rely entirely on the results of previous control work. In cases where these previous checks were carried out under the *Financial and Administrative Framework Agreement (FAFA)* between the European Commission and the United Nations, the contractor is not always able to carry out additional substantive testing as the FAFA limits the Commission's verification rights.

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[3] 2017, 2018, 2019, 2020 and 2021 annual reports.

9.22. For 2022, the RER study estimated an overall RER for DG NEAR as a whole (referred to as the 'global (DG derived) error rate' in the AAR) of 1.00 %, below the Commission's 2 % *materiality threshold*. The RER sample consisted of 256 transactions under contracts closed during the reference period (September 2021 to August 2022). The RER study also includes an estimate of the residual error rate for grants under *direct management* (the 'grant error rate'). However, this rate is not included in the calculation of DG NEAR's overall RER.

9.23. Based on the overall RER of 1.00 %, the Director-General declared DG NEAR's financial exposure to be below the 2 % materiality threshold. As we do not have a representative sample to estimate an error rate for MFF heading 6 'Neighbourhood and the world', we are unable to verify this statement against the results of our audit work.

9.24. From the overall RER, DG NEAR derived an estimated risk at closure of €44 million. It then worked backwards from the risk at closure to arrive at the estimated risk at payment. This entailed adding on estimated future corrections resulting from recovery orders in respect of undue payments identified by DG NEAR's *ex post* checks[4]. DG NEAR estimated these future corrections at €4.2 million[5]. It thus arrived at a risk at payment of €46.99 million (0.91 %) for 2022 expenditure.

9.25. Moreover, we found that DG NEAR's 2022 corrective capacity figure was overstated due to undetected errors, namely the inclusion in the calculation of recovery orders relating to unspent pre-financing. We audited 11 recovery orders and found three of them, totalling €0.7 million, to be incorrect.

DG INTPA's AAR

9.26. Our work on DG INTPA´s 2022 AAR is presented in detail in our annual report on the 9th, 10th and 11th European Development Funds (EDFs).

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[4] DG NEAR's 2022 AAR, footnote 6 of Annex 9.

[5] *Ibid.*

Conclusion and recommendations

Conclusion

9.27. Our examination of transactions and systems highlighted four areas with scope for improvement. While we did not audit sufficient transactions to estimate the level of error for this MFF heading (see paragraph ***9.7***), our audit results indicate that it is a high-risk area. The results of transaction testing contribute to our statement of assurance.

Recommendations

9.28. ***Annex 9.2*** shows the findings of our follow-up review of the three recommendations we made in our 2019 annual report. The Commission had implemented two recommendations in full, while one had not been acted upon at all.

9.29. We consider recommendation 1, that the Commission disclose the limitations of the RER study in DG NEAR's 2020 AAR and future AARs, to have been implemented. This reflects our assessment that these limitations were disclosed in the 2020 AAR and in all subsequent AARs.

9.30. We consider recommendation 3, that DG NEAR, DG DEVCO, DG ECHO, DG CLIMA and FPI strengthen checks by identifying and preventing recurrent errors, to have been implemented. These directorates-general strengthened their checks and took action to prevent recurrent errors. This included issuing new guidance to staff, increasing training and awareness-raising activities for both their own staff and beneficiaries, and strengthening financial monitoring and controls.

9.31. We also reviewed recommendations from the 2020 and 2021 annual reports that required immediate action or were targeted for implementation during 2022. The Commission had implemented two recommendations in full, one in most respects and one in some respects (***Annex 9.2***).

9.32. We consider recommendation 2 from our 2020 annual report, that DG ECHO establish a procedure to ensure that partner organisations base their allocation of shared costs on expenditure actually incurred, to have been implemented[6].

9.33. We consider recommendation 3 from our 2020 annual report, that DG NEAR establish obligations for the RER study contractor to report to the Commission any suspected fraud against the EU budget detected during its work on the RER study, to have been implemented. DG NEAR's RER methodology includes a new procedure for the contractor to report suspicions of fraud and of sexual exploitation, abuse and harassment.

9.34. Based on this review and our findings and conclusions for 2022, we recommend that the Commission:

Recommendation 9.1 – Prevent irregular alteration of proposals at the contracting stage

Strengthen controls to prevent irregular alteration of proposals at the contracting stage when awarding grants on the basis of a call for proposals.

Target implementation date: June 2024

Recommendation 9.2 – Take steps so that staff complete a risk assessment before paying pre-financing without a bank guarantee

Carry out risk assessments, as required by the manual of procedures, to ensure that pre-financing payments of between €60 000 and €300 000 are only made without a bank guarantee if the risk is assessed as low.

Target implementation date: end of 2024

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[6] 2021 annual report, paragraph 8.32.

Recommendation 9.3 – Establish an appropriate timeframe when engaging contractors directly for expenditure verifications

Establish an appropriate timeframe so that expenditure verification reports issued by contractors for grant contracts are available before processing payments or clearing expenditure.

Target implementation date: end of 2025

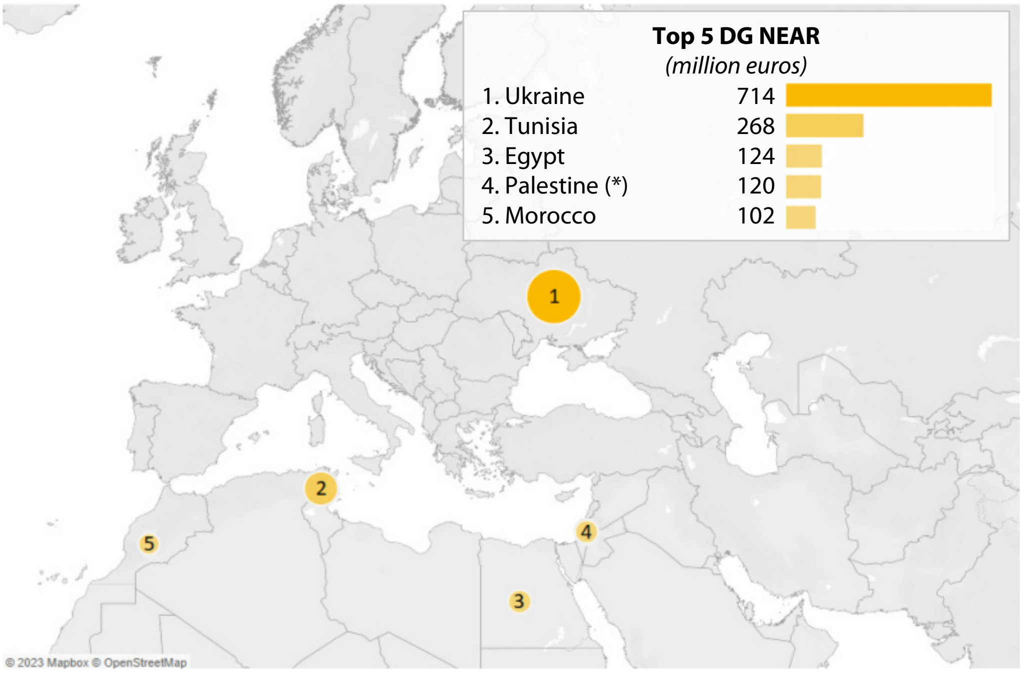
Recommendation 9.4 – Enhance controls to exclude recovery orders for unspent pre-financing from the corrective capacity calculation

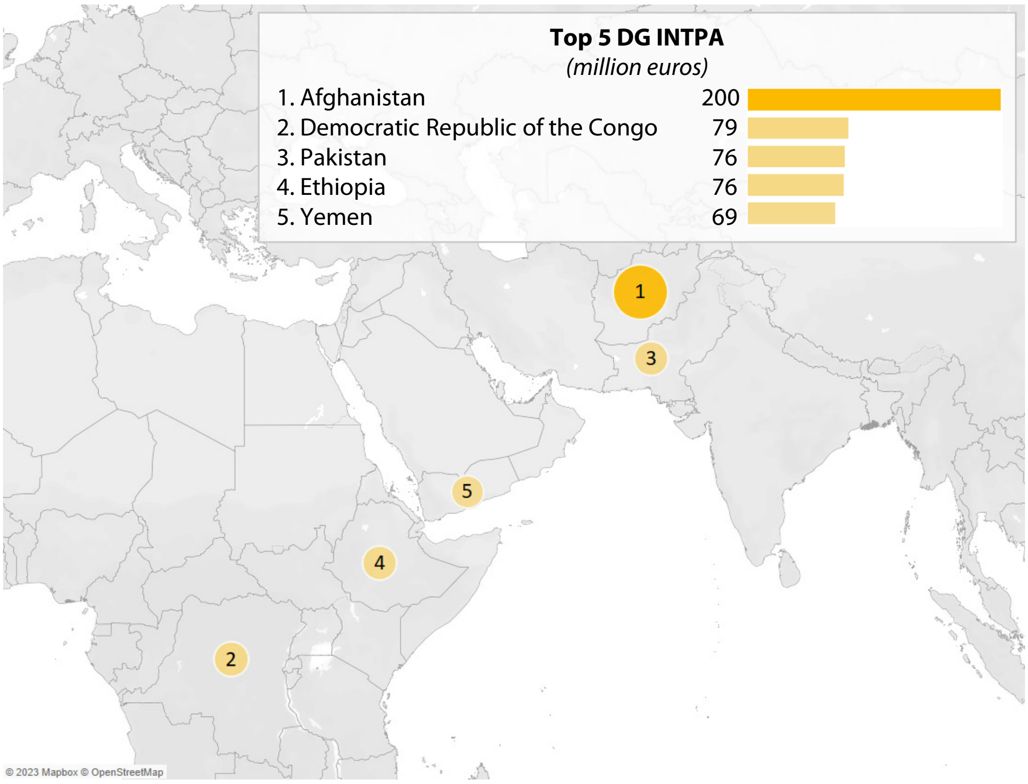
Enhance controls to exclude recovery orders for unspent pre-financing from the calculation of DG NEAR’s corrective capacity.

Target implementation date: from the 2023 annual activity report onwards

Annexes

Annex 9.1 – Payments per delegation for DG NEAR and DG INTPA





(*) This designation shall not be construed as recognition of a State of Palestine and is without prejudice to the individuals positions of the member states on this issue.

Source: Created with "Tableau" by ECA, map background ©Mapbox and ©OpenStreetMap licensed under the Creative Commons Attribution-ShareAlike 2.0 license (CC BY-SA).

Annex 9.2 – Follow-up of previous recommendations for 'Neighbourhood and the world'

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2019	We recommend that DG NEAR: **Recommendation 1:** Disclose the limitations of the RER study in DG NEAR's 2020 AAR and future AARs. Timeframe: by the time the next AAR is published in Q1 2021	Fully	
	We recommend that DG NEAR: **Recommendation 2:** Increase the confidence level DG NEAR uses in its methodology for calculating the grant rate to the same level applied to the rest of RER population, to reflect more accurately the higher risk in the area of direct management grants. Timeframe: by the end of 2021	Not implemented	DG NEAR did not accept this recommendation.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	We recommend that DG NEAR, DG DEVCO, DG ECHO, DG CLIMA and FPI: **Recommendation 3:** Strengthen checks by identifying and preventing recurrent errors (e.g. lack of time-recording systems and charging ineligible VAT to EU-funded projects). Timeframe: by the end of 2021		
2020	We recommend that the Commission: **Recommendation 1:** Take steps so that international organisations provide the ECA with complete, unlimited and timely access to documents necessary to carry out our task in accordance with the TFEU, and not just in read-only format. Timeframe: by the end of 2021		The Commission intensified communication with international organisations regarding our access to documents. Some United Nations (UN) organisations, such as the International Organisation for Migration (IOM), the United Nations Children's Fund (UNICEF), the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA) and the United Nations Development Programme (UNDP) continue to provide read-only access to supporting documentation, or do not provide access to all supporting documentation requested.
	We recommend that DG ECHO: **Recommendation 2:** Establish a procedure to ensure that partner organisations base their allocation of shared costs on expenditure actually incurred. Timeframe: by the end of 2021		

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	We recommend that DG NEAR: **Recommendation 3:** Establish obligations for the RER study contractor to report to the Commission any suspected fraud against the EU budget detected during its work on the RER study. Timeframe: by the end of 2022		
2021	We recommend that DG NEAR: **Recommendation 3:** Disclose the type and value of contracts excluded from the population of the RER study in the 2022 annual activity report and future annual activity reports. Target implementation date: in the 2022 annual activity report		In the 2022 annual activity report, DG NEAR included information on the type of contracts excluded from the RER population. However, it did not mention their value.

Source: ECA.

Chapter 10

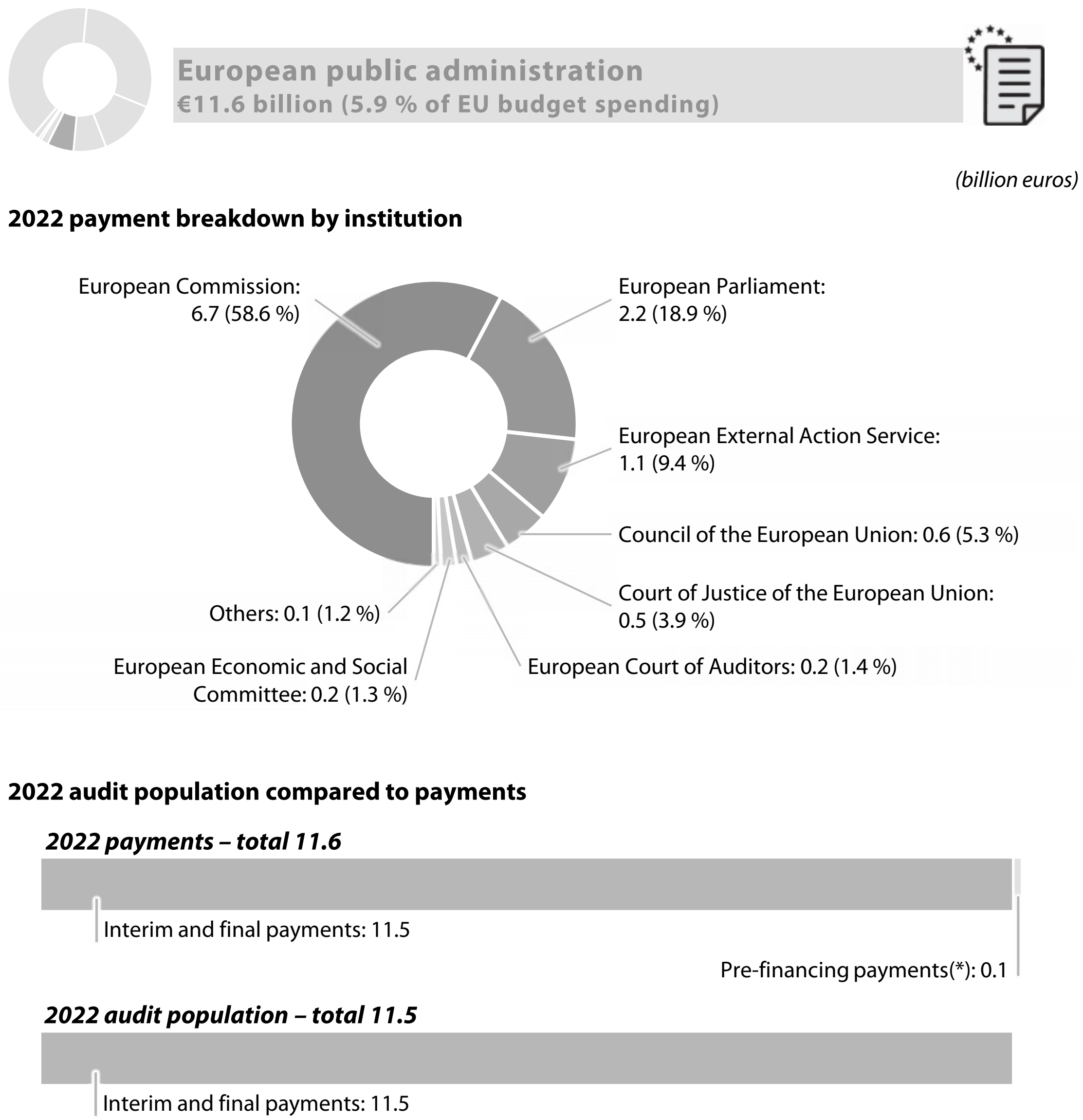
European public administration

Contents

Introduction

10.1. This chapter presents our findings for *MFF* heading 7, 'European public administration'. ***Figure 10.1*** gives an overview of the spending of the EU institutions and bodies under this heading in 2022.

Figure 10.1 – Payments and audit population



(*) In line with the harmonised definition of underlying transactions (see ***Annex 1.1***, paragraph ***18***).

Source: ECA, based on data from the 2022 *consolidated accounts* of the European Union.

10.2. We report separately on the EU agencies, other EU entities and the European Schools. Our specific annual reports on these bodies are published on our website. Our mandate does not cover the financial audit of the European Central Bank.

Brief description

10.3. Administrative expenditure comprises expenditure on human resources including pensions, which in 2022 accounted for about 70 % of the total, and on buildings, equipment, energy, communications and information technology. Our work over many years indicates that, overall, this spending is low risk.

Audit scope and approach

10.4. Applying the audit approach and methods set out in ***Annex 1.1***, we examined the following for this MFF heading in 2022:

(a) a statistically representative sample of 60 *transactions* covering the full range of spending under this MFF heading. We took transactions from each EU institution and body. Our objective was to estimate the level of *error* for this MFF heading and to contribute to the *statement of assurance*.

(b) the supervisory and control systems of the Court of Justice, in particular the implementation of internal control standards, risk management, and the functioning of key controls defined in the *Financial Regulation*, including *ex ante* and *ex post* controls on payments.

(c) the *regularity* information given in the *annual activity reports* of all the institutions and bodies, including those of the European Commission's directorates-general and offices primarily responsible for administrative expenditure[1], and then included in the Commission's *Annual Management and Performance Report* (AMPR).

10.5. Our own expenditure is audited by an external firm[2]. The results of its audit of our financial statements for the year ending 31 December 2022 are covered by paragraph ***10.7***.

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[1] DG Human Resources and Security, Office for the Administration and Payment of Individual Entitlements, Offices for Infrastructure and Logistics in Brussels and Luxembourg, and DG Informatics.

[2] ACG Auditing & Consulting Group S.r.l.

Regularity of transactions

10.6. Of the 60 transactions examined, 14 (23 %) contained errors. Based on the five errors we have quantified, we estimate the level of error to be below the *materiality threshold*.

Observations on the transactions examined

10.7. Our observations, which we describe in the following paragraphs, concern the European Parliament, the European Commission and the European External Action Service. We did not identify any specific issues concerning the Council of the European Union, the Court of Justice of the European Union, the European Economic and Social Committee, the European Committee of the Regions, the European Ombudsman or the European Data Protection Supervisor. Our external auditor did not report any specific issues based on its work.

European Parliament

10.8. From our sample of 13 transactions for the European Parliament, three related to payments to European Parliament's political groups, and one to a payment to a European political foundation. We examined samples of the expenses declared by each selected political group and foundation relating to these payments. For three of these four transactions, we found *quantifiable errors* in more than one third of the expenses sampled (see paragraphs ***10.9***, ***10.10*** and ***10.12***).

10.9. We found that the provisions relating to *public procurement* in the European Parliament's internal rules[3] for the management of *appropriations* of the Parliament's political groups were still not in line with the Financial Regulation. The Financial Regulation stipulates the use of *open* or *restricted procurement procedures* for high-value contracts (i.e. contracts with a value above €139 000). However, the internal rules adopted by the Bureau of the European Parliament, which these groups must follow, require the use of *negotiated procurement procedures*. These internal rules limit competition, as they allow for the pre-selection of possible tenderers for high-value contracts and do not require the publication of a contract notice. In the 2021 annual report[4], we recommended that the European Parliament's administration

[3] Rules on the use of appropriations from Budget Item 400, as last amended on 4 July 2022.

[4] See the 2021 annual report, paragraph 9.8. and recommendation 9.1.

revise its guidelines on the application by political groups of the rules on public procurement. We also recommended that it propose a revision of these rules to the Parliament's Bureau in order to better align them with the Financial Regulation. The timeframe for these recommendations is the end of 2023.

10.10. In addition, we found that:

(a) two out of three political groups did not fully follow the provisions relating to public procurement in the European Parliament's internal rules on the management of appropriations[5], as they did not seek enough tenders. We drew attention to the same issue in our 2021 report.

(b) for two sampled expenses, one of the political groups did not have valid contracts with the service provider, so we could not check whether the contractual conditions were met or whether the amounts paid were justified.

(c) one of the political groups declared *recoverable VAT* for some of its eligible purchases, but *VAT* was not subsequently reclaimed, resulting in a loss for the EU budget. The same group used a flat rate for reimbursing staff travel expenses that overestimated the actual costs. In addition, we consider that the group paid for services and reimbursed expenses that were not explicitly referred to in the contract signed.

10.11. Moreover, we found cases of non-compliance with procurement procedures by political groups with no direct financial impact on the EU budget. These include cases where the political groups did not adequately document the criteria they used to award contracts; did not prepare evaluation reports to justify the award decision; or used discriminatory selection criteria that might have restricted competition. Overall, our audit work identified significant weaknesses in procurement procedures for the transactions we examined concerning political groups.

10.12. We reported a quantifiable error for the payment to a European political foundation. One invoice was claimed and reimbursed twice by the foundation, which indicates a weakness in the internal control system, and some of the services acquired were not covered by a valid contract with a service provider.

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[5] Rules on the use of appropriations from Budget Item 400, as last amended on 4 July 2022.

European Commission

10.13. We did not identify any quantifiable errors in the Commission's payments, but the pension files for two of the eight pension payments we audited did not contain a recent life certificate. Life certificates are needed to demonstrate ongoing entitlement to the pension and other allowances. The Commission obtained these life certificates after our audit.

European External Action Service

10.14. We found two quantifiable errors in payments made by the European External Action Service. One concerned the absence of a valid underlying contract for security services acquired by an EU Delegation. The other related to child allowances received by a staff member from other sources but not deducted from their pay. Last year[6], we found similar errors in respect of family allowances paid by the Commission and also in respect of the absence of a valid contract for services acquired by another EU Delegation.

Observations on supervisory and control systems

10.15. We found no significant issues with the supervisory and control systems we examined at the Court of Justice (see paragraph ***10.7***).

[6] See paragraph 9.11 of the 2021 annual report.

Annual activity reports and other governance arrangements

10.16. The annual activity reports we reviewed did not identify material levels of error, which is consistent with our audit findings (see paragraph ***10.6***).

Conclusion and recommendations

Conclusion

10.17. The overall audit evidence we obtained and have presented in this chapter indicates that the level of error in spending on 'European public administration' was not material.

Recommendations

10.18. ***Annex 10.1*** shows the findings of our follow-up review of the recommendation we made to the European Economic and Social Committee in our 2019 annual report. We consider this recommendation to have been implemented in some respects.

10.19. Based on our audit work, we recommend the following:

Recommendation 10.1 – European Parliament

The European Parliament's administration should strengthen its guidance of the implementation of budget appropriations by the European political groups, and propose to the Parliament's Bureau actions to require the political groups to effectively apply the internal rules and to ensure compliance with procurement procedures (see paragraphs ***10.10***-***10.11***).

Target implementation date: by the end of 2024

Annexes

Annex 10.1 – Follow-up of previous recommendations for 'European public administration'

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2019	We recommend that: **Recommendation 1:** the European Economic and Social Committee implement a policy for dealing with sensitive functions, drawing on a comprehensive risk assessment leading to the identification of mitigating controls which take into account the Committee's size and the nature of its work.	in some respects	The Committee has since taken action, and plans to update its policy on staff mobility.

Source: 2019 annual report.

Chapter 11

Recovery and Resilience Facility

Contents

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Annex 11.1 – Audit approach and methodology

Annex 11.2 – Results of the audit of the regularity of transactions

Annex 11.3 – Follow-up to previous recommendations

Introduction

11.1. The RRF was established by Regulation (EU) 2021/241 ('Regulation') that entered into force on 19 February 2021. It supports reforms and investment projects in member states since the start of the pandemic in February 2020, and will continue to do so until 31 December 2026. The RRF was funded with €723.8 billion (at current prices) in loans (€385.8 billion) and non-repayable financial contributions ('*grants*') (€338 billion).

Brief description

Policy objectives

11.2. The main objective of the RRF is to mitigate the economic and social consequences of the COVID-19 pandemic, while building member states' economies to be more resilient and better prepared for future challenges, including accelerating their way towards green and digital transition. Member states can use the RRF in six policy areas (see ***Figure 11.1***).

Figure 11.1 – Policy areas addressed by the RRF (six pillars)

Source: ECA.

11.3. The *REPowerEU* plan, the EU's response to global energy-market disruption caused by Russia's war of aggression against Ukraine, was presented by the Commission in May 2022. Its main objective is to end the EU's dependence on Russian fossil fuels by transforming the EU's energy system. In February 2023, the European Parliament and Council adopted amendments to the RRF Regulation allowing member states to include a dedicated 'REPowerEU chapter' in their recovery and resilience plans. These comprise new reforms and investments, starting from 1 February 2022, that contribute to the REPowerEU objectives[1].

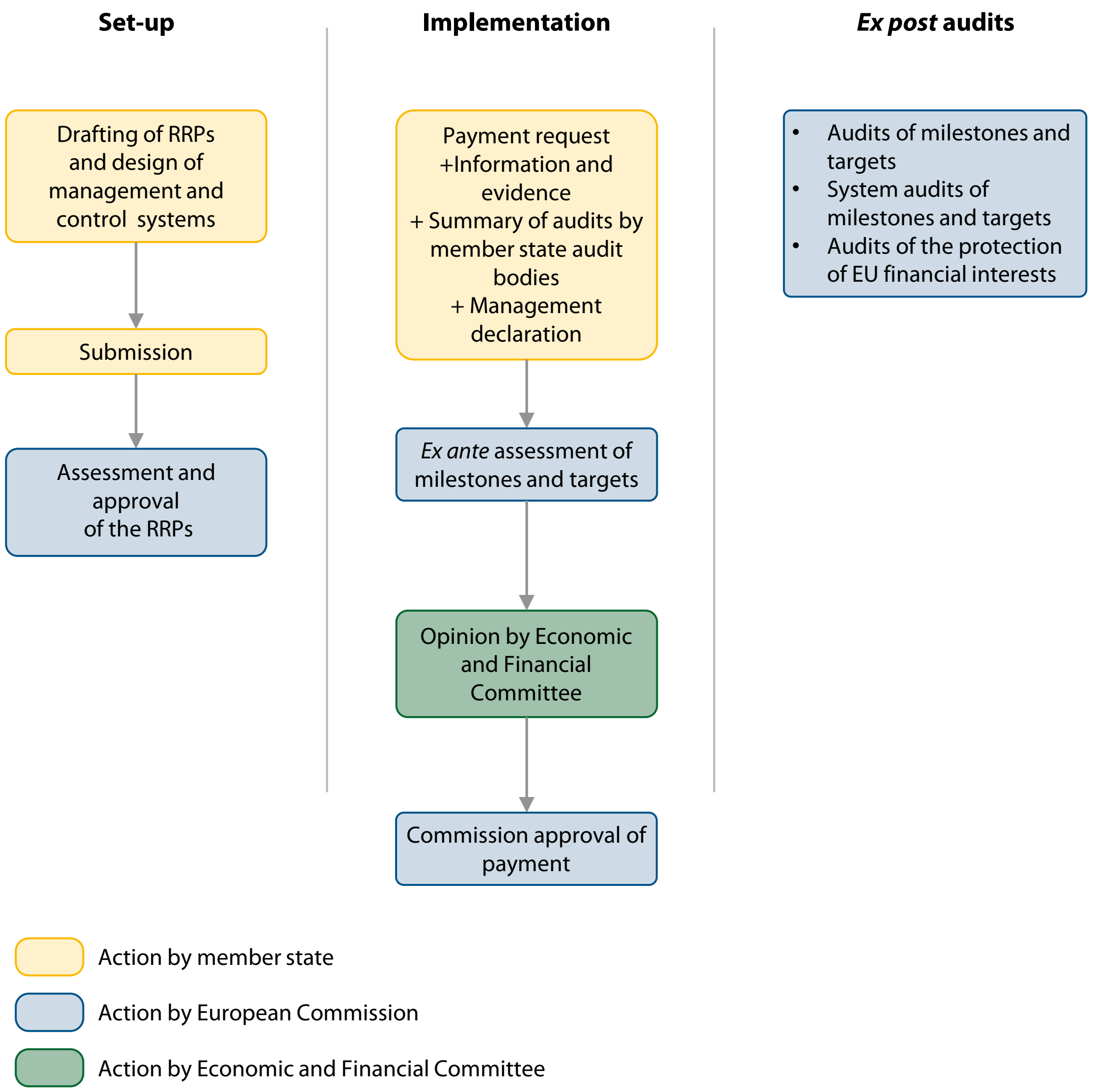
Management and control framework for the RRF

11.4. The RRF is implemented through *direct management* by the Commission. This type of management means that the Commission is directly responsible for a *programme*'s implementation.

11.5. The Regulation sets out the Commission's and member states' roles and responsibilities in the management and control of the RRF when assessing Recovery and Resilience Plans (RRPs) ('set-up'), approving payment requests ('implementation') and carrying out checks after payments have been made ('*ex post* audits') (see ***Figure 11.2***).

[1] Regulation (EU) 2023/435.

Figure 11.2 – Management and control framework for the RRF



Source: ECA.

Set-up

11.6. The member states were required to draw up their RRPs and design appropriate management and control systems. RRPs should comprise a coherent package of public investments and reforms ("measures"), grouped into components. Member states must set milestones and/or targets for each measure and – for targets – provide details of the associated baseline.

11.7. They must also set up systems to collect data on the *final recipients* of funds and to ensure access to these data[2]. They can use existing national management and control systems, or other systems used for related purposes, such as systems used for managing other EU funds. Member states may also use the Commission's data mining and risk-scoring tool. Member states' RRPs must describe in detail the various national bodies involved.

11.8. The Commission assesses the RRPs submitted by member states for relevance, *effectiveness*, *efficiency* and coherence before any payment is made. This assessment also checks the appropriateness of the member states' control systems as outlined in their RRPs. The Council adopts the positive assessment of the plans based on a Commission proposal.

Implementation

11.9. After the Council's approval of the RRP, member states may request pre-financing of up to 13 % of the financial contribution. The pre-financing is then cleared proportionally through the subsequent payments. By the end of 2022, all 27 member state RRPs had been approved by the Council and 21 member states had received pre-financing. Member states had submitted 27 payment requests to the Commission and the Commission had made 14 payments (one in 2021 and 13 in 2022) (see ***Table 11.1***).

[2] Regulation (EU) 2021/241, Article 22(2)(d).

Table 11.1 – RRF grant payments by member states as of 31 December 2022

(million euros)

Member state	2021			2022		
	Pre-financing	Payment	Clearing	Pre-financing	Payment	Clearing
Belgium	770					
Bulgaria					1 369	
Czechia	915					
Denmark	202					
Germany	2 250					
Estonia	126					
Ireland						
Greece	3 965				1 718	257
Spain	9 037	10 000	1 494		12 000	1 793
France	5 118				7 400	1 106
Croatia	818				1 400	209
Italy	24 893				20 000	2 989
Cyprus	157				85	13
Latvia	237				201	30
Lithuania	289					
Luxembourg	12					
Hungary						
Malta	41					
Netherlands						
Austria	450					
Poland						
Portugal	2 159				553	83
Romania	3 794				1 772	265
Slovenia	231					
Slovakia	823				399	60
Finland				271		
Sweden						
Total	**56 286**	**10 000**	**1 494**	**271**	**46 897**	**6 803**

Source: ECA.

11.10. Member states must submit the following with each payment request:

(a) information and evidence confirming the satisfactory fulfilment of the milestones and targets set out in the annexes to the Council Implementing Decision (CID);

(b) a summary of the audits carried out by the member state authorities, including details of any weaknesses identified and any corrective action taken[3];

(c) a management declaration[4] to the effect that:

(i) the funds were used for their intended purpose;

(ii) the information submitted with the payment request is complete, accurate and reliable; and

(iii) the control systems put in place provide the necessary assurance that the funds were managed in accordance with all applicable rules, in particular the rules aimed at preventing conflicts of interest, *fraud*, corruption and double funding.

11.11. Disbursements under the RRF are conditional upon member states satisfactorily fulfilling the milestones and targets set out in the CIDs approving their RRPs. Further requirements to be respected are that targets or milestones that have previously been satisfactorily fulfilled by a member state should not have been reversed and that there is no breach of the double funding principle. The eligibility conditions laid down in the Regulation include compliance with the eligibility period, the 'Do No Significant Harm' (DNSH) principle, and non substitution of recurring national budgetary expenditure.

11.12. Through its preliminary assessments, the Commission assesses whether milestones and targets underlying the payment request have been satisfactorily fulfilled. Based on this work, the Commission submits its preliminary assessment to the Economic and Financial Committee (EFC) for an opinion and takes the final decision on whether to authorise the disbursement of funds, subject to scrutiny by a committee of member state experts.

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[3] *Ibid.*, Article 22(2)(c).

[4] *Ibid.*

11.13. If the Commission concludes during its preliminary assessments that a milestone or target has not been satisfactorily fulfilled, payment of all or part of the financial contribution should be suspended for a maximum of 6 months. Suspensions can be lifted only if member states provide the Commission with evidence of satisfactory fulfilment of the milestones or targets. If this does not happen within 6 months, the Commission must reduce the amount of the financial contribution proportionately[5].

***Ex post* audits**

11.14. After payment has been made, the Commission carries out complementary *ex post* audits of milestones and targets. It also carries out related systems' audits and audits that focus on the protection of the EU's financial interests.

11.15. The Commission can recover amounts paid (a reduction in the level of support provided, or recovery of funds already disbursed) if during its *ex post* audits it finds:

(a) serious irregularities affecting the EU's financial interests that have not been corrected by the member state; or

(b) serious breaches of the conditions laid down in financing or loan agreements[6].

Audit scope and approach

11.16. The objective of our audit was to contribute to the statement of assurance and provide the basis for our opinion on the regularity of 2022 RRF expenditure.

11.17. Our 2022 audit population totalled €53.7 billion and comprised all 13 grant payments amounting to €46.9 billion and the *clearing* of the related pre-financing amounting to €6.8 billion (see ***Table 11.1***). These 13 grant payments and clearings of pre-financing ('RRF expenditure') were made to 11 member states and concerned the fulfilment of 274 milestones and 37 targets (see ***Figure 11.3***). Our audit does not cover the loans part of the RRF.

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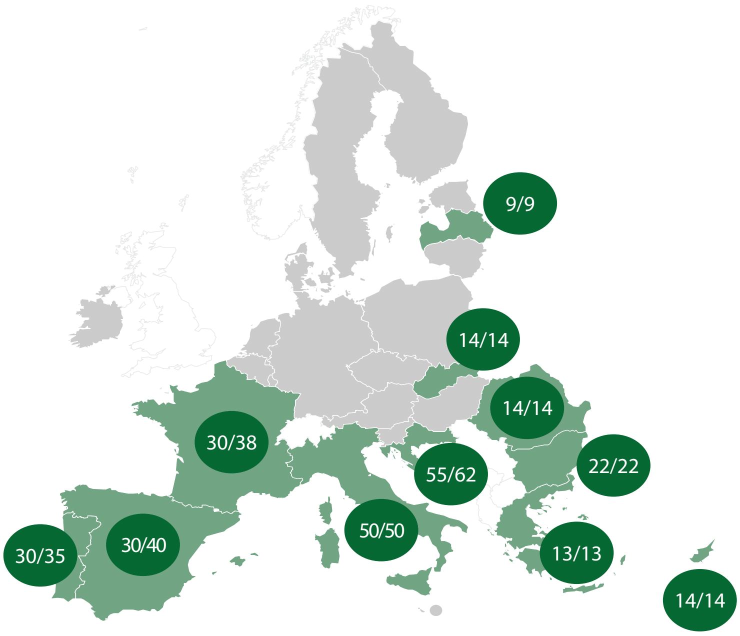
[5] *Ibid.*, Article 24(6-8).

[6] *Ibid.*, Article 22(5).

Figure 11.3 – Audited and total milestones and targets underpinning the 2022 RRF grant payments



Member state	Number of milestones audited	Number of targets audited	Total number of milestones	Total number of targets
Spain	21	9	31	9
Italy (*)	48	2	48	2
France	16	14	24	14
Romania	12	2	12	2
Greece	13	0	13	0
Bulgaria	21	1	21	1
Croatia (*)	50	5	57	5
Portugal	26	4	31	4
Slovakia	14	0	14	0
Latvia	9	0	9	0
Cyprus	14	0	14	0
Total	**244**	**37**	**274**	**37**

(*) Italy and Croatia each received two payments in 2022

Source: ECA.

11.18. Applying the audit approach and methods set out in ***Annex 11.1***, for our opinion on the regularity of 2022 RRF expenditure, we examined:

(a) the satisfactory fulfilment of 244 of the 274 milestones and all 37 targets included in the 13 grant payments made in 2022;

(b) 20 targets on the spot in five member states (Spain, France, Croatia, Italy and Romania);

(c) the fulfilment of milestones and targets linked to the member states' audit and control systems, including systems for collecting data on final recipients;

(d) the Commission's preliminary assessment of the 281 milestones and targets in order to establish whether the assessment has been properly documented, covers all necessary elements of the milestone or target, is based on sufficient and appropriate audit evidence, and reaches a conclusion about satisfactory fulfilment that is consistent with such evidence;

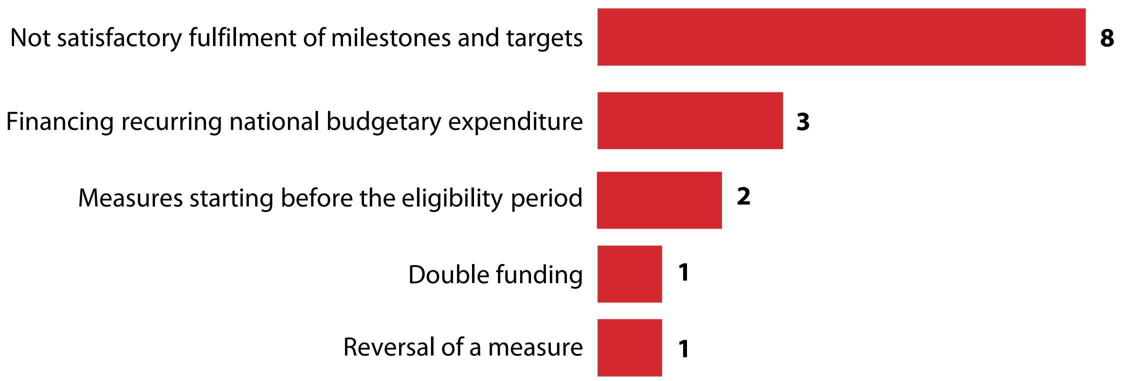
(e) five Commission *ex post audit*s (Spain, France, Croatia, Italy and Portugal), in order to assess whether they were carried out effectively to provide a level of assurance in addition to the preliminary assessments; and

(f) DG ECFIN's reporting on the regularity of 2022 RRF expenditure in its *Annual Activity Report (AAR)* and the way this information is presented in the *Annual Management and Performance Report (AMPR)*.

Regularity of transactions

11.19. We found that 15 of the 281 milestones and targets were affected by regularity issues (see ***Annex 11.2***). These concerned 11 out of the 13 RRF payments (and related clearings of pre-financing). The milestones and targets affected by such issues were either not satisfactorily fulfilled or did not comply with eligibility conditions. Given the nature of the RRF spending model, and considering that the Commission's payment suspension methodology[7] relies on many judgements to be made, possibly leading to different interpretations, we do not provide an *error* rate comparable to other EU spending areas (see ***Annex 11.1***). Taking into account these limitations, we estimate the minimum financial impact of these findings to be close to our *materiality threshold*. ***Figure 11.4*** presents the breakdown of our findings.

Figure 11.4 – Breakdown of findings



Source: ECA.

The RRF spending model requires a different audit scope

11.20. The RRF spending model is based on 'financing not linked to costs' with member states as beneficiaries. Such funding is conditional upon the fulfilment of *results* measured through previously set milestones or through *performance* indicators or fulfilment of conditions as opposed to funding based on reimbursement of incurred costs and/or compliance with conditions[8]. Consequently, the main condition for payment under the RRF is the satisfactory fulfilment of predefined milestones or targets. Individual instalments to member states are based neither on the estimated

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[7] Annex 2 of COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL Recovery and Resilience Facility: Two years on. A unique instrument at the heart of the EU's green and digital transformation (COM(2023) 99).

[8] Financial Regulation, Article 125(1)(a)(ii).

cost of the relevant investments or reforms nor on the actual expenditure incurred by final recipients. Under the Regulation, member states are not obliged to provide information with their payment request on the amount of RRF funds received by final recipients or on expenditure incurred when the milestones or targets are implemented.

11.21. As the milestones and targets are defined at member state level, our audit of the regularity of RRF *transactions* underlying the EU's accounts, i.e. RRF grant payments to member states, focuses mainly on whether the relevant payment and eligibility conditions[9] were met. As compliance of expenditure incurred by final recipients with EU and national rules is not a condition for RRF payments, our regularity audit does not involve a systematic assessment of this aspect.

Not satisfactory fulfilment of milestones or targets

11.22. The Regulation does not stipulate further criteria on how to interpret the word 'satisfactorily', and therefore leaves the Commission with broad discretion. On 21 February 2023, the Commission, published a communication presenting the framework for assessing the satisfactory fulfilment of milestones and targets[10]. 'Satisfactory' fulfilment means that – except for minimum deviations – the requirements have been fulfilled. Non-satisfactory fulfilment of milestones and targets means that there is a risk that the objectives of the relevant reform or investment will not be fully fulfilled (see paragraph ***(10)*** of ***Annex 11.1***).

11.23. Our checks identified eight milestones and targets in eight payments where we concluded that the requirements had not been satisfactorily fulfilled. We found that not all elements required by the milestone or target had been fulfilled, and that these elements could not be considered as a minimal deviation (see example in ***Box 11.1***).

[9] Regulation (EU) 2021/241, Articles 5, 9, 17(2) and 24(3).

[10] COM(2023) 99, Annex 1.

Box 11.1

Examples of milestones that have not been satisfactorily fulfilled

Greek milestone 42 – 'Charging points for electric vehicles – Entry into force of legal framework'

Description of the milestone in Greece's CID:

'Entry into force of all Ministerial Decisions (MDs) provisioned in law 4710/ 2020 and signed by the Minister of Environment and Energy; Minister of Infrastructure and Transport, Minister of Interior and Minister of Finance, organizing the electric vehicles' market, with focus on charging services market and provides tax based incentives for the purchasing of electric vehicles and the installation of charging infrastructure for electric vehicles'.

