

**ANNUAL REPORT ON THE ACTIVITIES  
FUNDED BY THE 8TH, 9TH AND 10TH  
EUROPEAN DEVELOPMENT FUNDS (EDFs)**

(2012/C 344/02)



**Annual Report on the activities funded by the 8th, 9th and 10th European Development Funds (EDFs)**

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## THE COURT'S OBSERVATIONS

## INTRODUCTION

1. This Annual Report presents the Court's assessment of the European Development Funds (EDFs). Key information on the activities covered and the spending in 2011 is provided in **Table 1**.

**Table 1 — European Development Funds — Key information**

(million euro)

Budget Title	Policy area	Description	Payments 2011	Management Mode
European Development Funds	8th EDF	Administrative expenditure	0	
		Operational expenditure		
		Projects	8	Centralised direct
		Budget Support	0	Centralised direct
		Projects	19	Centralised indirect
		Projects	59	Decentralised
		Projects	3	Joint management
			<b>89</b>	
	9th EDF	Administrative expenditure	3	
		Operational expenditure		
		Projects	112	Centralised direct
		Budget Support	77	Centralised direct
		Projects	- 4	Central indirect
		Projects	591	Decentralised
		Projects	127	Joint management
			<b>906</b>	
	10th EDF	Administrative expenditure	90	
		Operational expenditure		
Projects		210	Centralised direct	
Budget Support		660	Centralised direct	
Projects		29	Centralised indirect	
Projects		407	Decentralised	
	Projects	483	Joint management	
		<b>1 879</b>		

<b>Total administrative expenditure</b>	<b>93</b>
<b>Total operational expenditure (Projects)</b>	<b>2 044</b>
<b>Total operational expenditure (Budget Support)</b>	<b>737</b>
<b>Total payments <sup>(1)</sup></b>	<b>2 874</b>

<b>Total individual commitments <sup>(1)</sup> <sup>(2)</sup></b>	<b>2 509</b>
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<b>Total global commitments <sup>(1)</sup> <sup>(2)</sup></b>	<b>3 049</b>
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<sup>(1)</sup> Financial Year 2011 net amounts.

<sup>(2)</sup> Global commitments relate to financing decisions. Individual commitments relate to individual contracts.

Source: European Court of Auditors on the basis of data provided by DG DEVCO.

## Specific characteristics of the European Development Funds

2. The EDF is the main instrument for providing European Union aid for development cooperation to the African, Caribbean and Pacific (ACP) States and Overseas Countries and Territories (OCTs). The partnership agreement, signed in Cotonou on 23 June 2000, for a period of 20 years (the Cotonou Agreement<sup>(1)</sup>), is the current framework for the European Union's relations with ACP States and OCTs. It is centred on the objective of reducing and eventually eradicating poverty, consistent with the objectives of sustainable development and the gradual integration of the ACP countries and OCTs in the world economy. It is based on three complementary pillars:

- development cooperation,
- economic and trade cooperation, and
- the political dimension.

3. The EDFs are funded by the Member States, governed by their own financial regulations and managed outside the framework of the EU general budget. The European Commission is responsible for the financial implementation of operations funded with resources from the EDFs. The European Investment Bank (EIB) manages the Investment Facility, which is not covered by the Court's Statement of Assurance or the European Parliament's discharge procedure<sup>(1)</sup> <sup>(2)</sup>.

4. Operations financed by each EDF are programmed at the beginning of the period covered. A Country Strategy Paper, prepared by the Commission and the ACP State or OCT concerned after consultation with a wide range of players in the development process, sets out the country's medium-term development objectives and strategies. It also indicates the programmable EU financial allocation from which the country or regional organisation may benefit.

3. *The accountability and transparency of the implementation of the Investment Facility is ensured by the publication of the Investment Facility's annual report, by its annual external financial audit as well as by the supervision of its operations by the European Court of Auditors.*

<sup>(1)</sup> See Articles 118, 125 and 134 of Council Regulation (EC) No 215/2008 of 18 February 2008 on the Financial Regulation applicable to the 10th European Development Fund (OJ L 78, 19.3.2008, p. 1) and the Court's Opinion No 9/2007 on the proposal for this Regulation (OJ C 23, 28.1.2008, p. 3).

<sup>(2)</sup> A tripartite agreement between the EIB, the Commission and the Court (Article 134 of Regulation (EC) No 215/2008) sets out rules for the audit of these operations by the Court.

## THE COURT'S OBSERVATIONS

5. The European External Action Service (EEAS) was launched on 1 December 2010. The EEAS prepares the Commission decisions for country allocations, country and regional strategy papers and national and regional indicative programmes jointly with relevant Commission departments, as part of the programming cycle for most external action instruments.

6. Following the creation of the EEAS and the Commission reorganisation in 2011, the newly created Directorate-General for Development and Cooperation (EuropeAid) combined the policy expertise of the former Directorate-General for Development and Relations with ACP States with the implementing resources of the former EuropeAid Cooperation Office. In June 2011, the new organisation setup for EuropeAid entered into force and new mission statements at directorate-general, directorate and unit levels were established. EuropeAid implements a wide range of the Commission's external assistance instruments<sup>(3)</sup> financed by the EDFs and the general budget<sup>(4)</sup>. In 2011, almost all the EDF interventions were managed by EuropeAid. A small proportion of these<sup>(5)</sup> related to humanitarian aid and was managed by the Directorate-General for Humanitarian Aid (DG ECHO).

7. EDF interventions are implemented through projects and budget support<sup>(6)</sup> under three main methods of implementation<sup>(7)</sup> (see **Table 1**):

(a) under centralised management (42 % of payments in 2011), the Commission implements the aid activities directly;

<sup>(3)</sup> European Neighbourhood and Partnership Instrument, Development Cooperation Instrument, Financing Instrument for the Promotion of Democracy and Human Rights, Instrument for Stability, Instrument for Nuclear Safety Cooperation, Facility for rapid response to soaring food prices in developing countries.

<sup>(4)</sup> See Chapter 7 'External relations, aid and enlargement' of the Court's 2011 Annual Report on the implementation of the EU budget.

<sup>(5)</sup> Representing 1,2 % of payments made in 2011.

<sup>(6)</sup> Budget support involves the transfer of funds by the Commission to the national treasury of the partner country to provide additional budgetary resources to support a national development strategy.

<sup>(7)</sup> Articles 21 to 29 of Regulation (EC) No 215/2008.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(b) under joint management (21 % of payments in 2011), international organisations are responsible for implementing European Union funded actions, provided that the accounting, audit, control and procurement procedures of the organisations offer guarantees equivalent to internationally accepted standards. EuropeAid's main partners are the United Nations agencies and the World Bank;

(c) under decentralised management (37 % of payments in 2011), the Commission may entrust the management of certain tasks to the authorities of beneficiary countries. In most cases, under decentralised management Commission's procedures are still to be used and EuropeAid remains responsible for performing ex-ante checks (e.g. on procurement procedures and invoices) and making payments to contractors.

8. The external aid financed by the EDFs and the general budget is implemented in a high risk environment, notably due to geographically dispersed activities, and the wide range of cooperation instruments, delivery methods, own financial rules and procedures, and implementing organisations. In addition, many partner countries have weak institutional and administrative capacities.

9. The Cotonou Agreement provides<sup>(8)</sup> that direct budgetary assistance should be granted in support of macro-economic or sectoral reforms, notably where public financial management (PFM) is sufficiently transparent, accountable and effective.

8. *The Commission mitigates these risks through substantial early detection and correction interventions. EuropeAid (at HQ and in delegations) performs a high level of ex-ante control both in terms of coverage and in terms of the nature of these controls, going well beyond the financial safeguards required by legislation. Preventative measures also play a very significant part in the control strategy including substantial training provision both for Commission staff and specifically designed for National Authorising Officer's (NAO) staff. In addition 'NAO support' has been put in place in a number of countries.*

<sup>(8)</sup> Article 61(2).

