



EUROPEAN COMMISSION

**DIRECTORATE GENERAL FOR AGRICULTURE  
AND RURAL DEVELOPMENT**

# **ANNUAL ACTIVITY REPORT 2010**

**March 2011**

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# 1. Policy Achievements

## 1.1. Key messages of the Director General

After the Barroso II Commission took office in February 2010, the priorities for the next years were outlined in the Europe 2020 strategy and further developed in the Commission Work Programmes for 2010 and 2011. The most important contribution to this work programme for DG AGRI was the publication - after an extensive consultation of stakeholders - of the Communication: "*Common Agricultural Policy towards 2020. Meeting the food, natural resources and territorial challenges of the future*" in November 2010. This strategic initiative will be followed up by legal proposals later this year and will determine largely our work for the coming years.

Since the entry into force of the Treaty on the functioning of the EU ("Lisbon Treaty"), the CAP is for the first time co-decided by the European Parliament and the Council. In that context, the process of aligning agricultural legislation to the Lisbon Treaty required a lot of efforts in 2010 and will continue to do so this year.

Another priority in 2010 was the follow-up of the dairy crisis of 2008/2009. As a response to this crisis, a High Level Expert Group on Milk (HLG) was set up in October 2009 with the purpose to discuss and recommend mid-term and long-term arrangements for the dairy sector. At the end of 2010, the Commission adopted proposals meeting the first four recommendations in the report adopted by the HLG in June 2010.

The so-called 'Quality Package' was also adopted at the end of 2010. This package put in place for the first time a comprehensive policy on certification schemes, value-adding terms for agricultural product qualities, and product standards, covering the different facets of quality, from the compliance with minimum standards to the production of highly specific products.

For rural development, 2010 was the mid-point of the programming period 2007-2013. Although it is still too early to see the bulk of the impact of the measures on the ground, a stocktaking exercise provided some valuable input to the reflections on the future of the rural development policy.

As far as international negotiations are concerned, although much technical work was undertaken, only limited progress was made on substance in the ongoing negotiations in the framework of the WTO's Doha Development Agenda (DDA). Concluding successfully in this area will remain a priority. More success was achieved on a number of other bi- and multilateral negotiations, e.g. with Central American and Mediterranean countries.

Positive results were also achieved in the field of sound financial management with the error rate continuing to oscillate around 2%. Efforts to consolidate and further improve the situation will continue.

All this is just the tip of the iceberg. I would like to thank the numerous colleagues who carefully handled the maybe less visible day to day management of both pillars of the CAP and provided the necessary support tasks for the functioning of this DG. Finally, I would like also to thank my predecessor Jean-Luc Demarty for the impressive work he has accomplished during the past years.

## 1.2. Impact of policy

### 1.2.1. Introduction

The mission of the Directorate-General for Agriculture and Rural Development (DG AGRI) is to promote the sustainable development of Europe's agriculture and to ensure the well-being of its rural areas. This is reflected in the three general objectives set up for the work of the DG:

- To promote a viable and competitive agricultural sector which respects high environmental and production standards, ensuring at the same time a fair standard of living for the agricultural community.
- To contribute to sustainable development of rural areas, in particular through:
  - Improving the capacity of the agricultural sector to meet new challenges;
  - Contributing to preserving the environment and the countryside;
  - Improving the quality of life in rural areas;
  - Contributing to the improvement of quality of agricultural products;
  - Helping EU agriculture, forestry and rural areas to contribute to climate change mitigation and to adapt to its possible consequences.
- To promote the European agricultural sector in world trade.

A series of indicators have been developed to monitor the implementation of policy. Indicators relating to the three general objectives are presented in *tables 1.1-1.3*. Further details on these indicators as well as an overview of indicators for each of the main activities of the DG are available in *Annex 6*. Main events in 2010 for each of these activities are presented in *sections 1.2.2 to 1.2.9*.

**Table 1.1. Impact indicators concerning the general objective to promote a viable and competitive agricultural sector**

GENERAL OBJECTIVE	Impact indicators														
	Indicator	Target	Milestones (if any)	Current situation											
To promote a viable and competitive agricultural sector which respects high environmental and production standards, ensuring at the same time a fair standard of living for the agricultural community	% of total direct payments which is decoupled	calendar year 2010/budget year 2011 onwards: 91.5 % <sup>1</sup> ; calendar year 2011/budget year 2012 onwards: 92 % <sup>2</sup> ; calendar year 2012/budget year 2013 onwards: 93.6 %;		calendar year 2006/budget year 2007: 82.7 % calendar year 2007/budget year 2008: 83.6 % calendar year 2008/budget year 2009: 83.8 % calendar year 2009/budget year 2010: 85.3%;											
	Farmers' income developments	Keeping the ratio to other economic sectors		<table border="1"> <thead> <tr> <th>Farm income developments<sup>3</sup></th> <th>Labour cost index for industry and services (excl. public administration)<sup>5</sup></th> </tr> </thead> <tbody> <tr> <td>2010: +12.3<sup>4</sup></td> <td>2010: +1.2%</td> </tr> <tr> <td>2009: -11.6%</td> <td>2009: +3.1%</td> </tr> <tr> <td>2008: -2.2%</td> <td>2008: +4.2%</td> </tr> <tr> <td>2007: +10.7%</td> <td>2007: +3.7%</td> </tr> <tr> <td>2006: +4.2%</td> <td>2006: +3.0%</td> </tr> </tbody> </table>	Farm income developments <sup>3</sup>	Labour cost index for industry and services (excl. public administration) <sup>5</sup>	2010: +12.3 <sup>4</sup>	2010: +1.2%	2009: -11.6%	2009: +3.1%	2008: -2.2%	2008: +4.2%	2007: +10.7%	2007: +3.7%	2006: +4.2%
Farm income developments <sup>3</sup>	Labour cost index for industry and services (excl. public administration) <sup>5</sup>														
2010: +12.3 <sup>4</sup>	2010: +1.2%														
2009: -11.6%	2009: +3.1%														
2008: -2.2%	2008: +4.2%														
2007: +10.7%	2007: +3.7%														
2006: +4.2%	2006: +3.0%														

<sup>1</sup> Budget 2011.

<sup>2</sup> Based on the current communications from the Member States on the use of Article 68 of the Council Regulation (EC) No 73/2009.

<sup>3</sup> The change in agricultural income, measured as real net value added per annual work unit, compared to previous year.

<sup>4</sup> First estimate by EUROSTAT.

<sup>5</sup> EUROSTAT data.

**Table 1.2. Impact indicators concerning the general objective to contribute to sustainable development or rural areas**

GENERAL OBJECTIVE	Impact indicators			
	Indicator	Target	Milestones	Current situation
<p>To contribute to sustainable development of rural areas, in particular through:</p> <ul style="list-style-type: none"> <li>• Improving the capacity of the agricultural sector to meet new challenges</li> <li>• Contributing to preserving the environment and the countryside</li> <li>• Improving the quality of life in rural areas</li> <li>• Contributing to the improvement of quality of agricultural products</li> <li>• Helping EU agriculture, forestry and rural areas to contribute to climate change mitigation and to adapt to its possible consequences</li> </ul>	Increase in Gross Value Added (GVA) in supported holdings	Increase 2007-2013: € 25.9 billion	By 2010	Total GVA in primary sector: € 180 billion Increase realised by 2009 <sup>6</sup> : € 1.2 billion
	Maintenance of high nature value areas (changes in High Nature Value (HNV) areas)	Increase 2007-2013: 3 400 000 ha	By 2010	Utilised agricultural area of HNV: 74 700 000 ha <sup>7</sup>
	Increase in production of renewable energy	Increase 2007-2013: 20 500 ktoe	By 2010	7 941 ktoe from agriculture <sup>8</sup> 68 218 ktoe from forestry
	Employment creation (net additional full time equivalent jobs created) <sup>9</sup>	Jobs created 2007-2013: 346 000	By 2010	Employed people in primary sector: 13 million <sup>9</sup>
	Adequate protection of quality products – number of registered Geographical Indications	By end 2012: 1 100		2010: 994 2009: 918
	Share of greenhouse gas emissions from agriculture	Reduce		9% (current situation) 11% (1990)

<sup>6</sup> The low implementation level of the indicators is explained by the fact that most programmes were approved by late 2007. The programmes started in 2008 and 2009 showed a first acceleration in the implementation. Cruising speed for many of the rural development measures could be expected by 2010/2011.

<sup>7</sup> JRC HNV study 2008.

<sup>8</sup> The first measurement of this indicator was submitted by Member States in December 2010 in the context of the mid-term evaluations. Baseline presented is based on the *Rural Development in the European Union - Statistical and Economic Information - Report 2007 and 2009*.

<sup>9</sup> This indicator refers to the net additional full time equivalent jobs created directly in supported projects and indirectly in the programme area that can be attributed to the intervention.

**Table 1.3. Impact indicators concerning the general objective to promote European agriculture in world trade**

GENERAL OBJECTIVE	Impact indicators				
	Indicator	Target	Milestones (if any)	Current situation	
To promote the European agricultural sector in the world trade	Value of trade flows in agricultural products between the EU and the rest of the world	To increase		Year	Export in mio euro
				2000	55 232
				2008	81 214
				2009	74 578
	Proportion of subsidised exports in percentage of total export	Lower than current situation		2010 (EU27)	0.4% <sup>10</sup>
			2009 (EU27)	0.9%	
			2008 (EU27)	1.2%	
			2007 (EU27)	1.9%	
			2006 (EU25)	3.4%	

<sup>10</sup> Trade data from EUROSTAT

## **1.2.2. Interventions on the agricultural markets (ABB 02)**

The measures taken in 2009 to help dairy farmers out of the difficult market situation were followed up in 2010 by the High Level Expert Group for Milk with the purpose of discussing mid-term and long-term arrangements for this sector. Following the Council presidency conclusions<sup>11</sup>, the Commission adopted the legislative proposal on the contractual relations in the milk and milk products sector, meeting the first four recommendations of the High Level Group. This proposal is targeted at strengthening the bargaining power of milk producers in the supply chain and increasing stability and transparency in the market place.

The European School Milk Scheme is intended to encourage consumption among children of healthy dairy products containing important vitamins and minerals. The number of products eligible for this programme has been adapted and for the 2010-2011 school year, 26 Member States will serve around 21 million pupils.

Eating more fruit and vegetables can play an important role in combating obesity. In November 2008, the Agriculture Council of Ministers agreed on a Commission proposal for a European Union-wide scheme to provide fruit and vegetables to school children. The school fruit scheme became operational in the school year 2009-2010. In school year 2010-2011, the 25 participating Member States carried out this initiative aimed to increase the children's intake of fruit and vegetables and contribute to a better and more balanced diet and to healthier eating habits.

The programme for food distribution to the most deprived persons in the Union was covered by a EUR 500 million budget, compared to EUR 300 million before 2009. In September 2010, the Commission adopted a proposal amending the 2008 proposal to revise the food distribution programme, aligning it with the requirements of the Lisbon Treaty and incorporating certain adjustments requested by the EP and Member States.

The reform of the wine sector led to re-shaping the vineyard register, to categorising grapevine products and oenological practices and to presenting rules on designations of origin and geographical indications. Better balancing of the Commission and national support programmes is on track, and legal simplifications of rules on existing producer and inter-branch organisations contribute to their better enforcement. The Council approved the further reduction and soft landing measures of the German ethyl alcohol monopoly.

In 2010, the Commission made a proposal to the European Parliament and the Council on alignment of the single CMO with the Lisbon Treaty requirements. The single CMO includes the ongoing proposals on the quality package's marketing standards and origin, the milk package, food for the most deprived persons in the Union, and the adopted German ethyl alcohol monopoly proposal.

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<sup>11</sup> Council presidency conclusions adopted at the Council meeting of 27 September 2010.

### **1.2.3. Direct aid (ABB 03)**

#### **A. CAP post 2013**

A major task in 2010 was to contribute to the preparation of the post 2013 CAP. Several analytical notes were produced with a view to the elaboration of the corresponding Commission Communication published in November 2010<sup>12</sup>. The future of the system of cross compliance under the post 2013 CAP was further elaborated. It consists in further simplifying the system by streamlining its scope and better adapt it to the new challenges in particular the climate change. This approach will be discussed with other DGs concerned in 2011.

#### **B. "Lisbon alignment"**

The entry into force of the Treaty on the functioning of the EU ("TFEU") required a lot of efforts to align the legislation to the differentiation introduced by the treaty between *delegated* and *implementing* powers (see also *section 1.2.8*).

In September 2010, the proposal amending Council Regulation (EC) No 73/2009 of 19 January 2009 establishing common rules for direct support schemes for farmers so as to align it to the TFEU was submitted to the European Parliament and the Council. The aim of this alignment exercise is to adapt the Commission powers included in Council Regulation (EC) No 73/2009, and which are already implemented in Commission Regulations (EC) No 1120/2009, No 1121/2009 and No 1122/2009.

A full and thorough technical examination of the proposal was completed with the Council Working Party on "Horizontal Agricultural Questions" at the meetings held from 7 to 9 December 2010.

#### **C. Advanced payments**

11 Member States requested in 2010 the authorisation to pay advances of direct payments. The reason for those requests were, in addition to the continuation of the financial crises, exceptional weather conditions which placed the farmers concerned in severe financial difficulties. All requests were accepted and corresponding decisions were adopted by the Commission.

#### **D. Complementary National Direct Payments (CNDP) and Enlargement issues**

10 Commission Decisions were prepared to authorise national payments in new Member States in 2010.

The work on enlargement file progressed further, especially in the case of Croatia where the positions on the use of national reserve and on CNDPs under the single payment scheme were prepared for the approval by the Commission.

### **1.2.4. Rural Development (ABB 04)**

The common European Rural Development Policy seeks to establish a coherent and sustainable framework for the future of Europe's rural areas. The policy addresses those economic, social, and environmental challenges that the European rural areas are facing. The

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<sup>12</sup> COM (2010) 672

objectives of the policy are to improve the competitiveness of the agri-food sector, the state of the environment and the countryside, and quality of life in the rural areas.

Rural Development achieves its objectives mainly through the funding and implementation of 94 Rural Development Programmes. The Rural Development Policy also integrates environmental concerns into the CAP, for instance through promoting more environmentally friendly agricultural practices, organic farming and development of renewable energies. In addition, Rural Development policy contributes to the safety and quality of food through quality policy for agricultural products and developing policy with regard to biotechnology aspects. The support provided through the EAFRD (European Fund for Agriculture and Rural Development) also helps to maintain a balance between urban and rural areas in a competitive and knowledge-based economy.

The implementation of the **Rural Development Programmes through EAFRD** is progressing well. The EAFRD payment rate for Rural Development accelerated in 2010. By the end of 2010, €33.9 billion of the total budget of €96.2 billion were executed. Out of the €33.9 billion, €6.6 billion were paid as pre-financing arrangements. The rest €27.3 billion was paid as co-financing of actually incurred Rural Development expenditure on the basis of requests made by the paying agencies of the Member States.

The rate of budget implementation varies between Member States, the four thematic Axes of the policy, as well as between different measures within the Axes. By the end of 2010, Member States implemented between 23% and 58% of their allocated EAFRD funds (including advance payments). The expenditure declared by the Member States so far focuses on measures related to improving the environment and the countryside, for which 39.2% of the total EAFRD allocation related to these measures is paid out. For measures related to improving the competitiveness of agriculture 25% of the total EAFRD allocation is spent. The budget implementation mirrors the importance of these measures, which receive approximately 80% of the total EAFRD budget. The differences in budget implementation between different measures clearly show that investment measures (Axis 1, 3, and Leader) are slower to get started than area or animal-related payments. Leader, in particular, has experienced a slow start, but the implementation has accelerated in 2010, reaching 6.4% of allocated budget.

The **Health Check (HC) of the CAP and the European Economic Recovery Plan (EERP)** increased the Rural Development financial envelope by €4.95 billion in 2009 and 2010, increasing the total EAFRD budget from €91.3 to €96.2 billion. A supplementary advance (€401 million) corresponding to the budgetary increase was paid out in 2010. The HC budget was allocated to new challenges, for which the Member States could spend the funds according to their needs. The majority of the HC financing concentrated on bio-diversity (31% of all HC/EERP funds, i.e. €1.5 billion) and water management (27%, i.e. €1.3 billion), followed by dairy restructuring, climate change measures, and renewable energy. €360 million was spent on the development of broadband infrastructure. Altogether 88 Rural Development programmes were revised as a result of the increased funding. 81 of them were presented to the Rural Development Committee in 2009 and 7 in 2010. The implementation of the HC and EERP funds has started, but only a small share of the funds has been declared as expenditure to the Commission by the Member States during 2010.

Since 2010 was the mid-point of the programming period 2007-2013, taking stock of the Rural Development programme achievements so far was highlighted in the work of Member

States and the Commission. The Member States examined the progress towards the goals set in their National Strategy Plans (NSP) for Rural Development. The strategic summary reports on the progress made in the NSP implementation were submitted to the Commission in the autumn. Furthermore, 90 **mid-term evaluations of the Rural Development programmes** were submitted to the Commission by the end of the year. In addition, a seminar on ensuring good management of the Rural Development programmes was organised in Brussels in September. The focus of the seminar was on knowledge-sharing amongst the Member States and illustrating best practises. The stock-taking and experience-sharing exercises have also stimulated the DG AGRI contributions to the future of the Rural Development Policy.

As a follow-up to the Commission Communication on better targeting **aid to farmers in areas with natural handicaps**, all Member States submitted reports on simulations of the biophysical criteria based on the criteria set in the communication. The reports were analysed by DG AGRI and JRC. Subsequently, all Member States received comments in written form and during bilateral meetings. Afterwards a complete analysis of the simulations was conducted.

As the eligibility of payments for programmes (Objective 1, Leader+, SOP) of the 2000-2006 programming period was extended in 2009, the **closure of the programmes** started in 2010. After the final eligibility date for payments, the Member States had fifteen months to submit the final report and the financial closure documents to the Commission. For 40 programmes, the closure documents had to be submitted by the end of March. Out of these, 15 programme closures were completely finalised by the end of the year. For 106 programmes the closure documents had to be sent in by the end of September. 4 programmes from this second group were fully closed by the end of the year.

Council Regulation (EC) No 1698/2005 on support for rural development by the European Agricultural Fund for Rural Development was **aligned to the provisions of the Lisbon Treaty** (TFEU). The proposal, which was adopted by the Commission in September, contained also a number of simplification proposals.

The Act of Accession of Finland and Sweden provides for the possibility of granting national aid to agriculture (**Nordic Aid schemes**) in order to maintain agricultural activities in the Northern regions of these two Member States. Whereas the Finnish Nordic Aid scheme was revised in 2009, the Swedish revision was adopted through Commission Decision in September 2010.

In 2010, the **European Network for Rural Development (ENRD)** was functioning at full capacity. During the year, the ENRD website became fully operational. The contents were broadly expanded, and a French version of the website was also launched. The paper-based and electronic publications were disseminated on a more frequent basis.

Regular meetings of the ENRD Coordination Committee, the Leader sub-committee, and the Thematic Working Groups (TWG) were held. In addition, the ENRD organised two thematic seminars in 2010. The seminars focused on semi-subsistence farming and public goods in agriculture respectively. A fourth TWG, focusing on delivery mechanisms of the European Rural Development Policy, was set up in the beginning of the year. The three first TWGs, which addressed territorial targeting, linkages between agriculture and wider rural economy and public goods, finalised their work in December. Furthermore, the collection of relevant examples and good practises of projects funded under the EAFRD was launched.

The cooperation with the **National Rural Networks (NRNs)** was reinforced through regular exchanges and meetings with NRNs, as well as support to their own events. Moreover, the trans-national cooperation of Leader groups was reinforced. A cooperation guide was developed, and an on-line search tool for cooperation partners was made available. Cooperation offers were also advertised in numerous fairs and events. The ENRD was also used as a concrete networking tool, which enhanced the public debate on the future of the CAP.

In December 2010, the Commission adopted the "Quality Package", which covers all facets of **agricultural product and foodstuff quality** from compliance with minimum standards to highly specific products. It also includes two legislative proposals (on agricultural product quality schemes and marketing standards) and two Commission Communications setting out voluntary guidelines (on best practice for voluntary certification schemes and on the labelling of products using geographical indications as ingredients). The "Quality Package", which was supported by an impact assessment, follows the Green Paper stakeholder consultation and the Commission Communication on agricultural product quality policy (respectively in October 2008 and May 2009).

In 2010, a study done for the Commission showed that more than 400 food quality certification schemes are operating in the EU. These schemes are increasingly used by retailers and farming groups to communicate to product characteristics and methods of production to the consumers. The results of the study formed the empirical background for the development of voluntary best practice guidelines for certification schemes.

With 99 new names added to the registers for **PDOs, PGIs and TSGs**<sup>13</sup>, the total number of registered agricultural products and foodstuffs rose to 994. In addition, 25 amendments of existing registered names were approved, and 31 applications were withdrawn by the applicants following analysis and comments by the Commission services.

The **new logo for organic products** was adopted by the Commission in March. The new logo entered into force on 1<sup>st</sup> July 2010. It is compulsory for pre-packed food, but optional for imported products. However, a transition period of two years is foreseen to allow for a smooth implementation of changing labels by the operators.

On 17 December 2010, the Commission adopted a proposal to amend Council Regulation (EC) No 834/2007 with a view to align the Commission powers to the Lisbon Treaty. Most of the Commission acts related to organic farming would be delegated acts.

The members of the EGTOP (expert group for technical advice on organic production) were appointed by the Commission and a pool list created. In the future, EGTOP is expected to deliver recommendations to the Commission for developing the EU standard for organic farming, for instance by recommending the addition of new substances to the list of authorised pesticides, fertilisers, or processing aids.

The equivalence between the Japanese and the EU standard was recognised, while significant progress was made in the examination of equivalence for the USA and Canada.

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<sup>13</sup> Protected Designations of Origin; Protected Geographical Indications, Traditional Specialities Guaranteed.

Contributions to Community environmental policy (biodiversity, water, soil, climate change) were provided in view of implementing the 6<sup>th</sup> Environment Action Programme, in particular by ensuring the **coherence with the requirements of sustainable agriculture**. Contributions to the **integration of environmental requirements** into the CAP was pursued by contributing to ongoing work on the CAP post-2013, notably concerning measures encouraging the delivery of eco-system services by agriculture. Progress was made in managing and implementing the 17 actions under the Community programme on the conservation, characterisation, collection and utilisation of **genetic resources** in agriculture (Council Regulation (EC) No 870/2004).

Practical guidelines and measures to ensure the co-existence of **genetically modified organisms** with conventional and organic farming in line with the European Strategy for Life Sciences and Biotechnology were provided. Analysis of the implications of asynchronous GMO approvals for EU imports of animal feed products and contribution to the conception and development of EU policy on low level presence of EU unauthorised GMOs in imported agro-commodities have been developed.

Work continued on contributions to further integrating **climate change** concerns into the CAP, in particular as regards the orientations for rural development post-2013. The expert group on climate change and agriculture met once. The discussion focused on the prospective impacts of climatic changes on EU agriculture, adaptation and mitigation action plans on national and regional level and grassland and soil carbon management. A study on greenhouse gas emissions from the EU livestock sector was finalised. Furthermore, contributions were made to the implementation of the Directive on **Renewable Energy**, in particular concerning bio fuels and their indirect effects, and the analysis of national Renewable Energy Action Plans. A number of actions of the EU Forest Action Plan were completed, including working group reports on forestry and climate change as well as on public procurement guidelines for wood and wood products.

### **1.2.5. SAPARD/IPARD (ABB 05)**

Whereas SAPARD (Special Accession Programme for Agriculture and Rural Development) was phased out and prepared for closure in 2010 for the three remaining Sapard beneficiary countries Romania, Bulgaria and Croatia, preparation for accession in the areas of agriculture and rural development continued under the rural development component – IPARD – of the Instrument for Pre-accession assistance (IPA). IPA supports the efforts of the following Candidate Countries (currently Turkey, Croatia and the former Yugoslav Republic of Macedonia) and potential Candidate Countries (Serbia, Bosnia and Herzegovina, Kosovo<sup>14</sup>, Albania and Montenegro) preparing for EU accession.

