



European Community Finances

STATEMENT ON THE 2002 EC BUDGET AND MEASURES
TO COUNTER FRAUD AND FINANCIAL MISMANAGEMENT

JULY 2002

Presented to Parliament by the Financial Secretary
by Command of Her Majesty

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INTRODUCTION

I.1 In 1980, following a recommendation by the Public Accounts Committee, the Government agreed to present an annual statement to Parliament giving details of the European Community Budget.

I.2 This White Paper is the twenty-second in the series. It describes the Budget for 2002 as adopted by the European Parliament and the United Kingdom's gross and net contributions to the Community Budget over the years 1997 to 2002. It also includes details of recent developments in EC financial management and the fight against fraud.

I.3 This year's White Paper has been expanded to include financial year information previously published in the Departmental Report of the Chancellor of the Exchequer's Departments. Detailed information on UK financial transactions with the EC has therefore now been brought together in a single source.

2

THE 2002 BUDGET

The Budget Process 2.1 The annual European Community Budget is established by the budgetary authority, which consists of the Council and the European Parliament, through a procedure involving several stages, as follows.

2.2 The procedure begins, usually in May, with the establishment of a Preliminary Draft Budget for the following year by the European Commission. On the basis of the Preliminary Draft Budget, the Council establishes its own Draft Budget in July. This is passed to the European Parliament for its first reading, which takes place in October. The budget then returns to the Council in November for the Council's second (and final) reading. The European Parliament makes its second reading in December, after which the budget is adopted by the Parliament.

2.3 The Council has the final say on the amount and structure of *compulsory* expenditure, which is defined as expenditure necessarily resulting from the Treaty or from acts adopted in accordance with it. Spending carried out under the Common Agricultural Policy – accounting for just under one-half of the budget – and certain small items in other sections of the budget, including the Monetary and Loan Guarantee Reserves, is classed as compulsory. The European Parliament has the final say on all other, *non-compulsory*, expenditure.

The Financial Perspective 2.4 Since 1988 the annual budget has been set within a multi-annual expenditure framework known as the Financial Perspective. In the 2002 budget the Financial Perspective sets out annual expenditure ceilings for seven broad expenditure categories (agriculture, structural operations, internal policies, external actions, administrative expenditure, reserves and pre-accession aid) which must be respected by the budgetary authority (Council and European Parliament) when it determines the budget. The expenditure ceilings are set in terms of expenditure *commitments*, i.e. legal expenditure obligations entered into during the year which will lead to *payments* either that year or in future years.

2.5 The Financial Perspective covering the budget year 2002 was part of the wider agreement at the March 1999 Berlin European Council covering EU expenditure for the years from 2000 to 2006. This agreement is set out in an Inter Institutional Agreement between the Commission, the Council and the European Parliament.

The Own Resources Decision 2.6 The arrangements for financing the Community Budget are set out in the Community's Own Resources Decision (ORD). The ORD sets a ceiling (the Own Resources ceiling) on the amount the Community can raise from Member States in any one year, which from 2002 is fixed in terms of a percentage of overall Community Gross National Income (GNI). For 2002, it is equivalent to 1.24% of Community GNI. The ceiling sets the maximum amount of Own Resources (in effect, Member States' contributions to the European Community Budget) which the Commission is allowed to call up each year. Because the Community is not allowed to borrow, revenue must equal expenditure. The Budget is therefore effectively limited by the amount of Own Resources that can be called up from Member States.

The 2002 Budget 2.7 Table 2.1 sets out the amounts established for the 2002 Budget at each stage of the budgetary procedure – which ran from May 2001 to December 2001 – and relates these to the Financial Perspective ceilings.

Table 2.1: 2002 EC Budget

€ million

	Financial Perspective Ceilings	Preliminary Draft Budget (including Letters of Amendment 1-2)	Council's First Reading Draft Budget (including Letters of Amendment 1-2)	European Parliament First Reading Draft Budget	Council's Second Reading Draft Budget (including Letters of Amendment 1-2)	Adopted budget 2002
Commitment appropriations						
Common Agricultural Policy	46,587	44,251	45,022	45,390	44,255	44,255
Structural Operations	33,638	33,835	33,638	33,638	33,838	33,838
Internal Policies	6,558	6,490	6,447	6,554	6,470	6,558
External Action	4,873	4,746	4,773	4,873	4,753	4,803
Administration	5,179	5,186	5,127	5,175	5,127	5,177
Reserves	676	676	676	676	676	676
Pre-accession aid	3,328	3,328	3,328	3,328	3,328	3,328
Total Commitment appropriations	101,039¹	98,512	99,011	99,634	98,448	98,635
Total Payment appropriations	100,245	95,794	95,600	98,737	94,827	95,655
Payment appropriations as a percentage of Community GNP ²	1.10	1.06	1.06	1.09	1.05	1.06

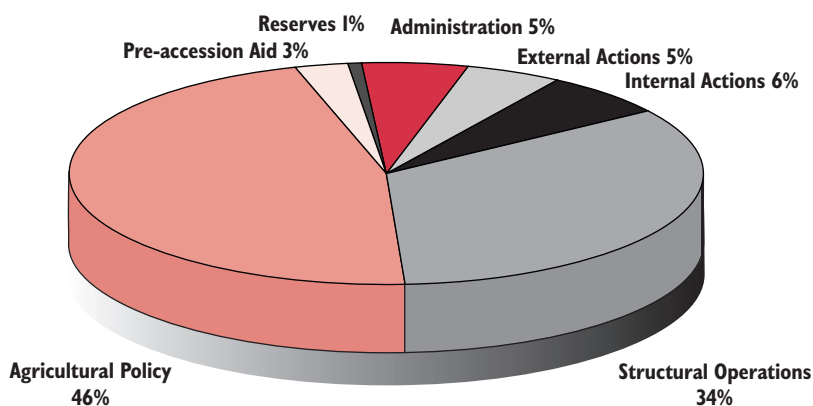
Notes:

¹ Includes the flexibility instrument (€200m).² Based on the GNP basis in Table 1 of the Adopted Budget.

Source: EC Adopted Budget 2002.

2.8 The finally adopted 2002 budget provides for commitment appropriations of €98,635 million or £60,019¹ million, an increase of 1.7 per cent over 2001; and payment appropriations of €95,655 million or £58,206 million, an increase of 2 per cent over 2001. The commitment and payment appropriations are within the limits provided under the Inter-Institutional Agreement and Financial Perspectives agreed at the Berlin European Council of 1999. The percentage share for each of the seven categories of the budget are shown in chart 2.1.

Chart 2.1: 2002 EC Budget – Payment Appropriations by Budget Category



Source: EC Adopted Budget 2002.