## THE COURT'S OBSERVATIONS

10. These legal provisions offer broad scope for interpretation<sup>(9)</sup> and what is considered as 'sufficient' in terms of transparency, accountability and effectiveness in PFM can vary greatly, depending on the specific situation of the country but also on the direction taken by its government. Under such circumstances, it should be recalled that:

- (a) budget support is often provided to countries with weak PFM systems. One important risk is that the budget of the recipient country may be affected by fraud and corruption. Given that the funds transferred under budget support operations are merged with other budget resources within the country's budget (known as 'fungibility'), they are also exposed to the same PFM weaknesses;
- (b) as budget support operations are implemented through the partner countries' PFM systems, processes and institutions, the Court's audit of legality and regularity cannot go beyond the stage where the aid is paid into the partner countries' budgets;
- (c) the Commission has wide flexibility in deciding whether a partner country is eligible for budget support. Due to this broad scope for interpretation, budget support operations carried out by the Commission are less prone to legality and regularity errors.

## THE COMMISSION'S REPLIES

**10. (a)-(c)** *The Commission does not fully share the Court's analysis of the operation of budget support.*

*Budget support operates in a development context where core government systems such as public financial management can have major weaknesses. Nevertheless eligibility conditions are rigorous. A partner country is eligible for budget support only when the government has a relevant and credible strategy in place to address these weaknesses. The Commission can also require specific short term measures to mitigate risks. New budget support guidelines<sup>(1)</sup> (which were revised in 2012 following the Commission proposals<sup>(2)</sup> and Council Conclusions of 14 May 2012 for a new approach to Budget Support) now include a number of new provisions to further clarify the rules. This includes new eligibility rules on transparency and oversight, a formal risk assessment process and a senior management governance framework.*

*Untargeted budget support is designed to reward results rather than finance activities. Therefore it is clear that audit cannot go beyond the stage where funds are transferred following the achievement of agreed conditions. However, the audit of activities which budget support payments may finance is the remit of national audit authorities to which accompanying programmes offer concrete support.*

*This aid delivery mechanism represents one of the ways in which the Commission has responded to calls by the international development community and EU stakeholders for more effective interventions which focus on results and ownership and are less administratively complex, thereby reducing transaction costs for partner countries.*

<sup>(9)</sup> See paragraph 46 of the Court's Annual Report on the activities of the sixth, seventh, eighth and ninth European Development Funds (EDFs) for the financial year 2003 (OJ C 293, 30.11.2004, p. 315).

<sup>(1)</sup> See [http://ec.europa.eu/europeaid/what/economic-support/documents/guidelines\\_budget\\_support\\_en.pdf](http://ec.europa.eu/europeaid/what/economic-support/documents/guidelines_budget_support_en.pdf)

<sup>(2)</sup> See the Commission's Communication on The Future Approach to EU Budget Support to Third Countries (COM(2011) 638 final).



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

11. Payments to international organisations for multi-donor actions are also subject to specific risks partly due to the notional approach adopted by the Commission <sup>(10)</sup>.

**11.** *The Commission is not aware of any specific problems with the 'notional approach' (which has been developed in recent years to allow the Commission to participate in multi-donor actions including trust funds). This approach guarantees that the legal requirements applicable to EU funding in external actions are met (by ensuring that the amount contributed by other donors is sufficient to pay for any activities which are ineligible under EU rules) while spending EU funds in the most efficient way (through donor coordination), in accordance with the principle of sound financial management.*

*The Commission limits this risk by assessing the accounting, audit, internal control and procurement procedures of the partner international organisations in advance of any joint working, the presence of its staff in the field (and participation in steering groups) and the rigorous overall financial reporting required of the international organisation. In addition, during the implementation of external actions, systems are regularly reviewed through the performance of verification missions undertaken by external auditors.*

*EuropeAid and ECHO auditors have not to date reported any findings or 'specific risks' of this nature.*

*The Commission believes that these internal control measures which it has put in place together with those of the international organisation concerned limits this theoretical risk to a level where it is indeed negligible.*

## CHAPTER I — IMPLEMENTATION OF THE 8TH, 9TH AND 10TH EDFs

### Financial implementation

12. In 2011, the 8th, 9th and 10th EDFs were implemented simultaneously. Each EDF agreement is usually concluded for a commitment period of around five years, but payments can be made over a longer period. The 8th EDF (1995-2000) amounts to 14 625 million euro and the 9th EDF (2000-2007) to 15 200 million euro.

<sup>(10)</sup> For an explanation of this notional approach, see paragraph 7.11 of the Court's 2011 Annual Report on the implementation of the EU budget.

## THE COURT'S OBSERVATIONS

13. The 10th EDF (2008-2013) amounts to 22 682 million euro. Of this amount, 21 967 million euro are allocated to ACP countries and 285 million euro to OCTs. These amounts include 1 500 million euro and 30 million euro for the investment facility managed by the EIB for the ACP and OCT countries respectively. Finally, 430 million euro are earmarked for the Commission's expenditure for programming and implementing the EDF.

14. In 2011, total contributions from the Member States to the Commission amounted to 3 100 million euro, including the final call for 660 million euro under the 9th EDF and the first contributions of 2 440 million euro under the 10th EDF.

15. **Table 2** shows the cumulative use of EDF resources managed by the Commission and their financial implementation. For 2011, individual commitments were 13 % below target, in particular due to delays in contracting important infrastructure programmes and significant global commitments made during the last months of 2011. Payments were 16 % less than planned, mainly due to lower budget support disbursements, because the eligibility conditions had not been met in some cases, and delays in infrastructure projects. Outstanding payments and old and dormant unspent commitments<sup>(1)</sup> remained stable compared with 2010.

### The Commission's Annual Report on the financial management of the 8th to 10th European Development Funds

16. The Financial Regulation applicable to the 10th EDF requires the Commission to report each year on the financial management of the EDFs<sup>(12)</sup>. In the Court's opinion, this report presents an accurate description of the achievement of the Commission's operational objectives for the financial year (particularly concerning financial implementation and control activities), as well as of the financial situation and the events that had a significant influence on the activities carried out in 2011.

## THE COMMISSION'S REPLIES

15. *EuropeAid achieved 101 % (3 279 million euro) of its 2011 global commitments target of 3 250 million euro. However contracts and payments came in slightly under target, notably due to decisions made by EuropeAid to withhold payments on budget support programmes in relation to non-achievement of disbursement conditions (for example, in the Central African Republic because of important fiscal slippage and absence of an IMF programme and in Benin because of poor performance in the implementation of the national development strategy and the slow pace of reforms in public financial management).*

<sup>(1)</sup> Old unspent commitments are funds committed more than five years ago and still unspent. Dormant unspent commitments are funds committed but neither contracted nor spent in more than two years.

<sup>(12)</sup> Articles 118 and 124 of Regulation (EC) No 215/2008.

Table 2 — Cumulative use of EDF resources at 31 December 2011

(million euro)

	Situation at end of 2010		Budgetary implementation during the financial year 2011 (net amounts) <sup>(6)</sup>				Situation at end of 2011				
	Consolidated amount	Implementation rate <sup>(2)</sup>	8th EDF <sup>(3)</sup>	9th EDF <sup>(3)</sup>	10th EDF	Consolidated amount	8th EDF	9th EDF	10th EDF	Consolidated amount	Implementation rate <sup>(2)</sup>
<b>A — RESOURCES <sup>(1)</sup></b>	<b>48 797</b>		– 38	70	25	<b>57</b>	10 663	16 552	21 639	<b>48 854</b>	
<b>B — USE</b>											
<b>1. Global commitments <sup>(4)</sup></b>	<b>37 778</b>	<b>77,4 %</b>	– 60	– 9	3 118	<b>3 049</b>	10 640	16 454	13 735	<b>40 827</b>	<b>83,6 %</b>
<b>2. Individual commitments <sup>(5)</sup></b>	<b>32 324</b>	<b>66,2 %</b>	– 13	8	2 514	<b>2 509</b>	10 494	15 691	8 648	<b>34 833</b>	<b>71,3 %</b>
<b>3. Payments</b>	<b>26 334</b>	<b>54,0 %</b>	90	905	1 879	<b>2 874</b>	10 330	14 026	4 852	<b>29 208</b>	<b>59,8 %</b>
<b>C — Outstanding payments (B1 – B3)</b>	<b>11 444</b>	<b>23,5 %</b>	– 150	– 914	1 239	<b>175</b>	310	2 428	8 883	<b>11 619</b>	<b>23,8 %</b>
<b>D — Available balance (A – B1)</b>	<b>11 019</b>	<b>22,6 %</b>	22	79	– 3 093	<b>– 2 992</b>	23	98	7 904	<b>8 027</b>	<b>16,4 %</b>

<sup>(1)</sup> Include initial allocations to the 8th, 9th and 10th EDFs, co-financing, interest, sundry resources and transfers from previous EDFs.