Under SAPARD, assistance was provided from 2000 – 2006 to ten new Member States<sup>15</sup> and in 2006 for Croatia. The SAPARD Programmes of the eight new Member States, which joined the EU on 1 May 2004, were completed by the end of 2008. The final applications for payment for the SAPARD programmes of Romania (RO), Bulgaria (BG), which joined the EU on 1 January 2007, and Croatia (HR) were submitted at the end of 2009 to the Commission.

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<sup>14</sup> As defined in UNSCR 1244.

<sup>15</sup> Poland, Lithuania, Latvia, Estonia, the Czech Republic, Slovakia, Slovenia, Hungary, Romania, Bulgaria

The total amount of Community contribution declared by these three countries was € 1.341 billion for 7,139 completed projects, of which 3,420 for farm investments, 768 for marketing and processing, 887 for infrastructure and 1,490 for diversification. The co-financed nature of SAPARD results in a leverage effect, because of the use of additional public and private funds for the financing of the projects. Community funds declared by BG, RO and HR under the programmes of € 1.341 million, together with national public and private funds, result in a total amount of € 3.92 billion of expenditure. Therefore, every Euro, given by the EU under SAPARD, results in an investment of € 2.18.

The Community contribution finally used by the three remaining SAPARD countries represent 72.3 %, 86.9 % and 48.3% respectively of the amounts initially allocated to Bulgaria, Romania and Croatia. Unused allocations were de-committed in 2010. Due to action plans put in place in 2008 and 2009 for Bulgaria and Romania to remedy control deficiencies, the closure procedure of these programmes, which started in 2010, is ongoing and should be finalised in 2011. Final Implementation Reports for the three countries must be analysed and approved by the Commission. The clearance of accounts procedures for Bulgaria and Romania are also ongoing. The 2009 accounts for Croatia have been cleared in 2010.

From 1 January 2007, IPA provides the basis for the co-ordination, management and implementation of the pre-accession strategy by the Commission. It is split into five components<sup>16</sup>, one of which is IPARD.

IPARD assists Candidate Countries<sup>17</sup> (CCs) with the preparation for the implementation of the "acquis communautaire" of the CAP and to align to EU structures, through the provision of financial assistance under multi-annual rural development programmes. Assistance under these programmes is based on the condition that the CCs have set up the required institutions and management and control capacity for the implementation of IPARD. IPARD also provides support to the CCs national administrations to implement certain types of rural development measures and approaches, such as agri-environmental schemes and LEADER type measures.

In 2010, the Sectoral Agreement, setting out the detailed rules for the management of IPARD on a fully decentralised base without ex-ante controls by the Commission, entered into force in TR subsequent to the conclusion of such agreements with HR and FYR of Macedonia in 2009. The Commission conferred the management of aid for two measures to HR in November 2009 and for three in the FYR of Macedonia in December 2009. Three additional measures received national accreditation in HR during 2010 and conferral is expected for early 2011. After the conclusion of the Multi-annual Financing Agreements (MFAs), representing the legal commitments of the Commission in 2010, the pre-financing payments for HR and FYR of Macedonia have been made. After a series of delays by the Turkish authorities, the national accreditation for 5 measures of the Turkish IPARD Programme was finally achieved in July 2010. Conferral of management is now expected to be granted for a first set of measures in a limited number of provinces in the second quarter of 2011.

In 2010, the Croatian Programme was modified adding an additional financial allocation for the year 2012 in accordance with the amounts adopted in the framework of the Multi-annual

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<sup>16</sup> Components I) capacity building; II) cross-border co-operation; III) regional development, IV) human resources and V) Rural Development (Instrument for Pre-Accession Assistance Rural Development – IPARD).

<sup>17</sup> Turkey (TR), the former Yugoslav Republic of Macedonia (FYR of Macedonia), Croatia (HR)

Indicative Planning Documents (MIPDs), the strategic document setting out the main priorities for the use of pre-accession assistance under IPA. An additional Programme modification to include additional technical details in preparation for conferral of management was prepared and put through ISC. The Commission decision is expected in early 2011.

For the potential Candidate Countries (pCCs) preparations for IPARD and the related management and control system have been intensified in 2010 through the implementation of capacity-building projects, meetings and a growing number of advisory missions. The IPARD Managing Authority and IPARD Agency have been designated in Albania, Montenegro and Serbia and a first draft IPARD Programme was submitted from Albania and commented upon by the Commission.

### **1.2.6. External relations (ABB 06)**

The successful conclusion of the Doha Round remains a top priority for the EU in 2011. However, in 2010 only limited progress was made on substance in the on-going negotiations in the framework of the WTO's Doha Development Agenda (DDA), although much technical work was done.

As in previous years, the EU fulfilled its obligations with respect to the implementation of the Uruguay Round Agreement on Agriculture through notifications concerning domestic support, market access commitments, licensing, export subsidies and food aid and notifications under the Subsidies and Countervailing Measures agreement.

The EU and **Central American** countries concluded negotiations for an Association Agreement in May 2010. This Association Agreement includes a comprehensive trade pillar. The EU also concluded FTAs with **Peru** and **Colombia**. The text of these two agreements is currently undergoing legal review and will be initialled as soon as this review is finalised. Exploratory talks also took place with Ecuador to evaluate its possible adhesion to the Andean Community Multiparty Trade Agreement. The EU and **Mercosur** conducted until the beginning of 2010, the informal process of contacts that was initiated in 2009 to assess if the conditions for a successful re-launch of the negotiations were present, and in May 2010, agreed on re-launching the negotiations that were suspended in 2004. Three rounds of negotiation took place in 2010 and the discussions are due to continue in 2011.

Four rounds of negotiations for an FTA with **India** were held with a view to concluding negotiations. Substantial progress was achieved in 2010, leading to a strong bilateral commitment to complete substantial negotiations in the spring of 2011.

Bi-regional Free Trade talks with **ASEAN countries** were suspended in spring 2009 and will be replaced by bilateral Free Trade Agreements. Negotiations with Singapore were launched in 2010 and four negotiation rounds took place. Negotiations with Malaysia were opened in December 2010.

Exploratory meetings took place with **Chile** and **Mexico** to assess whether current tariff market access conditions could be further improved in accordance with the review clauses of the existing agreements between the EU and these countries.

Major results have been achieved in 2010 trade negotiations on liberalisation of agriculture products with **Mediterranean countries**. Agreement with Morocco has been signed by the Council in December 2010 and now awaits the European Parliament approval. Agreements signed with Egypt and Israel in late 2009 entered into force on 1 January 2010 (Israel) and on 1 June 2010 (Egypt). Negotiations with Tunisia are very advanced and EU could conclude these negotiations rapidly, taking into account the current political situation of Tunisia. Consultations with Algeria are ongoing regarding the decision of Algerian authorities not to open specific tariff rate quotas foreseen in the association agreement concerning EU preferential treatment.

Negotiations with **Norway** on further liberalisation of agricultural trade concluded in January 2010, and the Draft Agreement adopted by the Council in November 2010 and submitted to the European Parliament for its consent. Five more negotiation rounds have been held with Ukraine and three with Switzerland to make progress in the trade negotiation.

Much effort was made to achieve concrete results in the **protection of Geographical Indications**. Negotiation has been finalised with Switzerland, proposal was submitted to the Council and Parliament in 2010. The agreement with Georgia was concluded on the negotiators level and initialled. Negotiation with Moldova reached its final stage, and the talks with Ukraine continue.

Following the opening of negotiations on an agreement for mutual protection of Geographical Indications in the **EU-China summit** in the end of 2009, two formal negotiation meetings took place in 2010. Negotiations will intensify in 2011. With regard to **EU-Canada FTA**, the negotiations continued throughout 2010 and substantial progress was achieved. As for **EU-Korea FTA**, the agreement was signed on 6 October 2010, and this will substantially improve market access for EU exports.

A carousel of duties on certain EU exports to the US was avoided via the EU-US beef/hormones settlement. The implementation of the settlement has run smoothly. A similar arrangement has been reached for Canada on beef-hormones, which should result in Canada removing sanctions on EU exports. In order to compensate EU producers for a discriminatory tax on wine, the Commission has achieved that Canada reduces import duties on certain EU wines to an amount equivalent to the amount of discriminatory tax.

Following intervention by the Commission, **Japan** has extended the recognition of equivalency of organic systems to the 12 new Member States, thus facilitating exports.

After lengthy negotiations the cheese quota by **South Africa** was opened with a substantial rise in exports as from April-May 2010.

### ***Enlargement***

As regards EU enlargement, accession negotiations with Croatia on chapter 11 - Agriculture and Rural Development continued during 2010 and reached the decisive stage. DG AGRI contributed to the Commission's Opinions on the EU applications of Iceland, Montenegro and Albania.

DG AGRI continued to provide guidance to candidate countries and potential candidates in order to advance their preparations for accession to the EU in the area of agriculture and rural

development. Substantial contribution to EU assistance programming and project identification documents in the framework of IPA was provided on time.

Implementation of Stabilisation and Association Agreements (SAA) and trade relations were effectively monitored.

In framework of the Progress Reports 2010 on the state of preparedness of candidate countries and potential candidates Commission's assessment confirmed uneven progress in the area of agriculture and rural development.

### **1.2.7. Audit (ABB 07)**

The management of agricultural expenditure is mostly shared between Member States and the Commission. Member States check and pay farmers and other beneficiaries, while the Commission remains ultimately responsible for the management of EU funds. In order to assume this responsibility, the Commission performs audits in Member States to ensure that EU funds have indeed been managed properly. Important actors in the management and control systems at Member State level are the paying agencies, certification bodies and coordinating bodies.

The objective of the audit programme of DG AGRI is to provide the Commission with reasonable assurance that agricultural expenditure has been paid out in a legal and regular manner. If audits show deficiencies in Member States' management and control systems, the Commission excludes the expenditure affected by these deficiencies from EU financing by imposing corresponding financial corrections on Member States. Lessons learned from such audit findings are also used to further improve the management and control systems.

In 2009, the European Court of Auditors for the first time published an annual report which concluded that the error rate for agricultural expenditure as a whole was below the materiality threshold of 2%. In 2010, the Court estimated the most likely error for agriculture to lie between 2% and 5%. Still, the Commission considers that an error rate, which over the recent years oscillated around 2%, confirms the overall positive assessment of previous years. This is also supported by the control statistics which Member States provide to DG AGRI on an annual basis and which for financial year 2010 show an overall residual error rate of 0.69%. The audit strategy of DG AGRI has played a key role in achieving this result.

Efforts continue to consolidate and further improve the situation. 96% of the number of audits planned for 2010 were carried out, and shorter average deadlines for finalizing audit reports and for observation letters were fixed. Updated guidelines on the statement of assurance<sup>18</sup>, the annual summaries (synthesis reports)<sup>19</sup> and the financial clearance process<sup>20</sup> were provided to Member States.

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<sup>18</sup> The director of each paying agency must provide an annual statement of assurance, accompanied by an opinion from the certification body.

<sup>19</sup> In Member States with more than one paying agency, the coordinating body must draw up an annual summary (synthesis report) of the statements of assurance and opinions thereon.

<sup>20</sup> Financial clearance is done when the Commission adopts a decision by which it accepts the annual accounts of a paying agency. This decision is based on information which the Commission receives from the certification body.

In order to further improve the assurance on legality and regularity at the level of the final beneficiaries, two further initiatives have been taken. First, starting from claim year 2010, Member States are obliged to assess the quality of their Land Parcel Identification Systems<sup>21</sup> with the help of the Joint Research Centre. Second, Member States have been invited to ask their certification bodies to re-perform, for each paying agency and expenditure population, a representative sample of transactions which the paying agency has checked on-the-spot. If on this basis the certification body is able to confirm the reliability of the Member State's control statistics, then the Commission will accept that the resulting error rates represent the maximum financial risk to the EU budget and will limit any financial corrections for deficiencies in the Member State's management and control systems to the error rate derived from the control statistic concerned. For both initiatives, the results of their first year of application are being or will be examined with a view to improving their operation in the future.

### **1.2.8. Policy strategy and coordination (ABB 08)**

During the course of 2010, DG AGRI launched the Impact Assessment Steering Group on the future of the CAP. It also prepared the Communication "CAP towards 2020", adopted in November. Also in 2010, the first of a set of "Agricultural Policy Perspectives Briefs" was launched.

DG AGRI continued to carry out a large number of economic and policy analyses related to the development of agricultural markets, short- and medium-term outlook, the development of food prices and agricultural income as well as the impact of economic crisis. A specific publication analysed the organic farming sector. In addition, analyses relevant for rural development provided insight into e.g. the structural development of the EU farm sector, agri-environmental issues and the standard of living and economic growth in rural areas.

In 2010, the development of the future farm return (definition of farm data collected by the EC) continued. The information system used by the Commission and Member States for the Farm Accountancy Data Network was upgraded. 2008 accounting year data for all MS but one (to be finalized in early 2011) were checked and prepared for use and all the data for accounting year 2009 collected.

6 ex-post evaluations were completed. These evaluations address the assessment of the effects of the CAP reform on the beef and the starch sectors, the environmental impacts of pig and poultry production, the markets effects of partial decoupling, Leader+ and the Sapard programmes. Seven new evaluations were launched in 2010, and the European Evaluation Network for Rural Development continued to provide support to the Member States for the implementation of the ongoing evaluation system of the rural development programmes 2007-2013, notably concerning the mid-term evaluations carried out in 2010.

More specifically on international aspects: options for the future of the CAP were assessed against the background of WTO negotiations, analytical support for on-going trade negotiations was provided (including modelling work), trade analysis was updated, deepened and published. In addition to the usual work on commodity markets (price monitoring, outlook comparison), specific issues were addressed (volatility, derivatives). Developments in

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<sup>21</sup> The Land Parcel Identification System contains information on agricultural parcels in Member States based on photos/satellite images

other key players were monitored, especially: related OECD work, analysis of costs of production. Several documents were put on-line (intra and internet) to enhance communication.

DG AGRI continued to drive the simplification process further: it kept the DG's Simplification Action Plan Rolling, ensured the continued follow-up to the list of 39 simplification suggestions and maintained a constructive relationship with other services of the Commission involved in simplification, as well as with the Stoiber group.

A training programme, named "the Harvest experience", was set up for DG AGRI officials so as to help them form a better understanding of the challenges faced by the agricultural sector and to collect simplification ideas.

Efforts were made for the legal implementation of the results of the Health check in the form of revised Commission regulations. In the area of state aid, the DG ensured a smooth and efficient handling in particular of notifications. In addition, it managed to close a number of difficult cases. The monitoring of the application of EU law by Member States included in particular a follow up of the Czech Republic's non-compliance with the reasoned opinion of the Commission concerning the use of the sales designation "Pomazánkové máslo" ("spreadable butter"). Consequently, in September 2010 the Commission decided to refer the case to the Court of Justice. Moreover, the Court of Justice at the end of 2010 issued a judgment against Italy for failing to amend its legislation on the labelling of chocolate products. The correct implementation of the Court decision is currently under scrutiny. The Directorate also ensured the smooth and effective operation of the agri-relevant internal and external decision-making procedures, sometimes under considerable time pressure.

Due to the entry into force of the TFEU in 2009, an important task was DG AGRI's preparation for the changes the new Treaty would bring about. To this end, an internal working group was created and there was a close collaboration with the Secretariat General and the Legal Service in particular as regards the new institutional arrangements for delegated and implementing Commission powers which will play an important role in DG AGRI's future CAP implementation activities. A significant number of legislative proposals for the alignment of the agricultural *acquis* on the institutional requirements resulting from the Lisbon Treaty was elaborated.

This division of existing Commission powers was done on the basis of a thorough screening of the basic act and the relevant Commission implementing acts. Their delegated or implementing character was decided on the basis of objective legal criteria in accordance with the definitions in Articles 290 and 291 of the TFEU.

Delegated acts were provided in all cases of "quasi-legislative acts" in the sense that they regulate non-essential elements of the legislative act, are of general application and amend or complete the legislative act itself. Implementing acts were provided for all acts of an "executive" nature in the sense that Member States are responsible for the implementation and there is a need for a uniform application.

DG AGRI was also closely involved, under the chairmanship of the Secretariat General, in the elaboration of the Commission proposal for a horizontal Regulation on the new comitology and after the proposal had been adopted, followed closely the negotiations in the EP and the Council. In that way it has been possible to make sure that the specific needs for the management of the agricultural markets could be considered and taken into account in the

final version which has been agreed between the EP, the Council and the Commission and which is scheduled to enter into force on 1 March 2011.

### **1.2.9. Administrative support for DG AGRI (AWBM 01)**

By the nature of the work, this activity is less visible to the citizen. However, it contributes to the good functioning of the DG and its operational activities by providing the necessary financial, human and IT resources and safeguarding their proper use in the DG. This is a continuous activity throughout the year and its results feed into the work of all units and directorates.

Detailed indicators and results for all ABB levels can be found in *Annex 6*.

## 2. Management and internal control systems

### 2.1. Introduction to DG Agriculture and Rural Development

The responsibility of DG AGRI is to ensure the application and development of the Common Agricultural Policy (CAP) as provided for by the Treaty. The policy is divided into two pillars: the **first pillar** consists of a framework for supporting the income of farmers through the payment of direct aid and a system for managing and supporting agricultural markets. The **second pillar** of the CAP provides a framework to support the development of rural areas of the Community. In general, the first pillar is 100% financed by the Community Budget, whereas the second pillar is co-financed between the Community Budget and the Member States.

Beneficiaries of the CAP are primarily farmers, in line with the Treaty objective to ensure a reasonable standard of living for the farming community. Other direct beneficiaries are operators in the food industry, who receive support for the disposal of products on either the internal market or for export. Following the consecutive reforms of the CAP, the by far largest part of support is now provided through direct aid. DG AGRI's main stakeholders are those who live in rural areas, organisations representing farmers, the processing industry and organisations involved in promoting the living conditions in rural areas and protection of the environment.

#### 2.1.1. Management modes

DG AGRI operates within three management modes:

- **Shared management:** Both pillars of the CAP are implemented under shared management. Implementation of the policy vis-à-vis the final beneficiaries is delegated to the Member States, while the Commission is responsible for the overall legal framework and for the implementation of the Budget. It supervises the work of the Member States;
- **Decentralised management:** The Sapard/IPARD pre-accession programme is implemented under decentralised management, i.e. implementation vis-à-vis the final beneficiaries is delegated to the authorities of the beneficiary third country;
- **Direct centralised management:** A relatively small part of DG AGRI's activities is under direct management. It mainly concerns contracts entered directly with third parties for supplying services to DG AGRI, for example studies, information and communication activities.

Total Community expenditure (commitments) in 2010 under the responsibility of DG AGRI was EUR 58.771.046.860,79. Of this, EUR 58.689.742.047,90 (99.86%) was under shared and decentralised management with the Member States. DG AGRI's direct managed expenditure for actions carried out by the Directorate General itself only represented EUR 81.304.812,89 (0.14%) of expenditure.

Overall, in 2010, execution rates of commitments and payments appropriations of DG AGRI have both decreased in relation to 2009. In 2010, 97% of commitments appropriations and 95% of payment appropriations have been executed (98% for both commitments and payments in 2009). The total amount committed of EUR 58.771 million decreased by 2% and the total amount paid of EUR 55.501,7 million increased by 0.7%, compared to 2009.

It should be noted that no suspension or interruption of payments occurred in 2010. More detailed financial data such as financial reports and draft annual accounts is presented in Annex 3.

## **2.1.2. Financial circuits in DG AGRI**

DG AGRI has in total five financial circuits in place for the management of the corresponding financial resources. The circuits can be divided into three main circuits and two additional ones (Abnormal Stock and Accounting). The circuits are set up in conformity with the principles established by the Financial Regulation, its implementing rules (in particular the principle of separation of responsibilities between initiation and verification) and the general guidelines issued by DG BUDG.

The main financial circuits are:

- Circuit N° 1: EAGF
- Circuit N° 2: EAFRD, EAGGF-Guidance section, Sapard and Ipard
- Circuit N° 3: Direct Centralised Management

A description of these main financial circuits can be found in the DG AGRI Annual Activity Report for 2008.

## **2.1.3. Cross delegations**

In 2010, DG AGRI has cross-delegated activities to five other DGs (JRC, ESTAT, EMPL, PMO and SANCO), see *table 2.1*. In addition, a sub delegation was given to DEVCO (ex-AIDCO) only to allow recoveries in a specific file (no credits involved so not included in *table 2.1*).

**Table 2.1. Cross delegations, 2010.**

Crossed Subdeleg. To:	JRC	ESTAT		EMPL	SANCO	PMO
<b>Budget Line</b>	<b>05.080300 (CD) *</b>	<b>05.080200 (CD)</b>	<b>05.080300 (CD)</b>	<b>05.040502 (CD)</b>		<b>05.040502 (CP)</b>
<b>Transferred Credit (CE ***)</b>	1.460.000,00	15.100.000,00	0,00	220.000,00		
<b>Transferred Credit (CP ****)</b>	1.515.000,00	10.538.838,85	128.293,90	47.000,00		600.000,00
<b>Consumed Credit (CE)</b>	1.459.511,60	14.784.854,04	0,00	219.730,00		
<b>Consumed Credit (CP)</b>	1.414.850,90	9.802.660,19	106.186,25	0,00		217.395,63
<b>Budget Line</b>	<b>05.070102 (CND) **</b>			<b>05.010404 (CND)</b>	<b>05.010201 (CND)</b>	
<b>Transferred Credit</b>	6.500.000,00			0,00	13.500,00	
<b>Consumed Credit</b>	6.486.029,44			0,00	13.500,00	

\*CD – Cr dit dissoci 

\*\* CND – Cr dit non dissoci 

\*\*\* CE – Cr dit d'engagement

\*\*\*\* CP – Cr dit de paiement

## **2.1.4. Working arrangements**

The exchange of information between DG AGRI and the Commissioner and his cabinet is governed by the working methods of the Commission 2010-2014 which lay down, amongst other things, the rules on consultation of the Cabinet. In DG AGRI:

- A regular dialogue is maintained through a meeting between the Commissioner and his cabinet and the Director General and the Deputy Directors-General (CAB-AGRI), held in principle every second week to exchange information and decide on any policy issues and/or important step to be taken - other meetings have been organised when needed.
- A half-yearly reporting to the Commissioner on the internal control environment has been regularly ensured in DG AGRI.

## **2.2. The functioning of the entire internal control system**

### **2.2.1. Compliance with the requirements of the control standards**

The Internal Control Coordinator supervises closely formal and effective compliance with the standards by assessing information provided by lead services ("chef-de-file") in the DG. This structured desk review complements other reporting tools in place for a continuous supervision of the proper functioning of the DG, in respect of the planning of activities, budgetary execution, risk management exercise, follow-up of audit recommendations etc.

- The Internal Control Coordinator made a preliminary assessment of compliance with the requirements under the internal control standards in the middle of the year; checked progress of planned actions in the remaining part of the year, in order to deem continued compliance and effectiveness; and, finally, reviewed the situation as of year-end, in the light of action taken and of the latest figures of relevant indicators.
- The desk review was completed with the assessment of information in DG AGRI managers' reports on supervision carried out on the activities under their responsibility, covering as well other important developments in the internal control environment, namely on ethics, deviations from established procedures and potential internal control weaknesses. Managers' reports for 2010 did not show any significant issue affecting the operational performance or the legality and regularity of the activities in the DG. Deviations from established procedures, for which the prior approval of the Director General was requested and provided in the reporting year, remained very limited in number (three, against five instances in 2009 and seven in 2008) and not systemic in nature. Finally, no significant or systemic internal control weaknesses were brought up as a result of management supervisory activities in the DG.

Based on this comprehensive review, DG AGRI considers being fully compliant with all the requirements of the internal control standards in 2010.

As for the derogations to the mandatory staff mobility requirement for sensitive functions, four jobholders would have been exercising the same sensitive function for more than 5 years at the end of 2010. Under the general mobility exercise, mobility was decided for two of them, and became effective on 1.2.2011. The Director General decided to grant a derogation to the other two jobholders, further to a risk assessment carried out in collaboration with the Internal Audit.

