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PURPOSE: presentation of the Annual report of the Court of Auditors on the implementation of the budget concerning the financial year 2016.

CONTENT: the Court of Auditors published its 40th annual report on the implementation of the general budget of the Union for the year 2016. This report follows a five-part structure:

- the statement of assurance (DAS) and a summary of the results of our audit on the reliability of accounts and the regularity of transactions;
- the analysis of budgetary and financial management;
- the Commissions performance reporting framework;
- the findings on EU revenue;
- the presentation of the main headings of the current multiannual financial framework (MFF), the results of the testing of the regularity of transactions.

1) **Statement of assurance:** for 2016, the Court expresses a qualified opinion (rather than an unfavourable opinion) on the regularity of the transactions underlying the 2016 accounts, which demonstrates a remarkable improvement in the financial management of the EU. The main conclusions of the Court are as follows:

- the revenues were free from material errors;
- the level of error in overall expenditure is estimated at 3.1%. It was 3.8% in 2015 and 4.4% in 2014;
- the errors were mainly limited to cost reimbursement payments (e.g. rural development, environment, climate action and fisheries, economic, social and territorial cohesion), for which the level of error is estimated at 4.8%;
- for entitlement payments (e.g. direct aid to farmers, administration, student and research grants, agri-environmental measures), the level of error is estimated at 1.3%, which is below the threshold of meaning of 2%.

The Court concludes that payments for 2016 are legal and regular, with the exception of those based on the cost reimbursement payments. It believes that the EU accounts present a true and fair view of the EUs financial position.

Main observations of the Court of Auditors in relation to the DAS:

Corrective measures: the Court points out that the corrective action by authorities in the Member States and by the Commission had a positive impact on the estimated level of error. Without this action, our overall estimated level of error would have been 1.2 % higher.

Management: this has a limited impact on error levels. Thus, the estimated level of error for shared management expenditure and that calculated for all other types of operational expenditure are almost identical in 2016. The highest error levels were for the Cohesion headings (which are part of shared management) and Competitiveness (managed directly by the Commission and indirectly through the entities in charge).

Fraud: in 2016, the Court found eleven instances of suspected fraud in the approximately 1 000 transactions that we audited for our statement of assurance and for other performance and/or compliance audits (2015: 12). These cases were forwarded to OLAF, along with five other cases brought to our attention by the public. Cohesion was the biggest contributor to our estimated level of error for 2016, followed by Natural resources, Competitiveness and Global Europe.

2) **Budgetary and financial management:** the main risk and challenges for the future budgets are highlighted:

Amounts to be paid in future years: in 2016, the EU made fewer payments than initially planned. This was mainly due to significant delays in the start of disbursements from many of the 2014-2020 multi-annual Financial Framework (MFF) programmes under shared management, in particular the European Structural and Investment (ESI) funds in the areas of cohesion and rural development. As a result, the amounts to be paid in future years have reached an all-time high of about EUR 238.8 billion. Clearing this backlog and avoiding a new one to form should be priorities when planning the MFF for the period beyond 2020.

Difficulties in absorbing some of the available EU funds: given the sizeable commitment appropriations still available under the 2014-2020 MFF, Member States where ESI funds represent significant percentage of general government expenditure may find it difficult to identify sufficient high-quality projects on which to spend the available EU funds or to provide co-financing.

Lack of flexibility to deal with unforeseen events: the EU also has a number of budgetary instruments to deal flexibly with emergency situations. These instruments have been used increasingly in recent years, for instance to address the refugee crisis. Given the payment delays for many of the 2014-2020 MFF programmes, the Court believes that there is a risk that spending ceilings may be exhausted through normal expenditure in the coming years. This would leave less room for the much-needed flexibility in the EU budget to respond to unexpected events.

Complexity of EU funding arrangements: driven by the need to find additional funds to tackle new challenges (such as the financial crisis, climate action, migration and refugee crisis and boosting investment in the EU), funding arrangements have evolved greatly over the years. As a result the number of entities and instruments involved in financing the implementation of EU policies and programmes has increased considerably. This makes it more difficult to manage, audit and report on EU spending effectively, or to obtain a comprehensive overview.

The Court recommends that the Commission put more emphasis on performance by: (i) balancing performance reporting better; (ii) presenting clearly, in its main performance reports, information on the main challenges encountered in obtaining the results; (iii) making its performance reports more accessible; and (iv) better demonstrate that evaluation results are well used.