¹ An explanation of exchange rates used throughout this Statement can be found in the glossary, page 27.

Multi-annual programmes **2.9** During the course of 2002 a number of new multiannual programmes came into effect following the passage of relevant legislation (EU Regulations). Such Regulations include indicative multiannual spending volumes, which are taken into account by the Budget Authority in setting the annual EC budget. Among the multi-annual programmes introduced in 2002 were:

- The Sixth Research and Development Framework Programme: €17.5 billion (2002-06) – see box 2.1;
- The Public Health Programme: €312 million (2002-2006); and
- Employment Incentive Measures: €55 million (2002-2006).

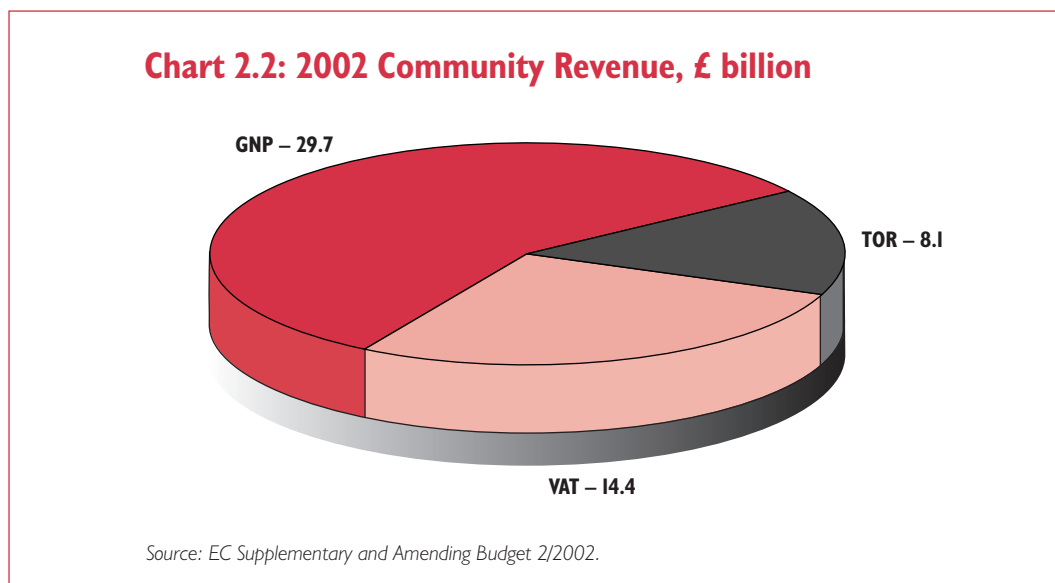
Box 2.1: 6th Research and Development Framework Programme

The 6th Research Framework Programme (FP6) represents the largest operational budget line within the internal policies section of the EC budget. The FP6 will contribute towards the March 2000 Lisbon European Council goal of transforming the EU into the most dynamic and competitive knowledge-based economy in the world by 2010.

The new programme has been allocated €17.5 billion for the period 2002-2006, and is structured around three main objectives:

- The creation of a European Research Area, which aims to achieve scientific excellence, improved competitiveness and innovation through increased co-operation in all research fields;
- New support instruments (networks of excellence and integrated projects), which will give EU activities a bigger impact and bring about a stronger structuring effect on research conducted in Europe. FP6 will make it possible to assemble genuine critical masses of resources, to better co-ordinate national research efforts and diversify support activities in key areas such as the mobility of researchers, research infrastructures and science and society issues; and
- Research priorities (focusing on a progressive integration of activities). Seven key research areas have been nominated within FP6 as critical to the advancement of knowledge and technological progress. These have been allocated approximately 75% of the total budget and are as follows:
 - Genomics and biotechnology;
 - Information society;
 - Sustainable development and the environment;
 - Nanotechnologies and new production processes;
 - Aeronautics and space;
 - Food safety and quality; and
 - Economic and social sciences.

2002 Community Revenue **2.10** The Own Resources Decision allows for four sources of Community revenue, or “Own Resources”: Customs duties, including those on agricultural products, Sugar levies, Contributions based on VAT and GNP based contributions. The first two Own Resources are known collectively as the ‘Traditional Own Resources’ (TOR). The VAT and GNP-based contributions are often referred to as the third and fourth resources. A more detailed explanation of these resources can be found in the glossary.



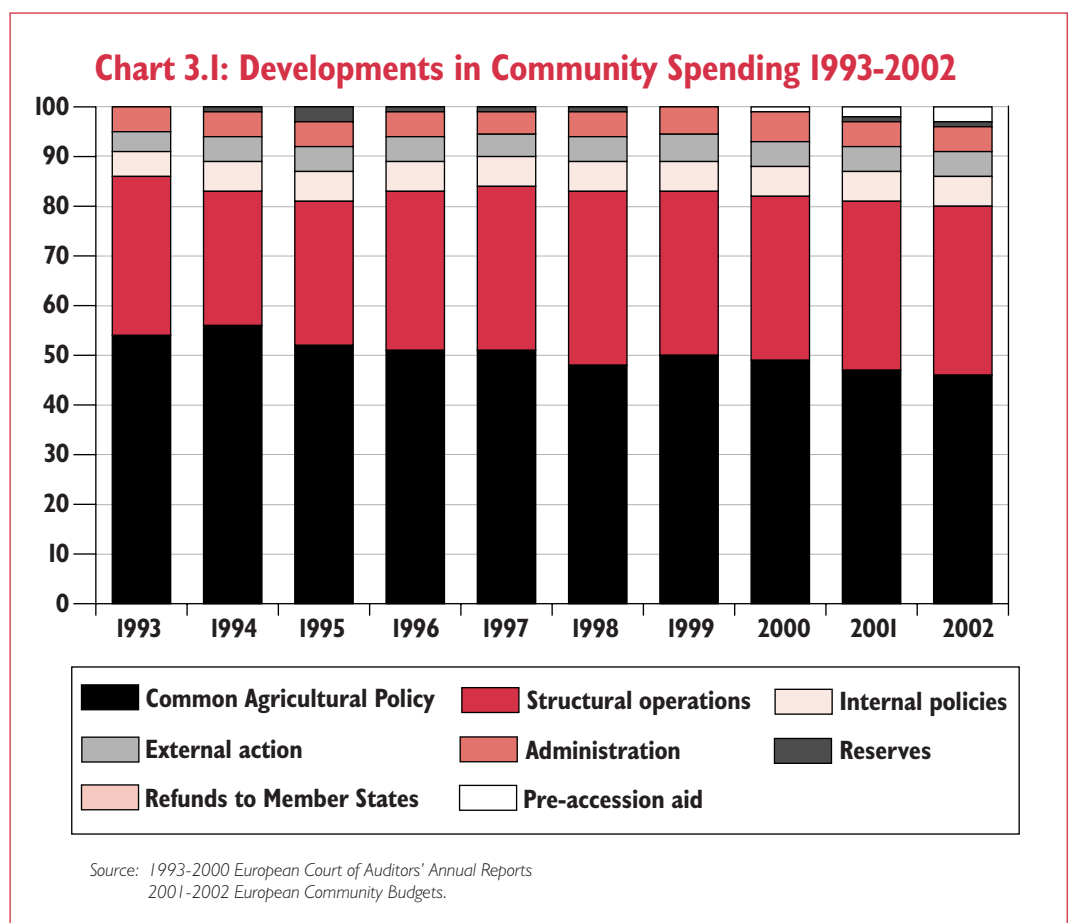
2.11 Chart 2.2 shows a breakdown of how the 2002 budget will be financed. Tables 2 and 2a (p.38 and p.39) show the gross contributions, after taking account of the UK abatement, by Member State, to the 2002 EC Budget along with the years 1996 to 2001. The key points to note in terms of the UK's contribution to the EC budget are as follows:

- the UK's share of TOR in 2002 is estimated as some 21.1%. In 2001 revenue from this source was estimated to be £9.7 billion, of which the UK's share was 21.0%;
- the UK's share of VAT in 2002 is some 19.3%. In 2001, total VAT contributions were estimated to be £19.1 billion, of which the UK's share was 18.9%;
- the UK's share of the fourth resource in 2002 (including potential contributions to Community reserves) is 18.1%. The equivalent figure for 2001 was £21.9 billion, with a UK share of 17.9%;
- the estimate of the UK's abatement in supplementary and amending budget 2/2002 (in respect of our net contribution in 2001) is around £2.8 billion, compared with £4.5 billion in 2001 (a detailed explanation of how the UK abatement is calculated can be found in the glossary); and
- the UK's net contribution in 2002 is forecast to be some £2.2 billion (see paragraphs 3.5 to 3.9).

3

DEVELOPMENTS IN COMMUNITY FINANCES

Expenditure 3.1 Chart 3.1 shows the developments in Community spending over the period 1993-2002. The two most significant trends are the reduction in the proportion of spending on agriculture – which now forms under half of the total budget – and the simultaneous increase in structural operations expenditure, which has increased to over one-third of the budget since 1996. Certain repayments to Member States (to Spain and Portugal in the early years of membership or in connection with the depreciation of agricultural stocks) have been discontinued, and a new budget category of pre-accession aid was created, to help candidate countries prepare for enlargement, following agreement at the 1999 Berlin European Council. The other categories of spending have remained fairly constant over the period.



3.2 Further details on spending in recent years are given in Table 1 and 1a (page 37). These tables show commitments and payments for the years 1997-2002, in euros and sterling. These tables also show the main spending programmes broken down by Financial Perspective category.

3.3 From 2002, the budget has also been presented using the Activity Based Budgeting (ABB) system – a new budget process, which will ensure budget allocations more closely reflect political priorities and objectives. Box 3.1 provides an outline of the rationale behind the new ABB methodology.

Box 3.1: Activity Based Budgeting

Activity Based Budgeting (ABB) is a new system for making budget decisions. It is key part of the Commission reform agenda, which will improve the decision making process by ensuring budget allocations more closely reflect pre-defined political priorities and objectives. Just as in the UK – where Public Service Agreements have replaced the old input driven approach – the setting of the EC budget will reflect evaluation evidence, it will be linked to measurable outputs and it will focus much more on what can be delivered for EU taxpayers.

ABB aims to provide a common conceptual framework for planning, budgeting and managing resources, but its full potential will only be realised when the Commission and others are able to link programming of work, management information systems, performance indicators and evaluation of results to indicators. To help improve decision-making on resource allocation, information on the full cost of running activities will be linked to the objectives being pursued and results achieved.

The 2002 and 2003 budgeting rounds use **ABB** alongside the traditional budgeting methodology. This involves:

- fully transformed working documents in **ABB** format
- new activity statements; and
- information on outputs.

In 2004 the budget will be presented in **ABB** format, with the traditional budget operating alongside it. In 2005 the budget will be presented wholly in **ABB** format.

Revenue 3.4 The current Own Resources Decision (ORD) came into effect on 1 March 2002. It sets a ceiling on Own Resources of 1.24% of Community Gross National Income (GNI), which is equivalent to the 1.27% Gross National Product (GNP) ceiling set in the previously applicable ORD. Box 3.2 sets out further details of the changes introduced in the new ORD.

Box 3.2: THE OWN RESOURCES DECISION (ORD)

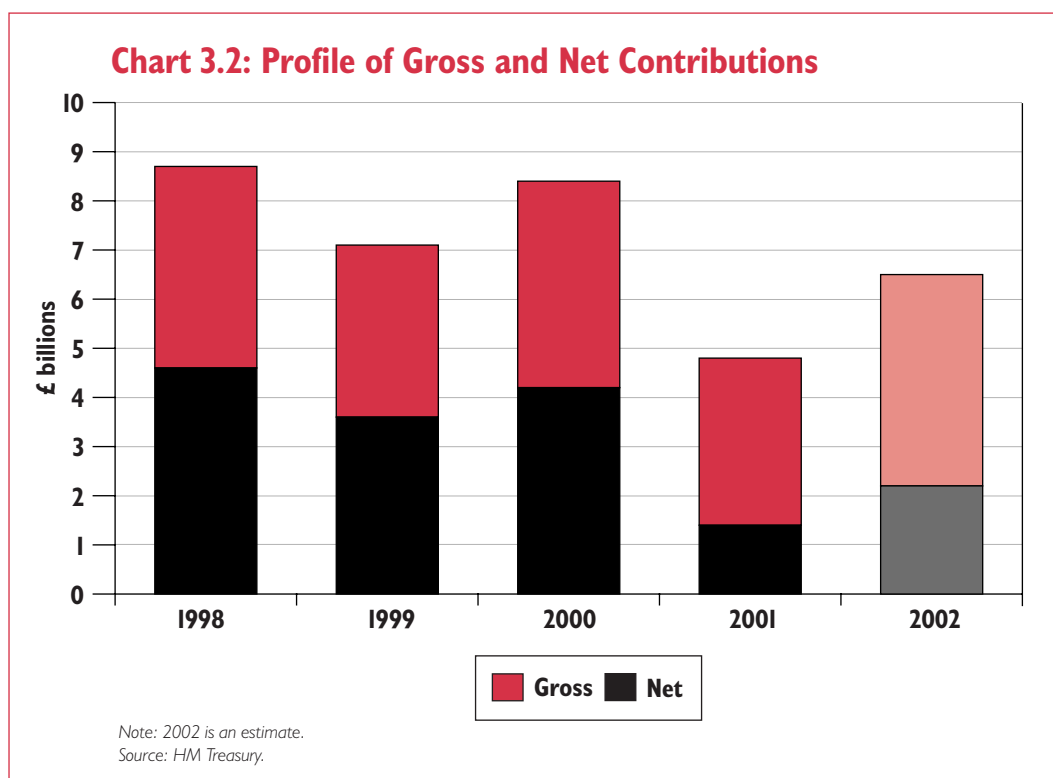
The ORD sets out the legal framework for determining Member States' contributions to the EC budget. A new ORD was agreed by the European Council on 29 September 2000, which entered into force from 1 March 2002 (retrospectively to 1 January 2002). The main changes were:

- Amendment to the current arrangements for VAT based contributions by reducing the maximum call up rate from 1% to 0.75% in both 2002 and 2003 and 0.5% thereafter (compensated by an increase in Member States' GNP based contributions);
- An increase, from 10% to 25%, in the proportion of Traditional Own Resources, i.e. customs duties and sugar levies, retained by Member States against collection costs (also compensated by an increase in Member States' GNP based contributions);
- Continuation of the UK abatement mechanism. But with a simplification in the calculation. This simplification does not affect the amount of the UK abatement;
- A change in other Member States' financing of the UK abatement, to reduce the amount borne by Germany, Austria, Sweden and the Netherlands. This does not affect the UK's contribution;
- Provision for the UK to forego the "windfall" gains it would have received from the changes to the VAT arrangements and collection costs referred to above. Similar treatment of a "windfall" was provided for by Article 4 (2) of the previous Decision (agreed at the Edinburgh European Council of 1994);
- The UK will also forego those "windfall" gains which would accrue at the time of enlargement from the switch in payments to acceding states from pre-accession aid to structural funds and other expenditure which is subject to the abatement; and
- A mechanism to calculate a new percentage figure for the ceiling on Own Resources. This mechanism ensures that the ceiling, previously expressed as a percentage of GNP calculated under ESA 79 statistics, is not affected now that ESA 95 data is being used to calculate GNI. For 2002, the ceiling is 1.24% of Community GNI, which is equivalent to 1.27% of Community GNP under the previous mechanism.

The UK's Net Contribution

3.5 The UK's net contribution varies considerably from year to year, as illustrated in chart 3.2. This is the result of a number of factors: variation in payments made to the EC budget, due to the nature of the ORD (see Technical Annex I); variations in public sector receipts; and as a result, the fluctuation of the UK abatement (see glossary). Table 3 (page 40) shows the UK's contributions to, abatement, and public sector receipts from, the Community Budget for the years 1996 to 2002. The figures for 2002 are estimates; those for earlier years are outturn.¹

¹ The amounts for the UK's gross contributions in Table 3 reflect payments made during each calendar year. They differ from the figures for gross contributions in Table 2 in that these figures, drawn from Commission documents, relate to payments to particular Community Budgets.



3.6 UK public sector receipts in 2002, mainly from the Agricultural Guidance and Guarantee Fund (EAGGF) and the Social and Regional Development Funds, are expected to be around £4.3 billion. The majority of these receipts are either paid to the private sector or used in its support.

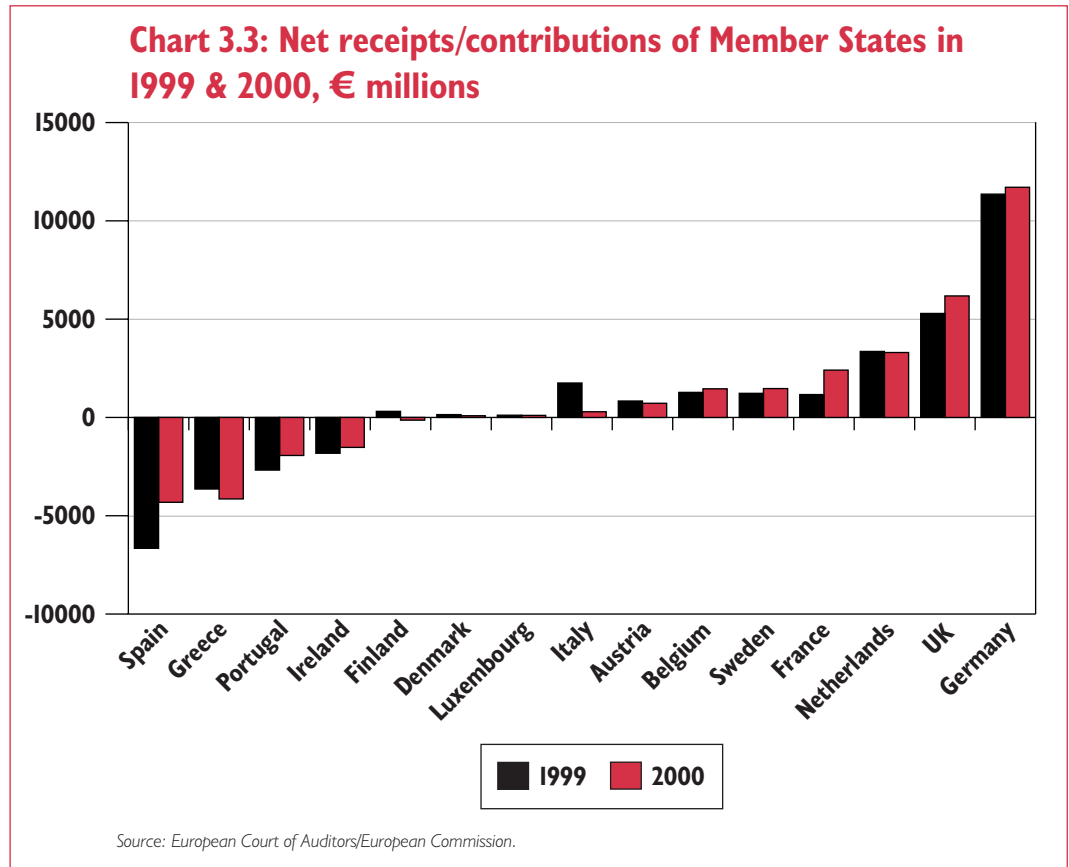
3.7 The Community pays some monies direct to the private sector. In 2002 these receipts are expected to be around £375 million. As these payments go direct to the private sector, they do not appear in Public Sector accounts and thus do not appear in Table 3 (page 40).