## **2.2.2. Effectiveness of implementation of the prioritised control standards**

The review of effectiveness of the prioritised control standards was carried out by the unit in charge of Internal Control, in cooperation with the Internal Audit.

Workshops were held in September with a sample of staff, randomly selected at all levels and functions other than management, and in October with a focus group of middle managers. A number of questions for measuring effectiveness were addressed, and the results were discussed with participants. The highlights of the exercise were presented to senior management in a coordination meeting early 2011, which provided additional input for concrete actions for improvement subsequently validated by the Director General.

The reasons for the choice of the prioritised standards, action taken and underway to ensure effectiveness, and the main results are summarised as follows:

### Processes and Procedures (internal control standard No 8)

#### *Reason for the choice of the standard:*

The standard, already selected in 2009, was maintained in order to pursue efforts to improve the quality of documentation of the DG's procedures, with a particular focus on the design and content of their intranet site.

#### *Action taken:*

- Continuous action was taken in the course of the reporting year by the officer in the Internal Control unit entrusted with steering the DG documentation exercise. In addition to verifying the presence of the necessary information elements before formal validation, this action entailed more and more a helpdesk function for the operational services in charge of developing new and/or updated procedures, so as to improve the quality of information.
- Attention was paid as well to raising staff awareness, through various information activities such as an article in the DG internal communication magazine and presentations to newcomers, in addition to the regularly provided internal control training sessions.
- In 2010 the intranet site with the main DG operational and financial procedures was revamped. It now features a structure based on the activities as defined in the

Management Plan, is accompanied by an alphabetical index for easier access to information, and provides regular highlights of news.

*Results of the effectiveness review and action underway:*

- The two workshops with staff which took place in the autumn to review the effectiveness of this control standard confirmed the positive perception of documented procedures for carrying out effectively the daily tasks and for ensuring business continuity in the DG.
- As for the use of the intranet section on procedures, the feedback by participants to the exercise suggests that the new initiatives, which at that point of time had only recently been launched, had not yet produced visible results.
- The results on staff awareness of how to deal with exceptions to procedures were not satisfactory. They should be read in the light of the composition of the sample, bringing together colleagues randomly selected at all functions/grades and with a different experience/seniority in the job, obviously concerned to a very different extent by this requirement for which management plays a key role. Secondly, this is a common challenge to other DGs, as shown by the discussions that took place in the Internal Control Coordinators network and signalled the need for complementary guidance at the Commission's level.

Actions already taken and underway to enhance staff awareness on how to deal with exceptions to procedures:

- DG AGRI management has been invited to discuss this item with staff, and mention it in the 2010 annual supervision report.
- Presentations have been provided to unit meetings, upon request; a more systematic information action will follow.
- Training on internal control, tailored so as to focus on how the control standards are implemented in the DG, is mandatory for newcomers as from 2011.

The standard is maintained as priority in 2011 to pursue these efforts.

#### Evaluation (internal control standard No 14)

*Reason for the choice of the standard:*

The standard was selected as DG AGRI manages policies and activities at the heart of EU agenda and public debate, for which high quality evaluation is crucial. The review of effectiveness was meant to take stock of good practice and look for areas and concrete action for improvement, in the light of the recent developments at the Commission's level calling all DGs to step up their efforts.

*Action taken:*

Training sessions on carrying out impact assessment in DG AGRI were provided in the course of the reporting year, in addition to those organised by the Commission's central services, for greater staff awareness. Roadmaps were prepared for several DG AGRI initiatives included in the 2010 Commission work programme which, by setting out the main features of

the initiatives and the plans for an impact assessment where relevant, enhance the transparency of the stakeholders' consultation process. Extensive work was carried out in the DG in relation to the preparation of the Communication on the future of the Common Agricultural Policy: a task force was created to produce a set of political and analytical notes, various working groups were set up for the impact assessment, and the steering group for the impact assessment was launched.

As for retrospective evaluation, in 2010 all planned evaluations of agricultural and rural development measures and instruments were completed and all planned new evaluations were launched. The DG evaluation function undertook various awareness-raising activities, such as lunchtime debates on key issues from evaluation reports and the animation of questions and answers sessions for rural development desk officers. Efforts for increasing Member States' involvement in the evaluation process, within the rural development policy, are bringing positive results<sup>22</sup>.

*Results of the effectiveness review and action underway:*

The review of effectiveness of this standard featured two workshops with staff, aimed at gathering the general awareness of the main features of the evaluation process in the DG, and a workshop with a selection of managers, as the assessment of the relevance and impact of evaluation requires a managerial perspective.

It showed that, while no major improvements are warranted, there are some aspects to be followed up for greater effectiveness of the standard.

- More in detail, the results of the review were positive for the general staff awareness of the evaluations carried out in the DG, in respect of their purpose or scope and of how they are integrated in the activities' cycle. The concrete steps to be taken when conducting evaluations would not be necessarily known: again, this should be seen against the composition of the staff sample, in which only a minority of colleagues have been or are directly involved in carrying out impact assessment, evaluation and studies. Information and awareness-raising activities for all staff will be pursued in the course of 2011.
- As for the planning of evaluations, the involvement of staff varies across units, as does the extent to which senior managers are involved in the overall process. One of the conclusions of the exercise is that evaluation would benefit from a greater degree of forward planning and strategic direction: action will be taken by enhancing the role of senior management.
- Evaluations are considered to have a clear impact on the DG's policies and activities and to be useful for the work in the respective units – discussions showed several good examples and areas for improvement as the use of evaluations for operational and reporting needs could be further enhanced.
- Information and communication was an area with mixed results. While efforts made to accompany the evaluation reports with summaries and/or analytical notes providing for politically relevant, concise and easily comprehensible information have been acknowledged, the dissemination of results remains a challenge.

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<sup>22</sup> Information on impact assessments and evaluations is also provided in part 1 of the Annual Activity Report, policy achievements for the activity "Policy Strategy and Coordination" and annexes.

The standard is maintained as priority in 2011 to pursue efforts for its effective implementation.

### Results on the other internal control standards

The annual review of effectiveness of the prioritised control standards entailed as well some questions on standards formerly retained (staff allocation and mobility, objectives and indicators), to compare results over time.

In addition, the desk review of compliance, mentioned under section 2.2.1, includes for all control standards a set of questions and/or indicators for assessing their effectiveness, developed according to the applicable guidelines. Such assessment is based on various information sources: management knowledge from daily operations, for instance on budgetary and financial execution indicators or on human resources scoreboards; on the review of surveys and/or other enquiries (typically, IT services satisfaction's survey); on the analysis of audit reports and recommendations, as part of the control and supervision activities in the DG.

Finally, while audit reports revealed a number of very important recommendations to address in specific processes (see section 3.1.2 of this report), these observations, with the exception of one issue subsequently included in the 2011 Risk register<sup>23</sup>, do not constitute a major risk at the overall DG AGRI level.

### **2.2.3. Conclusion**

There is satisfactory evidence that the internal control system in its entirety is implemented effectively in DG AGRI.

The procedures put in place control the main risks by providing a reasonable assurance that the key objectives are met and that the activities are carried out as intended, with action underway to address important audit recommendations and other identified areas for improvement

The European Court of Auditors, in its annual report for 2009, concluded that the supervisory and control systems for agriculture and natural resources were, at most, partially effective in ensuring the regularity of payments. According to the Commission, the Integrated Administration and Control System is generally an effective control system for limiting the risk of error or irregular expenditure, provided that it is properly applied - please see section 3.1.2.3 of this report for details on the difference in opinion.

## **2.3. Information to the Commissioner**

The main elements of this report and assurance declaration, including the reservation envisaged, have been brought to the attention of Commissioner Ciolos.

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<sup>23</sup> The issue has been identified as a significant risk from an overall DG perspective, requiring a close follow up in the course of 2011 through a targeted action plan which has been set up. It is the risk of an increasing backlog in timely treating equivalence requests under the import system of organic products in the EU.

## **3. Building blocks towards the declaration of assurance (and possible reservations to it)**

### **3.1. Building blocks towards reasonable assurance**

#### **3.1.1. Building block 1: Assessment by management**

##### **3.1.1.1. Shared management – EAGF and EAFRD expenditure**

This sub-chapter reports on the management of EAGF and EAFRD expenditure by:

- describing the management and control system for this expenditure which is based on four complementary levels;
- summarising the main findings and indicators resulting from these four control levels around three assurance blocks regarding the legality and regularity of the underlying transactions.

###### ***3.1.1.1.1. Description of the management and control system***

The EAGF and EAFRD expenditure is implemented under shared management through a comprehensive management and control system based on four levels. This system includes, on the one hand, all the necessary building blocks to guarantee a sound administration at Member States' level and, on the other hand, allows the Commission to audit the proper functioning of their management and control systems and, if need be, to counter the risk of financial losses as a result of any deficiencies in the set-up and operation of those systems through the conformity clearance mechanism. Taken together, the four levels and the results that they produce are the basis for DG AGRI to gain reasonable assurance as to the effective management of the risk of error in the legality and regularity of the underlying transactions.

###### **A. A compulsory administrative structure at the level of the Member States**

Management and control of the expenditure is entrusted to dedicated paying agencies, which prior to their operation must be accredited by the Member States on the basis of a comprehensive set of accreditation criteria laid down in EU law. The paying agencies' compliance with these criteria is subject to a detailed review by an external audit body as well as to constant supervision by the competent national authority, and clear procedures exist as to how to address and remedy any problems.

Moreover, the heads of the paying agencies are required to provide an annual statement of assurance which covers the completeness, accuracy and veracity of the accounts as well as a declaration that a system is in place which provides reasonable assurance on the legality and regularity of the underlying transactions. These statements of assurance are verified by independent certification bodies, which are required to provide an opinion thereon. For those Member States with only one paying agency, this statement of assurance from the director of the paying agency, together with the certificate and opinion of the certification body, constitute by definition, the annual summary referred to in Article 53b of the Financial Regulation. The 10 Member States which have more than one paying agency are further required to produce a synthesis report of all statements of assurance and of all certificates from the certification bodies.

**B. Detailed systems for ex-ante administrative controls and dissuasive sanctions**

These systems are to be applied by the paying agencies and contain some common features and special rules tailored to the specificities of each aid regime. The systems generally provide for exhaustive ex-ante administrative controls of 100% of the aid applications, cross-checks with other databases where this is considered appropriate as well as pre-payment on-the-spot controls of a sample of transactions ranging between 1% and 100%, depending on the risk associated with the regime in question. If the on-the-spot controls reveal a high number of irregularities, additional controls must be carried out.

In this context, the by far most important system is the IACS (Integrated Administration and Control System), which in financial year 2010 covered 89% of EAGF expenditure (89% in 2009). To the extent possible, the IACS is also used to manage and control rural development measures relating to parcels or livestock, which in 2010 accounted for 49.8% of payments under the EAFRD (59.7% in 2009, the difference being essentially due to the fact that expenditure under Axis 1 and 3 has increased as compared to last year). For both Funds together, the IACS covered 81.1% of total expenditure.

A detailed reporting from the Member States to the Commission on the checks carried out by them and on the sanctions applied is foreseen in the legislation. The reporting system allows both the Member States and the Commission to analyse the efficiency of the management and control system and provides for a quantification of aid not paid to beneficiaries as a result of the paying agencies' on-the-spot checks, thus allowing DG AGRI to calculate, for each aid scheme concerned, the error rate at the level of the final beneficiaries. In financial year 2010, the accuracy of the statistical information reported and the quality of the underlying on-the-spot checks had, for the third time, to be verified and validated by independent certification bodies for direct aids and rural development measures.

**C. Ex-post controls**

In addition to the ex-ante controls, all aid measures other than direct payments covered by the IACS are subject to ex-post controls under either Regulation (EC) No 485/2008 or, for rural development measures, Regulation (EC) No 1975/2006 (now Regulation (EC) No 65/2011). Moreover, the paying agencies' annual accounts and the functioning of their internal control procedures are verified and certified on an ex-post basis by the certification bodies. Both types of ex-post controls are carried out in accordance with an annual audit plan established on the basis of a pre-determined audit strategy.

#### **D.            Clearance of accounts**

The clearance of accounts through the Commission consists of both an annual financial clearance and a multi-annual conformity clearance.

The financial clearance covers the integrality, accuracy and veracity of the paying agencies' accounts. Moreover, it includes a mechanism under which 50% of any undue payments which the Member States have not recovered from the beneficiaries within 4 or, in the case of legal proceedings, 8 years will be charged to their respective national budgets (50/50 rule). If the undue payments are the result of administrative errors committed by the national authorities, the entire amount involved is deducted from the annual accounts and, thus, excluded from EU financing. Even after the application of the 50/50 rule, Member States are, however, obliged to pursue their recovery procedures and, if they fail to do so with the necessary diligence, the Commission may decide to charge the entire outstanding amounts to the Member State concerned.

The conformity clearance, for its part, relates to the legality and regularity of the underlying transactions. It is designed to exclude expenditure from EU financing which has not been executed in compliance with EU rules, thus shielding the EU budget from expenditure that should not be charged to it (financial corrections). In contrast, it is not a mechanism by which irregular payments to beneficiaries are recovered, which according to the principle of shared management is the sole responsibility of Member States.

Financial corrections are determined on the basis of the nature and gravity of the infringement and the financial damage caused to the EU. Where possible, the amount is calculated on the basis of the loss actually caused or on the basis of an extrapolation. Where this is not possible, flat-rates are used which take account of the severity of the deficiencies in the national control systems in order to reflect the financial risk for the EU. Where undue payments are or can be identified as a result of the conformity clearance procedures, Member States are required to follow them up by recovery actions against the final beneficiaries. However, even where this is not possible because the financial corrections only relate to deficiencies in the Member States' management and control systems, financial corrections are an important means to improve these systems and, thus, to prevent or detect and recover irregular payments to final beneficiaries. The conformity clearance thereby contributes to the legality and regularity of the transactions at the level of the final beneficiaries.

##### ***3.1.1.1.2. Findings and indicators***

The findings and the indicators which result from the four control levels described above can be summarised in three assurance blocks regarding the legality and regularity of the underlying transactions:

- the functioning of the paying agencies,
- the control results at the level of the final beneficiaries,
- the conformity audits on Member States' management and control systems.

## **A. The functioning of the paying agencies**

### **A.1 Compliance with the accreditation criteria**

#### **A.1.1 Status of the paying agencies' accreditation**

In the course of the financial year 2010, the 5 paying agencies under probation or provisional accreditation have seen their "final" accreditation restored, the respective competent authorities having provided a follow-up report according to which the paying agency had fulfilled the remedial plans.

At the end of financial year 2010, out of the 81 accredited paying agencies:

- 1 paying agency, OPEKEPE (Greece), was under limited accreditation;
- 1 paying agency, APA (Slovak Republic) was put under probation by the competent authority;
- 1 paying agency, ARBEA (Italy, Basilicata) had its accreditation withdrawn with effect as of 15/10/2010 by the competent authority. Its responsibilities were taken over by AGEA.

**Table 3.1. Status of paying agencies' accreditation.**

	At the beginning of financial year 2010	At the end of financial year 2010
Fully accredited	76	79
Limited accreditation	1 <sup>1)</sup>	1 <sup>3)</sup>
Accreditation under probation or provisional accreditation	5 <sup>2)</sup>	1 <sup>4)</sup>
Total	82	81

1) ARMA (Poland). The Competent authority limited the accreditation to the EAFRD measures for which a proper control system and procedures had been implemented. Full accreditation was provided on 23 November 2009, i.e. after the end of financial year 2009

2) FOGAIBA (Spain), ODARC (France), ASP (France), AgriMer (France) and Helaba (Germany).

3) OPEKEPE (Greece).

4) APA (Slovak Republic)

As regards those paying agencies whose accreditation was, at the end of financial year 2010, either limited, under probation or for which serious deficiencies in the accreditation criteria were detected by either the certification bodies or by DG AGRI, the situation is described in Annex 8. These findings show that the accreditation system laid down in Article 2 of Regulation (EC) No 885/2006 is functioning properly.

#### **A.1.2 Certification of the functioning of the paying agencies' internal control systems**

In the context of the financial clearance exercise for financial year 2010, the certification bodies are required to report and certify whether the internal control systems of the paying agencies have operated satisfactorily. For 69 paying agencies, the certificates indicate that this

was the case. For one paying agency (Rheinland-Pfalz) no certificate will be provided before 31 March 2011<sup>24</sup>. For the remaining 12 paying agencies, the situation is as follows:

For 3 paying agencies, the certificate contains a qualification related to deficiencies, systemic problems or insufficient procedures with regard to authorisation processes<sup>25</sup>. This is however limited to EAFRD only. In 1 case, (Italy-ARBEA), the certificate indicates several deficiencies related to control activities and internal environment for both EAGF and EAFRD.

For 8 paying agencies<sup>26</sup> the certificate contains qualification solely related to errors in the EAGF or EAFRD accounts, but still confirms that the internal control systems were operating adequately, with the exception of 1 paying agency (FR-ASP) for which the certificate does not confirm that the internal control system has operated satisfactorily, but that the internal control procedures exist.

It has also to be noted that without qualifying its opinion with regard to the internal control procedures, the audit certificate for OPEKEPE (Greece) indicates that for both EAGF and EAFRD, the internal control procedures to implement Non IACS payments could be improved.

The sum of all these errors is not material (far below 2% of total expenditure under each Fund at Community level).

### **A.1.3 The Commission's accreditation audits and summary of findings**

The Commission regularly performs accreditation audits, based on a detailed risk analysis, to check whether the paying agencies (continue to) respect the accreditation criteria. In 2010, 10 such accreditation audits were carried out covering 10 paying agencies<sup>27</sup>. For 6 paying agencies, the missions did not reveal any serious deficiencies which would have required their accreditation to be put under probation (AGEA, ARCEA, ASP, Baden-Württemberg, AGRIMER, HELABA).

For 3 paying agencies serious deficiencies were revealed (APA, ARBEA and Bayern). The deficiencies for APA have according to the certification body in its report for financial year 2010 been rectified and the accreditation of ARBEA was withdrawn on 15/10-2010. According to the information received from the German authorities the accreditation of the Bavarian paying agency will be put on probation as from 1 April 2011, and an action plan to remedy the deficiencies found is currently being established. The situation is summarised in Annex 8 (see also point A.1.1. above).

Regarding the new paying agency currently being established in Croatia, good progress has been made up to now.

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<sup>24</sup> For Baden-Württemberg, Bayern and HELABA (Germany), the certificate and report will also be provided after 31 March 2011 but for EAFRD only (the information was timely submitted for EAGF).

<sup>25</sup> Région Wallone (Belgium), Extremadura (Spain), APA (Slovakia), all for EAFRD only.

<sup>26</sup> AMA (Austria), OPEKEPE (Greece), Pais Vasco (Spain), ODARC and ASP (France), Ministry of Agriculture (Luxembourg), IFAP (Portugal) and PARDF (Romania)

<sup>27</sup> AGEA, ARBEA and ARCEA (Italy), ASP and AGRIMER (France), APA (Slovakia), Baden-Württemberg, Bayern and HELABA (Germany) and the new paying agency being established in Croatia for EAGF and EAFRD.

#### **A.1.4      The certification bodies' reports for financial year 2010 and summary of findings**

The certification bodies identified clear non-respect of accreditation criteria or serious deficiencies in 4 cases (ARBEA-Italy, Madrid-Spain, OPEKEPE-Greece and Région Wallone-Belgium) out of the 81 cases for which a certificate and report were provided before 31 March 2010 (see point A.1.2 and footnote 25 for the late submissions of audit reports and certificates).

With regard to ARBEA the serious deficiencies concern, according to the certification body, 3 out of the 8 accreditation components for both EAGF and EAFRD (control activities, human resources and delegation of tasks). They are consequently widespread thus confirming DG AGRI's own analysis. The deficiencies are currently being pursued under the conformity clearance procedure and the paying agency ceased to exist on 15 October 2010.

In the case of Madrid, the deficiencies are limited to the monitoring of on-the-spot checks for the EAFRD IACS measures. It appears that a sample of on-the-spot controls and inspection reports have not been re-performed or reviewed by the paying agency. The certification body has however confirmed that this issue does not prevent the paying agency from fulfilling its tasks.

In the case of OPEKEPE, the deficiencies identified relate to the payment execution procedures for some EAGF Non IACS schemes. The certification body found out that for investment measures under the fruit and vegetables operational programmes, actual payments to beneficiaries were executed much later than the 5 working days deadline after the issuance of the payment order. The payments concerned however met all the eligibility criteria according to the paying agency.

In the case of Région Wallone, the deficiencies relate to the administrative controls for EAFRD Non IACS schemes, where systemic serious deficiencies were identified in respect of: control of eligibility of claims, authorisation of claims, validity and integrity of documents and communication with the claimants (notification of acceptance or of rejection of claims).

Where necessary, DG AGRI will require the national authorities to put the agencies' accreditation under probation.

Further details regarding these paying agencies are provided in Annex 9.

### **A.2            Statement of assurance from the directors of the paying agencies and related opinion from the certification bodies as well as synthesis reports drawn up by the coordinating bodies and national declarations**

#### **A.2.1      Statement of assurance from the directors of the paying agencies**

In respect of financial year 2010, all the directors of the paying agencies (82) have submitted to the Commission their statements of assurance thereby declaring that they have put in place a system which provides reasonable assurance on the legality and regularity of the underlying transactions.

All the statements were without reservations.

#### **A.2.2      Opinion on the statement of assurance from the certification bodies**

81 of the 82 statements of assurance referred to above have been subject to an opinion from the certification bodies, the exception being Rheinland-Pfalz for both EAGF and EAFRD for

which the opinion is expected to be delivered after 31 March 2011. It has also to be noted that out of these 81 opinions, further 3 are missing solely for EAFRD for Baden-Württemberg, Helaba and Bayern (see point A.1.2 and footnote 25).

71 of these opinions are favourable (unqualified) thus confirming the accuracy of the statements of assurance presented by the directors of the paying agencies. The 10 paying agencies for which the opinion is qualified are:

- AMA (Austria) in respect of material errors found in the EAGF-Non IACS payments and, for both Funds, of the certification body's assessment of the paying agency's internal audit service and of the fact that the management should pay more attention to the documentation of the internal control systems and to the statement of assurance;
- Région Wallone (Belgium) due to the anomalies identified in the administrative controls for some EAFRD investments measures (112 and 121);
- SFA (Bulgaria) for which the certification body expresses an inability to confirm the correctness of EAGF IACS and rural development control statistics (scope limitation) due to the fact that they have been up-dated after the certification body's checks;
- Extremadura (Spain) where systemic errors were found in the administrative controls for some EAFRD Non IACS schemes;
- Islas Canarias (Spain) where the certification body is not in a position to confirm the rural development control statistics related to on-the-spot and ex-post controls and can therefore not assess the correctness of data underlying the statement of assurance;
- Cantabria (Spain) for an insufficient audit trail regarding the reconciliation of EAGF IACS (area aids and animal premia) and rural development control statistics between what was submitted to the Commission and the paying agency's database;
- La Rioja (Spain) for the same reason (insufficient audit trail with regard to the reconciliation of control statistics) but for rural development statistics only;
- ARBEA (Italy), where the certification body considers that the statement of assurance should have emphasized the weaknesses identified in the internal control systems;
- OPEKEPE (Greece) due to the material errors found in the EAGF accounts (the Most likely errors being 13,5 million EUR for IACS and 0,9 million EUR for Non-IACS + a known error for the Non-IACS population of 4,1 million EUR);
- IFAP (Portugal), where the total upper error limit exceeds the materiality threshold for EAFRD Non IACS schemes (Most likely error being 3,8 million EUR).

The financial impact is not material (far below 2% of the total expenditure for the EAGF and the EAFRD at EU level).

### **A.2.3 Follow-up of Reservations included in the Paying Agency Director's Statements of Assurance**

Reservations included in previous years' statements of assurance have been properly followed-up though remedial actions taken by the paying agencies and/or financial corrections resulting from conformity clearance enquiries. All the issues can now be considered as closed with the exception of only one reservation regarding the Portuguese paying agency IFAP which is still outstanding. Measures have been taken to rectify the situation and record in the debtor's ledger cases which were previously missing.

