Fact Sheet

MANAGING THE AGRICULTURE BUDGET WISELY
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1. Introduction

For more than 40 years, the common agricultural policy (CAP) has been the European Union’s (EU) most important common policy. This explains why traditionally it has consumed a large part of the EU’s budget, although the percentage has steadily declined over recent years to presently 50.5% (2005). The agricultural expenditure is financed by two funds, which form part of the EU’s general budget: the European Agricultural Guarantee Fund (EAGF) finances direct payments to farmers and measures to regulate agricultural markets such as intervention and export refunds, while the European Agricultural Fund for Rural Development (EAFRD) finances the rural development programmes of the Member States. The maximum total amount which may be allocated for the 2007–2013 period is EUR 862.4 billion, of which EAFRD expenditure accounts for EUR 88.3 billion (incl. Bulgaria and Romania).

Figure 1: EU budget 2007 (126.5 billion EUR)

The European taxpayer rightly expects that these sums are correctly spent. It is therefore of paramount importance that management and checking systems are in place which give reasonable assurance that the sums are spent properly and that any irregular payments are detected and recovered.

2 COUNCIL OF THE EUROPEAN UNION, Financial Perspective 2007–2013, 15915/05
This fact sheet provides an overview of the systems for the management and checking of agricultural expenditure, both at national and EU level, and describes the roles and responsibilities of the different actors.

2. How does the system work

The basic rules for the financial management of the CAP have been laid down by the Council of Ministers. Under these rules, the Commission is responsible for the management of the EAGF and the EAFRD. However, the Commission itself normally does not make payments to beneficiaries. According to the principle of shared management, this task is delegated to the Member States, who themselves work through 85 national or regional paying agencies. Before these paying agencies can claim any expenditure from the EU-budget, they must be accredited on the basis of a set of criteria laid down by the Commission. If you want to know more about this accreditation process you will find further details in point 3 below.

The paying agencies are, however, not only responsible for making payments to the beneficiaries. Prior to doing so, they must, either themselves or through delegated bodies, satisfy themselves of the eligibility of the aid applications. The exact checks to be carried out are laid down in the different sectoral regulations of the CAP and vary from one sector to another. You will find the most important control rules described in point 4 below.

The expenditure made by the paying agencies is then reimbursed by the Commission to the Member States, in the case of the EAGF on a monthly basis and in the case of EAFRD on a quarterly basis. Those reimbursements are, however, subject to any subsequent corrections which the Commission may make under the clearance of accounts procedures explained in point 5 below.

Box 1: The role of a paying agency

Paying agencies are the authorities and bodies of the Member States, whose role is to provide sufficient guarantees that:

- The admissibility of claims and compliance with EU rules are checked before payment is authorised;
- The payments effected are correctly and fully recorded in the accounts;
- Requested documentation is submitted within deadlines and in the way stipulated in EU rules;

Compliance with a set of accreditation criteria is designed to ensure that the paying agency provides sufficient guarantees that:

- The eligibility of aid applications is checked before any payment is made;
- Accurate and exhaustive accounts are kept;
- The checks required by the sectoral regulations are made;
- All requisite documents are properly kept, accessible and presented in time.

3. Accreditation of paying agencies

The responsibility for the accreditation of a paying agency lies with the Member State which for this purpose appoints an authority at ministerial level. Accreditation may only be granted if the paying agency complies with a set of detailed criteria laid down by the Commission, which concern the agency’s internal environment and control activities, information and communication as well as its monitoring activities.

Once a paying agency is accredited, the task of the Member State is not over. Constant supervision remains the rule and the Commission must be informed about the results of this supervision. In case of deficiencies in respect of the accreditation criteria, the Member State has to remedy the situation. If this is not the case, the accreditation has to be withdrawn. If the Member State does not remedy adequately the deficiencies nor withdraws the accreditation, the Commission can impose financial corrections on the Member State under the conformity clearance procedure.

Where more than one paying agency exists in a Member State, a so-called coordinating body has to be appointed which acts as the Commission’s sole interlocutor for all questions regarding the management and control of agricultural expenditure.

From the financial year 2007 onwards the head of the paying agency must sign a statement of assurance declaring that his accounts give a true, complete and accurate view of the expenditure and receipts and that his management and control system provides reasonable assurance on the legality and regularity of the transactions. The accuracy of that statement is then verified by the certification body and by the Commission in the framework of the clearance of accounts.