3) **Analysis of budgetary implementation for the main MFF headings:**

- Competitiveness for growth and jobs: in 2016, expenditure subject to audit in this area was EUR 15.2 billion. Research and innovation expenditure, which accounted in 2016 for 59 % of spending under this sub-heading, is made through the Seventh Framework Programme for Research and Development 2007-2013 (FP7) and Horizon 2020, the framework programme for 2014-2020. The Court considered that the level of error amounted to 4.1%. Most of the errors are related to the reimbursement of ineligible personnel costs, other ineligible direct costs (e.g. travel and equipment costs not related to the project) or ineligible indirect costs declared by beneficiaries. The Court recommended: (i) streamlining the Horizon 2020 rules and procedures by making greater use of simplified cost options (such as unit costs, lump sums, flat-rate financing and prices) in the revised Financial Regulation; (ii) reducing the time taken to close ex-post audits and improve internal processes for planning, monitoring and reporting of audits.

- Economic, social and territorial cohesion: in 2016, expenditure subject to audit in this area was EUR 35.7 billion. Expenditure comprises two main parts: (i) EU regional and urban policy, which together accounted for 76% of cohesion expenditure in 2016; (ii) the Employment and Social Affairs policy area, which accounted for 21% of cohesion expenditure in 2016. The Court considered that the level of error amounted to 4.8%. The principal sources of error in spending on Economic, social and territorial cohesion as a whole are the inclusion of ineligible costs in beneficiaries declarations, the selection of ineligible projects, activities or beneficiaries, and the infringement of public procurement legislation. Several Member States had difficulties in using all of their allocations. The Court recommends: (i) paying particular attention to areas in which there is a higher risk of ineligible expenditure or of the disclosure of inaccurate information that may lead to an over-reimbursement when closing the 2007-2013 programmes; (ii) strengthening the programme focus on performance and simplify the mechanism for payments.

- Natural resources: this heading covers the Common Agricultural Policy (CAP), the Common Fisheries Policy (CFP) and environmental measures. In 2016, expenditure subject to audit in this area was EUR 57.9 billion. With regard to rural development, the environment, climate action and fisheries, the Court identified ineligible beneficiaries, activities, projects and expenditure items, but also errors relating to ineligible land and overstated eligible hectares. Expenditure under this heading is affected by a significant level of error (2.5%).

The Court recommends reviewing the approach taken by paying agencies to classify and update land categories in their LPIS and to perform the required cross-checks, in order to reduce the risk of error in the greening payment. Guidance should be given to national authorities to ensure that their checks identify links between applicants and other stakeholders involved in the supported projects.

- Security and citizenship: the expenditure subject to audit in this area was EUR 2.4 billion. The Commission and the Member States have made very slow progress with payments under shared management from AMIF and the ISF. By the end of the 2015 financial year, no payments at all had been cleared by the Commission for 15 Member States. The Court also identified a number of weaknesses for SOLID, AMIF and the ISF that may delay the implementation of these funds, impair the Commission's assessment of Member State systems.

- Global Europe: for 2016, expenditure subject to audit in this area was EUR 8.3 billion, with spending disbursed across more than 150 countries. The estimated error rate is 2.1%. 37% of the estimated error is attributable to expenditure for which essential supporting documentation was not provided. Other important types of error include expenditure that either has not been incurred or is ineligible. DG NEAR commissioned a study to assess the Residual Error Rate (RER) in expenditure in this area. The Court recommends: (i) working together with the audit authorities in pre-accession beneficiary countries to improve their competence; (ii) developing risk indices; (iii) properly disclosing the scope of the RER study and the estimated lower and upper error limits in its next annual activity report.

- Administration: expenditure subject to audit of all EU institutions and other bodies was EUR 9.4 billion. Staff-related expenditure (such as salaries, pensions and allowances) accounted for about 60 % of the total. The remainder was spent on buildings, equipment, energy, communications and information technology. The examination of systems did not reveal any significant weaknesses overall. However, the Court recommends that the European Parliament reviews its framework for monitoring the implementation of budget appropriations allocated to political groups. It should also provide better guidance to political groups and monitor more effectively how they apply the rules for authorising and settling expenditure, and how they carry out procurement procedures.

It should be noted this year's analysis of follow-up concluded on 108 recommendations issued to the Commission between 2010 and 2013. The Court notes that the Commission implemented 90 recommendations fully or in most respects. Even recommendations that the Commission initially did not accept were in most cases implemented.