However, the certification body confirmed that not all the cases were recorded as of end of financial year 2010. The missing cases (amounting to less than EUR 1 million) are currently dealt with in the context of conformity clearance enquiries. The financial impact of this still unresolved issue is thus very limited and does not have any material impact at EU level.

### **A.2.4 Annual summaries (synthesis report) drawn up by the coordinating bodies**

If a Member State has accredited more than one paying agency, the coordinating body of the Member State concerned is obliged to draw up an annual summary (synthesis report) of the statements of assurance and of the certificates of the certification bodies and to transmit it to the Commission. The Commission has reinforced its guideline for the financial year 2010 in order to make these annual summaries more informative.

For financial year 2010, 10 Member States (Austria, Belgium, Germany, Spain, France, Italy, the Netherlands, Poland, Romania and the United Kingdom) were required to draw up an annual summary. 9 of these Member States (with the exception of Romania) complied with this obligation and submitted an annual summary to the Commission (though in the case of Germany and Spain it will be subject to an addendum due to still missing documents from the certification bodies).

All the annual summaries received report on both the statements of assurance from the directors of the paying agencies and the certificates from the certification bodies. For Austria, Germany (some of the documents were not received yet), the Netherlands, Poland and the United Kingdom, they show that neither the statements of assurance nor the certificates are subject to any reservations or qualifications. In the absence of any such reservations or qualifications, no further detailed analysis of problems of more general nature is required. For the remaining Member States (Belgium, France, Italy and Spain), they show that the certificates are subject to qualification(s), and these Member States have provided a further analysis of the problems identified.

The annual summaries are further required to provide an overall summary of the information evaluated, and in this respect the revised guideline explicitly requests a more detailed qualitative analysis of the main cross-cutting issues and a concise description of information on control statistics and the recovery of undue payments. All annual summaries received include such a qualitative analysis and addressed both control statistics – with the exception of Poland – and recoveries, and their added value as regards the main cross-cutting issues at national level improved compared to last year.

In conclusion, the Member States have complied with their legal obligations and largely followed the guideline established by the Commission services. Compared to last year, the quality of the analysis included in all annual summaries has again improved, but in a very

limited number of cases the assessment of certain basic elements should still be further improved. As regards the control statistics a very limited number of Member States did not provide the summary of the requested error rates per aid schemes at the level of the Member State. Also, in some cases a requested explanation of error rates above 2% were not provided. As already in the previous years, the Commission will raise these points with the Member States concerned at the next suitable occasion.

#### **A.2.5 National declarations**

Although there is no legal requirement in EU law for a national declaration by a Member State on the management and control of the funds it receives from the EU, some Member States draw up such a declaration on a voluntary basis.

By reinforcing the national accountability for the use of EU Funds under shared management, the national declarations are intended to lead to improved management at national level. Moreover, they make the control process in the Member States more transparent and effective.

The Court of Auditors has stressed that their value for building assurance depends on the value of the underlying work. In its Opinion No 6/2007 the Court states that it would only be possible to make use of the potential assurance from the audited national declarations or national audit work on the following precondition: "...the national declarations or national audit work would need to be of appropriate scope, approach and timing, and be carried out according to international standards".

For financial year 2010, only the Netherlands has provided such a declaration which was made available to the Commission by the Dutch Minister of Finance on 18 March 2011. The declaration, covering the EAGF, EAFRD, the ERDF, the ESF and the EFF, the European Refugee Fund, the European Integration Fund, European Return Fund and the European External Borders Fund, will be formally presented to the Dutch Parliament on 18 May 2011.

The part of the Dutch national declaration covering the EAGF and the EAFRD states that: (i) the Dutch management and control systems provide reasonable assurance on the legality and regularity of expenditure and revenue (underlying transactions) and the eligibility of the aid applications concerned; (ii) the expenditure and revenue as declared by the Dutch paying agencies to the European Commission and included in the consolidation statement are, according to the best knowledge of the Dutch Finance Minister, legal, regular, correct and complete up to the level of the final beneficiaries and (iii) pending claims on behalf of these Funds as included in the consolidation statement are, according to the best knowledge of the Dutch Finance Minister, legal, regular, correct and complete.

In principle, such additional work constitutes an additional source of assurance for the CAP-expenditure. The Dutch Court of Auditors will publish an independent opinion on the preparation of the national declaration, the assertion made on the systems for the management and control of EU funds and the legality and regularity of expenses down to the level of the beneficiary.

### **A.2.6 Summary**

The situation as regards the instruments discussed above is summarised in *table 3.2* below.

**Table 3.2. Overview of statements of assurance, opinions and national declarations.**

Member State	Paying Agency	Statement of assurance received	Reservation + population concerned by reservation	Quantification	Opinion certification body received	Reasons for qualification(s)	Summary received	Voluntary national declaration received
AU	AMA	yes/unqualified	NA	NA	yes / qualified	See under par. A.2.2	YES	-
AU	Zollamt Salzburg	yes/unqualified	NA	NA	yes/unqualified	NA		
BE	BIRB	yes/unqualified	NA	NA	yes/unqualified	NA	YES	-
BE	ALV	yes/unqualified	NA	NA	yes/unqualified	NA		
BE	Reg. Wallonne	yes/unqualified	NA	NA	yes / qualified	See under par. A.2.2		
BG	State Fund Agriculture	yes/unqualified	NA	NA	yes / qualified	See under par. A.2.2	NA	-
CY	CAPO	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
CZ	SAIF	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
DE	BLE	yes/unqualified	NA	NA	yes/unqualified	NA	YES (only preliminary version received)	-
DE	Hamburg-Jonas	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Baden-Württemberg	yes/unqualified	NA	NA	EAGF yes/unqualified EAFRD not received	NA		
DE	Bayern StMLF	yes/unqualified	NA	NA	EAGF yes/unqualified EAFRD not received	NA		
DE	Brandenburg MLUV	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Hamburg	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Mecklenburg-Vorpommern	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Niedersachsen	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Nordrhein-Westfalen	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Rheinland-Pfalz	yes/unqualified	NA	NA	Not received			
DE	Saarland	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Sachsen	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	SachsenAnhalt	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Schleswig-Holstein	yes/unqualified	NA	NA	yes/unqualified	NA		

Member State	Paying Agency	Statement of assurance received	Reservation + population concerned by reservation	Quantification	Opinion certification body received	Reasons for qualification(s)	Summary received	Voluntary national declaration received
DE	Thüringen	yes/unqualified	NA	NA	yes/unqualified	NA		
DE	Helaba	Yes/unqualified	NA	NA	EAGF yes/unqualified EAFRD not received	NA		
DK	DFE	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
EE	PRIA	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
ES	Andalucia	yes/unqualified	NA	NA	yes/unqualified	NA	YES subject to an addendum due to still missing documents from the certification bodies	-
ES	Aragon	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Asturias	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	FOGAIBA	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Islas Canarias	yes/unqualified	NA	NA	yes/qualified	See under par. A.2.2		
ES	Cantabria	yes/unqualified	NA	NA	yes/qualified	See under par. A.2.2		
ES	Castilla La Mancha	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Castilla y León	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Catalonia	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Extremadura	yes/unqualified	NA	NA	yes/qualified	See under par. A.2.2		
ES	Galicia	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Madrid	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Murcia	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Navarra	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	Pais Vasco	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	La Rioja	yes/unqualified	NA	NA	yes/qualified	See under par. A.2.2		
ES	Comunidad Valencia	yes/unqualified	NA	NA	yes/unqualified	NA		
ES	FEGA	yes/unqualified	NA	NA	yes/unqualified	NA		
FI	MAVI	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
FR	ODEADOM	yes/unqualified	NA	NA	yes/unqualified	NA	YES	-
FR	ODARC	yes/unqualified	NA	NA	yes/unqualified	NA		
FR	ASP	Yes/unqualified	NA	NA	yes/unqualified	NA		
FR	France	Yes/unqualified	NA	NA	yes/unqualified	NA		

Member State	Paying Agency	Statement of assurance received	Reservation + population concerned by reservation	Quantification	Opinion certification body received	Reasons for qualification(s)	Summary received	Voluntary national declaration received
	AGRIMER							
GB	DARD	yes/unqualified	NA	NA	yes/unqualified	NA	YES	-
GB	SGRID	yes/unqualified	NA	NA	yes/unqualified	NA		
GB	WAG	yes/unqualified	NA	NA	yes/unqualified	NA		
GB	RPA	yes/unqualified	NA	NA	yes/unqualified	NA		
GR	OPEKEPE	yes/unqualified	NA	NA	yes/qualified	See under par. A.2.2	NA	-
HU	ARDA	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
IE	DAF	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
IT	AGEA	yes/unqualified	NA	NA	yes/unqualified	NA	YES	-
IT	SAISA	yes/unqualified	NA	NA	yes/unqualified	NA		
IT	ENR	yes/unqualified	NA	NA	yes/unqualified	NA		
IT	Veneto (AVEPA)	yes/unqualified	NA	NA	yes/unqualified	NA		
IT	Basilicata (ARBEA)	yes/unqualified	NA	NA	yes/qualified	See under par. A.2.2		
IT	Toscana (ARTEA)	yes/unqualified	NA	NA	yes/unqualified	NA		
IT	Emilia-Romagna (AGREA)	yes/unqualified	NA	NA	yes/unqualified	NA		
IT	ARPEA	yes/unqualified	NA	NA	yes/unqualified	NA		
IT	OPR Lombardia	yes/unqualified	NA	NA	yes/unqualified	NA		
IT	OPPAB	Yes/unqualified	NA	NA	yes/unqualified	NA		
IT	APPAG	Yes/unqualified	NA	NA	yes/unqualified	NA		
IT	ARCEA	yes/unqualified	NA	NA	yes/unqualified	NA		
LT	NPA	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
LU	Min of Agriculture	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
LV	RSS	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
MT	RAPAD	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
NL	DLG	yes/unqualified	NA	NA	yes/unqualified	NA	YES	YES
NL	Dienst Regelingen	yes/unqualified	NA	NA	yes/unqualified	NA		
PL	ARMA	yes/unqualified	NA	NA	yes/unqualified	NA	YES	

Member State	Paying Agency	Statement of assurance received	Reservation + population concerned by reservation	Quantification	Opinion certification body received	Reasons for qualification(s)	Summary received	Voluntary national declaration received
PL	AMA	yes/unqualified	NA	NA	yes/unqualified	NA		-
PT	IFAP	yes/unqualified	NA	NA	yes/qualified	See under par. A.2.2	NA	-
RO	PARDF	yes/unqualified	NA	NA	yes/unqualified	NA	NO	-
RO	PIAA	yes/unqualified	NA	NA	yes/unqualified	NA		
SE	SJV	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
SL	AAMRD	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-
SK	APA	yes/unqualified	NA	NA	yes/unqualified	NA	NA	-

NA: not applicable

### **A.3 Financial clearance exercise for 2010 expenditure**

The rules on the financing of the CAP provide for an annual financial clearance exercise covering the completeness, accuracy and veracity of the paying agencies' accounts. By 1 February following the end of the financial year in question, Member States are required to send the annual accounts of their paying agencies to the Commission, together with a certificate from the certification body of each paying agency stating whether it has gained reasonable assurance that these accounts are true, complete and accurate and that the agency's internal control procedures have operated satisfactorily. The Commission then has until 30 April to review this information and, if the information is considered acceptable, to adopt a decision clearing the accounts of the paying agencies concerned.

At the date of signature of this Annual Activity Report, the 2010 accounts of all paying agencies and the related certificates from the certification bodies have been received, with the exception of the certification report and audit certificate for expenditure carried out by the German paying agencies of Baden-Württemberg, Helaba, Bayern (EAFRD only) and Rheinland-Pfalz (both EAGF and EAFRD). They will not be received in time to enable the clearance of these accounts. For the rest, as in the previous financial clearance exercises, the accounts of a limited number of paying agencies probably cannot be cleared by the 30 April deadline either because certain key information has been submitted late or is missing or because the certificates from the certification bodies are qualified, thus requiring further work from the paying agencies. The accounts of these paying agencies will be disjoined from the financial clearance decision due by 30 April 2011 and cleared at a later stage.

## **B. Control results at the level of the final beneficiaries**

### **B.1 Control results reported by Member States**

The Member States are required to send to the Commission on a yearly basis statistical material in relation to the checks carried out and the resulting exclusions and reductions.

These statistics provide detailed information on the applications introduced by the beneficiaries and checked by the Member States' paying agencies on-the-spot<sup>28</sup>. On the basis

<sup>28</sup> This statistical information is the result of a very large sample of applications checked: SPS/SAPS: 576 555 applications checked; animals: 1 033 587 animals checked (suckler cow premium and beef special premium);

of the exclusions and reductions resulting from the on-the-spot checks and the ensuing error rate, the residual risk in the non-controlled population can be calculated. The statistics provide thus the necessary information for the Commission to verify the error rate resulting from the on-the-spot checks as well as to estimate the residual error rate. As the statistics are compiled at the level of the final beneficiaries and give information on the errors in the underlying transactions, they provide assurance on the legality and regularity of the transactions at the level of these beneficiaries.

### **B.1.1 ABB activity - 03 - direct aid (covered by IACS)**

Unless otherwise stated, the approach retained in calculating the error rate for direct aid for 2010 (financial year 2010 = claim year 2009) uses the error rate from the samples selected at random and the EU average has been weighted according to the relevant portion of expenditure and of checks carried out by the Member States. When comparing the results to those from 2009, the latter have been updated to take account of new figures submitted by Member States and the same approach has been used as that described above for 2010.

#### **B.1.1.1 Area aid**

The results of the IACS controls regarding the Single Application Scheme (SPS) and the Special Area Payment Scheme (SAPS) for the claim year 2009 (financial year 2010) are shown in *Annex 7.A - Area aids covered by IACS*<sup>29</sup>.

According to the figures communicated by the 27 Member States, the error rate for the samples selected at random, and therefore most representative, is 0.78%. This compares with 0.77% for 2009.

Overall, this result once again confirms the positive impact of the recent CAP reforms and the IACS. A more detailed analysis shows, however, that the error rates in some Member States remain high. However, globally for the EU the error rate remains relatively stable and significantly below the 2% materiality threshold presently used by the European Court of Auditors.

#### **B.1.1.2 Animal premiums**

The results of the IACS on-the-spot controls regarding bovine animals for the claim year 2009 (financial year 2010) are shown in *Annex 7.B – Bovine base premium*. The error rate is around 0.33% in terms of amounts not paid which is slightly less than last year.

For the two most important premia, the situation is the following: suckler cow premium scheme (SCP) the error rate in terms of amounts though relatively stable has fallen to 0.37% (0.48% in 2009). For the special beef scheme (SBP) the error rate has fallen to 0.58% in 2010 (0.92% in 2009), see *Annex 7.C – Suckler cow premium* and *Annex 7.D – Beef special premium*. In particular the error rates for Slovenia and Denmark have improved.

#### **B.1.1.3 Conclusion for ABB activity 03 – direct aid**

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export refunds: 7 213 declarations checked; 262 891 checks carried out on beneficiaries for area related rural development measures.

<sup>29</sup> The figures for claim year 2007 are based on the latest communications received for that year. These latest communications contain revised figures and therefore some figures differ slightly from the ones used for the AAR 2008.

In conclusion, the statistical information provided by the Member States on the results of their controls and the error rates that result thereof, indicates that for the ABB activity direct aid, the residual risk for transactions which were not controlled on the spot was 0.60% (0.86 % in 2009) and thus well below the materiality level of 2% presently used by the Court of Auditors.

## **B.1.2 ABB activity – 02 - intervention on agricultural markets**

### **B.1.2.1 Export refunds – physical checks**

Export refund applications are subject to administrative checks by customs as well as physical or substitution checks. Article 16 of Regulation (EC) No 1276/2008 obliges Member States to present by the 1 May of each year an annual report to the Commission on the implementation of physical and substitution checks in the preceding year. The latest reports available relate to calendar year 2009. Overall, expenditure for export refunds decreased further to EUR 627 million.

The reporting on the physical checks reveals that in EU27 physical checks were carried out on 6.5% of the total number of export declarations received, see *Annex 7.E – Export refunds – physical checks*. In terms of amounts, declarations examined correspond to 7.2% of the total amount of refunds claimed.

In all, 5% of physical checks detected an irregularities amounting to a financial incidence of 1.28% of the refund claims examined (1.26% in 2009), of which 70% arose in Germany. For this Member State, an audit mission will be organised.

### **B.1.2.2 Sugar stocks (quotas) and restructuring**

Article 12 of Regulation (EC) No 952/2006 obliges Member States to present to the Commission by 31 March of each year following the marketing year concerned an annual report on the implementation of stock accounting and other checks in the preceding year. This annual reporting provides an overview of checks on approved manufacturers and refiners, quantities carried forward, processors and restructuring aid, see *Annex 7.F – Sugar CMO*. The successful execution of these checks is nevertheless important given the need to manage quotas and eligibility requirements for sugar exported subsequently with refunds.

As far as restructuring is concerned, the reporting on the checks of the undertakings involved show that Member States controlled 100% of the undertakings concerned, which has been verified also by Commission audits. In consequence, all errors found (2.8%) will be covered.

### **B.1.2.3 Fruit and vegetables**

Article 99(3) of Regulation (EC) No 1580/2007 obliges Member States to present to the Commission by 15 November of each year an annual report on the implementation of financial accounting controls and other checks on producer organisations' operational programmes and on producer groups' recognition plans in the preceding year.

The reporting received concerning operational programmes expenditure incurred in financial year 2010 in respect of operational year 2009 shows that 63% of expenditure was subject to on-the-spot control coverage by Member States, which is significantly above the legal requirement of 30%, see *Annex 7.G – Fruit and vegetables [– Operational programmes]*. These controls resulted in aid reductions totalling EUR 12.5 million for findings relating to operational programmes and recognition. This leads to an error rate of 2.8% (2.3% last year).

#### B.1.2.4 Wine

Annual reporting is based on the annexes to Regulation No (EC) 555/2008, whereby Member States are required to report annually to the Commission not later than 1 December the results of controls conducted in the framework of the restructuring and conversion and grubbing up schemes.

##### Restructuring and conversion

Aid applications for restructuring and conversion in the wine sector are subject to 100% of on-the-spot inspection before and after operations, both to assess the eligibility of parcels and to carry out measurements. The controls are performed by means of both remote sensing techniques and classical (on-the-spot) controls both prior and subsequent to restructuring operations. Control and error reporting received from all concerned Member States shows that the regulatory control requirements have been respected, and that consequent to this control 4.2 % of claimed areas have been refused as ineligible. It should be noted, though, that the percentage found in many cases is due to the difference in area as noted in the land register and area in the wine register and not necessarily to a false declaration by the beneficiary. See *Annex 7.H – Wine: restructuring and conversion*.

##### Grubbing up

Areas receiving grubbing-up premium have to be systematically verified before and after the execution of the grubbing up, i.e. there is 100% control before and after the operation either by remote sensing and / or classical (on-the-spot) control. Control and error reporting received from all concerned Member States shows that the required levels of control have been achieved, and that consequent to this control 4.21 % of claimed areas have been refused as ineligible. As in the restructuring and conversion, it should be noted that the percentage found in many cases is due to the difference in area as noted in the land register and area in the wine register and not necessarily a false declaration of the beneficiary. See *Annex 7.I – Wine: grubbing up premium*.

##### Green Harvesting

Areas receiving green harvesting premium have to be systematically verified by means of a classical on the spot control after the execution of the harvesting, i.e. there is 100% control after the operation. Control and error reporting received from all concerned Member States shows that the required levels of control have been achieved and that consequent to this control 7.30 % of claimed areas have been refused as ineligible. Only three Member States however have made use of this measure so far and of those Italy is by far the most important. Again as in all cases concerning wine measures based on the cultivated area, the percentage found in many cases is due to the difference in area as noted in the land register and area in the wine register and not necessarily a false declaration of the beneficiary. See *Annex 7. J – Wine: green harvesting premium*.

#### B.1.2.5 Intervention storage

Regulation (EC) No 884/2006 requires Member States to submit data on the annual inventory carried out on intervention storage of all products in store. Most recent data supplied and analysed concerns the stocks as of 30 September 2010.

The data reported by the Member States for 2010 show a control rate of 49.3% of quantities that, as in previous years, remains much in excess of the 5% inventory rate required by the legislation, see *Annex 7.K – Intervention storage*. The data continues to indicate a very low level of anomaly found as a result of these controls – missing quantities representing only 0.01% of inventoried stock for 2010 (0.29% in 2009).

#### B.1.2.6 Dried fodder

Member States must submit data on the dried fodder scheme to the Commission by 31 May after the end of the marketing year running from 1 April to 31 March most recently in respect of the marketing year 2009/2010, relating to financial years 2009 and 2010. The administrative, accounting, analytical and other physical controls to be carried out on producers, processors and purchasers are laid down in Regulation (EC) No 382/2005.

On-the-spot controls were performed on processing undertakings on the basis of *on-the-spot* accounting/administrative controls (55.47 % of claimed quantity) and laboratory analysis (7.22 % of claimed quantity) in marketing year 2009/2010, and established quantitative errors of 0.41 % on the quantity declared for aid (0.55% last year), see *Annex 7.L - Dried fodder: checks on processors*.

#### B.1.2.7 School milk

In accordance with Article 17 of Regulation (EC) No 657/2008, by 30 November following the end of the previous period running from 1 August to 31 July ('school' year) Member States should provide summary details of the number of participating applicants and educational establishments, on-the-spot checks carried out and the related findings.

This annual reporting shows that on-the-spot control was conducted on 35.5% of applicants, which is significantly above the minimum regulatory level of 5%, and that aid recovered following these checks represented 0.75% of the total aid controlled, see *Annex 7.M - School milk*.

#### B.1.2.8 School fruit

In accordance with Article 15(1) of Regulation (EC) No 288/2009, Member States shall notify the Commission each year by 30 November of the year in which the period mentioned in Article 4(1) ends, (a) of the results of the monitoring exercise and (b) of the on-the-spot checks carried out and of the related findings.

This annual reporting was received for the first time in November 2010. It shows that on-the-spot checks were conducted on 29.0% of aid distributed for the 2009/2010 school year, which is significantly above the legal requirement of 5%.

#### B.1.2.9 Other market measures for which no statistics on ex-ante checks are available

Measures not covered by the IACS for which there is neither statistical information available nor a 100 % control obligation are still subjected to ex-post checks pursuant to Regulation (EC) No 485/2008. Although there might not be a direct link between the expenditure incurred in 2010 and that controlled by the post-payment checks, DG AGRI considers that, nonetheless, assurance can be derived from those checks for the 2010 expenditure because the system of controls as such is functioning properly and the error rate of 0.42% is consistently stable and well below materiality, see *Annex 7.N - Scrutiny report*. This confirms that the pre-payment and accounting checks in the sectors concerned have generally been executed correctly.

#### B.1.2.10 Conclusion for ABB Activity 02 – Market Measures

For the 70.5% in value terms of the market measures for which Member States either have provided statistics or have a 100% on-the-spot control rate, the residual error rate is 0.52% (compared with 0.23% for 2009).

### **B.1.3**      **ABB activity – 04 - rural development**

As regards the around EUR 10.7 billion of expenditure reimbursed to Member States under the EAFRD in financial year 2010 (excluding advances), around 50% (EUR 5.4 billion) concerns measures under Axis 2 such as agri-environmental payments, natural handicap payments and afforestation measures. These measures are, as regards their area and animal related aspects, subject to the IACS.

In order to have information on controls and error rates in the area of rural development, Regulation (EC) No 1975/2006 (now Regulation (EC) No 65/2011) provides for detailed and systematic reporting of the results of the Member States controls and reductions applied. These reports cover, on the one hand, the area payments under Axis 2 of the rural development programmes and, on the other hand, measures under Axis 1, 3 and 4 (investment measures, flat rate support, Leader etc).

Unless otherwise stated, the approach retained in calculating the error rate for rural development for 2010 uses the error rate from the samples selected at random and the EU average has been weighted according to the relevant portion of expenditure and of checks carried out by the Member States. When comparing the results to those from 2009, the 2009 figures have been updated to take account of new figures submitted by Member States and the same approach has been used as that described above for 2010.