<sup>(2)</sup> As a percentage of resources.

<sup>(3)</sup> Negative amounts correspond to decommitments.

<sup>(4)</sup> Global commitments relate to financing decisions.

<sup>(5)</sup> Individual commitments relate to individual contracts.

<sup>(6)</sup> Net commitments after decommitments. Net payments after recoveries.

Source: Court of Auditors, based on the EDF reports on financial implementation and financial statements at 31 December 2011.

**CHAPTER II — THE COURT'S STATEMENT OF ASSURANCE ON THE EDFs****The Court's Statement of Assurance on the 8th, 9th and 10th European Development Funds (EDFs) to the European Parliament and the Council — Independent Auditor's Report**

I — Pursuant to the provisions of Article 287 of the Treaty on the functioning of the European Union (TFEU) and Article 141 of the Financial Regulation applicable to the 10th EDF, which also applies to previous EDFs, the Court has audited:

- (a) the annual accounts of the 8th, 9th and 10th European Development Funds which comprise the financial statements <sup>(13)</sup> and the report on financial implementation for the financial year ended 31 December 2011; and
- (b) the legality and regularity of the transactions underlying those accounts within the legal framework of the EDFs in respect of the part of the EDF resources for whose financial management the Commission is responsible <sup>(14)</sup>.

*Management's responsibility*

II — In accordance with Articles 310 to 325 of the TFEU and the Financial Regulations applicable to the 8th, 9th and 10th EDFs, management is responsible for the preparation and fair presentation of the annual accounts of the EDFs and the legality and regularity of the transactions underlying them:

- (a) Management's responsibility in respect of the annual accounts of the EDFs includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies, on the basis of the accounting rules adopted by the EDF accounting officer <sup>(15)</sup>; and making accounting estimates that are reasonable in the circumstances. The Commission approves the annual accounts of the EDFs.
- (b) The way in which management exercises its responsibility for legality and regularity of underlying transactions depends on the method of implementation of the EDFs foreseen in the EDF Financial Regulations. Implementation tasks have to comply with the principle of sound financial management, requiring designing, implementing and maintaining effective and efficient internal control including adequate supervision and appropriate measures to prevent irregularities and fraud and, if necessary, legal proceedings to recover funds wrongly paid or used. Regardless of the method of implementation applied, the Commission bears the ultimate responsibility for the legality and regularity of the transactions underlying the accounts of the EDFs (Article 317 of the TFEU).

<sup>(13)</sup> The financial statements comprise the balance sheet, the statement of economic outturn, the statement of cash flow, the statement of changes in net assets and the table of items payable to the European Development Funds.

<sup>(14)</sup> Pursuant to Articles 2, 3, 4, 125(4) and 134 of the Financial Regulation applicable to the 10th EDF this Statement of Assurance does not extend to the part of the EDFs resources that are managed by the EIB and for which it is responsible.

<sup>(15)</sup> The accounting rules adopted by the EDF accounting officer are derived from International Public Sector Accounting Standards (IPSAS) issued by the International Federation of Accountants or, in their absence, International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board. In accordance with the Financial Regulation, the financial statements for the financial year 2011 were prepared on the basis of these accounting rules adopted by the EDF accounting officer, which adapt accruals based accounting principles to the specific environment of the European Union, while the report on implementation of the EDFs continues to be primarily based on movements of cash.

### *Auditor's responsibility*

III — The Court's responsibility is to provide, on the basis of its 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. The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI International Standards of Supreme Audit Institutions. These standards require that the Court plans and performs the audit to obtain reasonable assurance whether the annual accounts of the EDFs are free from material misstatement and the transactions underlying them are legal and regular.

IV — An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts and the legality and the regularity of the transactions underlying them. The procedures are selected based on the auditor's judgment, including an assessment of the risks of material misstatement of the accounts and of material non-compliance of the underlying transactions with the requirements of the legal framework of the EDFs, whether due to fraud or error. In assessing those risks, the auditor considers internal control relevant to the preparation and fair presentation of the final accounts, and supervisory and control systems implemented to ensure legality and regularity of underlying transactions, in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of accounting estimates made, as well as evaluating the overall presentation of the accounts and the annual activity report.

V — The Court considers that the audit evidence obtained is sufficient and appropriate to provide a basis for its statement of assurance.

### **Reliability of the accounts**

#### *Opinion on the reliability of accounts*

VI — In the Court's opinion, the annual accounts of the 8th, 9th and 10th EDFs present fairly, in all material respects, the financial position of the EDFs as of 31 December 2011, and the results of their operations and cash flows for the year then ended, in accordance with the provisions of the EDF Financial Regulation and the accounting rules adopted by the accounting officer.

### **Legality and regularity of the transactions underlying the accounts**

#### **Revenue**

#### *Opinion on the legality and regularity of revenue underlying the accounts*

VII — In the Court's opinion, revenue underlying the accounts for the year ended 31 December 2011 is legal and regular in all material respects.

**Commitments***Opinion on the legality and regularity of commitments underlying the accounts*

VIII — In the Court's opinion, commitments underlying the accounts for the year ended 31 December 2011 are legal and regular in all material respects.

**Payments***Basis for adverse opinion on the legality and regularity of payments underlying the accounts*

IX — The Court's audit revealed that the supervisory and control systems are partially effective. The Court's estimate for the most likely error rate for payments from the 8th, 9th and 10th EDFs is 5,1 %.

*Adverse opinion on the legality and regularity of payments underlying the accounts*

X — In the Court's opinion, because of the significance of the matters described in the basis for adverse opinion on the legality and regularity of payments underlying the accounts paragraph, the payments underlying the accounts for the year ended 31 December 2011 are materially affected by error.

26 July 2012

Vítor Manuel da SILVA CALDEIRA

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## THE COURT'S OBSERVATIONS

**Information in support of the Statement of Assurance***Audit scope and approach*

17. The observations regarding the reliability of the EDFs' accounts set out in paragraph VI of the Statement of Assurance, are based on an audit of the financial statements<sup>(16)</sup> and the report on the financial implementation of the 8th, 9th and 10th EDFs<sup>(17)</sup>. The audit examined, on a test basis, evidence relating to the amounts and disclosures. It included an assessment of the accounting principles used, significant estimates made by management and the overall presentation of the accounts.

18. The Court's overall audit approach and methodology regarding the regularity of transactions underlying the accounts is described in Annex 1.1, Part 2, of Chapter 1 of the 2011 Annual Report of the Court of Auditors on the implementation of the budget. The observations regarding the regularity of EDF transactions, set out in paragraphs VII to X of the Statement of Assurance are based on the following components:

- (a) an audit of all contributions from Member States and a sample of other types of revenue transactions;
- (b) an audit of a sample of 193 transactions, corresponding to 30 global commitments and 163 interim and final payments made by delegations or the Commission headquarters<sup>(18)</sup>. Where necessary, implementing organisations and final beneficiaries were visited on the spot to verify the underlying payments declared in financial reports or cost statements;
- (c) an assessment of the effectiveness of supervisory and control systems at EuropeAid's headquarters and delegations; this covered the following elements:
  - (i) control environment and internal control standards;
  - (ii) ex-ante checks of contracts and payments by the authorising officers, including the national authorising officers;

<sup>(16)</sup> See Article 122 of Regulation (EC) No 215/2008: the financial statements shall comprise the balance sheet, the statement of economic outturn, the statement of cash flow, and the table of items payable to the EDF.