The primary law provided for the entry into force of twelve ministerial decisions necessary for the organisation of the electric vehicles market. We found that the milestone was not satisfactorily fulfilled as three ministerial decisions (penalties for market players, requirements for charging points in traditional settlements and training of electric vehicle technicians) did not enter into force when the payment was made.

Romanian milestone 142 'Task-force to implement and monitor Digital Transformation reforms and investments established and operational'

Description of the milestone in Romania's CID:

'The operationalisation of a temporary Digital Transformation Task force that shall employ during the implementation period of the Recovery and Resilience Plan 17 highly specialised contractual posts in the field of digital technologies and project management specialists. The main tasks of this unit are…'.

We found that on the payment request date (31 May 2022), employment contracts had been signed for only four of the 17 members of the task force. At the time of the Commission's payment on 24 October 2022, only 11 members were employed as envisaged in the CID. In addition, in line with the objectives of the milestone and in order to be operational, the job descriptions should have required professional experience or an educational background in the field of digital technologies and project management. We found that this requirement was not fulfilled for four cases, meaning that the milestone had not been satisfactorily fulfilled when the payment was made.

Measures starting before the eligibility period or RRF financing recurring national budgetary expenditure

11.24. The Regulation stipulates for eligibility conditions defining the timing and nature of measures that are eligible under the RRF. In particular:

(a) only measures that started after 1 February 2020 are eligible for RRF funding[11]; and

(b) in addition, RRF funds should not replace recurring national budgetary expenditure, unless duly justified[12].

11.25. This means that the RRF should only finance actions that are non-recurring in nature and fall within the eligibility period. For example, staff and operating costs of government entities should not be funded by the RRF as these represent recurrent national budgetary expenditure. By contrast, the RRF may fund public government investment such as the construction of hospitals or the installation of solar panels as long as these investments started after 1 February 2020.

11.26. In one payment, we found that two investment targets were a continuation of a pre-existing project started before February 2020. In another payment, we identified three reform targets that were a substitution of recurring national budgetary expenditure (see example in ***Box 11.2***).

[11] Regulation (EU) 2021/241, Article 17(2).

[12] *Ibid.*, Article 5(1).

Box 11.2

Example of RRF financing a recurring national budgetary expenditure

Spanish 'Target 384 – Cooperative model – Transparency Reports'

Description of target in Spain's CID:

'The Tax Agency shall implement a project in 2021 which shall encourage multinational enterprises to disclose information about their operations. These disclosures may have consequences in taxation of those companies. The target shall be 20 Transparency Reports submitted in 2021.'

We found that the action had been a recurring activity funded from national budgetary expenditure since 2017 when the first transparency reports for the fiscal year 2016 had been submitted. Since 2017, the number of transparency reports submitted had always been above 20, reaching a figure of 38 in 2020. As the member state received RRF funding for the fulfilment of this target, we consider that it represents a substitution of recurring national budgetary expenditure.

Double funding

11.27. Avoiding double funding is an eligibility principle for EU expenditure[13]. According to this principle, combining funding from different EU instruments in a single project is possible, as long as the same cost is not financed twice from different EU funding streams.

11.28. The RRF Regulation explicitly prohibits double funding of the same costs between the RRF and other EU funds[14]. Moreover, the Regulation stipulates that member states must provide cost estimates for the reforms and investments included in the plans[15].

11.29. Although RRF payments are made upon the satisfactory fulfilment of milestones and targets, meaning that the RRF is not a cost-based financing instrument, the member states provided cost estimates for measures in the RRP. Based on these cost estimates, the Commission assessed the plausibility of the overall amount of RRF

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[13] Financial Regulation, Article 191(3).

[14] Regulation (EU) 2021/241, Article 9.

[15] *Ibid.*, Article 18.4(k).

funding per member state. Some measures were considered by member states as ‘zero-cost’. This however, does not mean that double funding between such measures and other EU funds can be excluded as the RFF payments are made once milestones and targets were satisfactorily fulfilled. In substance, the same deliverable cannot be financed twice from the EU budget, whether through a cost-based or a non-cost based financing instrument.

11.30. We found one case of double funding in Slovakia. The milestone consisted of establishing an investment plan for railway infrastructure projects. We found that the investment plan of this milestone was funded by the European Social Fund. Although the milestone was part of a measure with zero estimated costs, we consider this to be double funding as the milestone was fulfilled with support from the European Social Fund while the member state also received RRF funds after the fulfilment of the milestone.

Reversal of a measure

11.31. According to the Regulation, measures and actions relating to previously fulfilled milestones and targets must not have been reversed[16]. Member states are required to confirm that this is indeed the case in the management declaration accompanying the payment request.

11.32. In our special report on the Commission’s control system for the RRF[17], we highlighted the lack of Commission guidance on how to identify reversals of previously fulfilled milestones and targets, and how to assess the financial impact of a reversal on past or current payment requests. Although we recommended that the Commission should provide guidance[18] in this area, it has still not done so.

11.33. We found one case of reversal of a target concerning the first payment to Italy (see example in ***Box 11.3***).

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[16] *Ibid.*, Article 24(3).

[17] Special report 07/2023: “Design of the Commission’s control system for the RRF – Assurance and accountability gap remains at EU level in the new delivery model, despite extensive work being planned”.

[18] *Ibid.*, paragraphs 66-70 and recommendation 2.

Box 11.3

Reversal of a target

Italian target M1C1-54 ‘Completed recruitment of experts for the implementation of the Italian recovery and resilience plan’

Description of the target in Italy’s CID:

‘Complete the recruitment procedures of the pool of 1 000 experts to be deployed for three years to support administrations in the management of the new procedures providing technical assistance’.

In December 2021, with the first payment request, the Italian authorities reported that 1 000 experts had been recruited as of 30 December 2021. The Commission assessed the target as satisfactorily fulfilled and made the payment on 13 April 2022. Our audit of this payment confirmed the Commission’s assessment.

The Commission carried out an *ex post* audit in May-June 2022 and found that the pool of experts had decreased to 935 as of June 2022. However, it did not report the issue as a reversal of the target that had previously been fulfilled.

The Commission finished its assessment of the second payment request on 27 September 2022 and made the second payment on 8 November 2022. On this date, there were only 924 experts in the pool. Thus, at the time of the second payment to Italy, the Commission did not suspend the payment for the reversal of the previously fulfilled target.

During our on-the-spot mission in February 2023, we found that the pool of experts had decreased further to 920. While we acknowledge that staff numbers can fluctuate within a reasonable range and that the member state launched procedures to fill the vacant posts, in this case we noted a persistent downward trend that was not corrected for nearly a year.

Other issues arising from our examination of the regularity of transactions

11.34. We identified 11 cases of problems with the reliability of the information that the member state authorities include in their management declarations for five payments. The aim of these declarations is to provide assurance that the information submitted with the payment requests is complete, accurate and reliable[19] (see ***Annex 11.2***).

11.35. Member states should only submit payment requests to the Commission when the relevant milestones and targets have been fulfilled[20]. In the 11 cases identified, member state authorities nonetheless submitted the payment requests without all milestones and targets having been fulfilled. In their management declarations member states can include *reservations* and highlight missing evidence to the Commission. However, none of the member states included such a reservation. Although the Commission assessed the relevant milestones and targets having been fulfilled before it made payment, these weaknesses cast doubt on the reliability of the information contained in the management declarations.

11.36. Through our assessment of 281 milestones and targets, we also identified six cases of weak design in the measures and underlying milestones or targets. Design weaknesses might lead to a situation where, even after satisfactory fulfilment, not all elements of the measure will be implemented, or the expected *output* or outcome will not have been fulfilled.

11.37. Except for quantitative elements, assessing satisfactory fulfilment requires several judgments to be made, thus leading to different possible interpretations. This is a particular risk when the milestone or target is vaguely defined. In our special report on the Commission's assessment of national recovery and resilience plans[21] and in our 2021 annual report[22], we highlighted the risk that unless milestones and targets were clear, fulfilment would be difficult to assess or the initial objective might not be fulfilled. For future assessments we recommended that the Commission should ensure that milestones and targets are properly defined and sufficiently clear.

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[19] Regulation (EU) 2021/241, Article 22(2)(c).

[20] *Ibid.*, Article 24(2).

[21] Special report 21/2022: "The Commission's assessment of national recovery and resilience plans – Overall appropriate but implementation risks remain", paragraph 82.

[22] 2021 annual report, paragraph 10.29.

Our assessment of selected monitoring and control systems

11.38. This part of the chapter contains the results of our assessment of selected RRF monitoring and control systems at the Commission and in the member states.

The Commission's *ex ante* assessments do not systematically cover compliance with all eligibility conditions

11.39. In our special report on the Commission's control system for the RRF[23], we assessed the design of preliminary assessments and concluded that, overall, the Commission had designed an extensive preliminary assessment process for verifying the fulfilment of milestones and targets. However, some issues remained mainly regarding documentation and specifying the various parties' contributions to the different stages of the assessment process. Furthermore, we noted that the scope of the preliminary assessment was limited to the satisfactory fulfilment of milestones and targets and did not cover horizontal eligibility conditions, such as not replacing recurring national expenditure[24].

11.40. Our review of the Commission's preliminary assessments for 281 milestones and targets confirms these limitations. In seven cases, the Commission's preliminary assessment did not detect that the measures corresponding to milestones or targets were ineligible due to a breach of the eligibility period or non-substitution of recurring national budgetary expenditure, breach of the double funding principle or reversal of a measure.

11.41. We also identified various minor weaknesses where the Commission relied on member state self-declarations or checks without performing further checks itself or when the Commission used incomplete and/or incorrect data when carrying out its assessment.

[23] Special report 07/2023, paragraphs 40-53.

[24] Regulation (EU) 2021/241, Article 5.

The Commission's *ex post* audits on milestones and targets are not used to their full potential

11.42. In line with the *Financial Regulation*[25], and the financing agreements signed with member states, *ex post* audits aim to detect and correct errors relating to operations after they have been authorised. The Commission carries out two types of *ex post* audit of milestones and targets:

(a) audits of milestones and targets which aim to check that milestones and targets have been satisfactorily fulfilled;

(b) audits that focus on the quality and reliability of established systems. These aim not only to assess data management and systems to collect, store, aggregate and report on milestones and targets, but also to verify the reliability of reported data.

11.43. In 2022, the Commission performed *ex post* audits on 23 milestones and targets in Spain, France, Croatia, Italy, Portugal and Romania.

11.44. As only the final audit reports for France and Spain were available at the time of our audit, we based our findings for other member states on the draft audit reports. Through our work, we assessed the *ex post* audit work related to 15 targets (five for Spain; five for France; three for Portugal, one for Croatia and one for Italy).

11.45. The Commission concluded that all 23 milestones and targets had been satisfactorily fulfilled. However, the Commission issued numerous findings that mainly concern:

(a) ineligible target items (quantitative indicators) that had no impact on satisfactory fulfilment of the target as they were within the maximum accepted deviation of 5 %;

(b) discrepancies between reported and actual data on milestones and targets; and

(c) weaknesses in the member states' control and reporting systems resulting in insufficient checks of eligibility conditions and inadequate quality of information provided to the Commission.

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[25] Financial Regulation, Article 74(6).

11.46. The Commission in general effectively implemented its *ex post* audit plan. However, we found that the *ex post* audit procedures do not provide for checks to verify whether the audited targets previously assessed as fulfilled were not reversed after the payment was assessed, and whether the measures are in compliance with the principle of non-substitution of recurring national budgetary expenditure. We also found that the Commission's *ex post* audits concluded that three targets had been satisfactorily fulfilled even though our own audit work led us to conclude otherwise (see ***Table 11.2***).

Table 11.2 – *Ex post* audit results and corresponding ECA results

Member state	Commission			ECA		
	Milestones covered by *ex post* audit	Targets covered by *ex post* audit	Milestones and targets assessed as not satisfactorily fulfilled	Targets covered by *ex post* audit and reviewed by ECA	Targets assessed as not satisfactorily fulfilled	Targets with eligibility issues
France	2	8	0	5	1	0
Italy	0	1	0	1	0	1
Spain	0	5	0	5	1	2
Portugal	0	3	0	3	1	0
Croatia	1	1	0	1	0	0
Romania	0	2	0	0	0	0
Total	3	20	0	15	3	3

Source: ECA.

Weaknesses remain in the set-up and functioning of member state systems

11.47. The adequacy of the member states' proposed monitoring and control systems was a condition for approval of the RRPs. In its assessment of these plans, the Commission identified deficiencies in some member states' systems. The Commission therefore required 16 member states (Belgium, Czechia, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Lithuania, Luxembourg, Romania, Slovenia, Slovakia and Finland) to include specific additional reforms and milestones ('control milestones') in order to address the remaining weaknesses. These control milestones had to be fulfilled before member states could request their first payment.

11.48. The 2022 RRF payments concerned 16 control milestones in eight member states (Bulgaria, Greece, France, Croatia, Italy, Cyprus, Romania and Slovakia). We reviewed the Commission's *ex ante* assessment for all 16 control milestones. In addition, for eight control milestones, we carried out on-the-spot visits in four member states (France, Croatia, Italy, Romania).

11.49. In general, we consider that the introduction of control milestones means that member state systems were not fully functional when the plans started to be implemented. This poses a risk to the regularity of RRF payments and the protection of the EU's financial interests. This risk is even greater for reforms and investments that started on 1 February 2020, i.e. even before the plans were approved[26].

11.50. We found that control milestones significantly vary in their requirements and granularity. For example, the control milestone for France merely requires a Circular signed by the Prime Minister, setting out the roles and responsibilities of the bodies involved, and a report on the control strategy, while for Greece it requires the establishment of the audit and control system. For some other member states (Bulgaria, Croatia, Italy, Romania, and Slovakia), the requirement is even stricter, requiring a repository system for monitoring the implementation of the RRF, to be in place and operational. There is no justification for requiring some member states merely to have designed the system, while requiring others to have a system that is operational.

11.51. For one member state (Croatia), a control milestone was included in the second payment request. The Commission identified this weakness in the CID design and carried out the assessment of the control milestone together with the first payment request.

11.52. During its *ex ante* work, the Commission considered all control milestones to be satisfactorily fulfilled. However, during its *ex post* systems audits, the Commission found weaknesses in the reporting and control system of six member states, such as:

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[26] Special report 21/2022, paragraphs 102 and 103.

- Lack of staff and adequate training of staff involved in RRF;
- Lack of collection of data listed in Article 22(2)(d) RRF Regulation and weaknesses on the reliability of the data for targets;
- Lack of plan and methodology for management verifications on the spot, weakness in the set-up of the risk assessment strategy and in the data verification process;
- Limited use of RRF IT system and weaknesses in the monitoring functionality;
- Limitations in checks for conflict of interest and risk of double funding.

11.53. We identified weaknesses in the control milestone for two member states (Italy and Croatia). These related to some functions that were not available in the IT system when the payment request was made. As the system could collect data by alternative means, we concluded that these weaknesses did not affect the satisfactory fulfilment of the control milestone (see example in ***Box 11.4***).

Box 11.4

Remaining weaknesses in the Italian repository system

The Italian control milestone required a repository system for monitoring implementation of the RRF to be in place and operational. The system must include the following minimum functions:

(a) collecting data and monitoring the fulfilment of milestones and targets; and

(b) collecting, storing and ensuring access to the data required by Article 22(2)(d)(i) to (iii) of the Regulation.

We found that at the time of the first Italian payment request (April 2022), the implementing bodies did not yet have direct access to the system, and so the coordinating body used the Excel files it had received from the implementing bodies to enter the data supporting the milestones and targets. This entailed a risk in terms of the accuracy and completeness of the data, as the system cannot carry out automated checks.

11.54. We also found that the data management system for the French RRP was not able to collect and store full data on final recipients. These weaknesses resulted in the French authorities not being able to provide full supporting documentation for three targets in our sample. The weaknesses were partly detected and reported by the audit authority in the summary of audits accompanying the first payment request. By means of its *ex post* audits, the Commission also identified problems in the collection and aggregation of data for one target. Although the weaknesses are not directly linked to the control milestone for France, they do represent a breach of the requirements of Article 22 of the Regulation and so undermine the effective functioning of the control system for protecting the EU's financial interests.

11.55. We noted a horizontal weakness affecting five member states (Italy, Greece, Croatia, Romania and Bulgaria) – but with potential implications for all member state systems – concerning the collection of data on beneficial owners of foreign companies. This information is collected on the basis of bilateral agreements, as there is no centralised EU database providing complete data on all beneficial owners of companies registered in the EU. A solution to this problem is the introduction of the Beneficial Ownership Registers Interconnection System, which would enable the registers of beneficial owners established by member states to be interconnected[27]. In its ruling of 22 November 2022, the European Court of Justice decided that open public access to the beneficial owner registers of EU companies would no longer be valid[28]. Consequently, there is no clear indication of when the issue of access to complete information on beneficial owners of foreign companies will be addressed.

[27] In accordance with Directive (EU) No 2015/849.

[28] Judgment of the Court in Joined Cases C-37/20, C-601/20.

AARs and the AMPR

11.56. AARs are the Commission DGs' main tool for reporting whether they have reasonable assurance that control procedures guarantee the regularity of expenditure.

11.57. Regarding the protection of the EU's financial interest, our special report on the design of the Commission's control system for the RRF[29] found that the assurance declaration for DG ECFIN's 2021 AAR was limited. It only covered the responsibility to recover any amount due to the EU budget in the event of fraud, corruption and conflicts of interest, where the member state has failed to do so, or in the event of an established serious breach of the financing or loan agreement. In its report on the *discharge* of the 2021 budget, the European Parliament called on the Commission to reconsider the wording of the *declaration of assurance* by the Director-General of DG ECFIN[30].

11.58. The Commission has revised its 2022 declaration of assurance for the RRF. The 2022 declaration of assurance by the Director-General of DG ECFIN has now been aligned with those of other Commission Directors-General. As a result, within its assurance declaration, DG ECFIN's Director-General provides assurance that "… the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions". In addition, in section 3 of the AAR dedicated to the RRF, DG ECFIN explains that the declaration of assurance covers:

(a) in the area of *state aid* and *public procurement*, member states regularly check that RRF financing has been used in compliance with all applicable rules, and measures for implementing reforms and investment projects have complied with all applicable rules, in particular regarding the prevention, detection and correction of fraud, corruption and conflicts of interests[31]. We note that such a statement is unclear about whether the regular checks carried out by member states provide reasonable assurance that their control systems ensure compliance with state aid and public procurement. We are currently carrying out an audit on the member states' control systems ensuring compliance of RRF funded

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[29] Special report 07/2023.

[30] European Parliament Report on discharge in respect of the implementation of the general budget of the European Union for the financial year 2021, Section III – Commission and executive agencies (2022/2081(DEC)).

[31] Regulation (EU) 2021/241, Article 22(2).

investments with procurement and state aid rules. This audit will assess the assurance that can be derived from the member states' checks; and

(b) implementing proportionate reductions in RRF support and recovery of any amount due to the EU budget or the request for early repayment of the loan, in cases of fraud, corruption, and conflicts of interests affecting the EU's financial interests that a member state has not corrected, or a serious breach of an obligation of the financing agreement[32].

11.59. As is the case of the 2021 AAR, the Commission does not estimate a payment-related risk for RRF expenditure on the grounds that a meaningful error rate cannot be determined due to the nature of this instrument. Instead, the Commission carries out a risk assessment (low, medium and high) for each RRF payment, based on the results of its *ex ante* and *ex post* checks.

11.60. As the Commission did not assess any of the milestones and targets underlying the 2022 RRF expenditure as not having been satisfactorily fulfilled, the overall conclusion is that 2022 RRF payments are low risk. Thus, the declaration of assurance does not include any reservation based on the Commission's materiality criteria and is not in line with our own findings.

11.61. Similarly to previous year, the 2022 RRF expenditure is not part of the overall risk at payment for expenditure related to the MFF disclosed in the Commission's 2022 AMPR. For the RRF, based on the control results and assurance provided in DG ECFIN's AAR, the Commission confirms that it has reasonable assurance on the three elements highlighted by DG ECFIN.

11.62. We note that the Commission's internal audit service issued an emphasis of matter in relation to the implementation of the RRF as part of its overall audit opinion in the AMPR[33]. The emphasis of matter refers to the need to further reinforce measures to protect the EU budget by:

— reviewing, and, if necessary, further enhancing, the design and implementation of the financial management systems and the audit and control strategies to ensure their adequacy;

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[32] *Ibid.*, footnote 2, Article 22(5).

[33] 2022 AMPR, Annex VI of Volume III.

— effectively applying the Commission’s framework for assessing milestones and targets and the Commission’s payment suspension methodology highlighting the potential need for their revision or amendment as the Commission gathers more experience with their application.

Conclusions and recommendations

Conclusions

11.63. The overall audit evidence from our work as presented in this chapter shows that:

(a) 15 milestones and targets were affected by regularity issues with financial impact (see paragraph ***11.19***);

(b) there were cases of weak design in the measures and underlying milestones or targets (see paragraphs ***11.36***-***11.37***);

(c) there were problems with the reliability of the information that member states included in their management declarations (see paragraphs ***11.34***-***11.35***);

(d) the scope of the Commission's preliminary assessments and *ex post* audits does not systematically cover key payment conditions such as compliance with the eligibility period and non substitution of recurring national budgetary expenditure. The *ex post* audit procedures do not provide for checks to verify whether the audited targets previously assessed as fulfilled were not reversed after the payment (see paragraphs ***11.40*** and ***11.46***);

(e) the introduction of control milestones means that the relevant member state systems were not fully functional when the plans started to be implemented, thus posing a risk to the regularity of RRF expenditure and the protection of the EU's financial interests. We also found that control milestones vary significantly in their granularity and requirements, although without any valid justification (see paragraphs ***11.49***-***11.50***); and

(f) weaknesses remain in the member states' reporting and control systems. In addition, we identified a horizontal issue linked to limitations in the availability of data on the beneficial owners of foreign companies. This is because there is no centralised EU database providing complete data on all beneficial owners of companies registered in the EU (see paragraphs ***11.53***-***11.55***).

11.64. Our findings and conclusions are not in line with the declaration provided by DG ECFIN's *Authorising Officer*.

Recommendations

11.65. ***Annex 11.3*** shows the findings of our follow-up review of the three recommendations we made in our 2021 annual report where the second recommendation was in full implemented, while for recommendations 1 and 3 it was too early to assess implementation as there was no preliminary assessment covered by the audit after the date of our recommendation. Based on our review of the recommendations we made in 2021 and on our findings and conclusions for 2022, we recommend that the Commission should:

Recommendation 11.1 – Improve preliminary assessments and *ex post* audits

(a) cover in its preliminary assessments and *ex post* audits compliance with the eligibility period and the principle of non-substitution of recurring national budgetary expenditure;

(b) revise its *ex post* audit procedures so that they provide for checks to verify whether the audited targets previously assessed as fulfilled were not reversed after the payment.

Target implementation date: immediately

Recommendation 11.2 – Verify that all milestones and targets are clearly defined when reviewing plans

Based on experience acquired during the RRF implementation, verify that the reviewed plans clearly define all milestones and targets and that all key elements of a measure are covered by milestones and targets.

Target implementation date: immediately

Annexes

Annex 11.1 – Audit approach and methodology

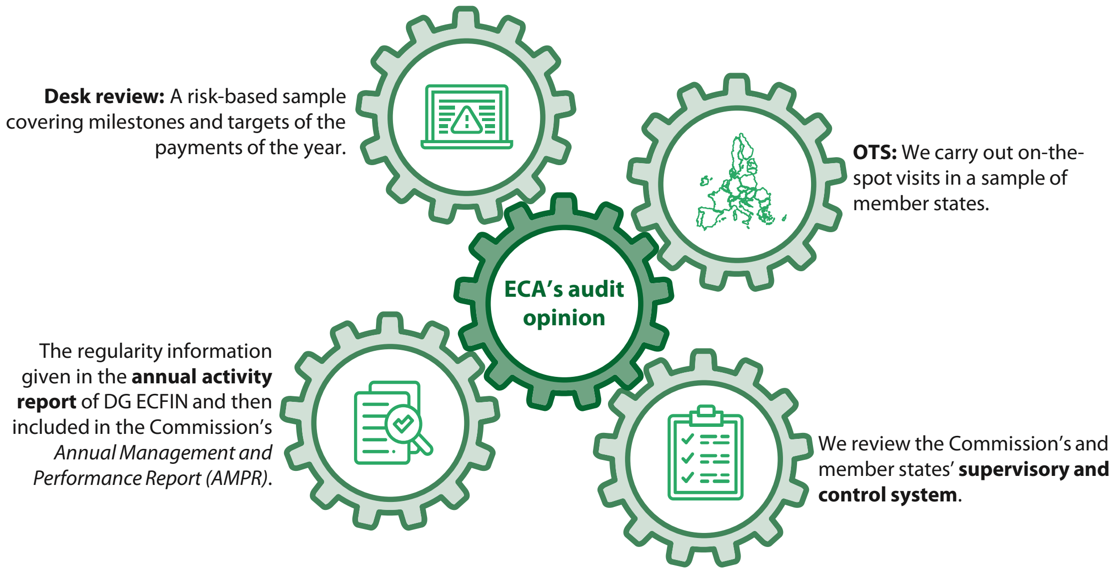
General

(1) This annex covers our audit approach and methodology for the statement of assurance on the regularity of RRF expenditure.

(2) We issue a separate opinion on the regularity of the RRF expenditure as part of our statement of assurance on the EU budget. This is because we consider the RRF delivery model to be different and a temporary instrument. With this opinion, we aim to provide reasonable assurance on the payments, and provide detailed information based on this opinion in the statement of assurance.

(3) We derive most of our assurance from substantive testing and the assessment of the supervisory and control systems. Our assurance is complemented by the AARs-AMPR and the reports of the Internal Audit Service. See ***Figure 11.5***.

Figure 11.5 – Audit opinion



Source: ECA.

(4) Our work conforms to international audit standards and ensures that our audit opinions are supported by sufficient and appropriate audit evidence.

(5) As regards our audit procedures in relation to fraud, we follow the approach detailed in part 3 of ***Annex 1.1***.

Regularity of transactions

How we define underlying transactions and how we test them

(6) The underlying transactions relevant for the statement of assurance work on the RRF are grant payments to member states and/or clearings of previous pre-financing. In contrast to most spending under the Multiannual Financial Framework, RRF payment requests are not supported by incurred costs, but by justification of satisfactory fulfilment of milestones and targets. As the RRF loans are not recognised as expenditure in the EU accounts, they are not part of our audit.

(7) Our substantive testing mainly consists of assessing whether RRF payments were made in compliance with the payment conditions laid down in the Regulation[34]. Where feasible, we cover the non-reversal of previously fulfilled measures and double funding. We also assess the fulfilment of other eligibility conditions, such as non-substitution of recurring national budgetary expenditure, compliance with the eligibility period and the 'Do No Significant Harm' principle[35].

(8) To reach our conclusion, we first used a risk-based sample to review whether the Commission had gathered sufficient and appropriate evidence during its preliminary assessments to support its assessment of satisfactory fulfilment. If we consider that the evidence available in the Commission's files is not sufficient for us to reach a conclusion, we ask the member state directly to provide further evidence. We also carry out on-the-spot visits in a sample of member states.

(9) We make a risk-based selection of individual milestones and targets to be tested. First, we select control milestones and milestones related to the *general regime of conditionality* for the protection of the Union budget[36]. We then apply a number of risk criteria to select the remaining sample.

(10) For our assessment of whether individual milestones and targets have been satisfactorily fulfilled, we use the Commission's framework[37]. In line with this framework, if the nature of the milestone (and, if applicable, the nature of the target) does not allow for an assessment based on quantitative elements, we will accept minimal deviations in substance, form and timing. For milestones or

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[34] Regulation (EU) 2021/241, Article 24(3).

[35] *Ibid.*, Articles 5, 9 and 17(2).

[36] Regulation (EU, Euratom) 2020/2092.

[37] COM(2023) 99.

targets for which an assessment based on quantitative elements is possible, we will accept deviations below 5 %.

(11) We may detect cases of fraud, corruption, conflicts of interest, double funding or breaches of the financing agreement (e.g. the unavailability of information on final recipients and of funding from other EU funds). In these cases, we assess (where feasible) how these ‘serious irregularities’ impact the legality and regularity of RRF expenditure.

How we evaluate the results of transaction testing

(12) We determine the type of each finding.

(13) Quantitative findings have a financial impact on the amount of the Commission payment, and are related to cases of non-compliance with the payment and eligibility conditions laid down in the Regulation, i.e. unsatisfactory fulfilment of milestones and targets; the reversal of previously fulfilled milestones and targets; non-compliance with the eligibility period, the DNSH principle and double funding.

In line with auditing standards, the auditor should use existing criteria[38]. Therefore, to quantify the financial impact of these findings, we use the Commission’s payment suspension methodology[39] as a basis. The methodology entails a three-step approach to arrive at the amount to be suspended:

(i) determining the unit value of a milestone or target included in a plan;

(ii) correcting unit values by applying a coefficient; and

(iii) adjusting the corrected unit values.

We do not estimate a financial impact when the milestone or target is satisfactorily fulfilled within 6 months[40] after the payment and within the audited year.

(14) Findings linked to suspicion of fraud, corruption and conflicts of interest will be quantified only if there is sufficient evidence to prove that they impact the fulfilment of a milestone or target (i.e. a fraudulent case that calls into question

[38] ISSAI 4000.

[39] COM(2023) 99, Annex 2.

[40] Regulation (EU) 2021/241, Article 24(8).

the existence of the items, or the complete absence of a procurement procedure).

(15) Findings without a financial impact are qualitative findings.

Assessment of supervisory and control systems

(16) Our assessment of the supervisory and control systems may identify:

(a) weaknesses in Commission and member state control and audit activity to ensure the regularity of RRF expenditure and the protection of the EU's financial interests;

(b) weaknesses in the availability of the list of final recipients, contractors, subcontractors and beneficial owners;

(c) weaknesses in the availability of information about the measure and the total public funding involved; and

(d) weaknesses in record-keeping.

(17) Such weaknesses might affect the regularity of RRF expenditure at member state level and results in a recovery (i.e. a reduction in the overall amount of the plan) after the Commission has made the payment to the member state. The financing agreements provide for flat-rate corrections for serious breaches, by taking account of the frequency and extent of such breaches. For our assessment, we will consider system weaknesses and breaches of the financing agreements as qualitative findings.

(18) We also assess the Commission's *ex post* audits. These audits may identify milestones and targets as not having been satisfactorily fulfilled. Where feasible, we use the findings that have not been corrected during the year of the payment to formulate our opinion.

Formulating our audit opinion

(19) Materiality is a fundamental concept, as it sets the level of deviation that we consider is likely to influence our stakeholders' decisions.

(20) We define materiality on both a quantitative and a qualitative basis.

(21) By analogy with other audits, we use the level of 2 % as the materiality threshold for our opinion, and we also take account of the nature, amount and context of errors and other available information.

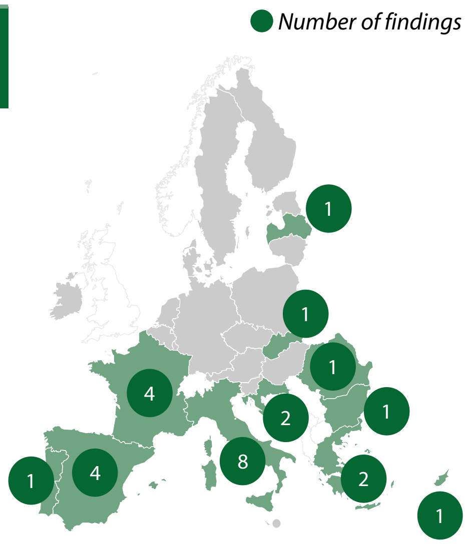
(22) The quantitative findings will be an important element for reaching our conclusion. To assess the regularity of RRF expenditure, we will reach a conclusion, based on the quantitative findings, as to how the estimated amount of error compares to the materiality threshold. To calculate the overall impact of quantitative findings (including those initially identified by the Commission's *ex post* controls), we use the Commission's payment suspension methodology as a basis.

(23) We will also consider the impact of the qualitative findings and the system weaknesses.

(24) Our audit opinion does not disclose an error amount/rate. Due to the RRF spending model it is not possible to determine an error rate comparable to those reported in other MFF chapters. This is because there is no link between RRF payments and costs incurred by final recipients. In addition, the nature of milestones and targets and the risk-based sampling does not allow for extrapolation of our results. Therefore, the result of our testing provides only an estimate of the minimum error amount.

Annex 11.2 – Results of the audit of the regularity of transactions

Member states	Quantitative findings	Qualitative findings	Total
Spain	4	0	4
Italy (*)	2	6	8
France	1	3	4
Romania	1	0	1
Greece	1	1	2
Bulgaria	1	0	1
Croatia (*)	2	0	2
Portugal	1	0	1
Slovakia	1	0	1
Latvia	0	1	1
Cyprus	1	0	1
Total	**15**	**11**	**26**



(*) Italy and Croatia each received two payments in 2022.

We have estimated the financial impact for 15 quantitative findings (see paragraph *11.19*)

Source: ECA.

Annex 11.3 – Follow-up to previous recommendations

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	Recommendation 1: Clearly and transparently justify the elements contained in the Operational Arrangements and CIDs that are not deemed relevant by them for the satisfactory fulfilment of milestones and targets.	-	For recommendations 1 and 3 it was too early to assess implementation as there was no preliminary assessment covered by the audit which started after the date of our recommendation.
2021	**Recommendation 2:** Develop a methodology to determine the amount to be suspended in accordance with Articles 24.6 and 24.8 of the Regulation.		In February 2023, the Commission published its methodology for suspending payments.
	Recommendation 3: Improve documentation of the assessment of milestones and targets by fully documenting all the elements examined during the *ex ante* work.	-	As for recommendation 1.

Source: ECA.

Institutions’ replies to the annual report on the implementation of the EU budget for the 2022 financial year

Contents

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 1: STATEMENT OF ASSURANCE AND SUPPORTING INFORMATION

I. THE COMMISSION REPLIES IN BRIEF

In 2022, just as the global economy was beginning to bounce back from the COVID-19 pandemic, Russia launched on 24 February a **war of aggression against Ukraine**, bringing a wide array of humanitarian crises, as well as a surge in energy and food prices and a new macroeconomic environment with a sharp rise in interest rates and inflation.

In that context, the **EU budget** has provided crucial political, humanitarian, and financial support to Ukraine, while at the same time providing help to those affected by the socio-economic consequences of the war within and outside the EU.

Also, in these unprecedented times, **the Commission continued to attach great importance to ensuring that the EU budget was spent responsibly and correctly**, and to working with all parties involved, including Member States, to make sure that it delivers tangible results on the ground.

The implementation of the EU budget entails handling millions of transactions, and hundreds of thousands of checks, across all programmes and management modes. The Commission, and the Member States authorities under shared management, have put in place robust, multiannual control strategies designed to prevent and detect weaknesses and correct them when identified. Wherever necessary, the Commission further adjusts, develops, and improves these strategies and it relentlessly strives for further simplifications across programmes. Thanks to these controls, and based on their results, **the Commission is confident that the information regarding the risks at payment (1.9% in 2022) presented in the Annual Management and Performance Report (AMPR) is representative of the level of error at the time of payment.** The stability of the risk at payment is consistent with the fact that most of the expenditure in 2022 still relates to the 2014 – 2020 programming period and that rules, systems and implementing bodies have remained stable.

The Commission also notes that it does not share the conclusions of the European Court of Auditors (ECA) on specific expenditure areas.

For 2022, the **difference between the Commission's estimated risk at payment** and **the ECA's estimated level of error** is significant for the area of **'Cohesion, resilience and values'**. The Commission takes note of the increase in the error rate estimated by ECA this year, compared to a relatively stable level of error reported for the last five years. The Commission notes that its risk at payment disclosed in the 2022 annual activity reports (AARs) remained comparable with those of previous years. The Commission attributes the difference namely to the fact that the ECA reports errors related to any breach of applicable rules. The Commission does not necessarily consider the associated expenditure to be ineligible. For programme authorities and the Commission to impose financial corrections, an error must be an irregularity within the sense of the Common Provisions Regulation (CPR). Not all errors reported by the ECA fall into this category.

For other budget headings, the Commission's estimations fall within the range of the ECA's estimated levels of error.

The Commission considers, in addition, that the error rate that represents best all the efforts made, both by the Member States and by its services, is the **risk at closure**, which measures the level of error remaining once all ex-post controls and additional corrections will have been made. For 2022, the overall risk at closure is estimated at 0.9%, well below the 2% materiality threshold, and in line with previous years' level (0.9% in 2020 and 0.8% in 2021). In the area of cohesion policy, for the 2007-2013 period and for the first years of the 2014-2020, the Commission has evidence confirming that the actual risk at closure is now well below 2%.

All in all, the Commission endeavours to **strike the right balance between a low level of errors, fast payments, and reasonable costs of controls**.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Audit findings

Reliability of the accounts

The Commission welcomes that the EU accounts are considered to be free from material error for the 16th year in a row.

Regularity of transactions

Error in specific types of spending

As regards the **revenue side of the EU budget** (§1.14a), the Commission welcomes, once again, that the ECA considers revenue free from material error and that the revenue managing systems were generally effective. As it does with its own findings, the Commission will follow up on the issues identified by the ECA's audit in certain Member States.

The Commission will also continue to intensify the follow-up on longstanding open traditional own resources (TOR) points and lifting VAT reservations where possible.

In addition, in May 2023, the Commission took a major step forward by proposing the most ambitious reform of the Customs Union since its creation. Strengthening EU risk management and data analysis capabilities is one of the key objectives of the reform and the legal proposal directly addresses the ECA's recommendations.

As regards **regularity of expenditure** (§1.14b), based on the numerous audits and controls carried out, the Commission's own estimate of the **risk at payment**, i.e. the remaining level of error at the time of payment after preventive controls, remained stable at **1.9%** of the relevant expenditure, i.e. the same level as in 2020 and 2021.

Given the **multiannual nature of its expenditure and of its differentiated control strategies**, the Commission, together with the Member States in shared management, deploys substantial efforts to perform controls after the payments and to continue to make corrections. These efforts are reflected in **the risk at the closure of the programme, which is estimated at 0.9% overall** (0.8% in 2021). This is well below the materiality threshold of 2% and in line with both the levels reached in previous years since 2016 and with the objective of the Commission.

As regard the reported increase in the error rate in the MFF heading 2 ('Cohesion, resilience and values') (§1.16), the Commission does not agree on 18 quantifiable errors out of 48 reported by ECA. For 13 of these errors, the Commission considers that, in line with the CPR, it could not conclude on an irregularity leading to ineligible expenditure. For 5 cases, the Commission is not able to apply the level of quantification used by the ECA. For these 18 cases, the Commission has assessed that it would not have legal ground to impose financial corrections (or higher corrections than those already applied). In addition, the Commission does not share the ECA's view that the **approaching end of the eligibility of the 2014-2020 programming period** could play a role in the reported increase in the error rate for the audited year (2021-2022): **another three accounting years are still available** for Member States to declare expenditure before the 2025 closure (last final payment in July 2024). The Commission further assesses that the impact on the overall calculated error rate of the quantifiable errors related to the measures under the **Coronavirus Response Investment Initiative (CRII)** and the **CRII+,** or to operations benefitting from a temporary increased EU co-financing of 100%, is similar to the impact of errors identified in other types of operations.

As regards the effectiveness of checks and verifications by managing and audit authorities (§1.16), the **quality of, and the error levels reported in the annual control reports** received by the Commission in February 2022 (for the accounting year 1 July 2020 to 30 June 2021) were **similar to previous years**. Besides, the Commission does not see any reason why the COVID-19 pandemic would have affected the control system for cohesion policy in a more acute way than other spending programmes, under the same or different management modes.

As regards the estimated level of error for the MFF heading 3 ('Natural resources and environment') (§1.17), the Commission takes note of the level of error of 2.2% estimated by the ECA. The Commission's own estimate of the risk at payment, at 1.7%, remains consistent with the results obtained in the last years by the Commission and the ECA. This is in line with the fact that expenditure in 2022 relates to the 2014-2020 programming period and that rules, systems and authorities have remained stable. As regards the small over-declarations of areas, the Commission notes that their number remains **in line with the levels detected by the ECA for 2020 and previous years**. While the Land Parcel Identification System (LPIS) is the basis for the geospatial aid application, over declarations may also stem from errors made by the farmers. Consequently, the Commission considers that the small over-declarations do not necessarily indicate specific weaknesses in the Member States' management of the LPIS. The Commission also refers to its reply to §7.35.

Impact of rules and of the way EU funds are disbursed on the risk of error

The Commission shares the ECA's view according to which **the way funds are disbursed has an impact on the risk of error** (§1.19), and in particular that the risk of error is lower for expenditure subject to simplified rules (mainly in entitlement-based payments) (§1.18).

Therefore, and in line with the requests from the European Parliament[1], the Commission has strived to **pursue its simplification efforts** to the greatest possible extent when designing the 2021-2027 programmes, especially in the areas of research and innovation and in cohesion policy, by promoting the use of simplified cost options as well as the financing not linked to costs schemes, and with the new delivery model for the common agricultural policy (CAP).

[1] European Parliament resolution of 10 May 2023 with observations forming an integral part of the decisions on discharge in respect of the implementation of the general budget of the European Union for the financial year 2021, Section III – Commission and executive agencies (2022/2081(DEC) – see in particular §14, §87, §92a, §92f, §109f, §124a and §146g.

Still, based on the detailed information at its disposal, the Commission considers that **the risks at payment are not uniformly material for reimbursement-based payments**. The risk exposure might differ within the same policy area and even within the same spending programme.

Specifically, thanks to the wealth of information gained through its controls and its detailed analysis thereof, including on Member States' control results, the Commission is able to **split the relevant expenditure**[2] between:

- **lower risk expenditure,** with a risk at payment below 2%, representing **63%** of the total expenditure,
- **medium risk expenditure**, with a risk at payment between 2% and 2.5%, representing **12%** of the total expenditure and,
- **higher risk expenditure**, with a risk at payment above 2.5%, representing **25%** of the total expenditure for 2022[3].

As an example, for the regional funds[4], the Commission finds that management and control systems function well or sufficiently well for 259 programmes covering 93% of expenditure certified in the 2021-2022 accounts but present serious deficiencies for 36 programmes. Likewise, the Commission can report that audit authorities for regional funds function well and provide overall reliable audit opinions, except for seven audit authorities for which Commission audits identified serious deficiencies. These seven authorities are in charge of auditing less than 2% of expenditure from the regional funds.

The Commission is taking **targeted remedial actions** for the medium- and higher-risk categories in particular. Such actions include raising beneficiaries' and implementing partners' awareness of applicable EU rules and of recurrent issues, adjusting the control strategies to the level of risks, applying the lessons learned to future programmes and simplifying rules wherever possible. At the same time, complex conditions and eligibility rules may sometimes be needed where the targeting of aid is necessary, in order to achieve ambitious policy objectives or to respect the fundamental principles of the Single Market (public procurement or State aid rules).