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How do checks and reductions work?

Member States are obliged to ensure that agricultural payments are carried out and executed correctly, to prevent and deal with irregularities and to recover amounts unduly paid.

For each aid scheme, the relevant sector regulations lay down detailed rules on checks and reductions of final beneficiaries which reflect the specific features of the scheme in question and the risk involved in its administration. The checks are carried out by the paying agencies or by delegated bodies operating under their supervision.

The systems generally provide that before any payment is made, all aid applications are subject to administrative checks, including cross-checks with other data where this is considered appropriate. Moreover, a sample of transactions which normally ranges between 5% and 10%, but may go up to 100%, depending on the risk associated with the aid regime in question, is checked on-the-spot. If these on-the-spot checks reveal a high number of irregularities, additional checks must be carried out. Effective, dissuasive and proportionate reductions are to be imposed on the final beneficiary if the checks reveal non-compliance with Community rules.

Amongst the different systems, by far the most important one is the Integrated Administration and Control System, commonly known as the IACS. It covers all direct payments to farmers\(^2\), such as the single payment scheme (SPS) and applies to a large extent to the new Member States having the single area payment scheme (SAPS), as well as those rural development measures which are based on the number of hectares or animals held by the farmer. This is for instance agri-environmental measures and less-favoured area payments. In financial terms, these schemes presently account for more than two-thirds of

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the expenditure financed by the EAGF, a figure which is expected to rise to more than 90% by 2013, and almost half of the expenditure financed by the EAFRD.

For aid schemes which do not fall under the IACS such as storage of products or export refunds, complementary checks must be carried out after the payment to the beneficiary has been made. These checks are carried out by a body in the Member State which is independent of the departments within the paying agency responsible for the pre-payment checks and the payments. They are a very important tool used to detect irregularities as they permit the controllers to investigate a wide range of documents and this not only at the level of the beneficiary but also at the level of, for example, trading partners of the beneficiary. Similar checks are foreseen for certain rural development measures which are not covered by the IACS.

Box 3: Soon, 90 % of expenditure will be managed via the Integrated Administration and Control System (IACS)

The Integrated Administration and Control System (IACS) of Member States consist of different elements which are needed in order to receive and process aid applications.

IACS includes:
• A computerised database;
• An identification system for farmers, agricultural parcels and for animals in case of payments linked to animals;
• A system for identification and registration of payment entitlements, aid applications and integrated controls system (checks and if needed calculation of reductions).

The Member States shall have this system to ensure a unique identification of the farmers as well as of all agricultural parcels and, if needed, of animals. It shall also cover the processing of the aid applications. The fulfilment of the criteria for aid is assessed through administrative checks and through checks carried out on-the-spot.

The administrative checks consist of a number of cross-checks of information in the farmer’s applications. The cross-checks are done automatically within a computerised database linking the different systems.

For the purpose of on-the-spot-checks Member States shall visit the farms chosen either randomly or through risk analysis. However, by means of available techniques such as aerial or satellite photos of the agricultural parcels it is in many cases possible to measures the size of a parcel and to check the plant cover without going to the field.

The databases have to be regularly updated by the Member States, but historical data for the farmers must also be saved. A substantial part of the system is now paperless and in some Member States farmers can apply for aid on-line. The requirements to the system are regularly updated in order to take new available techniques into account and to simplify the system.

The Member States report annually to the Commission supplying detailed statistics on applications, checks and reductions.

The European Court of Auditors has repeatedly confirmed that, where properly applied, the IACS is an effective control system to limit the risk of irregular expenditure.
5. **Clearance of accounts – an efficient tool for the Commission**

The control chain would, however, not be complete without a mechanism which ensures that the Member States carry out their work properly and, if they fail to do so, draw the necessary financial consequences. This mechanism consists of the clearance of accounts procedures operated by the Commission, which include an annual financial clearance of the accounts of each paying agency and a multi-annual conformity clearance covering the conformity of the transactions with EU rules.

**5.1. Financial clearance – true, complete and accurate accounts**

The financial clearance is based on an examination by the certification body, a body which is independent from the paying agency. This body draws up a certificate stating whether it has reasonable assurance that the accounts of the paying agency are true, complete and accurate and that the internal control procedures have operated satisfactorily (see above point 3). They also give an opinion on the statement of assurance signed by the head of the paying agency.