<sup>(17)</sup> See Article 123 of Regulation (EC) No 215/2008: the reports on financial implementation shall comprise tables describing the appropriations, the commitments and the payments.

<sup>(18)</sup> EuropeAid: 125 projects and 30 budget support payments; DG ECHO: 8 project payments on humanitarian aid.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

- (iii) monitoring and supervision;
  - (iv) external audits;
  - (v) internal audit;
- (d) a review of Commission management representation, comprising an assessment of the annual activity report of EuropeAid.

*Reliability of the accounts*

19. The Court found that the accounts of the EDFs for the financial year ended on 31 December 2011 fairly present, in all material respects, the financial position of the EDFs and the results of their operations and cash flows, in accordance with the provisions of the respective Financial Regulations and the relevant accounting rules adopted by the accounting officer.

20. As in previous years, the Court and EuropeAid's own checks (see paragraph 40) identified a high frequency of encoding errors<sup>(19)</sup>. While the Court's audit found that the financial statements are free from material error, encoding errors remain a source of concern as they affect the accuracy of the data used for the preparation of the annual accounts, in particular with respect to the annual cut-off exercise at year-end<sup>(20)</sup>.

*Regularity of transactions*

21. **Annex I** contains a summary of the results of transaction testing.

**Revenue**

22. The Court's audit of revenue transactions found them to be free from material error.

**19.** *The Commission welcomes the Court's positive Statement of Assurance concerning the reliability of the EDF accounts.*

**20.** *The Commission shares the Court's concern and will continue to improve the quality of data held in the external aid management information system (CRIS). However, as the Court states, the encoding errors found have had no material impact on the annual accounts.*

*See also reply to paragraph 58(b).*

<sup>(19)</sup> E.g.: contract type, contract start and end dates, management mode.

<sup>(20)</sup> The cut-off exercise seeks to ensure that both revenue and expenditure is completely and accurately recorded in the correct accounting period.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**Commitments**

23. The Court's audit of commitments found them to be free from material error.

**Payments**

24. The Court's audit found that payments were affected by material error. The Court's testing of its sample of 163 transactions found 54 (33 %) to be affected by error. The most likely error estimated by the Court is 5,1 % <sup>(21)</sup>.

25. With regard to the 133 project payments sampled, 47 (35 %) were affected by errors, of which 29 (62 %) were quantifiable errors. For the 30 budget support payments tested, 7 (23 %) were affected by errors, all of which were non-quantifiable errors.

*Project payments*

26. For the transactions related to projects, the majority of the errors were found in grants and contribution agreements with international organizations; out of the 45 transactions tested, 26 (58 %) were affected by error. Programme estimates <sup>(22)</sup> were also revealed to be prone to error, with errors found in 10 of the 27 transactions tested.

**24-26.** *The Commission will step up its efforts to prevent, detect and correct such errors in 2012.*

*Nevertheless, the Commission underlines the multi-annuality of EuropeAid's control architecture which means that some errors highlighted by the Court would have been corrected in a later period within the normal cycle of external aid controls. Nearly two thirds of payments in the sample concern transactions such as interim payments or clearings for which checks and corrections can still be made at final payment.*

*Furthermore, the Commission's monitoring of external aid expenditure does not finish with final payments. An extensive programme of ex-post audits is managed by EuropeAid and ECHO on an annual basis, based on a formal risk assessment process.*

*However, given the high risk environment in which development and humanitarian aid operates, the risk of financial error cannot be realistically reduced to zero.*

<sup>(21)</sup> The Court calculates its estimate of error from a representative statistical sample. The figure quoted is the best estimate (known as the MLE). The Court has 95 % confidence that the rate of error in the population lies between LEL 2,0 % and UEL 8,1 % (the lower and upper error limits respectively).

<sup>(22)</sup> A programme estimate is prepared, usually annually, to establish a work programme and the resources necessary to carry this out. It is implemented by the institution or beneficiary concerned but subject to prior approval by the partner country's representative and the Commission.

## THE COURT'S OBSERVATIONS

27. Of the 47 project transactions affected by error 26 had already been subject to external audits contracted by the Commission or the beneficiary. Of the 29 transactions affected by quantifiable errors, 11 were final payments already subjected to the Commissions checks <sup>(23)</sup>.

28. The types of quantifiable errors found in project payments concerned:

- (a) occurrence: absence of invoices or other supporting documents to justify expenditure (affecting 5 transactions), prefinancing cleared for expenditure not incurred by beneficiaries (affecting 3 transactions) and quantities claimed in excess of works carried out (affecting 3 transactions);
- (b) eligibility: expenditure incurred outside the implementation period or related to activities and services not included in the contract (affecting 5 transactions), ineligible VAT (affecting 4 transactions), non-compliance with procurement procedures by the beneficiary (affecting 4 transactions), non-compliance with the rules of origin or nationality (affecting 3 transactions) and non-compliance with daily allowances limits (1 transaction);
- (c) accuracy: calculation errors (affecting 1 transaction) and use of incorrect exchange rates (affecting 3 transactions).

## THE COMMISSION'S REPLIES

27. *Ex-ante controls have to be considered within the context of the overall control system as ex-post audits and other checks can still be made after final payment.*

28. (a)-(c) *The Court's observations comprehensively illustrate the main challenges in working with implementing organisations and partner countries in the development and humanitarian aid context.*

*Regarding the retention of supporting documents, EuropeAid has implemented an action plan to improve record keeping and archiving in delegations in 2012.*

*For clearing, EuropeAid has launched an internal reflection to clarify the interpretation of 'incurred costs' for the purposes of clearing which has led to these errors. The Commission considers that these are self-correcting errors since the clearing in excess of cost should be covered by subsequent expenditure.*

*Regarding non-conformity with rules of origin, the Commission underlines that the legislation in force does foresee derogations to the ACP/EU origin of goods rules, where duly justified. EuropeAid accepts that contractors should in some cases have made a derogation request, but considers that some of these errors, where conditions allowing derogation to the rule were in place, had no financial impact.*

*VAT remains a challenging eligibility issue and is the subject of new proposals in the context of the revision of the Financial Regulation. The Commission operates in countries where it is difficult if not impossible for contractors (often NGOs) to get mandatory VAT payments reimbursed by the State.*

<sup>(23)</sup> See also paragraph 7.17 of Chapter 7 'External relations, aid and enlargement' of the Court's 2011 Annual Report on the implementation of the EU budget.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

Examples of errors are provided below.

**Examples of errors**

Non-compliance with procurement rules and lack of supporting documents

The Court examined a final payment under a grant agreement providing for water supply, sanitation and hygiene promotion and support for improved management of natural resources in Ethiopia. Contracts were awarded on the basis that the suppliers guaranteed access to spare parts and maintenance facilities, although this was not a criterion set in the tender notice. In addition, part of the expenditure could not be corroborated by supporting documents due to the unsatisfactory quality of the beneficiary's accounting records. The auditors contracted by the beneficiary to perform the expenditure verification had not identified these problems.

Non-compliance with the rule of origin

Expenditure under a grant for rural electrification in Mozambique related to supplies that did not comply with the rule of origin: supplies originated from China, and not from either the European Union or ACP countries. The auditors contracted by the beneficiary to verify the expenditure had not identified this problem.

29. The most frequent types of non-quantifiable errors concerned insufficient supporting documents (affecting 14 transactions) and the nonadjustment of performance guarantees after changes in the contract (affecting 3 transactions).

*Budget support payments*

30. As regards budget support payments, the non-quantifiable errors resulted from a lack of a structured demonstration of compliance with the eligibility criteria because PFM achievements were not compared with the objectives set for the period under review.