Legality and regularity must therefore be **balanced with the achievement of policy objectives** while bearing in mind the costs of administration and control.

High-risk expenditure

As regards the **ECA findings on the expenditure it considers high-risk** (§1.21-§1.29), the Commission recalls that its own estimation is that for 37% of the expenditure, the risk at payment is above 2%. This relates to some operational programmes for 'Cohesion', i.e. only those that show serious deficiencies and/or have residual error rates above 2%; the grants for the research programme Horizon 2020 and other complex grants in the same MFF heading; individual CAP paying agencies for direct payments and rural development as well as some Member States for market measures that have error rates above 2%.

[2] More details can be found in the Annual Management and Performance Report 2022, Volume II, page 57

[3] In the case of the European Regional Development Fund, the Cohesion Fund and the European Maritime and Fisheries Fund, the level of risk has also been considered high, irrespective of the risk at payment, when the audit opinion issued in the annual activity reports on the functioning of the management and control system of the programmes was either adverse or qualified.

[4] European Regional Development Fund and Cohesion Fund

Specifically:

- In the policy area of **'Cohesion, resilience and values'** (§1.22), in the accounting year under analysis, audit authorities reported total error rates above 2% for around one fifth of programmes, thus demonstrating their detection capacity.
  Based on their common typology, the Commission and the audit authorities identified the following categories as the main sources of irregularities: ineligible expenditure, public procurement, audit trail and State aid. This is in line with the ECA's own findings.
  Regarding specifically the cases of eligibility errors identified and quantified by the ECA in funds under cohesion policy (§1.27), the Commission considers that, for several of these cases, the breach of a legal provision or rule reported by the ECA does not allow the Commission to qualify the error as an irregularity to be corrected in line with the definition in Article 2(36) of the Common Provisions Regulation. Therefore, the Member State or the Commission cannot pursue financial correction procedures, and such errors would not enter into the Commission's estimate of its risk at payment. Besides, the Commission also notes that in some cases the ECA did not have the same assessment of the facts or the same interpretation of applicable national or programme-specific rules. The Commission also refers to its replies to §6.16, 6.17, 6.21 and §6.77.

- Concerning the policy area of '**Natural Resources and environment'** (§1.23), the Commission sees higher risk of errors in the areas of market measures and rural development, as does the ECA. Under the 2014-2022 CAP legislative framework, complex conditions and eligibility rules apply where, in order to achieve ambitious policy objectives, the targeting of aid is necessary. It is thus needed to balance legality and regularity considerations with the achievement of policy objectives while bearing in mind the costs of control. For the 2023-2027 period, the Commission is addressing this by promoting the use of simplified cost options and by simplifying the CAP.

  In the area of '**'Single market, innovation and digital'** (§1.24), the Commission takes note of the level of error calculated by the ECA, and its drop compared to last year. The Commission's own estimation of the risk at payment for this MFF heading is at 1.5%, below the materiality threshold. For Horizon 2020 specifically, the Commission estimates the risk at payment at 2,7%, in line with the ECA's error rate for the programme. The Commission acknowledges that funding based on actual costs remains relatively complex and error prone, in particular for certain types of beneficiaries despite the Commission efforts to provide guidance to all participants. In addition, as alternative to funding based on actual costs, the Commission is increasing the use of lump sums and a unit cost system for personnel costs available in any grant, ineligible personnel costs being a major source of errors.

- Referring to '**Neighbourhood and the world'** (§1.25), the Commission considers that the lower-risk expenditure under this chapter is not limited to merely the budget support payments and to administrative expenditure, but includes also other expenditure under direct and indirect management segments that have a low or medium risk at payment. Hence the risk at payment for this heading at 1.1%, well below the materiality threshold of 2%.

The Commission will continue to take actions for implementing simplified cost options and improving the effectiveness of ex ante and ex-post checks. Finally, as stated in the replies to §6.16, §6.17, §6.21, §6.24, §6.28 and §6.32, the Commission does not agree with the ECA assessment in a certain number of cases.

Low-risk expenditure

The Commission welcomes the ECA's conclusion that **direct aid to farmers** (§1.30) remain free of material error, confirming thus the important role played by the Integrated Administration and Control System (IACS), including the LPIS, in preventing and reducing the level of error.

Commission's regularity information

Commission's estimate of error

The Commission's objective is to identify where issues are to take appropriate and targeted remedial actions accordingly. To do so, it has built its assurance from the bottom up and at a detailed level, i.e. by programme or other relevant segment of expenditure, since implementation is not homogenous across programmes and Member States.

In the AMPR, the Commission uses the risks at payment disclosed by its services in their respective AARs. These risks at payment correspond to the services' best estimate, based on hundreds of thousands of checks carried out every year by the Commission and the Member States, following carefully established control strategies, tailored to the specificities of the spending programmes.

The Commission is closely monitoring the risk at payment and risk at closure, with the objective to maintain the risk at closure below the materiality threshold of 2%.

The Commission's approach, as manager of the EU budget, is different from that followed by the ECA in its role of external auditor. This may result in differences between the estimation of the level of error by the two institutions.

In addition, the Commission does not always share the ECA's assessment on individual errors. Nevertheless, the Commission notes that its **estimations of the risk at payment fall within the range of the ECA's estimated levels of error for all budget headings, except, for the first time in ten years, for the area of 'Cohesion, resilience and values'**.

For this area, the maximum value of the Commission's risk at payment (2.6% in 2022), that is considered in the AMPR for the calculation of the Commission's overall risk at payment, is below the ECA's estimated level of error. Overall, the Commission reports a **material risk at payment for cohesion**, covering a differentiated situation at programme level. The Commission notes that its estimate reflects irregularities rendering the underlying expenditure ineligible and for which the Commission (and Member States) can effectively apply financial corrections, whereas the ECA"s estimate reflects any breach of applicable rule, even if this breach does not lead to an irregularity as defined in Article 2(36) of the CPR.

Commission's risk assessment

The Commission continues to take **actions to improve the effectiveness of ex-post checks**. It recalls however that, in order to remain cost-effective, controls need to be targeted and risk-based.

In the area of '**Research and Innovation'**, the Commission intends to make the most efficient use of the resources from the Common Audit Service to guarantee effective achievement of its objectives, while keeping an appropriate balance between trust and control and considering administrative and other costs of controls at all levels, including for beneficiaries. This is in line with the experience gained in Horizon 2020 according to which it is planned that a maximum of 7% of the number of beneficiaries can be audited. At the same time, the Commission further intensified the frequency of its trainings and outreach activities, in particular targeting error-prone beneficiaries such as SMEs and newcomers.

In the area of **cohesion policy**, the Commission considers that, overall, reliance can be placed on the work of audit authorities and their control bodies, except for a limited number of them clearly reported in the AARs. In some cases, additional errors detected are occasional and do not point to a system weakness at the level of the audit authority. The Commission has continued in 2022 to extensively cooperate with Member States' audit authorities to ensure a consistent and robust assurance and control framework.

As regard the ECA's observations on desk reviews under cohesion programmes (§1.37), the Commission is confident that its **detailed assessment based on a combination of desk and on-the-spot audit work** covering the different individual programmes and assurance packages, depending on the risks attributed to them, enables it to establish a reasonable and fair estimate of the error rates for each programme, every year, and cumulatively for cohesion policy funds. The Commission considers that its systematic desk reviews constitute an **efficient and proportionate approach** for programmes that are found to reliably report low error rates year after year. For riskier programmes, audits are re-performed or the desk review is complemented by fact-finding visits.

For the assurance packages received in 2022, the Commission recalculated the reported residual error rate in the AARs of the Directorates-General for employment, social affairs and inclusion and for regional and urban policy for 35 and 79 programmes respectively, above 2% in 12 cases, based only on the desk reviews. This clearly shows the added value of this approach. Finally, to take account of the recommendation of the ECA in its Special Report 26/2021, the Commission has included a top-up for programmes not audited on the spot in its methodology to calculate the maximum risk reported in the annual activity reports.

In the policy area **'Neighbourhood and the world'**, the Commission considers that the residual error rate (RER) study – which is neither an assurance engagement nor an audit - is fit for purpose and is not subject to limitations that may contribute to an underestimation of errors, but rather to an overestimation; when partial or full reliance is placed on previous checks carried out by contractors of the Commission or on ECA audits. This is the reason why the RER methodology allows to rely on previous control work under strict conditions and criteria and that the Commission limits the number of cases of full reliance, which remain in line with the historic average.

Commission's reporting on financial corrections and recoveries

Corrections are a key element of the Commission's control system. In the AMPR on financial year 2022, the Commission continued to provide a **complete and transparent picture** of all the measures implemented during the financial year, both preventive and corrective, by both the Commission and the Member States. Corrective **measures** amounted to **EUR 1.8 billion, out of which net financial corrections amounted to EUR 734 million** – an increase compared to 2021 (EUR 523 million). These concern in particular shared management funds (common agricultural policy as well as closed programming periods under cohesion policy). The application of net financial corrections protects the EU budget from reimbursing irregular expenditure.

In addition, in the area of **cohesion policy**, **EUR 14.5 billion** have been temporarily or definitely withdrawn by Member States from annual certified amounts, before submission to the Commission, since 2014. The Commission believes that this significant amount of withdrawals is linked to the deterrent effect of the possibility for the Commission, under the CPR, to apply **net financial corrections** in case of corrective measures not accepted by the Member States, reinforcing the Commission's supervisory role. In addition, the Commission recalls that the co-legislator has set strict criteria in the 2014-2020 legal framework for the Commission to implement net financial corrections, that are subject to cumulative requirements limiting their scope of application and in practice leading to considerable challenges in applying net financial corrections. This explains the absence of net corrections so far and illustrates the **will of the co-legislator to only avail to this possibility in cases where serious deficiencies are demonstrated**.

The Commission finally recalls that there is no regulatory deadline to continue protecting the EU budget. Corrections can still occur many years after the end of the programming period or at the closure of a programme.

Reporting on rule-of-law procedures

On 16 February 2022, the Court of Justice of the EU fully confirmed the validity of the Conditionality Regulation, and on 2 March 2022, the Commission issued guidance on its application. **All the affected services referred to the implementation of the Conditionality Regulation in their AARs for 2022.**

2. Report on suspected fraud

As regard the risk of fraud in **lump sum decisions** (§1.50), the Commission notes that Article 181(4)(a) of the Financial Regulation does not require that the authorising decision documents such a risk. Nevertheless, the point 2.2. of the Horizon Europe lump-sum Decision describes the checks and reviews that shall be carried in order to minimise the risk of irregularity or fraud. It is the opinion of the Commission that this adequately addresses the requirement of the Financial Regulation. However, the Commission will reassess the content of this Decision with a view to consider whether the aspects related to risk could be made more explicit. The Commission also refers to its reply to §5.29.

Regarding the audit authorities' work to address the risk of fraud in the area of **cohesion policy** (§1.50), the Commission recalls that audit authorities, as part of their system audits, **verify the effectiveness of the proportionate anti-fraud measures** in place, using specific checklists developed with the Commission. For audits of operations, the Commission welcomes the increase in the number of audit authorities' checklists allowing to document the actions they take to identify possible red flags of fraudulent actions as reported by the ECA in §6.56. The Commission will continue to remind remaining audit authorities to also appropriately document their work.

In addition, the Commission, under the **Action Plan of the Commission Anti-fraud Strategy**, has planned several actions to remind Member States authorities about their obligations to report suspected fraud in OLAF's irregularly management system. The Commission has also helped Member States adopt and update anti-fraud policies, through dedicated guidelines which continue to be applicable to the 2021-2027 programming period. In parallel, the use of its **data-mining and risk-scoring tool ARACHNE**, offered to Member States to strengthen their capacity to identify and prevent fraud and corruption and recently enriched with new modules, is evolving positively with an increasing number of connections and active users.

The negotiations on the recast of the Financial Regulation, with a proposal to make the use of a data-mining tool mandatory as from 2027, have relaunched the debate on the voluntary use of the current tool in a number of so-far reluctant Member States. The Commission also refers to its replies to §6.58 to §6.63.

III. COMMISSION REPLIES TO THE CONCLUSION

The Commission remains confident that the information regarding the risks at payment (1.9%) presented in the 2022 AMPR is representative of the level of error at the time of payment. It is in line with the levels reported in previous years[5]. The stability of the risk at payment is consistent with the fact that most of the expenditure in 2022 still relates to the 2014 – 2020 programming period and that rules, systems and implementing bodies have remained stable.

As regards the ECA's conclusion that the Commission's estimated risk at payment is significantly below its range (§1.55), the Commission notes that this is due to the cohesion policy area, for which the Commission does not share the ECA's assessment on 18 individual errors.

[5] The Commission's risk at payment was at 1.9% in 2021 and 2020.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 2: BUDGETARY AND FINANCIAL MANAGEMENT

I. THE COMMISSION REPLIES IN BRIEF

The Commission takes all necessary measures to ensure **full and efficient implementation of the EU budget** in accordance with the existing financial and legal framework. The Commission constantly monitors the implementation of the budget and the evolution of the outstanding commitments, as well as the related underlying factors. It regularly informs the Council and the European Parliament of the forecast needs (for a given year as well as for the following years) and of the potential risks for the future and regularly presents and explains the state of play of budget implementation. The main documents provided to that effect are: Working Document V attached to the draft budget, the annual report on the long-term forecast on the future inflows and outflows of the EU budget, which is part of the Integrated Financial and Accountability Reporting (IFAR), and input documents for the interinstitutional meetings on payments.

2022 was the second year of implementation of the EU budget under the Multiannual Financial Framework (MFF 2021-2027). As a result of the late adoption of the MFF Regulation (17 December 2020) the legal acts of the new generation of programmes were only adopted in 2021. In addition, the prolonged impact of the COVID-19 crisis and the war in Ukraine required placing a priority on the implementation of urgent rescue and recovery measures. The broader crisis situation affected the start of certain activities and implementation steps (calls, selections, contracting) and, consequently, payments. The Commission actively monitored budget implementation and made appropriate changes or proposals in 2022, which ensured essentially the full implementation of the voted appropriations, i.e. 99.3 % for commitments[1] and 99.9 % for payments when taking into account both automatic and non-automatic carry overs[1]. In order to achieve those results, the Commission presented proposals for amending budgets (five in total, of which three amending the expenditure side of the budget), 23 proposals for budgetary transfers and numerous autonomous transfers.

Total **outstanding commitments** ('reste à liquider' – RAL) amounted to EUR 452.2 bn at the end of 2022 and, as expected, increased compared to the previous year (EUR 341.6 bn at the end of 2021). The main driver of that increase was the implementation of the non-repayable part of NextGenerationEU (NGEU) contributing EUR 189.1 bn (42 %) to the total RAL at the end of 2022. The NGEU assigned revenue will continue to contribute to a temporary increase of RAL as the commitments are to be made until the end of 2023 and payments until 2026. The Commission will continue proposing levels of payment appropriations that adequately meet payment needs during the annual budgetary procedures. It will strive to make the best use of some far-reaching simplifications adopted in the Common Provisions Regulation (CPR) (i.e. broader use of simplified cost options) as well as of the several measures in place to coordinate the implementation of the Recovery and Resilience Facility (RRF) and of cohesion policy funds.

As regards the increased **risks and challenges** for the EU budget associated with future financial obligations in connection with the extraordinary events of the COVID pandemic and the Russia's war of aggression on the Ukraine, the Commission notes that contingent liabilities have increased in recent years mainly due to budgetary guarantees provided to different implementing partners to

[1] As authorised by the art 12 of the Financial Regulation and/or new legal bases

leverage external funds and increase the impact of the EU budget. The Commission is fully transparent and treats contingent liabilities in line with international accounting standards. Contingent liabilities are disclosed in the EU annual accounts and are assessed regularly. Thanks to its robust corporate risk management and reporting framework, the Commission ensures an effective oversight of the management of debt, asset and contingent liabilities in view of ensuring sustainability of the EU budget.

The Commission continuously monitors the **impact of inflation on the EU budget**. Concerning the risk for the EU budget associated with the high level of inflation the Commission acknowledges that the unprecedented increase of inflation experienced in 2022 affects distinct types of expenditures and programmes differently. The overall impact will, however, depend on actual inflation outturn, which is currently difficult to estimate given forecast volatility. In the case of administrative expenditure, the Commission has continued to respect the limit of 2 % for non-salary related expenditure, on the basis of which the current MFF is programmed, by reprioritisation, and has requested all other institutions to apply the same approach. With respect to remuneration, the actual update rates to be applied in a given budgetary year are confirmed at end-October, and as was done in 2022, the Commission will revise the requested amounts for the budget and the draft budget, in line with this final figure, and in close cooperation with all institutions.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Budgetary and financial management in 2022

EU budget implementation - commitments and payments

Use of commitment and payment appropriations

When analysing the final rates of the implementation of the EU budget, the Commission recalls that, on top of the elements considered in the report in §2.3, there is a possibility to carry over to the following year appropriations which were not implemented at year-end in cases allowed by the Financial Regulation and/or by the new legal bases. The Commission carried over EUR 1.5 bn of commitments and EUR 1.9 bn of payments to 2023 (special instruments included).

Start of the implementation of 2021-2027 shared management funds under the Common Provisions Regulation by the Member States

Concerning the implementation of 2021-2027 cohesion policy programmes (§2.10 to 2.12), the Commission continuously works with the Member States and monitors closely the progress in implementing EU Funds. Regular monitoring committee meetings take place at least once per year and a performance review is done annually. In addition, more formal events, technical meetings, exchange of letters and other informal communication take place as needed. In case bottlenecks are identified, the Commission works closely with the relevant authorities in order to resolve them, with the help of various technical assistance tools.

Particular attention is paid to the implementation of the Just Transition Fund (JTF), due to the timeframe to spend NextGenerationEU (NGEU) resources by the end of 2026. A large range of actions has therefore been proposed for accelerating JTF delivery in addition to the existing support tools.

Use of ESI funds to react to the COVID pandemic and Russia's war on Ukraine

Concerning its various emergency response initiatives (§2.3 to 2.17), the Commission recalls that the last three years have been shaped by a series of ongoing crises – from the COVID-19 pandemic to the war in Ukraine and its wider impact on energy prices. In response, the cohesion policy legislative framework was revised several times. Each modification (through CRII(+), REACT-EU, CARE(+), FAST-CARE and SAFE) provided more flexibility in the rules of cohesion policy, more liquidity for Member States and regions to quickly finance urgent projects and simplification allowing the funds to reach faster the people most in need and helping avoid even more negative effects on people's lives and economies of Member States and regions, in line with the strategic goal of cohesion funding to strengthen economic, social and territorial cohesion.

Over 600 programme amendments have been carried out for cohesion policy programmes which so far resulted in new financing (EUR 50.6 bn under REACT-EU), increased liquidity (almost EUR 30.6 bn[2]) and reallocation (EUR 24 bn under CRII/CRII+ and about EUR 1.3 bn under CARE). Further increase of the prefinancing rate from the 2021-2027 period resulted in another EUR 3.5 bn being disbursed (due to the increased pre-financing for all cohesion policy programmes under the Investment for jobs and growth goal by 0.5 % in 2022 and 2023 under FAST-CARE). This has had a positive effect on 2014-2020 absorption.

Implementation of NGEU and the RRF

As regards the progress in the implementation of NGEU (§2.18 to 2.22), the RRF Regulation is in force since February 2021 and the first national Recovery and Resilience Plans were endorsed by the Council in July 2021. Since this date, up to the end of 2022, the Commission has disbursed a total of EUR 138.7 bn under the Facility, in both grants (EUR 93.5 bn) and loans (EUR 45.2 bn). These funds support the Member States to implement reforms and investments and both foster the recovery from the pandemic and build resilience against future shocks. Implementation of the RRF and NGEU more generally is overall in line with expectations taking into account the adoption date of the different Council Implementing Decisions.

Outstanding commitments

As regards the level of outstanding commitments (§2.23 to 2.26), the existence of RAL is a natural result of the implementation rules adopted for each policy area by the legislative authority. The increase of the level of outstanding commitments in 2022 as compared to 2021 was expected due to implementation of the NGEU (non-repayable part) contributing 42 % to the overall RAL. The Commission monitors the evolution in the level of outstanding commitments. The long-term payment forecast of June 2023 provides an update, in absolute terms, of the amount of outstanding payments and more importantly in relation to Gross National Income (GNI) evolution projected for the coming years.

2. Risks and challenges

The exposure of the EU budget's in 2022

The Commission concurs with ECA's presentation of the total exposure of the EU budget at the end of 2022 and the situation of the Common Provisioning Fund as of 31st of December 2022. The Commission publishes annually the total annual exposure of the EU budget to the contingent

[2] Consisting of: EUR 7.6 bn in unrecovered pre-financing (CRII) + EUR 12.9 bn from 100 % co-financing in 2020-2021 (CRII+) + EUR 6.6 bn from 100 % co-financing in 2021-2022 (CARE) + EUR 3.5 bn in increased pre-financing from REACT-EU (CARE+).

liabilities arising from financial assistance to Member States in line with Article 250 of the Financial Regulation.

Financial risks associated with Russia's war of aggression against Ukraine

Concerning the provisioning requirements linked to the Macro-Financial Assistance Plus (MFA+) instrument against the risk of default (§2.44), the Commission underlines that the Financial Regulation (Article 211(2)) foresees the possibility for a basic act to set out a specific method of provisioning or otherwise backing a financial liability. In addition, due account should be taken of the highly concessional terms of the loan with long repayment periods of MFA+ loans (up to 35 years, cf. Article 16(2) of Regulation (EU) 2022/2463), of the start of the repayment of the principal not before 2033, of subsidized interest costs, as well as of the fact that MFA+ loans are being provided by the EU to Ukraine as a country that is a candidate for membership of the EU. Under specific and circumscribed circumstances, the use of the headroom represents an efficient method for backing MFA+ loans given their specific features (including the total amount). It backs the full amount of related financial liabilities, with the EU Member States being obliged to cover calls for eventual losses up to the Own Resources Ceiling. This method is lean in administrative and procedural terms compared to the alternative use of Member State guarantees.

Risks and challenges linked to inflation

The Commission concurs with the ECA's observation (§2.50 to 2.57) that inflation above 2 % negatively affects the purchasing power of the EU budget. However, it underlines that the overall impact will depend on how different types of expenditure are affected.

The Commission also acknowledges that rising prices tend to lead to higher revenue from traditional own resources and the Value-Added Tax (VAT) based own resource. However, whether and to what extent this effect occurs also depends on the development of trade volumes and the consumer behaviour, which must also be considered in a reliable forecast.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Recommendation 2.1 – Substantially reduce the level of outstanding commitments

In the light of the high level of outstanding commitments which await payment from future EU budgets, the Commission should identify ways to help member states accelerate the use of EU funds, in particular of shared management funds under the Common Provisions Regulation, while respecting sound financial management.

(Target implementation date: end of 2026)

The Commission **accepts** this recommendation.

The Commission already monitors the implementation of the budget and the evolution of the overall level of outstanding commitments (RAL), as well as the related underlying factors. It regularly informs the Council and the European Parliament of the forecast needs and potential risks for the future. This information is included notably in the annual report on the long-term forecast on the future inflows and outflows of the EU budget, which is part of the Integrated Financial and Accountability Reporting (IFAR) under Article 247 of the Financial Regulation.

The Commission will continue to propose adequate levels of payment appropriations in the framework of the annual budgetary procedures in order to meet the payment needs, also in light of the implementing rules for specific programmes and funds, as adopted by the co-legislators. The Commission recalls that the adoption of the budget lies ultimately within the remit of the budgetary authority.

Recommendation 2.2 – Assess the impact on the EU budget of high inflation over several years

The Commission should assess the impact on the EU budget of high inflation continuing over several years and identify tools to mitigate resulting key risks. In this regard, the Commission should protect the EU budget's ability to meet its legal and contractual commitments, such as rising financing costs.

(Target implementation date: end of 2024)

The Commission **accepts** the recommendation.

The Commission will assess the impact of inflation on the EU budget in the context of the mid-term review of the Multiannual Financial Framework. In that context, the Commission will seek to identify specific tools to mitigate related risks, in particular those stemming from increasing financing costs, noting that the EU budget already has the necessary safeguards to meet its legal and contractual obligations.

Recommendation 2.3 – Sustainability of the EU budget's exposure

In the face of the EU budget's increasing exposure from borrowing for additional payment needs, such as those triggered by the COVID 19 pandemic and Russia's war of aggression against Ukraine, as well as from budgetary guarantees, the Commission should take any appropriate actions needed to ensure that its risk mitigation tools, such as the common provisioning fund, have sufficient capacity and make public its estimate of total annual exposure.

(Target implementation date: end of 2025)

The Commission **partially accepts** the recommendation.

The Commission highlights that, in light of the increasing importance of budgetary guarantees and financial assistance programmes for the implementation of EU policies, it has enhanced in recent years its risk management tools to deal with contingent liabilities. In particular, it established a horizontal cross-Commission framework for the implementation and monitoring of such programmes, with the Steering Committee on Contingent Liabilities at its heart. The ultimate objective is to fully protect the EU budget from the unforeseen materialization of losses originating from the budgetary guarantees or provisioned loan programmes.

The Commission provides annually an assessment of the budgetary sustainability of both provisioned and unprovisioned contingent liabilities in the context of reports drawn up in compliance with Articles 41(5) and 250 of the Financial Regulation. In the former, the Commission already assesses every year whether the headroom is sufficient to deal with the annual exposure of unprovisioned exposures. In the latter, the Commission already assesses whether it has sufficient provisioning for provisioned exposures and whether the provisioning rates are still adequate. For provisioned exposures, the Commission considers that this is the relevant analysis to monitor the risks. This approach is in line with the Financial Regulation and the Commission will therefore not publish the total annual exposure.

The Commission will continue to assess the adequacy of its risk management system to the future development in the risk profile and amount of both provisioned and unprovisioned contingent liabilities.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 3: GETTING RESULTS FROM THE EU BUDGET

Part 1 – Results of the ECA performance audits

The conclusions presented in Part 1 of Chapter 3 are derived from the ECA's special reports that were published in 2022. These special reports were subject to extensive clearing and adversarial procedures, in line with the requirements of the Financial Regulation. The detailed Commission replies reflecting the Commission's position on the special reports and their related recommendations have been published alongside the reports and are available to the public.

The Commission takes note of the ECA's summaries of the European Parliament and Council statements issued after the publication of the special reports issued in 2022 and listed in Part 1 of Chapter 3.

The Commission underlines that the **acceptance rate of the ECA's recommendations** as reflected in Part 1 (§3.7) **is generally very high**, illustrating the Commission's constructive approach towards addressing the issues identified by the ECA. The Commission did not accept only 3% of the recommendations.

More specifically, the Commission would like to recall its position on several special reports referred to by the ECA in part 1 of Chapter 3.

In relation to the ECA Special Report 19/2022 on the EU COVID-19 vaccine **procurement** (§3.14), the Commission underlined in its replies that Europeans have seen the benefits of what EU solidarity can achieve in health, especially with regard to the vaccines strategy to fight the COVID-19 pandemic. The EU Vaccines Strategy presented by the Commission on 17 June 2020 aimed to accelerate the development, manufacturing and deployment of COVID-19 vaccines. By working together with the Member States, the Commission was able to secure the broadest portfolio of vaccines in the world and ensure that all Member States – irrespective of their size - received them at the same time. Although some countries were slightly faster at the beginning because they operated in a different legal context, the EU achieved this success while remaining open to the world by sharing vaccines. The **Commission accepted both recommendations** to create pandemic procurement guidelines on the basis of lessons learned and to stress-test the EU's procurement approach for medical countermeasures.

In relation to the ECA Special Report 21/2022 on the **Commission's assessment of national recovery and resilience plans** (§3.15), the Commission recalled that it proactively worked with all parties, and particularly with the Member States, to ensure a swift and ambitious reform and investment agenda across the EU. The Commission engaged immediately after the publication of its proposal for the RRF Regulation with the Member States, both to explain and discuss the legal provisions, and to guide them in preparing their Recovery and Resilience Plans (RRPs). The Commission also provided a specific response to the ECA special report as regards how disbursement profiles were set and as regards the assessment of milestones and targets. The Commission published in February 2023 its framework for assessing milestones and targets as well as a methodology for the determination of payment suspensions under the Recovery and Resilience Facility Regulation. **The Commission fully accepted the six recommendations** issued by the ECA, with the exception **of one sub-recommendation 4 b) which it partially accepted.**

For ECA Special Report 9/2022 on **climate spending in the 2014-2020 EU budget** (§3.58), the Commission noted in its replies that while acknowledging that its climate tracking methodology used for the 2014-2020 MFF remains an approximation, it did not share the ECA's view that climate reporting is unreliable. Mainstreaming climate action in EU funds is a key tool to help achieve the EU's climate goals, one of the EU's top priorities, as underscored by the European Green Deal. The Commission has invested substantial resources into developing a sound methodology to track and report on climate spending in the EU budget, benefiting from close exchanges and cooperation with the European Parliament and the Council. The Commission is always pursuing opportunities to improve its methodology, as outlined in the June 2021 Communication on the Performance Framework for the EU budget. Many shortfalls have been addressed for the 2021-2027 Multiannual Financial Framework (MFF), for example by moving to an "effect-based" methodology for the 2021-2027 Multiannual Financial Framework (MFF) from an "intent-based" methodology used for the 2014-2020 MFF. This ensures greater consistency in the attribution of climate relevance across different programmes. The Commission **accepted the three recommendations** on: the climate relevance of agricultural funding; enhancing climate reporting; and linking the EU budget to climate and energy objectives. The Commission is currently working to implement these recommendations.

Part 2 – ECA follow-up of the recommendations made in the report on the performance of the EU budget – status at the end of 2019

The Commission notes that out of the five recommendations from the annual report on the performance of the EU budget – status at the end of 2019, three are assessed by the ECA as fully implemented or implemented in most respect. For the two recommendations which are assessed as implemented in some respect, the Commission would like to note the following:

With respect to **recommendation 4 related to the presentation in the programme statements of targets for indicators**, the Commission would like to point out that the number of indicators for which it has been able to present targets (and associated methodologies) has greatly increased with the ongoing reporting cycle (linked to 2022 Annual Management and Performance Report (AMPR) and the 2024 draft budget). This mostly reflects the establishment of targets for those programmes (mostly under shared management, including Regional Policy, ESF+, and EMFAF) for which the adoption of the basic acts had been delayed. The Commission estimates that, at present, targets have been established for almost 70% of the universe of all key performance indicators for the 2021-2027 programmes. This percentage is higher (close to 80%) if one excludes from the relevant universe the indicators for those programmes that have started in the course of the MFF (e.g., the CAP, which started in 2023 and EU4Health), for which more time is naturally needed, and those indicators (such as for InvestEU) which are established mostly for monitoring purposes, and for which setting a target is not appropriate given the demand-driven nature of the instruments.

With respect to **recommendation 2 related to the reliability of performance information presented in the programme statements and in the AMPR**, the Commission has always acknowledged that improving quality of performance information is a continuous effort. With respect to the specific observations made, the Commission has established an action plan to address the recommendations of the Internal Audit Service (IAS)[1] that will ensure enhancements both on the control framework and on the reporting as of the next reporting cycle. Some other enhancements have already been introduced in the ongoing reporting cycle. The Commission has for example streamlined reporting into a single document for each programme (the Programme Performance Statement, replacing the Programme Statement and the Programme Performance Overview), in order to enhance consistency, readability and accessibility of reporting. The Commission has also invested significant resources in establishing a novel IT platform, based on SAP-BPC, which subjects data encoded by DGs for the purpose of the central reporting to a battery of business rules, thus minimizing inadvertent entry/coding errors.

Part 3 – ECA follow-up of the recommendations made in special reports from 2019

Regarding the European Court of Auditors' (ECA) recommendations addressed to the Commission (§3.89-3.93), **the Commission gives the utmost importance to the implementation of all accepted recommendations.** The Commission follows up on the implementation of the actions that it committed to implement and that fall within its mandate. It cannot, however, be excluded that the ECA assesses recommendations as partially implemented when the Commission considers them fully implemented.

More in detail, in relation to the proportion of recommendations fully accepted (§3.85 – 3.88), the level of recommendations not accepted by the Commission in 2019 remains stable compared to 2018 (around seven percent of the recommendations issued). **As regards non-acceptance or partial acceptance of recommendations**, this can have several reasons. These cover for instance (i) the limits entailed by the existing regulatory framework and/or the difficulty to pre-empt future EU legislation, (ii) the remit of roles and competences (including responsibility and accountability arrangements) between different EU Institutions, bodies, Member States and stakeholders, (iii) the complementarity with policies, legislation and programmes, (iv) The Commission's assessment of the feasibility of the recommendations and/or the resources and timing implications.

Regarding the **correlation between the level of implementation and the auditees' acceptance** (§3.101), in its official replies published together with the corresponding ECA reports, the Commission provided justifications for all cases where it considered that it could not commit to implement specific recommendations, or parts of them. It is therefore understandable that the vast majority of the recommendations which the Commission could not initially accept have eventually not been implemented (83 percent (figure 3.13)). Likewise, as the level of partial acceptance of recommendations increased for the year 2019 compared to 2018 (Figure 3.7 and figure 3.13) this will typically lead to an increase in the ECA assessment 'implemented in some respect' (§3.90). The ECA indeed assesses the level of implementation against the recommendation it formulated, independently from whether or not it was fully accepted by the Commission. The Commission, on the other hand, assesses the level of implementation against the commitment it undertook in the replies to special reports. The Commission furthermore notes that in some cases, the full implementation of recommendations may also depend on actions or measures that fall within the remit of other entities.

Concerning the **timely implementation of recommendations** (§3.99-3.100), the timeliness of the follow-up actions is also to be seen in conjunction with the acceptance of the ECA's recommendations. The Commission is fully committed to implement all accepted recommendations

[1] IAS audit report on the Commission's control system in relation to the reliability of performance information on EU financial programmes

within the timeframes set-up in the ECA's special reports. This is however not applicable for recommendations which the Commission did not accept in the first place, for the reasons set out in the published replies to the concerned special report.

In addition, in some cases, the follow-up actions may require more time than initially expected due to the complexity of the measures, legislative or policy-related developments, resources constraints, external factors, or to the need to involve other institutions or entities. The fact that a recommendation is not fully implemented by the initial expected completion date does not entail that this recommendation will not be implemented thereafter. Evolving circumstances, or changes in the policy or political context, may typically lead to a reprioritisation of actions. In that context, the COVID-pandemic has led many Commission services to redefine and adjust priorities in the course of 2020 and 2021.

Annex – Follow-up of 2019 special report recommendations – European Commission

Special Report 02/2019: Chemical hazards in our food: EU food safety policy protects us but faces challenges

Reply to recommendation 1a, paragraph 73: The ECA's recommendation to "assess potential changes to the legislation governing chemical hazards in light of the capacity to apply it consistently" was fully implemented by the Commission through the REFIT exercise and the Farm to Fork Strategy. To show that the recommendation is not only implemented through a one-off action but also through continuous supervision and measures, the Commission Directorate-General for Health and Food Safety (DG SANTE) points to pesticides and Food Contact Materials as examples. The complete list of ongoing and planned evaluations and fitness checks is updated annually in DG SANTE's Management Plan.

Special Report 04/2019: The control system for organic products has improved, but some challenges remain"

Reply to recommendation 2c, paragraph 97: The Commission considers this recommendation as fully implemented. The Commission has discussed a working paper (12.06.2023) with the Member States giving guidance on physical checks, specifically sampling and laboratory analysis, of consignments from third countries prior to release for free circulation in the European Union. The final version, incorporating comments received, will be distributed in the course of the month of June 2023.

Reply to recommendation 3a, paragraph 98: The Commission considers this recommendation as fully implemented. The Commission carries out systematically traceability checks on products certified by Control Bodies (CB) in different Member States, often involving ingredients produced in third countries. This exercise is mainly used as a tool by the Commission to carry out its control tasks. The withdrawal of five CBs from India and one from Argentina show that the Commission is using traceability exercises effectively to carry out its control tasks on the CB. Moreover, the Commission Directorate-General for Health and Food Safety (DG SANTE) carries out such exercises during audits to verify if the Member States or the third country or CB maintain control over the whole chain. The results of traceability exercises will also be integrated in the audit plan to better target CB and focus on their possible shortcomings.

Reply to recommendation 3b, paragraph 98: The Commission considers this recommendation as fully implemented. The Commission envisages to continue in the course of 2023 analysing in close cooperation with Member States the results of traceability exercise and working on identifying and implementing corrective actions.

Reply to recommendation 3c, paragraph 98: The recommendation implementation is on-going. The system has been working effectively in the Member States since January 2023 and will be extended to third countries as of 2024.

Special Report 05/2019 FEAD-Fund for European Aid to the Most Deprived: Valuable support but its contribution to reducing poverty is not yet established

Reply to recommendation 1c, paragraph 61: The Commission accepted this recommendation partially, i.e. it accepted the part concerning the setting out of the intervention logic. The Commission considers this part implemented, as acknowledged by the ECA analysis. The Commission did not consider that setting quantified targets in the programmes for operations in question would be meaningful. It considered that Member States should have flexibility to address over time different target groups or complement national policies with different instruments. Moreover, it may also not be proportionate, in view of the efforts needed by beneficiaries working with volunteers, and in order to respect the dignity of end recipients.

SR 06/2019 Tackling fraud in EU cohesion spending: managing authorities need to strengthen detection, response and coordination

Reply to recommendation 1b, paragraph 80: The Commission notes that the ECA's recommendation does not fix an obligation of result for the Commission (all managing authorities / Member States to have an anti-fraud strategy in place) but recommends taking steps to require Member States' authorities to adopt such strategies. The Commission took a number of such steps (such as the OLAF's recommendation in the 30th and subsequent Annual reports on the protection of the EU's financial interests that Member States should adopt a national anti-fraud strategy; the workshop on Anti-fraud strategies and the regions held on 13 October 2020 with the participation of, amongst others, Transparency International EU and the Members of the European Parliament; or the Commission recommendations to adopt anti-fraud policies in the context of the negotiation of the new programmes for the 2021-2027 programming period). Furthermore, the Commission has proposed to make national anti-fraud strategies mandatory in the framework of the current recast of the Financial Regulation. The Commission therefore considers that it has implemented the ECA's recommendation in most respects.

Reply to recommendation 3b, paragraph 87: The Commission underlines that the "EU Funds Anti-Fraud Knowledge & Resource Centre" goes beyond the content of the electronic data-exchange system. In particular, it contains the "Library of Good practices and Case studies" and eight video modules addressed to practitioners and focused on prevention and detection of fraud and corruption in EU funds. Furthermore, the Commission is carrying out regular 4-day anti-fraud trainings that are addressed to the national authorities dealing with Cohesion policy funds. It has also launched regular courses on Integrity Pacts. The trainings include updated presentations, case studies and good practices that REGIO is making available also by publishing them on ec.europa.eu website. The Commission's "Guidance on the avoidance and management of conflicts of interest under the Financial Regulation" of 9 April 2021 is also based on case studies and good practices.

The Commission informed the Member States that the already existing guidance notes issued with reference to the programming period 2014-2020 are to be considered applicable by analogy in the 2021-2027 programming period. Therefore, the Commission considers that this recommendation is fully implemented.

Reply to recommendation 3c, paragraph 87: The European Anti-Fraud Office (OLAF) has completed its analysis of the level of reporting of irregularities (fraudulent and non-fraudulent) for all Member States at the level of Operational Programmes. The analysis offers a new level of insight into the irregularities detected and reported by the Member States. Furthermore, the country factsheets contained in the 2022 'Annual Report on the Protection of the European Union's financial interests and the Fight against fraud' (PIF Report) have been updated to include an overview of all authorities dealing with the protection of the EU's financial interests in the ESIF area external to its management and control system. These new "products" represent the country profiles. The Commission considers that recommendation 3c is fully implemented.

Reply to recommendation 4a, paragraph 89: OLAF keeps monitoring the implementation of the reporting obligations. The 31st and 32nd PIF Reports contained specific recommendations and analyses in this regard. OLAF is addressing specific issues on reporting (including about suspected fraud) on bilateral bases and will launch a targeted review in cooperation with the MS experts of the "Handbook on irregularities reporting" in the last quarter of 2023. On the reporting of suspicions of fraud, there is a systemic problem linked to the communication between prosecution services and reporting authorities in the Member States. As foreseen by Regulation (EU) N. 2021/1060 (Annex XII, paragraph 1.5) on the reporting obligations, where "national provisions provide for the confidentiality of investigations, only information subject to the authorisation of the competent tribunal, court or other body in accordance with national rules may be reported".

Despite these issues, in comparison to the programming period 2007-13, the fraud detection rate reported in the latest PIF Report in relation to the cohesion policy has increased, even if this is mainly due to a limited number of Member States.

The Commission is also addressing issues about completeness and quality of the reporting in the framework of the 2023 round of the annual coordination meetings. Irregularity Management System (IMS) has been fully developed for the reporting of the irregularities linked to the period 2021-2027 and needs no further adaptation in this respect. Further developments are nonetheless foreseen to maintain the performance of the system and improve the users' experience. These developments have no direct impact on the respect of the reporting obligation by the Member States. The Commission considers this recommendation as fully implemented.

Reply to recommendation 4b, paragraph 89: The Commission has repeatedly encouraged Member State authorities to systematically assess the horizontal implication of suspected fraud identified at programme level, as provided in section 4.4 of the guidance note on fraud risk assessment.

The Commission has informed of this requirement all Audit Authorities during the Technical Meeting in 2019 and all Member State delegations during the Expert group on European Structural and Investment Funds (EGESIF) meeting of 2020. Furthermore, the Commission has introduced a point on fraud risk assessment to the standard agenda of all Annual Coordination Meetings with the Audit Authorities taking place in 2022. Finally, the Commission also refers to recent explanations provided to the programme authorities on how to implement risk-based management verifications in the 2021 – 2027 period. In their review of the risk assessment, management authorities are systematically invited to reflect on risks identified and to take them into account in the implementation of their management and control systems and for the purposes of their management verifications. This presents a significant change with respect to the current approach of systematic controls which by nature do not focus on any specific risks identified. With all these actions, the Commission considers that it has fully implemented recommendation 4b.

Reply to recommendation 5, paragraph 91: The Commission has encouraged Anti-Fraud Coordination Services to expand their role of coordination with managing authorities and to liaise with all national bodies involved with auditing, investigating and prosecuting suspected fraud. As a result, the Commission considers this recommendation fully implemented. Further clarification on the functions of the Anti-Fraud Coordination Services goes beyond the original recommendation and therefore beyond the Commission's commitment to implement it.

Special Report 07/2019: EU actions for cross-border healthcare: significant ambitions but improved management required

Reply to recommendation 3, paragraph 72: A number of deliverables are expected by the end of 2023 feeding into the consultation and reflection process that could be initiated by the end 2023, meeting the target implementation date.