As a result of the activities of a DG AGRI task force that has examined closely the methodology used by the Member States for reporting control statistics for expenditure under Axis 2, the quality and reliability of these reports have significantly increased compared to previous years. The residual risk in the population not controlled on-the-spot, which remains after the errors detected through the (100%) administrative controls have been corrected, can now be established.

The control results submitted by the Member States for area measures under Axis 2 show that the overall rate of corrections following administrative controls and on-the spot checks for these measures amounts to 3.2%, compared to 3.4 % in the previous year; see *Annex 7.O – Rural development: Axis 2 – all area related measures*. Taking into account that the reductions resulting from the 100 % administrative controls are around 1.2 % and that some 8.1% of all claimed amounts were controlled on-the-spot, the residual error rate is slightly below 2 %.

A further breakdown shows that for agri-environmental measures, representing around 60 % of the Axis 2 expenditure in financial year 2010, the rate of reductions following all controls (random sample) reported by Member States is, with 4.0%, higher than for Axis 2 as a whole

(3.5% last year); see *Annex 7.P - Rural development: Axis 2 - agri-environmental measures*).<sup>30</sup>

In respect of 'natural handicap' payments, the overall rate of corrections following administrative controls and on-the spot checks amounts to 2.6% in 2010 (2.8% last year); see *Annex 7.Q – Rural development: Axis 2 - natural handicap payments*.

The fact that the error rate for Axis 2 measures is higher than for other area related IACS payments (SPS) is the consequence of the fact that reductions are not only due to over-declarations but most likely also to the non-respect of agri-environmental commitments. Moreover, there is no "buffer" effect as is the case for the SPS, where over-declarations do not lead to reductions if the available eligible area, despite over-declarations, is still sufficient to activate the entitlements.

The control statistics submitted by Member States for Axis 1 and 3 measures are attached in *Annex 7.R - Rural development: Axis 1 and 3*. Based on both the risk and random sample, they show a very low error rate of 0.6% (0.3% last year).

Overall, the statistical information provided by the Member States shows that the error rate in rural development as a whole continues to decrease and is now at 1.7% as compared to 2.8% last year (taking into account the increased spending for investment measures under Axes 1 and 3); see *Annex 7.S - Rural development: All Axes*. As a consequence, the residual error rate is around 1.13% for rural development expenditure as a whole. This is a significant improvement of the situation and implies that for the ABB activity rural development, the residual error rate is now below the 2% threshold presently used by the Court.

#### **B.1.4 Assessment of the Member States management and control of agricultural expenditure under the three ABB activities**

**For the three ABB activities intervention in agricultural markets (ABB 02), direct aid (ABB 03) and rural development (ABB 04), the situation at Member State level resulting from the control statistics referred to above is summarised in the table below:**

**Table 3.3. Assessment of the Member States by ABB activity**

Member State	ABB02 Intervention in agricultural markets	ABB03 Direct aid	ABB04 Rural development
AT	< 2%	< 2%	2% - 5%
BE	< 2%	< 2%	< 2%
BG	< 2%	> 5%	2% - 5%
CY	< 2%	> 5%	-
CZ	< 2%	< 2%	< 2%
DE	> 5%	< 2%	< 2%
DK	< 2%	< 2%	< 2%
EE	< 2%	< 2%	2% - 5%
ES	2% - 5%	< 2%	2% - 5%
FI	< 2%	< 2%	< 2%
FR	2% - 5%	< 2%	< 2%
GB	2% - 5%	< 2%	< 2%

<sup>30</sup> Figures for all Member States with the exception of Cyprus and Portugal, which were not able to comply with the new reporting standards. For Cyprus, the non-reporting is due to a punctual problem with the IT system, while for Portugal it is due to the long delays in carrying out on-the-spot controls.

<b>Member State</b>	<b>ABB02</b> Intervention in agricultural markets	<b>ABB03</b> Direct aid	<b>ABB04</b> Rural development
<b>GR</b>	2% - 5%	< 2%	2% - 5%
<b>HU</b>	> 5%	2% - 5%	< 2%
<b>IE</b>	< 2%	< 2%	< 2%
<b>IT</b>	< 2%	< 2%	< 2%
<b>LT</b>	< 2%	2% - 5%	< 2%
<b>LU</b>	< 2%	< 2%	< 2%
<b>LV</b>	< 2%	< 2%	> 5%
<b>MT</b>	< 2%	2% - 5%	> 5%
<b>NL</b>	< 2%	< 2%	< 2%
<b>PL</b>	< 2%	< 2%	< 2%
<b>PT</b>	> 5%	2% - 5%	-
<b>RO</b>	< 2%	> 5%	2% - 5%
<b>SE</b>	< 2%	< 2%	> 5%
<b>SI</b>	< 2%	2% - 5%	2% - 5%
<b>SK</b>	< 2%	2% - 5%	< 2%

NB: No complete figures are available for Cyprus and Portugal as regards ABB04.

## **B.2 Assessment of the control statistics by the certification bodies**

### **B.2.1 Opinion on the quality of the on-the-spot checks**

The certification bodies have been asked to give an opinion on the quality of the on-the-spot checks carried out by the paying agencies by assessing it against a scale of 1 to 5. To this end, the certification bodies should normally have checked a sample of 10 inspections for each of the following four populations: EAGF-IACS, EAGF-non-IACS, EAFRD-IACS and EAFRD-non-IACS. Moreover, the certification bodies should have reviewed, for each of these populations, the plans for on-the-spot checks, instructions and manuals, human resources, the competencies and training of controllers, the methodology and equipment used, the agreements with delegated bodies, the monitoring and supervision system put in place by the paying agency, the adequacy of the inspection reports and the application of reductions and sanctions.

An analysis of the certification reports received shows that in more than 90% of all cases, the certification bodies carried out this work and, with a few exceptions, according to the standards requested by DG AGRI's guideline.

For the two EAGF and EAFRD populations covered by the IACS, the quality of on-the-spot checks was considered to be at least adequate in 99 % and 92 % respectively of the cases. For the two EAGF and EAFRD populations not covered by the IACS, the quality of on-the-spot checks was considered to be at least adequate in 97 % and 89 % respectively of the cases

### **B.2.2 Opinion on the accuracy of the control statistics**

The certification bodies have further been asked to verify and validate the Member States' control statistics for EAGF expenditure covered by the IACS and for EAFRD expenditure. In particular, they should reconcile the information provided by the paying agencies to the underlying information in the databases and records as regards the number of aid applications and the total area declared, the number of applications and the total area covered by checks and the results of the checks carried out, including the reductions and exclusions applied. Moreover, in order to test the databases and records, they should reconcile on a sample basis 20 field inspection reports to the information entered into the databases and records.

An analysis of the certification reports received shows that in around 97% of the EAGF-IACS cases and around 89% of the EAFRD cases, respectively, the certification bodies carried out this work and, with a few exceptions according to the standards requested by DG AGRI's guideline. In around 77% of the EAGF-IACS cases and 71% of the EAFRD cases, respectively, the certification bodies concluded positively on the accuracy of the control statistics.

### **B.2.3      Conclusion**

It can be concluded that both the coverage of the certification bodies' checks on statistics and the extent of positive opinions has further improved as compared to 2009, *see table 3.4*:

**Table 3.4. Opinion of certification bodies.**

<b>Opinion of certification bodies on the quality of on-the-spot checks</b>				
	Financial year 2010		Financial year 2009	
Population	Work done	Positive conclusion	Work done	Positive conclusion
EAGF-IACS	99%	99%	94%	92%
EAGF-Non-IACS	96%	97%	86%	90%
EAFRD-IACS	94%	92%	91%	87%
EAFRD-Non-IACS	91%	89%	83%	87%

  

<b>Opinion of certification bodies on the accuracy of control statistics</b>				
	Financial year 2010		Financial year 2009	
Population	Work done	Positive conclusions	Work done	Positive conclusions
EAGF-IACS-areas	97%	77%	94%	70%
EAFRD	89%	71%	85%	54%

## **B.3      Cross compliance**

The respect of the cross-compliance criteria is not an eligibility condition for the respective aid schemes. The control statistics referred to below do not therefore correspond to errors in underlying transactions.

The results of the controls on cross-compliance are shown in *Annex 7.T – Cross compliance: claim year 2009*. It shows that 2.5% of the claimants for direct payments were controlled for cross-compliance in claim year 2009 and that the minimum control rates of 1% were globally respected. The rate of farmers controlled on-the-spot and subject to a subsequent sanction for cross-compliance was higher than in 2008 (15.35%) at 17.30% of all farmers controlled in 2009.

According to the control statistics, total cross-compliance sanctions<sup>31</sup> in respect of the 2009 claim year amounted to EUR 24.6 million for EAGF and 4.1 million for EAFRD.

An analysis of the figures indicates that, as far as the EAGF is concerned, the sanctions applied in case of negligence of the farmer, i.e. excluding the sanctions for repetition and intentional non-compliance, amount to EUR 13.7 million (2.36% of the aid granted), and for the EAFRD, the sanctions amount to EUR 2.6 million (2.43% of the aid granted). To these

<sup>31</sup> The figures presented exclude France, as financial data on sanctions are missing for this Member State.

sanctions are to be added the total of sanctions following repetition and intentional non-compliance of EUR 12.4 million.

## **C. Conformity audits on Member States' management and control systems**

### **C.1 Number and coverage of the conformity audits**

The Commission's conformity audits are compliance audits on the functioning of the management and control systems of the paying agencies. As long as the control systems do not change, for example as a result of legislative changes to the aid scheme concerned, these audits provide assurance not only for the year in which they took place, but also in respect of the preceding and subsequent years. Under the conformity clearance procedure, expenditure may be excluded from EU financing for a period starting 24 months prior to the Commission's communication to the Member State up to the moment that the deficiency has been rectified. An overview of the coverage of the audits, broken down by ABB activity, is presented in *table 3.5* (audits carried out in 2010) and *table 3.6* (audits carried out in 2008-2010).

**Table 3.5. Audits carried out in financial year 2010.**

	ABB 02	ABB 03	ABB 04 <sup>1)</sup>	Total <sup>2)</sup>
Number of conformity audits with missions carried out <sup>3)</sup>	40	39	36	115
MS covered	all except BE, BG, CY, CZ, EE, GB, LT, LU, MT, NL and SE	all except BE, CY, CZ, EE, FI, LT and PL	all except BE, DE, EE, GR, LT, LV, NL and SK	all except BE, EE and LT
Expenditure, - total, € million	4 312,9	39 675,7	11 315,5	54 304,1
- audited, € million	1 420.2	17 673.6	3 915.9	23 009.7
- % covered	32.9%	44.6%	34.6%	41.6%

<sup>1)</sup> concerns only EAFRD, thus excluding the EAGGF Guidance section.

<sup>2)</sup> not including 11 audits covering cross-compliance, 4 audits covering entitlements and 3 audits covering irregularities.

<sup>3)</sup> if an audit covers more than one ABB, it is allocated to all ABB covered by that audit.

**Table 3.6. Audits carried out in financial years 2008-2010.**

	ABB 02	ABB 03	ABB 04 <sup>1)</sup>	Total <sup>2)</sup>
Number of conformity audits with missions carried out <sup>3)</sup>	122	116	84	322
MS covered	all except CY, EE, LU and MT	all MS and also including HR	all MS	all MS and also including HR
Expenditure, - total, € million	16 758,9	116 358.2	28 148,3	161 265.4
- audited, € million	4 620.0	56 927.9	8 526.2	70 074.1
- % covered	27.6%	48.9%	30.3%	43.5%

<sup>1)</sup> concerns only EAFRD, thus excluding the EAGGF Guidance section.

<sup>2)</sup> not including 28 audits covering cross-compliance, 15 audits covering entitlements and 12 audits covering irregularities.

<sup>3)</sup> if an audit covers more than one ABB, it is allocated to all ABB covered by that audit.

For both the year 2010 and for the period 2008-2010 the audits carried out covered, respectively, 19.9% and 17.8% of the global composite risk<sup>32</sup> as determined in DG AGRI's central risk analysis, representing in turn, respectively, 41.6% and 43.5% of total expenditure during those periods.

## **C.2 Results of the conformity audits in 2010**

While the financial consequences will only be determined at the end of the conformity clearance procedures, the results of the audits are already known. Most of the audits performed in 2010 have not revealed any deficiencies in the control systems which would suggest that those systems are ineffective in determining the eligibility of claims or preventing irregularities, possibly deserving a financial correction of 10%, with the exception of Bulgaria, Portugal and Romania, for which a reservation regarding the functioning of their IACS with respect to expenditure in financial year 2010 is made in this AAR. A summary of the results is presented below.

### **C.2.1 ABB activity 03 - direct aid**

#### C.2.1.1 Introduction

The Integrated Administrative Control System (IACS) constitutes the key control mechanism for direct aid.

As from claim year 2010, Member States are required to make an annual assessment of the quality of their LPIS and to report to the Commission. Where appropriate, they shall draw up an action plan to remedy any deficiencies identified and a time-table for its implementation<sup>33</sup>. This new obligation should help avoiding outdated information in the LPIS in all Member States in the future. The reports will be analysed in April as to allow further discussion on their results with the Member States in the course of May 2011 with the view to better guide them for the work to be carried out in claim year 2011.

The control of the IACS is at the core of the Commission's audit activities as referred to below.

#### C.2.1.2 Coverage

##### Area Aids

In order to show the multi-annual audit coverage of IACS paying agencies, *table 3.7* below provides an overview of all paying agencies dealing with area aid that have been audited in the three year period since 2008.

As regards the audit coverage since the introduction of the CAP reform in 2005, all Member States have been subject to an audit. The paying agencies audited have been selected on the basis of a risk analysis and those not yet visited, are paying agencies with a limited, regional scope.

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<sup>32</sup> Global composite risk is the sum of risk factors taken into account for the central risk analysis (last audit date, inherent risk, control system risk, paying agency risk, OLAF risk and ECA risk) multiplied by their respective weights, thus giving a 'weighted risk'. The 'weighted risk' is multiplied by the risk factor for the materiality of an audit field at paying agency level which results in the 'composite risk'. The 'composite risk' of all audit fields at all paying agencies is summed up to the 'global composite risk'.

<sup>33</sup> See Article 6(2) of Regulation (EC) No 1122/2009 as amended by Regulation (EC) No 146/2010.

**Table 3.7. Audit coverage for paying agencies dealing with area aid.**

Member State	Paying Agency	Audited		
		2010	2008-2010	Ineffective
AT	AMA		X	
BE	ALV Vlaamse Gemeenschap		X	
BE	SPW-DGARNE		X	
BG	SFA	X	X	X
CY	CAPO		X	
CZ	SZIF/ SAIF		X	
DE	Baden-Württemberg			
DE	Bayern		X	
DE	Brandenburg			
DE	Hessen	X	X	
DE	Mecklenburg-Vorpommern MELFF			
DE	Niedersachsen		X	
DE	Nordrhein-Westfalen	X	X	
DE	Rheinland-Pfalz		X	
DE	Saarland			
DE	Sachsen			
DE	Sachsen-Anhalt			
DE	Schleswig-Holstein			
DE	Thüringen		X	
DK	FERV		X	
EE	PRIA		X	
ES	Andalucía		X	
ES	Aragon			
ES	Asturias			
ES	Islas Baleares		X	
ES	Cantabria	X	X	
ES	Castilla La Mancha			
ES	Castilla y León			
ES	Cataluña		X	
ES	Extremadura	-	X	
ES	Galicia		X	
ES	Madrid		X	
ES	Murcia	X	X	
ES	Navarra			
ES	Pais Vasco			
ES	La Rioja			
ES	Valenciana		X	
FI	MAVI		X	
FR	ASP	X	X	
GB	DARD		X	
GB	SGRPID	X	X	
GB	WAG		X	
GB	RPA		X	
GR	OPEKEPE	X	X	
HU	ARDA	X	X	
IE	DAFF	X	X	
IT	AGEA	X	X	
LT	NMA / NPA		X	
LU	Ministère de l'Agriculture	X	X	
LV	RSS		X	
MT	MRRPA	X	X	
NL	DR	X	X	
PL	ARiMR / ARMA		X	
PT	IFAP	X	X	X
RO	PIAA	X	X	X
SE	SJV	X	X	
SI	AAMRD		X	
SK	APA		X	

### Animal Premia

Similarly, *table 3.8* provides an overview of all paying agencies dealing with animal premia that have been audited since 2008:

**Table 3.8. Audit coverage for paying agencies dealing with animal premia.**

Member State	Paying agency	Audited Bovine premia		Audited Ovine premia	
		2010	2008-2010	2010	2008-2010
AT	AMA				
BE	ALP Vlaamse Gemeenschap				
BE	RW-IG2				
DK	Danish Food Industry Agency	X			
ES	Andalucía	X		X	
ES	Aragón				
ES	Asturias				
ES	Baleares				
ES	Cantabria		X		X
ES	Castilla La Mancha				X
ES	Castilla y León				
ES	Cataluña				
ES	Galicia				
ES	Extremadura				
ES	Madrid				
ES	Murcia				
ES	Navarra				
ES	Pais Vasco				
ES	La Rioja				
ES	Valencia				
FI	MAVI	X		X	
FR	AUP		X	X	X
NL	Dienst Regelingen				
PT	IFADAP				X
SI	AAMRD		X		
SE	SJV				

No ovine premia granted by paying agency.

#### C.2.1.3 Scope of the audits

During 2010, audits have been carried out with the general objective to review if Member States carry out the administration and control of the area based aid schemes in accordance with EU legislation.

In these audits particular attention is paid to the existence and functioning of the following key elements of the IACS: the LPIS-GIS implementation and the functioning of the cross-checks, the quality of the risk-analysis and the on-the-spot checks, supervision and follow-up (including correct application of sanctions) of administrative and on-the-spot checks.

As regards animal premiums, audits cover the quality and level of the on-the-spot checks, the checks on compliance with retention periods and their correct calculation as well as the checks on the eligibility of claimed animals.

#### C.2.1.4 Audit results

##### Area Aids

Regarding area based aid schemes, the audits in respect of claim year 2009 showed that the basic elements of IACS were established and generally operational.

As regards Greece, in particular, the action plan established in 2006 to resolve the longstanding deficiencies in the Greece IACS, was completed by 31 December 2008, resulting in a new LPIS-GIS accompanied by a new claim procedure. Certain operational

problems existed in the first year of application (claim year 2009), but these were subsequently resolved, so that the overall situation as regards the management and control of area based subsidies in Greece is comparable to the situation in other Member States.

However, serious IACS control deficiencies which would suggest that the system is ineffective in determining the eligibility of claims or preventing irregularities, possibly deserving a financial correction of 10%, were found in the following three Member States:

#### *Bulgaria*

A detailed Bulgarian IACS action plan was developed for the period 2009-2011 in order to address the following IACS administration and control deficiencies:

- High level of negligent errors in farmers' aid applications: Analysis of the reasons for high error rate in terms of area not found following on-the-spot checks, e.g. regional issues, distinction in method of on-the-spot control, type of farmers/ land etc.
- LPIS-GIS: acquisition of new ortho-imagery covering the entire territory, the quality control of the digitisation process (incl. rapid field visits) and the up-dating process as well as the responsibilities of different parties involved.
- Assistance provided to farmers for introducing the aid application: provision of comprehensive information on eligibility of the land claimed for e.g. creation of the farmers' blocks taking into account flagging of reference parcels (percentage of abandoned land).
- Additional efforts/resources to ensure the required standard and level of on-the-spot checks.

This action plan was accepted by the Commission in the summer 2009. DG AGRI continuously monitors the progress based on trimester reports and regular audit missions. The action plan is foreseen to be completed, as originally planned, by the end of November 2011. The deadline for an important milestone of the plan, consisting in an update of 60% of the area in the LPIS with 2010 images, was the end of February 2011. A mission carried out from 21-25 March showed that good progress has been made in the implementation of the plan and the quality of the work carried out has improved as compared to last year. However, the February milestone has not been achieved completely, with the update being limited to 53% of the area. Moreover, the results of the 2010 on-the-spot checks have not been fully included in the LPIS and, thus, cannot be used by the farmers when lodging their claims for 2011. For these reasons and given the fact that the rest of the action plan still awaits completion, no adequate IACS will be in place to manage the 2011 claims. Therefore, DG AGRI considers it necessary to carry-over the reservation for Bulgaria.

#### *Romania*

A detailed Romanian action plan was established for the period 2009-2011 in order to address the following IACS administration and control deficiencies:

- LPIS-GIS: acquisition of new ortho-imagery covering the entire territory, the quality control of the digitisation process as well as the up-dating process with information from new ortho-photo and the results of on-the-spot checks. Furthermore appropriate actions

related to the problem of the very big physical blocks together with the significant surface of abandoned land should be defined.

- Assistance given to farmers for introducing the aid application: updating of information given to farmers, reinforcing regional and local offices, and the creation of the additional LPIS-GIS layer with the digital cadastral maps to be provided by ANCP.
- The delays in the performance of on the spot checks, in particular those carried out by remote sensing due to the multiple malfunctions in the data exchange between the paying agency and the external contractor.

This action plan was accepted by the Commission in the summer 2009. DG AGRI has been monitoring the progress based on trimester reports and regular audit missions. The latest audit mission to Romania carried out in the second week of March 2011 showed that the plan had been completed by end of February 2011 and that the necessary steps to ensure the effective use of the updated information for the claim year 2011 have been taken or are planned. Since, however, DG AGRI has not yet sufficient assurance that the application of the new elements in the handling of the 2011 claims will work properly, it considers it necessary to carry-over the reservation for Romania.

#### *Portugal*

Audit missions carried out in Portugal in the past have revealed serious deficiencies. Portugal has put in place an action plan in order to address the following deficiencies:

- the LPIS-GIS: updating process and quality improvement.
- the delays and quality of the on-the-spot controls.

This action plan was supposed to address the weaknesses by the end of 2010. However, recent audit information indicates that the implementation of the plan has been postponed. Until now, only a small part of the necessary work concerning the LPIS-GIS has been completed and delays regarding on-the-spot-controls still persisted for 2009 and 2010 claims. An audit mission to Portugal carried out in the first week of March 2011 confirmed this overall negative assessment and the action plan will therefore have to be reinforced as regards the detailed work to be carried out and the deadlines for the completion of each milestone. For these reasons it is necessary to make a reservation for the serious deficiencies in the Portuguese IACS.

#### *Other*

Regarding animal premiums, based on the audits, there are no indications that IACS systems were not generally operational in respect of claim year 2009 (financial year 2010).

The specific support measures under Article 68 of Regulation (EC) No 73/2009 were also included in two conformity audits in 2010. Some recommendations were made. However, the audits were in part of pre-emptive nature as they were carried out before aid was paid.

#### C.2.1.5 Conclusions

If the error rates for area aid reported by Bulgaria, Romania and Portugal are applied to the expenditure not controlled on-the-spot, the residual amount of irregular payments totals EUR 54 million. Even if this amount is doubled to take account of the possibility that the error rates reported by the Member States are understated, the residual amount of irregular payments

would still be far below the 2% materiality threshold presently used by the Court of Auditors (2% of EUR 39.6 billion = EUR 790 million).

For the reasons set out in detail under point 3.2.2 of this report, DG AGRI considers it necessary to make a reservation, based on the reputational risk for the Commission, for the serious deficiencies in the IACS in Bulgaria, Romania and Portugal as regards expenditure for direct aid in financial year 2010.

### **C.2.2      ABB activity 02 - intervention on the agricultural markets**

The audits performed in 2010 related directly to expenditure totalling EUR 4,3 billion for 2010.

Regarding the market measures, the audits generally show a very high degree of conformity by Member States. Previously encountered non-compliant issues are established as being for the most part historical (i.e. pre 2007) with remaining non-compliant aspects usually limited to lesser expenditure items often geographically confined.

In the wine sector some Member States established higher than expected levels of error in respect of the implementation of the new grubbing up and restructuring schemes, particularly caused by new rules on parcel definition led to mis-declarations. However, thanks to the 100% control rates foreseen under the governing regulation, there is not deemed to have been any loss to the EU budget. It is, therefore, concluded that regulatory systems and particularly controls are in place, and that Member States are complying to a very high degree with key controls.