**Examples of errors**

Non-compliance with procurement rules and lack of supporting documents

The access to spare parts and maintenance facilities is an important factor in the award of a contract concerning the purchase of vehicles, notably in countries where this access is difficult. At the time of the tender notice an error was made by the beneficiary in not communicating this criterion to potential suppliers. However, the selection of the supplier to whom the contract was awarded did then take into account the presumed availability of spare parts and maintenance services. Moreover, the audit of this contract had been foreseen in the 2010 audit planning following the delegation's risk assessment.

Non-compliance with the rule of origin

The legislation in force does specifically allow for derogations to the ACP/EU origin of goods rules, where duly justified. It is currently almost impossible to avoid non-EU/ACP electric supplies when implementing these kinds of projects in Africa. The beneficiary should have requested derogation from the Commission which would have been given if duly justified.

29. See reply to paragraph 28(a)-(c).

30. In the specific cases concerned the Commission is seeking to bring its assessments into line with its standard practice as applied in other countries. This is based on an annual assessment of progress against clearly identified milestones and objectives which results in a structured demonstration of compliance with the eligibility criterion. In a number of cases in 2011 the Commission withheld disbursements when it was not satisfied that sufficient progress had been made in this area.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

*Effectiveness of systems*

31. **Annex 2** contains a summary of the results of the Court's examination of supervisory and control systems. The Court considers the systems to be partially effective.

32. As indicated in paragraph 6, EuropeAid implements most of the external assistance instruments financed from the general budget and the EDFs. Therefore, unless otherwise specified, the Court's observations concerning both the effectiveness of supervisory and control systems and the reliability of the director-general's annual activity report (the annual activity report) and declaration for 2011 refer to EuropeAid's area of responsibility.

**Control environment**

33. EuropeAid has a clear control strategy to prevent or detect and correct errors and the Commission's Internal Control Standards are largely implemented. It has an action plan to strengthen its management and control systems<sup>(24)</sup> which addresses most of the observations and recommendations from the Court's previous annual reports. In 2011, EuropeAid has notably introduced the new version of the External Assistance Management Report (EAMR) (see paragraph 39) and issued the 'Financial Management Toolkit for recipients of EU funds for external actions' (see paragraph 41).

*The newly created Budget Support Steering Committee made up of the Directors and Director-General of EuropeAid will examine, among other questions, all sensitive cases. This will improve the governance and assessment of eligibility criteria.*

*See also replies to paragraphs 10 and 15.*

31. See reply to paragraph 56.

33. *Other guidance has also been significantly expanded including the publication in 2011 of an online Practical Guide to Contracts as well as an e-learning module on the same topic available via the internet which makes contract award and management guidance publicly available on demand — notably for the benefit of implementing organisations.*

<sup>(24)</sup> Action plan for a strengthened EuropeAid management and control pyramid, 19.11.2010.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

34. The annual activity report indicates that human resources policy has continued to be a persistent concern<sup>(25)</sup> due to the high staff turnover and the reorganisation that took place mid-2011 (see paragraph 6). A cause for concern was that EuropeAid staff members were being used for tasks other than aid management over and above the flexibility limits agreed with the EEAS. EuropeAid considers that, if a rebalancing of resources is not carried out, this will have a negative impact on the assurance which can be given for 2012.

34. The high turnover of Contract Agent staff in HQ should be reduced with the entry in force of the new staff regulation. It is expected that the new staff regulation will foresee an extension of the maximum duration of CA contracts of two or three years (i.e. from the current 3-year to a 5 or 6-year duration). In addition, EuropeAid has been granted the possibility to convert a certain number of CA credits into AD official job quotas for 2011, 2012 and 2013, de facto reinforcing its permanent staff.

The potential risks related to staff resources not being used for the purposes for which they were intended has been mitigated by a number of actions including formal joint EEAS-Commission guidance to Heads of Delegation, specific human resources reporting from the field (in the External Assistance Management Reports) and internal audit planning in 2012.

The staff rebalancing exercise in delegations is a prerequisite for the implementation of the new development policy, to be able to increase monitoring in the field, to increase thematic know-how and to pursue efficient aid delivery. Human resources are likely to be reinforced in Africa and in the 'Neighbourhood' region.

**Ex-ante checks**

35. The Court assessed ex-ante checks by authorising officers at EuropeAid's headquarters and in the delegations as partially effective.

36. Given the high risk environment (see paragraph 8), EuropeAid's control architecture places most reliance on ex-ante checks by Commission staff, external supervisors (for works contracts) or external auditors (for programme estimates, grants and fee-based service contracts) before final project payments. While they detect and correct significant amounts of ineligible expenditure, the frequency of errors found by the Court, including in final claims of expenditure which had been subject to external audits and expenditure verifications, point to weaknesses in these ex-ante checks.

36. The internal control architecture put into place by EuropeAid to verify the legality and regularity of expenditure relies on the work of external auditors, technical supervisors and project management staff in addition to the Commission's own internal controls, within a multi-annual framework. The Commission recognises that a certain residual risk of error remains even at the completion of all these checks. Nevertheless, given the challenges of carrying out further ex-ante checks given the associated costs and project implementation delays, the Commission will continue its efforts to improve its current systems in order to provide a reasonable assurance based on a cost-effectiveness assessment.

See also reply to paragraph 24.

<sup>(25)</sup> Pages 21, 37, 38 and 45.

## THE COURT'S OBSERVATIONS

37. The Court notes that EuropeAid's ex-post transactional checks have also found procedural errors in ex ante checks, such as incorrect or missing checklists, for about 20 % of the transactions checked <sup>(26)</sup>. The Internal Audit Service (IAS) has also found weaknesses in several key control layers concerning programme estimates and calls for proposals for EDF grants <sup>(27)</sup>.

**Monitoring and supervision**

38. The Court considered monitoring and supervision to be effective for EuropeAid's headquarters and partially effective for delegations.

*EuropeAid's headquarters*

39. In July 2011, under its Action Plan, EuropeAid implemented, for the first time, the new version of the six-monthly External Assistance Management Report (EAMR) based on key performance indicators (KPIs) and statements of assurance signed by the Heads of Delegation. This strengthens the role of the EAMR as the main accountability tool between delegations and EuropeAid's headquarters. However, the reliability of KPIs related to financial checks is affected by inaccurate CRIS <sup>(28)</sup> data. In addition, many indicators are difficult to interpret.

## THE COMMISSION'S REPLIES

37. Ex-post checks are always referred for formal follow-up to the relevant authorising officer. However the procedural errors cited (such as incorrect or missing checklists) had no quantifiable financial impact.

Following the finalisation of the IAS audit reports the implementation of action plans are underway in 2012 to respond to the IAS recommendations and mitigate the risks identified.

39. The Commission considers that one of the most effective ways of ensuring that CRIS data improves in the medium to long term is to make more visible to Heads of Delegation the consequences of putting incorrect data into the management information system (CRIS). The new EAMR system does this by using CRIS data to 'feed' the regular reports from delegations. However the EAMR has been designed to allow delegations to correct and comment on the reporting data, so that incorrect data does not 'pollute' accurate reporting but does serve to highlight and correct data and improve entry over time. Even during an EAMR exercise it is possible to refresh data if a delegation spots an error which is easy to amend. The EAMR thus represents a structural step forward in responding to the Court's findings on deficiencies in CRIS data quality (while paying the price of errors being more 'visible' in the short term).

The Commission does not share the Court's view regarding the utility of indicators for monitoring purposes. The KPIs were newly introduced by a steering group representing a wide range of interests and stakeholders for annual reporting on 2011 (in 2012). The KPIs are set of indicators in a standardised format which are meaningful for the purposes of performance monitoring at delegation, region, instrument or portfolio level and — given the complexity of the development environment — can be open to different interpretations in many different contexts. Some have quantified targets — based on well understood historic data — and some do not.

See also reply to paragraph 59(d).

<sup>(26)</sup> Annual activity report, p. 33.

<sup>(27)</sup> Annual activity report, p. 40.