Special Report 08/2019: Wind and solar power for electricity generation: significant action needed if EU targets to be met

Reply to recommendation 5a, paragraph 87: The Commission took action in the broader context of the Energy Union Governance, in relation to the National Energy and Climate Plans. In that respect, the Commission considers that it took the action it had committed and therefore considers the recommendation as implemented to the extent of what was accepted.

The infrastructure gaps assessment is done at a national level through the national infrastructure development plans and at EU level, in a centralised manner, at the moment of the TYNDP for all Member States. This work also underpins assessments used under the Governance Regulation (NECPs) and the European Semester process where also interactions with stakeholders allows to pinpoint specific issues as regards grid reinforcement. The Commission notes that, due to the need to massively deploy renewable energy, all Member States are facing this issue. Furthermore, the revised TEN-E Regulation specifically now includes Article 13 on infrastructure gaps analysis.

Reply to recommendation 5b, paragraph 87: The Commission took action in the broader context of the Energy Union Governance. The Commission interacts with Member States and provides advice through the High-level groups and the Trans-European Networks for Energy (TEN-E) Regional groups. This is in addition to the European Semester process and the National energy and climate plans (NECPs). The Commission has intensified contacts and support for Member States following the Repower EU Plan and has set-up the platform for national competent authorities in charge of permitting.

Reply to recommendation 5c, paragraph 87: The Commission highlighted to Member States the various options for funding for the grid and interconnectors in several instances. For the programming period 2021-27, an amount of EUR 4.3 Billion European Regional Development Fund (ERDF)/ Cohesion Fund (CF) is planned to be invested by Member States into smart energy systems and related storage, which includes power grids and interconnectors. This is a substantial increase from the 2014-2020 programming period in which EUR 1.9 billion was invested into power grids and storage. Thus, the Commission considers that this recommendation is implemented in most respects, albeit with a delayed follow-up action.

Special Report 09/2019: EU support to Morocco – Limited results so far

Reply to recommendation 2(ii) and 2(iii), paragraph 101: The Commission would like to highlight that the deadline for implementation of actions was set as “by the end of 2020” by the ECA before the pandemic; the health crisis has affected significantly the implementation of the action plan, despite the efforts made by the Commission to implement all the actions related to the accepted recommendations.

Reply to recommendation 4 (i) and (iii), paragraph 103: The Commission did initially not accept the recommendation and therefore did not follow up on this recommendation.

Reply to recommendation 4 (ii), paragraph 103: The Commission did not accept this recommendation, as it considered that the funds had been disbursed on the basis of reliable evidence that targets had been achieved, according to standard practice. During the audit, it was not agreed that an update of the budget support guidelines should take place. The Commission adds that updates to the templates for action documents and appendix to budget support were made, which reflect some methodological comments (i.e increased attention to the credibility of the sources of verification). Building on the trainings and guidance material updated in 2021, the Commission reviews the underlying evidence supporting the performance data provided by partner countries and makes sure that additional checks are performed, where necessary.

Reply to recommendation 5 (i), paragraph 104: This recommendation was partially accepted by the Commission. Given the exceptional Covid-19 crisis and the restrictions on movement imposed at both national and international levels, the Commission considered carefully the relevance of field visits, based on (often) fluctuating conditions. As a result, field visits took place only when possible. The Commission considers the agreed part of the recommendation fully implemented.

Reply to recommendation 6, paragraph 106: The Commission partially accepted this recommendation. The Commission strives to follow a strategic approach on communication, with focus on some specific sectors as mentioned above. The Commission considers the agreed part of the recommendation fully implemented.

Special Report 10/2019: EU-wide stress tests for banks: unparalleled amount of information on banks provided but greater coordination and focus on risks needed

Reply to recommendation 5, paragraph 113: In its original reply to the Special Report No 10/2019, the Commission committed to again review the operation of the European Supervisory Authorities (ESAs) and determine whether further improvements to the governance of the European Banking Authority (EBA) would be warranted, based upon the outcome of that review. In 2022, the Commission reviewed the operation of the ESAs (COM (2022)228 final) but concluded that not enough time had passed since the latest changes began to apply in practice to determine whether further amendments were warranted. The consultation feedback clearly showed that stakeholders did not overall support further legislative changes. Therefore, following the 2022 review of the ESAs founding regulations, the Commission refrained from proposing further changes.

The Commission believes that the recommendation has been implemented in most respects and certainly to the extent the Commission originally committed. In addition, the successive stress tests carried out by EBA have been characterised by increased levels of severity of testing parameters and hence increased credibility of the testing outcome.

The governance structure will continue to be in the scope of any future review of the operation of the ESAs. Based upon the outcome of these future reviews, the Commission will determine whether further improvements to the governance of the EBA would be warranted.

Special Report 13/2019: The ethical frameworks of the audited EU institutions: scope for improvement

Reply to recommendation 2 (3), paragraph 89: The Commission has made a proposal on 8 June 2023[2] for an agreement between all institutions and advisory bodies listed in Article 13 TEU which aims to establish an interinstitutional EU Ethics Body which should develop common standards for, amongst others, declarations of interests and assets by members of all institutions and advisory bodies (see Article 7(2) and (3) of the proposed agreement).

The Commission has therefore formally offered to the other institutions to work together on this topic. The next steps are now in the hands of the other institutions (incl. the Court of Auditors) to accept starting such negotiations and then to find an agreement on the proposal.

The Commission has therefore implemented the recommendation by making a formal proposal to all institutions to set up a body which would develop common standards for such declarations as well as for the procedures to check these declarations. **Special Report 16/2019: European Environmental Economic Accounts: usefulness for policymakers can be improved**

[2] https://ec.europa.eu/commission/presscorner/detail/en/IP_23_3106

Reply to recommendation 2(b), paragraph 60: The preparatory work for the Commission proposal (COM/2022/329 final) took place between January 2020 and March 2022. The statistical office of the European Union (Eurostat), which led this Commission initiative, consulted the relevant Commission departments about their specific policy data needs throughout the preparation process and at several levels, including: the annual strategic discussions at senior management level ('Hearings') between Eurostat, DG Environment and DG Climate Action that took place in 2020 and 2021; bilateral consultations at technical level; participation of DGs in Eurostat expert group meetings with Member States in 2020 and 2021; and the formal Commission inter-service consultation in March 2022.

Special Report 17/2019: Centrally managed EU interventions for venture capital: in need of more direction

Reply to recommendation 1(a), paragraph 113: The Commission considers all the elements that the Commission accepted as fully implemented. The Commission draws attention in this respect to i) the relevant legislative proposal (COM(2020) 403 final), including the associated impact assessment, detailing financing gaps in various InvestEU target sectors, and sometimes even sub-sectors, broken down by instrument, ii) the information provided regularly by the EIB and the EIF as well as the internally collected data and surveys, and iii) the implications of providing extensive market analyses in scoreboards at the level of each project. The impact assessment is conducted ex-ante by the Commission before adopting a legislative proposal, except in cases of urgency, not ex-post.

Reply to recommendation 2(a), paragraph 116: The Commission considers all the elements that the Commission accepted as fully implemented. The follow-up by ECA focused only on InvestEU, while the Commission has undertaken numerous steps to support less developed venture capital markets also under other initiatives and policies, exactly as described in its original reply to the recommendation. As a result, ECA was invited to consider all the relevant legislative and financial measures (including under RRF, the Capital Markets Union and the cohesion policy) that support less developed venture capital markets, also outside the InvestEU programme.

Reply to recommendation 2(b), paragraph 116: The Commission considers all the elements that the Commission accepted as fully implemented. One of the key performance and monitoring indicators is the amount of private finance mobilised by the InvestEU Fund. In that respect, there has been a positive change as the participation of public financial institutions, participating from their own capital in funding rounds, can no longer be considered as a private investment. In addition, the guarantee agreements concluded to implement the InvestEU Fund contain provisions on the multiplier and leverage effect as well as on the private financing mobilised to monitor the achieved results.

Reply to recommendation 2(c), paragraph 116: The Commission considers it has implemented this recommendation. The InvestEU Guarantee Agreements do contain provisions concerning secondary sales of equity fund investments.

Reply to recommendation 2(d), paragraph 116: The Commission considers it has implemented this recommendation. Contrary to the ECA's conclusion, the Commission points out that the European Scale-up Action for Risk Capital mechanism (ESCALAR) indeed provides for asymmetric risk sharing, as when the fund performs well, ESCALAR shares are remunerated with a so-called hurdle rate and the excess profits are for the benefit for the private investors. In this case, therefore, the latter's profits will not be commensurate to their risk.

Reply to recommendation 3(b), paragraph 121: The Commission considers it has implemented this recommendation. As stated in the Commission response to the recommendation, the Commission engaged with the European Investment Fund (EIF) who presented its deal allocation policy, and the recommendation was therefore already implemented at the time of the publication of the ECA report. Specifically under InvestEU, the EIF is required under the Guarantee Agreement to apply the EIF allocation policy to InvestEU operations.

Reply to recommendation 3(c), paragraph 121: The Commission considers that has implemented this recommendation. The Call for Expression of Interest published by the EIF regarding the InvestEU Equity Product refers to the identification of suitable and achievable exit routes for targeted investments as an item to be taken into consideration in the EIF's commercial assessment of the intermediaries' application. At the time of the investment, exit routes cannot and should not be predetermined. Potential exit routes should be assessed, but the outcome should not be set, as it depends on the return of the investment, business growth and market conditions at the time of exit.

Special Report 19/2019 INEA: benefits delivered but CEF shortcomings to be addressed

Reply to recommendation 2(b), paragraph 84: The Commission makes a clear distinction between the KPIs related to the performance of the Agency (established following discussion among the agency, its parent DGs), and the KPIs measuring programme results. The later include indicators such as implementation and absorption of funds and should not be used as agency KPIs given that they are already reported in Programme Statements, in the evaluation of the delegated EU programmes and sometimes in the Annual Activity Reports of the parent DGs.

Reply to recommendation 5(a), paragraph 89: The Regulation, Part I of the Annex defines a performance framework to monitor the programme closely and measure notably the extent to which the programme's general and specific objectives have been achieved. In addition, sectorial intervention logics are currently being developed, in order to reinforce this framework.

Reply to recommendation 5(b), paragraph 89: Trans-European Network infrastructure projects are often Global Projects of which only certain elements are supported by Connecting Europe Facility (CEF); other parts being financed by other means. Results indicators of such projects (such as reduction of CO2 emissions, travel time savings) can only be measured in the long term, after the completion of the project. The Commission envisages to capture these results through dedicated ex-post assessments.

Special Report 21/2019: Addressing antimicrobial resistance: progress in the animal sector, but this health threat remains a challenge for the EU

Reply to recommendation 3(a), paragraph 75: The Commission carried out a case of study related to Antimicrobial Resistance in the third quarter of 2022. The case of study provides elements and lines to take to keep working on this domain.

Special Report 22/2019: EU requirements for national budgetary frameworks: need to further strengthen them and to better monitor their application

Reply to recommendation 2, paragraph 101: The Commission has in the meantime tabled legislative proposals to reform economic governance (on 26 April 2023). The proposed amendments to the Directive form a package with a proposed new Regulation on the preventive arm and proposed amendments to the Regulation on the corrective arm which together significantly strengthen IFIs (including regarding ECA findings in paragraph 36 inasmuch as this can be regulated in a Directive) and medium-term budgeting in the EU, in particular regarding bindingness, monitoring and possible updates. In particular, the proposed new legislation strengthens independent fiscal institutions via article 22 preventive arm, articles 2, 3 and 10 corrective arm, and new article 8 of the Directive and medium-term orientation mainly via articles 9 to 12 of the preventive arm regulation and articles 9 and 10 of the amended Directive. The Commission considers that this recommendation is implemented.

Reply to recommendation 4(d), paragraph 105: The Commission has prepared a note on the implementation checks for Medium-term budgetary frameworks which was undertaken in 2022. Some of the findings will be also published in an ECFIN discussion paper. For 2023, implementation checks on international financial institutions (IFIs) have been started.

Special Report 23/2019: Farmers' income stabilisation: comprehensive set of tools, but low uptake of instruments and overcompensation need to be tackled

Reply to recommendation 2(b), paragraph 88: The Commission considers it has fully implemented the part of the recommendation it did accept. The Commission did not accept the part of the recommendation to collect information on the specific indicators such as area and capital insured. Due to strong reservations by Member States about the potential associated administrative burden thereof, Commission Implementing Regulation (EU) 2022/1475 is limited to variables that are strictly related to the management of CAP payments. Evaluations might allow providing more information on risk management tools implemented by Member States.

Reply to recommendation 3(a), paragraph 90: The Commission considers it has fully implemented the part of the recommendation it did accept. The Commission did not accept the part of the recommendation to define ex-ante objective market and economic parameters and criteria triggering exceptional measures as it would contradict the essence of the measure by impairing its aim: addressing catastrophic risks, usually sudden and unforeseeable.

Reply to recommendation 4(b), paragraph 91: The Commission considers it has fully implemented the recommendation. As regards the use of exceptional measures and considering that the audit focussed on those in the fruit and vegetables sector following the "Russian ban", the Commission has undertaken its follow-up actions within this framework. It has first of all carried out an assessment of the practicalities of setting aid rates below 100 % and requiring significant co-financing when Member States play a large role in defining key elements of support schemes. The assessment showed that the Commission has not been empowered by the co-legislators to deviate from the 100% support of eligible costs for free distribution in fruit and vegetables sector as this criterion is set in Regulations (EU) 1308/2013 and (EU) 2021/2115 (while the overall support is limited to 5 % of the value of marketed production of the producer organisation). The Commission has not been empowered, either, to set any co-financing rate of Member States for these sectoral programmes which public support is 100% EU financed. As a second step, the Commission amended the secondary legislation in the fruit and vegetables sector. In order to avoid any risk of overcompensation, the Commission has adopted Regulations (EU) 2020/743, (EU) 2022/1863 and (EU) 2022/2513 as regards rules applicable to the Common Market Organisation (CMO) for fruit and vegetables aid scheme as well as Regulations (EU) 2022/126 and (EU) 2023/330 as regards rules applicable to the CAP Strategic Plans sectoral interventions in the fruit and vegetables sector. In addition, under Regulation (EU) 2021/2115, this approach applies to the olive oil and table olive sector and other sectors as referred to in Article 42(f) of that Regulation since recognised producer organisations of these sectors implement approved operational programmes as in the fruit and vegetables sector.

REPLIES OF THE **EUROPEAN BANKING AUTHORITY** TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT ANNEX 3.3: Follow-up of 2019 special report recommendations – Other auditees

Recommendation 1(1)

The EBA would like to add that it performs quality assurance calls and collects quality assurance feedback in two separate cycles. The Authority reports to its Board of Supervisors on the results of quality assurance activities.

Recommendation 2

The EBA would like to point out that that some top-down elements have already been introduced in the 2023 EU-wide stress test, for example, the net fees and commission income projections are now projected in a top-down manner.

Recommendation 3

It is the Authority's view that the recommendation has been implemented "in most respects" taking into the account the increased coverage of banks from 50 to 70 (from 70% to 75% in terms of EU banking assets). We would like to add that such an increase by 5 ppt of the banking assets coverage required to increase the sample by 40%, which represents a substantial additional burden for all stakeholders and merits due consideration from a proportionality perspective. The criteria to include banks in the sample is based on objective criteria and includes the countries that the ECA perceives as vulnerable.

Recommendation 6 (1)

It is the Authority's view that the recommendation has been implemented "in most respects". The EBA has included the banks' institution-specific minimum capital requirements in the information it publishes and presents the results in a way that enables users to put the results into perspective (e.g., grouping results by country, indirectly by the stress level banks were exposed to, and by type and size of bank).

Recommendation 6 (2)

It is the Authority's view that the recommendation has been implemented "in most respects". The EBA has made assertions about the resilience of the EU financial system as a whole in comparison to the previous stress test and indicates which are the main factors having an impact on the resilience as requested by the Recommendation.

REPLIES OF FRONTEX TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 3: GETTING RESULTS FROM THE EU BUDGET

Annex 3.3. The Agency would like to kindly indicate that the Recommendation 6a) of the Special Report 24/2019, in the parts for which Frontex was responsible, has been fully and timely implemented by Frontex.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 4: REVENUE

I. THE COMMISSION REPLIES IN BRIEF

The Commission welcomes that the European Court of Auditors (ECA) considers revenue continues to be **free of material error** and that **revenue-related systems** it examined were **generally effective.** The Commission will follow-up on the issues identified by the ECA.

As regards the **Value Added Tax (VAT)-based own resource**, the Commission will include the recommendations in its ongoing revision of the administrative procedures applicable to the inspection work for this particular own resource. The revision is also needed as the legal framework for the VAT-based own resource has changed towards a significant simplification from the financial year 2021 onwards. The Commission intends to complete this work by mid-2024.

As regards **Traditional Own Resources** (TOR), the Commission will continue the monitoring of TOR open points and the reassessment of write-off cases not subject to a legal deadline. Furthermore, the Commission will recalculate the TOR losses attributable to all Member States in line with the judgment from the Court of Justice of the European Union (CJEU) C-213/19 against the United Kingdom.

Regarding **Gross National Income** (**GNI) data** used for own resource purposes, the Commission welcomes the ECA's recent special report (No 25/2022) which covered the 2016-2019 GNI verification cycle and which the ECA refers to in the annual report, and the conclusions that the GNI verification process was overall effective. Eurostat has prepared an action plan to address the ECA recommendations, including further prioritisation and documentation of its verifications, with the view to implementing them by 2025, at the start of the verification cycle following the 2020-2024 cycle.

The Commission also attaches great importance to the close monitoring of the timeliness of submission, by the Member States, of the work on GNI reservations. The Commission has put in place a system of monitoring of Member States' compliance with the legal requirements. Addressing and verifying GNI reservations is a complex and time-consuming process, involving intensive exchanges of information, that may in some cases exceed the internal objective of lifting the reservations within one year.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Examination of elements of internal control systems

Member States' accounting and management of TOR

Reply to Box 4.1

Significant amounts omitted from the Belgian TOR statements of duties collected due to an error belatedly detected

The Commission will follow-up on the weaknesses identified by the ECA in the Belgian customs authorities' IT system and internal controls of "globalized" import declarations, which related to the specific case detected by the Belgian authorities themselves. The first Commission letter was sent to the Belgian authorities on 17 May 2023. The Commission will further monitor the situation in the framework of future TOR inspections to Belgium.

Reply to Box 4.2

Administrative delays in establishing, notifying and recovering customs debts after carrying out post-release controls in Poland

The Commission will follow-up on the ECA findings of administrative delays in establishing, notifying and recovering customs debts after carrying post-release controls in Poland for specific cases, and on the related process of streamlining administrative procedures. The Commission will further monitor the situation in the framework of future TOR inspections to Poland.

Concerning the reliability of the TOR statements in the Netherlands (§ 4.13), the Commission will follow-up on the ECA findings. In particular a dedicated TOR inspection will be held in the Netherlands in June 2023 to analyse the new IT system aiming to ensure an automated compilation of the TOR statements.

Customs debt write-off cases

Concerning customs debt write-off cases (§ 4.15), as regards outstanding cases of Member States' write-offs for which the Commission's reassessment had not yet been finalised at the end of 2022, the number of 59 outstanding reassessment requests referred to by the ECA, which are not subject to a legal deadline, has already been reduced to 13 by 1 June 2023.

VAT reservations and TOR open points

As regards the follow-up of TOR open points (§ 4.18), the Commission understands the ECA's position on the prioritization of TOR open points according to their significance. However, the Commission already informed the ECA in 2019 that, in the vast majority of cases, the correct amounts at stake cannot be immediately determined pending additional information to be provided by Member States. Notwithstanding, the Commission reiterates its commitment that any finding - irrespective of its qualitative and quantitative nature - will be timely followed-up.

VAT reservations related to non-application of the VAT Directive

Concerning infringement procedures (§ 4.19 and § 4.20), the Commission attaches great importance to their timely handling, including those related to the incorrect application of the VAT Directive. The Commission has a clear set of rules in place for the management of all infringement procedures. These include internal benchmarks to measure the time taken to handle infringement procedures, which aim to ensure an efficient and timely handling. The Commission remains committed to take timely action to ensure proper application of the VAT Directive.

Concerning the specific case mentioned by the ECA in §4.19, it should be noted that the Member State has now provided explanations on the methodology, sources, and compensation calculations, and also replied to the outstanding questions raised at the previous inspection. The country submitted calculations for the years 2009-2021 using the same methodology. The national authorities provided supporting evidence demonstrating that there had been no negative impact on the VAT-based own resource during the period in question. The outstanding reservation has been lifted in the latest inspection report.

Concerning § 4.20, the ECA bases its assessment on a Commission Staff Working Document (SWD) published in 2016 the first time. The Commission did not launch any infringement procedure based on the information in the SWD. The Commission sets a reservation if an infringement has been launched or after the issue has been examined together with the Member State, and disagreement has been established.

GNI data compilation

In relation to ECA's special report on the 2016-2019 GNI verification cycle (§ 4.21), the Commission welcomes the report and the conclusions that the GNI verification process was overall effective. Eurostat has prepared an action plan to address the recommendations made by the ECA, including further prioritisation and documentation of its verifications, with the view to implementing them by 2025, at the start of the verification cycle following the 2020-2024 cycle.

GNI reservations

Concerning the monitoring of GNI reservations (§ 4.22 and § 4.23), the Commission attaches great importance to the close monitoring of the timeliness of submission, by the Member States, of the work on GNI reservations. The Commission has put in place a system of monitoring of Member States' compliance with the legal requirements and informs the stakeholders on the state of play of reservations in a transparent manner. The Commission reiterates that it continuously follows up the progress of the work on GNI reservations and sends reminders and non-compliance letters where needed. Addressing and verifying GNI reservations is a complex process that involves intensive exchanges of information. Therefore, it is not always feasible to meet the internal objective of lifting the reservations within one year of receipt of the information.

Commission actions to improve TOR risk management and reduce the customs gap

With regard to the completion of the data analysis projects under the Commission's Customs Action Plan (§ 4.24 and § 4.25), the Commission considers it is on track to meet the 2023 deadline agreed with the ECA in the Special Report 04/2021 on customs controls. In addition, the Commission has proposed in May 2023 the most ambitious reform of the Customs Union since its creation. Strengthening EU risk management and data analysis capabilities is one of the key objectives of the reform and the legal proposal directly addresses the ECA's recommendations in its 2021 Special report on 'Customs controls'.

2. Annual activity reports

Regarding the recalculation of TOR losses (§ 4.31), the Commission has requested from all Member States the data necessary to recalculate the TOR losses attributable to them in accordance with the CJEU judgment of 8 March 2022 (C-213/19).

Regarding the calculation for the UK, the Commission recalculated the TOR losses to the EU budget, amounting to € 1.57 billion of principal and a further € 1.4 in interest. The UK paid in February 2023 all outstanding amounts due in this case, and the Commission closed the infringement.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Follow-up of previous years recommendations

With respect to the first recommendation in the ECA 2019 Annual report, as also indicated by the ECA in its Box 4.3, the full use of Surveillance III data at EU level for more targeted and granular data analysis is dependent on the Member States' capability to provide the full Union Customs Code (UCC) dataset with their national IT systems to the Commission, while there are still delays for many Member States in this respect. In the course of 2022 and 2023 the Commission developed and provided the Member States with trade flow analysis tools, and provided guidance on how to use them. The Commission considers that the recommendation 1b) has been implemented in respect to these analytical tools.

With respect to recommendation 2(a) from the ECA 2019 Annual Report, the Commission reiterates that, in the vast majority of cases, the correct amounts at stake cannot be immediately determined pending additional information to be provided by Member States. The Commission remains committed to follow-up any finding - irrespective of its qualitative and quantitative nature - in a timely manner (cf. also § 4.18). Therefore, the Commission considers this recommendation overall implemented. With respect to the third recommendation in the ECA 2020 annual report, the Commission will follow-up on the ECA findings on the reliability of the TOR statements for the Netherlands. A dedicated TOR inspection will be held in the Netherlands in June 2023 to analyse the new IT system aiming to ensure an automated compilation of the TOR statements. (cf. also the Commission's reply to §4.13 above).

Recommendation 4.1 – Improve the management of cases related to non-application of the VAT Directive

Review its procedures for managing cases of non-application of the VAT Directive that could impact the EU budget by:

(a) systematically monitoring the timelines for the various steps of both the infringement procedure, and other enforcement actions intended to resolve non-compliance, and taking timely action to avoid excessive delays;

(b) assessing whether the non-conformity affecting the VAT-based own resource identified in one member state is cross-cutting in nature and may therefore apply to other member states;

(c) taking timely action, and possibly setting cross-cutting reservations that ensure the correct payment of VAT-based national contributions to the EU budget.

(Target implementation date: by mid-2024)

The Commission **accepts** the sub-recommendations 4.1a), 4.1b) and 4.1 c).

4.1a) The Commission has in place an internal framework for monitoring the management of its enforcement actions, including infringement procedures with a view to ensure their timely handling. In its 2022 Communication *Enforcing EU law for a Europe that delivers* (COM(2022) 518 final), the Commission announced that a stocktaking exercise is under way within the Commission and with Member States. In particular this exercise evaluates whether the current way of managing complaints, EU Pilot processes and infringements continue to be fit for purpose. A number of improvements to enforcement activities are already under consideration as part of this analysis.

4.1 b) Work is ongoing to revise the internal procedures governing the VAT-based own resource.

4.1 c). It intends to include this aspect in the revision of the internal procedures governing the VAT-based own resources.

Recommendation 4.2 – Conclude the reassessment of TOR write-off cases not subject to regulatory time limits

Conclude, without delay, the reassessment of requests received from member states (prior to May 2022 that are not subject to regulatory limits) expressing disagreement with the Commission's initial assessment of TOR write-off cases.

(Target implementation date: by mid-2024)

The Commission **accepts** recommendation 4.2 and will treat the remaining reassessment requests by mid-2024.

<u>THE NETHERLANDS' RESPONSES TO THE 2022 ANNUAL REPORT OF THE EUROPEAN COURT OF AUDITORS (CHAPTER 4 – REVENUE)</u>

The automation of the remittance administration was a lengthy process, with December 2022 being a milestone for achieving the automated compilation of statements of duties collected. This remedied the shortcomings in the previous IT system. The Dutch customs authorities have continued to improve the IT system in the first few months of 2023, and the quarterly statements of customs duties established but not yet collected are now also fully automated.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 5: SINGLE MARKET, INNOVATION AND DIGITAL

I. THE COMMISSION REPLIES IN BRIEF

Payments under the Multiannual Financial Framework heading 1 'Single Market, Innovation and Digital' (MFF1) cover several programmes such as **Connecting Europe Facility (CEF)**, **Horizon 2020** and **Horizon Europe**.

The Commission takes note of the **level of error** calculated by the European Court of Auditors (ECA) (§5.7), and its significant drop compared to last year.

Horizon Europe is the biggest research and innovation programme in Europe, with a budget of EUR 95.5 billion. This program is based on the experience gained in Horizon 2020.

Horizon Europe uses a **standard Model Grant Agreement (MGA)** for all EU funding programmes, makes extensive use of simplified costs options (unit cost, flat rate and lump sums), employs simpler cost reimbursement schemes in appropriate areas and implements a streamlined audit system.

In particular, the **use of lump-sums** in Horizon Europe has been rolled out cautiously, following positive assessments by the Commission and in a study commissioned by the European Parliament. It is also fully in line with the Commission's corporate objectives of simplifying EU funding and reducing administrative burden, in particular for beneficiaries.

The Commission will continue to monitor lump-sum grants and improve the approach if needed. Its increasing use and the on-going development of an optional unit cost (a single daily rate per beneficiary), replacing all the calculations for personnel costs, will contribute to reducing the risk of errors.

Regarding controls and ex-post audits, the Commission is currently working on the **Control Strategy for Horizon Europe**. In this context, the audit strategy is expected to be launched by the end of 2023. The target the Commission has set for the Horizon Europe residual error rate is no more than 2% by the end of the framework programme. The Commission will seek to find the right balance to obtain the necessary assurance with cost-effective measures that do not unduly burden the beneficiaries and respect the provisions of the Financial Regulation regarding the ex-post controls for lump-sums.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Regularity of transactions

The Commission takes note of the level of error of 2.7% calculated by the ECA (§5.7), which represents a decrease of 1.7% as compared with 2021. The Commission will follow up on the issues identified by the ECA (see §5.7 to §5.22 of the ECA report) as presented in the sections below.

Regarding legality and regularity of EU expenditure, the ECA calculates an estimated level of rate on an annual basis. At the same time, the Commission implements a multiannual ex-post audit control strategy for each individual Framework Programme. As a consequence, the Commission estimates a residual error rate, which takes account of recoveries, corrections and the effects of all controls and audits over the period of implementation of the programme.

As regards the types of errors identified (§5.8, §5.9), as Research & Innovation framework programmes are mostly based on the reimbursement of eligible costs, simplification of the applicable rules is key to avoiding errors by beneficiaries when calculating their costs for reimbursement.

The Commission has simplified the rules for Horizon Europe as compared with its predecessor Horizon 2020 and continues to do so. As an example, the unit cost system for personnel costs in Horizon Europe, currently under development, has enormous potential since personnel costs represent more than 60% of the budget of an average grant, and is by far the biggest source of errors. In addition, the Commission is providing support to Horizon Europe applicants through communication campaigns and workshops, targeting the more 'error-prone' beneficiaries such as small and medium-sized enterprises and newcomers. Furthermore, the Commission is making greater use of lump sum funding (see also below section of the replies) which simplifies the administrative charge of the beneficiaries.

As regards the error identified for Connecting Europe Facility (CEF) project (§5.10), the case concerned an irregularity in a procurement procedure and is related to a situation where a national court had declared a procurement procedure illegal while not voiding the contract. As the contract remained in effect, and since the works were effectively delivered, the Commission had to consider the costs eligible and make the corresponding payments.

The Commission notes that corrective measures it had applied as part of its control systems have led to a reduced estimated error for the chapter (§5.11). In addition, the Commission takes note of the cases of quantifiable errors reported by the ECA for further action.

As regards cases where the auditors contracted by beneficiaries to issue certificates on financial statements (CFS auditors) did not detect the errors found by the ECA (§5.12), it should be noted that the certificates on the financial statements (CFS), issued by the CFS auditors, cover the amount of the grant claimed by a participant and they certify ex-ante the eligibility of cost claims reimbursed by the Commission. To further improve the quality and reliability of the CFSs, the Commission organises targeted webinars for the CFS auditors to raise awareness of the most common errors found during audits (e.g. personnel costs, subcontracting and other direct costs, etc.). In addition to the self-explanatory template for Horizon 2020 certificates, the Commission provides feedback to the CFS auditors when errors in the CFS are identified via ex-post financial audits. Lastly, the Research Enquiry Service (a dedicated helpdesk on EU Research programmes) provides guidance to the CFS auditors through online requests.

Personnel costs

The Commission acknowledges that although Horizon 2020 was a step forward in the simplification and harmonisation of the rules for reimbursement of costs incurred, personnel costs have remained the main source of errors (§5.13). This seems to be, at least partially, a logical consequence of the fact that personnel costs account for the largest share of the total cost declared by Horizon 2020 beneficiaries.

The Commission has further intensified the frequency of its trainings and outreach activities, in particular targeting error-prone beneficiaries such as SMEs and newcomers. The Commission continued to organise webinars on “how to avoid errors in declaring personnel costs in Horizon 2020 grants”. During these events, which continued to take place on a bi-monthly basis in 2022, the Commission encourages the use of the personnel cost wizard.

Additionally, the Commission has organised a webinar addressed to Project Officers and Financial Officers where the Commission raised awareness on the importance of reducing the error rate in Horizon 2020. This event included an exhaustive presentation of the available tools (IT tools, guidance, trainings, webinars) to perform ex-ante controls.

Finally, the Commission has established a corporate Model Grant Agreement, applicable also to Horizon Europe[1], that provides a simple method for charging personnel costs, based on a daily rate calculation, replacing the error-prone methods used in Horizon 2020.

Calculation of hourly rates

The calculation of hourly rates (§5.14 to §5.16) remains a major focus of outreach activities organised on a regular basis by the Commission referred to above. The extensive use of the Personnel Cost Wizard (developed by the Commission) would also help beneficiaries to correctly declare their personnel costs. Moreover, beneficiaries are encouraged to make use of the Research Enquiry Service to directly request clarifications on practical matters related to grant management, including practical examples on eligibility of bonuses.

Time reporting

The Commission is aware of shortcomings in time recording and reporting and has simplified the Horizon 2020 procedures by introducing a declaration for persons working exclusively for the action.

In Horizon Europe, the Commission has further simplified the formal requirements related to time recording by introducing a simplified methodology for calculating daily rates for personnel costs. In this context, different guidance documents have been made available, focusing on the mandatory nature of recording hours devoted to the execution of the action. The auditors contracted by the beneficiaries (CFS auditors) are also instructed to verify the existence of proper record-keeping systems when providing the Certificate on Financial Statement.

The double ceiling rule

The double ceiling rule is important to ensure the respect of the non-profit principle underlying the cost reimbursements under EU programmes. The Commission makes available to beneficiaries all necessary information to correctly claim personnel costs in the Annotated Model Grant Agreement[2] (which includes practical examples on the double ceiling, the MSCA-RISE actions etc.), the Research Enquiry Service or the outreach communication activities.

Reply to Box 5.1

[1]https://ec.europa.eu/info/funding-tenders/opportunities/docs/2021-2027/common/agr-contr/general-mga_horizon-euratom_en.pdf

[2] https://ec.europa.eu/info/funding-tenders/opportunities/docs/2021-2027/common/guidance/aga_en.pdf

Example of a breach of the double ceiling rule

The follow-up to the breach of the double ceiling rule referred to by the ECA in Box 5.1 is already ongoing. The Commission is establishing the final debt amount based on the EU contribution percentage.

Other errors in personnel costs

Reply to Box 5.2

Example of ineligible costs declared for a Marie Skłodowska-Curie Research and Innovation Staff Exchange action

The follow-up to the example of the ineligible costs declared for a Marie Skłodowska-Curie Research and Innovation Staff Exchange action referred to by the ECA in Box 5.2 is ongoing.

Subcontracting

Horizon beneficiaries may award subcontracts when required, for implementing an action. The outreach communication events specified above, the Annotated Model Grant Agreement and the Research Enquiry Service are sources of explanations, clarifications, and practical examples on subcontracting to inform beneficiaries and ensure the respect of related principles and requirements. Moreover, all three information sources cover issues concerning consumables, equipment, prototypes, and travel costs. In a similar manner, they also deal with topics concerning VAT, internally invoiced goods and services, exchange rates, etc. (§5.21 to §5.23).

Reply to Box 5.3

Example of not ensuring best value for money and absence of conflict of interest when awarding a subcontract

The Commission agrees with the ECA's finding in Box 3, related to **a case of not ensuring best value for money and absence of conflict of interest when awarding a subcontract**. This error could only be detected by an ex-post audit. Any amount unduly paid will be recovered.

Small and Medium Enterprises

The Commission shares the assessment of the ECA that SMEs (and newcomers) are the most error-prone beneficiaries (§5.24). However, their participation, vital to the success of the programme, is encouraged at all levels.

To mitigate the risk of errors, the Commission provides support to Horizon Europe applicants through online information and communication campaigns and workshops on avoiding errors when declaring costs. These actions target the more 'error-prone' beneficiaries such as small and medium-sized enterprises and newcomers. Moreover, the increased use of lump-sum funding under Horizon Europe simplifies the administrative charge of the beneficiaries and is expected to further reduce the error rate. (Please see also below section of the replies).

2. Review of the Commission's procedures for lump sum funding in research

The roll-out of simplified cost options

The Financial Regulation defines several simplified cost options (SCOs) such as unit costs and lump-sums, which are becoming an increasingly common way to provide funding in EU grants in general, beyond the research framework programme. SCOs have enormous potential to reduce administrative burdens, help the beneficiaries focus more on the achievements of the EU-funded projects and are key to reducing the error rate.

The Commission piloted lump sum funding in Horizon 2020, in line with a recommendation from the ECA to test lump sums on a larger scale in the research and innovation framework programme (ECA Special Report 28/2018).

The Horizon 2020 pilot was analysed in a study by the European Commission[3], which concluded that lump sum design was generally fit for wider use. Based on this, the Commission decided to use more lump sum funding in Horizon Europe. In line with the findings regarding project size, lump-sum funding is mostly used for small and mid-sized grants, without however excluding larger projects use cases. The decision to expand the use of lump sums was also in line with a study commissioned by the European Parliament[4] showing that lumps sums were popular among users.

The existing studies could not cover the full lifecycle of lump sum funding because most grants were still ongoing. Waiting for an assessment of the completed pilot (§5.26) would have implied postponing the introduction of lump sums to the end of Horizon Europe or to the next multiannual financial framework. This would have run counter to the Commission's objectives and meant that the potential of lump sums to reduce administration, simplify funding rules and focus more on achievements, would have been left untapped.

In line with the expectation of many stakeholders, the Commission opted for a cautious and gradual introduction of this SCO. The Commission used this time to improve the respective guidance and support, following up on the main recommendations from the studies of the pilot.

Starting with the Horizon Europe work programme for 2023-2024, lump sums will see a significant use in Horizon Europe for the first time, expected to cover 20% of the call budget in 2024. As they are new for many participants, the Commission will continue to provide intensive training and support for lump sums, monitor related grants closely, and adjust the methodology if needed.

Lump sum funded grants

The Commission welcomes the ECA's methodological audit on lump sum grants in research expenditure.

Point 2.2. of the Horizon Europe lump-sum Decision describes the checks and reviews that shall be carried in order to minimise the risk of irregularity or fraud. It is the opinion of the Commission that

[3] European Commission assessment of lump sum funding (October 2021) https://ec.europa.eu/info/news/lump-sum-funding-works-practice-assessment-pilot-horizon-2020-2021-oct-06_en

[4] European Parliament (STOA) study on lump sums in Horizon 2020 (May 2022) https://www.europarl.europa.eu/stoa/en/document/EPRS_STU(2022)697218 'The content of the document is the sole responsibility of its author(s) and any opinions expressed herein should not be taken to represent an official position of the Parliament.'

this adequately addresses the requirement of the Financial Regulation (§5.29). However, the Commission will reassess the content of this Decision with a view to consider whether this could be made more explicit.

The Commission considers that rules regarding compliance with procurement are in place (§5.30). For instance, Article 11 of the 'lump sum MGA'[5] states that the beneficiary must implement the action in accordance with the agreement, and all legal obligations under applicable EU, international and national law (which includes applicable rules on procurement). Moreover, the lump sum decision does not contain specific information on checks and controls on procurement, since this is not required by the Financial Regulation.

Fraud-risks, similar to any other type of risk, are taken into consideration in the risk-assessment performed by the Commission.

According to the lump sum model grant agreement, payment requires that the work packages are completed, and the work is properly implemented as described in the agreement, irrespectively of the objectives achieved. The corporate lump sum guidance aimed to clarify the payment conditions for Horizon Europe. The Commission will improve further its guidance for applicants to help them better describe the proposed activities, notably by further harmonizing the terminology used.

Finally, the existing guidance on monitoring projects applies to all Horizon Europe grants, including lump sum grants. The expected standards of project implementation are the same, independent of the type of funding used (e.g., actual costs, unit costs, or lump-sums) (§5.31).

As regards guidance to expert evaluators (§5.32), the Commission provides them with a detailed briefing on how to carry out their task, including for lump sum proposals. This covers the assessment of the lump-sum budget and, as of the end of 2022, the use of the 'Horizon dashboard for lump-sum evaluation', which is the benchmark provided by the Commission for personnel costs. In practice, lump-sum evaluations have systematically used this benchmark since it became available. In the revision of the guidance, the use of benchmarks will be made obligatory.

Lump-sum proposals provide detailed cost estimates, and experts are instructed to check the necessity of these costs for the activities proposed based on their expert opinion. Other proposals contain much fewer budget details, meaning the level of scrutiny in terms of economy, efficiency and effectiveness is higher in the evaluation of lump-sum proposals.

3. Annual activity reports and other governance arrangements

The Commission welcomes the observation from the ECA that the DG RTD and DG DEFIS Annual Activity Reports (AARs) provide a fair assessment of the financial management in relation to the regularity of underlying transactions (§5.33).

As regards the level of error reported in its AAR (§5.34), DG RTD reports a cumulative representative error rate for Horizon 2020 at 2.71% and a residual error rate at 1.67%. Both error rates are calculated on the results of the audits carried out by the Commission on Horizon 2020 (2014-2021) for the representative error rate and the result of the corrections made for the residual error rate.

[5] https://ec.europa.eu/info/funding-tenders/opportunities/docs/2021-2027/common/agr-contr/ls-mga_en.pdf

To resolve the methodological issue previously raised by the ECA (annual versus multi-annual sample), the Common Audit Service calculated a top-up of 0.38%. Despite this, the Commission remains confident with the result of the error rate calculated in accordance with its methodology.

As regards ex-post audit campaign for the new framework programme Horizon Europe (§5.35), the Commission is currently working on the Control Strategy for Horizon Europe. In this context, the audit strategy is expected to be launched by the end of 2023. The target the Commission has set for the Horizon Europe residual error rate is no more than 2% by the end of the framework programme.

At present, most of the payments made for Horizon Europe are prefinancing. Therefore, no basis for an assessment of the error rate for this Framework Programme currently exists.

In relation to the seventeen Internal Audit Service (IAS) recommendations addressed to DG RTD and open at the end of 2022 (§5.36), they have been taken into account in the assessment of DG RTD's internal control system. Action Plans for all recommendations have been prepared and are being implemented. This includes the critical recommendation on the governance framework of the European Innovation Council (EIC) programme for which a joint action plan was drafted in coordination with EISMEA and DG CNECT. The need to restructure the EIC Fund following the provisions of the Horizon Europe legislation led to significant delays in the implementation of the EIC Accelerator scheme, with operational consequences for the beneficiaries as individual investment decisions and payments had to be put on hold. However, the Commission is progressively absorbing the backlog of investment decisions. In parallel, an interim solution has been put in place while finalising the negotiations with the European Investment Bank for the implementation of the indirect management mode, expected to be concluded in 2023.

In the Annual Management and Performance Report (AMPR, §5.39), the Commission uses the risks at payment disclosed by the DGs in their AARs which correspond to their best estimate and that underwent a careful and structured quality review.

Based on the work carried-out, the Commission considers that the risk at payment presented in the AMPR for MFF1 is representative and provides true and fair view of the level of error. This estimate is based on a methodology which allows the Commission, as a manager of the EC budget, to identify and distinguish between higher, medium and lower risk areas and therefore focus the Commission's efforts to mitigate the risk.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Recommendation 5.1 – Evaluate the lump sum funding

(a) In the framework of the mid-term evaluation of Horizon Europe, include an evaluation of lump sum funding in order to assess whether certain types of projects (in terms of content, size, etc.) are not suited to lump sum funding, as well as cover the risk of irregularities and fraud.