3.8 The UK's net contribution in 2002 is forecast to be some £2.2 billion, compared with an outturn of some £1.4 billion in 2001.

3.9 The UK's net contribution to the Community Budget can vary considerably from year to year. This is the result of a number of factors. The main reasons for the difference between the forecast for 2002 and the outturn for the 2001 net contribution are:

- an increase in the UK's gross contribution before abatement (£9,590 million (2002) compared with (£9,379 million (2001))
- an estimated abatement (£3,099 million) smaller than the exceptionally high amount (£4,560 million) in 2002; and
- an increase in the expected level of public sector receipts (£4,318 million (2002) compared with (£3,423 million (2001)).

3.10 Chart 3.3 shows how the UK's net contribution compares with net contributions or net receipts of the other Member States over 1999 and 2000. In 2000 the UK was, according to figures released by the European Commission and the European Court of Auditors (ECA), one of 10 net contributors to the EC budget. Figures published by the ECA do not however allocate administrative expenditure between the Member States. Any allocation of administrative expenditure, would benefit Belgium and Luxembourg more than other Member States, and thus significantly reduce their relative net contributions.



Financial Year Transactions **3.11** The Community financial year runs to 31 December (calendar year) whereas the UK's runs to 5 April. Tables 3.1 and 3.2 show a breakdown of the UK's transactions with the European Communities on a UK financial year basis between 1996/97 and 2001/02. Table 3.1 shows the breakdown of the UK's contribution to the EC budget. Table 3.2 details a breakdown of UK receipts from the EC budget.

3.12 The calendar year equivalent estimate of the UK's net contribution in 2002, shown in Table 3 (page 40), differs from the estimate for the UK financial year 2002-03 contained in Table 3.1 for two main reasons:

- first, the estimates relate to different time periods; and
- second, the figure in Table 3 reflects the actual net contribution expected to be paid in 2002, whereas the figure for 2002-03 reflects the trend in the UK's net contribution.

Table 3.1: Cash payments and receipts

	£ million					
	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
	Outturn	Outturn	Outturn	Outturn	Outturn	Estimated Outturn
Gross payments ¹	9,278	8,603	10,507	9,207	10,640	9,213
Public sector receipts	-4,567	-4,472	-3,950	-3,676	-4,099	-3,298
UK Abatement	-2,418	-1,563	-2,447	-2,206	-2,223	-4,427
Net contributions to EC Budget ²	2,293	2,567	4,111	3,325	4,318	1,488
Contributions to reserves and capital of the EIB	15	0	0	0	0	0
Grants received from European Coal and Steel Community	-27	-6	-:	-:	-:	-1
Payments to EC budget attributed to the aid programme ³	-464	-408	-520	-519	-621	-717
Net payments to EC institutions (excluding Overseas Aid) ²	1,817	2,153	3,590	2,807	3,697	770

Notes:

: Signifies receipts of less than £0.5 million

¹ Gross payment figures include Traditional Own Resources payments at 90% (75% in March 2002). The remaining 10% (25% in March 2002) is retained by the UK to cover the costs of administering collection on behalf of the European Community.

² Due to rounding, totals may not exactly correspond to the sum of individual items.

³ For domestic/public expenditure planning purposes, part of the UK's contribution to the Community budget is attributed to the overseas aid programme. The aid programme also includes payments to the European Development Fund, not included here.

Source: HM Treasury.

Table 3.2: Public Sector Receipts (other than UK abatement) from the Community Budget

	£ million					
	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02
	Outturn	Outturn	Outturn	Outturn	Outturn	Estimated Outturn
Agricultural Guarantee Fund	3,155	2,904	3,028	2,456	2,647	2,631
Agricultural Guidance Fund	39	51	52	103	35	18
Social Fund	733	867	511	698	523	146
Regional Development Fund	621	640	348	411	887	501
Other Receipts	19	11	10	7	7	2
Total	4,567	4,472	3,950	3,676	4,099	3,298

Notes: Due to rounding, totals may not exactly correspond to the sum of individual items.

Source: HM Treasury.

3.13 The Community's financing system produces considerable fluctuations in Member States' contributions from year to year. The fluctuations are caused by factors such as adjustments made to Member States' gross contributions in previous years, as later information becomes available, differences in the level and timing of receipts and changes in the size of the UK's abatement. The effects are particularly marked in the case of the UK because we use a different financial year to that of the Community.

3.14 In view of these fluctuations and the difficulties of predicting the net position accurately, Government forecasts of the UK's net contributions to the EC budget have since 1996 been made on the basis of the statistical trend in future Community costs. Table 3.2 shows a trended net contributions forecast for the current financial year and 2003/04.

Table 3.3: Forecast of the trend in the UK's contributions¹

	£ million	
	2002-03 Plans	2003-04 Plans
Trended Net Contributions to European Community budget	2,975	3,225
Contributions to reserves and capital of the EIB	0	0
Grants received from European Coal and Steel Community	0	0
Payments to EC budget attributed to the aid programme ²	-813	-861
Net payments to EC institutions (excluding Overseas Aid)	2,162	2,364

Notes:

¹ An exchange rate of £1 = 1.59 euro has been assumed.

² For domestic/public expenditure planning purposes, part of the UK's contribution to the Community budget is attributed to the overseas aid programme. The aid programme also includes payments to the European Development Fund, not included here.

Source: HM Treasury.

**Comparison
Between the
Government's
and the Court of
Auditor's Figures
for the UK's Net
Contribution**

3.15 In its Tenth Report, of 21 February 1996, the Public Accounts Committee asked the Government to provide each year an explanation for the difference between the Government's own outturn figure for the UK's net contribution and the figure for the UK's net contribution that can be derived from the European Court of Auditors' (ECA) annual report for the same year. A full account of the main factors causing the likely difference for the 2000 calendar year can be found in technical annex II.

European Court of Auditors' annual report on the 2000 budget

4.1 The latest Annual Report and Statement of Assurance from the Court of Auditors relate to implementation of the budget for the 2000 financial year, and were published together (in a provisional version) on 13 November 2001. As usual, the report covered the main areas of the budget – Own Resources, agriculture, structural funds, internal policies, external aid and administrative expenditure, and financial instruments and banking activities. For the first time, the Court included a chapter examining pre-accession aid.

4.2 Technical Annex III gives details of the European Court of Auditors and the requirement on it to publish an annual report on the Commission's implementation of the general budget, as part of the discharge process.

4.3 The Court praised improvements in the management of EU funds following the reform of the agricultural clearance-of-accounts systems, and the integrated administrative and control system. The URBAN Community initiative has helped the implementation of many urban development projects. The work of the agency charged with the reconstruction of Kosovo had been efficient, and the TACIS cross-border co-operation programme had worked well. The Court also welcomed the Commission's proposal for recasting the Financial Regulation – the budgetary “rule book” for the general EC budget.