Taken in their entirety, the technical, administrative and accounting checks performed in line with the regulatory requirements of each sector contribute to a reasonable level of assurance as to the legality and regularity (conformity) of expenditure charged to the EU budget, and no very significant deficiencies were detected in the control systems such as to merit a financial correction of 10%.

*Table 3.9* below shows the audit coverage of the control systems in place in Member States' paying agencies for operational programmes for fruit and vegetables between 2008 and 2010.

**Table 3.9. Audit coverage for paying agencies dealing with fruit and vegetables.**

Member State	Paying agency	Measure audited	Audited in	
			2010	2008-2010
BE	BIRB	Operational Programmes		X
DE	Brandenburg MLUV	Operational Programmes	X	X
DE	Niedersachsen	Operational Programmes	X	X
DK	FERV	Operational Programmes	X	X
DK	FERV	Pre-recognised Producer Groups		X
ES	Andalucía	Operational Programmes	X	X
ES	Cataluña	Operational Programmes	X	X
ES	Comunidad Valenciana	Operational Programmes	X	X
ES	Comunidad Valenciana	Withdrawals	X	X
ES	Murcia	Operational Programmes	X	X
GB	RPA	Operational Programmes		X
GR	OPEKEPE	Pre-recognised Producer Groups	X	X
GR	OPEKEPE	Withdrawals	X	X
HU	ARDA	Operational Programmes	X	X
IT	AGEA	Operational Programmes	X	X
IT	AGREA	Operational Programmes	X	X
IT	APPAG	Operational Programmes	X	X
IT	ARBEA Basilicata	Operational Programmes	X	X
IT	ARCEA	Operational Programmes	X	X
IT	ARPEA	Operational Programmes	X	X
IT	ARTEA	Operational Programmes	X	X
IT	AVEPA	Operational Programmes	X	X
IT	ENR	Operational Programmes	X	X
IT	OPPAB	Operational Programmes	X	X
IT	OPR Lombardia	Operational Programmes	X	X
IT	SAISA	Operational Programmes	X	X
NL	DR	Operational Programmes		X
PL	ARiMR / ARMA	Operational Programmes	X	X
PL	ARiMR / ARMA	Pre-recognised Producer Groups	X	X
PL	ARR / AMA	Operational Programmes	X	X
PL	ARR / AMA	Pre-recognised Producer Groups	X	X
PT	IFAP	Operational Programmes	X	X

The audits did not reveal any significant control deficiencies which would suggest that the systems audited are ineffective in determining the eligibility of claims or preventing irregularities, possibly deserving a financial correction of 10%.

**Table 3.10. Audit coverage for paying agencies dealing with wine, tobacco and POSEI**

Member State	Paying agency	Measure audited	Audited in	
			2010	2008-2009
BG		Wine Restructuring		X
CY		Wine Restructuring		X
CZ	SZIF	Wine Restructuring		X
ES	Castilla la Mancha	Wine Grubbing up		X
ES	Castilla la Mancha	Wine Restructuring/ distillation	X	X
ES	Extremadura	Tobacco		X
ES	Canary Islands	POSEICAN	X	
FR	France Agrimer	Tabacco	X	
FR	ODEAMA	POSEIDOM	X	X
FR	France Agrimer	Wine Grubbing up		X
FR	France Agrimer	Wine Restructuring/ distillation	X	X
FR	France Agrimer	Distillation/special mission	X	
GR	OPEKEPE	Wine potential	X	X
GR	OPEKEPE	Tobacco		X
GR	OPEKEPE	POSEI	X	
HU		Wine , new regime	X	
IT	AGEA	Tobacco	X	X
IT	AGEA	Wine restructuring/ grubbing up	X	
PT	IFAP	Wine restructuring	X	X
PT	IFAP	Tobacco		X
PT	IFAP	POSEIMA	X	
RO	APIA	Wine Restructuring	X	X

The audits did not reveal any significant control deficiencies which would suggest that the systems audited are ineffective in determining the eligibility of claims or preventing irregularities, possibly deserving a financial correction of 10%.

Table 3.11 shows the audit coverage of the control systems for various other market measures between 2008 and 2010.

**Table 3.11. Audit coverage for various other market measures.**

Member State	Export refunds		Sugar CMO and restructuring		Milk quotas		Storage – public and private		Aid for the most deprived	
	2010	2007-2009	2010	2007-2009	2010	2007-2009	2010	2007-2009	2010	2007-2009
AT			X		X					
BE		X		X						X
BG		X		X						X
CZ		X		X		X		X		
CY						X				
DE		X	X	X		X		X		
DK	X	X	X	X						
ES		X	X	X		X				X
FI			X		X (School milk)					
FR	X	X	X	X	X (School milk)		X	X	X	
GB		X		X						
GR		X	X	X						
HU	X	X	X	X				X		X
IE	X	X	X	X						
IT		X	X	X		X	X	X		
LT		X		X						X
LV	X		X							
NL		X		X				X		
PL		X		X		X		X		
PT	X	X	X	X						
RO										X

SE		X		X				X		
SI			X							
SK			X						X	

The audits did not reveal any significant control deficiencies which would suggest that the systems audited are ineffective in determining the eligibility of claims or preventing irregularities, possibly deserving a financial correction of 10% except in a number of Member States where there are ongoing clearance procedures relating to the sugar restructuring scheme.

### **C.2.3 ABB activity 04 - rural development**

#### C.2.3.1 Audit missions for Axis 2 measures

In 2010 the audit missions on expenditure financed under the EAFRD and dedicated to the Axis 2 measures concerned the agri-environmental measures and natural handicaps measures. These 14 enquiries covered also Hungary and Malta (which had not yet been checked for the new programming period) while the others were selected on the basis of the central risk analysis which also took into account the latest available control statistics transmitted by the Member States in accordance with Article 34 of Regulation (EC) No 1975/2006. Deviations occurred mainly when the Paying Agency had already been visited in 2009 and in order to limit the number of missions for certain Member States (mainly Member States with several paying agencies, Germany Italy and Spain).

The audits looked in particular into the control systems adopted by Member States in order to ensure that the eligibility criteria are met and that the commitments, related to the agri-environmental measures, to be respected by the beneficiaries, are controllable and verifiable. Moreover, these enquiries aimed to assess that the controls were effectively applied and that appropriate reductions and sanctions were imposed in the case of non-respect.

In terms of coverage of the different measures, it is noted that although audits covering Axis 2 measures only started in 2008, additional assurance could be obtained based on audits on agri-environmental measures and afforestation measures under the previous programming period which was added when appropriate to the scope of the audits. For Bulgaria, Romania and Portugal, the control deficiencies found, as far as the IACS is concerned, suggested that the systems in question were ineffective in determining the eligibility of claims or preventing irregularities. More precisely, for all three Member States, it was found that there was an absence of correct information in the LPIS-GIS, late performance of checks and a high level of anomalies. For that reason, remedial plans contributing to the resolution of the problems were established. For further explanations see point C.2.1.4. above.

The control system for the other Member States visited in 2010 was found to be effective; however, there is scope for improvements for the following issues:

- Continued efforts are required to provide simple and clear eligibility criteria as well as the definition of the baseline requirements beyond which the commitments for agri-environmental payments have to go and to inform beneficiaries about their obligations in a clear manner in order to be easily respected.
- Additional efforts are required to extent the administrative verification of certain AEM commitments which could be easily checked by administrative controls (training certificate, organic certificate, state of the crops...)

- Continued improvements of the control system are necessary in order to better assess the respect by the farmer of the undertaken commitments, to perform the control at the best time when the most of the commitments are verifiable and to integrate the visual checks with several control tools in combination.

Moreover a better traceability and clear conclusions of the quality of the controls carried out have to be achieved by indicating how the checks were performed and how the inspectors came to their conclusions. The control methods used, to verify the respect of the commitment by the farmer, during the on-the-spot check shall be indicated in the control report as well as measurements, verification of fertilizers and counting of the animals in order to conclude on the respect of the livestock density whenever is appropriate.

#### C.2.3.2 Audit missions for Axis 1 and 3 measures and for Leader

In 2010, 18 audits (including two desk audits) were carried out on Axis 1, 3, Leader and Technical Assistance. These audits focused in particular on the procedures implemented by Member States in order to ensure that the administrative checks, the on-the-spot checks as well as the ex-post checks were carried out in conformity with EU legislation. Special attention has been paid to the correct application of selection criteria, the respect of eligibility criteria, that the risk of double funding has adequately been covered and that appropriate reductions and sanctions are imposed in the case of non-respect.

In two cases (missions of 2010) the audits revealed management and control deficiencies which would suggest that the systems are ineffective in determining the eligibility of claims or preventing irregularities, possibly deserving a financial correction of 10%.<sup>34</sup>

- The young farmer scheme in Bulgaria gives cause for significant concern. Out of seven young farmers visited at their farm, there are doubts in respect of four as to whether they fulfill the conditions to receive the aid. It should be noted that two further missions (of 2009 and 2010) in Bulgaria on Axis 1 expenditure (investment measures) revealed also weaknesses in key controls but which are less important.
- Interest rate subsidies paid in France for loans of the former programming period are not correctly checked before the payment is made to the banks which gave out such loans to farmers. The eligibility of the amounts is only checked several years after the payment is made (in the past, this verification took up to 10 years). At the time of the exhaustive check, a certain part of the files is already destroyed. For loans of the new programming period, an improved system is applied.

For further missions, the audits revealed weaknesses for which probably no financial corrections or limited financial corrections have to be proposed. These missions concerned seven Member States (AT, DK, CY, DE, ES, PL, RO). It should be underlined that two missions have been carried out to Romania, which showed an improved situation in comparison to the past years.

Furthermore, it is recalled that the semi-subsistence farming scheme in Poland is considered to also have serious weaknesses (audit mission of 2009). This scheme had been implemented under the old programming period. Payments are carried for five years and therefore, projects approved at the time have still received payment in 2010 financed under the EAFRD. Weaknesses have been observed with regard to the approval of projects (projects have been

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<sup>34</sup> It is underlined that the clearance of accounts procedure is still ongoing and that the financial correction is only fixed at the last stage.

approved which hardly contributed to restructuring of the farm) and to the checks for the eligibility of the beneficiaries who could participate in the scheme. It should be noted that the semi-subsistence farming scheme is no longer applied for new projects in the new programming period. Furthermore, the other measures audited in Poland and which concerned the new programming period only, did not reveal such management and control deficiencies and it is concluded that the management and control system for the new period is effective.

**Table 3.12. Rural development – multi-annual audit coverage and results of audits – programming period 2007-2013.**

Member State	Paying Agency	Audits on Axis 1 and 3 and LEADER			Audits on Axis 2		
		2010	2008-2010	System ineffective	2010	2008-2010	System ineffective
AT	AMA	x	x		x	x	
BE	SPW-DGARNE					x	
BG	SFA	x	x	3)		x	1)
CY	CAPO	x	x			x	
CZ	SZIF/ SAIF					x	
DE	Baden-Württemberg MLR	x	x			x	
DE	Bayern StMLF		x			x	
DE	Brandenburg MLUV				x	x	
DE	Mecklenburg-Vorpommern MELFF	x	x				
DE	Sachsen-Anhalt				x	x	
DK	FERV	x	x			x	
EE	PRIA		x			x	
ES	Andalucía					x	
ES	Aragón	x	x				
ES	Asturias	x	x				
ES	Castilla La Mancha	x	x				
ES	Extremadura				x	x	
ES	Galicia				x	x	
FI	MAVI				x	x	
FR	CNASEA		x			x	
FR	ASP	x	x	4)			
GB	DARD				x	x	
GB	WAG				x	x	
GB	RPA		x			x	
GR	OPEKEPE					x	
HU	ARDA		x		x	x	
IE	DAFF		x		x	x	
IT	AGEA		x		x	x	
LT	NMA / NPA		x			x	
LU	Ministère de l'Agriculture				x	x	
LV	RSS		x			x	
MT	MRRA PA				x	x	
NL	DR					x	
PL	ARiMR / ARMA	x	x	2)	x	x	
PT	IFAP				x	x	1)
RO	PARDF	x	x			x	1)
SE	SJV				x	x	
SI	AAMRD		x		x	x	
SK	APA					x	

- 1) The management and control system is ineffective as far as IACS is concerned. Please see the more detailed explanations above.
- 2) The management and control system in Poland is, for the new programming period, considered to be effective. However, the system for the semi-subsistence farming scheme is considered to be ineffective. This scheme had been implemented under the old programming period and payments for projects approved at the time have still been paid in 2009. For more detailed explanations, please see above.
- 3) The management and control system is ineffective as far as the Young Farmers scheme is concerned. Please see the more detailed explanations above.
- 4) The management and control system is ineffective with regard to interest rate subsidies paid for loans approved in the former programming period.

### **3.1.1.1.3. Recovery cases**

Regulation (EC) No 1290/2005 introduced an automatic clearing mechanism under which 50% of any undue payments which the Member States have not recovered from the beneficiaries within 4 years or, in the case of legal proceedings, 8 years will be charged to their national budgets (50/50 rule). Even after the application of this mechanism, Member States are, however, obliged to pursue their recovery procedures and, if they fail to do so with the necessary diligence, the Commission may decide to charge the entire outstanding amounts to the Member States concerned. Moreover, since 2008, Member States are required to off-set any outstanding debts against future payments to the debtor (compulsory compensation).

Undue payments that are the result of administrative errors committed by the national authorities also have to be deducted from the annual accounts of the paying agencies concerned and, thus, excluded from EU financing.

In 2010 the 50/50 rule was applied by Commission Decisions 2010/258/EU of 30 April 2010 and 2010/730/EU of 30 November 2010, which cleared all pending non-recovered cases dating from 2005 or 2001 (cases that were 4 or 8 years old respectively). EUR 22.8 million was charged to the Member States in this way and EUR 20.3 million was borne by the EU budget for reasons of irrecoverability (out of the EUR 63.8 million declared irrecoverable by the MS, EUR 43.5 million had already been cleared under the 50/50 rule and, therefore, the loss is shared between the EU and the MS). A further EUR 11.9 million have been charged to Member States in early 2011 by subsequent Commission Decisions clearing the accounts for financial year 2009 of those paying agencies that were disjoined in April 2010, see also *table 3.15*.

Regarding financial year 2010, Member States reported the information about irregularity cases by 1 February 2011. Based on the information available in March 2011, Member States recovered EUR 175.2 million during financial year 2010, and the outstanding amount still to be recovered from the beneficiaries at the end of that financial year was EUR 1 193.3 million. The financial consequences of non recovery for cases dating from 2006 or 2002 will be determined in accordance with the 50/50 rule mentioned above by charging approximately EUR 28.4 million to the Member States concerned. Moreover, around EUR 29.2 million will be borne by the EU budget for cases reported irrecoverable during financial year 2010. The final figures will be established in April 2011 when the financial clearance decision for financial year 2010 will be adopted. Due to the application of the 50/50 rule for the fifth time since its introduction, important non-recovered sums have already been charged to the Member States for EAGF expenditure (EUR 446 million see *table 3.15*). Consequently, out of the EUR 1 193.3 million to be recovered from the final beneficiaries at the end of financial year 2010 the amount outstanding towards the EU budget was limited to EUR 888.8 million. As regards the recovery of undue payments financed by the EAFRD, it has to be noted that

the 50/50 rule will only commence being applied after the closure of the rural development programmes.

The new clearance mechanism (50/50 rule) referred to above provides a strong incentive for Member States to recover undue payments from the beneficiaries as quickly as possible. As a result, by the end of financial year 2010, 42% of the new EAGF debts from 2007 and thereafter had already been recovered, which is a significant improvement compared to the past. The detailed breakdown of this recovery rate has developed as follows:

**Table 3.13. Recovery rate of irregularities detected since 2007 (EAGF)**

		recovery rate			
		until end of 2007	until end of 2008	until end of 2009	until end of 2010
year of discovery of the irregularity	2007	33%	47%	50%	53%
	2008	-	24%	40%	47%
	2009	-	-	24%	33%
	2010	-	-	-	29%
	2007-2010	-	-	-	42%

It's worth noting that some of these new debt amounts were already written off by Member States in the period 2007-2010 (EUR 24.2 million) and therefore they will not be recovered. For more details on the recovery rates at Member State level as well as regarding the evolution of the recovery of the amounts outstanding at the end of financial year 2006 to the benefit of the EU, see the tables below.

**Table 3.14. Recoveries for cases detected since 2007, euro (EAGF)**

MS	New cases since 2007	Adjustments	Recoveries	Recovery rate
AT	17,366,133.25	-2,178,544.09	-14,783,530.04	97%
BE	70,891,948.67	-1,851,453.42	-11,236,999.56	16%
BG	120,942.25	11,665.15	-30,541.31	23%
CY	1,021,796.53	-18,860.56	-729,203.14	73%
CZ	1,185,916.43	-156,100.95	-986,465.04	96%
DE	47,748,637.59	8,793,331.15	-42,388,565.28	75%
DK	25,708,237.57	6,061,852.67	-17,456,825.74	55%
EE	2,141,947.43	-1,056,058.91	-1,049,964.76	97%
ES	164,723,600.93	-13,171,085.53	-78,198,627.26	52%
FI	5,080,018.28	71,454.71	-4,543,744.42	88%
FR	130,801,590.07	-4,445,150.51	-45,170,654.05	36%
GB	30,691,454.02	-5,158,158.82	-15,936,754.51	62%
GR	24,824,666.01	-1,752,467.94	-4,408,720.21	19%
HU	5,088,032.29	10,201,401.70	-6,306,406.62	41%
IE	16,218,147.68	-1,550,528.00	-11,674,082.99	80%
IT	154,845,871.11	75,192,967.85	-48,255,563.45	21%
LT	5,026,705.31	-934,169.96	-2,446,887.11	60%
LU	642,645.30	-374,511.68	-178,597.68	67%
LV	760,970.61	-29,821.43	-673,840.04	92%
MT	215,314.32	2,273.50	-103,416.94	48%

NL	18,988,578.07	-1,556,062.41	-16,913,854.75	97%
PL	5,555,253.20	1,001,842.44	-5,034,021.68	77%
PT	45,631,525.57	-4,677,399.78	-16,338,660.13	40%
RO	4,469,727.01	903,863.18	-1,337,968.52	25%
SE	8,124,762.69	-663,564.33	-6,591,083.64	88%
SI	2,771,726.35	21,823.64	-2,427,079.57	87%
SK	1,938,198.02	-809,336.61	-301,611.96	27%
<b>Totals</b>	<b>792,584,346.55</b>	<b>61,879,201.06</b>	<b>-355,503,670.38</b>	<b>42%</b>

**Table 3.15. Recoveries for cases detected before 2007, euro (EAGF)**

MS	Outstanding at the end of FY 2006	Recovered by the MS in 2007-2010 from the amount outstanding in the end of 2006 <sup>1)</sup>	Amounts corrected by the Commission from the amount outstanding at the end of 2006					Outstanding towards EU at the end of FY 2010 <sup>3)</sup>	Recovery rate (EU level)
			50/50 corrected 2006	50/50 corrected 2007	50/50 corrected 2008	50/50 corrected 2009	50/50 corrected 2010 <sup>2)</sup>		
AT	6,848,021	4,189,443	933,968	21,739	44,207	169,196	17,473	1,471,994	79%
BE	32,219,432	2,118,047	5,988,929	1,106,152	61,022	464,520	4,071,365	18,409,396	43%
BG	0	0	0	0	0	0	0	0	0%
CY	0	0	0	0	0	0	0	0	
CZ	1,463	1,577	0	0	0	0	0	0	100%
DE	80,784,138	16,454,264	12,705,599	6,539,871	2,896,242	478,680	779,304	40,930,179	49%
DK	3,014,483	986,701	115,027	31,243	1,982	108,276	10,206	1,761,048	42%
EE	113,754	19,379	0	0	0	0	0	94,375	17%
ES	179,160,019	35,747,477	23,710,127	4,327,593	4,564,318	3,785,162	2,741,049	104,284,293	42%
FI	493,459	268,138	36,370	17,428	7,736	10,921	10,284	142,582	71%
FR	130,088,018	51,584,627	14,427,122	4,472,851	18,942,380	5,990,135	3,773,500	30,897,405	76%
GB	35,571,499	6,573,805	10,191,889	36,167	61,847	97,620	71,087	18,539,085	48%
GR	49,443,261	2,251,208	9,517,176	5,925,969	723,493	394,283	560,236	30,070,895	39%
HU	445,996	774,365	0	0	0	0	0	0	100%
IE	12,274,909	4,584,594	3,565,119	258,831	209,340	169,220	198,768	3,289,036	73%
IT	666,877,732	16,022,431	124,557,507	114,581,209	4,363,298	14,355,208	15,478,498	377,519,581	43%
LT	353,587	168,400	0	0	0	5	14	185,167	48%
LU	40,295	35,100	2,643	532	0	4,561	2,520	0	100%
LV	44,716	37,917	0	0	0	0	0	6,799	85%
MT	5,252	66	0	0	0	0	0	5,186	1%
NL	23,930,421	8,388,505	6,099,744	49,946	65,076	677,835	5,836	8,643,480	64%
PL	223,540	730,528	0	0	0	0	43,354	0	100%
PT	43,409,839	11,673,044	1,095,429	210,899	217,121	8,047,050	613,271	21,553,025	50%
RO	0	0	0	0	0	0	0	0	0%
SE	1,157,867	562,308	122,621	14,380	6,018	10,532	8,309	433,699	63%
SI	38,228	27,644	0	0	0	0	0	10,584	72%
SK	278,181	0	0	0	0	0	0	278,181	0%
<b>Total</b>	<b>1,266,818,110</b>	<b>163,199,568</b>	<b>213,069,270</b>	<b>137,594,808</b>	<b>32,164,080</b>	<b>34,763,204</b>	<b>28,385,075</b>	<b>658,525,990</b>	<b>48%</b>

1) Includes adaptation during the course of 2007-2010 by the paying agencies of the initial amount outstanding at the end of financial year 2006.

2) Amounts may change until the financial clearance decision is published (April 2010)

3) Significant part of these amounts (EUR 288 million in total) was written off by Member States in the period 2007-2010

During the years 2008-2010, the Commission has been auditing the correct application of the new clearance mechanism through 15 on-the-spot controls covering 16 paying agencies in 12

Member States (including all EU-15 Member States with a low recovery rate for the cases detected since 2007). In general the Member States' authorities have adequate procedures in place to protect the financial interest of the European Union. Deficiencies found during these audits are being followed in the context of conformity clearance procedures. The diligence of the Member States' authorities in the recovery of the most significant individual irregularity cases is assessed in the context of further 9 conformity clearance procedures.

#### **3.1.1.1.4. Management's analysis and indicator on cost-effectiveness of controls**

DG AGRI has also assessed whether the control system put in place is cost-effective in terms of sound financial management. Given that the management and control of agricultural expenditure has, in accordance with the principle of shared management, been delegated to Member States, virtually all costs for carrying out these tasks are incurred by the Member States. Therefore, the assessment is based on data on the number and type of controls as well as staff involved in control activities provided by Member States' authorities for financial year 2008. However, since the overall approach has not been changed between 2008 and 2010, the information provided is considered valid for 2010 and, thus, related with 2010 agricultural expenditure. The following conclusions can be drawn:

- Expressed as a percentage of total expenditure under the EAGF and the EAFRD, the average cost of controls amounts to some 5%;
- As regards the relation of costs of controls and expenditure per Fund, the percentage of costs of controls for EAFRD (5.28 %) is around twice as high as the percentage for EAGF (2,86 %), which results from the more complex rules and eligibility conditions compared to the EAGF.
- For rural development, any increase of the level of on-the-spot controls beyond the current level would seem not to be cost-efficient. As the error rate in that area decreased compared to previous years, costs of any additional controls would still be significantly higher than the gain which on average can be expected from these controls. This is, in particular, considered to apply for the more risky measures under Axis 2.

As regards the effectiveness of the Member States' management and control of agricultural expenditure under the three ABB activities direct aid, intervention in agricultural markets and rural development, reference is made to the summary table in point 3.1.1.1.2, B.1.4.