Target implementation date: Horizon Europe mid-term evaluation (end 2025)

(b) Prior to the next Horizon Europe calls, assess the appropriateness of using lump sum funded grants for high-budget projects and of fixing a maximum amount for such grants.

(Target implementation date: end 2024)

The Commission **accepts** the sub-recommendations 5.1a) and 5.1.b).

5.1a) The Horizon Europe mid-term evaluation will analyse the simplification measures introduced to the programme, including the use of lump sums.

5.1b). Based on the pilot in Horizon 2020, the Commission found that research lump sum funding works best for small and mid-sized projects.

The Commission will assess if introducing such a limit specifically for lump sum grants under Horizon Europe would help reduce risks and if it is adequate with regard to the results to be delivered under the programme, as requested by the Financial Regulation.

Recommendation 5.2 – Improve experts' evaluations of lump sum grants

For lump sum grants, ensure that expert evaluations of grant applications, in particular the budget proposals therein, are carried out with due considerations of relevant benchmarks and are properly documented.

(Target implementation date: end 2023)

The Commission **accepts** this recommendation.

The Commission agrees that relevant benchmarks are a useful reference to be used in the evaluation of the lump sum budget, and that the assessment should be properly documented. The relevant guidance and expert briefing will be reviewed to further clarify this.

Recommendation 5.3 – Define clearer requirements on implementation of Horizon Europe grants

Further specify for lump sum grants the requirements defining proper implementation, including the elements of each work package that will trigger payment, as well as provide detailed guidance to those involved in assessing the implementation of projects.

(Target implementation date: Q1 2024)

The Commission **accepts** this recommendation.

The Commission will review (1) all relevant guidance to ensure harmonised terminology in this regard (e.g., activities vs. tasks vs. work done), and (2) the requirements in the proposal template for the drafting of the technical annex of the projects.

Recommendation 5.4 – Define the scope of *ex-post* controls of lump sum grants

For lump sum grants, define the scope of *ex post* controls, which should include checks on high-risk areas, such as procurement rules, absence of conflict of interest and the use of the resources indicated in the grant agreement.

(Target implementation date: mid 2024)

The Commission **partially accepts** this recommendation.

The Commission is developing an *ex post* control strategy for Horizon Europe grants (including lump-sum grants) based on the rules of the Financial Regulation. Ex-post technical reviews will be a key element, verifying proper implementation according to the applicable rules whilst increasing the focus on content.

The Commission will continue performing robust risk assessments and will focus its control resources on high-risk areas. The Commission does not accept the part of the recommendation dealing with the *ex-post* control of the use of resources, since the budgeted resources are systematically checked *ex ante*. Although the Commission cannot predetermine high-risk areas, the Commission notes that any further checks on the use of resources would require financial checks (in particular of time sheets of staff working on the action) which would invalidate the potential simplification of using lump sums.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 6: COHESION, RESILIENCE AND VALUES

I. THE COMMISSION REPLIES IN BRIEF

The funds dedicated to the economic, social and territorial cohesion are spent through a system of shared management between the European Commission and national authorities.

Member States are in the first instance responsible for putting in place robust management and control systems, allowing to implement the agreed objectives through operations and to prevent, detect and correct irregularities in related expenditure, where necessary and legally feasible. The Commission supervises the effective functioning of these management and control systems, making recommendations for improvements as need be, seeks reasonable assurance that the annual error rate for each programme is below 2% and, if necessary, makes additional financial corrections.

The Commission Single Audit Strategy for Cohesion aims at obtaining such reasonable assurance through a combination of review and re-performance of the work of programme authorities. The objective is to ensure that no serious deficiencies remain undetected or uncorrected by the Member States in the accounts submitted each year with assurance packages. The audit approach is also complemented by capacity building actions that include the definition of common methodologies to be applied, recommended corrective actions and feedback on detected errors allowing programme authorities to improve their work, where deemed necessary.

Based on all national and Commission audit results available, and continuous efforts by programme authorities to improve their work based on audit recommendations, the directorates general for regional and urban policy (REGIO) and for employment, social affairs and inclusion (EMPL) concluded in their AARs that management and control systems function well (or sufficiently well) for almost 90% of programmes. For the remaining programmes, weaknesses remain mainly at the level of managing authorities or their intermediate bodies (deficiencies in management verifications, the first level controls). Moreover, some errors continued to remain undetected by some audit authorities, in most cases however without questioning the reliability of the audit work carried out.

Against this background, the Commission and programme audit authorities have not detected and reported an overall year-on-year deterioration in the functioning of most management and control systems during the accounting year audited by ECA (2020/2021). In all cases where deficiencies or irregularities were identified, the Commission requested remedial actions to avoid the recurrence of errors for the future, to correct past affected expenditure and stopped EU payments as long as such corrective measures were not implemented, in line with the regulatory tools at its disposal.

Under the exceptional circumstances and consequences of the COVID pandemic, the Commission has taken the necessary measures to help Member States as quickly as possible. Flexibilities granted in the use of yet uncommitted cohesion policy funds (CRII/CRII+ measures) and additional funding made available (REACT-EU) led to the largest and fastest re-programming exercise of the 2014-2020 period to ensure that funds help counter the socio-economic effects of the pandemic. The ECA reported on this challenging period in its Special report 02/2023: "Adapting cohesion policy rules to respond to COVID19".

Since the outbreak of the COVID-19 pandemic, the Commission has requested programme authorities to pay particular attention to new risks related to the additional funding made available under NextGenerationEU (NGEU,) in particular the risk of double funding, conflict of interest, fraud or corruption, and to the flexibilities introduced with the Coronavirus Response Investment Initiative (CRII) and the Coronavirus Response Investment Initiative Plus (CRII+) amendments, especially the risk of unjustified use of emergency public procurement procedures. The Commission paid attention in its assessment of annual control reports for each programme whether such risks had been identified and, if so, whether appropriate corrective measures were taken. Transparent reporting on identified breaches of applicable rules was made in the respective annual activity reports (AARs) of REGIO and EMPL.

The Commission and Member States closely cooperated during this period to ensure that the control and assurance framework continued to effectively address the identified risks, taking into account the flexibilities introduced to enable an adequate response in the emergency situation, as unanimously adopted by the co-legislators.

The related expenditure only started being reimbursed by the Commission in the 2020/2021 accounts, as reflected in the sample audited by ECA. Audit activity related to the 2020/2021 accounts gradually went back to normal in most cases and in February 2022 the Commission received the same quality annual control reports as part of assurance packages, with error levels reported similar to previous years. The risks at payment reported in both AARs are therefore consistent with previous years and correspond to the best Commission's estimate of the level of error in the expenditure certified, following a careful and structured quality review on reported results. Given its detailed segmentation of expenditure according to risk profiles and control systems, the Commission, when detecting errors, and taking also account of the ECA's work, is able to identify the specific part of the programme population that is most likely to be affected. This approach allows to clearly identify the areas where improvements are needed, to apply proportionate financial corrections where appropriate and legally possible and to give a differentiated view of the level of error across the payments made.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

Regularity of transactions, AARs and other governance arrangements

Results of ECA's transaction testing

The Commission takes due note of the increase in the error rate estimated by the ECA this year (§6.16), compared to a relatively stable level of error reported for the last five years. The Commission's risk at payment disclosed in the 2022 AARs remained comparable with those of previous years.

The Commission attributes the difference namely to the fact that the ECA reports errors related to any breach of applicable rules. The Commission does not necessarily consider the associated expenditure to be ineligible. For programme authorities and the Commission to impose financial corrections, an error must be an irregularity within the sense of Article 2(36) of the Common Provision Regulation (CPR). Not all errors reported by the ECA fall into this category.

The Commission's own reported risk at payment thus represents a rate of irregularities that leads to financial corrections based on applicable regulatory provisions, following contradictory procedures with the concerned programme authorities.

Moreover, out of the 48 errors reported and quantified in 2022 by the ECA for Cohesion policy funds, the Commission does not agree with the assessment for 18 errors.

For 13 of these errors, the Commission considers that, in line with the above-mentioned CPR provisions, it could not conclude on an irregularity leading to ineligible expenditure. This includes two transactions assessed by the ECA as major projects not notified to the Commission. The Commission does not agree that the related operations correspond to the definition of major projects in the CPR (see further details in the Commission reply to paragraphs 6.24 and 6.25).

Moreover, for 5 cases, the Commission is not able to apply the level of quantification used by the ECA. This includes two public procurements where the Commission considers that the level of correction applied by the programme authorities is justified by the type of breaches identified by the audit authority or the Commission (see below Commission reply to paragraphs 6.32 and 6.33).

Overall, for these 18 cases, the Commission has assessed that it would not have legal ground to impose financial corrections (or higher corrections than those already applied), as further developed in the Commission replies to the paragraphs below.

The Commission will duly follow up all other cases and request financial corrections, where appropriate. The Commission will also recommend remedial actions to the concerned programme authorities to further improve the management and control systems, as necessary.

The Commission does not share ECA's assessment (§6.17) on all errors reported (see reply to paragraph 6.16), nor the view that the increased flexibility in the use of Cohesion policy funds during the COVID pandemic can explain the increase in the error rate reported by the ECA. The Commission notes that its own control results indicate overall a good functioning of the management and control systems during the period, except for a limited number of programmes (see reply to paragraph 6.42). The Commission further assesses that the impact on the overall calculated error rate of the 17 quantifiable errors related to the CRII/CRII+ measures or to operations benefitting from a temporary increased EU co-financing of 100%, is similar to the impact of errors identified in other types of operations.

In relation to the approaching end of the eligibility period for the 2014-2020 programming period and possible absorption pressure, the Commission also recalls that after the audited year (2021-2022), another three accounting years were still available to programme authorities to declare expenditure before the 2025 closure (last final payment in July 2024).

As regards quantifiable errors reported by the national audit (§6.18), audit authorities play an important role in detecting errors which led to significant financial corrections and withdrawals before the programme accounts were submitted to the Commission. As reported in REGIO and EMPL 2022 AARs, Member States deducted cumulatively from the programme accounts, since the beginning of the 2014-2020 period, EUR 2.5 billion of definitive financial corrections for European Regional Development Fund (ERDF), Cohesion Fund (CF), European Social Fund (ESF) or Youth Employment Initiative (YEI) as a result of the audit authorities' work. These amounts brought the residual error rate down to below 2% where necessary.

In the accounting year under analysis, audit authorities reported total error rates above 2% for around one fifth of programmes, thus demonstrating their detection capacity.

The Commission, however, agrees that some errors remained undetected or were inappropriately considered in the calculation of the reported error rates, in individual cases. For this reason, REGIO and EMPL adjusted the risk at payment and KPI on legality and regularity they reported in their respective annual activity reports, following a programme-by-programme assessment.

As regards error types (§6.19), based on their common typology, the Commission and the audit authorities identified generally the same categories of irregularities as the ECA under Cohesion policy: ineligible expenditure, public procurement, audit trail and State aid.

The Commission will follow up all reported errors that it accepted and will apply financial corrections, where necessary and legally feasible.

Eligibility of costs

Management verifications should be designed to prevent and detect errors, in particular ineligible costs (§6.21 and §6.22).

The Commission addressed updated guidance to Member States for the 2014-2020 programming period, which, combined with the enhanced use of simplified costs options, aimed at improving further the efficiency of management verifications to detect ineligible costs and operations. Efficiency of verifications depends however on the number of staff available in the concerned administrations for such verifications, the level of training they received and their related experience.

The Commission is taking preventive and corrective action and requests remedial measures as soon as deficiencies are detected in first level controls. This entails improvement of methodological tools, recruitment of additional staff including experts, training activities on newly developed tools or on the correct interpretation of most frequent errors, as well as improvement in selection procedures. In the 2021-2027 period, management verifications have become risk-based to better focus the available administrative resources on the targeted root causes of errors, including ineligible expenditure.

Moreover, for 10 out of the 37 eligibility errors identified and quantified by the ECA, the Commission does not share the ECA's assessment of the facts, or its interpretation of the applicable national or programme-specific rules, and considers that it has no grounds for imposing financial corrections.

Reply to Box 6.1

Ineligible expenditure for COVID 19 emergency support due to incomplete declaration of sales income

The ineligible costs found by the ECA in relation to COVID-19 measures in Greece (Box 6.1) were already partially identified by a Commission audit and already largely corrected by the Member State. Moreover, in Italy the reported error was not an error at the time of the EU payment and of the audit of the audit authority, therefore this error could not have been identified then corrected by anticipating whether the condition for the grant increase would be fulfilled or not by March 2023. This error will be corrected in the current accounting year and in the Commission's view it does not affect the audited accounting year.

As for the two Slovakian cases, the Commission will duly follow up the errors identified.

Reply to Box 6.2

Expenditure declared without a major project notification being sent to the Commission

Regarding the two operations reported by ECA and considered to be part of major projects (§6.24, §6.25 and box 6.2), the Commission agrees with the Member States that these operations fulfil the CPR requirement to be technically and economically divisible, and that they were feasible, functional and usable independently.

Moreover, in the Romanian case the total public eligible cost of the project is below the CPR thresholds according to the basis for the calculation of eligible expenditure under the programme.

The Commission also disagrees with the position of the ECA that expenditure associated with major projects that would not be notified to the Commission becomes ineligible. In exercising its prerogatives as a public authority, a managing authority's abstention to submit/notify a major project in accordance with Article 102 CPR does not result in an irregularity in the meaning of Article 2(36) CPR. Therefore, it does not render the expenditure declared to the Commission in relation to that major project ineligible. Moreover, the absence of notification does not lead to any prejudice, actual or potential, to the budget of the European Union since the programme authorities can, at any moment, notify the major project and confirm the expenditure as fully eligible. This possibility to reintroduce expenditure linked to unnotified major projects under Article 102 of the CPR is not offered for irregularities (e.g. ineligible expenditure) under Article 2(36) of the CPR.

The Commission therefore concludes that expenditure declared for these two operations was eligible.

As regards simplified cost options (SCOs, §6.27), since their introduction, the Commission has actively worked to progressively extend their use and notes that these efforts have already led to positive results and significant simplification and reduction of administrative burden. The Commission therefore finds it encouraging that over one quarter of expenditure audited in the ECA sample was declared under SCOs. As per ECA past recommendations, the Commission will continue to actively promote the use of SCOs based on the reinforced 2021-2027 CPR provisions, to reduce the administrative burden on the beneficiaries, promote result-orientation and further reduce the risk of error.

The Commission will follow up the issues identified.

Eligibility of projects

Reply to Box 6.4

Project scope did not comply with selection criteria

Concerning the findings of the report linked to ineligible projects (§6.28 and box 6.4), the Commission agrees that some expenditure on this project was ineligible, but it disagrees with the level of quantification of the error. It considers that part of the construction costs rejected by ECA can effectively be linked to energy-efficiency measures, and therefore the 25% threshold which would have made the project ineligible was not reached – see Commission reply to paragraph 6.16.

The Commission noted these compliance issues referred to in §6.29 that, however, did not lead to a quantification of the error and will follow-up with the programme managing authority to ensure that the documents establishing the condition for support to the concerned public beneficiary are clearer in the future.

Internal market rules: State aid and public procurement

As regards State aid rules, the Commission notes the errors detected by the ECA and referred to in §6.30 and §6.31 and will follow them up with the concerned programme authorities. It further notes, however, that over the past years, errors related to State aid account for a smaller share of all errors identified, as illustrated by the ECA results as well. For the most recent accounting year 2020/2021, only 2.6% or 10% of the ERDF/CF findings identified respectively by Member States and the Commission concerned State aid (see REGIO 2022 AAR).

The Commission will continue to implement the measures designed under its State aid action plan identifying and disseminating good practices and offering training to all European structural and investment funds (ESI funds) stakeholders, to ensure a good understanding and correct implementation of State aid provisions.

As regards public procurement (§6.32 to §6.34), this is characterised by complex national and EU rules and remains an important source of error that is however better detected and reported by audit authorities nowadays. This is a sign that the administrative capacity actions implemented under the Commission's action plan on public procurement bear fruit. This is also reflected in the relatively limited number of public procurement errors reported by the ECA in the last years.

The Commission decision on financial corrections for public procurement errors updated in May 2019 (Decision C (2019) 3452) contributes to this clarification of the applicable legal framework. This harmonised approach allows programme authorities to better detect and deal with possible breaches of public procurement legislation.

The Commission does not agree with the quantification in six of the seven cases reported by ECA. It considers that in three cases, the authorities concerned have provided sufficient and acceptable supporting evidence to accept the expenditure linked to the public contracts they declared as eligible (see also reply to box 6.6). Moreover, in three cases, the Commission considers that the correction applied by the programme authorities was commensurate to the irregularity that occurred, and that it was in line with the Commission's guidelines.

In the remaining case, the Commission agrees with the ECA. However, it notes that mitigating measures were in place to allow for competition in line with the Directive, although the ECA considered these were not sufficient in relation to the national practice (see box 6.6).

Reply to box 6.7

Inconsistent application of emergency exemptions in public procurement procedures for the purchase of face masks

The Commission notes that the case referred to in box 6.7 concerning the supply of face masks in March 2020 in Spain was carried out in line with applicable emergency procedures. The COVID outbreak had indeed generated an unprecedented situation of urgency requiring exceptional measures to preserve public health.

Despite the extremely difficult situation to obtain masks on the world market at that time (China, de facto the biggest provider, having restricted its export rules in April/May 2020), the contractor ensured the effective supply of 150 million face masks of the required quality and at the price set, be it with a delay of 3,5 months under the health emergency situation that remained extremely acute in Spain in the delivery period.

The Commission agrees with the Spanish authorities that the above facts did not put into question the eligibility of the related expenditure in this non-quantified case. It will remain attentive to any development, in close cooperation with the Spanish authorities.

Supporting documents

For the Spanish case (§6.36 and §6.37), the Commission notes that the beneficiary has provided the necessary evidence for the eligibility for the concerned expenditure (timesheets of participants), before its payment was made, in line with the applicable rules under the project call and instructions to beneficiaries. The Commission will however remind the programme authorities to ensure that adequate timesheets supporting the declaration of expenditure are to be signed by ESF beneficiaries in due time.

In the Portuguese case, the Commission considers that the system put in place by the universities to decide on scholarships for students is based on an assessment of the fiscal revenue of the households concerned, according to the self-declarations delivered by the concerned students and cross-checked with the tax system, and on students' academic records, available online as subsequently confirmed by the universities after ECA's audit. When risks appear in the self-declarations, students are called for in-depth interviews to clarify their application which is then accepted or rejected. Although the Commission did not identify any irregular scholarship in the audit authority's sample reviewed by ECA, it will discuss with the programme authorities whether further system improvements are still needed to avoid any risk of incorrect calculation of the amounts of scholarship granted.

Financial instruments

For the six cases reported by ECA (§6.38 to §6.40), the Commission considers that the authorities have provided sufficient supporting evidence that demonstrates the eligibility of the final recipients or supported activities.

The Commission further notes that the CPR foresees that the eligibility of underlying transactions and expenditure for financial instruments is determined at closure (Article 42 CPR). Therefore, any irregularity identified at the level of final recipients of financial instruments can still be corrected and substituted with eligible expenditure under the respected financial instrument by closure (in 2025). The Commission and audit authorities' audit strategies foresee targeted preparation to closure audits to ascertain the eligibility of expenditure declared under financial instruments up to closure. In this frame, the Commission will follow up the system weaknesses reported by ECA, as necessary.

Sound financial management

Reply to box 6.8

Use of simplified cost options resulting in an excessive financial benefit for a member state

The Commission notes that the SCOs used under this Italian Education programme referred to in box 6.8, at EU and beneficiaries' levels, cover different outputs (success of trainees / students following their participation to training in the EU level SCO, and the training courses costs in the national SCO). It is therefore expected that the reimbursed costs differ between the two schemes. Moreover, under the regulations and in particular Article 14(1) of the ESF regulation, there is no direct correspondence between the methods applied at national level for determining the eligible costs of the specific operations and the calculation methods applied between the Member State and the Commission to determine the EU reimbursement. Both methods approximate the real costs, and according to Article 14(1), any difference between these calculation methods should not be deemed ineligible. The Commission will continue to follow up with the programme authorities that the adjustment method for the SCO, explicitly foreseen in Article 14(1), is applied as necessary.

Regarding the renovated cultural centre in Italy, the Commission reminded the programme authorities that the operation will have to be physically completed by 1 March 2025 at the latest. Issues related to the effective use and contribution of operations to the objective of the programme are clearly underlined in the updated version of the Commission closure guidelines made available to Member States (Commission notice (2022/C 474/01) of 14 December 2022), and will be duly monitored, in the context of the closure of the programmes.

Work of audit authorities

Managing authorities and audit authorities

Under shared management, programme authorities are responsible in first instance to prevent, detect and correct irregularities in the expenditure declared by beneficiaries (§6.42 and §6.43), through management verifications by the managing authority (when accepting expenditure declared by beneficiaries) and audits of representative samples of expenditure carried out by audit authorities (second level to assess whether the first level was effective in ensuring the legality and regularity of expenditure declared, before certifying expenditure in the programme annual accounts).

The Commission has continued in 2022 to extensively cooperate with the programme authorities to ensure a consistent and robust assurance and control framework, including following the practical restrictions during the pandemic.

As reported in the AARs of REGIO and EMPL, the Commission has identified weaknesses and requested improvements for 52 ERDF/CF/ESF managing authorities and 10 audit authorities or their control bodies (in charge of auditing 2.1% and 8.5% of ERDF/CF and ESF, YEI, and Fund for European Aid to the Most Deprived (FEAD) expenditure respectively) out of the total 116 cohesion audit authorities.

The Commission assesses the effectiveness and reliability of the work of an audit authority based on various different aspects, the error rate being only one of them. Some additional errors that the Commission detects are more occasional: even if they significantly affect the error rate, they do not necessarily indicate a systemic weakness of the audit authority.

Residual error rates

For the accounts accepted in 2022 (§6.44 to §6.47), the Commission confirmed a residual error rate:

- below materiality (including in some cases after adjustments without a material impact) for 278 ERDF/CF/ Instrument for Pre-Accession (IPA)/ European Neighbourhood Instrument ENI (87%) and 193 ESF/YEI/FEAD (90%) programmes, and

- above materiality for 41 ERDF/CF/IPA/ENI (13%) and for 22 ESF/YEI/FEAD (10%) programmes, respectively. These programmes with a residual rate above materiality represented in 2022 12% of all Cohesion policy programmes. Over the past years this proportion has remained stable for ERDF/CF programmes (around 13%) and even decreased for ESF/YEI/FEAD programmes (from 40% in 2017 to 10% in 2022).

The Commission considers that the cases with residual error rates recalculated by the ECA above 2% in the assurance packages audited in 2022 are partly attributable to differences in the appreciation of individual cases or the interpretation of applicable rules, which may differ between the ECA and the Commission and/or the concerned audit authorities.

In this respect, the Commission refers to its replies to paragraphs 6.16, 6.17, 6.21, 6.24, 6.28 and 6.32, where it expressed the reasons for disagreeing on a number of errors reported by ECA that contribute to these recalculations of the residual error rates above 2% for a number of programmes. Out of the sixteen cases of assurance packages recalculated above 2% by the ECA, the Commission had already adjusted ten above 2%. Based on its assessment of reported facts and applicable rules (that should have led audit authorities to effectively detect and quantify the additional errors in the concerned cases), the Commission considers that only four of the remaining six assurance packages reported by the ECA should be recalculated above 2%.

In addition, the Commission assesses the reliability of audit authorities not only on the basis of the recalculated error rates (which can be influenced by single errors having an important statistical impact), but on a number of criteria which, if not satisfactorily assessed, reflect the presence of systemic weaknesses in the work of audit authorities.

Taking into account these criteria, the audit evidence the Commission has collected, and the ECA results this year, the Commission assesses the effectiveness of audit authorities' work to be similar to the one reported in previous years.

The Commission also refers to its common reply to paragraphs 6.48 to 6.51 below.

Audits by audit authorities in 2022

The Commission considers that it has reasonable assurance on the work of most audit authorities (§6.48 to §6.51), except for a limited number of them (10) that require major improvements of their audit capacities to remedy the weaknesses found (see the common Commission reply to paragraphs 6.43 and 6.44 above).

Targeted remedial actions recommended in several cases allowed addressing the identified weaknesses and led to concrete improvements (e.g. the Bulgarian audit authority, with no error found in recent years, following past years of systemic weakness in quantifying public procurement errors).

In addition to recommendations to improve targeted weaknesses identified for some audit authorities, the Commission has established a robust continued cooperation with the audit community. This includes the sharing of common audit tools and good practices in line with the 'Charter on good practices promoted by the Audit Community when auditing ESI Funds'.

The Commission is also continuously reminding audit authorities to keep an adequate audit trail of their audit work, in line with the "Reflection paper on audit documentation" elaborated jointly by representatives of audit authorities and the Commission (see ECA 2020 Annual Report).

In relation to the weaknesses that the ECA considers occurred in the audit authorities' work on verifying a number of issues, the Commission also refers to its reply to paragraph 6.16, pointing to the fact that the audit authorities would not have the basis to consider and report some of the errors quantified by the ECA, due to the difference in approaches and interpretation of applicable rules.

Reply to box 6.9

Beneficiaries' self-declarations not checked against reliable and verified sources by audit authorities

In general, the Commission considers that self-declarations are a useful tool to gain assurance when finding alternative supporting evidence would be difficult or administratively too costly for the beneficiaries, project promoters or participants. Issues related to the General Data Protection Regulation may also occur. Therefore, a certain degree of proportionality is needed in the verification of such declarations. The Commission will continue to work with audit authorities to promote a pro-active audit approach, when possible (as it did for example in the verification of the 'Not in Employment, Education or Training' (NEET) status in France following the ECA recommendation in its 2021 annual report).

Shortcomings in audit authorities' checks of financial instruments (§6.51)

The Commission refers to its reply under paragraphs 6.38 to 6.40.

Multiannual nature of operations to be taken into account when determining financial corrections

The request to implement financial corrections for all past expenditure, independently of the accounting year, when a deficiency / irregularity is identified, is normal practice for the Commission and for audit authorities (§6.52 and §6.53). This is for example typically the case for breaches of public procurement errors that affect all expenditure declared so far by the operation (as well as all future expenditure to be declared under the affected contract). This being said, the Commission will continue to ensure through its audits that any irregularity detected by national or EU audits in an operation is corrected for all past expenditure affected.

Measures to fight and report fraud against the EU budget

The Commission has zero tolerance for fraud (§6.54 to §6.56). Management and control systems set in the CPR also include the 'implementation of proportionate and effective anti-fraud measures proportionate to the risks identified" for each programme (key requirement 7, Article 125(4)(c) and annex IV Regulation 480/2014 as amended). As part of their audit strategies, that the Commission supervises and monitors, audit authorities carry out system audits of the effective implementation of key requirement 7 for each programme.

In addition, following the ECA recommendation N° 5.2 in its 2020 annual report, the Commission also requested audit authorities to better document their work to detect fraud alerts (see Commission reply to paragraph 5.55 of the ECA's 2020 annual report). The ECA results this year reflect improvements compared to previous years in that respect, showing a steady improvement in the documentation of this part of the audit authorities' work.

The Commission Anti-Fraud Strategy and the Cohesion policy specific Joint Anti-Fraud Strategy also foresee several other anti-fraud actions, all implemented in 2022 (see REGIO and EMPL AARs, pp. 52 and 78, respectively).

This includes the continued Commission encouragement to programme authorities, including audit authorities, to make systematic use in their work of the Commission data-mining and risk-scoring tool ARACHNE, strengthening their capacity to identify and prevent fraud and corruption affecting cohesion policy funds (see Commission reply under 6.60-6.62).

Member states' reporting of suspected fraud cases in IMS

The Commission has planned several actions under the Action Plan of the Commission Anti-fraud Strategy (currently under update) to remind Member States authorities about their obligations to report suspected fraud in OLAF's Irregularity Management System - IMS (§6.57 and §6.58): trainings, awareness raising in regular meetings, for example with anti-fraud coordination services (AFCOS) or programme authorities, and an update of the guidance on reporting (IMS Handbook). As part of their system audits, audit authorities also ensure a specific verification of the effectiveness of anti-fraud measures in place (key requirement 7), using specific checklists developed with the Commission. REGIO and EMPL also added in 2021 a clear reference to reporting in IMS in audit checklists, aiming at ensuring clear reporting mechanisms on both suspicions of fraud and on control weaknesses.

In two of the three cases referred to by the ECA, the authorities concerned have in the meantime corrected their initial mistake and reported the instances of irregularities and possible fraud in IMS. The last case did not fulfil the criteria for reporting at the time of submitting the accounts since the national authorities were not aware of any investigation launched at that time.

In addition, the CPR, annex XII, section 1.5 states that "*Where national provisions provide for the confidentiality of investigations, only information subject to the authorisation of the competent tribunal, court or other body in accordance with national rules may be reported*." The confidentiality of the investigations could therefore explain the delayed or non-reporting of some of the cases.

New IT tools on data mining and risk scoring

Since 2010, the Commission has developed its data-mining and risk-scoring tool ARACHNE and offered Member States to make systematic use of the tool in their work, free of charge, to strengthen their capacity to identify and prevent fraud and corruption affecting cohesion policy funds (§6.59 to §6.61). The recently released ex ante module allows to use the tool preventively at project selection and award phase, in addition to ex post verifications to control implementation of projects. The use of ARACHNE by Member States is evolving positively (constantly increasing numbers of connections and active users). Moreover, negotiations on the recast of the Financial Regulation, with a proposal to make the use of a data-mining tool mandatory after 2027, has relaunched the debate on the voluntary use of the current tool in a number of so-far reluctant Member States (Sweden joined the tool for a pilot exercise on a number of programmes).

Applying the new provisions only to programmes adopted under and financed as from the post-2027 multiannual financial framework (MFF) is meant to allow enough time for the necessary adaption of electronic data systems, and for guidance and training. Voluntary application (with compulsory transfer of data into the system) will remain possible and encouraged during that transitional period.

The voluntary use of the tool is indeed based on a jointly agreed charter of rights and obligations that foresees limitations to the use by external parties of the Member States' data transferred into the tool. Until now, the Commission has normally provided access to the targeted results in ARACHNE for given cases whenever a request is made by OLAF, the ECA or the European Public Prosecutor's Office (EPPO) for the needs of their activities. A targeted electronic access module for these third-party control bodies is also currently under development, to allow direct, specific (instead of general, in line with the above-mentioned charter) access to the required information in the tool.

Follow-up to ECA's special report on fraud in cohesion spending (§6.62)

The Commission committed not to issue guidance in the 2021-2027 programming period in the effort of simplifying the rules for programme bodies and beneficiaries. Instead, the 2014-2020 guidance to Member States on how to design proportionate anti-fraud measures and the attached risk-assessment tool remain of application by analogy for the Member States, who are used to these documents.

The Commission has undertaken several actions to help the Member States to adopt and update formal anti-fraud policies. "Guidelines for national anti-fraud strategies for European Structural and Investment Funds (ESIF)" were issued and disseminated in 2014. The document continues to be applicable to the 2021-2027 programming period. Furthermore, the Commission obtained evidence that some managing authorities in the five Member States mentioned by the ECA have adopted formal anti-fraud policies or statements for their 2021-2027 programmes, or reinforced their anti-fraud measures within the context of the technical assistance provided by EU funding.

The Commission's assurance work and reporting of residual error rate in its annual activity reports

The Commission's key performance indicator on regularity in annual activity reports (§6.64 to §6.67)

The Commission has designed its assurance system to allow the Directors-General to provide assurance on each of the 416 individual programmes under Cohesion policy, as per their obligation as authorising officers by delegation. The Commission concluded in the AARs of REGIO and EMPL that "*overall for cohesion, there is a material level of irregular expenditure remaining in the accepted accounts despite the control layers and corrections already applied at Member State level*". Based on all audit evidence at its disposal, the Commission is confident, however, about its estimated risk at payment reported in the AMPR, expressed as a maximum of 2,6% of the relevant expenditure. The Commission reported in detail in the AARs the programmes for which all audit results point to the need for potential additional financial corrections, based on a thorough and robust methodology applied for each programme. The Commission also refers to its reply on the assurance it obtained on the work of audit authorities in paragraph 6.49-6.51 above.

Moreover, the aggregated key performance indicator (KPI) is reported in the AARs as a weighted average of all confirmed error rates, including taking account of audit results under contradictory at the time of this assessment. The Commission also reports a maximum level of this KPI (worst-case scenario), taking into account all pending information still under validation. Since last year, this maximum includes a risk 'top-up' for programmes which have never been audited by the Commission itself or for which prior audits revealed certain irregularities that could be repeated to non-audited programmes.

In the Annual Management and Performance Report (AMPR), the Commission uses the risks at payment disclosed by the DGs in their AARs which correspond to their best estimate of the level of error in the expenditure certified, following a careful and structured quality assessment of reported results for each programme. Given this detailed segmentation of expenditure according to risk profiles and control systems, the Commission, when detecting errors, and taking also account of the ECA's work, is able to identify the specific part of the programme population that is most likely to be affected. This approach allows to clearly identify the areas where improvements are needed, to apply financial corrections where justified and legally possible and to give a differentiated view of the level of error across the payments made.

Furthermore, national authorities and the Commission may carry out audits and implement any additional required financial corrections in a multiannual period (including up to three years after the year in which accounts were accepted). This possibility offered by the co-legislator is important for the Commission to be able to discharge its responsibilities in relation to implementation of the EU budget under multiannual programmes.

To reflect these multiannual actions, the Commission determines a risk at closure, meaning the remaining risk of error in the expenditure after all controls and corrections have taken place. For 2022, the risk at closure has been estimated at 1.3% for MFF subheading 2a, similar to previous years. Based on the further audit work carried out and additional financial corrections effectively implemented for previous accounting years, the Commission re-calculated the Cohesion risk at closure for previous reporting years and concluded that it was now well below 2%, as it had been anticipated. For the reasons explained in its replies to paragraphs 6.16, 6.17, 6.21, 6.24, 6.28 and 6.32 above, the Commission considers it can effectively apply financial corrections for 30 of the 48 errors reported by the ECA, after its own due contradictory procedure with the concerned programme authorities.

The Commission compliance audits and desk reviews remain

The Commission considers that the desk reviews (§6.68 to §6.70) it carries out for every programme each year is an efficient and proportionate approach for programmes that are found to reliably report low error rates year after year.

The Commission's desk assessment takes account of all cumulative knowledge and audit results in relation to previous audit work carried out on the audit authority and programme concerned (including Commission's, ECA's and national audits) to critically review the audit conclusions provided in the annual control report. The Commission liaises with audit authorities when it needs clarifications. For riskier programmes, the desk review is complemented by fact-finding visits or audits are re-performed.

In 2022, based on desk reviews only, EMPL and REGIO recalculated the reported residual error rate for 35 and 79 programmes respectively, above 2% in twelve cases. This clearly shows the added value of this approach.

When it comes to the estimate of the error rate (KPI) in the AARs, to take account of the ECA recommendations in its Special report 26/2021 (see footnote 26 in the ECA text), the Commission has complemented its calculation of the maximum risk with a top-up, set at flat rate, for unaudited programmes. In its calculation, the Commission also takes account of the ECA audit results reported before the signature of the AAR. Top-ups (maximum risks) remain an estimation based on the Commission's best professional judgement that can be confirmed or not by further audit work. This methodology allows the best estimate of the risk at payment to be established at the time of signing off the AARs, as the Commission does not (and cannot) audit on-the-spot every single programme each year.

Once the desk review is completed, the Commission carries out its risk-assessment to determine the programmes to be audited on the spot. The Commission fully reported the results of its audits in the AARs.

The Commission also refers to its disagreement with eighteen errors included in the ECA's estimated error rate (see Commission replies to paragraphs 6.16, 6.17, 6.21, 6.24, 6.28 and 6.32).

Net financial corrections (§6.71 and §6.72)

The co-legislator has set strict criteria in the legal framework for the Commission to implement net financial corrections that are subject to strict cumulative requirements considerably limiting their scope of application and in practice leading to considerable challenges in applying such net corrections. This explains the absence of such decisions so far and illustrates the will of the co-legislator to only avail to this possibility in cases of identified serious deficiencies, after all possibilities were given to the Member States to correct the concerned expenditure.

However, the Commission notes that the mere existence of this legal provision, reinforcing the Commission supervisory role, has had in practice a deterrent effect and contributed to increase the corrective actions taken by Member States compared to previous programming periods, thus reducing the need for the Commission to step in through formal decisions for net financial corrections. This is illustrated by the important cumulative amounts temporarily or definitely withdrawn by Member States from annual certified amounts (EUR 14.5 billion since 2014 in total), as reported in the REGIO and EMPL 2022 annual activity reports.

Closure of the 2007-2013 programme period

The Commission notes that the 2007-2013 closure (§6.73 to §6.75) is now almost complete, with only six programmes still fully open for all Funds due to remaining serious issues. The Commission will not make the 5% final payment for these remaining programmes until all issues are solved, including through the adoption of a Commission decision for financial correction to reduce the programme funding (net corrections) if necessary. For all 2007-2013 programmes closed so far, as a result of the important additional financial corrections implemented up to and during closure, REGIO and EMPL reported a residual risk at closure of 0.3% and 0.6% respectively in their 2022 annual activity reports.

There is indeed no regulatory deadline to continue protecting the EU budget. Corrections (often net) can still occur many years after the end of the programming period or the closure of a programme, as reported in the annual activity reports.

In 2021, the Commission issued early guidance to Member States to ensure due preparation for the closure of 2014-2020 programmes (planned in 2025). Closure will be simplified due to the annual acceptance of accounts and (partial) clearance of legality/regularity issues for previous accounting years, but will still entail a number of important checks of the final eligibility of operations and expenditure, as indicated by ECA. Since the regulation distinguishes the financial settlement of each accounting year from the assessment of legality and regularity, such assessment for the last block of expenditure will go beyond programme closure (defined as the financial settlement of the last accounting year and acceptance of the last implementation report). The timing to eventually settle all open legality and regularity issues will depend on the seriousness of issues identified and need for contradictory procedures on the issue disputed by the concerned Member States. However, for low and medium risk 2014-2020 programmes, closure of all three aspects (accounting, implementation report and assessment of the legality and regularity of underlying expenditure) can occur by end 2025, according to best estimates.

The Commission will report to the Discharge authority on the progress of closure for 2014-2020 in the annual activity reports, as it did for the closure of the previous programming period.

Reporting on several rule of law procedures (§6.76)

The Authorising Officers by Delegation of the Directorates-General REGIO and EMPL have taken into account in their risk assessment all relevant elements which may appear in the context of the procedure under the Conditionality Regulation and on which they have the possibility to act under the sectoral legal base.

Pre-financing is not subject to the fulfilment of enabling conditions. The sole consequence of a failure to fulfil an enabling condition is that expenditure related to operations linked to the concerned specific objective, although they may be included in payment applications, shall not be reimbursed_by the Commission until the Commission has informed the Member State of the fulfilment of the enabling condition (Article 15(5) CPR). The Commission has therefore effectively reported in the 2022 AARs and AMPR that no interim payment to Hungarian and Polish programmes can be reimbursed as long as the horizontal enabling condition on the Charter of Fundamental rights is not assessed as fulfilled.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Conclusion

The Commission takes due note of the increase in the error rate estimated by the ECA this year (§6.77 and §6.78), compared to a relatively stable level of error reported for the last five years. The Commission's risk at payment disclosed in the 2022 AARs remains comparable with those of previous years.

The Commission attributes the difference namely to the fact that the ECA reports errors related to any breach of applicable rules. The Commission does not necessarily consider the associated expenditure to be ineligible. For programme authorities and the Commission to impose financial corrections, an error must be an irregularity within the sense of Article 2(36) of the CPR. Not all errors reported by the ECA fall into this category.

Moreover, out of the 48 errors reported and quantified in 2022 by the ECA for Cohesion policy funds, the Commission does not agree with the assessment for eighteen errors.

For thirteen of these errors, the Commission considers that, in line with the above-mentioned CPR provisions, it could not conclude on an irregularity leading to ineligible expenditure. This includes two transactions assessed by the ECA as major projects not notified to the Commission. The Commission does not agree that the related operations correspond to the definition of major projects in the CPR (see further details in the Commission reply to paragraphs 6.24 and 6.25).

Moreover, for five cases, the Commission is not able to apply the level of quantification used by the ECA. This includes two public procurements where the Commission considers that the level of correction applied by the programme authorities is justified by the type of breaches identified by the audit authority or the Commission (see below reply to paragraphs 6.32 and 6.33). Overall, for these eighteen cases, the Commission has assessed that it would not have legal ground to impose financial corrections (or higher corrections than those already applied).

The Commission will duly follow up all other cases and request financial corrections, where appropriate. The Commission will also recommend remedial actions to the concerned programme authorities to further improve the management and control systems, as necessary.

The objective of the assurance model (§6.79) under Cohesion policy is to have a residual error rate below 2% for each programme individually, each year. If this is not the case, the Commission has the tools to detect the individual programmes concerned and to apply the necessary additional financial corrections when the individual residual errors are above 2%.

Management verifications (§6.80) are the first line of defence against errors and should be more effective in preventing and detecting errors in the first instance for a number of programmes (see the Commission's reply to paragraph 6.42).

The Commission reports on the effectiveness of the functioning of management and control systems in the AARs of the Directorates General REGIO and EMPL (pages 43 and 69, respectively), and concluded based on all cumulative audit evidence available that management and control systems function well or sufficiently well for 88% of Cohesion programmes.

The Commission considers that, overall, reliance can be placed on the work of audit authorities and their control bodies (§6.81), with the exception of ten instances clearly reported in the AARs. In other cases, additional errors detected are occasional and do not point to a systemic weakness at the level of the audit authority.

The fact that a residual error rate is found to be above 2% in a particular year, despite the audit authority having reported a rate below 2%, does not necessarily point to a serious or systematic deficiency in the work of the audit authority. Individual errors that went undetected, sometimes complex ones, may not always be representative of the work carried out by the audit authority and can be due to different interpretations of the applicable legislation.

Moreover, the Commission assesses the work of audit authorities taking into account different parameters, including the results from system audits, in addition to the re-calculated error rates.

The Commission will continue to closely work with the managing and audit authorities of the programmes concerned, to follow up on agreed conclusions and to achieve over time a residual level of error below 2% for all programmes, using the regulatory instruments to apply additional financial corrections when deemed necessary.

The Commission puts in place audit procedures to obtain reasonable assurance for each programme whether the error rates reported each year by the different audit authorities are acceptable, or whether there are indications or evidence that material levels of errors remain (§6.82).

The Commission considers that its detailed assessments lead to a nuanced and differentiated conclusion for each programme and cumulatively for Cohesion policy Funds. Audit evidence available to the Commission and reported in the respective annual activity reports does not point to an increase in its estimate of the level of error (KPI) disclosed in the AARs, in contrast to the one reported by ECA this year.