The financial clearance covers the annual accounts of each paying agency and the control systems set up by these. Within this framework, particular attention is paid to the certification bodies’ conclusions and recommendations (where weaknesses are found), following their reviews of the paying agencies’ management and control systems. This review also covers aspects relating to the accreditation criteria for the paying agencies.

The Commission adopts an annual clearance of accounts decision, by which it conveys that it accepts the paying agencies annual accounts on the basis of the certificates and reports from the certification bodies, but without prejudicing any subsequent decisions to recover expenditure which proves not to have been effected in conformity with EU rules (this is reserved for the conformity clearance). The Commission must adopt this decision by 30 April of the year following the financial year in question (for agricultural expenditure a financial year starts on 16 October of one year and ends on 15 October of the next year).

**5.2. Conformity clearance – checking the system**

In contrast to the financial clearance, the conformity clearance is designed to exclude expenditure from EU financing which has not been paid in conformity with EU rules, thus shielding the EU budget from expenditure that should not be charged to it. These so-called financial corrections are recovered from the Member States. The conformity clearance is, therefore, not a mechanism by which irregular payments are recovered from the final beneficiaries, which according to the principle of shared management is the sole responsibility of the Member States. However, financial corrections are a strong incentive for the Member States to improve their management and control 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.

Whereas the financial clearance is an annual exercise, conformity clearance does not follow an annual cycle. It covers expenditure incurred in more than one financial year, with the exception of expenditure made more than 24 months before the Commission officially notifies the Member State of its audit findings.
Every year, the Commission’s Directorate-General for Agriculture and Rural Development carries out over 300 audits, about half of which include on-the-spot missions to the paying agencies in the Member States. The paying agencies to be visited are selected on the basis of a detailed risk analysis, and the audit work normally concentrates on the functioning of the agencies’ management and control systems.

### Box 4: Clearance of accounts procedures

**CLEARANCE OF ACCOUNTS**

*Two independent procedures*

<table>
<thead>
<tr>
<th>Financial Clearance</th>
<th>Conformity Clearance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trueness, completeness and accuracy of the accounts of the paying agency</td>
<td>Compliance with Community law</td>
</tr>
<tr>
<td><strong>Annual exercise</strong></td>
<td><strong>Ad-hoc compliance decisions cover up to 24 months prior to Commission’s notification of audit findings to the Member State</strong></td>
</tr>
<tr>
<td>after the end of the EAGF financial year</td>
<td>(starting on 16 October of one year and ending on 15 October of the next year)</td>
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<tr>
<td>Audit to check:</td>
<td>Audits to check:</td>
</tr>
<tr>
<td>• Whether the paying agency’s annual accounts are kept as required;</td>
<td>• Whether the expenditure is effected in compliance with Community rules;</td>
</tr>
<tr>
<td>• Whether the internal control procedures have operated satisfactorily.</td>
<td>• Whether the paying agency has carried out the checks as required.</td>
</tr>
</tbody>
</table>

**Financial clearance decision by the Commission**

Annually, by 30 April of the year following the financial year

**Conformity clearance decisions by the Commission**

2 to 3 times per year
5.3. How does the procedure work in practice?

If an audit reveals deficiencies in the functioning of the national systems, the Commission initiates a conformity clearance procedure with a view to determining whether to impose a financial correction on the Member State in question and, if so, what the amount of that correction should be. Such a procedure comprises the following steps:

- First, the Commission officially notifies the Member State of its audit findings and indicates the corrective measures which the Member State should take to remedy the deficiencies found. The Member State then has two months to reply to the Commission’s findings.

- Second, the Commission arranges a bilateral meeting with the Member State where both parties shall endeavour to reach an agreement on the corrective measures to be taken as well as on the gravity of the infringement and the financial damage caused to the EU budget. Again, the Member State has two months after having received the minutes of the meeting to react and provide further information.

- Third, the Commission formally communicates its conclusions to the Member State, including the financial correction which it envisages to impose on the Member State.

- Fourth, within 30 working days following receipt of these conclusions, the Member State may submit the case for conciliation to the so-called Conciliation Body. The Conciliation Body has four months to try to reconcile the positions of the Commission and the Member State and, at the end of this period, to draw up a report on the results of its efforts and any recommendations it may wish to make to the parties.