### 3.1.1.1.5. Conclusion

DG AGRI has, through the control statistics provided by Member States, information on the error rate at the level of the final beneficiaries. This statistical information is the result of a very large sample of applications checked<sup>35</sup>. Together with the findings on the functioning of the paying agencies and the result of DG AGRI's conformity audits, this information provides DG AGRI with reasonable assurance as to the effective management of the risk of error in the legality and regularity of the underlying transactions<sup>36</sup>.

First, the statistical information provided by Member States indicates that for the ABB activities direct aid and market intervention financed by the EAGF, the residual error rates in the transactions were, respectively, 0.60% and 0.52%. For the ABB activity rural development financed by the EAFRD, the information indicates that the residual error rate was 1.13%, which allowed the reservation regarding expenditure for rural development measures under Axis 2 (improving the environment and the countryside) of the 2007-2013 programming period to be lifted (see 3.1.3.1).

The situation is summarized in *table 3.16*.

**Table 3.16. Summary of control statistics provided by Member States.**

	2010		2009
	Percentage of amount with statistics or 100% check	Percentage <u>residual</u> risk	Percentage <u>residual</u> risk
<b>EAGF</b>			
Market measures	70.48%	0.52%	0.23%
Direct aid	98.89%	0.60%	0.86%
Total EAGF	96.23%	0.59%	0.78%
<b>EAFRD</b>			
Axis 1 and 3	100.00%	0.29%	0.79%
Axis 2	94.44%	1.84%	3.06%
Total EAFRD	90.10%	1.13%	2.10%
<b>Total EAGF and EAFRD</b>	94.60%	0.69%	<b>0.98%</b>

In this context, it should be recalled that in 89% to 99% of the cases, the statistical information on direct aids and rural development has been verified and validated by the certification bodies with regard to the quality of the underlying on-the-spot checks and the accuracy of the control statistics themselves. In more than 89% of these cases, the certification bodies concluded positively on the quality of the on-the-spot checks and in around 77% (EAGF-IACS) and 71% (EAFRD) respectively of the cases on the accuracy of the control statistics.

<sup>35</sup> This statistical information is the result of a very large sample of applications checked: SPS/SAPS: 576 555 applications checked; animals: 1 033 587 animals checked (suckler cow premium and beef special premium); export refunds: 7 213 declarations checked; 262 891 checks carried out on beneficiaries for area related rural development measures.

<sup>36</sup> The reservation regarding Bulgaria, Romania and Portugal is based on reputational risk and does not entail a material level of financial risk for the ABB activities direct aid and rural development.

Second, the findings on the functioning of the paying agencies and the results of DG AGRI's conformity audits suggest that the deficiencies identified under each of these two assurance blocks do not call in question the overall conclusions set out above.

Moreover, the following should be noted:

- Even if a safety margin of a 25% increase in the error rates communicated by the Member States were applied,<sup>37</sup> the residual error rates for expenditure on direct aids, market intervention and rural development measures would still be clearly below 2%.
- The overall conclusions set out above are also in line with the general orientations of the Court of Auditors' DAS exercise over the past years as regards the error rates in the expenditure done under, respectively, the EAGF and the EAFRD based on the same management and control systems as applied in 2010.
- The financial risk for the 2010 expenditure under the two Funds resulting from these residual error rates is further reduced at the level of the EU budget execution by the amount which will be excluded from EU financing as a result of DG AGRI's conformity audits and which on the basis of the findings is provisionally estimated at EUR 655 million<sup>38</sup>.

For these reasons, DG AGRI concludes that it has reasonable assurance as to the legality and regularity of the underlying transactions of the ABB activities financed by the EAGF and the EAFRD and that the resources assigned to the activities covered by this report have been used for their intended purpose in accordance with the principles of sound financial management.

The detailed key indicators on all three assurance blocks:

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<sup>37</sup> A 25% safety margin is used, for example, when evaluating the results from simple random sampling. Thus a possible understatement of these error rates could be taken into account.

<sup>38</sup> The total amount clawed back from Member States through conformity decisions executed in financial year 2010 was EUR 834.3 million.

<b>KEY INDICATORS FOR LEGALITY AND REGULARITY – EAGF AND EAFRD FINANCIAL YEAR 2010</b>			
<b>ASSURANCE DERIVING FROM THE FUNCTIONING OF THE PAYING AGENCIES</b>			
<b>Accreditation of paying agencies<sup>39</sup></b>	Fully accredited	79	
	Limited accreditation	1	
	Accreditation under probation	1	
	Total	81	
<b>Certificates and reports of certification bodies on functioning of paying agencies' internal control systems</b>	Received	81 <sup>41</sup>	
	Not received	1	
	Not conclusive	1 <sup>42</sup>	
	Effective <sup>40</sup>	76	
<b>Statements of assurance signed by the directors of paying agencies</b>	Not effective	4	
	Received	82	
	Not received	0	
	Unqualified	82	
<b>Opinions of certification bodies on statements of assurance</b>	Qualified with reservation (and amount involved)	0 (€ 0)	
	Received	81 <sup>43</sup>	
	Not received	1	
	Unqualified	71	
<b>Annual summaries by the coordinating bodies</b>	Qualified	10	
	Due	10	
	Received	9	
	Complete	7	
<b>ASSURANCE DERIVING FROM CONTROL RESULTS AT THE LEVEL OF THE FINAL BENEFICIARIES</b>			
	Percentage of amount with statistics or 100% check	Percentage residual risk	
EAGF:	Market measures	70.48%	0.52%
	Direct aid	98.89%	0.60%
	Total	96.23%	0.59%
EAFRD:	Axis 1 and 3	100%	0.29%
	Axis 2	94.44%	1.84%
	Total	90.10%	1.13%
Total EAGF and EAFRD		94.60%	0.69%
<b>Opinion of certification bodies on the quality of the on-the-spot controls</b>			
Population	Work done	Positive conclusion	
EAGF-IACS	99%	99%	
EAGF-Non-IACS	96%	97%	
EAFRD-IACS	94%	92%	
EAFRD-Non-IACS	91%	89%	
<b>Opinions of certification bodies on the accuracy of the control statistics</b>			
Population	Work done	Positive conclusion	
EAGF-IACS	97%	77%	
EAFRD	89%	71%	

<sup>39</sup> State of play on 16 October 2010

<sup>40</sup> Effective means very good, good or adequate.

<sup>41</sup> The EAFRD certificate and report has not been received from Baden-Württemberg, Bayern and HELABA (all Germany)

<sup>42</sup> For 1 paying agency the "unqualified" certificate does not confirm that the internal control system has operated satisfactorily, but it only confirms that the internal control procedures exist.

<sup>43</sup> The EAFRD part of the opinion has not been received from Baden-Württemberg, Bayern and HELABA (all Germany).

<b>ASSURANCE DERIVING FROM CONFORMITY AUDITS ON MEMBER STATES' MANAGEMENT AND CONTROL SYSTEMS</b>				
<b>Overview of conformity audit missions in 2010</b>				
	ABB 02	ABB 03	ABB 04	Total
Number of conformity audit missions on-the-spot	40	39	36	115
Member States covered	all except BE, BG, CY, CZ, EE, GB, LT, LU, MT, NL and SE	all except BE, CY, CZ, EE, FI, LT and PL	all except BE, DE, EE, GR, LT, LV, NL and SK	all except BE, EE and LT
Expenditure audited	32.9%	44.6%	34.6%	41.6%
<b>Overview of conformity audit missions in the period 2008-2010</b>				
	ABB 02	ABB 03	ABB 04	Total
Number of conformity audit missions	122	116	84	322
Member States covered	all except CY, EE, LU and MT	all MS and also including HR	all MS	all MS and also including HR
Expenditure audited	27.6%	48.9%	30.3%	43.5%
<b>Financial corrections</b>				
Financial corrections resulting from conformity clearance executed in financial year 2010, gross		Decision 31 Decision 32 Decision 33 Total		€ 216.8 million € 351.8 million € 265.7 million € 834.3 million
Expenditure effected in financial year 2010 likely to be excluded in future conformity clearance decisions		ABB 02 ABB 03 ABB 04 Total		+/- € 180 million +/- € 380 million +/- € 95 million +/- € 655 million

### **3.1.1.2. Shared management – EAGGF Guidance Section expenditure**

#### **A. Closure of Compliance audits carried out by Commission services**

For programmes under 2000-2006 programming period financed by EAGGF Guidance, the deadline for payments by Member States was 31.12.2009 at latest.

In total, at the end of 2010, 103 programmes out of the 152 have been subject to audit (67,8%), covering €21,7 bn (96,4%) of total programmed expenditure. The total number of programmes been subject to a follow-up audit was 44. During 2010 all those audits have been closed.

Consequently, pre-closure activities have been started.

#### **B. Pre-closure activities - Examination of winding-up declarations**

In accordance with Article 38 (1) (f) of Council Regulation (EC) No 1260/1999 Member States have to submit a declaration drawn up by a person or department having a function independent of the designated managing authority summarizing the conclusions of the checks carried out during previous years and assesses the validity of the application for payment of

the final balance and the legality and regularity of the transactions covered by the final certificate of expenditure.

Until 31.12.2010, the examination of those winding-up declarations submitted by Member States was finalised as regards to 78 programmes, representing 51.3%.

### **C. Closure follow-up activities**

Ex-post closure audits regarding programming period 2000-2006 will start in the second semester of 2011 and will be continued throughout 2012 and 2013.

The main objectives are to verify that the national authorities have taken all necessary measures to ensure that the final payment claims presented to the Commission are free of errors and include only expenditure eligible for Community co-financing and furthermore, that the conclusions of respective winding-up declarations are based on sufficient reliable audit evidence.

#### **3.1.1.3. Decentralised management – SAPARD/IPARD expenditure**

##### ***3.1.1.3.1. Description of the management and control system***

For Sapard the assurance is obtained from a management and control system of programmes that has been established in line with both the principles under the agricultural Funds and the relevant external aid provisions of the Financial Regulation.

It is based on a decentralised approach with six main characteristics:

- Sapard Agencies established and accredited by each applicant country, responsible for the implementation of the programmes;
- conferral of management by the Commission;
- rules for ex-ante controls to be carried out by the Sapard Agencies on 100 % of all projects and related payments before approval of the project and before each payment;
- rules for ex-post controls to be carried out by the Sapard Agencies on all projects within 5 years of the final payment;
- certification of the annual accounts of the Sapard Agencies by independent auditors;
- clearance procedure in two steps: an annual financial clearance of accounts procedure, determining the amount of expenditure effected by the Sapard Agencies during the preceding financial year, which shall be recognised as being chargeable to Sapard fund and a conformity clearance excluding financing that has been effected without respecting the applicable rules.

IPARD, the Pre-Accession Instrument for Agriculture and Rural Development, introduced by Council Regulation (EC) No 1085/2006, is also based on a decentralised approach. The management- and control systems have been, compared to Sapard, further improved.

The main novelties in comparison to Sapard are in particular the following:

- the introduction of the obligation for the National Authorizing Officer (NAO) to issue an annual Statement of Assurance;
- the role of the Certifying Body will be exercised by the Audit Authority. Its functions and responsibilities have been reinforced and aim at verifying the effective functioning of the management and control systems on an annual basis;
- reinforcement of control rules through obligation for the management and control systems to improve reporting on controls and their results.

### **3.1.1.3.2. Findings and indicators**

#### **A. Pre-accession financial clearance and conferral of management**

In 2010, six audit missions were carried out (to Croatia, the former Yugoslav Republic of Macedonia and Turkey).

In addition, four advisory and fact-finding missions were carried out to Serbia, Montenegro and Albania.

#### **B. IPARD**

By the end of 2009, Croatia and the former Yugoslav Republic of Macedonia were already in a position to start contracting under the IPARD Programme for some measures. In 2010, the Commission's Services focused on the so-called second wave conferral of management, covering the remaining part of those measures, with the exception of Turkey which has encountered significant delay towards the setting up of the management and control systems and fulfilling the accreditation criteria.

##### **B.1 Croatia**

The conferral audits carried out aim at preparing the decisions for the 2 remaining measures (measure 301 "Improvement and development of rural infrastructure" and measures 302 "Diversification and development of rural economic activities"), for which a decision was adopted in March 2011.

##### **B.2 The former Yugoslav Republic of Macedonia**

No new measure has been accredited in 2010.

##### **B.3 Turkey**

Turkey has made further progress in respect of programming and the setting up of an IPARD agency. However, severe delays have been encountered in the preparation of the procedural and organisational arrangements and consequently the national accreditation has been granted only in July 2010. Further to the two first conferral missions carried out in December 2010 and January 2011, the management and control system set up is currently not considered to

provide for effective controls. Consequently, the Turkish authorities will be requested to remedy the deficiencies identified.

### **C. SAPARD**

For Bulgaria, Croatia and Romania, the last declaration of expenditure was submitted by the end of 2009. Nevertheless, the MS have the obligation to continue during five years after the final payment of the project, to check that the projects did not undergo a substantial modification as stated in Article 4(4) of Section B of MAF which fixes the period of eligibility of EU co-financing of projects at five years after the date on which the final payment to the project was made by the Sapard Agency.

It shall also be noted that as provided by Article 14(2.8), Section A of the Multi Annual Financing Agreement (MAFA) stipulates, that the recording in the debtors' ledger has to continue until all debts are written off at the end of the second year following its registration. This implies that the Sapard agencies are obliged to keep a debtors' ledger for the recording of all debts, including irregularities. These amounts "*shall be written off at the end of the second year following its registration in the debtors' ledger and deducted from the next application for payment*", the registration of debt can happen even after end of programme. In practice this means that a programme will be closed after a maximum of seven years after final payment was made to the projects (5 + 2 years as described hereafter). For the eight Member States, which joined the EU in 2004, this period will cease at the latest at the end of 2013 (date of last project payment plus the two periods mentioned above (end of 2006 + 5 years + 2 years = 31.12.2013)). Similarly, the end date for recoveries regarding Bulgaria, Romania and Croatia would at the latest be 31.12.2016 (end of 2009 + 5 years + 2 years = 31.12.2016).

In 2010, **Croatia** was visited in order to assess that the management, control and sanction procedures established in connection with measures 1 "Investments in Agricultural Holdings" and 2 "Processing and Marketing" of the SAPARD programme, were in accordance with the provisions of the relevant Multi-Annual Financing Agreement (MAFA). The procedure of the clearance of accounts is ongoing.

End of 2010 a follow-up mission was carried out in Romania to check the respect of Article 14 (2.8) section A of MAFA, as described above, by monitoring the respect of the procedures implemented by the Paying Agency in relation to the Debtor's Ledger and recovery.

The Sapard programmes are still in the central risk analysis elaborated by DG Agriculture and Rural Development, in order to select the programme/country with the highest percentage of risk and to carry out conformity audits on Sapard expenditure also after the execution of the final payments by the Commission. This applies to 8 Sapard countries (Malta and Cyprus did not benefit of the Sapard programme), as well as to Bulgaria, Romania and Croatia.

Possible financial corrections to be applied in the framework of the clearance of accounts procedure to these countries will be executed by recovery orders.

### 3.1.2. Building block 2: Results from audits during the reporting year

#### 3.1.2.1. IAC reports and opinion

During 2010, Internal Audit published 9 audit reports and prepared two draft audit reports, including in total 17 very important and 38 important recommendations. All the reports concluded that the control systems were satisfactory, with the exception of the 17 very important recommendations, which concerned:

Set up of control activities	4
Effective and efficient use of resources	3
Operational structure, responsibility setting	2
Objective setting and monitoring	6
Information and Communication	1
Formal compliance with regulations	1

A follow up exercise was carried out on outstanding recommendations that are past the deadline, which revealed overall a good rate of implementation.

Internal Audit concluded that, based on the results of its audits as described in the objectives and scope of the engagements carried out during 2010, the internal control system in place **provides reasonable assurance**<sup>44</sup> regarding the achievement of the business objectives set up for the processes audited, **except for** the very important issues arising out of the assurance work.

All the very important recommendations are related to specific processes or units, and therefore these observations, with the exception of one issue subsequently included in the 2011 Risk register, do not constitute a major risk at the overall DG AGRI level.

The internal auditor of DG AGRI furthermore states that nothing has come to her attention which seriously puts into doubt the operation of the internal control system as a whole.

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<sup>44</sup> Even an effective internal control system, no matter how well designed and operated, has inherent limitations – including the possibility of the circumvention or overriding of controls – and therefore can provide only *reasonable assurance* to management regarding the achievement of the business objectives and not *absolute assurance*.

### **3.1.2.2. Relevant IAS audit reports**

The IAS published one report on DG AGRI in 2010 on Intervention in Agricultural Markets. The IAS concluded that the internal control system in place provides reasonable assurance regarding the achievement of the business objectives set up for the management and audit of market measures for milk and milk products, except for two very important recommendations. In the meantime, for one very important observation appropriate actions have been taken. The other very important recommendation concerned the need for DG AGRI, in order to be in a better position to respond in a timely manner to possible future crises in a given market, to consider in the framework of the post 2013 CAP exercise to extend the scope of article 186, the inclusion in article 11 of a clause giving the Commission the power to extend the intervention periods mentioned in this article, and the inclusion of other sectors in the scope of article 45 of Council Regulation 1234/2007. This second very important observation is addressed in the framework of the CAP post 2013 reform.

The audits of Internal Audit of DG AGRI and the IAS are designed to cover all major risk areas over a three year period. They provide an independent opinion of the operation of different areas to support assurances already given by management. The operations of Internal Audit cover the main internal processes of the DG, particularly the compliance of the DGs operations with the rules, the achievement of objectives and efficiency and effectiveness issues. It can be concluded that the nature of the weaknesses identified, in 2010 and in previous years, do not put into question the assurance that can be gained for the AAR.

### **3.1.2.3. ECA reports**

On 9 November 2010 the European Court of Auditors published its annual report concerning financial year 2009. In the course of the year, the Court also published the following special reports related to the activities of DG AGRI:

- Special Report No 5/2010 "Implementation of the Leader approach for rural development";
- Special Report No 6/2010 "Has the reform of the sugar market achieved its main objectives?";
- Special Report No 7/2010 "Audit of the Clearance of Accounts procedure"; and
- Special Report No 10/2010 "Specific measures for agriculture in the outermost regions and the smaller Aegean islands".

#### Annual Report 2009

The structure of the annual report for 2009 changed. Former chapters on the Commission internal control system and on budgetary management were merged into the DAS chapter and the policy group chapters. As a result, the numbering of the latter was altered and DG AGRI activities covered in chapter 3 "Agriculture and natural resources" of the Court's annual report. Chapter 1 "The Statement of Assurance and related information" includes as well observations relevant to DG AGRI.

The Court's conclusion as regards the legality and regularity of the underlying transactions in the policy group "Agriculture and natural resources" is that the most likely error rate lies

between 2% and 5% (3.18). The Commission considers that the error rate is just above 2%, thus confirming the overall positive assessments of previous years.

This different interpretation is due to the fact that the Commission does not agree with the Court's appreciation of two individual transactions. The Court found such cases to be affected by error whereas the Commission considers them legal and regular. In fact the Court's criticism is linked to the political choice made by the EU legislator, rather than the regularity of these transactions under the relevant EU rules.

With regard to the supervisory and control systems, the Court of Auditors concluded that they were generally, at most, partially effective (3.71). The IACS, although well designed, would need significant improvements. The Court found that out of the eight paying agencies audited, the IACS was effective in one of them, partially effective in four and ineffective in the other three: Greece, Cyprus and Malta (3.33, 3.72).

The Commission considers however that the IACS is generally an effective control system for limiting the risk of error or irregular expenditure. The effectiveness and constant improvement of the IACS is confirmed by the results of the conformity audits which the Commission has carried out over the past years in all Member States, as well as by the low error rate indicated in the control statistics from Member States, verified and validated by the certification bodies.

The Commission found that for claim year 2008, significant deficiencies existed in the IACS in Bulgaria and Romania. As a result, these two Member States established action plans in 2009 which have been closely followed up by the Commission. In addition, a reservation for the IACS in Bulgaria and Romania was made by the Director-General of DG AGRI in his 2009 annual activity report, based on the reputational risk for the Commission.

Other Member States and in particular Greece, Cyprus and Malta, have deficiencies of a lesser nature in their IACS which do not render their systems ineffective but, rather, perfectible and for which they have taken or are taking action to resolve their deficiencies. All these deficiencies are followed up through conformity clearance procedures which ensure that the risk to the EU budget is adequately covered.

The Court includes as well in chapter 3 observations on the systems related to recoveries and corrections. The criticisms addressed to the clearance of accounts procedure are those developed in detail on the Court's special report N° 7/2010. Please refer to the specific section below for more information on this matter.

Chapter 3 of the Court's annual report contains an assessment of DG AGRI's annual activity report (AAR) for 2009. The Court gives a "B" mark and concludes that the reports in the policy group "Agriculture and natural resources" only give a partially fair assessment of financial management in relation to the regularity of transactions (annex 3.3, 1.28). In particular, as regards DG AGRI, the Court criticises the approach retained for determining the residual error rate (3.67) and as to the reservations, it repeats last year's remark on the former reservation on the IACS in Greece which was, in their view, prematurely lifted (3.68).

DG AGRI does not share the Court's criticisms. It considers that both the AAR and the Director-General's declaration of assurance have been established in accordance with the Commission's internal guidelines and they do provide a fair assessment of the financial management in relation to the regularity of agricultural expenditure. DG AGRI's current approach of determining the residual error rate on the basis of the results of the randomly

selected on-the-spot checks is correct. Moreover, to cover the risk that the error rates in the control statistics received from the Member States are understated, DG AGRI applied a 25% increase to these error rates.

In what concerns the reservation on IACS Greece, such reservation was based on reputational grounds and not on the financial risk for the EU budget, which has always been covered by the financial corrections imposed on Greece via the conformity clearance procedures. After Greece honoured its commitment and completed by end of 2008 its action plan to remedy the deficiencies in the implementation of its IACS, the high reputational risk for the Commission no longer existed and it was therefore fully justified to lift the reservation already in the AAR 2008.

Finally, the Court issued the following recommendations (3.73):

- to overcome the system weaknesses leading to errors relating to ineligible land or over-declarations of land as well as inaccurate entitlements, notably by improving the reliability and completeness of the data recorded in the land parcel identification system (LPIS);
- to ensure that all IACS databases provide a reliable and full audit trail for all modifications made;
- to clarify and enforce further the rules so that EU direct aid is not paid to claimants who have neither used the land for farming nor maintained it in GAEC;
- to set at EU level minimum annual maintenance requirements for grassland to be eligible for EU direct aid.

The Commission is closely working together with Member States on actions to improve the reliability of the information in the LPIS. In this sense, as from claim year 2010, Member States must perform a yearly quality assessment of their LPIS according to pre-determined procedures. They must report to the Commission the results of such assessment and, where necessary, the actions envisaged to improve the situation. The audit trail in all IACS databases is already required by Regulation (EC) No 885/2006 as part of the accreditation criteria. Such criteria are checked by the certification bodies on an annual basis.

As to the farmer definition, the Commission addressed this issue in the framework of the Health Check by giving Member States the possibility to exclude natural or legal persons from the direct payment schemes whose principal business objects do not consist of agricultural activities or whose agricultural activities are insignificant (Article 28(2) of Regulation (EC) No 73/2009). Further reflections on "a better definition and targeting of support to active farmers" have been announced in the Commission Communication "The CAP towards 2020: meeting the food, natural resources and territorial challenges of the future"<sup>45</sup>

Finally, with regard to land maintenance, the present system provides for a common legal framework within which the Member States are responsible for defining the maintenance criteria under the GAEC. Such as system allows taking duly into account the diversity of agricultural areas and traditions in the EU.

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<sup>45</sup> COM(2010) 672 final, adopted on 18 November 2010.

In the area of rural development, the Court underlined that further efforts are needed to further simplify rules and conditions. The Commission pointed out that the new regulatory framework for the programming period 2007-2013 has already simplified rules and conditions and strengthened controls. Efforts on simplification will continue in the future.

#### Special Report No 5/2010

The special report on LEADER was published by the Court of Auditors on 16 November 2010. This performance audit aimed at assessing to what extent Leader has been implemented in ways that add value, while minimising the risks to sound financial management. It covers the 2000-2006 Leader+ programmes and the initial steps in implementing Axis 4 strategies in the 2007-2013 period.