In the AMPR, the Commission uses the risks at payment disclosed by the Directorates-General (DGs) in their AARs following a careful and structured quality review. Given its detailed segmentation of expenditure according to risk profiles and control systems, when detecting errors, and taking also account of the ECA's work, the Commission is able to identify the specific part of programmes most likely to be affected. It is thus able to give a differentiated view of the level of error across the payments made and to clearly identify the areas where improvements are needed.

Recommendations

Concerning the recommendations reviewed by ECA from the 2020 and the 2021 annual reports (6.84), the Commission notes that the Recommendation 5.6 on the reporting of Rule of law procedures against Member States, issued in the 2021 annual report, was not accepted.

Recommendation 6.1 – Mitigation measures for recurring errors

Strengthen the measures designed to address the recurring errors, specifically in relation to ineligible costs and projects, ensure sufficient coverage of its own audit work for all audit

authorities and disseminate the results to reduce the occurrence and impact of irregular spending.

(Target implementation date: December 2025)

The Commission **accepts** the recommendation.

Ongoing continued actions with the audit authorities aim at improving their detection capacity and ensure an adequate coverage of their audit work through the Commission's audit plan. In particular, the Commission provides regular feedback to programme authorities about errors that remained non-detected by managing and/or audit authorities. The continuous monitoring and analysis of the root causes of such undetected errors feeds into the Commission's annual risk assessment for selecting programmes in view of subsequent risk-based audits.

The Commission continues all necessary efforts towards the target to ensure compliance and a residual risk below materiality for all programmes, ideally each year and by all means over time.

Recommendation 6.2 – Major projects notifications

Verify, when closing the 2014-2020 programmes, that only expenditure linked to notified major projects has been accepted, taking particular account of the situation detected this year.

(Target implementation date: latest by March 2025)

Although the Commission disagrees on individual operations reported by ECA this year as alleged major projects, the Commission **accepts** the recommendation to make appropriate checks at closure.

The Commission monitors major projects through the list of such projects included in operational programmes, which is evolving based on continuous discussions with Member States.

At closure, the Member States will be requested to confirm the eligibility of expenditure declared against the applicable rules for major projects. The Commission considers however that the absence of notification of a major project cannot be legally interpreted as an irregularity under the provisions of Article 2(36) of the Common Provisions Regulation that would make the whole related expenditure and operation ineligible.

Recommendation 6.3 – Thematic audits on conflicts of interest

Plan and implement focused thematic audits on conflicts of interest for the 2021-2027 programmes, based on its own risk assessment and in view of the shortcomings identified.

(Target implementation date: December 2024)

The Commission **accepts** the recommendation.

In line with its 2021-2027 Single Audit Strategy, the Commission intends to carry out different thematic audits, inter alia on measures in place to prevent and mitigate the risk of conflict of interest, based on its own risk assessment. For this, the Commission will also base itself on the methodology and experience developed through such thematic audits on conflict of interest carried under the 2014-2020 period.

Recommendation 6.4 – Targeted checks on financial corrections for multi-annual operations during closure

Carry out specific targeted checks in its 2014-2020 closure audits to ensure that member states have applied the necessary financial correction for errors detected in one accounting year which also affect expenditure in other accounting periods.

(Target implementation date: from February 2025 until end of closure of all 2014-2020 OPs)

The Commission **accepts** the recommendation.

The Commission will ask the audit authorities to confirm that all corrections have been implemented correctly, at the latest in the last annual control report, as a result of the audits of accounts that audit authorities must carry out each year.

The Commission has planned a number of thematic audits on the preparation for the programme closure process, including on the recommended aspect.

Recommendation 6.5 – Reliability of self-declarations

Ensure that audit authorities have appropriate methods in place to check the validity and reliability of self-declarations and share good practices, taking particular account of the situation detected this year.

(Target implementation date: December 2023)

The Commission **accepts** the recommendation.

The Commission stands ready to collect and share identified good practices on how to check self-declarations.

The Commission recalls, however, that self-declarations are an alternative source of assurance for programme authorities, when reliable and verified sources are not easily and directly available. Self-declarations may be subject to checks according to an appropriate methodology against other sources of information if available, but it has to be assessed on a case-by-case basis.

Recommendation 6.6 – Enhancing fraud risk awareness to ensure a more effective reporting on suspected fraud

(a) Plan and implement focused thematic audits on risk awareness of the managing authorities and the use of data mining and risk-scoring tools for the 2021-2027 programmes.

(b) Specify minimum requirements for the audit authorities to cover the risk of fraud in their checklists and audit work.

(c) Reiterate to member states their obligations regarding fraud reporting.

(Target implementation date: for recommendation 6.6(a) by December 2025, for recommendations 6.6(b) and 6.6(c) by December 2023)

The Commission **accepts** the recommendation.

a) Thematic audits on the implementation of effective antifraud measures are part of the anti-fraud strategy and Single Audit Strategy for the 2021-2027 programmes. In addition, specific methodological support is offered to the programme authorities on management verifications based on risks, including workshops and early preventive system audits. The Commission systematically promotes and encourages the use of the data mining and risk scoring tools, and ensures a close monitoring on the use of Arachne.
b) The effective implementation of proportionate anti-fraud measures is part of the system requirements which audit authorities need to cover in their assessment of the functioning of management and control systems. Specific fields were integrated in the updated Commission audit checklists for operations and system audits that have been shared with audit authorities as a follow-up of to the ECA Special report 6/2019 on "Tackling fraud in EU cohesion spending: managing authorities need to strengthen detection, response and coordination". The Commission will continue to ensure that audit authorities appropriately document in their check lists how they covered the risk of fraud during their audits of operations.
c) In their audits, the Commission auditors intend to embed an additional check whether the reporting of programme authorities in the Irregularity Management System (IMS) duly reflects detected errors and irregularities. The Commission services, with OLAF in the lead, will continue to remind Member States of their obligations regarding fraud reporting. OLAF also intends launching a revision of the "Handbook of irregularities reporting in shared management" before the end of 2023. This process will involve experts from other Commission services and the Member States.

Recommendation 6.7 – Deployment of data mining and risk-scoring tool

Advance the date for deployment of the single integrated IT tool for data mining and risk-scoring from 2028 to 2025, the first year when a significant amount of 2021-2027 expenditure is expected to be declared. In the meantime, ensure that OLAF, the EPPO and the ECA have access to Arachne.

(Target implementation date: December 2025)

The Commission **partially accepts** the recommendation.

The Commission is unable to accept the first part of the recommendation aiming at advancing the date for the deployment of the single integrated IT tool for data mining and risk scoring from 2028 to 2025. A Commission proposal to recast the Financial Regulation is currently debated by the co-legislator, who will ultimately decide if the use of the data mining tool is mandatory and by when. The ECA recommendation is therefore coming too late in the legislative process. Moreover, an anticipation of the use of such a tool in 2025 is technically unfeasible due to the need to expand the existing tool for corporate use, incorporate advanced functionalities and emerging technologies.

The Commission accepts the second part of the recommendation aiming at ensuring that meanwhile, OLAF, the EPPO and the ECA have access to Arachne on a case-by-case basis. For the ECA, this direct access will cover entities involved in operations which are the subject of ongoing audits. Developments are ongoing to provide such case-related direct access, in the frame of the existing charter of rights and obligations of the Commission and Member States in using Arachne.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 7: NATURAL RESOURCES AND ENVIRONMENT

I. THE COMMISSION REPLIES IN BRIEF

The Multiannual Financial Framework (MFF) heading 3 "Natural resources and environment" covers EU spending on the common agricultural policy, the maritime and fisheries policy and the LIFE programme for environment and climate action.

The Common Agricultural Policy (CAP), accounting for most of the spending under this heading, is a genuinely European policy as Member States pool resources to operate a single common policy with a single European budget. The CAP objectives as set out in the Treaty and the CAP regulations are: to increase agricultural productivity; to ensure a fair standard of living for the agricultural community; to stabilise markets; to assure the availability of supplies; to ensure that supplies reach consumers at reasonable prices.

With 6.3 million beneficiaries of the CAP, European agricultural guarantee fund (EAGF) and European agricultural fund for rural development (EAFRD) expenditure is implemented under shared management through a comprehensive management and control system, which is designed to ensure the legality and regularity of the underlying transactions at the level of the final beneficiaries. The robust assurance model of the CAP includes the first level controls by the paying agencies, the audit work carried out by the independent certification bodies and the Commission's own work through the clearance of accounts.

This assurance model put in place for the CAP and thus the extent and granularity of the information available to the Commission on the functioning of the management and control system at the level of each paying agency contribute to estimating, as precisely as possible, the level of the error in the CAP, as presented in the Annual Activity Report (AAR) of DG AGRI.

The Commission welcomes the ECA's conclusion that Direct Payments remain free of material error, confirming thus the important role played by the Integrated Administration and Control System (IACS), including the Land Parcel Identification System (LPIS), in preventing and reducing the level of error. The Commission takes note of the level of error estimated by the ECA for the MFF heading 3 as a whole and of the level of error for rural development and market measures, which remains material, in line with the Commission's own assessment. (§7.35).

Based on its robust assurance framework and its detailed assessment, the Commission considers that its own estimate of the risk at payment, as presented in the AAR of DG AGRI remains consistent with the results obtained in the last years by the Commission and the ECA. This is in line with the fact that the expenditure in 2022 relates to the 2014-2020 programming period and that rules, systems and authorities have remained stable.

As regards the increase detected by the ECA in the number of small over-declarations of areas in comparison with 2021, the Commission notes that, looking at the situation over several years, the number of small over-declarations in 2022 remains in line with the levels detected by the ECA for 2020 and previous years. While LPIS is the basis for the geospatial aid application, over declarations may also stem from errors made by the farmers. Consequently, the Commission considers that the small over-declarations do not necessarily indicate specific weaknesses in member states' management of the LPIS.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Regularity of transactions

Results of transaction testing

The Commission takes note of the level of error estimated by the ECA at 2.2% for the MFF heading 3

Coherence checks of member states' control statistics and payments data

The Commission welcomes ECA's assessment that the systems of the paying agencies are overall reliable and provide correct calculation for the aid amount (§7.27). The Commission carries out its own analysis in the form of annual quality reviews of the payment and control data submitted by the Paying Agency as well as data integrity audits on paying agencies' information systems, which confirm the ECAs assessment.

2. Annual activity reports and other governance arrangements

DG AGRI and DG MARE reporting on the regularity of spending (§7.28 to §7.32)

Certification Bodies have been delivering an opinion on legality and regularity of expenditure for eight years now. Thanks to capacity building actions by the Commission (issuing of guidelines, regular expert group meetings), their reports contain sound, substantial and valuable information on the legality and regularity of expenditure. This information is examined in detail by DG AGRI and was the basis for the calculation of DG AGRI's adjusted error rate for financial year 2022. The Commission further stresses that, as a result of all corrective actions for the CAP (estimated at 1.5%), the final amount at risk (risk at closure) for the CAP in 2022 is estimated at 0.35%, as presented in DG AGRI's AAR 2022.

The Commission welcomes the ECA's observation that DG AGRI's and DG MARE's methodology for the calculation of the final risk at payment (or closure) was in line with the Commission guidelines.

The Commission's Annual Management and Performance Report (AMPR) (§7.33)

In the AMPR, the Commission uses the risks at payment disclosed by the DGs in their AARs which correspond to their best estimate of the level of error in the expenditure made, following a careful and structured quality review.

Overall, the Commission reports a non-material risk at payment for Heading 3: Natural resources and environment, based on hundreds of thousands of checks carried out every year by the Member States and audits by the Commission, following their carefully established control strategies, tailored to the specificities of the Funds. With its detailed approach, the Commission is able to identify the specific parts of the programme population that are most likely to be affected by errors, to clearly identify the areas where the improvements are needed, to apply financial corrections where appropriate and to give a differentiated view of the level of error across the payments made. Based on the work carried-out, the Commission considers that the risk at payment presented in the AMPR for Heading 3 “Natural resources and environment” is representative of the level of error.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Recommendation 7.1 – Monitoring the quality of agricultural area data

Given that agricultural area will be the basis for performance indicators under the new CAP 2023-2027, continue monitoring how accurately members states assess the eligible area in the Land Parcel Identification System.

(Target implementation date: 2024)

The Commission **accepts** this recommendation, referring to the legal requirement on the LPIS Quality Assessment, laid down in Article 68 of Regulation (EU) 2021/2116 and recital 59 of the said Regulation on the Member State´s obligation to report on the quality of their LPIS. Accordingly, the Commission continues its annual evaluation of Member State´s LPIS quality assessments. Therefore, the Commission considers that the recommendation will be implemented with the next monitoring of the LPIS quality assessments.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER: 8 MIGRATION AND BORDER MANAGEMENT – SECURITY AND DEFENCE

I. THE COMMISSION REPLIES IN BRIEF

The Commission welcomes the ECA's observations, accepts the recommendation issued in the Chapter, that is already being implemented, and commits itself to engage in the areas where the need for improvements has been identified, with a view to reducing the risk of errors in the future.

The management of most Asylum, Migration and Integration Fund (AMIF) and Internal Security Fund (ISF) funding for 2014-2020 and of most AMIF, the Instrument for Financial Support for Border Management and Visa Policy (BMVI) and ISF funding for 2021-2017 is shared with the Member States (or Schengen Associated Countries). The Commission welcomes the acknowledgment that the Member State Audit Authorities examined by ECA are making progress in their preparations for the 2021-2027 period and will closely monitor the pending developments, providing guidance where required. Since the Directorate General for Migration and Home Affairs (DG HOME) applies the Common Provisions Regulation, as the directorates for Regional and Employment policies (DG REGIO and DG EMPL), the Audit Authorities join the technical meetings organised by the Joint Audit Directorate of DG REGIO and DG EMPL (DAC).

The Commission considers expenditure for migration, border management, security and defence to be a low risk expenditure. With reference to paragraph 8.19, the Commission considers that it has detailed and robust evidence concluding to a risk at payment below 2% for the expenditure on migration and border management, as well as for security and defence. The Commission's estimate is based on all the controls and audits carried out, with the audit coverage for 2014-2020 programming period reaching 21.7% of the expenditure as of 31.12.2022[1].

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Regularity of transactions

Regarding the examined transactions which were affected by errors (§8.10) the Commission engages itself to address the issues identified, reinforcing guidance where required to reduce the number of errors in the future.

[1] The assessment of the levels of risk is done according to the Commission's methodology, and is disclosed in the Commission's 2022 Annual Management and Performance Report (AMPR Volume I - page 18 or Volume II, Annex 2, section 2.1.3 heading 4 and heading 5).

The Commission highlights however that, in one case, which is included in box 8.1. (accommodation costs due to irregularities in public procurement procedures), at the time of the ECA's audit, the Member State's verification controls had not been finalised.

Reply to Box 8.1

Ineligible personnel and equipment costs

The Commission takes note of the ECA's findings.

On the examples given in relation to the ineligible personnel costs the Commission would like to point that in view of the varied national fiscal and social security rules and appreciating the specificities of the labour market, the Grant Agreement does not define any nominal remuneration limits relative to employment of persons under direct services compared to employment contracts, leaving room for the authorising officer's appreciation.

In the cases of ineligible equipment costs, the acquisition cost of computers was declared while according to the grant agreement only the depreciation costs of the equipment were eligible. The Commission would like to note that in both cases the computers had already been used and were subsequently refurbished and that the price of the individual computers was approximately 300-350€.

Ineligibility of declared accommodation costs due to irregularities in public procurement procedures

At the time of the ECA's audit, the corresponding verification controls prior to final payment had not been finalised by the Responsible and Audit Authorities in relation to the AMIF project under shared management in Spain. The transaction selected by the ECA was a payment made by the Spanish authorities to the project beneficiary and declared as an advance payment to the Commission, for which all the legality and regularity requirements were met (i.e., no declaration of incurred costs is necessary at that stage).

In accordance with the provisions of the legal basis, Member States should withdraw any irregularity detected in the final verification controls from the accounts. The Commission monitors the final payments done by the Member States' authorities and of the amounts withdrawn from the accounts.

2. Examination of elements of internal control systems

The Commission welcomes the fact that the system audits of the six Member State Audit Authorities concluded with no findings.

The assurance package needs to be provided for "each accounting year for which payment applications have been submitted" (art. 98(1) CPR). Since no payment applications have been submitted in the accounting year 2022, no Member State has presented an assurance package in February 2023.

3. Annual activity reports and other governance arrangements

Regarding the examination of the AAR (§8.18), the Commission recalls that the Director General's declaration of assurance is based on the examination of several pieces of information from multiple sources (self-assessment, ex post controls, Internal Audit Service and ECA reports) ensuring its reliability.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Recommendation 8.1 – Better target checks on project cost eligibility for Union actions directly managed by DG HOME

Carry out better targeted ex ante checks on the eligibility of expenditure for Union actions, with a specific focus on the potential risks related to, for example, the type of expenditure (e.g. personnel costs, equipment, procurement), or the type of beneficiary.

When preparing its risk assessment, the Commission should take into consideration that audit certificates supporting beneficiaries' payment claims have limitations.

(Target implementation date: end of 2024)

The Commission **accepts** this recommendation and considers it already being implemented.

A sound, targeted methodology for the analysis of the final requests for payments in the context of Union actions already exists and the Commission covers with its ex-ante verification 100% of the transactions. Dedicated checklists were already reinforced in the context of the implementation of recommendations made in the 2018 ECA annual report. Before the final payments are executed, ex-ante controls are applied, as necessary.

With the objective of maintaining the costs effectiveness of control system the Commission employs a significant number of preventive actions, paying attention to cost eligibility at all stages of the project cycle taking also into account the different types of expenditure and improving the guidance given to beneficiaries, in particular newcomers, via inter alia the kick-off meetings.

The Commission is already undertaking a reassessment of the ex-ante methodology, to accommodate various changes to the model Grant Agreement for MFF 2021-2027. Following the recommendation of the ECA, the Commission will ensure that the methodology specifically targets the checks on the type of beneficiary and the root causes of errors, identified in all audits.

The model Grant Agreements define the requirements for the certificate on the financial statements and the audit methodology to be applied by auditors.

The audit certificate is only one of the elements for the Commission ex-ante assurance in the implementation of the Union Actions. Before the final payments are executed other ex-ante-controls are applied, as necessary.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 9: NEIGHBOURHOOD AND THE WORLD

I. THE COMMISSION REPLIES IN BRIEF

The Commission takes note of the ECA findings for this chapter and is committed to implementing the appropriate remedial actions where necessary. In reply to some observations related to DG NEAR's Residual Error Rate study, the Commission provides clarifications on the features of the study and its contribution to building the annual declaration of assurance, along with the other elements of the internal control framework. Similarly, replies and clarifications are provided in reply to some observations related to DG NEAR's Annual Activity Report.

Concerning some observations on the regularity of the audited transactions, the Commission provides clarifications on the errors reported in this chapter of the Annual Report. The Commission considers the errors on clearing of pre-financing to be of a temporary nature, as any over-clearing is adjusted with the final acceptance of costs.

The Commission further clarifies that it divides expenditure into segments with different levels of risk: lower (below 2%), medium (between 2% and 2.5%) and higher (above 2.5%). In 2022, the expenditure of the MMF heading 'Neighbourhood and the World' assessed by the Commission as "medium risk" is the segment corresponding to direct management grants only. The other segments are assessed at lower levels of risk. The assessment of the levels of risk is done according to the Commission's methodology, and is disclosed in the Commission's 2022 Annual Management and Performance Report (AMPR): Annual management and performance reports (europa.eu).

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Regularity of transactions

Regarding the errors reported as expenditure not incurred (§9.8 and Box 9.1), the Commission notes that they include errors due to **excess clearing**, meaning a practice where expenditure not incurred is included in the accounts as expenditure incurred. The Commission considers these errors as temporary as they will no longer exist after the final clearings. The Commission has taken several actions including asking its partners to review their reporting templates to allow for easier identification of incurred expenditure and will step up its efforts in this regard. It expects to see positive results in the coming years.

Reply to Box 9.1

Serious failure in applying grant award rules

DG INTPA

The Commission agrees with the ECA's finding in relation with the application of grant award rules and underlines that current provisions are very strict and do not allow for any alteration of proposals at the contracting stage.

The Commission acknowledges that the procedures could be strengthened to avoid any other case similar to the one detected in Rwanda. In this sense, the existing guidance on 'Contract preparation and signature' will be reinforced by clarifying the obligations of the contracting authority, such as respecting the eligibility requirements announced in the guidelines when preparing the contract and not allowing any alteration of the submitted proposals.

Ineligible expenditure included in the cost claim

DG NEAR

In the context of an audit of sustainable use of natural resources in Palestine *, the ECA found that at the end of 2021, a development agency was still reporting to the Commission in its progress reports that the project was being financed, even though it was not being implemented. The ECA concludes by stating that the Commission regarded the project as incurred expenditure.

The Commission cleared the amount based on reported incurred costs, a management declaration and the audit opinion provided by the development agency. The Commission considers that an interim clearing is not equal to the final acceptance of the cost, which will only take place after reception of the final report and the final clearing of the total expenditure under the project. Based on the financial information received from the development agency, the Commission could not detect the error.

The development agency considers the funds transferred to the banks as committed and only the funds transferred to the final beneficiary as incurred. In this case a misunderstanding by the local branch of the development agency was the cause of an incorrect interim report.

** This designation shall not be construed as recognition of a State of Palestine and is without prejudice to the individual positions of the member states on this issue.=*

Reply to Box 9.2

Mandatory risk assessment not conducted

DG NEAR

The ECA found that the Commission made a pre-financing payment without conducting the mandatory risk assessment and in absence of a bank guarantee.

The Commission agrees with this finding but points out that it is an isolated case, and that the applicable procedures are clear and accessible to the staff. Since the relevant controls are in place but were not correctly applied in this case, the remedial action will consist of a reminder to all Delegations of the rules pertaining to the risk assessments.

Regarding the regularity of transactions mentioned in paragraph 9.8, the Commission is of the opinion that some errors in procurement do not have a financial impact and therefore there is no legal ground to recover the funds.

Under the notional approach, the EU cost eligibility requirements are met as long as the action includes an amount of costs eligible under EU rules equivalent to the EU contribution and the amount contributed by other donors is sufficient to cover the costs that are ineligible under EU rules (Article 155(5) of the Financial Regulation). This makes it possible for the EU to contribute to multi-donor actions without the earmarking of funds (i.e. jointly co-financed actions). There are no legal obligations for the Commission to report separately on the proportion of funds, entrusted to implementing partners, to which the notional approach applies.

2. Examination of elements of internal control systems

Reply to Box 9.4

Expenditure verification report received after final payment already made

DG NEAR

The Commission usually requires grant beneficiaries to engage a contractor to verify their expenditure to date and produce expenditure verification reports. The ECA found that in one EU Delegation, the final payment had been made to the beneficiary before receiving the expenditure verification report.

The Commission considers that there is no shortcoming in the functioning of the internal control system of the EU Delegation, as different layers of controls (not necessarily cumulative) are allowed. The Commission is of the opinion, that according to Article 15.7[1] of the General Conditions and Article 5.2 of the Special Conditions of the Grant Agreement an expenditure verification report is not required in case the EU Delegation has performed the verification itself. In this particular case, the EU Delegation carried out the checks before payment.

As a general rule, the EU Delegations carry out desk analysis and on-the-spot visits prior to final payments for grant contracts with or without the expenditure verification report, in line with the existing control methodology.

Delegation staff not trained in fraud prevention in past 5 years

DG NEAR and DG INTPA

Some members of the staff in the audited EU delegations had not attended training courses in fraud prevention in the past five years (box 9.4). Attendance to fraud prevention training is only one of the tools available to raise staff awareness in fraud prevention in a modern organization. As a result, the learning objective of the Anti-Fraud Strategies is to strengthen internal awareness on fraud-related issues and does not entail an objective of 100% staff attendance to fraud prevention training every 5 years.

All staff members in external relations have access to various relevant learning opportunities. In addition, the Commission provides a wide range of tools and resources to ensure unlimited access

[1]"The expenditure verification report shall not be provided by the coordinator if the verification is directly done by the contracting authority's own staff, by the Commission or by a body authorised to do so on their behalf, according to Article of 5.2 of the special conditions."

Article 5.2:"The expenditure verification(s) referred to in Article 15.7 of Annex II will be carried out by the contracting authority or any external body authorised by the contracting authority."

in time and geographical area to the required information on fraud prevention. In fact, the Commission offers a variety of additional activities and guidance to cover fraud-related issues – including an anti-fraud network with appointed anti-fraud focal points, presentations during relevant seminars and meetings, staff notes, manual and guidance, intranet pages, surveys, newsletters, supervision missions, etc.

OPSYS information system not fully operational

During the ECA's visit, EU Delegation's staff reported problems with the IT programme OPSYS that had led to delays, disruptions to the smooth functioning of the delegation and increased resource consumption. As observed by ECA, DG NEAR reported difficulties with the implementation of OPSYS in its Annual Activity Report (AAR).

The Commission is of the opinion that those difficulties did however not result in unreliable data or incomplete management information. Inevitably, the introduction of OPSYS came along with significant challenges in the transition period for EU Delegations, as there were certain technical defects, notably during the forecasting exercise. However, the Commission was aware of these issues during the transition period and took measures to mitigate the related risks, notably with the resolution of the most problematic flaws at the end of the process (validation of the forecast).

3. Annual activity reports and other governance arrangements

DG NEAR's AAR & RER

The Commission considers that the RER study is not subject to limitations that may contribute to an underestimation of errors. On the contrary, there might be cases of overestimation. The extrapolation of the error to the untested transactions may actually lead to an overestimation of the error rate given that the error identified in a given budget heading of the financial report submitted by a beneficiary is not necessarily pervasive in other budget headings.

As regards reliance on the work of others, the Commission recalls that in line with the RER methodology, the contractor can rely entirely or partially on the results of expenditure verifications carried out by independent auditors for DG NEAR and on ECA audits. It is also important to clarify that full and partial reliance are not the same, and each of them requires a set of testing steps to take place. The Commission limits the number of cases of full reliance in RER studies, which remain in line with the historic average (14% in DG NEAR RER studies in 2021 and in 2022).

DG NEAR's Annual Activity Report also recalls that the RER study is not an assurance engagement nor an audit. The RER study is built on a distinct methodology, serving a specific purpose: to measure the overall performance of the control system by estimating a representative residual error rate.

DG NEAR's global error rate builds on the errors found in all segments of expenditure, including grants under direct management which is the segment of expenditure that the Commission considers "medium risk". However, additional controls on grants are carried out to calculate a specific error rate for this segment of expenditure which is considered as "medium risk". These controls provide corroborative information, which is important to DG NEAR as it complements the grant-related information coming from the main error rate, where some grants are included.

Concerning the errors identified by the ECA in the estimation of the corrective capacity in DG NEAR's Annual Activity Report, the Commission points out that despite its checks on 298 recovery orders, three recovery orders were incorrectly included in the estimation of the amount at risk at payment of DG NEAR. The total value of these three recovery orders is EUR 745.285. The error resulted in a difference of EUR 840.000 in the estimation of the amount at risk at payment: EUR 46.99 million instead of EUR 46.15 million, out of a total relevant expenditure of EUR 5.14 billion.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Follow-up of previous years' recommendations

Regarding Recommendation 2 from the ECA 2019 Annual Report, the Commission recalls that it did not accept the recommendation, hence the Commission made it clear in the replies to the 2019 Annual Report that it would not implement it.

Regarding Recommendation 1 from the ECA 2020 Annual Report, the Commission intensified communication with International Organisations on ECA's access to documents. The Commission is working actively with the concerned International Organisations whose transactions contributed to the error rate, both through practical solutions and high-level dialogue.

The issue of providing the ECA access to documents has also been discussed in recent meetings of the EU-UN FAFA Working Group and bilateral meetings between the Commission and International Organisations. It is also systematically included in the regular dialogue with the Commission partners such as UN Organisations. The Commission has also facilitated technical discussions between the UN and ECA with a view to ensure mutual understanding of the constraints of all parties and to identify concrete and practical steps towards ensuring smooth access to documents. In 2023, joint trainings with UN staff have resumed, and the Commission has also agreed with the UN to set up Joint Reference Groups to discuss regularly audit and control issues.

However, for some International Organisations, in particular in the UN family, providing more than "read only" access to their documents goes against their internal rules.

The Commission will continue to take action to find practical and long-term solutions to these issues.

Recommendation 9.1 – Prevent irregular alteration of proposals at the contracting stage

Strengthen controls to prevent irregular alteration of proposals at the contracting stage when awarding grants on the basis of a call for proposals.

(Target implementation date: June 2024)

The Commission **accepts** the recommendation and will reinforce the relevant guidance.

Recommendation 9.2 – Take steps so that staff complete a risk assessment before paying pre-financing without a bank guarantee

Carry out risk assessments, as required by the manual of procedures, to ensure that pre-financing payments of between €60 000 and €300 000 are only made without a bank guarantee if the risk is assessed as low.

(Target implementation date: end of 2024)

The Commission **accepts** the recommendation and will remind the staff of the existing rules.

Recommendation 9.3 – Establish an appropriate timeframe when engaging contractors directly for expenditure verifications

Establish an appropriate timeframe so that expenditure verification reports issued by contractors for grant contracts are available before processing payments or clearing expenditure.

(Target implementation date: end of 2025)

The Commission **does not accept** this recommendation. The Commission considers that the procedures in place already set the appropriate timeframe. When specific circumstances so require, the contractual provisions allow the Commission to process a payment based on checks carried out by its staff.

Recommendation 9.4 – Enhance controls to exclude recovery orders for unspent pre-financing from the corrective capacity calculation

Enhance controls to exclude recovery orders for unspent pre-financing from the calculation of DG NEAR’s corrective capacity

(Target implementation date: from the 2023 annual activity report onwards)

The Commission **accepts** the recommendation.

REPLIES OF THE EUROPEAN PARLIAMENT TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT

CHAPTER 10: European public administration

10.9. As per Article 1 of the "Rules on the use of appropriations from budget item 400" ("Rules 400"), the political groups manage the funds allocated to them according to the principles of indirect management of funds in analogical application of Article 62(1)(c) of the Financial Regulation. These Rules themselves replace the "contribution agreements" (as referred to in article 155(6) of the Financial Regulation).

Parliament's administration is subject to the Financial Regulation and its procurement rules. However, for political groups, and only for them, the Bureau has adopted the Rules 400, which contain a number of specific provisions for procurement procedures taking into account the administrative capacity of political groups.

Parliament takes note of the observations of the Court of Auditors (ECA). According to Article 1.4 of the Rules, the political groups shall be responsible to the institution for the management of appropriations, within the limits of the powers conferred upon them by the Bureau for application of these rules. They shall ensure that the appropriations are managed in accordance with these rules and they shall take appropriate action to prevent any expenditure, which is not in accordance with these rules.

Parliament's administration has previously demonstrated efforts to assist the political groups with the aim to improve their internal financial management. It will considerably increase the guidance to political groups.

10.10. Parliament takes note of the observations of the ECA.

10.11. Parliament takes note of the observations of the ECA.

10.12. Parliament agrees with the ECA's conclusion and will propose to deduct the corresponding amounts from the eligible costs during the upcoming closure exercise.

Recommendation 10.1 - European Parliament

Parliament's administration agrees to increase its guidance to the political groups on the proper implementation of the funds under Rules 400 and assist the political groups with the aim to improve their internal financial management. In particular, it will further clarify the guidelines on procurement by political groups and it will propose to better align Rules 400 to the Financial Regulation.

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' 2022 ANNUAL REPORT CHAPTER 11: RECOVERY AND RESILIENCE FACILITY

I. THE COMMISSION REPLIES IN BRIEF

The Commission acknowledges the ECA's chapter 11 concerning specifically the Recovery and Resilience Facility (RRF) with its unique financing model.

Out of 311 milestones and targets for which payments were made for non-repayable support in 2022, the ECA has audited 281 and identified regularity issues with 15. Having carefully examined these cases, the Commission maintains that it considers the original assessment of 'satisfactory fulfilment' to be correct and notes that the ECA's conclusions that some milestones and targets were 'not satisfactorily fulfilled' are principally based on **differences in interpretation of the legal requirements, or differences in the qualitative judgement**.

In one specific case, the ECA concludes that *double funding* has occurred while the measure in question has no cost under the RRF. The Commission stresses that, in line with the wording of the RRF Regulation, the concept of double funding is explicitly linked to cost. By definition, if the Member State has anticipated that the measure would be fully funded from other sources and thus has not put forward any estimated costs as part of the Recovery and Resilience Plan (RRP),[1] the RRF does not cover any cost for the measure's implementation and there cannot be "double funding". The Commission stresses that reforms are an essential criterion to have a positive assessment of the Recovery and Resilience Plans by the Commission. Such inclusion of no cost reforms does not increase the financial allocation. Yet, their inclusion in the plan ensures their effective and timely implementation.

Some other ECA findings relate to whether the measures set by the Council are *eligible*. For each of these findings, the Commission disagrees with the ECA's policy judgement and maintains that there is no reason to consider these measures ineligible. Moreover, these findings have, in the Commission's view, no bearing on the legality and regularity of payments. Article 24 of the RRF Regulation[2] obliges the Commission to assess the milestones and targets set by the Council in its Council Implementing Decision, and not to re-assess the *eligibility* of measures set out in the Council Implementing Decisions, as adopted by the Council. If the milestones and targets as set by the Council in its implementing decision have been satisfactorily met, the Commission must pay.

To quantify the financial impact of its findings and establish the level of materiality, the ECA uses the Commission's published methodology for the partial suspension of payment. Whilst the

[1] Under the RRF, the Member States are asked to put forward a cost estimate for each measure they include in their RRP. This cost estimate may also be EUR 0 if the costs are fully funded from other sources. The cost estimate justifies the overall allocation to the Member State. The cost estimate is the only moment the Member State indicates costs to the Commission, as later payments are fully based on *performance*, not costs incurred.

[2] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility

Commission retains its view that the milestones and targets were correctly assessed as satisfactorily fulfilled, the Commission notes that ECA considers the minimum financial impact of the findings to be close to ECA's materiality threshold. This finding by ECA is based on a risk-based sample of 281 milestones and targets out of 311 to reach this conclusion (Annex 11.1, Paragraph 8).

The Commission further notes that, in line with that methodology, it would have applied adjustments differently to fully take into account the progress in the implementation and/or the importance of the measure, resulting in a significantly lower value considered at error.

In light of this, the Commission does not consider that any milestones and targets have been paid erroneously and in line with DG ECFIN's Annual Activity Report[3], the Commission considers that in the 2022 RRF payments there was a low level of risk.

The Commission nevertheless acknowledges that further improvements can be made to its process for the assessment of milestones and targets in the future and is putting in place changes to address these findings. In this respect, **the Commission broadly accepts the recommendations that ECA has made in this Chapter**.

The Commission welcomes ECA's recognition that the Commission has in general effectively implemented its ex-post audit plan and takes note that ECA did not raise any issues related to the satisfactory fulfilment of audit and control milestones that were assessed during 2022.

Finally, the Commission would like to highlight that DG ECFIN's Annual Activity Report[4] makes clear the work done by the Commission to obtain reasonable assurance that Member States' control systems comply with their obligations, including on State aid and public procurement. Notably, following recommendations of the ECA and of the European Parliament, the Commission has increased its work in this area. DG ECFIN's Annual Activity Report specifies in detail the work carried out by the Commission's own auditors, including audit work on bodies that are common for the RRF and for the cohesion policy funds, as well as how the Commission has considered audit work carried out by national audit bodies.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Regularity of transactions

Satisfactory fulfilment of milestones or targets

The Commission takes note that the ECA recognises the broad discretion conferred on the Commission by the RRF Regulation when assessing the satisfactory fulfilment of milestones and targets (§11.22). The Commission uses that discretion when conducting the technical assessment of satisfactory fulfilment in line with the requirements set in the relevant Council Implementing Decisions and in line

[3] https://commission.europa.eu/publications/annual-activity-report-2022-economic-and-financial-affairs_en

[4] https://commission.europa.eu/publications/annual-activity-report-2022-economic-and-financial-affairs_en

with the RRF Regulation. The Commission has transparently framed its exercise of this discretion by communicating to the European Parliament, Member States, the ECA and the general public a framework for assessing the satisfactory fulfilment of milestones and targets[5]. All payments are assessed against this framework, ensuring transparency and equal treatment. In line with the application of the *de minimis principle* and generally applicable interpretation methods, minimal deviations from the established requirements provided for by the Council Implementing Decision can be accepted under specific circumstances, as explained in the framework. The Commission recalls the mandatory involvement of the Economic and Financial Committee, composed of all Member States, which provides an opinion on satisfactory fulfilment and, therefore, evaluates how the Commission has used this discretion on each and every case. In accordance with a previous recommendation from the ECA[6], the Commission more transparently reports any use of this discretion. This enables Member States to express a positive or negative opinion on the Commission's approach to each milestone and target. Furthermore, the Commission would recall further that each decision for payment is subject to scrutiny by a committee of Member State experts under the comitology procedure. The Commission's Internal Audit Service, in the context of the preparation of its 2022 Overall Opinion, has conducted a specific engagement covering a sample of the RRF-related payments audited by the ECA in 2022. During this engagement, it analysed the key documentation underlying the ECA's work as well as the Commission services' position.

On the basis of its framework for assessing the satisfactory fulfilment of milestones and targets, the Commission does not share the ECA's assessment that for eight milestones and targets the requirements of the Council Implementing Decision had not been satisfactorily fulfilled (§11.23). In most cases, the ECA questions either the interpretation of the requirements set by the Council which the Commission and Member States applied when assessing the milestone or target, or makes a different qualitative judgement. The Commission has transparently published its assessment in each case, justifying its interpretation in line with the applicable framework, receiving both the positive opinion of the Economic and Finance Committee and the comitology committee of Member State experts on its approach and interpretation of each case. The Commission highlights that in each case the divergences between the Commission and the ECA assessment are specific to the case.

The Commission takes note of cases where the ECA provides its own, different, legal interpretation of the milestone or target and, on this basis establishes that one element, which the ECA considers a requirement, is not fulfilled. The first example in box 11.1 – Paragraph 11.23 (Greek Milestone 42), exemplifies such a case: the ECA and the Commission have a different understanding of which of the Ministerial Decisions provisioned in law 4710/ 2020 are required for "organizing the electric vehicles' market". Out of eighteen secondary acts mentioned in the primary law, the Commission and the ECA agree that six are not relevant and do not need to be fulfilled. A further nine are for both institutions relevant and indeed enacted. Finally, the institutions disagree on the remaining three secondary acts: the Commission considers they are not required, while the ECA considers they are required but were not in force at the time of the payment, and thus concludes the milestone is not fulfilled. The Commission had transparently flagged in its assessment that such acts were not in place but were not necessary to organise the market, as existing legal provisions were in place covering all three elements, where the Member States gave a positive opinion on this position. Despite this, ECA however

[5] COM(2023) 99 final, Annex I

[6] European Court of Auditors, Annual Report 2021, chapter 10 "Recovery and Resilience Facility", Recommendation 1

considers that the milestone was not satisfactorily fulfilled. This includes, for example, the way that charging points will be installed in traditional settlements (such as archaeological and cultural heritage sites). The Commission considers that the electric vehicle market in Greece can be organised without such element and that on this basis the milestone was correctly considered as satisfactorily fulfilled.

The second example in box 11.1 - Paragraph 11.23 (Romanian milestone 142) provides another case, for which the ECA has a different legal interpretation to the requirements to that of the Commission and Member States. The ECA considers that a task force was not operational as at the time of the payment only eleven out of seventeen people were hired and the job description of four people did not require professional experience or educational background in a field that the ECA considers is a requirement. The Commission[7] does not share this approach, where the milestone requires the task force to be operational, and does not consider that full staffing is required to achieve this goal.

Eligibility of measures

The RRF Regulation contains a number of distinct eligibility conditions that need to be respected during the assessment of the Recovery and Resilience Plans. One such eligibility condition is that measures must have started from 1 February 2020.[8] In the context of the Covid-19 pandemic, the co-legislators provided this **'retroactivity clause'** to allow the Member States to immediately take actions to address the pandemic, build resilience and support Europe's recovery, even before the RRF Regulation itself entered into force. As a fully separate condition, the RRF Regulation requires that the Facility shall not, unless in duly justified cases, substitute **recurring national budgetary expenditure**. Rather than the timing of when costs incur, this clause provides that the RRF cannot cover regular annual or monthly expenses, which the Member State would incur also without the RRF. A third separate eligibility condition is the **RRF-specific concept of 'additionality' laid down in Article 9 of the RRF Regulation**: *"Support under the Facility shall be additional to the support provided under other Union programmes and instruments. Reforms and investment projects may receive support from other Union programmes and instruments provided that such support does not cover the same cost"*[9]. This clause assures that no double funding occurs between the RRF and other EU funds. However, this clause has no bearing on national funding: the RRF contribution at the moment of payment *becomes* national funding. Accordingly, there can never be 'double funding' of RRF and national funds at Member State level. Additionality under RRF therefore only concerns additionality between the RRF and other EU funds.

The Commission and ECA interpret these clauses and their moment of assessment differently, which inevitably leads to diverging conclusions. For the example in Box 11.2 – Paragraph 11.26, the ECA notes that Spain had previously undertaken such *type* of activity as is measured by the target. On this basis, not on the merits of the underlying measure but rather only considering the specific target,

[7] European Commission's preliminary assessment on the first payment request by Romania, 14 September 2022

[8] Article 17(2) of Regulation (EU) 2021/241: "*Measures started from 1 February 2020 onwards shall be eligible provided that they comply with the requirements set out in this Regulation*"

[9] Also referenced under Article 5(1) of Regulation (EU) 2021/241: "*Support from the Facility shall not, unless in duly justified cases, substitute recurring national budgetary expenditure and shall respect the principle of additionality of Union funding as referred to in Article 9*."

the ECA concludes that the measure included in the RRP is a 'continuation of a recurring activity' and declares it ineligible as it substitutes recurring national budgetary expenditure, including despite the fact that the Member State declared no costs for the measure to be covered under the Recovery and Resilience Plan. The ECA takes this approach in a number of cases to declare measures (or parts of measures) ineligible. The Commission takes note of this position, but recalls that there is no basis for it in the RRF Regulation. Before the RRF existed, Member States were undertaking standard and recurring actions for which an increased level or improvement of those actions are later included in Recovery and Resilience Plans. The Commission furthermore recalls that the Regulation explicitly provides that such recurring national budgetary expenditure may be included under Recovery and Resilience Plans if duly justified. Moreover, as circumstances change, including in particular in the context of the severe economic and social disturbances brought by the COVID-19 pandemic, previously present actions may also have ceased to take place without their inclusion in the Recovery and Resilience Plan.

Finally, the Commission recalls that, after assessing the eligibility of measures during the assessment of the Recovery and Resilience Plans, the Council decides by means of a Council Implementing Decision whether a measure is eligible or not. At the payment stage, the Commission cannot overrule the Council to decide that a given measure should not be paid under the RRF. In this respect, as long as milestones and targets in the Council Implementing Decision are satisfactorily fulfilled, the related payment from the Commission cannot be affected by an error.