- Finally, after having examined the Conciliation Body’s report, the Commission notifies the Member State of its final conclusions.

Box 5: The Role of the Conciliation Body

The Conciliation procedure was set up in order to reconcile the divergent positions of the Commission and the Member State, occurring during the conformity clearance procedure.

The Conciliation Body is composed of five members, who are highly qualified in matters regarding the financing of the CAP or in the practice of financial audit and originate from different Member States. The chairman and the four other members are nominated by the Commission, after having consulted the Committee on the Agricultural Funds. They are appointed for three years (renewable for a year at a time only). The secretariat of the Body is provided by the Commission.

Only reasoned requests from the Member States are accepted by the Conciliation Body. A request for conciliation is only admissible when the correction proposed by the Commission services either exceeds EUR 1 million or accounts for more than 25% of the Member State’s total annual expenditure under the budget headings concerned or, if these thresholds are not reached, if the request concerns a matter of principle relating to the application of Community rules.

The Conciliation Body has four months to reconcile the positions of the Commission and the Member State. At the end of its work – which takes place as informal and rapid as possible – the results are to be reported to the Member State concerned, to the Commission and to the other Member States through the Committee on the Agricultural Funds.

The Conciliation Body is completely independent; it carries out its duties neither seeking nor accepting any instructions from Member States or other body.
5.4. How does the Commission calculate the financial correction?

Financial corrections are determined on the basis of the nature and gravity of the infringement and the financial damage caused to the EU budget. 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 management and control systems in order to reflect the financial risk for the EU. In order to ensure equal treatment of all cases of this kind, the Commission has adopted guidelines which provide for standard correction rates of 2%, 5%, 10% or 25% of the expenditure at risk, depending on whether the deficiencies concern key or ancillary control requirements which are determined for each aid schemes.
On this basis, the guidelines provide that:

- A correction of 2% is justified when a Member State has failed to take measures to improve the application of ancillary controls;

- When all key controls are applied, but not in the number, frequency or depth required, then a correction of 5% is justified as it can reasonably be concluded that the checks do not provide a sufficient level of assurance of the regularity of claims and that, therefore, the risk of loss to the EU budget was significant;

- When one or more key controls are not applied or applied so poorly or so infrequently that they are completely ineffective in determining the eligibility of the claim or in preventing irregularity, then a correction of 10% is justified as it can reasonably be concluded that there was a high risk of widespread loss to the EU budget;

- When a Member State’s application of a control system is completely absent or gravely deficient and there is evidence of widespread irregularity and negligence in countering irregular or fraudulent practices, then a correction of 25% is justified as it can reasonably be assumed that the freedom to submit irregular claims may lead to exceptionally high losses to the EU budget.

The rate of correction may be fixed at an even higher rate to exclude all expenditure when weaknesses are so serious that they constitute a complete failure to comply with EU rules.
5.5. How much has the Commission charged Member States so far?

Between 1999 and April 2007, 24 conformity decisions have been adopted. The Commission has clawed back financing to a total of about 4,170 Million EUR. The breakdown of financial corrections is shown in the following graphs.

**Figure 2: Conformity decisions 1–24 (1999–2007) by Member State**

Financial corrections by Member State
Figure 3: Conformity decisions 1–24 (1999–2007) by sector

Financial corrections by sector
6. Irregularities – recoveries from the final beneficiaries

As previously stated, Member States are obliged to recover sums lost as a result of irregularities following their national rules and procedures. If they succeed in getting the money back from the beneficiaries, they have to credit the recovered sums to the Funds.

However, it is not always easy to recover the sums spent irregularly. If the Member State needs more than four years to recover, or eight years in case of national court proceedings against the beneficiary, the Commission charges 50% of the outstanding sum to the Member State concerned thereby protecting the financial interests of the EU (the so-called 50/50 rule). This is done via the financial clearance procedure described above under point 5.1.

After this accounting exercise, the Member State is obliged to continue its recovery actions. 50% of the sums thus recovered are to be handed over to the EU budget.

Under all circumstances, the Commission keeps an eye on the Member States’ recovery actions. If a Member State does not pursue the recovery or is not diligent in its actions, the Commission may decide to intervene via the conformity clearance procedure and to impose a financial correction on the Member State concerned.

7. Further information

Website for further information:
http://ec.europa.eu/agriculture/index_en.htm