<sup>(28)</sup> Common RELEX Information System.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

40. In 2011, EuropeAid made 15 verification visits to check the adequacy of the delegations' internal organisation, systems and processes. These visits were useful in identifying areas which required improvements, such as insufficient expertise available, training needs hindered by human and financial resource constraints, inaccurate CRIS data and inadequate project monitoring. However, an IAS audit noted that there is no evidence for a formal annual verification visit programme based on a documented risk assessment. Furthermore, EuropeAid has not developed procedures for monitoring the implementation of recommendations from these verification visits and the annual activity report does not provide any information in this respect <sup>(29)</sup>.

41. Audit firms which have signed framework contract agreements with EuropeAid provide annual summary reports on their audit findings and recommendations. These reports provide valuable information on the systemic weaknesses and the measures required to prevent or reduce ineligible expenditure. On this basis, in January 2011, EuropeAid issued the 'Financial Management Toolkit for recipients of EU funds for external actions' to improve their knowledge of financial management and eligibility rules.

42. The quality of external audits and verifications contracted by the Commission is subject to a review by EuropeAid, the results of which are presented in an annual report. The annual activity report does not provide information on the results of this review <sup>(30)</sup>.

43. The audit and recovery modules of the CRIS information system were linked in 2011 <sup>(31)</sup>. This is a significant improvement but does not yet provide complete and accurate information on the results and follow-up of all ex-ante checks:

- (a) CRIS-Audit does not provide information on the amounts eventually considered ineligible by EuropeAid;

**40.** Action has been taken in relation to the IAS audit mentioned to ensure a more formalised planning process for delegation verification missions.

*For the future, the Commission will consider whether the purpose and the specific objectives of EuropeAid's delegation verification missions need to be re-examined and whether the current risk-based approach to selecting delegations could be complemented by additional selection criteria.*

*See also reply to paragraph 59(b).*

**42.** The Commission did not finalise a 2011 audit quality review in EuropeAid as was done for 2010, so it clearly could not have featured in the Annual Activity Report. In any event, the 2010 audit quality report was not the subject of any text in the 2010 AAR either, not least given that the AAR Standing Instructions do not require its inclusion.

**43.** The Commission is not currently in a position to supply and maintain the necessary additional resources for significant further processing of financial management data. Moreover it is currently engaged in a streamlining process on local IT applications across the Commission.

- (a) The audit module of the external aid management information system (CRIS) was designed to plan, and record the results of external audits rather than track audit follow-up made by the Commission. However the Commission would like to be able to develop this functionality in the medium term, resources permitting.

<sup>(29)</sup> Page 38.

<sup>(30)</sup> Page 30.

<sup>(31)</sup> As stated in the Commission's reply to paragraphs 42 and 63(c) of the Court's 2010 Annual Report.

## THE COURT'S OBSERVATIONS

(b) CRIS does not provide complete information on the amounts found ineligible and corrected by the Commission's own ex-ante checks <sup>(32)</sup>; and

(c) the accuracy of CRIS data remains problematic, as found by EuropeAid's own ex-post checks.

*Delegations*

44. As in previous years, the Court found poorly documented and ineffective checks at most national authorising officers in EDF beneficiary countries. EuropeAid's headquarters and the delegations frequently provided technical assistance to improve these checks, but this cannot compensate for the underlying weaknesses.

45. Most delegations visited by the Court in 2011 did not perform a risk-based selection and planning of on-the-spot monitoring visits. Verification missions from EuropeAid's headquarters (see paragraph 40) found that delegations were often faced with resource constraints on staffing and mission budgets which limited their capacity to perform monitoring activities, such as on-site project monitoring, particularly as regards financial aspects. The important reorganisation which took place in 2011 and the use of resources for tasks other than aid management did not improve this situation (see paragraphs 6 and 34).

## THE COMMISSION'S REPLIES

**(b)** CRIS provides robust and adequate information on amounts considered ineligible in the processing of claims, including basic categorisation of ineligible amounts. However contractors do often send a replacement invoice (rather than a credit note and a new invoice) once the Commission notifies them of errors detected, and thus not all effective interventions by Commission staff in detecting errors can be fully captured in the accounting system. Exhaustive information on the results and follow-up of all ex-ante checks would absorb significant resources with a limited benefit and are therefore judged not cost effective.

**(c)** Although encoding errors found have had no material impact on the annual accounts, the Commission shares the Court's concern to continue to improve the quality of data held in the external aid management information system (CRIS). EuropeAid will re-launch its efforts to improve CRIS data quality in 2012.

44. The Commission is aware that national administrations do not systematically perform to the required standards of financial management and therefore implements the bulk of its project support under partially decentralised management, with ex-ante controls carried out by its Delegations on the major part of the portfolio. The Commission continues to reinforce the capacities of National Authorising Officers through a significant training effort.

45. The prioritisation of limited resources is clearly a key factor in decision making regarding the planning and implementation of on-the-spot monitoring activities in delegation. Indeed, given that most on-the-spot monitoring visits are made by operational staff and are not primarily for the purpose of financial checks, risk is rarely the most important factor in the planning of such field visits. On-the-spot visits are one of the elements contributing to the follow-up of activities along with — *inter alia* — implementation reports, contacts with the beneficiaries, Results Orientated Monitoring reports, evaluations and audits.

Regarding the use of resources for tasks other than aid management, instructions were sent to delegations in December 2011 in a joint communication from the Commission and the EEAS to clarify the possibilities for and limitations on 'flexibility' in the use of staff.

See also reply to paragraph 59(b).

<sup>(32)</sup> E.g. cases of invoices sent back to beneficiaries or contractors for correction or invoices paid including identified ineligible expenditure for which a correction is to be made in a subsequent invoice.



## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

**External audits**

46. The Court assessed the external audit function as effective with regard to EuropeAid's headquarters and partially effective in respect of the delegations.

47. EuropeAid's headquarters have developed a methodology on the set-up, implementation and follow-up of annual audit plans. They closely monitor the delegations' external audit functions and the quality of external audits carried out under the Commission's audit framework contract.

48. In most respects, the delegations managed their external audits in accordance with the applicable methodology. Audit plans were set up in accordance with the guidelines and implemented in a timely manner and audit findings were acted upon, in particular through recoveries and deductions from subsequent payments. However, the Court found that there remained areas where improvement was necessary. As indicated in previous years<sup>(33)</sup>, risk-based audits were not always selected on the basis of a documented risk assessment and were fewer than necessary due to staff constraints and the priority to be given to compulsory audits. In some cases, there were delays in the audit clearance process, which could lead to ineligible expenditure becoming irrecoverable.

**Internal Audit**

49. The Court assessed internal audit as partially effective.

50. The Commission reorganisation that took place in 2011 (see paragraphs 6 and 34) had a major impact on the activity of the Internal Audit Capability (IAC)<sup>(34)</sup>. There was a major change in the staffing of the unit and most of the new staff members had no audit experience. The IAC was able to implement only about half of its initial annual work plan. This is not mentioned in the annual activity report<sup>(35)</sup>.

48. *While it is true that staffing constraints can have a negative impact on the length of the audit clearance process, all mandatory audit reports must be received before the Commission makes final payment, and therefore the risk that funds become irrecoverable is very limited.*

50. *The initial 2011 Annual Work Plan was only partially implemented for obvious reasons, since as a result of the reorganisation of EuropeAid in June, an entirely new Annual Work Plan had to be established for the new internal audit unit in early July 2011. This new work plan had to take account of the changes to the Directorate-General and the new staffing situation in the IAC requiring extensive audit training.*

*See also reply to paragraph 59(e).*

<sup>(33)</sup> Paragraph 45 of the 2009 Annual Report and paragraph 48 of the 2010 Annual Report.

<sup>(34)</sup> The IAC is a unit of a Commission Directorate-General. It is managed by a Head of Unit who reports directly to the Director-General. Its task is to provide independent assurance on the effectiveness of the internal control system with a view to improving the Directorate-General's operations.

<sup>(35)</sup> Pages 39 and 40.

## THE COURT'S OBSERVATIONS

51. In 2011, the Internal Audit Service (IAS) <sup>(36)</sup> finalised two audits on the financial management of programme estimates and EDF grants. Its findings concur with those of the Court as regards weaknesses in ex-ante checks (see paragraph 36).