Double funding

The RRF is a performance-based instrument, which means that the payment is not made based on costs but rather on the results achieved, as measured by milestones and targets. The only moment 'costs' are considered under the RRF, is when the Member State initially submits its Recovery and Resilience Plan. This 'cost estimate' serves to establish the overall allocation of funding to the Member State. To ensure an efficient and complementary implementation of Union funds, the RRF Regulation specifically foresees that investments and reforms can be supported by both the RRF and other Union funds, "provided that such support does not cover the same cost". The Commission took this provision into account during the assessment of the Recovery and Resilience Plans and of the specific investments and reforms put forward by Member States. Notably, when submitting their cost estimates for measures under the RRF, the Member States declared 'Estimated costs for which funding from the RRF is requested' and 'Funding from other sources' (including funding 'From other EU programmes') for which RRF funding was not requested. This allowed the Commission to systematically ensure that where investments or reforms are supported by other Union instruments, the RRF does not cover the same costs.

The RRF is a performance-based instrument where payments are made exclusively upon the satisfactory fulfilment of milestones and targets (RRF Regulation, Art 24(1)). The Commission wishes to clarify that, in line with Article 5, 'no breach of the double funding principle' is an horizontal principle that needs to be respected when implementing the facility. Any actual cases of double funding may lead to a 'serious breach of obligation' under the RRF Financing Agreement, where the Regulation provides the Commission the right to reduce and recover funds in such circumstances (RRF Regulation, Art 22(5)). Accordingly, the Commission does not consider that 'no breach of the double funding principle' is a condition for RRF disbursement, as indicated in paragraph §11.11 of the ECA report, that would affect the regularity of payments (§11.19). The above-mentioned separation between the satisfactory fulfilment of milestones and targets and the arrangements to avoid double funding is not just a requirement of the RRF Regulation, but is inherent in the nature of milestones and targets.

The Commission fully agrees with the ECA's statement that "*In substance, the same deliverable cannot be financed twice from the EU budget, whether through a cost-based or a non-cost-based financing instrument*." The Commission however recalls that the RRF does not 'finance' milestones or targets, which are '*measures of progress towards the achievement of a reform or investment'* (RRF Regulation; Art. 2(4)) and not financeable actions in and of themselves. That an element is mentioned (or required) as part of a milestone or target, such as entry into force of a law or the tax investigations undertaken by the authorities, cannot in any legal or practical way be interpreted to mean that they are 'funded' by the RRF. As recalled above, the funding by the RRF is determined based on estimated costs.

For a Slovak reform for the preparation of transport investment projects, the ECA recognises that zero costs were included in the Recovery and Resilience Plan put forward by the relevant Member State. Nonetheless the ECA concludes that double funding has occurred, as a specific report provided for the milestone was produced with support from another Union fund (§11.30). The Commission does not see any evidence of double funding of this report and highlights that this approach of the ECA towards this case is counter to the text of the RRF Regulation, which provides that Union support for a single measure can come from multiple instruments provided that they do not cover the same costs. By definition, if the Member State indicated that a specific reform or investment would be fully funded without RRF contribution, there cannot be "double funding", even if another fund finances its implementation in part or in full as the RRF has not covered any costs. Outside of legal considerations, this would imply that there could be no complementarity between the RRF and other Union instruments as allowed for by the Regulation[10] and lower the impact of Union budget expenditure, which the Commission would find deeply regrettable. The fact that a RRP may include targets or milestones linked to 'zero-cost' measures does not mean that the RRF covers costs related to these measures.

Reversal of a measure

As Member States continue the implementation of their Recovery and Resilience Plans, it is imperative that previously satisfactorily fulfilled milestones and targets are not reversed by the Member State. The Commission agrees with the ECA that it is important to provide clear guidance and it is developing internal guidance and procedures for the case where a Member State reverses a milestone or target for which a payment was already made (e.g. by repealing a reform).

The Commission considers that any approach that the Commission would follow if presented with the possible reversal of a milestone or target that was satisfactorily fulfilled and the related payments made, should be embedded in the legal requirements that stem from the RRF Regulation. This includes that the milestones and targets "*have not been reversed by the Member State concerned*" (Article 24(3)). Where a milestone or target is not reversed by the Member State concerned (e.g. a natural disaster destroys an investment that was created), the Commission does not consider that a "reversal" in the meaning of the RRF Regulation has occurred.

On the specific case in box 11.3 – Paragraph 11.33 (Italian Target M1C1-54) concerning a target for the number of "*completed recruitment procedures"* for experts, the ECA confirms the Commission's assessment that the target was fulfilled as part of the first payment request. However, the ECA informed the Commission that it considers that the Council Implementing Decision *"explicitly requires the experts to be deployed for a 3 years period"* and, as the level of 1 000 was not fully maintained,

[10] Complementarity is explicitly required by Articles 9 and 28 of Regulation (EU) 2021/241.

concludes that the target had been reversed at the time of the second payment to Italy. The Commission considers that the specific target concerned recruitment procedures, not a permanent staffing level, and that even taking the ECA's view that a staffing level is intended, the Member State cannot prevent some staff level fluctuations, for instance that individual experts change posts. As such, the Commission does not consider that the Member State has "reversed" this target due to the temporary reduction in employed staff. In particular, the Member State was readily taking action to replace the people that had left by recruiting new staff, as recognised by the ECA. Taking a general perspective, imposing a requirement that events outside the control of the Member State amount to a reversal, even if the Member State is taking ready action to address the situation, would go beyond the requirements of the legislation.

Other issues

The Commission would like to recall that the quality and completeness of the management declaration falls under the responsibility of the Member States. At the same time, the Commission acknowledges that not all Member States included reservations in their management declarations (§11.35) when there were slight delays in the satisfactory fulfilment of milestones and targets; or when evidence was submitted only after the submission of the payment request. The Commission will follow up on such cases and agrees with the ECA that this has not affected the fulfilment of the milestones and targets in question.

2. ECA's assessment of selected monitoring and control systems

The Commission's ex-ante assessments

The Commission recalls that during the assessment of Recovery and Resilience Plans, as required by the RRF Regulation, the Commission has checked the eligibility of all measures (investments and reforms) included in the Plans. As per the Regulation, this assessment of eligibility for each measure takes place during the approval of the Recovery and Resilience Plan, as each investment or reform may have multiple milestones and targets tracking its implementation. The ECA considers a limitation that the Commission's ex-ante verifications did not detect cases of 'ineligible' measures. (§11.38-11.39). The Commission recalls the points in section 1 and notably that the measures are set by the Council following an assessment of eligibility when the Recovery and Resilience Plans are initially submitted. Therefore, the Commission does not share the view of ECA as it would lead to the Commission questioning the Council's Implementing Decision. Nor is there a legal basis or requirement to repeat the assessment of eligibility for each measure repeatedly at the assessment of each milestone and target. Repeating the assessment each time would also lead to an inefficient utilisation of resources.

The ECA also considers that it is a limitation that during its ex-ante assessment, the Commission did not detect what ECA considers to be a reversal. The Commission recalls its explanation above and does not agree that there has been a reversal.

The Commission's ex-post audits

The Commission welcomes ECA's recognition that the Commission has in general effectively implemented its ex-post audit plan.

Regarding the Commission's ex-post audits on milestones and targets, as the ECA came to conclusions of 'not satisfactorily fulfilled' for milestones and targets also audited by the Commission, it considers that the Commission audits should have identified the same issues. The Commission, as a basic rule in auditing, considers the various legal bases, i.e. the Council Implementing Decision approving the plans and the Commission decisions approving the payments. The Commission does not share ECA's view that these milestones and targets were not satisfactorily fulfilled at the initial assessment and therefore also does not consider that such issues should have been detected in the ex-post audits or represent a weakness in its ex-post checks.

Regarding the use of ex-post audits to monitor reversals, the Commission has in practice been undertaking risk-based checks on whether the audited targets previously assessed as satisfactorily fulfilled have not been reversed after the payment. Nonetheless, the Commission accepts that this has not been codified in its ex-post audit procedures. The Commission also notes that the ECA considers ex-post audits on milestones and targets should verify eligibility conditions related to the underlying measures. In line with above (see section *Eligibility of measures*), the Commission cannot accept this point.

Set-up and functioning of member state systems

The RRF Regulation explicitly provides in Article 19 for an ex-ante assessment of the Recovery and Resilience Plans, including of the monitoring and control systems. In the context of the Recovery and Resilience Plan assessment, when relevant, Member States committed to take additional measures and introduced specific 'audit and control milestones', to ensure the full adequacy of the systems to protect the financial interests of the Union. Logically, the actual implementation of those systems follows their initial design and assessment. The RRF Regulation itself provides for a legal basis with the exclusive purpose to introduce such milestones.[11] The ECA considers "*a risk to the regularity of RRF payments and the protection of the EU's financial interests"* that control milestones were introduced (§11.49). The Commission notes that the same issue was already raised in ECA's Special Report 07/2023, to which the Commission has provided written replies which address this point.[12] The Commission further recalls that an ex-ante assessment and retroactivity provisions in the RRF mean that, by design, control systems cannot be fully in place at the time the plans start to be implemented.

Each such milestone must be unique to the context of the Member State and its control system. The Commission therefore does not share the ECA's statement that there is "*no justification*" for these milestones to differ (§11.50). The Commission further recalls that the Commission's assessment of the Recovery and Resilience Plans, including the introduction of such milestones, has been extensively covered in previous ECA reports, for example Special Report 21/2022 ('*The Commission's assessment of national recovery and resilience plans')* and the ECA concluded that "*the Commission managed the assessment process effectively*"[13].

[11] Article 20(5)(e) of Regulation (EU) 2021/241

[12] The replies to SR 07/2023 are available on the ECA's website, ref. section II.1: https://www.eca.europa.eu/Lists/ECAReplies/COM-Replies-SR-2023-07/COM-Replies-SR-23-07_EN.pdf

[13] Paragraph 113 of Special Report 21/2022

The Commission takes note that ECA did not raise any issues related to the satisfactory fulfilment of audit and control milestones that were assessed during 2022. The Commission welcomes this and considers such milestones are important steps in the implementation of the RRF's control system.

It is not uncommon to find differences between the initial design and actual implementation of systems. For that purpose and to confirm the implementation of adequate systems, the Commission carries out system audits for each Member State and additional risk-based audit work to verify the compliance of the systems with the regulatory requirements. At the end of 2022, the Commission had carried out 16 system audits covering 64 ministries and agencies. Where relevant, recommendations for improvement were issued and the Commission is actively following up on the effective implementation of these recommendations.

Concerning France's data collection system (§11.53), the Commission notes that the French authorities have taken action to improve the weaknesses identified by national and Commission auditors. The Commission also notes that the ECA has not received the requested information for some of their information requests addressed to the French authorities.

3. Annual Activity Reports and the Annual Management and Performance Report

The Commission has taken on board concerns expressed by the ECA[14] and the European Parliament[15] by (a) aligning the wording of the declaration of assurance of the Director-General of DG ECFIN with that used by all other Directors-General in the Commission and (b) providing further details in the Annual Activity Report of DG ECFIN on the work undertaken by the Commission, notably related to the protection of the financial interests of the Union. The Annual Activity Report specifies in detail the work carried out by Commission's own auditors, including audit work on bodies that are common for the RRF and for the cohesion policy funds, as well as how the Commission has considered audit work carried out by national audit bodies. In this respect, as it is the case for all statements of assurances provided by every Director-General of the Commission, the statement of assurance of DG ECFIN's Director-General is to be read together with the whole of the Annual Activity Report. This is why the declaration of assurance is published as part of the Annual Activity Report.

Whilst ECA draws attention to certain elements in the declaration of assurance that come directly from the RRF Regulation, the Annual Activity Report clearly and comprehensively describes the work that the Commission has done to obtain reasonable assurance that Member States control systems comply with their obligations, including on State aid and public procurement.

In the Annual Management and Performance Report, for the RRF, the Commission uses the level of risk disclosed by DG ECFIN in its Annual Activity Report, which underwent a careful and structured quality review. Based on the work carried out, the Commission considers that the low level of risk presented in the Annual Management and Performance Report for the RRF is representative. This estimate is based on a methodology that allows the Commission, as a manager of the Union budget,

[14] Special Report 07/2023 of the European Court of Auditors on the design of the Commission's control system for the Recovery and Resilience Facility (RRF) adopted on 8th March 2023

[15] European Parliament resolution of 10 May 2023 with observations forming an integral part of the decisions on discharge in respect of the implementation of the general budget of the European Union for the financial year 2021

to identify and distinguish between higher, medium and lower risk areas and therefore focus the Commission's efforts to mitigate the risks.

4. Conclusions and materiality of errors

The Commission takes note that the ECA does not provide an error rate but considers the 'minimum financial impact' of its findings to be close to its materiality threshold of two percent. The Commission further notes that the ECA audited 281 milestones and targets out of 311, where the 281 were chosen on a risk basis (Annex 11.1, Paragraph 8). The Commission welcomes that, in estimating the financial impact, the ECA applies the Commission's methodology for determining payment suspensions[16] and that the quantification was discussed with the Commission. The Commission however disagrees on some points with the way the ECA has applied the Commission's suspension methodology to determine the financial impact. Whilst the Commission retains its view that the milestones and targets were correctly assessed as satisfactory fulfilled, if it had to apply this methodology in these cases, it would still have confirmed the Authorising Officer by Delegation's conclusion in DG ECFIN's Annual Activity Report that 2022 RRF payments of non-repayable support were subject to a low level of risk.

Beyond disagreements with findings which, as already expressed in the previous sections, are principally based on differences in interpretation or judgement, the Commission notes:

Concerning the findings of milestones and targets 'not fulfilled' and 'reversal', the Commission understands that the ECA does not apply the methodology the same way the Commission would apply it. Notably, in line with the discretion provided by the RRF Regulation for the Commission's assessment of satisfactory fulfilment, the methodology foresees discretion for the Commission to apply both up- and downward coefficients and up- and downward adjustments. Such adjustments are applied, for instance, to reflect that a reform is of less importance and/or that the Member State has made substantive progress towards the achievement of the overall objective of the reform. Depending on the use of the coefficients and adjustments, there can be different estimations of the estimated financial impact for the same findings.

Concerning the findings of non-eligible measures, the Commission considers that such 'ineligible measures' would, if actually confirmed, need to be corrected by removal of these measures from the Council Implementing Decisions. As all measures concerned by this type of finding have no cost to the RRF, the financial impact would be EUR 0.

Concerning the finding of 'double funding', the Commission maintains that the RRF does not 'finance' milestones or targets, which are '*measures of progress towards the achievement of a reform or investment'* (RRF Regulation Art. 2(4)) and not financeable actions in and of themselves. The Commission therefore does not consider that a 'zero cost' measure can possibly imply 'double funding' by the RRF and another Union fund. The financial impact of double funding would imply a correction of the twice disbursed funds, which in such a case would amount to EUR 0.

[16] COM(2023) 99 final, ANNEX II - Commission methodology for the determination of payment suspension under the Recovery and Resilience Facility Regulation

In summary, the Commission considers that in any case only findings of the first two types (not satisfactorily fulfilled and reversed) can be considered to impact the materiality level. Further, the Commission considers that, even if the underlying findings were accepted, the impact would be far below the materiality level.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Recommendation 11.1 – Improve preliminary assessments and ex-post audits

The Commission should:

a) Cover in its preliminary assessments and ex-post audits compliance with the eligibility period and the principle of non-substitution of recurring national budgetary expenditure;

b) Revise its ex-post audit procedures so that they provide for checks to verify whether the audited targets previously assessed as fulfilled were not reversed after the payment.

(Target implementation date: immediately)

The Commission **partially accepts** this recommendation, for future payment request submissions.

The Commission recalls first that, as per Article 24 of the RRF Regulation, the legality and regularity of RRF payments is solely based on the satisfactory fulfilment of milestones and targets. A recommendation to 'expand' the scope outside this context goes beyond what is prescribed by the legal basis.

The Commission **accepts** to include verifications in its ex-ante work regarding whether the evidence that is submitted to meet a milestone or target is outside the eligibility period. The Commission considers that it is already part of the scope of its ex-post audits to check whether the evidence put forward by a Member State is outside the eligibility period.

The Commission also **accepts** to revise its ex-post audit procedures so that they provide for checks to verify whether the audited targets previously assessed as fulfilled were not reversed after the payment.

However, the Commission **does not accept** to undertake in the context of work on the legality and regularity of *payments* a re-assessment of requirements that the Regulation applies to the initial assessment of the Recovery and Resilience Plan. Notably, the Commission has no legal basis for and hence cannot be expected to conduct a reassessment of the eligibility of the Recovery and Resilience Plan's measures set out in and considered eligible by the Council Implementing Decisions. It therefore, does not accept to re-question with each payment, in both its ex-ante and ex-post work, whether the principle of non-substitution of recurring national budgetary expenditure is fulfilled.

Recommendation 11.2 – Verify that all milestones and targets are clearly defined when reviewing plans

Based on experience acquired during the RRF implementation, verify that reviewed plans clearly define all milestones and targets and that all key elements of a measure are covered by milestones and targets.

(Target implementation date: immediately)

The Commission **accepts** this recommendation, for upcoming revisions of Recovery and Resilience Plans.

The Commission highlights that to make a proposal to change elements of a Council Implementing Decision requires a legal justification for such changes. Accordingly, the Commission agrees to review the definitions of measure descriptions and milestone and target requirements for new measures and – where relevant – for existing measures for which a Member State has submitted an amended or revised plan and for which a legal basis justifies changes to the measure as part of a specific Recovery and Resilience Plan revision.

Annual report on the activities funded by the 9th, 10th and 11th European Development Funds for the 2022 financial year

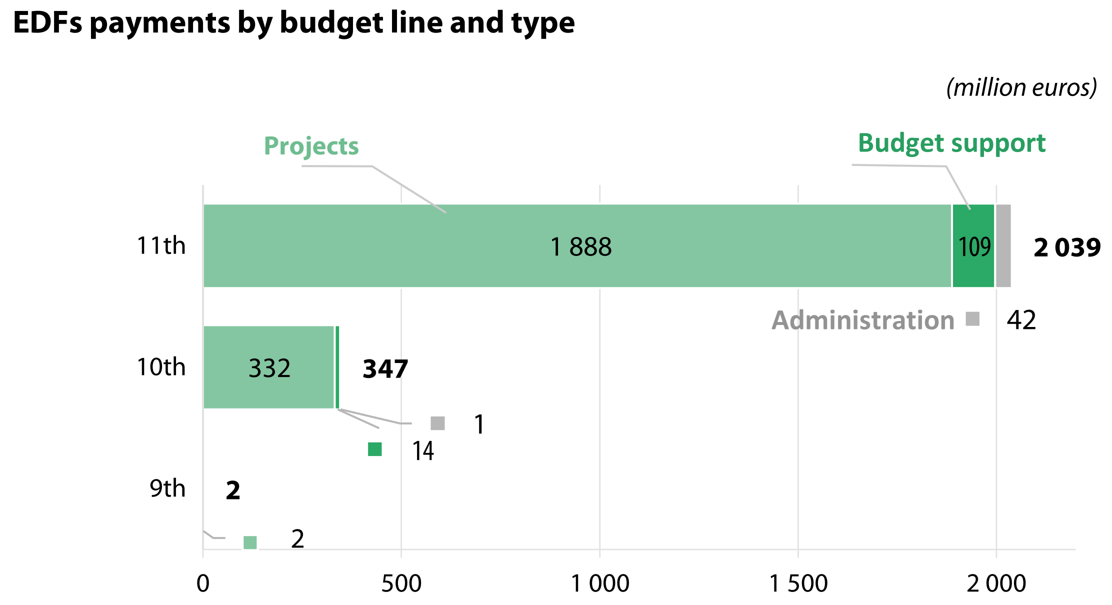
Contents

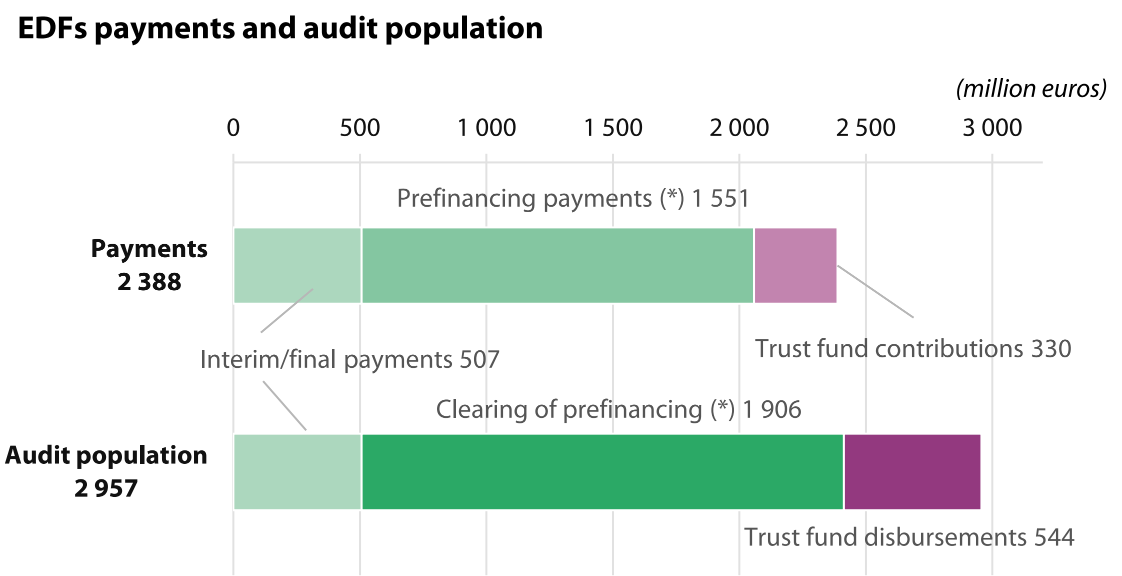
Contents

Introduction

01 This annual report presents our findings on the 9th, 10th and 11th[1] European Development Funds (EDFs). ***Figure 1*** gives an overview of the activities and spending in this area in 2022.

Figure 1 – European Development Funds: 2022 financial overview





(*) In line with the harmonised definition of underlying transactions (for details see ***Annex 1.1***, paragraph ***18***).

Source: ECA, based on the 2022 annual accounts of the 9th, 10th and 11th EDFs.

Brief description of the EDFs

02 Launched in 1959, the EDFs were the main instruments, outside the EU general budget, by which the European Union (EU) financed development cooperation with African (Sub-Saharan), Caribbean and Pacific (ACP) countries and regions, as well as *overseas countries and territories (OCTs)*, until the end of 2020. The 11th EDF[2] covers the 2014-2020 multiannual financial framework (MFF). The framework governing the EU's relations with ACP countries and OCTs was a *partnership agreement* signed in Cotonou ('the *Cotonou Agreement*') on 23 June 2000 for a period of 20 years. The application of its provisions has been extended, currently until 30 June 2023. The primary objective of the EDFs is to reduce and ultimately eradicate poverty, in accordance with the primary objective of development cooperation as laid down in Article 208 of the Treaty on the Functioning of the European Union (TFEU).

03 For the 2021-2027 MFF, development cooperation with ACP countries and regions is covered by the *Neighbourhood, Development and International Cooperation Instrument – Global Europe ('NDICI-Global Europe')* and cooperation with the OCTs has been incorporated into the Decision on the Overseas Association, including Greenland. However, the 9th, 10th and 11th EDFs themselves have not been incorporated into the EU general budget and continue to be implemented and reported on separately until their closure.

04 In 2019, the Commission closed the remaining outstanding *transactions* for 8th EDF projects. All balances and *decommitments* were transferred to the 9th EDF. In 2021, the Commission announced the financial and operational closure of the 8th EDF, closing all contracts and financial decisions in the EDF accounts.

05 The EDFs are specific in that:

(a) they are directly financed by the member states' and UK contributions based on quotas, or 'contribution keys', which were set by the national governments at the Council of the European Union in subsequent internal agreements concluded between the representatives of EU member states meeting within the Council;

(b) they are managed by the Commission, outside the framework of the EU general budget, and the European Investment Bank (EIB);

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1 Financial Regulation applicable to the 11th EDF.

2 *Ibid*.

(c) due to the intergovernmental nature of the EDFs, the European Parliament plays a more limited role in their functioning than it does for the development cooperation instruments financed by the EU general budget; notably, it is not involved in establishing and allocating EDF resources. However, the European Parliament is the *discharge* authority, except for the Investment Facility, which is managed by the EIB and is therefore outside the scope of our audit[3]. A tripartite agreement concluded in 2012 between the EIB, the Commission and the ECA (Article 134 of Regulation (EC) No 215/2008 on the Financial Regulation applicable to the 10th EDF) sets out the rules for our audit of these operations.

(d) the principle of *annuality* does not apply to the EDFs: EDF agreements were usually concluded for a *commitment* period of 5 to 7 years, and payments can be made over a much longer time frame e.

06 The EDFs are managed almost entirely by the Commission's Directorate-General for International Partnerships (DG INTPA). A small proportion (5 %) of the 2022 EDF payments was managed by the Directorate-General for European Civil Protection and Humanitarian Aid Operations (DG ECHO).

07 The expenditure covered in this report is delivered in 78 countries (see ***Annex I***) using a wide range of methods such as works, supply and service contracts, *grants*, *budget support*, *programme estimates* and contribution and *delegation agreements* concluded with *pillar-assessed* entities (e.g. international organisations).

[3] Articles 38, 42-44 and 52 of Regulation (EU) 2018/1877 on the financial regulation applicable to the 11th European Development Fund.

Financial implementation of the 9th, 10th and 11th EDFs

08 The budget of the 9th EDF (2000-2007) was €13.8 billion, and that of the 10th EDF (2008-2013) €22.7 billion.

09 The internal agreement establishing the 11th EDF (2015-2020) came into force on 1 March 2015. Between 2013 and 2015, funds were committed via a *bridging* facility to ensure continuity pending ratification of the 11th EDF. The 11th EDF provides €30.5 billion, of which €29.1 billion has been allocated to the ACP countries and €0.4 billion to the OCTs, with €1 billion for administrative costs.

10 ***Figure 2*** shows the use of EDF resources both in 2022 and cumulatively for the 9th, 10th and 11th EDFs.

Figure 2 – Use of EDF resources at 31 December 2022*

(million euros)

	Situation at end of 2021		*Budgetary implementation during the 2022 financial year (net)[6]*				*Situation at end of 2022*				
	Total amount	Implementation rate[2]	*9th EDF[3]*	*10th EDF*	*11th EDF[3]*	*Total amount*	*9th EDF*	*10th EDF*	*11th EDF*	*Total amount*	*Implementation rate[2]*
A – RESOURCES[1]	**66 092**		***-20***	***337***	***-721***	***-404***	***15 245***	***21 284***	***29 157***	***65 686***	
B – USE											
1. Global commitments[4]	***65 348***	***98.9 %***	***-5***	***356***	***-18***	***333***	***15 245***	***21 162***	***29 275***	***65 682***	**100.0 %**
2. Individual commitments[5]	***63 040***	**95.4 %**	***-1***	***241***	***611***	***851***	***15 244***	***20 841***	***27 806***	***63 891***	**97.3 %**
3. Payments	***55 046***	**83.3 %**	***2***	***347***	***2 039***	***2 388***	***15 218***	***20 302***	***21 912***	***57 432***	**87.4 %**
C – Outstanding commitments (B1-B3)	**10 302**	**15.6 %**					***27***	***860***	***7 363***	***8 250***	**12.6 %**
D – Available balance (A-B1)[7]	**744**	**1.1 %**					***0***	***122***	***-118***	***4***	**0.0 %**

* Rounded figures.

1 Include initial allocations to the 9th, 10th and 11th EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.

2 As a percentage of resources.

3 Negative amounts correspond to decommitments.

4 Global commitments relate to Commission financing decisions.

5 Individual commitments relate to individual contracts with project beneficiaries.

6 Net commitments after decommitments. Net payments after recoveries.

7 Available balance includes 'non-mobilisable reserve' (unusable without unanimous decision from the Council).

Source: ECA, based on the 2022 annual accounts of the 9th, 10th and 11th EDFs. The figures presented do not cover the part of the EDFs managed by the EIB.

11 Every year, DG INTPA sets itself *key performance indicators (KPIs)* and related targets on *sound financial management* and the efficient use of resources. The indicators and related targets cover DG INTPA's entire area of responsibility, comprising the EU general budget, the EDFs and EU trust funds. For 2022, DG INTPA achieved its targets of reducing 'old' pre-financing (i.e. pre-financing not cleared after 2 years) by 40 % compared to 2021 and keeping the proportion of open expired contracts (i.e. those not closed after the end of their operational activities) in its portfolio below 13 %. For the KPI on reducing unspent commitments, its result fell marginally short of the target – see ***Box 1***.

Box 1

KPIs on reducing old pre-financing, unspent commitments and proportion of open expired contracts

In 2022, DG INTPA decided to set a new target for the KPI on reducing old pre-financing (KPI 10), increasing it from 35 % to 40 %. It exceeded the target, achieving 54.31 % for the EDFs and 52.51 % across its entire area of responsibility. This KPI takes into consideration the amount of each pre-financing transaction, but not the number of years for which it has remained open. As a result, DG INTPA's achievement of this KPI did not reflect the difficulties it had encountered in *clearing* older pre-financing transactions, some of which had been open for up to 12 years (see paragraph ***19***). Likewise, DG INTPA set a new target for the KPI on the maximum proportion of open expired contracts in its portfolio (KPI 11), decreasing it from 15 % to 13 %. Once again, it exceeded the target, both for the EDFs (10.56 %) and for the EU general budget (8.39 %).

DG INTPA maintained the previous year's target of 35 % for its KPI on reducing unspent commitments. It achieved this target for the EDFs (36.83 %), but not for the EU general budget (34.85 %) due to technical issues with the OPSYS IT system[4].

[4] ***Box 4*** in ***chapter 9*** for more details about the technical issues with OPSYS.

Statement of assurance on the EDFs

The ECA's *statement of assurance* on the 9th, 10th and 11th EDFs to the European Parliament and the Council

Opinion

I. We have audited:

(a) the annual accounts of the 9th, 10th and 11th EDFs, which comprise the balance sheet, the statement of financial performance, the cash flow statement, the statement of changes in net assets and the report on financial implementation for the financial year ended 31 December 2022, approved;

(b) the legality and regularity of the underlying transactions of which financial management falls to the Commission[5].

Reliability of the accounts

Opinion on the reliability of the accounts

II. In our opinion, the annual accounts of the 9th, 10th and 11th EDFs for the year ended 31 December 2022 present fairly, in all material respects, their financial position as at 31 December 2022, the results of their operations, their cash flows and the changes in their net assets for the year then ended, in accordance with the EDF Financial Regulation and with accounting rules based on internationally accepted accounting standards for the public sector.

Legality and regularity of the transactions underlying the accounts

Revenue

Opinion on the legality and regularity of revenue

III. In our opinion, the revenue underlying the accounts for the year ended 31 December 2022 is legal and regular in all material respects.

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[5] Pursuant to Articles 43, 48-50 and 58 of the Financial Regulation applicable to the 11th EDF, this statement of assurance does not extend to the EDF resources managed by the EIB.

Expenditure

Adverse opinion on the legality and regularity of expenditure

IV. In our opinion, owing to the significance of the matter described under 'Basis for adverse opinion on the legality and regularity of expenditure', the expenditure accepted in the accounts for the year ended 31 December 2022 is materially affected by error.

Basis for Opinion

V. We have conducted our audit in accordance with the IFAC International Standards on Auditing (ISAs) and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions (ISSAIs). Our responsibilities under these standards and codes are described in more detail in the 'Auditor's responsibilities' section of our report. We have also met independence requirements and fulfilled our ethical obligations under the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Basis for adverse opinion on the legality and regularity of expenditure

VI. The expenditure recorded in 2022 under the 9th, 10th and 11th EDFs is materially affected by error. Our *estimated level of error* for expenditure accepted in the accounts is 7.1%.

Key audit matters

VII. Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, but we do not provide a separate opinion on these matters.

Accrued charges

VIII. We assessed the accrued charges presented in the accounts which are subject to a high degree of estimation. At year-end 2022, the Commission estimated that eligible expenses incurred but not yet reported by beneficiaries amounted to €5 427 million (year-end 2021: €5 381 million).

IX. We examined the calculation of these accrual estimates and reviewed a sample of 30 individual pre-financings and 28 invoices in step 1 to address the risk that the accrual was misstated. The work performed led us to conclude that the accrued charges recognised in the final accounts were appropriate.

Potential impact on the 2022 EDF accounts of the United Kingdom's withdrawal from the European Union

X. On 1 February 2020, the United Kingdom (UK) ceased to be an EU Member State. Following the conclusion of the agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (the 'Withdrawal Agreement') between the two parties, the UK committed to remain party to the EDF until the closure of the 11th EDF and all previous unclosed EDFs. The UK will assume the same obligations as the member states under the internal agreement by which the 11th EDF was set up, as well as the obligations arising from previous EDFs until their closure.

XI. The Withdrawal Agreement also states that, where the amounts from projects under the 10th EDF or from previous EDFs have not been committed or have been decommitted on the date of entry into force of this agreement, the UK's share of those amounts will not be reused. The same applies to the UK's share of funds not committed or decommitted under the 11th EDF after 31 December 2022.

XII. Based on this, there is no financial impact to report on the 2022 EDF accounts. We conclude that the EDF accounts as at 31 December 2022 correctly reflect the state of the withdrawal process at that date.

Responsibilities of management

XIII. In accordance with Articles 310 to 325 of the TFEU and with the 11th EDF Financial Regulation, management is responsible for preparing and presenting the EDF annual accounts on the basis of internationally accepted accounting standards for the public sector and for the legality and regularity of the underlying transactions. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to *fraud* or error. The Commission is ultimately responsible for the legality and regularity of the transactions underlying the EDF accounts.

XIV. When preparing the EDF accounts, the Commission is responsible for assessing the EDFs' ability to continue as a going concern, disclosing any relevant matters and using the going concern basis of accounting unless it either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

XV. The Commission is responsible for overseeing the EDFs' financial reporting process.

Auditor's responsibilities for the audit of the EDF accounts and underlying transactions

XVI. Our objectives are to obtain reasonable assurance as to whether the EDF accounts are free from material misstatement and the underlying transactions are legal and regular, and to provide, on the basis of our audit, the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions. Reasonable assurance is a high level of assurance, but it is not a guarantee that the audit has necessarily detected all instances of a material misstatement or non-compliance that may exist. These can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence any economic decisions taken on the basis of these EDF accounts.

XVII. For revenue, we examine all contributions from member states and a sample of other types of revenue transactions.

XVIII. For expenditure, we examine payment transactions once expenditure has been incurred, recorded and accepted. This examination covers all categories of payments (other than advances) at the point they are made. Advance payments are examined once the *recipient* of funds has provided evidence of their proper use and the institution or body has accepted that evidence by clearing the advance payment, which might not happen until a subsequent year.

XIX. We exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the EDF accounts and of material non-compliance of the underlying transactions with the requirements of the EDF legal framework, whether due to fraud or error. We design and perform audit procedures responsive to those risks and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. Instances of material misstatement or non-compliance resulting from fraud are more difficult to detect than those resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Consequently, there is a greater risk of such instances not being detected.

- Obtain an understanding of internal control relevant to the audit in order to design appropriate audit procedures, but not for the purpose of expressing an opinion on the effectiveness of the internal control.

- Evaluate the appropriateness of the accounting policies used by management and the reasonableness of management's accounting estimates and related disclosures.

- Conclude as to the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, as to whether material uncertainty exists owing to events or conditions that may cast significant doubt on the EDFs' ability to continue as a going concern. If we conclude that such material uncertainty exists, we are required to draw attention in our report to the related disclosures in the EDF accounts or, if these disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our report. However, future events or conditions may cause the entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual accounts, including all disclosures, and assess whether the annual accounts fairly represent the underlying transactions and events.

XX. We communicate with management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including findings of any significant deficiencies in internal control.

XXI. Of the matters discussed with the Commission, we determine which were of most significance in the audit of the EDF accounts and are therefore the key audit matters for the current period. We describe these matters in our report unless law or regulation precludes public disclosure or, as happens extremely rarely, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh any public interest benefits.

6 July 2023

Tony Murphy
President

European Court of Auditors

12, rue Alcide De Gasperi – L-1615 Luxembourg

Information in support of the statement of assurance

Audit scope and approach

12 ***Annex 1.1*** to our 2022 annual report on the implementation of the EU budget sets out our audit approach and methods, which also apply to the audit of the EDFs.

13 Our observations on the reliability of the EDFs' accounts are based on the financial statements[6] of the 9th, 10th and 11th EDFs, as approved by the Commission[7], together with the accounting officer's letter of representation received on 20 June 2023. We tested amounts and disclosures and assessed the accounting principles used, as well as any significant estimates made by the Commission and the overall presentation of the accounts.

14 To audit the regularity of transactions, we examined a sample of 140 transactions (all payments were through DG INTPA) that were representative of the full range of spending from the EDFs. This comprised 27 transactions related to the Emergency Trust Fund for Africa, 98 transactions authorised by 20 EU delegations (Benin, Botswana, Burkina Faso, Djibouti, Ethiopia, Fiji, Gabon, São Tomé and Príncipe, Guinea-Bissau, Haiti, Côte d'Ivoire, Liberia, Madagascar, Malawi, Nigeria, Tanzania, The Gambia, Togo, Uganda and Zimbabwe) and 15 transactions approved by Commission headquarters. Where we detected errors in the transactions, we analysed the underlying causes to identify potential weaknesses.

15 We also examined the following for 2022:

(a) all member state contributions and a sample of other types of revenue transaction, such as other countries' co-financing contributions;

(b) the systems used by DG INTPA and the EU delegations for: (i) *ex ante* checks by Commission staff and external auditors (contracted by the Commission or beneficiaries) before payments were made, (ii) monitoring and supervision, notably the follow-up of external audits and the *residual error rate (RER)* study;

(c) the reliability of the regularity information in the *annual activity report (AAR)* of DG INTPA, the consistency of the methodology for estimating amounts at risk,

[6] Article 39 of Regulation (EU) 2018/1877.

[7] *Ibid.*, Article 38.

future corrections and recoveries and their inclusion in the Commission's *Annual Management and Performance Report (AMPR)*; and

(d) the follow-up of our previous recommendations.

16 As stated in paragraph ***06***, DG INTPA implements most of the external aid instruments financed from both the EU general budget and the EDFs. Our observations on systems and on the presentation of information in the AAR refer to DG INTPA's entire area of responsibility, not just the EDFs.

Reliability of accounts

17 We found that the accounts were not affected by material misstatements.

18 The Commission announced the closure of the 8th EDF to the Council in October 2021. In the annual accounts of the EDF for the financial year 2022, the Commission indicated that all 8th EDF activities had been completed. Among other things, this meant that all contracts and financial decisions had been closed in the EDF accounts and the remaining open recovery orders had been transferred to the 9th EDF. However, financial information on the 8th EDF still appeared in the accounts, and some 8th EDF balances were still open in 2022. The full accounting closure of the 8th EDF therefore did not take place in a timely manner.

19 While testing pre-financing transactions, we noted that some had been open for up to 12 years. The Commission did not always clear pre-financing on a regular basis to properly reflect the actual amounts repayable to the Commission by beneficiaries. Likewise, the Commission did not clear invoices (invoices received and to be checked and accepted by Commission) to reflect the actual amounts payable by the Commission to beneficiaries. In 2021, we informed the Commission about these cases detected in our sample. The Commission's measures to correct these issues did not yield the expected results. In 2022, we continued to find pre-financing and invoices transactions that had been open for a long time without being cleared.

Regularity of transactions

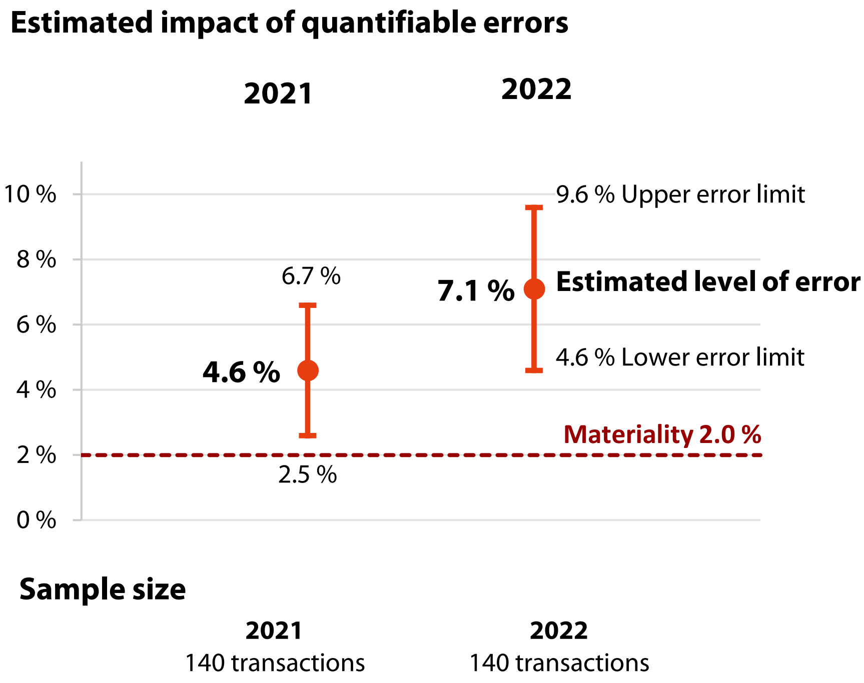
Revenue

20 Revenue transactions did not contain a material level of error.

Expenditure

21 Of the 140 transactions we examined, 57 (40.7 %) contained errors. On the basis of the 48 errors we have quantified, we estimate the level of error to be 7.1 % (see *Figure 3*).

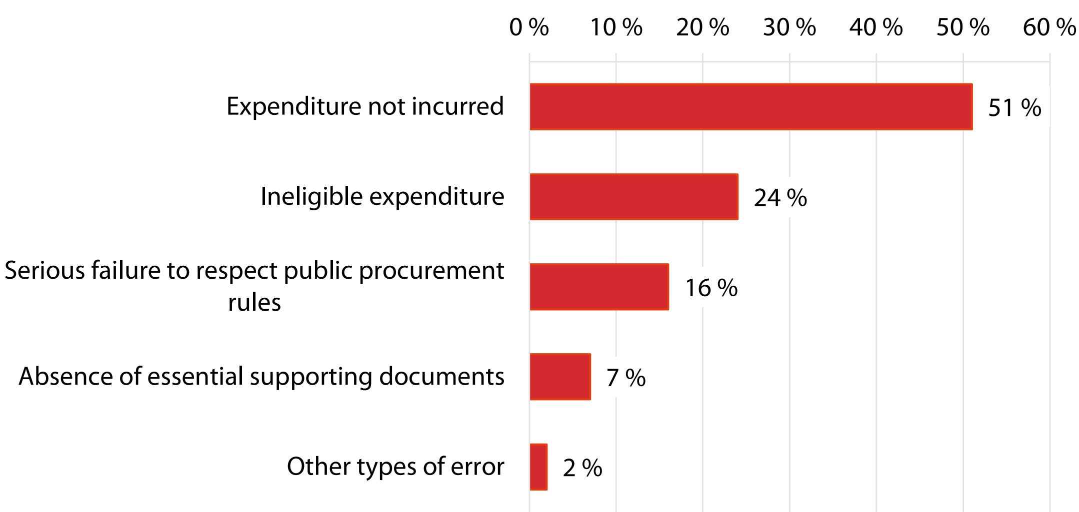
Figure 3 – Results of transaction testing



Source: ECA.