4.4 The Court criticised some structural funds measures which had poorly-defined objectives, but noted that the Commission's reform programme was increasing the focus on results and performance measurement. (See Box 4.2 for a summary of the Commission reform programme). The Court found weaknesses in the management of funds shared between the Commission and Member States, and regretted that its previous findings in some areas had not always been adequately followed up. The budget surplus of €11.6 billion at the end of the 2000 calendar year was heavily criticised – the Court thought the Commission should have issued a supplementary and amending budget once it realised that such a large surplus was developing. Because of the way in which it is financed, some degree of surplus in the EC budget is inevitable and this is returned to Member States in the following year. However, the level of surplus from the 2000 budget was extremely high. The Government is keen to see the Commission improve its monitoring of in-year expenditure to ensure that for future years Member States are not asked to fund amounts which cannot be utilised in year.

4.5 As in last year's report, the Court paid considerable attention to the follow-up of its observations from previous Annual or Special reports. For example, in the case of BSE, the Court followed up the observations made in its 1998 Special Report, and concluded that the Commission's strategy for dealing with BSE was basically sound, but its effectiveness had been reduced by some Member States' failure to implement the ban on meat and bone in cattle feed, and to implement effective animal identification and registration systems.

**European
Court of
Auditors'
statement of
assurance**

4.6 As in previous years, the Court of Auditors gave a positive opinion on the reliability of the accounts, and on the legality and regularity of revenue, commitments and administrative payments. But, for the seventh successive year, it declined to give a positive opinion on the legality and regularity of other payments because of weaknesses in the functioning of control procedures, and the unacceptable incidence of substantive or formal errors (see Technical Annex III).

4.7 The Court again gave an assessment for each budget sector in the context of the Statement of Assurance:

- **Own Resources:** the Court found that a sound and adaptable framework for the management of quality control of GNP data was in place, but that it was not being systematically applied. The Court also found weaknesses in the concept and application of systems for collecting Traditional Own Resources, both in the Commission and Member States;
- **Common Agricultural Policy:** the Integrated Administration and Control System (IACS), which specifies the checks to be carried out by national authorities, was found to be a good basis for managing the risk of incorrect or inaccurate claims, but the Commission should ensure a fuller and more consistent application;
- **Structural measures:** the Court recognised that better regulations had been put in place for the 2000-2006 programmes, but considered that Member States had sometimes failed to carry out sufficient checks before closure of 1994-1999 programmes;
- **Internal policies:** the Court continued to find significant incidence of overcharging in this sector, which is managed by the Commission. The Commission had also failed to impose sufficient checks on the implementation of policies;
- **External aid:** the Court's audit revealed the Commission had a well-developed invoice-processing system and that controls were generally effective; and
- **Administrative expenditure:** the Court's audit concluded that the administrative expenditure of the Commission, the European Parliament, the Council and the Court of Justice, was satisfactory.

Box 4.1: “EU LOSES £3 BILLION TO FRAUD?”

A typical newspaper headline following the publication of the European Court of Auditors annual report, suggests total fraud each year is worth £3 billion. But is it true?

In past years the European Court of Auditors published an estimated global error rate in its Annual Report and Statement of Assurance. This was calculated by testing a sample of transactions from all budget areas, and extrapolating the number of substantive errors found. The error rate was usually around 5 per cent - which equates to 5 billion euro or £3 billion. But this does not mean that £3 billion was lost to fraud. Some of the errors detected were certainly frauds against the EC budget, but the majority represent genuine errors: such as small overpayments to farmers, which are subsequently recovered, or errors made when trying to comply with often complex EU regulations. This misrepresentation of the error rate figure led the Court of Auditors to decide to withdraw from publishing an error rate.

The true level of fraud is much harder to estimate and the scale is likely to vary from year to year. A Commission analysis of irregularities, reported in the 1999 Fight Against Fraud Report estimated that around €190 million could be attributed to suspected fraud – which was around 20 per cent of their estimate of total irregularities for that year. Nonetheless this is still a significant amount and the UK Government will continue to work with others to find ways to improve both deterrence and detection of fraud in the coming years.

**Council
recommendation
to the European
Parliament**

4.8 The Council’s recommendation to the European Parliament on the terms of the discharge to be granted to the Commission for implementation of the 2000 budget was discussed by ECOFIN on 5 March 2002. As in previous years, the Council recommended that the Parliament grant discharge, but its recommendation was accompanied by detailed comments, which criticised financial management in some of the areas discussed and called for improvements. The Council’s approach, as in the past, has been to work constructively to bring about improvements, reflecting an awareness that failings lie not only with the Commission but also with all those who have a part in the administration of the budget (i.e. including the Council, the Member States and the European Parliament). The Council therefore made a number of recommendations – not just for the Commission, but also for itself, the Member States and for the Court of Auditors.

4.9 The Council’s recommendations included:

- the Commission should adjust the budget mid-year if necessary (by means of a supplementary and amending budget) to avoid an excessive surplus;
- the Commission should revise, simplify and improve the quality of the information which it exchanges with Member States to take better advantage of the Integrated Administration and Control System (IACS);
- earlier Structural Fund programmes (for the period 1994-99, and earlier), should be wound up as soon as possible – the Commission can help by making quick decisions;
- Member States, as system users, should be consulted when the Commission implements the new computer system with a shared database for the next research framework programme;
- payments for external aid measures should be spread more evenly through the year, rather than concentrated in December as at present, and the Commission should continue to introduce performance indicators for all new programmes; and

- The Court of Auditors should provide sufficient information to make an objective comparison of progress made in relation to the objectives set, and to adopt a method that makes it possible to assess the results from one year against another.

Box 4.2: COMMISSION REFORM

There are three key strands to the Commission reform programme; better governance, getting the financial rules right and modernising the human resources policy. On each of these, the UK Government has been active in helping to achieve real change:

- on governance the Government advocated and supported the code of conduct for Commissioners, the creation of an independent Advisory Group on standards in public life for all EU institutions, a new whistleblowers charter, a beefed-up anti-fraud office and new disciplinary procedures for officials. All of these are now in place;
- most of the focus recently has been on the Financial Regulation, the EU's budgetary rulebook, which is being recast by the Council based on a proposal from the Commission. In the Council discussions, the UK Government has been a very strong advocate of providing for clear lines of responsibility and accountability for Commission officials – this will not only reduce fraud but should also cut waste and inefficiency. The UK Government has also led the way in advocating the incorporation of objectives, performance indicators and evaluation into the budgetary process – changes which will not only improve transparency in the budget but also increase its effectiveness. The new Financial Regulation was adopted unanimously in May and completed conciliation with the European Parliament in June. It will come into force at the start of 2003;
- the human resources side is taking longer, because it involves changing cultures within the EU Institutions. Vice President Kinnock's March 2000 White Paper set out an ambitious agenda to modernise human resource management, which the UK Government has strongly supported. The next step is to revise the Staff Regulation. The Government is keen to ensure that proven merit and taking on additional responsibilities are rewarded, that equal opportunities are promoted, managerial skills are valued and that under-performance is tackled.