The Court claims that Local Action Groups (LAGs) have generally implemented the Leader approach in ways that limit its potential added value linked to the so-called 'Leader features' such as the bottom-up elaboration and implementation of local development strategies or the interaction between different sectors. LAGs are also negatively assessed in terms of sound financial management. Particular focus is given to problems of conflict of interest in the assessment and selection of projects, and to deadweight, where grants were awarded to projects already underway or even favoured the selection of projects close to completion.

The Court considers that Member States should take a tougher stance in ensuring that LAGs correctly implement the Leader approach, and that the Commission should adopt a stricter regulatory framework, coupled with reinforced control activities. Given the costs and risks involved, more should also be done to demonstrate the added value achieved from Leader.

The Commission points out in its replies that the weaknesses identified by the Court in the implementation of Leader in the audited LAGs need to be addressed by the Member States in line with the subsidiarity principle. The Commission from its side will continue promoting better management and control systems in the Member States by further clarifying certain rules and principles in the relevant regulatory framework, through the provision of advice and guidance, as well as through recommendations stemming from its audits and where appropriate by applying financial corrections. The ex-post evaluation of Leader+, whose final report was due by the end of 2010, will provide information on the effectiveness and efficiency of Leader expenditure.

#### Special Report No 6/2010

The special report on the reform of the sugar market was published on 10 November 2010. The Court has assessed in this report to what extent the objectives of the reform of the sugar market have been achieved. The main findings are structured around four main conclusions:

- the future competitiveness of the EU sugar industry has not been fully ensured;
- the stability of the EU sugar market and of prices has been achieved, but the EU has become a net sugar importer;
- there is no evidence yet on the extent to which the measures put in place to mitigate the social impact of the reform have had the intended effect; and
- the reform has not been budget neutral as initially foreseen by the Commission.

In its replies, the Commission has claimed that the overall competitiveness of the sugar sector has been fully achieved in so far as the companies operating after the reform have to maintain

profitability in a scenario of lower institutional prices. It has also pointed out that the current balance between EU sugar production and consumption is rather a result of EU trade and development policies than of the sugar market reform. As to the social impact of the reform, the Commission has upheld the value of the accompanying measures in mitigating the negative consequences of the reform in the regions concerned while reminding that in line with the subsidiarity principle, responsibility for the implementation of the diversification measures lies with Member States. Finally, the Commission has firmly sustained that the sugar reform has been budget-neutral in terms of agricultural expenditure. The accompanying measures for ACP countries, duly anticipated by the Commission, are not covered by CAP expenditure as far as they concern development aid to the ACP countries.

### Special Report No 7/2010

The special report on the clearance of accounts procedure was published by the Court of Auditors on 29 October 2010. This report includes some fundamental criticisms of the current clearance of accounts system and DG AGRI's audit work. It is divided into three sections. The first section examines the financial clearance procedure. The Court concludes that the procedure provides the Commission with sufficient information to take its annual financial decision. However, the Court criticised the more recent elements on the legality and regularity of payments by national certification bodies for assurance purposes. The Commission does not share this criticism and considers that the new work required from the national certification bodies does provide additional elements for assurance purposes on the legality and regularity of the underlying transactions.

The second section deals with the conformity clearance procedure. The Court criticises several elements of the current procedure, in particular the partial coverage of the agricultural expenses, the "24-month rule"<sup>46</sup> for financial corrections, the frequent use of flat-rate corrections, the alleged lack of a clear link between the amounts recovered and the total amounts of irregular payments at the level of final beneficiaries, and finally the lengthiness of the procedure itself. The Commission does not share these conclusions and clarifies that the 24-month rules ensures legal certainty for Member States, that flat-rate corrections are the most effective method when deficiencies concern Member State's management and control system - whose degree of financial risk for the EU budget is reflected into the amount of the correction, and finally that the time needed to complete conformity clearance procedures depends on several factors, including the Member State's right of defence.

In the third section the Court considers the clearance of accounts procedure as a whole and concludes that in its current form it does not provide the "necessary clarity regarding the amount recognised as chargeable to the budget for a given financial year, as stipulated by the Financial Regulation". It goes on to state that the Parliament and the Council are asked to grant discharge to the Commission for expenditure which cannot be considered definitive and could be corrected at later stage by conformity decisions. The Commission has firmly contested these statements by referring to the annual financial clearance decision which establishes, without prejudice of future conformity decisions, the amount of expenditure recognised as chargeable to the EU budget for the specific year. This, together with the information disclosed in the Commission's accounting system and in a note to the financial statements on the amount of expenditure likely to be excluded by future conformity decisions,

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<sup>46</sup> This rule, enshrined in Art. 31(4)(a) of Regulation 1290/2005, states that financing may not be refused for expenditure which is incurred more than twenty-four months before the Commission notifies the Member State in writing of its inspection findings.

provides the Council and the Parliament with the necessary information for the discharge procedure.

*Special Report No 10/2010*

The special report on "Specific measures for agriculture in the outermost regions and the smaller Aegean islands" (POSEI) was published by the Court of Auditors on 22 December 2010.

The Court's audit sought to clarify to what extent the 2006 reform of the specific measures, introducing a more decentralised approach with greater regional participation, has led to a more effective EU support to the needs of the outermost regions and of the Aegean islands. The Court concludes that in effect the specific measures are effective and of great importance for the agriculture in the regions concerned but highlights some weaknesses in the programme's management. The Court considers that during both the approval and the subsequent modification of programmes the Commission limited itself to ensure conformity with the legal framework, instead of playing a more active role in assisting Member States to ensure effective programmes/strategies. The Court has also found examples of measures for which effectiveness can be put in question and control mechanisms are not always adapted to the diversity of the specific measures. Finally, the Court considers that the monitoring and evaluation tasks should be further reinforced.

The Commission is very satisfied with the Court's main conclusion in this special report and will continue its efforts, in close cooperation with Member States, to address the weaknesses and recommendations put forward by the Court. In particular, the Commission will continue assisting Member States in the design of their programmes, especially by spreading best practices. The Commission has also the intention to propose changes to the relevant rules so as to facilitate and simplify the annual revision process of the programmes. The Commission has proposed as well a harmonised framework of common indicators that will allow monitoring programme performance more effectively already as from 2011 onwards. Finally, with regard to control systems, these are checked on the spot by the Commission services and where weaknesses are identified, the Commission takes the appropriate measures during the clearance procedure and proposes suitable improvements to the Member State concerned.

### **3.1.3. Building block 3: Follow up of previous years' reservations and action plans for audits from previous years**

#### **3.1.3.1. Reservation regarding expenditure for rural development measures under Axis 2 (improving the environment and the countryside) of the 2007-2013 programming period**

DG AGRI's AAR 2007 contained a reservation regarding rural development expenditure because the control statistics provided by Member States were neither complete nor certified by the certification bodies. Consequently, they did not permit to conclude whether the error rate for rural development expenditure was below the 2% materiality threshold used by the Court of Auditors.

In the AAR 2008, the reservation was limited to rural development measures under Axis 2 (improving the environment and the countryside) on the ground that for these measures alone, Member States' control statistics showed an error rate which was significantly above the 2% materiality threshold. In the AAR 2009, this reservation was carried over because the error rate, despite having decreased, was still considerably higher than the 2% materiality threshold, which in turn was the reason why the error rate for rural development expenditure as a whole also remained above 2%.

In 2010, as a result of the work of DG AGRI's task force which has investigated Member States' reporting of errors for measures under Axis 2 and provided detailed guidelines for such reporting, the quality and reliability of Member States' control statistics and the degree of quantification of the errors found and reported have improved significantly. These improvements allow DG AGRI to calculate the residual error rate for measures under Axis 2 more precisely than in previous years, when it did not have the necessary assurance that Member States compiled their statistics with the necessary rigor. In particular, it is considered justified to deduct the errors found and corrected through the administrative checks, which are carried out on 100% of the aid applications, from the overall error rate in order to arrive at the residual error rate for measures under Axis 2 (an approach already applied for the direct payments under the first pillar). On the basis of this approach, although the overall error rate reported for 2010 is only slightly lower than the one from 2009 (3.2% as compared to 3.4%), the residual error rate reported for 2010 amounts to 1.84% and is, thus, below the 2% materiality threshold currently used by the Court of Auditors. Also the residual error rate for rural development as a whole is, with 1.13% (2.1% in 2009), well below the materiality threshold<sup>47</sup>.

Moreover, the action plan set out in the reservation of previous years has now been completed, and the error rates reported are, with a couple of exceptions, now considered

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<sup>47</sup> The calculation is based on information provided by all Member States with the exception of Cyprus and Portugal, which were not able to comply with the new reporting standards for the financially important agri-environmental measures. However, even if these two Member States should have higher than average error rates, their impact would in all likelihood not increase the residual error rate for rural development as a whole above the 2% materiality threshold.

tolerable. Any further reduction of errors could only be achieved by increasing the level of on-the-spot checks, which would not be cost effective. In this respect, the main conclusions of the cost-of-controls analysis made in preparation of the Commission's proposal of May 2010 on the tolerable risk of error in rural development, which suggested that the costs of any such additional checks would be five times higher than the average gain in terms of recovery of undue payments which could be expected from the checks, are still fundamentally valid (see also point 3.1.1.1.4).

Finally, as regards the high error rates for Bulgaria and Romania for measures under Axis 2, which remain of concern, the relevant expenditure for these two Member States is covered by the reservation for IACS. Likewise, the new reservation for Portugal due to the serious deficiencies in its IACS also covers the Axis 2 expenditure.

Consequently, it is not necessary to carry over the reservation regarding expenditure for rural development measures under Axis 2 to the AAR 2010.

### **3.1.3.2. Reservation regarding serious deficiencies in the IACS in Bulgaria and Romania**

DG AGRI's AAR 2009 contained a reservation regarding serious deficiencies in the IACS in Bulgaria and Romania. The audits which DG AGRI carried out in Bulgaria and Romania in 2007, 2008 and 2009 revealed serious deficiencies in the functioning of their respective IACS, which over this period have not yet been remedied.

The seriousness of these deficiencies is confirmed by the very high error rates in both Member States for SAPS payments, which is far above the EU average. Bulgaria and Romania have established action plans to remedy the deficiencies, which have been accepted by the Commission in July 2009, but the completion of these plans is only foreseen by 2011 and there were some delays in the implementation of the individual actions.

Although the financial risk for the fund that can be estimated to be below the 2 % materiality threshold currently used by the Court of Auditors is adequately covered by the conformity clearance procedures, the reservation is justified by the **reputational risk** for the Commission due to the failure of Bulgaria and Romania to put into place the single most important control system of the CAP in a satisfactory way.

The implementation of the action plans and the respect of the deadlines for the individual actions were closely monitored by the Commission on the basis of trimester progress reports from the two Member States and through on-the-spot missions.

As regards Romania, the action plan was supposed to be completed by the end of February 2011. An audit mission carried out from 14-18 March 2011 concluded that the plan had been completed by end of February 2011 and that the necessary steps to ensure the effective use of the updated information for the claim year 2011 have been taken or are planned. Since, however, DG AGRI has not yet sufficient assurance that the application of the new elements in the handling of the 2011 claims will work properly, it considers it necessary to carry-over the reservation for Romania.

As regards Bulgaria, the action plan is foreseen to be completed, as originally planned, by the end of November 2011. The deadline for an important milestone of the plan, consisting in an update of 60% of the area in the LPIS with 2010 images, was the end of February 2011. A mission carried out from 21-25 March showed that good progress has been made in the implementation of the plan and the quality of the work carried out has improved as compared to last year. However, the February milestone has not been achieved completely, with the update being limited to 53% of the area. Moreover, the results of the 2010 on-the-spot checks have not been fully included in the LPIS and, thus, cannot be used by the farmers when lodging their claims for 2011. For these reasons and given the fact that the rest of the action plan still awaits completion, no adequate IACS will be in place to manage the 2011 claims. Therefore, DG AGRI considers it necessary to carry-over the reservation for Bulgaria.

Following the lifting of the reservation regarding expenditure for rural development measures under Axis 2 (improving the environment and the countryside) of the 2007-2013 programming period, this reservation also covers the expenditure made by Bulgaria and Romania for Axis 2.

### **3.1.3.3. Follow-up of any weaknesses reported by the IAS and IAC and in the previous Synthesis report**

A report of the follow-up to previous Internal Audit recommendations was published in March 2010. It revealed a good overall level of implementation. The follow-up continues to improve, thus confirming the progress noted over the past years. The failure to implement certain recommendations in time did not lead to any critical weaknesses.

The IAS did not initiate any follow-up audits in 2010. Previous IAS recommendations were followed up by DG AGRI during 2010, and will be followed up more formally by the IAS in 2011. The key necessary improvements have already been made, or are underway.

There are no delays to signal related to ongoing actions stemming from the previous year's synthesis report.

### **3.1.4. Building block 4: Assurance received from other Authorising Officers in cases of cross sub-delegation**

When DG AGRI cross delegates activities to other services, a work programme for the activity concerned is requested and must be signed by the Director General of the service concerned. Similarly, after the end of the year, the service must provide a report on the activity carried out. The Directorates General concerned reported no problems or anomalies for the year 2010 for the cross delegations to JRC, ESTAT, EMPL, PMO, SANCO and DEVCO. The AOSD confirmed that the funds were executed in accordance with the financial circuits and control procedures in place and in conformity with the financial rules.

No additional controls were carried out by DG AGRI on the funds sub delegated.

### **3.1.5. Completeness and reliability of the information reported in the building blocks**

EAGF and EAFRD expenditure is implemented under shared management through a comprehensive management and control system (described in detail at part 3.1.1.1.1 of this report) which is designed to ensure the legality and regularity of transactions at the level of the final beneficiaries.

Through findings on the functioning of Member States' paying agencies, including the statements of assurance from their directors and the opinion thereon from the certification bodies, the control statistics from the Member States which provide information of the error rate at the level of final beneficiaries and its own conformity audits on the spot, DG AGRI has received reasonable assurance as to the effective management of the risk of error in the legality and regularity of the underlying transactions.

The multi-layered approach taken by DG AGRI and set out in the preceding chapter means that evidence can be drawn from different sources in order to provide the basis for an assessment. These various sources of evidence corroborate and complement each other and enable the conclusion to be drawn that the information reported in the building blocks is complete and reliable as confirmed by the statement of the Internal Control Coordinator (*Annex I*).

## 3.2. Reservations

### 3.2.1. Serious deficiencies in the IACS in Bulgaria, Romania and Portugal

<b>DG</b>	<b>Agriculture and Rural Development</b>
<b>Title of Reservation</b>	<b>Serious deficiencies in the IACS in Bulgaria, Romania and Portugal</b>
<b>Domain</b>	Shared management - European Agricultural Guarantee Fund (EAGF) and European Agricultural Fund for Rural Development (EAFRD)
<b>ABB activity</b>	Direct aids (05 03): In financial year 2010, total EU expenditure was around EUR 39.7 billion. Rural development (05 04), measures under Axis 2 (improving the environment and the countryside): In financial year 2010, total EU expenditure was around EUR 5.4 billion.
<b>Reason for the reservation</b>	<p>The Integrated Administration and Control System (IACS) is the by far most important system for the management and control of agricultural expenditure. It covers most of the direct payments to farmers under the first pillar of the CAP, including SPS and SAPS, and to the extent possible is also used to control rural development measures relating to parcels or livestock under Axis 2 (improving the environment and the countryside). In financial year 2010, the payments concerned accounted for 89% of EAGF expenditure and 49.8% of EAFRD expenditure (81.1% for both Funds).</p> <p>For area-related payments, the cornerstone of the IACS is the Land Parcel Identification System (LPIS), which is used for providing the farmers with the necessary information to complete their aid applications as well as for carrying out cross-checks and on-the-spot checks. Serious deficiencies regarding the quality of the information included in the LPIS therefore imply that the system as a whole is ineffective in determining the eligibility of claims or preventing irregularities.</p> <p>Given the importance of the IACS for the management and control of agricultural expenditure, serious deficiencies in its set-up and operation expose the Commission to a reputational risk, even if their financial impact does not exceed the 2% materiality threshold presently used by the Court of Auditors for the ABB activity direct aids.</p>

### **Carry-over of the reservation for Bulgaria and Romania**

The audits which DG AGRI carried out in Bulgaria and Romania in 2007, 2008, 2009 and 2010 revealed serious deficiencies in the functioning of their respective IACS, which over this period have not yet been remedied. These deficiencies concern the quality of the information in the LPIS, the lack of assistance given to farmers in completing their aid applications and, for Romania, delays in the execution of the on-the-spot checks. The seriousness of these deficiencies is confirmed by the very high error rates in both Member States for SAPS payments, which is far above the EU average. Bulgaria and Romania have established action plans to remedy the deficiencies, which were accepted by the Commission in July 2009.

As regards Romania, the action plan was supposed to be completed by the end of 2010, but the Romanian authorities have reported a delay of two months (until end of February 2011). The latest audit mission to Romania carried out in the second week of March 2011 showed that the plan had been completed by end of February 2011 and that the necessary steps to ensure the effective use of the updated information for the claim year 2011 have been taken or are planned. Since, however, DG AGRI has not yet sufficient assurance that the application of the new elements in the handling of the 2011 claims will work properly, it considers it necessary to carry-over the reservation for Romania.

As regards Bulgaria, the action plan is foreseen to be completed, as originally planned, by the end of November 2011. The deadline for an important milestone of the plan, consisting in an update of 60% of the area in the LPIS with 2010 images, was the end of February 2011. A mission carried out from 21-25 March showed that good progress has been made in the implementation of the plan and the quality of the work carried out has improved as compared to last year. However, the February milestone has not been achieved completely, with the update being limited to 53% of the area. Moreover, the results of the 2010 on-the-spot checks have not been fully included in the LPIS and, thus, cannot be used by the farmers when lodging their claims for 2011. For these reasons and given the fact that the rest of the action plan still awaits completion, no adequate IACS will be in place to manage the 2011 claims. Therefore, DG AGRI considers it necessary to carry-over the reservation for Bulgaria.

### **Introduction of a new reservation for Portugal**

As regards Portugal, missions carried out in the past have revealed serious deficiencies in the Portuguese LPIS-GIS. Portugal has put in place an action plan which was initially supposed to be completed in 2010. However, recent audit information indicates that the implementation of the plan has been postponed. Until now, only a small part of the necessary work concerning the LPIS-GIS has been completed and delays regarding on-the-spot-controls still persisted

	<p>for 2009 and 2010 claims. An audit mission to Portugal carried out in the first week of March 2011 confirmed this overall negative assessment and the action plan will therefore have to be reinforced as regards the detailed work to be carried out and the deadlines for the completion of each milestone. It is therefore necessary to include Portugal in the current reservation regarding serious deficiencies in the IACS.</p>
<b>Materiality criterion/criteria</b>	<p>The reservation for all three Member States is justified by the <b>reputational risk</b> for the Commission due to fact that the IACS is the single most important control system for the CAP. The Member States have established action plans to remedy the serious deficiencies in their IACS, but the reservation is necessary as long as there is no credible evidence that the improvements foreseen in the plans have been correctly implemented, are of the required quality and work properly when handling new aid claims.</p>
<b>Quantification</b>	<p>In financial year 2010, the expenditure under the ABB activity direct aids was EUR 272.5 million in Bulgaria, EUR 617 million in Romania and EUR 637 million in Portugal. If the error rates reported by the three Member States for this expenditure are applied to the expenditure not controlled on the spot, the residual amount of irregular payments comes to around EUR 54 million. Even if this amount were doubled to take account of the risk that the error rates were understated, the residual amount would still be significantly below the 2% materiality threshold presently used by the Court of Auditors (around EUR 790 million). In any case, the financial risk for the EU budget will be adequately covered by the ongoing conformity clearance procedures.</p> <p>In financial year 2010, the expenditure for rural development measures under Axis 2, which mostly are managed and controlled through the IACS, was EUR 18.9 million in Bulgaria, EUR 222.7 million in Romania and EUR 199 million in Portugal. If the error rates reported by Bulgaria and Romania for this expenditure are applied to the expenditure not controlled on the spot, the residual amount of irregular payments comes to around EUR 24 million. For Portugal, comparable information is not available. Even if the amount for Bulgaria and Romania were doubled to take account of the risk that the error rates reported by these Member States were understated and a safety margin of another EUR 50 million were added for Portugal, the residual amount would still be significantly below the 2% materiality threshold presently used by the Court of Auditors (around EUR 214 million for the ABB activity rural development, excluding advances). In any case, the financial risk for the EU budget will be adequately covered by the ongoing conformity clearance procedures.</p>
<b>Impact on the assurance</b>	<p>Serious deficiencies in the most important management and control system for agricultural expenditure in Member States bears the risk that the underlying transactions concerned are not legal and regular.</p>

<b>Responsibility for the weakness and its remedy</b>	<p>Bulgaria, Romania and Portugal are responsible for the proper implementation of the IACS in their respective territories. The Commission supervises them in this respect, notably through conformity audits.</p>
<b>Corrective action</b>	<p>Corrective actions have been or are being taken at the following levels:</p> <ol style="list-style-type: none"> <li>1. All three Member States have established actions plans to remedy the serious deficiencies identified. The most important elements of the <u>Bulgarian and Romanian</u> plans are: <ul style="list-style-type: none"> <li>– acquisition of new ortho-imagery covering the entire territory, quality control of the digitisation and the updating process;</li> <li>– enhanced assistance to farmers in completing and introducing their aid applications;</li> <li>– improvements in the quality of the on-the-spot checks.</li> </ul> <p>The Portuguese authorities will be asked to reinforce their action plan in order to properly address and correct the following deficiencies:</p> <ul style="list-style-type: none"> <li>• the updating process and quality improvement of the LPIS-GIS,</li> <li>• the delays and quality of the on-the-spot controls.</li> </ul> </li> <li>2. The implementation of both the Bulgarian and Portuguese action plans and the respect of the deadlines for the individual actions are closely monitored by the Commission on the basis of progress reports from these two Member States and through on-the-spot missions.</li> <li>3. As from claim year 2010, Member States are required to make an annual assessment of the quality of their LPIS and to report to the Commission. Where appropriate, they shall draw up an action plan to remedy any deficiencies identified and a time-table for its implementation (see Article 6(2) of Regulation (EC) No 1122/2009 as amended by Regulation (EC) No 146/2010). This new obligation should help to avoid outdated information in the LPIS in all Member States in the future.</li> <li>4. In 2011, DG AGRI will continue with its intensive audit programme by carrying out two on-the-spot audits in each of the three Member States. At the same time, it is pursuing the open conformity clearance procedures and will impose financial corrections on these Member States with a view to protecting the EU's financial interests.</li> </ol>

### **3.3. Overall conclusion on the combined impact of the reservations on the declaration as a whole**

This year's Annual Activity Report contains a reservation for serious deficiencies in the IACS in Bulgaria, Romania and Portugal. Given that the IACS is the by far most important system for control of agricultural expenditure, these serious deficiencies expose the Commission to a reputational risk. The financial impact does not exceed materiality and the financial risk is adequately covered by the ongoing conformity procedures.

Therefore, DG AGRI considers that the risk resulting from this reservation does not compromise the statement of assurance for the year 2010.

## 4. Declaration of assurance

*I, the undersigned, José Manuel SILVA RODRIGUEZ*

*Director-General of the Directorate General of Agriculture and Rural Development*

*In my capacity as authorising officer by delegation*

*Declare that the information contained in this report gives a true and fair view.*

*State that I have reasonable assurance that the resources assigned to the activities described in this report have been used for their intended purpose and in accordance with the principles of sound financial management, and that the control procedures put in place give the necessary guarantees concerning the legality and regularity of the underlying transactions.*

*This reasonable assurance is based on my own judgement and on the information at my disposal, such as the results of the self-assessment, ex post controls, the work of the internal audit capability, the observations of the Internal Audit Service and the lessons learnt from the reports of the Court of Auditors for years prior to the year of this declaration.*

*Confirm that I am not aware of anything not reported here which could harm the interests of the institution.*

*However the following reservation should be noted:*

- *Reservation concerning serious deficiencies in the IACS in Bulgaria, Romania and Portugal*

*[signed]*

José Manuel SILVA RODRIGUEZ