22 *Figure 4* gives a breakdown of our *estimated level of error* for 2022 by error type.

Figure 4 – Breakdown of estimated level of error by error type



Source: ECA.

23 *Box 2* presents examples of errors we have quantified, likewise by error type.

Box 2

Expenditure not incurred: deficiency in the EU delegations' control systems for the clearing of pre-financing

In one EU delegation visited this year, we found that six of the nine transactions we audited were affected by the same type of error. The Commission had cleared pre-financing transactions based on the beneficiary's declared total expenditure of €11 million. Our checks revealed that the actual expenditure for the projects concerned had been €3.8 million. The difference, €7.2 million, comprised commitments which had not yet been spent. We therefore considered that this expenditure was not incurred and therefore not eligible.

The fact that we detected this error in two thirds of the transactions we audited points to a weakness in the functioning of the delegation's internal control systems for the clearing of pre-financing.

Ineligible *value added tax (VAT)* charged to the project

The Commission signed a *contribution agreement* with an international organisation for an action in Malawi to improve pupils' nutrition and health by providing diversified school meals and enhancing hygiene and sanitation. The total cost of the action was €19 million, with an EU contribution of €16 million.

The international organisation rented a warehouse to implement the action and charged €33 000 to the project, including €4 700 in VAT. Deductible VAT is not considered eligible expenditure and therefore should not have been charged to the project.

Serious failure to respect *public procurement* rules: unjustified decisions by the national authorising officer

Benin´s EDF national authorising officer awarded a contract to a consultancy company to strengthen civil society involvement in the country. The contract was worth €1.4 million and was 100 % funded by the EU.

The national authorising officer used a restricted call for tenders to award the contract. Four tenderers reached the final stage of the evaluation. The evaluation committee rejected one of these tenderers for not meeting a technical requirement included in the tender file.

We found that this rejection was based on a calculation method that differed from the one included in the tender file. We concluded the national authorising officer had made an unjustified decision that breached public procurement rules. In addition, we found that the evaluation committee had not sufficiently documented the procedure. As a result, the transaction was affected by a quantifiable error of 100 %.

Absence of essential supporting documents

The Commission signed a delegation agreement with an international organisation for an action to contribute to sustainable growth in the agricultural sector and reduce food insecurity and malnutrition in The Gambia.

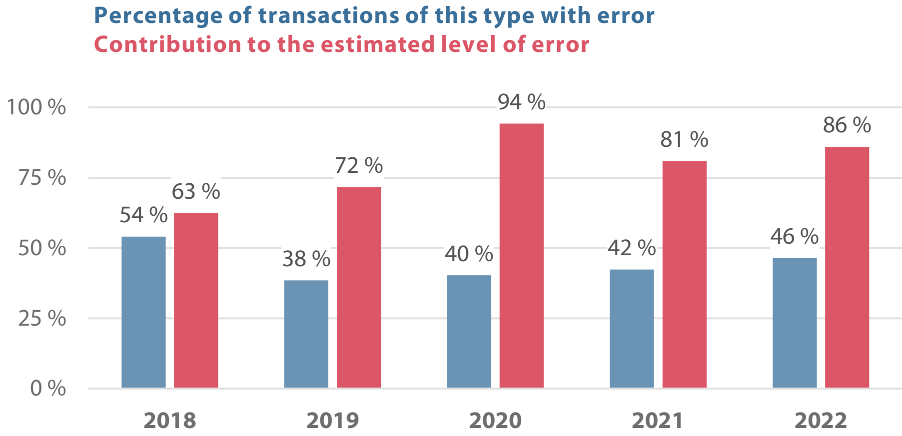
One component of the project was the distribution of cash to schools for meals. The international organisation was unable to provide essential supporting documents for the component's total expenditure of €11 200, such as evidence that the families supported were eligible or proof that the support had been received by final beneficiaries.

Another component of the project was the delivery of training activities. We did not receive key supporting evidence for payments worth €5 400, comprising daily allowances for certain participants and fuel expenditure.

Due to the absence of essential supporting documents, we considered a total of €16 600 for these two components to be ineligible.

24 As in the past, the Commission and its implementing partners committed more errors in transactions relating to programme estimates and *grants* and to *contribution and delegation agreements* with beneficiary countries, international organisations and member state agencies than they did with other forms of support (such as those covering works, supply and service contracts). Of the 99 transactions of this type that we examined, 46 contained *quantifiable errors*, which accounted for 86 % of the estimated level of error (see ***Figure 5***).

Figure 5 – Errors relating to programme estimates, grants, and contribution and delegation agreements between 2018 and 2022



	2018	2019	2020	2021	2022
Number of transactions of this type audited	61	65	67	92	99
Number of transactions of this type affected by error	33	25	27	39	46

Source: ECA.

25 In 23 cases of quantifiable error and five cases of non-quantifiable error, the Commission had sufficient information to prevent, or to detect and correct, the error before accepting the expenditure. Had the Commission made proper use of all the information at its disposal, the estimated level of error would have been 5.5 percentage points lower.

26 Moreover, 22 transactions containing quantifiable errors, contributing 2.3 percentage points to the estimated level of error, were subject to an audit or expenditure verification. DG INTPA's control system is based on *ex ante* checks, which assess the eligibility of expenditure prior to its acceptance). The information provided in the audit/verification reports describing the work actually done did not allow us to assess whether the errors could have been detected and corrected during these *ex ante* checks. DG INTPA's *ex ante* checks are selected using a risk-based approach and, as such, are not intended to cover 100 % of the reported expenditure. These reports do not always give sufficient detail to confirm whether the items for which we identified errors had been part of their sample.

27 We identified two spending areas in which transactions are less prone to errors due to specific payment conditions. These areas are (i) budget support and (ii) multi-donor projects implemented by international organisations and subject to the

'*notional approach*'. In 2022, we audited two budget support transactions and eight notional approach projects managed by international organisations.
Paragraphs ***9.11***-***9.12*** in ***chapter 9*** of our 2022 annual report on the implementation of the budget give more details on budget support and the notional approach.

28 As in previous years, we faced delays in receiving requested documentation from some international organisations and, consequently, in carrying out our work. These organisations provided only limited access to documents (e.g. in read-only format), which hindered the planning, execution and quality control of our audit. These difficulties persisted despite the Commission's attempts to resolve them through ongoing communication with the international organisations concerned.

Annual activity report and other governance arrangements

29 As in the preceding years, DG INTPA issued action plans to address the weaknesses in the implementation of its control system. In 2020 and 2021, we reported on the satisfactory progress achieved on the 2019 and 2020 action plans.

30 By April 2023, the implementation status of the 2020 action plan remained the same as in 2022: out of seven actions, four had been completed and three were ongoing. In the 2021 action plan, DG INTPA increased the number of actions to eight. Four had been completed and four were still ongoing.

31 The 2022 action plan consists of 10 actions. Four new actions were added: (i) improve the follow-up of the findings of ECA reports and residual error rate (RER) studies; (ii) strengthen controls when drafting financing agreement for budget support operations; (iii) strengthen controls in respect of legal bases before signing contracts; and (iv) remind partners to fulfil their obligation to notify the Commission when counterparties are identified as being in exclusion situations. As of April 2023, one action had been completed and nine were still ongoing (see ***Annex II***).

2022 RER study

32 In 2022, DG INTPA had its 11th RER study carried out by an external contractor. The purpose of the study is to estimate the rate of those errors that have evaded all DG INTPA management checks to prevent, detect and correct such errors across its entire area of responsibility, in order to conclude on the effectiveness of those checks. The study is an important element underlying the Director-General's *declaration of assurance*, and feeds into the regularity information on *external action* disclosed in the AMPR.

33 The RER study does not constitute an *assurance engagement* or an audit; it is based on the RER methodology and manual provided by DG INTPA. Our previous annual reports[8] on the EDFs have already described limitations in the studies that may have contributed to the RER's underestimation. For the 2022 RER study, DG INTPA used a sample size of 480 transactions, as in previous years (some of the sampled transactions had a value higher than the *sampling interval*; therefore, the final sample size was 407). The study estimated the overall RER at 1.15 % – below the Commission's 2 % *materiality threshold* for the seventh year in a row.

34 We reviewed the calculation method used for the 2022 RER study and found that the methodology for extrapolating high-value items was not sufficiently clear. As a result, the external contractor had not correctly extrapolated high-value items (i.e. ones with a value higher than the sampling interval) from the sample. We consider that the RER was underestimated. Our calculation yields an RER of 1.35 %.

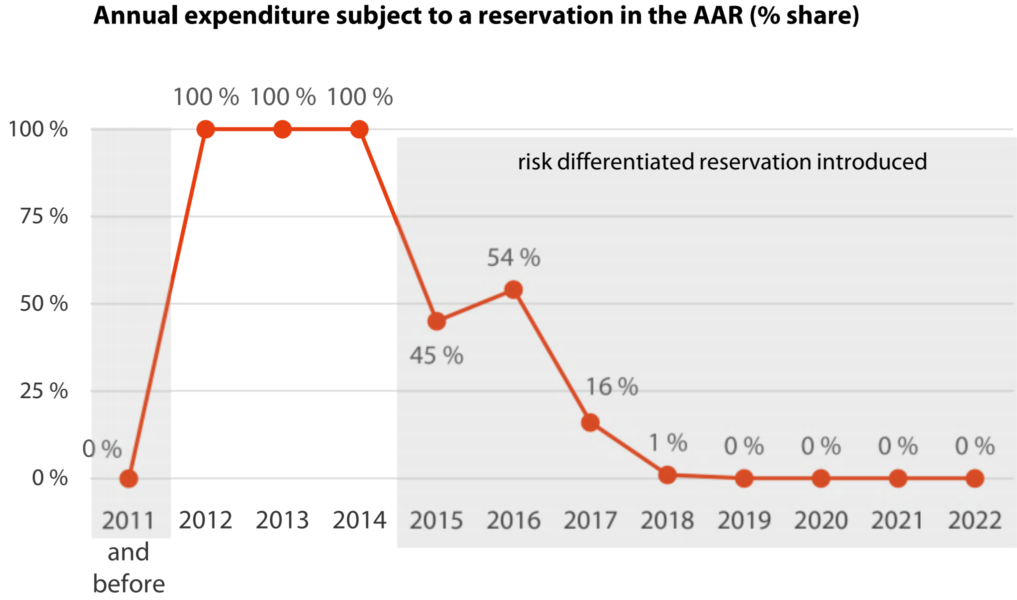
35 As in previous years, we observed, among other things, that the RER methodology allows the contractor to rely entirely on the results of DG INTPA´s management checks. We maintain our view that placing reliance on the work of other auditors is contrary to the purpose of an RER study, which is to estimate the rate of errors that have evaded all DG INTPA management checks to prevent, detect and correct such errors. In cases where these previous checks were carried out under the *Financial and Administrative Framework Agreement (FAFA)* between the European Commission and the United Nations, the contractor is not always able to carry out additional substantive testing as the FAFA limits the Commission's verification rights.

Review of the 2022 AAR

36 The Director-General's declaration of assurance in the 2022 AAR does not include any *reservations*. From 2018 onwards, DG INTPA significantly reduced the scope of reservations (i.e. the share of expenditure covered by them), initially from 16 % to 1 % and then to zero. ***Figure 6*** shows the scope of reservations presented in the AARs each year from 2011 to 2022.

8 2017, 2018, 2019 and 2020 annual reports on the EDFs.

Figure 6 – DG INTPA AAR reservations 2011-2022



Source: ECA, based on data from DG INTPA annual activity reports, 2011-2022.

37 We find the lack of reservations in the 2022 AAR unjustified and consider that it results partly from the limitations of the RER study. Our findings on this study also concern the estimates of amounts at risk based thereupon. Due to the incorrect extrapolation of high-value items (see paragraph ***34***), the error rate for expenditure related to *indirect management* with third organisations exceeded the 2 % *materiality threshold*. The Commission should therefore have formulated a reservation for this expenditure category, which accounts for 42.7 % of INTPA´s relevant expenditure.

38 DG INTPA estimates the overall amount at risk at payment to be €83.3 million (1.4 % of 2022 expenditure) and the overall amount at risk at closure to be €71.7 million[9]. Of the amount at risk at payment, DG INTPA estimates, based on historical data, that €11.6 million (19 %) will be corrected by its checks in subsequent years (this amount is known as the *'corrective capacity'*). Applying the RER of 1.35 % resulting from our calculation, we arrive at an overall amount at risk at payment of €95.5 million and an overall amount at risk at closure of €83.9 million. As in previous years, DG INTPA performed targeted checks on recovery orders to correct the discrepancies identified. We reviewed the calculation of the corrective capacity for 2022. Having tested 64.5 % (by value) of the total population of recoveries, we

[9] DG INTPA's 2022 AAR, p. 36.

identified one case in which the Commission had recorded a *recovery order* incorrectly in its IT system.

Conclusion and recommendations

Conclusion

39 Our audit shows that the EDFs' accounts for the financial year ending 31 December 2022 present fairly, in all material respects, their financial position, the results of their operations, their cash flows and the changes in net assets for the year then ended, in accordance with the provisions of the EDF *Financial Regulation* and the accounting rules adopted by the accounting officer.

40 Our audit shows that, for the financial year ending 31 December 2022:

(a) the revenue of the EDFs was not affected by a material level of error;

(b) EDF payment transactions were affected by a material level of error (see paragraphs ***21***-***26***). We estimate the level of error to be 7.1 % based on our transaction testing.

Recommendations

41 ***Annex III*** shows the findings of our follow-up review of the two recommendations we made in our 2019 annual report on the EDFs. The Commission had implemented one of these recommendations in some respects, while the other had not been acted upon at all.

42 We also reviewed the three recommendations from our 2020 annual report on the EDFs (see ***Annex III***). The Commission had implemented one of these recommendations in full, while one had been implemented in some respects and the third had not been acted upon at all.

43 We consider recommendation 3, that DG INTPA establish obligations for the RER study contractor to report to the Commission any suspected fraud against the EU budget, to have been implemented. DG INTPA's RER methodology includes a new procedure for the contractor to report suspicions of fraud and of sexual exploitation, abuse and harassment.

44 Based on this review and our findings and conclusions for 2022, we recommend that the Commission:

Recommendation 1 – Check that accounting balances for closed EDFs are cleared in a timely manner

Check that all accounting balances for closed EDFs are cleared and that information in the annual accounts is updated in a timely manner.

Target implementation date: in time for the preparation of the 2023 accounts

Recommendation 2 – Check that pre-financing and invoices are cleared in a timely manner in the annual accounts

Check that pre-financing and invoices are cleared in a timely manner.

Target implementation date: end of 2024

Recommendation 3 – Take measures to improve EU delegations' controls systems for the clearing of pre-financing

Take appropriate measures to improve EU delegations' control systems so that amounts not yet spent but claimed as incurred costs are identified before making payments or clearing expenditure.

Target implementation date: end of 2024

Recommendation 4 – Reiterate the obligation to comply with VAT rules and carry out appropriate checks

Reiterate to beneficiaries of EU projects that they must abide by contractual conditions relating to VAT eligibility, and carry out the necessary checks to ensure that deductible VAT is not charged to projects.

Target implementation date: end of 2024

Recommendation 5 – Strengthen *ex ante* controls before accepting expenditure

Take into consideration all available technical and financial information to prevent, or detect and correct, errors before accepting expenditure.

Target implementation date: end of 2024

Recommendation 6 – Improve the RER methodology and verify its proper application

Improve the methodology used for the RER study so that high-value items are extrapolated correctly, and verify that the contractor applies it properly.

Target implementation date: end of 2024

Assessment of project performance indicators during our audit visits

45 This year, as part of our audit visits, we assessed the achievement of *performance* indicators for projects that were either completed or close to completion. Our aim was to make observations on performance aspects going beyond the regularity of transactions. Our assessment included, but was not limited to, a review of *output* and outcome indicators, as well as project results.

46 Our checks revealed cases where funding had been used effectively and contributed to the achievement of project objectives. We also identified cases where EU funds had been spent less efficiently, as procured goods were not being used as planned, and cases where objectives and performance targets had not been achieved – see ***Box 3***.

Box 3

Examples of performance observations

(a) Successful implementation of a project

The Commission signed a grant agreement for €2 million with a company for a project to contribute to participatory and accountable governance in Zimbabwe with a view to improving gender equality and children’s rights. Our audit visit confirmed that the project had helped to significantly improve the capacity of civil society organisations (CSOs), enabling them to participate in policy dialogue. This resulted, for example, in Zimbabwe including the prevention of child marriage on its national agenda. The CSOs’ sustained advocacy resulted in the passing of the Marriages Act, which addresses the issue of child marriage.

(b) Ineffective use of purchased equipment

The Commission signed a contribution agreement with an international organisation for a project to support vocational technical education in Ivory Coast for €17 million. During our audit visit, we found that one of the beneficiary schools was not using some of the laboratory equipment purchased under the agreement. Some items remained unopened in storage, while others could not be located at the school during our visit.

This indicates that some equipment purchased under the agreement was either unnecessary or was not being used for its intended purpose.

(c) Failure to achieve expected project results due to overambitious objectives

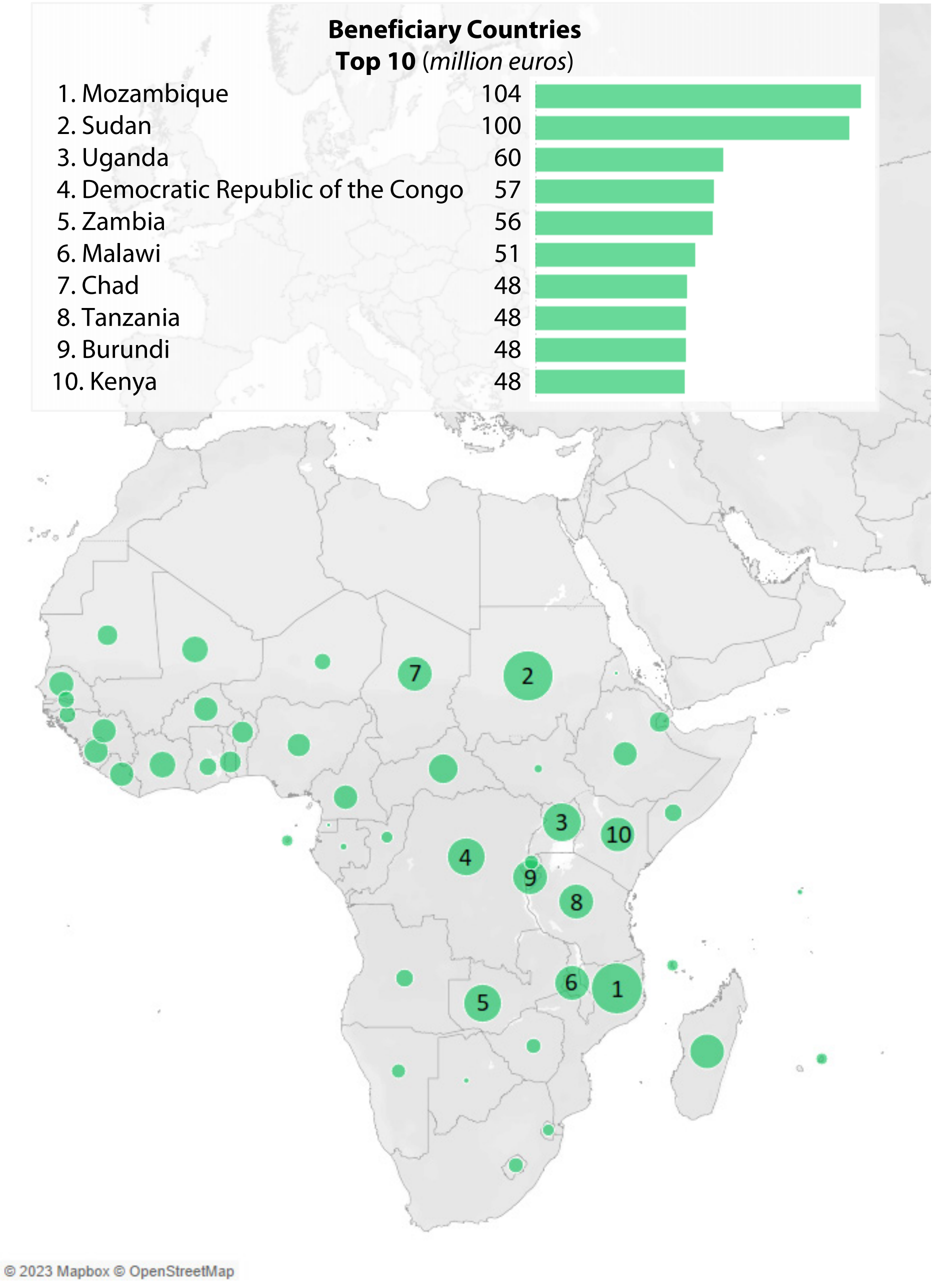
The Commission signed a programme estimate contract for €2.8 million with a consultancy company for a project to promote sustainable development and poverty reduction in Madagascar. These objectives were to be achieved by making Madagascan businesses more competitive at national and international level.

Our audit visit confirmed that the project had not achieved some of its planned outputs, such as the targets for the number of companies to be certified or new markets to be developed. One reason for this was that the targets set were too ambitious given the project duration and budget; another reason was delays in the implementation of some activities.

Annexes

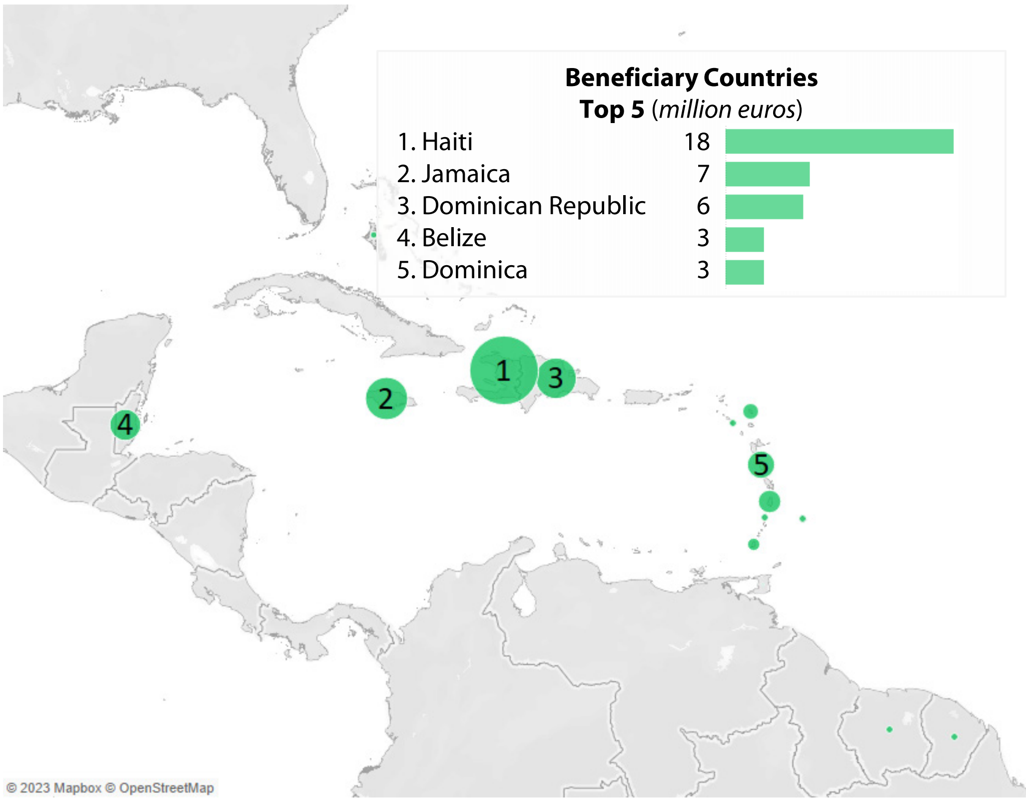
Annex I – EDF payments in 2022 by main region

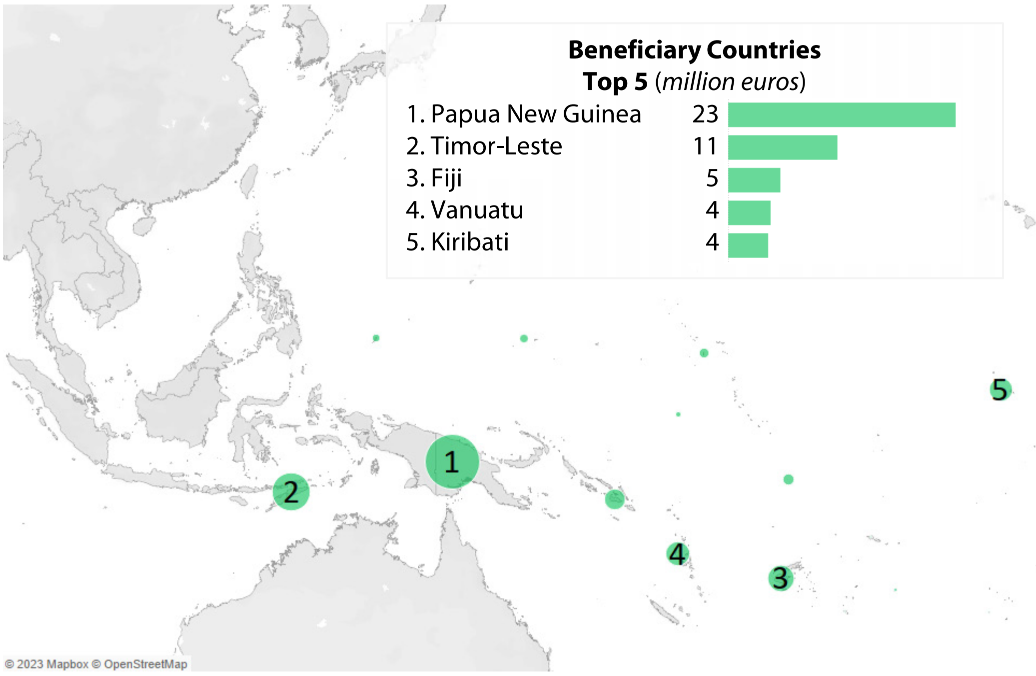
European Development Fund Payments – Africa



Source: Created with "Tableau" by ECA, map background © Mapbox and © OpenStreetMap licensed under the Creative Commons Attribution-ShareAlike 2.0 license (CC BY-SA).

European Development Fund Payments – Caribbean and Pacific





Source: Created with "Tableau" by ECA, map background © Mapbox and © OpenStreetMap licensed under the Creative Commons Attribution-ShareAlike 2.0 license (CC BY-SA).

Annex II – Status of implementation of the action plans

2020 action plan			
A.1	Simplify and clarify procedures and contractual conditions for grants.	🔵	Ongoing
A.2	Maintain awareness on frequently occurring errors in financial and document management for the implementation of grant contracts.	🟢	Implemented
B.1	Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.	🟢	Implemented
C.1	Clarify and promote use of results-based financing.	🔵	Ongoing
C.2	Improve the methodology and manual of the RER study (new action build on AP 2019/D4).	🟢	Implemented
C.3	Reduce excess clearing of pre-financing (new action).	🔵	Ongoing
C.4	Conduct an evaluation on the use of ToR for Expenditure Verifications (EV) (new action).	🟢	Implemented
2021 action plan			
A.1	Simplify and clarify procedures and contractual conditions for grants.	🔵	Ongoing
B.1	Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.	🟢	Implemented
B.2	Address the high-risk observations from the IAS audit on pillar assessment of external actions (new action).	🟢	Implemented
C.1	Clarify and promote use of results-based financing.	🔵	Ongoing
C.2	Improve the methodology and manual of the RER study.	🟢	Implemented
C.3	Address vulnerabilities to excess clearing of prefinancing.	🔵	Ongoing
C.4	Conduct an evaluation on the use of Terms of Reference (ToR) for Expenditure Verifications (EV).	🟢	Implemented
C.5	Share information on frequently occurring errors with relevant control stakeholders (new action).	🔵	Ongoing

2022 action plan			
A.1	Simplify and clarify procedures and contractual conditions for grants.	🔵	Ongoing
B.1	Continue and reinforce cooperation with International Organisations in view of sustainable reduction of errors.	🟢	Implemented
C.1	Clarify and promote use of results-based financing.	🔵	Ongoing
C.2	Address vulnerabilities to excess clearing of prefinancing.	🔵	Ongoing
C.3	Reinforce the ToR for Expenditure Verifications (EV) (Build on AP 2021/C4).	🔵	Ongoing
C.4	Share information on frequently occurring errors with relevant control stakeholders (Build on AP 2021/C5).	🔵	Ongoing
C.5	Improve the follow up of ECA/RER findings (new action).	🔵	Ongoing
C.6	Strengthen controls when drafting financing agreement for budget support operations (new action).	🔵	Ongoing
C.7	Strengthen controls in respect of legal bases before signing contracts (new action).	🔵	Ongoing
C.8	Remind partners to fulfil their obligation to notify the Commission when counterparties are identified as being in exclusion situations (new action).	🔵	Ongoing

Source: The Commission’s 2020, 2021 and 2022 action plans.

Annex III – Follow-up of recommendations

Level of implementation: fully; in most respects; in some respects; not implemented.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
2019	**Recommendation 1:** Further improve the methodology and manual used for the RER study to address the issues we have identified in this report, in order to make the error rate reported in the study more reliable. Timeframe: by the end of 2021.		The Commission updated continuously RER rules, but most observations from our previous reviews (e. g. the review of the 2021 RER study) persist.
	Recommendation 2: Issue reservations for all areas found to have a high level of risk, regardless of their share of total expenditure and their financial impact. Timeframe: by the time the 2020 AAR is published.		
2020	**Recommendation 1:** Take steps so that international organisations provide the ECA with complete, unlimited and timely access to documents necessary to carry out its task in accordance with the TFEU, and not just in read-only format. Timeframe: by the end of 2021.		The Commission intensified communication with international organisations regarding our access to documents. Some United Nations (UN) organisations, such as the United Nations Children's Fund (UNICEF), the World Health Organisation (WHO) and the United Nations Development Programme (UNDP), continue to provide read-only access to supporting documentation.

Year	ECA recommendation	ECA analysis of progress made in implementing recommendation	
		Level of implementation	Remarks
	Recommendation 2: Issue reservations for all areas found to have a high level of risk, regardless of their share of total expenditure and their financial impact. Timeframe: by the time the 2021 AAR is published		
	Recommendation 3: Establish obligations for the RER study contractor to report to the Commission any suspected fraud against the EU budget detected during its work on the RER study. Timeframe: by the end of 2022.		

Source: ECA.

European Commission replies to the annual report on the activities funded by the 9th, 10th and 11th European Development Funds for the 2022 financial year

REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS' REPORT ON THE ACTIVITIES OF THE 9TH, 10TH AND 11TH EDFs FOR THE FINANCIAL YEAR 2022

I. THE COMMISSION REPLIES IN BRIEF

The Commission welcomes the report of the Court on the European Development Funds (EDFs). The Commission wishes to underline that the implementation of EDF takes places in risky, complex and increasingly fast-evolving environments. It is characterised by diversity:

- in terms of geographical dispersion, covering many different EU Delegations (EUD) around the world;
- in terms of implementing entities and partner countries with their diverse management and control capacities, ranging from small local NGOs to International Organisations; and
- in terms of assistance delivery methods, including traditional projects, budgetary support, sectoral policy support programmes, contributions to global instruments, blending, budgetary guarantees, and other aid implementation modalities. In addition, there are difficulties to deploy staff to Delegations in hardship countries and shortage of specialized profiles both in EUD and in headquarters (HQ).

The Commission considers that in this challenging context, a zero-error scenario is unlikely and it would not be cost efficient. The Commission however takes all necessary measures to ensure full and efficient implementation of the EDF in accordance with the existing legal and financial framework. The Commission continues to adapt and refine its procedures to further reduce the risk of errors, taking into account, amongst others, the results of the ECA's statement of assurance. The action plan that is adopted every year by the Commission services includes, among others, actions that target the reduction of errors through simplification of procedures, updated guidance, trainings and awareness raising campaigns for its staff and partners. To address the ECA's 2022 recommendations on the EDF, the Commission will take further actions to strengthen its internal control system as deemed appropriate considering also cost efficiency.

II. COMMISSION REPLIES TO MAIN ECA OBSERVATIONS

1. Reliability of the accounts

The European Commission confirms that all 8th EDF activities were completed in 2021. However, some balances still appear in the 8th EDF accounts. The Commission will clear the relevant accounts in time for the preparation of the 2023 accounts.

As to the ageing of open invoices and pre-financings that have remained uncleared for up to 12 years (§19), the Commission notes that the majority of these old pre-financings are linked to litigation cases.

To reduce the old open pre-financings and to address the ageing of invoices, the Commission has already put in place annual controls. In addition, the Commission is using a Portfolio Dashboard that allows its staff:

- to monitor the ageing of the pre-financings via a specific indicator[1];

-to follow up on invoices that are suspended for more than one year. All the long overdue invoices are flagged in the Dashboard so that the authorising officer can identify them and take action.

The Commission will continue to closely monitor these open transactions and will issue further internal instructions to reduce them.

2. Regularity of transactions

Expenditure

Concerning the breakdown of errors (§22), the Commission notes that in 2022 approximately 50% of the summed errors are due to **excess clearing**, meaning a practice where expenditure not incurred is included in the accounts as expenditure incurred. The Commission considers these errors as temporary as they will no longer exist after the final clearings. The Commission has taken several actions including asking its partners to review their reporting templates to allow for easier identification of incurred expenditure and will step up its efforts in this regard. It expects to see positive results in the coming years.

Errors in **procurement procedures** account approximately for 15% of the overall error. These may be due to an important document missing or some error during the evaluation. However, errors of this kind do not necessarily mean that the relevant projects have not been successfully implemented or that there are legal grounds to recover the funds.

Another type of error that the Commission has also contested in past Annual Reports and is included in the ineligible expenditure of figure 4, concerns the **7% of indirect costs of sub-grantees** that are reported as direct costs for the implementing partners. In the Commission's view, this is in line with the Financial Regulation. The Commission is of the opinion that both the implementing partner and the sub-grantees are entitled to a maximum 7% each of indirect costs/remuneration.

Finally, the Commission notes that one of the EU Delegations accounted for approximately 30% of the total error. Remedial measures are currently being taken in order to address internal control weaknesses in this Delegation.

Regarding the audit/verification reports referred to in paragraph 26, the Commission underlines that it is regularly updating the terms of reference for the expenditure verifications to make them more efficient and fit for purpose. For example, the audit/verification reports need now to include the list of transactions subject to audit/verification and identify the ones that are included in the sample. This revision aims at improving the completeness and clarity of reporting.

Reply to Box 2

Expenditure not incurred: deficiency in the EU delegations' control systems for the clearing of pre-financing

The Commission acknowledges the error; a set of remedial actions to improve the EU Delegations' control systems, including training of staff and a supervision mission, from HQ have already been decided and their implementation has started.

1. Indicator I08 - Reduction of Old Pre-financing.

Ineligible value added tax (VAT) charged to the project / Absence of essential supporting documents

The Commission is following up with the International Organisation concerned and will take appropriate corrective actions.

Serious failure to respect public procurement rules: unjustified decisions by the national authorising officer

The Commission considers that the evaluation of the public procurement procedure could have been better documented. The Commission points out that the Evaluation Committee used its discretionary power to apply a calculation method necessary to verify the compliance with the technical requirement.

Annual activity report and other governance arrangements

Directorate General for International Partnerships (DG INTPA) continues to take action to address all control issues as appropriate. While DG INTPA adopts a new action plan related to internal control every year, each new plan is based on the assessment of the previous action plan, findings by the ECA and the Commission's Internal Audit Service and an evaluation of underlying risks. Therefore, the action plans in most cases also include actions related to areas subject to reservations in previous Annual Activity Reports.

The implementation of the current action plan 2022 addressing identified control weaknesses and high risks is on track. The target date of most actions (six) is end of 2023 or later. DG INTPA will assess the implementation of the 2022 action plan in the autumn of 2023, taking into consideration, inter alia, the ECA's findings in its 2022 Annual report on the EDF.

RER Study

The Residual Error Rate (RER) study is an important element underpinning the declaration of assurance of the Director General but is not the only source of assurance. DG INTPA has a comprehensive internal control framework and control strategy covering the full implementation cycle. All elements of the control framework serve as building blocks for its assurance which is reported in its Annual Activity Report. The latter is the basis for the regularity information in the Annual Management and Performance Report (AMPR).

Regarding paragraph 34, the Commission considers that the external contractor applied the extrapolation of high value items in line with the methodology of the RER studies. Therefore, the Commission considers that the RER (1.15%) was not underestimated.

As to the view that placing reliance on the work of other auditors is contrary to the purpose of an RER study (p§ 35), the Commission, following past observations on an alleged overreliance, amended the documents governing the RER Studies. Now the Commission requires that instances of full and partial reliance on prior control work should be monitored in the light of historical averages, which should not be significantly exceeded without a detailed reasoning.

Review of the 2022 Annual Activity Report (AAR)

The ECA finds the lack of reservations in the 2022 AAR unjustified and considers that it results partly from the limitations of the RER study but also from the incorrect extrapolation of errors. The Commission, in line with the explanation above in reply to paragraph 34, considers the absence of reservations to be justified. It is the result of the correct implementation of the RER methodology and instructions by its central services whereby a reservation, other than reputational, has to be issued when the residual error rate for the corresponding segment of expenditure is above the 2% materiality threshold.

III. COMMISSION REPLIES TO THE RECOMMENDATIONS

Follow-up of previous years' recommendations

Regarding recommendation 1 from the ECA 2019 annual report on the EDF on improving the methodology and the manual used for the RER study, the Commission has updated the RER Study's manual and the methodology in January 2022 addressing the ECA's recommendations as appropriate, without altering the nature of the study. Therefore, the Commission considers that it has implemented the ECA's recommendations to the extent possible.

Regarding recommendation 2 from the ECA 2019 and 2020 annual reports on the EDF on issuing reservations for all areas found to have a high level of risk, the Commission did not accept these recommendations for the reasons provided in the responses published with the ECA report. Since the 2019 financial year, a de-minimis rule for issuing reservations in the AARs has been introduced at corporate level, applicable to all Annual Activity Reports across the Commission. Its purpose is to focus the number of reservations on the significant ones only, while maintaining the transparency in management reporting as the cases for which the de-minimis rule is applied are duly mentioned in the AAR. As a result, the recommendations were rejected.

Regarding recommendation 1 from the ECA 2020 annual report on the EDF to ensure the ECA's timely, unlimited and complete access to International Organisations' documents, the Commission intensified communication with International Organisations on ECA's access to documents. The Commission is working actively with the concerned International Organisations whose transactions contributed to the error rate, both through practical solutions and high-level dialogue. The Commission has also a permanent contact point who liaises immediately with relevant International Organisations whenever a problem is brought to its attention by the ECA, to speed up submission of documents.

The issue of providing the ECA access to documents has been discussed in recent meetings of the EU-UN Financial and Administrative Framework Agreement (FAFA) Working Group and bilateral meetings between the Commission and its partners. It is also systematically included in the regular dialogue with the UN organisations. The Commission has also facilitated technical discussions between the United Nations (UN) and the ECA with a view to ensure mutual understanding of the constraints of all parties and to identify concrete and practical steps towards ensuring smooth access to documents. Joint trainings with UN staff have resumed in 2023, and the Commission has also agreed with the UN to set up Joint Technical Groups to discuss regularly audit and control issues. However, for UN Organisations, providing more than "read only" access to their documents goes against their internal rules. The Commission will continue to take action to find practical and long-term solutions to these issues.

Recommendation 1 – Check that accounting balances for closed EDFs are cleared in a timely manner

Check that all accounting balances for closed EDFs are cleared and that information in the annual accounts is updated in a timely manner.

(Target implementation date: in time for the preparation of the 2023 accounts)

The Commission **accepts** this recommendation and will implement the relevant action.

Recommendation 2 – Check that pre-financing and invoices are cleared in a timely manner in the annual accounts

Check that pre-financing and invoices are cleared in a timely manner.

(Target implementation date: end of 2024)

The Commission **accepts** this recommendation and will continue to closely monitor these open transactions. In addition to the existing controls, the Commission will issue further internal instructions and recall the need to clear pre-financing and invoices in a timely manner.

Recommendation 3 – Take measures to improve EU delegations' controls systems for the clearing of pre-financing

Take appropriate measures to improve EU delegations' control systems so that amounts not yet spent but claimed as incurred costs are identified before making payments or clearing expenditure.

(Target implementation date: end of 2024)

The Commission **accepts** this recommendation and considers it as partially implemented. Several measures were already taken, such as a new checklist, additional guidance and training seminars for its staff in order to raise awareness and prevent this recurrent accounting error.

Recommendation 4 – Reiterate the obligation to comply with VAT rules and carry out appropriate checks

Reiterate to beneficiaries of EU projects that they must abide by contractual conditions relating to VAT eligibility, and carry out the necessary checks to ensure that deductible VAT is not charged to projects.

(Target implementation date: end of 2024)

The Commission **accepts** the recommendation and will reiterate this obligation to the beneficiaries of EU projects.

Recommendation 5 – Strengthen *ex ante* controls before accepting expenditure

Take into consideration all available technical and financial information to prevent, or detect and correct, errors before accepting expenditure.

(Target implementation date: end of 2024)

The Commission **accepts** this recommendation and will continue to raise awareness to its staff to correctly implement the contractual framework and relevant procedures when it comes to considering the available technical and financial information before accepting expenditure. At the same time the Commission will strengthen the analysis of recurrent findings in order to prevent, detect and correct errors.

Recommendation 6 – Improve the RER methodology and verify its proper application

Improve the methodology used for the RER study so that high-value items are extrapolated correctly, and verify that the contractor applies it properly.

(Target implementation date: end of 2024)

The Commission **does not accept** the recommendation. The Commission considers it is not necessary to change the methodology used for the RER study for the extrapolation of high-value items.

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Our annual report presents our opinion on whether the EU's annual accounts are reliable and whether the underlying revenue and expenditure transactions comply with the applicable rules and regulations. It also presents our analysis of the budgetary and financial management and performance aspects of the EU budget´s implementation.

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