**Reliability of Commission management representation**

52. The Director-General declares <sup>(37)</sup> that he has obtained reasonable assurance that the control procedures put in place give the necessary guarantees concerning the regularity of the underlying transactions. The annual activity report contains no reservation. Instead, it states <sup>(38)</sup> that, taking into account the design and the results of its multiannual control architecture, EuropeAid does not believe that the residual error rate — once all of its controls have been applied — is material. This is in contrast to the material error rate, high error frequency and partially effective systems found by the Court for 2011.

53. The Court's review of the annual activity report shows that:

- (a) evidence is not presented to support the contention that the residual error rate is below 2 %;
- (b) strong concerns are expressed about the adequacy of staff resources for aid management (see paragraph 34); and

## THE COMMISSION'S REPLIES

51. See reply to paragraph 36.

52. The Court's methodology for annual most likely estimated error rate and error frequency for the EDFs cannot be directly compared to the criteria for the residual amount at risk (once all multiannual checks have been completed) which is a key factor in Director-General's Statement of Assurance relating to the EuropeAid portfolio as a whole financed by the EDFs and by the EU budget. The Commission notes that the Court's annual most likely estimated error rate for external aid under the EU budget — the larger proportion of the portfolio — has been below materiality for 2010 and 2011, as were the EDFs in 2009.

See also replies to paragraph 57 and 58(a).

53.

(a) See reply to paragraph 58(a).

(b) It is now more than 10 years since the devolution process was launched. The Commission has taken stock of its very positive results but also become aware of imbalances which have arisen over time and need to be corrected. In line with the Communication 'Agenda for Change' and following the workload assessment of EuropeAid's staff in EU Delegations carried out in 2011, a report on the use of Commission resources in the EU Delegations was submitted to the Secretary General on 12/03/2012 and presented to the Commissioner's Group on External Relations. It entails conclusions on rebalancing of staff between Delegations to better match EuropeAid's needs and priorities with existing resources. The conclusions will be/were submitted for Commission approval in July 2012.

See also reply to paragraph 34.

<sup>(36)</sup> The IAS is a Directorate-General of the Commission. It is headed by the Commission's Internal Auditor and reports to its Audit Progress Committee. Its task is to provide independent assurance on the effectiveness of the internal control systems and to help the Commission by means of opinions, advice and recommendations.

<sup>(37)</sup> Page 47.

<sup>(38)</sup> Page 46.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

(c) control weaknesses are identified by both the IAS and EuropeAid's own ex-post transactional checks (see paragraphs 37 and 51).

(c) *Both the internal audit process and the ex-post transactional checks are designed to pinpoint control weaknesses and are the subject of extensive follow-up, including formal action plans.*

**Conclusions and recommendations***Conclusions*

54. Based on its audit work, the Court concludes that the EDFs accounts for the financial year ended on 31 December 2011 fairly present, in all material respects, the financial position of the EDFs and the results of their operations and cash flows for the year then ended, in accordance with the provisions of the Financial Regulation and the accounting rules adopted by the accounting officer.

54. *The Commission welcomes the Court's positive Statement of Assurance on the reliability of the EDF accounts.*

55. Based on its audit work, the Court concludes that, for the financial year ended on 31 December 2011:

55.

(a) the revenue of the EDFs was free from material error;

(b) the global commitments entered into by the EDFs were free from material error; and

(c) the payments made by the EDFs were affected by material error (see paragraphs 24 to 30).

(c) *The Commission will step up its efforts to prevent, detect and correct such errors in 2012.*

*Nevertheless, the Commission underlines the multi-annuality of EuropeAid's control architecture which means that some errors highlighted by the Court would have been corrected in a later period within the normal cycle of external aid controls. Nearly two thirds of payments in the sample concern transactions such as interim payments or clearings for which checks and corrections can still be made at final payment. Furthermore, the Commission's monitoring of external aid expenditure does not finish with final payments. An extensive programme of ex-post audits is managed by EuropeAid and ECHO on an annual basis, based on a formal risk assessment process.*

*However, given the high risk environment in which development and humanitarian aid operates, the risk of financial error cannot be realistically reduced to zero.*

## THE COURT'S OBSERVATIONS

56. Based on its audit work, the Court found that the examined supervisory and control systems of EuropeAid were partially effective (see paragraphs 31 to 53).

57. The Court concludes that the quality of CRIS data remains a source of concern and affects both the accuracy of the data used for the preparation of the annual accounts (see paragraph 20) and the effectiveness of supervisory and control systems (see paragraphs 39, 40 and 43) <sup>(39)</sup>.

*Recommendations*

58. **Annex 3** shows the result of the Court's review of progress in addressing recommendations made in its 2009 Annual Report. The following points should be noted:

- (a) EuropeAid has made significant progress in implementing many of the Court's recommendations. This is notably the case in relation to the development of the methodology for estimating the residual error rate, the dissemination of the financial management toolkit to improve the beneficiaries' knowledge of eligibility rules, the planning and monitoring of audits and the assessment of eligibility for budget support;
- (b) further efforts are necessary to fully implement the Court's recommendations concerning the quality of CRIS data, the follow-up of audit findings and recommendations and the assessment of the cost-effectiveness of the transactional ex-post control system.

## THE COMMISSION'S REPLIES

**56.** The Commission has designed its controls to cover the full lifecycle of its multi-annual projects. It believes that these supervisory and control systems are effective and have significantly improved year on year, covering both the operation of the EDFs and activities financed by the EU budget. Despite the challenges of a high risk external aid environment, the Court's most likely estimated annual error rate for external aid under the EU budget has been below materiality for 2010 and 2011, and was below materiality for the EDFs in 2009.

**57.** The Commission shares the Court's concern to continue to improve the quality of data held in the external aid management information system (CRIS). However, as the Court states in paragraph 20, the encoding errors found have had no material impact on the annual accounts.

**58.** With particular reference to the provisions of the Financial Regulation applicable to the 10th European Development Fund <sup>(3)</sup> and in view of the proposed reduction of its available resources, the Commission will consider the cost and benefits of the Court's recommendations before taking and/or proposing appropriate action.

- (a) The Commission's results for the estimation of EuropeAid's residual error rate i.e. the financial impact of errors remaining after all planned controls are completed) will be available in early 2013 for the 2012 reporting period.
- (b) EuropeAid will re-launch its efforts to improve CRIS data quality in 2012 and better link the financial findings of audits to the recovery of funds. The transactional ex-post system was suspended in 2012.

<sup>(39)</sup> See also the Court's Special Report No 5/2012 'The Common External Relations Information System (CRIS)' (<http://eca.europa.eu>).

<sup>(3)</sup> Articles 11-13.

## THE COURT'S OBSERVATIONS

## THE COMMISSION'S REPLIES

59. Following this review and the findings and conclusions for 2011, the Court recommends that EuropeAid:

- (a) improve the management of contract awarding procedures, by setting out clear selection criteria and better documenting the evaluation process (see paragraph 28(b));
- (b) introduce documented risk-based planning and systematic follow-up for verification visits (see paragraph 40) and on-the-spot monitoring visits (see paragraph 45);
- (c) render compulsory the guidelines on risk analysis for the preparation of annual audit plans by delegations and EuropeAid's headquarters (see paragraph 48);
- (d) review the design of KPIs to ensure that they are unambiguous and easy to interpret (see paragraph 39);
- (e) assess the IAC's capacity to perform its task effectively (see paragraph 50).

59.