European Court of Auditors' special reports 4.10 During the process of considering its discharge recommendation, the Council also considered the Court of Auditors' Special Reports 6/200, 16/2000, 18/2000, 21-23/2000, 1-4/2001, 6-12/2001 and 14/2001. (NB – not all ECA special reports have financial implications.) A full list of all the Special Reports published in 2000 and 2001 can be found in the Bibliography section of this White Paper.

European Parliament's report on discharge for 2000 4.11 The European Parliament's Budgetary Control Committee considered the Council's recommendations on discharge and made its own report consisting of many detailed recommendations. However, the report did recommend that discharge should be given to the Commission, and the European Parliament adopted this decision on 10 April.

UK Government response to the European Court of Auditors 4.12 The UK Government argued in the Council in 1995 in favour of a procedure for Member States to make responses to the Court of Auditors on the observations about them in its reports. This has now become established procedure, and the Commission now asks Member States to comment also on general issues in the report. A copy of the UK response is always sent to both Houses of Parliament.

4.13 As usual, there were some specific criticisms of the UK in the Court of Auditors' report on 2000. Remedial action has been implemented where necessary, but not all the Court's findings are accepted. Some examples are as follows:

Own Resources 4.14 The quality of the customs control depends on an effective and adequate use of the available tools. In the United Kingdom the number of errors and omissions found during the Court's audit showed insufficient use of available tools.

4.15 At the time of the Court's audit of anti-dumping duties (ADD) in November 2000, the UK had four national profiles in operation. Following the audit, a further two national profiles were introduced. HM Customs and Excise (HMCE) is currently reviewing the operation of ADD in the UK as a whole with a view to introducing further national measures to strengthen the administration and collection of ADD. HMCE is also reviewing existing ADD training and guidance with a view to reducing the number of errors and omissions in the administration of ADD.

4.16 Problems were noted in most Member States visited by the Court concerning cases where anti-dumping duties had to be collected retroactively on registered imports. In Southampton, due to failures in the registration procedure, the retroactive collection of duties on imports of handbags from China started only shortly before the audit visit of the Court. The collection of outstanding anti-dumping duties for about 0.4 million euro was still in progress at the time of the Court's audit. Southampton carried out a review and only identified one case for retrospective collection of ADD. A post clearance demand for £231,352 is now subject to an appeal. Action has been taken to review and improve local processes including the issue of guidance, the identification of consignments and the notification of agents/importers where there is a liability to ADD. A local profile has been introduced to capture registration details.

Agriculture 4.17 In the United Kingdom, two audit visits by the Commission revealed that aid had been granted for growing a variety of flax, which is not normally eligible for aid. The British authorities had treated it as an experimental variety, which is allowed by the Regulation.

4.18 The flax variety "Klasse" underwent extensive national trials prior to its inclusion in the EU Common Catalogue. Agreement on inclusion was reached at the EU Standing Committee on Plant Varieties and Seeds on 13/14 May 1997. The legislation at the time made no provision for a limit on the size of trial areas and permitted the payment of aid on varieties subject to national trials. Following a ruling in the ECJ it was accepted that aid had been paid correctly on this variety. The ECA report observes that no proof was provided to the Commission of tests on the quality of fibres. The UK carried out all tests required to enter the variety on the national list and EU Common Catalogue and presented them to the Standing Committee. Without these it could not have been entered into the EU Common Catalogue.

4.19 In general, the situation with regard to debtors remains unsatisfactory with particular concerns in respect of Valencia (Spain), DCCC (Direzione Compartimentale delle Contabilità Centralizzate) and AGEA (Agenzia per le Erogazioni in Agricoltura - Italy) and Welsh Office.

4.20 At the National Assembly for Wales Agriculture Department (NAWAD), levels of control and procedure have been reviewed regularly and have been systematically improved and strengthened. A set of guidance instructions for staff on debt recovery was issued in November 1998 and a further version issued in April 1999. Following re-structuring, the process was examined by internally by NAWAD and the instructions revised and reviewed regularly. An improved, more comprehensive Guidance Document was issued in October 2000 and further versions strengthening procedures were issued in April 2001 and June 2001.

4.21 These actions have been done in conjunction with internal reviews of the debt system. The process for identifying debt has also been examined. The procedures for dealing with debt have been further strengthened in 2001 by the establishment of debt teams within each of the Divisional Offices, who deal specifically with debt cases.

Structural Funds 4.22 In 2000, progress in the closure of old Structural Fund programmes was still slow even if an improvement was noted in the case of certain Member States (in particular Italy and the United Kingdom).

4.23 The additional requirement for independent closure statements linked to 5% inspection checks has added an additional dimension to programme closure and this, in turn, will bring added delays to closing the 1994-1999 programmes. However, the UK's record in closing old programmes has improved and it submitted all the outstanding ERDF 1989/93 programmes for closure within the EC deadline.

4.24 The Department for Work and Pensions (DWP) issued a letter to Government Office (GO) Regional Directors requesting their assistance to help with the closure of programmes. DTLR asked Regions to ensure that the EC deadline for closure of the 1989/93 programmes was met. Guidance was issued in February 2001. DWP held a workshop with GO Inspection teams to agree a plan of action on closure, and a methodology for calculating error rates with Internal Audit was also agreed.

NAO report on the Court of Auditors' report 4.25 The National Audit Office produces an annual report to Parliament (published this year on 30 May) explaining the findings in the Court of Auditors' Annual Report and Statement of Assurance, and considering other relevant financial management issues. This year it also included a section on enlargement

Box 4.3: FRAUD OR WASTE?

Media headlines tend to concentrate on cases of fraud against the EC budget. Many of these are irregularities rather than fraud – money which has been mis-spent because of misunderstanding or genuine error, and which is later recovered when the problem is detected. But it is also the case that money can be mis-spent or wasted on projects of little or no value, even if no rules have been broken. The introduction of Activity-Based Budgeting by the Commission, as part of the reforms, will go some way to reduce waste of money:

- **the Commission will have to set objectives for each activity;**
- **achievement against objectives will be evaluated annually and inform decisions about future budget allocations; and**
- **each Directorate-General will also set objectives and performance indicators, and evaluation of achievements will be published in an annual report (rather like the Departmental Reports published annually in the UK).**

The European Anti-Fraud Office (OLAF) 4.26 The European Anti-Fraud Office (known by its French acronym, OLAF) was set up on 1 June 1999 to replace the Commission's Unité de coordination de la lutte anti-fraude (UCLAF). (Technical Annex IV describes OLAF)

Annual Report on the Fight against Fraud 4.27 European Commission's Annual Report on the Fight Against Fraud was published on 3 July 2002. It gives details of irregularities, including fraud, detected during 2001. Overall, the amount of irregularity detected and reported by Member States since the previous year's report has fallen from €1,116 million to €690 million – the only sector which shows an increase in the amounts detected is Structural Funds (even though there is a decrease in the number of cases reported). For the second time, the report includes a summary of Member

States' activities in the fight against fraud and the protection of the Communities' financial interests, as required under Article 280 of the Treaty. (See glossary entry on fraud and irregularity.)

OLAF's second report on operational activities **4.28** The Director of OLAF published a report on OLAF's second full year of existence, covering the period 1 June 2000 to 31 May 2001, in the Official Journal on 20 December 2001. The report gives details and statistics of OLAF's work – for example, as at 1 June 2000, OLAF was investigating a total of 636 cases and was evaluating (ie assessing whether a case should be opened) a further 612 cases. OLAF has also introduced a number of improvements and new systems:

- a manual for internal use;
- new IT systems including the Case Management System, the Electronic Communication Registry (to manage data provided under the sectoral rules), and the Anti-Fraud Information System (to exchange information with partners in the fight against fraud);
- an anti-fraud freephone system in all Member States;
- systems to improve co-operation with candidate countries (such as building a new anti-fraud structure in Poland) and third countries (such as the Mutual Information System set up with the Russian Authorities); and
- systems to carry out administrative, financial, judicial and legislative follow-up of investigations.

Second report from OLAF's Supervisory Committee **4.29** In order to ensure OLAF's independence, the Regulation which set up the new Anti-Fraud Office also set up a Supervisory Committee, to monitor regularly its investigative function. The Supervisory Committee comprises 5 independent Members, is required to meet at least ten times a year, provides opinions on OLAF's activities and is required to make at least one report each year to the other institutions.

4.30 The Committee published its second report, covering the period July 2000 to September 2001, in the Official Journal on 20 December 2001. The Committee continued to criticise the slowness of the recruitment process to fill OLAF's remaining vacancies (notably the obstacles placed in its path by the European Parliament's freeze on 76 posts, and disagreement with the Commission over the procedure for appointing to Director-level posts), but has welcomed the establishment of OLAF's new structure (which now comprises three directorates covering policy, legislation and legal affairs (Directorate A), investigations and operations (Directorate B) and intelligence, operational strategy and information technology (Directorate C)). The Committee made the following recommendations:

- OLAF should establish and implement a reactive and proactive policy on investigations (involving co-operation between Directorates B and C);
- the Magistrates' Unit (set up to provide legal advice to the Office) should be fully involved in the investigation of cases;
- the internal investigation function (ie investigations within EU institutions) should have a higher profile; and
- OLAF's function in external investigations, and co-operation with national authorities, should be clarified.

Box 4.4: FRAUD BUSTERS

Action taken in the UK to reduce and prevent fraud includes:

- the Anti-Fraud freephone hotline managed by the Rural Payments Agency, which encourages the public to report suspected fraud, led to 34 investigations in 2001;
- satellite imaging systems allow the Rural Payments Agency to keep track of arable crops and provide a strong deterrent against fraudulent claims;
- computer-based systems in Northern Ireland enable details of animals claimed to be cross-checked;
- in 2001, the UK Customs signed a Memorandum of Understanding with India Customs, covering all fraud and investigation including customs duties (this allow for exchange of information between the two countries);
- the Scottish Executive has set up a dedicated Recoveries Unit to concentrate solely on action to recover overpaid or ineligible grants;
- issue of clear guidance to officials who check claims; and
- regular and effective communication channels within UK customs.

Ratification of the Convention on the protection of the European Community's financial interests (the "Fraud Convention")

4.31 The Fraud Convention specifies minimum rules, which Member States should adopt through their criminal law to deal with fraud against the Community Budget. It also requires all Member States to ensure that frauds are punishable with imprisonment and are extraditable. When all Member States have notified the Commission of the completion of the ratification process, the Convention and Protocols will enter into force.

4.32 The UK completed the formal process to ratify the Fraud Convention and its three protocols on 11 October 1999. All Member States except Italy (which has adopted the legislation, but not yet notified ratification) have now notified the Commission that they have ratified the Convention. Ratification of the three protocols is taking longer – only eight Member States (including the UK) had completed the process as at 22 March 2002.

European Public Prosecutor

4.33 The Commission proposed the establishment of a European Public Prosecutor (EPP) at the Nice Inter-Governmental Conference of December 2000. The proposal was for an EPP to have responsibility for prosecuting offences, deciding whether to prosecute, bringing and closing prosecutions and executing sentences where the offences concerned two or more Member States. However, the proposal was rejected by a majority of Member States at Nice.

4.34 Despite this, the Commission wished to carry out a wider consultation on the issue, and published a Green Paper, titled "Criminal Law protection of the financial interests of the Community and the establishment of a European Public Prosecutor" in December 2001. Its purpose was to launch a public debate about the possible creation of a European Public Prosecutor, responsible for investigating and prosecuting cases of fraud against the Community budget. Following a consultation process, the Home Office responded for the UK. The Commission intends to hold a public hearing for interested parties later in 2002.

Eurojust

4.35 The European Council at Tampere in October 1999 agreed to set up a judicial co-operation unit named Eurojust. In December 2000, a Council decision established a provisional unit made up of a magistrate, prosecutor or police officer of equivalent competence from each Member State to reinforce the fight against serious organised crime. On 28 February 2002, the Council decision for the final Eurojust body was adopted. Full implementation of Eurojust will take approximately 18 months from adoption of the Council decision.

4.36 The Government believes that Eurojust, in partnership with OLAF, will make an effective contribution to combating fraud against the Community budget. However Eurojust's competence extends beyond the fraud arena. Its aim is to facilitate the proper coordination of national prosecuting authorities and to support criminal investigations in cases of all serious crime which cross national borders.

4.37 In the UK, Eurojust has helped get information and evidence from abroad for the trials of drugs traffickers. Eurojust also helped to provide information which led to arrests of suspected al-Qaeda terrorists in Spain and Italy before and since 11 September, and the aversion of planned terrorist attacks in mainland Europe.