- (a) *The Commission will launch a process designed to learn the lessons of the errors detected by the Court in the contract awarding process and a revision of the Practical Guide to Contracts will be issued in 2013.*
- (b) *The Commission will consider whether the purpose and the specific objectives of EuropeAid's delegation verification missions need to be re-examined.*

*EuropeAid will introduce a more formal assessment and annual planning process for both verification missions to delegations and on-the-spot monitoring of projects. However the Commission considers that the current risk-based selection process may usefully be complemented by additional selection criteria.*

*See also reply to paragraph 40.*

- (c) *The Commission will consider making EuropeAid's audit planning risk analysis methodology compulsory for the 2013 period onwards.*
- (d) *The Commission is not able to undertake to review the EuropeAid's Key Performance Indicators in the short to medium term. The KPIs were newly introduced (by a steering group representing a wide range of interests and stakeholders) for annual reporting on 2011 (in 2012) and the Commission does not yet have sufficient information or analysis of the dataset. However they may well require adjustment over time once the new reporting system is embedded.*
- (e) *The Commission will assess the capacity of EuropeAid's Internal Audit Unit (IAC) and consider a potential reinforcement if found to be necessary.*

*Given the commitment to reduce its overall staff, EuropeAid will look in the first instance at possibilities for enhancing available expertise.*

## ANNEX 1

## RESULTS OF TRANSACTION TESTING FOR THE EUROPEAN DEVELOPMENT FUNDS

	2011			2010	2009	2008
	Projects	Budget support	Total			
<b>SIZE AND STRUCTURE OF THE SAMPLE</b>						
Total commitments	27	3	<b>30</b>	30	50	45
Total transactions (of which):	133	30	<b>163</b>	165	170	170
Advances	0	0	<b>0</b>	0	0	40
Interim/Final payments	133	30	<b>163</b>	165	170	130
<b>RESULTS OF TESTING <sup>(1)</sup> <sup>(2)</sup></b>						
<b>Proportion (number) of transactions tested found to be:</b>						
Free of error	65 % (86)	77 % (23)	<b>67 % (109)</b>	73 %	78 %	76 %
Affected by one or more errors	35 % (47)	23 % (7)	<b>33 % (54)</b>	27 %	22 %	24 %
<b>Analysis of transactions affected by error</b>						
<b>Analysis by type of error</b>						
Non-quantifiable errors:	38 % (18)	100 % (7)	<b>46 % (25)</b>	49 %	65 %	61 %
Quantifiable errors:	62 % (29)	0 % (0)	<b>54 % (29)</b>	51 %	35 %	39 %
Eligibility	52 % (15)	0 % (0)	<b>52 % (15)</b>	70 %	23 %	44 %
Occurrence	38 % (11)	0 % (0)	<b>38 % (11)</b>	17 %	23 %	38 %
Accuracy	10 % (3)	0 % (0)	<b>10 % (3)</b>	13 %	54 %	19 %
<b>ESTIMATED IMPACT OF QUANTIFIABLE ERRORS</b>						
Most likely error rate				<b>5,1 %</b>		
Upper error limit (UEL)				8,1 %		
Lower error limit (LEL)				2,0 %		

<sup>(1)</sup> To improve insight into areas with different risk profiles within the policy group, the sample was split up into segments.

<sup>(2)</sup> Numbers quoted in brackets represent the actual number of transactions.

## ANNEX 2

RESULTS OF EXAMINATION OF SYSTEMS FOR THE EUROPEAN DEVELOPMENT FUNDS AND DEVELOPMENT AID  
UNDER THE GENERAL BUDGET

## Assessment of the systems examined

System concerned	Ex-ante controls	Monitoring and supervision	External audits	Internal audits	Overall assessment
Central systems EuropeAid	Partially effective	Effective	Effective	Partially effective	<b>Partially effective</b>
Delegations	Partially effective	Partially effective	Partially effective	N/A	<b>Partially effective</b>

## ANNEX 3

## FOLLOW-UP OF PREVIOUS RECOMMENDATIONS FOR THE EUROPEAN DEVELOPMENT FUNDS

Year	Court recommendation	Court's analysis of the progress made	Commission reply
2009	EuropeAid should, in the context of its planned review of its overall control strategy, develop a key indicator for the estimated financial impact of residual errors after all ex-ante and ex-post controls have been implemented, based for example in an examination of a representative statistical sample of closed projects (2009 Annual Report, paragraph 54(a)).	EuropeAid has adopted a methodology to estimate the residual error rate and contracted an external audit firm to perform this work. The results of the first exercise should be available to be taken in consideration in EuropeAid's 2012 AAR.	<i>The implementation of this recommendation is ongoing. The Commission's work is on track in relation to the establishment of the residual error rate for the EuropeAid portfolio.</i>
	EuropeAid should, in the context of this review, assess the cost-effectiveness of the various controls, notably of the transactional ex-post control system (2009 Annual Report, paragraph 54(b)).	In its replies to the 2010 Annual Report, the Commission has stated that it had started work on the cost effectiveness of controls in 2010. This work was to be reviewed and relaunched in 2011/2012 in the context of the final outcome of the current revision of the Financial Regulation. Limited progress was made in 2011.	<i>The implementation of this recommendation is ongoing. Progress was indeed made in 2011 in relation to the costs and benefits of controls as set out in the Annual Activity Report 2011 which details the costs of many internal controls (e.g. audits, training, ex post controls) and reports on new and innovative ways of measuring benefits such as key performance indicators lifted from CRIS data and pre and post training tests. Cost benefit analysis has for example led to the suspension of ex-post transactional controls in 2012.</i>
	EuropeAid should finalise and disseminate the financial management toolkit targeting the high inherent risk of errors at the level of implementing organisations, contractors and beneficiaries to ensure adequate knowledge of financial management and eligibility rules (2009 Annual Report, paragraph 54(c)).	The Financial Toolkit was finalised and disseminated in early 2011.	<i>The Commission believes that this recommendation has been fully implemented.</i>
	EuropeAid should continue its efforts to ensure that the Delegations record data in CRIS Audit in a comprehensive and timely manner (2009 Annual Report, paragraph 54(d)).	The quality of CRIS data remains an issue. EuropeAid has stated its intention to relaunch its efforts in 2012.	<i>The implementation of this recommendation is ongoing. The Commission shares the Court's concern to continue to improve the quality of data held in the external aid management information system (CRIS). EuropeAid will relaunch its efforts to improve CRIS data quality in 2012.</i>



Year	Court recommendation	Court's analysis of the progress made	Commission reply
	<p>The design of CRIS Audit should be modified to provide information on the amounts of final ineligible expenditure and financial corrections done after the audit clearance process with the auditee has been completed (2009 Annual Report, paragraph 54(e)).</p>	<p>As indicated in the Commission's reply to the Court's 2010 Annual Report, the audit and recovery modules of the CRIS information system were linked in 2011. This is a significant improvement but does not provide yet complete information on the results and follow-up of audits.</p> <p>CRIS-Audit does not provide information of the amounts eventually considered ineligible by EuropeAid after the contradictory process with the beneficiaries, including in respect of amounts which the auditors considered warranted further consideration by EuropeAid.</p>	<p><i>The audit module of the external aid management information system (CRIS) was designed to plan, and record the results of external audits rather than track audit follow-up made by the Commission. However the Commission would like to be able to develop this functionality in the medium term, resources permitting.</i></p>
2009	<p>EuropeAid should ensure that the specific conditions for performance-based variable tranches clearly specify the indicators, targets, calculation methods and verification sources (2009 Annual Report, paragraph 55(a)).</p>	<p>This recommendation has been fully implemented.</p>	
	<p>EuropeAid should ensure that Delegations' reports provide a structured and formalised demonstration of public finance management progress by clearly setting the criteria against which progress was to be assessed (i.e. the results that the recipient government had to achieve during the period concerned), the progress made and the reasons why the reform programme may have not been implemented according to plan (2009 Annual Report, paragraph 55(b)).</p>	<p>The quality of the assessment of the PFM general eligibility criterion has improved since the introduction of the new reporting format for the Delegation's PFM Annual Monitoring Reports in 2010. However, the Court still detected cases in 2011 where this assessment was not sufficiently structured and formalised, as the PFM achievements were not compared with the objectives/targets set for the reference period.</p>	<p><i>The Commission believes that this recommendation has been fully implemented. Nevertheless efforts will continue for the improvement of the budget support performance framework, notably in the revision of Budget Support Guidelines due to be issued in 2012.</i></p>